2021 Annual Review

UTAM
Engagement Highlights

UNIVERSITY OF TORONTO
ASSET MANAGEMENT CORPORATION

Federated Hermes
EOS

www.hermes-investment.com
For professional investors only

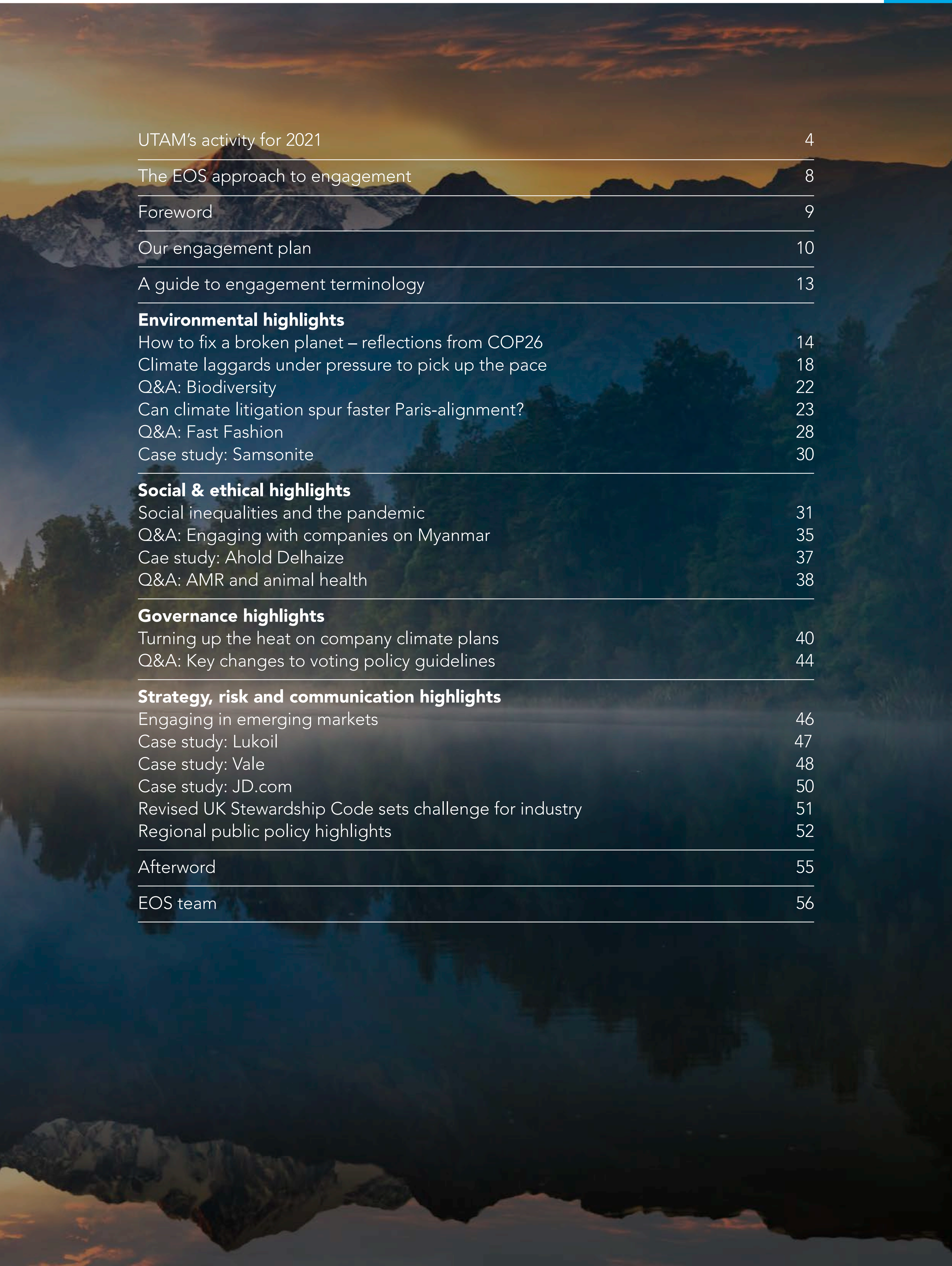
In investing responsibly, we consider environmental, social and governance (ESG) factors in our research and analysis, assessment and management of risk, reporting and disclosures, and in our company engagement, proxy voting and advocacy.

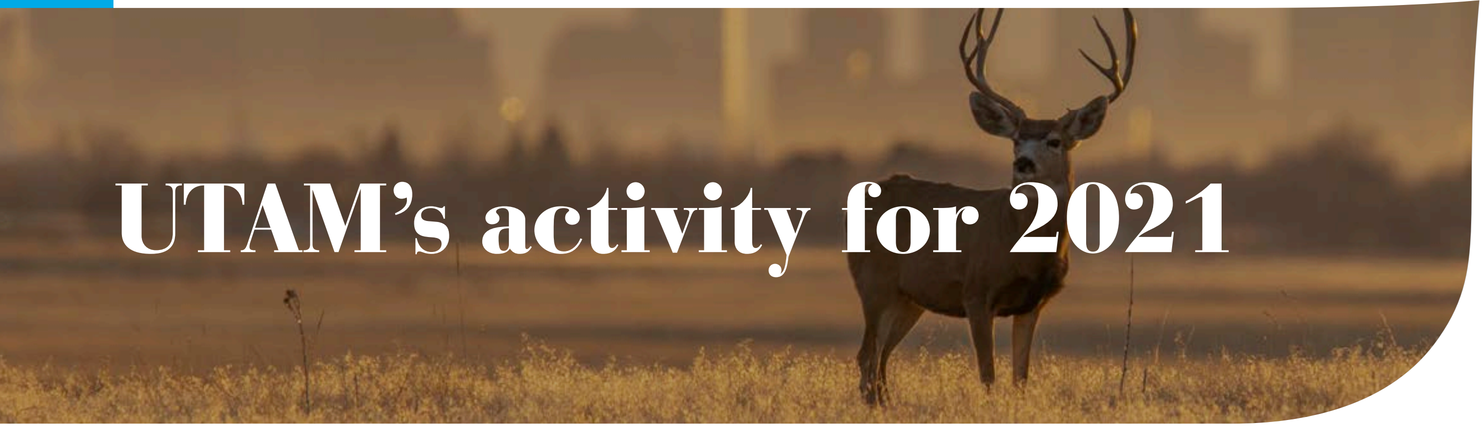
We undertake engagement activities with issuers mostly in collaboration with others and we have partnered with EOS in these efforts since 2019. This allows us to leverage the influence of a larger asset base, and to represent our ESG concerns to issuers globally.

In October 2021, the University of Toronto announced critical steps in advancing its longstanding sustainability commitment. These include a pledge to achieve net zero carbon emissions associated with its Endowment by 2050.

EOS has made significant progress through the engagement activities it conducts on our behalf, particularly in climate change. As we work towards fulfilling our net zero commitment, our partnership with EOS will be a critical component.

Chuck O'Reilly
President and Chief Investment Officer,
University of Toronto Asset Management Corporation





UTAM's activity for 2021

Engagement by region

In 2021, we engaged with 791 companies on 3,136 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 791 companies over the last year.

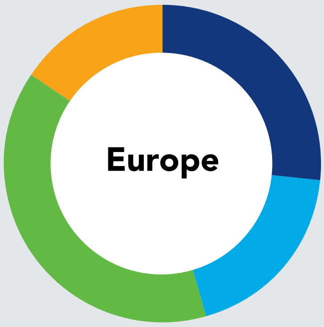
- Environmental **27.5%**
- Social and Ethical **20.3%**
- Governance **37.6%**
- Strategy, Risk and Communication **14.6%**

We engaged with 99 companies over the last year.

- Environmental **31.6%**
- Social and Ethical **19.4%**
- Governance **39.1%**
- Strategy, Risk and Communication **10.0%**

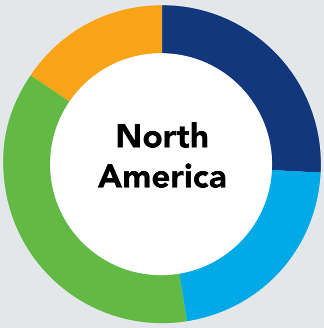
We engaged with 92 companies over the last year.

- Environmental **32.0%**
- Social and Ethical **13.1%**
- Governance **39.1%**
- Strategy, Risk and Communication **15.8%**



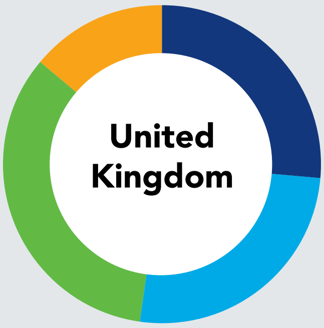
We engaged with 175 companies over the last year.

- Environmental **26.9%**
- Social and Ethical **18.9%**
- Governance **38.7%**
- Strategy, Risk and Communication **15.5%**



We engaged with 331 companies over the last year.

- Environmental **25.9%**
- Social and Ethical **21.7%**
- Governance **37.1%**
- Strategy, Risk and Communication **15.3%**



We engaged with 59 companies over the last year.

- Environmental **26.4%**
- Social and Ethical **26.0%**
- Governance **33.7%**
- Strategy, Risk and Communication **13.8%**

We engaged with 35 companies over the last year.

- Environmental **35.6%**
- Social and Ethical **19.2%**
- Governance **35.6%**
- Strategy, Risk and Communication **9.6%**

Engagement by theme

A summary of the 3,136 issues and objectives on which we engaged with companies in 2021 is shown below.

Environmental topics featured in 27.5% of our engagements over the last year.

- Climate Change **80.6%**
- Forestry and Land Use **4.5%**
- Pollution and Waste Management **10.7%**
- Supply Chain Management **1.6%**
- Water **2.5%**

Social and Ethical topics featured in 20.3% of our engagements over the last year.

- Bribery and Corruption **1.4%**
- Conduct and Culture **12.7%**
- Diversity **25.3%**
- Human Capital Management **21.7%**
- Human Rights **31.6%**
- Labour Rights **6.3%**
- Tax **1.1%**

Governance topics featured in 37.6% of our engagements over the last year.

- Board Diversity, Skills and Experience **23.3%**
- Board Independence **13.8%**
- Executive Remuneration **44.7%**
- Shareholder Protection and Rights **14.8%**
- Succession Planning **3.3%**

Strategy, Risk and Communication topics featured in 14.6% of our engagements over the last year.

- Audit and Accounting **7.2%**
- Business Strategy **40.0%**
- Cyber Security **3.1%**
- Integrated Reporting and Other Disclosure **23.8%**
- Risk Management **26.0%**

Engagement methodology and progress in 2021

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

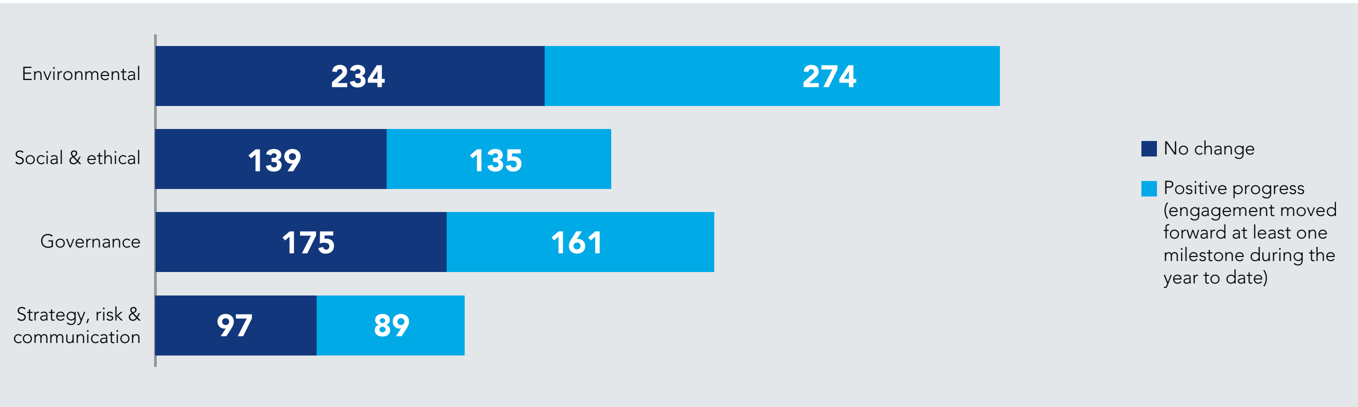
Milestone status of engagement

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	508	45	74	183	126	67	13
Social and ethical	274	12	40	106	73	36	7
Governance	336	2	89	106	60	55	24
Strategy, risk and communication	186	8	45	66	40	21	6
Total engagements	**1,304**	**67**	**248**	**461**	**299**	**179**	**50**

Engagement progress in 2021

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).

1,804 of the issues and objectives engaged in 2021 were linked to one or more of the SDGs

* This represents the proportion of issues and objectives assigned to the remaining SDGs.

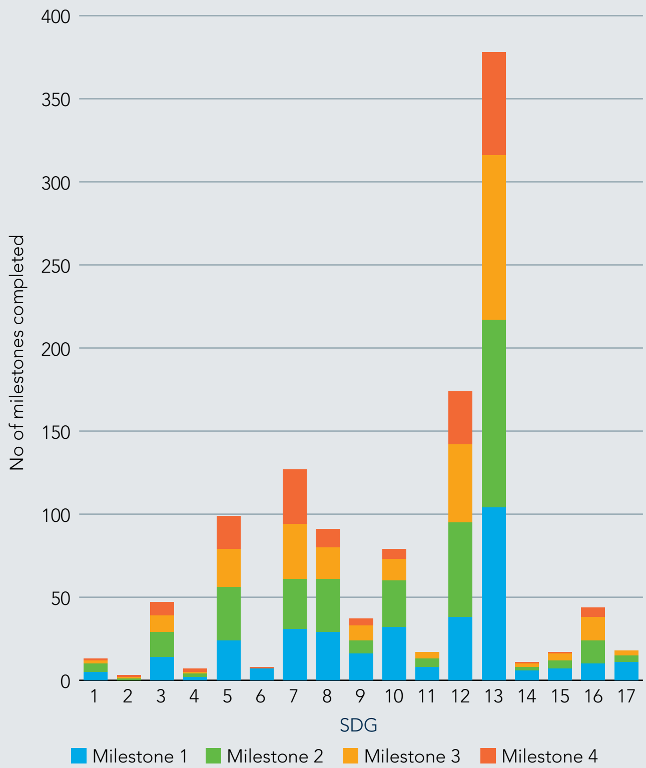
- 1 No poverty
- 2 Zero Hunger
- 3 Good health and well-being
- 4 Quality Education
- 5 Gender equality
- 6 Clean water and sanitation
- 7 Affordable and clean energy
- 8 Decent work and economic growth
- 9 Industry, innovation and infrastructure
- 10 Reduced inequalities
- 11 Sustainable cities and communities
- 12 Responsible consumption and production
- 13 Climate action
- 14 Life below water
- 15 Life on land
- 16 Peace, justice and strong institutions
- 17 Partnerships for the goals

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



Source: EOS data for 2021

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.

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.

Voting

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

Screening

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

Advisory

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

The EOS advantage

- **Relationships and access** – Companies understand that EOS is working on behalf of pension funds and other large institutional investors, so it has significant leverage – representing assets under advice of US$1.64tn as of 31 December 2021. 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
Head of EOS at Federated Hermes

The climate crisis may have been overshadowed by the pandemic in 2020, but in 2021 it dominated the news agenda once again.

The evidence that global heating poses a threat to life on earth is incontrovertible. Yet at COP26 we saw how ambitious plans to decarbonise economies and accelerate the shift to renewables could be jeopardised by opposition from those heavily dependent on fossil fuels.

One of the challenges for investors in 2022 and beyond will be to work with companies and policymakers to ensure a just transition for employees and communities at the sharp end of structural change, to ensure that efforts to keep global heating within 1.5°C are not derailed. Moreover, developed nations must deliver on their promise to mobilise $100bn a year in climate finance for developing countries. Even when this target is met, the transition is likely to proceed at different speeds in different regions.

COP26 demonstrated how climate change, human rights and social inequality are intertwined, just as deforestation, a warming planet and biodiversity loss are linked. Accordingly, investors will need to develop a sophisticated, holistic understanding of the ESG challenges at companies if climate change is to be tackled successfully. We thank our clients for working with us to identify, understand and address these interconnected and complex challenges. With their support we are committed to helping them be active, successful and responsible investors.

Stewardship outcomes

We believe that the pace of the low carbon transition – and ultimately its success or failure – will be driven by companies, investors, policymakers and civil society working together, encouraging each other to go further, faster. To this end, investor stewardship must be outcomes-focused, and investors must be ready to escalate engagements with companies when necessary to spur change. This has long been a subject of discussion with our clients and has informed the way we work, organise and report on their behalf.

In our engagements we set objectives for companies related to the material ESG concerns that we identify. We define engagement strategies to achieve them within a certain timeframe, and systematically track their progress through our proprietary milestone system. We apply this approach to the companies we engage with on climate change. When they implement a strategy or measures to address the concerns we have raised, we document the outcomes internally on our systems as well as through public case studies, articles and other reporting.

We believe that every investor should be able to demonstrate the impact and outcomes of active ownership through such systems, processes and reporting, as required by increasingly demanding regulations and stewardship codes. Our experience suggests that a systematic approach, combined with tried and tested methods of escalation such as collaboration or shareholder meeting interventions, is needed to accelerate change at companies failing to prepare for the low-carbon transition.

In 2022, companies’ climate transition votes, which are becoming more common in certain markets, must be made to count. We will scrutinise companies’ strategies closely and recommend votes against plans that fail to come up to scratch. Where necessary, we will recommend voting against the chair and other relevant directors to escalate concerns at climate change laggards. In this way, shareholders can connect environmental and governance issues.

Integrating stewardship insights

Driving change through engagement is one side of the coin – effective integration of stewardship insights is the other. It is encouraging that the UK’s revised Stewardship Code requires investors to systematically integrate stewardship and investment, including material ESG issues and climate change, and to report on how this informs decisions to divest. This is a key shift in terms of the approach and scope of stewardship, and confirms that ultimately investment and engagement activities go hand in hand.

To balance competing interests and needs in the battle to mitigate and adapt to the climate crisis, investors will need to develop a more holistic understanding of ESG issues and how they intertwine. They must ensure they have the systems and processes in place to deliver impact-generating outcomes, and stewardship insights must be integrated effectively into investment decisions. This is a critical next step, not just in terms of a just transition on climate change, but in the development of responsible investment.

Our engagement plan

Our engagement plan identifies 12 key themes and 37 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.

In 2021, the postponed UN COP26 climate conference finally took place, driving strong momentum on climate change. Meanwhile, the Covid-19 pandemic is far from over, with officially recorded deaths having risen to over five million worldwide, from approximately two million at the end of 2020. Despite continuing stop-start lockdowns in many markets and severely curtailed international travel, economic activity bounced back in 2021, revealing a labour shortage for many sectors and forcing companies to re-evaluate their employee value proposition in order to retain staff.

We review our engagement plan every year to ensure it is up to date and reflects client priorities. In 2021, we spent some time reflecting on our approach to engagement and updated the theme taxonomy to reflect latest best practice areas. The theme formally referred to as conduct, culture and ethics has been renamed wider societal impacts to reflect the societal impact of positive ethical behaviours (such as zero tolerance of bribery and corruption), as well as the benefits of achieving safer products and responsible tax practices.

Our four priority themes for 2022 are as follows:

Climate change action

In the run up to COP26, over 300 companies committed to achieving net-zero emissions. However, data from the Climate Action 100+ Benchmark shows that while 52% of the world's largest emitters had net-zero goals, only 20% had short and medium-term emissions reduction targets and only 7% had targets aligned with the Paris Agreement goals. The emphasis of our engagement is therefore on matching long-term commitments with a Paris-aligned strategy and targets. We also support action to ensure that published financial accounts and political lobbying are similarly aligned. And as the climate changes and extreme weather events become more frequent and severe, it will be important for companies to demonstrate that they have a physical risk strategy.

Data from the Climate Action 100+ Benchmark shows that

52% of the world's largest emitters had net-zero goals, but only

20% had short and medium-term emissions reduction targets and only

7% had targets aligned with the Paris Agreement goals.

Human and labour rights

The Covid-19 pandemic has exacerbated social inequalities, increasing the risk of unacceptable working conditions such as modern slavery, and limiting access to food and medicines, including effective coronavirus vaccines. In our engagements we ask companies to respect all human and labour-related rights linked to a company's operations, products and supply chains, including through the provision of affordable essential goods and services to help reduce poverty. Other areas of focus include indigenous and community rights, and high-risk regions such as disputed territories or conflict areas. We also engage on digital rights in the virtual world, such as challenges to data privacy rights and freedom of expression.

> **The Covid-19 pandemic has exacerbated social inequalities, increasing the risk of unacceptable working conditions such as modern slavery, and limiting access to food and medicines, including effective coronavirus vaccines.**

Engagement themes for 2021-23

Human capital

The pandemic has shone a light on companies' treatment of their employees, including contract workers. In 2022, we will press companies to provide fair wages and benefits so that everyone can achieve a decent living standard. We will also encourage them to develop and implement a human capital management strategy to promote best practice physical and mental wellbeing in the workplace.

We will continue to emphasise the importance of diversity, equity, inclusion and representation, asking companies to develop a strategy and action plan to close the ethnic pay gap and achieve proportionate ethnic and gender representation at all levels. We will also challenge companies to expand their consideration of diversity metrics to include representation and equity for the LGBTQ+ community and differently-abled. These strategies should include articulation of a culture and employee proposition to improve workforce loyalty and wellbeing.

Board effectiveness and ethical culture

In 2022, to enhance the quality of board performance and corporate decision-making, we will focus on ensuring that boards make improvements to ethnic diversity that at least match the recent progress on gender diversity. The goal will be for the board to achieve representation that is reflective of the diversity of the stakeholders it aspires to serve.

We will also ask boards to consider the lessons of the pandemic, including the possibility for more internationally diverse board appointments, enabled by more effective remote working practices. We remain committed to improving a board's "software" (relating to how it functions), in addition to its "hardware" (relating to its composition and structure). The board should continuously monitor and assess the prevailing company culture to ensure it is in line with the company's purpose, strategy and values.

Expanding themes

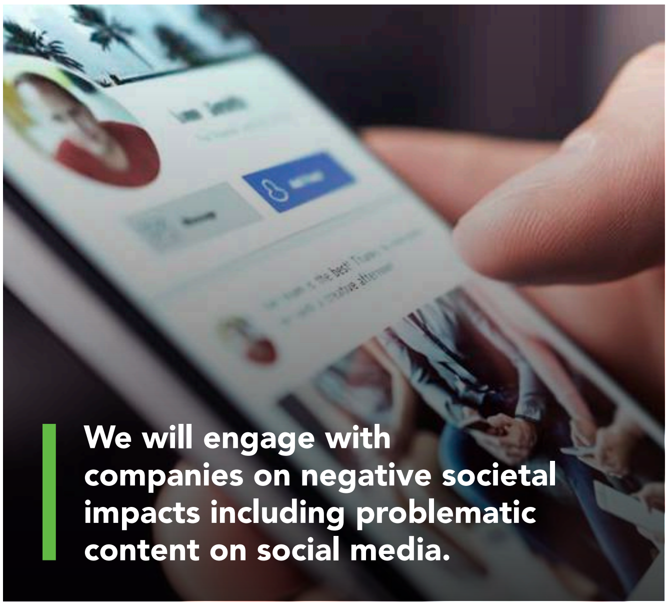
In addition to the priority themes, we will pursue further engagement in these fast-growing areas:

Biodiversity

In 2022, we will engage with companies, especially those that are involved in the production and sale of food, on halting and reversing biodiversity loss. As we outlined in our white paper on biodiversity, as a priority companies must identify, assess and measure their impacts and dependencies on biodiversity and ecosystem services. They must reduce their impacts on biodiversity across the value chain following the mitigation hierarchy and aim for a net-positive impact on biodiversity as best practice. Depending on the specific company context, engagement will cover various issues including deforestation, regenerative agriculture, sustainable proteins and chemical run-off management.

Fast fashion

We will continue to engage with apparel companies on their environmental and social impacts. We will push companies to acknowledge the need to move to a circular business model and assess the risks to their business from their environmental impacts, including in their supply chain and from product disposal. We urge companies to set science-based greenhouse gas emissions reduction targets and time-bound targets for sustainable materials. We will also engage on the management of salient human rights risks in companies' value chains.



We will engage with companies on negative societal impacts including problematic content on social media.

Digital rights

We will publish high-level expectations on digital rights in 2022. Digital products and services can play a critical role in strengthening human rights but have also engendered unexpected harms and created new challenges. We will engage with companies on negative societal impacts including problematic content on social media; the misuse of artificial intelligence; health and safety impacts on children and young people; and the environmental and social impacts in hardware supply chains. We expect companies to balance freedom of expression with obligations to remove problematic content, and take action to respect privacy rights online.

As a priority, companies must identify, assess and measure their impacts and dependencies on biodiversity and ecosystem services.

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.

> **To measure our progress and the achievement of engagement objectives, we use a four-stage milestone strategy.**

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.

Environmental

How to fix a broken planet – reflections from COP26

In the wake of the UN's COP26 climate summit, Bruce Duguid, head of stewardship at EOS, reflects on how we should interpret its outcomes and the implications for investor stewardship.

Expectations were high going into the UN's climate summit, held in Glasgow last November. Policymakers were under pressure to step up their national commitments to keep alive any hope of limiting global heating to 1.5°C. In August,[1] the Intergovernmental Panel on Climate Change (IPCC) had issued its starkest warning yet, calling for drastic action. So did COP26 deliver?

What we wanted to see

Over the last two years, we have advocated for a number of changes to public policy and market best practice, including asking governments to commit to more ambitious climate targets. We also asked the International Energy Agency to produce a 1.5°C scenario, which was published in May 2021, and advocated for mandatory TCFD disclosures for companies, through engagement with the US Securities and Exchange Commission, the European Union and the UK government.

In the run up to COP26 we set out our expectations of policymakers, calling for the following:

- Countries to make more ambitious commitments, called Nationally Determined Contributions (NDCs), to reduce their emissions in line with 1.5°C. These NDCs should have clear short and medium term commitments over the vital period to 2030, to help cut global emissions by 40-60% from today's baseline by 2030.
- Developed nations to meet and go beyond the existing pledge of $100bn per annum dedicated to helping developing nations to accelerate their energy transition and adapt to the growing physical impacts of climate change.
- Finalisation of the Paris Rulebook (the rules needed to implement the Paris Agreement), including Article 6, which covers international carbon markets. This would enable nations to trade emissions allowances and create offsets, unlocking financial flows and market efficiencies to streamline decarbonisation and target the least-cost carbon reduction opportunities first.

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Bruce Duguid
Executive Director, Head of Stewardship, EOS

[1] https://www.ipcc.ch/report/ar6/wg1/

Further, Faster – Federated Hermes at COP26

Bruce Duguid chairing a panel at the Further, Faster event.

To complement our advocacy for more ambitious and rapid public policy commitments, Federated Hermes hosted a two-day conference, 'Further, Faster', in Glasgow on 4-5 November 2021.

This event brought together world-leading experts to help identify actionable objectives to tackle the linked emergencies of climate change, the degradation of nature, and social injustice. Guest speakers included Baroness Helena Kennedy, QC, Tim Lenton of the Global Systems Institute at Exeter University, Douglas Gurr from the Natural History Museum, Howard Dryden from the GOES Foundation, and Paul Druckman from the World Benchmarking Alliance.

EOS led discussions on climate change action; the protection of nature, including biodiversity and our expectations of COP 15; and the fast fashion industry, illustrating how unsustainable environmental and social issues need to be tackled together. You can read more about our biodiversity and fast fashion work later in this report.

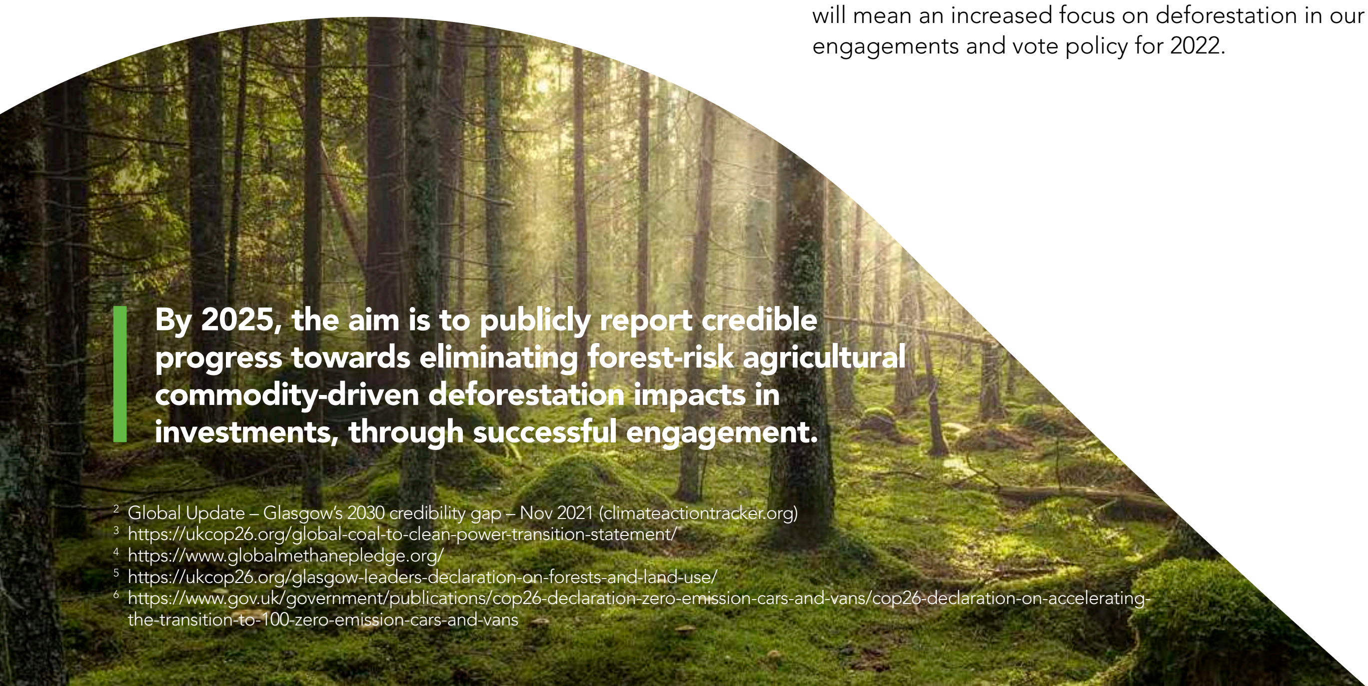
Stepping up

In the days leading up to COP26 we witnessed a successful 'ratcheting' of the NDCs, with over 75% of countries updating their national climate plan. While some countries failed to raise their national ambition, and two even reduced their ambition, 22 countries and the EU (representing some of the biggest emitters) submitted stronger targets than in 2015. At the conference itself, India's Prime Minister Narendra Modi made a surprise announcement on the first day of the World Leaders' Summit, saying that India would aim for net-zero emissions by 2070. Taken together, these enhanced pledges improved the global heating projection from an estimated 2.6°C outcome in 2020 to 2.1°C after COP26, according to analysis by Climate Action Tracker.[2]

COP26 also saw the creation of new alliances and 'coalitions of the willing', with sectoral agreements involving commitments from countries, regions, and companies. These included 46 countries agreeing to a more rapid phase out of unabated coal use[3]; 111 countries committing to a 30% methane reduction by 2030[4]; over 140 countries committing to halt and reverse forest loss and land degradation by 2030[5]; and various governments, cities, manufacturers and financial institutions committing to zero emissions vehicles by 2040.[6]

We signed the declaration on zero emission cars and vans as EOS at Federated Hermes and the international business of Federated Hermes. This commits us to working towards 100% zero emission car and van sales by 2035 in leading markets, and no later than 2040 globally. Our commitment will include proactive engagement and escalation, encouraging the decarbonisation of fleets in line with science-based targets. This will mean a continued focus on our engagements in the auto sector through Climate Action 100+ and directly.

The international business of Federated Hermes also signed the pledge to halt and reverse forest loss and land degradation, committing to addressing the risks of commodity-driven deforestation in its investment portfolios. This commitment will be met primarily through due diligence, engagement and stewardship. By 2025, the aim is to publicly report credible progress towards eliminating forest-risk agricultural commodity-driven deforestation impacts in investments, through successful engagement. For EOS this will mean an increased focus on deforestation in our engagements and vote policy for 2022.



By 2025, the aim is to publicly report credible progress towards eliminating forest-risk agricultural commodity-driven deforestation impacts in investments, through successful engagement.

[2] Global Update – Glasgow's 2030 credibility gap – Nov 2021 (climateactiontracker.org)
[3] https://ukcop26.org/global-coal-to-clean-power-transition-statement/
[4] https://www.globalmethanepledge.org/
[5] https://ukcop26.org/glasgow-leaders-declaration-on-forests-and-land-use/
[6] https://www.gov.uk/government/publications/cop26-declaration-zero-emission-cars-and-vans/cop26-declaration-on-accelerating-the-transition-to-100-zero-emission-cars-and-vans

Some 450 financial institutions representing US$130tn of assets formed the Glasgow Financial Alliance for Net Zero (GFANZ). This pledged to mobilise finance at scale to achieve net-zero emissions by 2050 or sooner, with a focus on near-term actions to achieve 50% decarbonisation by 2030.[7] Together, these sectoral commitments added emission reductions equivalent to an extra 50% of those promised in the NDCs themselves.

This panoply of targets and pledges made a considerable dent in global warming estimates – for the first time, projections indicated that warming might be halted below 2°C. However, to achieve this 1.8°C estimate, from Climate Action Tracker analysis, not a single target or pledge can go unfulfilled. Short-term action is essential to make this possible and close the significant outstanding 2030 ambition gap.

Away from the headline announcements, negotiators were busy finalising the Paris Rulebook, concluding the rules for the 2015 Paris Agreement. The agreements struck on Article 6 created two international carbon markets for over-achieving countries and companies to sell emissions reductions to those failing to meet their targets. This paves the way for the unlocking of private finance and efficient decarbonisation pathways.

This panoply of targets and pledges made a considerable dent in global warming estimates – for the first time, projections indicated that warming might be halted below **2°C**

Yet throughout the negotiations a sticking point remained. The promise made 12 years ago by developed countries to mobilise $100bn a year in climate finance for developing countries by 2020 has not been met. And despite the new pledges made at COP26, the target is not estimated to be met until 2023. Any further delay will threaten ongoing global North-South cooperation.

Finally, and somewhat unexpectedly, COP26 closed with the Glasgow Climate Pact. In this, almost 200 countries agreed to make further pledges in 2022 at COP27 in Egypt to seek alignment with 1.5°C, to phase down unabated coal power and to phase out inefficient fossil fuel subsidies. While not the most strongly-worded commitment, this was the first time that the long-term decline of fossil fuels had been signalled in agreed text.

How to interpret these results is a matter of perspective. It is tempting to be disappointed that COP26 did not conclusively deliver national targets aligned with 1.5°C or manage to consign coal to history. However, taking a longer view, COP26 has set by far the most ambitious government targets to date, putting us within striking distance of limiting climate change to below 2°C. This is a significant improvement on the approximately 4°C projections of a decade or so ago. And if 1.5°C is missed, this will only increase the pressure and urgency for all participants in the economy, including investors and companies, to act.

COP26 also demonstrated that national targets are no longer the only element playing a role – investors and companies can make a difference, with approximately a third of G20 listed companies having net-zero targets.[8] Further, in GFANZ, the finance community has arguably become the foremost progressive business voice driving climate goals, with a majority of asset managers now committed to net-zero investing. Investors must give companies a mandate to pursue net-zero goals with targets aligned to 1.5°C to help bridge the gap between national targets and the required reductions.

Stewardship in 2022 and beyond

How might this work in practice? In July 2021, the international business of Federated Hermes committed to being a net-zero investor under the Net Zero Asset Managers Initiative and many other EOS clients are similarly committed, some as members of the Net-Zero Asset Owners Alliance. Some signatories are using the Net-Zero Investment Framework (NZIF) to support the development of their strategy, which makes clear that stewardship has to be the primary means through which to achieve change in the real economy, with selective divestment seen as a last resort. With investors representing almost $60tn of assets now committed to net zero, there is considerable pressure on companies to change their strategies to align with 1.5°C.[9]

COP26 closed with the Glasgow Climate Pact. In this, almost 200 countries agreed to make further pledges in 2022 at COP27 in Egypt to seek alignment with 1.5°C, to phase down unabated coal power and to phase out inefficient fossil fuel subsidies.

[7] https://www.gfanzero.com/press/amount-of-finance-committed-to-achieving-1-5c-now-at-scale-needed-to-deliver-the-transition/
[8] https://eciu.net/media/press-releases/2021/net-zero-targets-are-becoming-mainstream-in-g20-governments-and-business-but-more-must-follow-to-realise-ambition-loops-that-can-accelerate-the-transition
[9] https://www.netzeroassetmanagers.org/

In 2020 we saw a tripling in the number of companies with a net-zero commitment. However, data from the Climate Action 100+ benchmark showed that while 52% of 159 of the world's biggest emitting companies had a net-zero goal, only 20% had short and medium-term targets covering a majority of their emissions, and only 7% had targets that are actually aligned to 1.5°C.

We aim to take companies up a ladder of ambition, starting with an initial commitment to net-zero emissions by 2050 or sooner. This should be followed by putting in place short, medium and long-term targets aligned with 1.5°C. These should be underpinned by a comprehensive strategy, with capital expenditure aligned to the Paris goals and good disclosures of progress, in line with the TCFD recommendations. The final step is for companies to become 'Aligned' by demonstrating good progress against these targets. Ultimately this should lead to a portfolio of net-zero companies, ideally by 2030 or sooner.

There are other important elements for engagement that will support these core objectives. These include demonstrable board oversight of climate change, with executive remuneration aligned to delivering net-zero goals, no political lobbying contrary to the Paris Agreement goals, and ensuring a just transition for employees and other stakeholders. Over time we also want to see increasing revenues aligned with green taxonomies, in line with sustainable finance reporting requirements.

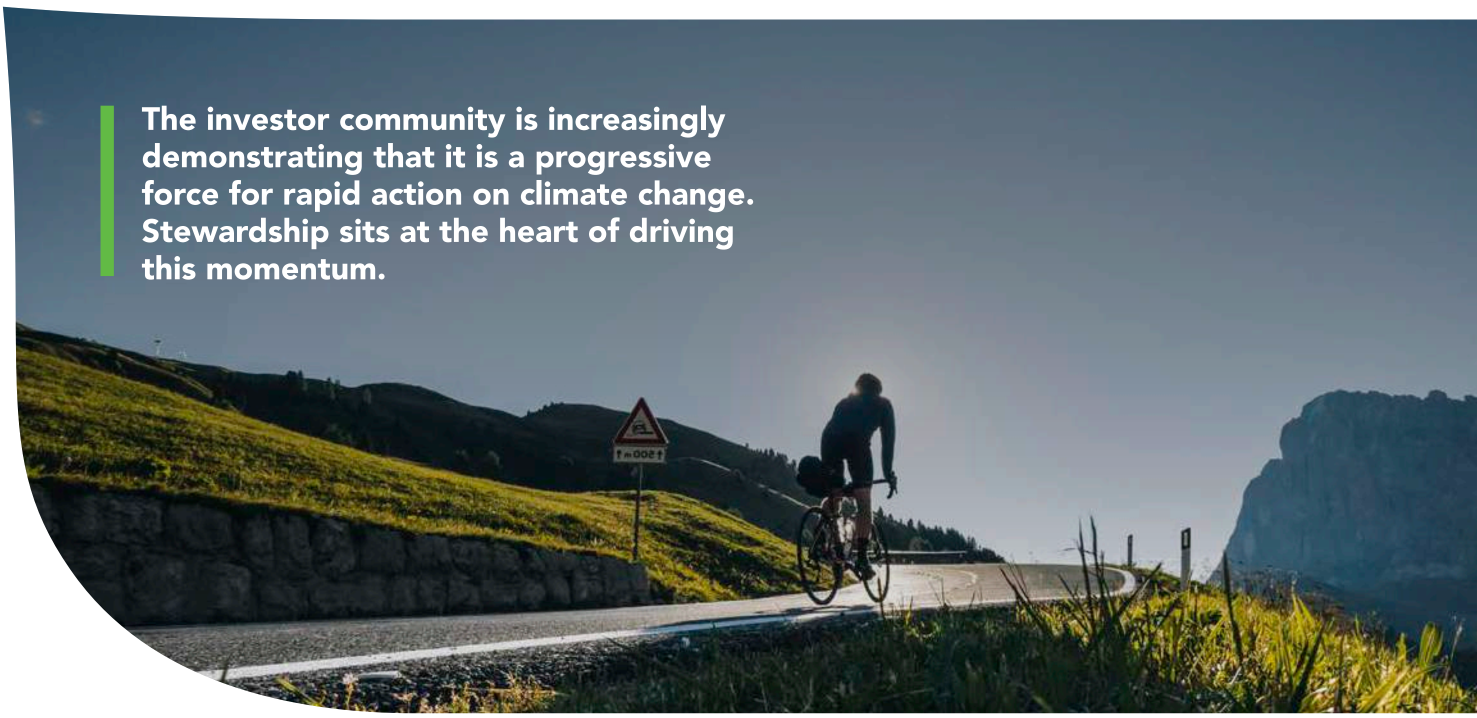
Escalating engagement

We believe that escalation of engagement will be increasingly important to ensure that companies make the necessary changes at the pace required. Ambitions and announcements must be translated into detailed plans and action. We expect to see more cross-sectoral commitments and coalitions of the willing, but it is likely that regular ratchets will be necessary, as climate-related events trigger social tipping points.

In previous years engagement has mainly focused on the biggest emitting sectors such as oil and gas, utilities and steel. In 2022 we are widening this to include vital sectors such as food and agriculture, the apparel industry and its supply chain, and banks, which need to align their lending portfolios to 1.5°C, in step with investors.

We will follow up with companies who signed COP26 commitments to ensure that they follow through on these. We will also focus on those companies that did not sign up to more ambitious standards – for example, Volkswagen, Toyota, Stellantis and Hyundai, which did not commit to the statement on net-zero emissions vehicles.

The investor community is increasingly demonstrating that it is a progressive force for rapid action on climate change. Stewardship sits at the heart of driving this momentum and we look forward to playing our role on behalf of clients to meet the Paris Agreement goals.



Climate laggards under pressure to pick up the pace

Collaborative engagement initiative Climate Action 100+ has now entered its fifth year. With high-emitting laggards under pressure to pick up the pace of their transition in the wake of COP26, how successful has CA100+ been to date? Owen Tutt assesses the progress made.

The devastating physical effects of climate change intensified in 2021 with a suffocating heat dome across Western Canada, deadly wildfires in the US and southern Europe, and destructive large-scale flooding across northern Europe. In August, the Intergovernmental Panel on Climate Change (IPCC) hammered home the urgent need to act in its Sixth Assessment Report,[1] labelled a "code red for humanity" by UN Secretary-General António Guterres.[2] This provided further categorical evidence that without immediate, rapid emission reductions, the goals of the Paris Agreement would slip beyond our reach.

November's COP26 conference in Glasgow gave policymakers the forum to respond to the climate crisis. But investors and their representatives are also playing a part in efforts to accelerate the low-carbon transition. Since December 2017 the collaborative engagement initiative Climate Action 100+ (CA100+) has been striving to bring the world's biggest corporate emitters into line with international ambitions for a 1.5-degree world. EOS is a significant supporter of CA100+, leading or co-leading engagement at over 25 of the 167 focus companies across Europe, North America, and Asia.

According to analysis by research company BNEF, 111 of the CA100+ focus companies have set a net-zero or equivalent target, compared with five prior to January 2018 when the initiative was launched. BNEF estimates that in 2030, the net-zero targets set by these 111 focus companies will reduce greenhouse gas emissions by 3.7bn metric tons of carbon dioxide equivalent annually.[3]

Net-zero benchmark

In March 2021, CA100+ published its first assessment of focus companies against the Net-Zero Company Benchmark, a standardised framework for evaluating company progress. EOS contributed to the benchmark through its collaboration with the Institutional Investors Group on Climate Change (IIGCC) – for example, on the inclusion of a test for capital expenditure alignment.

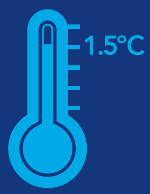
The benchmark found that companies still had work to do, with alignment of value chain greenhouse gas emissions – Scope 3 – often a blind spot. For example, while 83 of the focus companies assessed – 52% of the total – had announced an ambition to achieve net zero by 2050 or sooner, 44 of these commitments did not cover the full scope of the companies' most material emissions.[4]

CA100+ also identified a need for long-term ambitions to be backed by clearer strategies and robust short- and medium-term targets. While 107 companies had set medium-term targets, only 21 met all the assessment criteria, and of the 75 companies to have set short-term targets, only eight met all the assessment criteria. Other worrying findings included the fact that only six companies had explicitly committed to aligning their future capital expenditure with their long-term emissions reduction targets. And only 10% of companies were using climate-scenario planning that included a 1.5-degree scenario that encompassed the entire company.

Owen Tutt
Theme: Climate Change

[1] https://www.ipcc.ch/report/ar6/wg1/
[2] https://www.un.org/press/en/2021/sgsm20847.doc.htm
[3] https://about.bnef.com/blog/two-thirds-of-the-worlds-heaviest-emitters-have-set-a-net-zero-target/
[4] https://www.climateaction100.org/news/climate-action-100-issues-its-first-ever-net-zero-company-benchmark-of-the-worlds-largest-corporate-emitters/

Key data for CA100+



Over **615** signatories

With over **US$65tn** under management

167 focus companies targeted, accounting for

80%+ of corporate industrial greenhouse gas emissions

Engaged across **33** markets

Brace for impact

After a period of uncertainty around global co-operation triggered by US withdrawal from the Paris Agreement and pandemic-induced disruption, COP26 reaffirmed that global climate policy will only tighten. Given the limited time left in which to take the necessary action to align with a 1.5-degree world, this increases the risk of a disorderly transition and worse outcomes for laggard companies, which have left themselves with so much to do.

In 2021 we stepped up engagement with notable laggards such as chemicals company LyondellBasell, leading a delegation of eight institutional investors who spoke at the annual shareholder meeting, in our role as CA100+ lead.

While the other agenda items together took only 12 minutes to resolve, this was followed by over 45 minutes of debate on the company's climate change strategy. We had escalated this engagement by obtaining support from 27 institutional investors to use a legal mechanism under Dutch law to require a discussion on climate change at the shareholder meeting. Later in the year, the company made a commitment to net-zero emissions by 2050 with interim steps towards achieving this goal. These included a 30% absolute reduction in emissions target, and a goal of sourcing at least 50% of its electricity from renewable energy by 2030.

We also attended the annual shareholder meeting of Air Liquide in our capacity as CA100+ co-lead to ask questions about the industrial gas company's energy transition plan. We asked about the absence of a target for Scope 3 emissions, which represent 40% of its total emissions, and when it would be communicating a climate action plan.

We followed up with a letter to the CEO seeking confirmation that the company would fully align its disclosures with the CA100+ Net-Zero Company Benchmark by the end of 2023. We also co-signed a letter to the chair and CEO about a ShareAction collaborative engagement initiative focusing on the climate risks posed by the European chemicals sector. In response, the company said that Scope 3 emissions in the chemicals sector were not yet well defined, but it was planning to participate in a Science-Based Targets initiative (SBTi) working group to define the sector's decarbonisation approach.

On the other side of the Atlantic, EOS's North American engagement team co-led a CA100+ engagement with the US oil company ConocoPhillips asking for an enhanced assessment of its climate-related risk. CA100+ has a flagging mechanism to enhance the impact of investor voting on climate-related resolutions. Seeking more ambition from ConocoPhillips, EOS flagged and recommended a vote for a shareholder proposal at the company's 2021 annual shareholder meeting that asked for absolute emissions reduction targets across Scopes 1 to 3. The proposal gained 58% support and we continue to engage on the company's response to this request.

After a period of uncertainty around global co-operation triggered by US withdrawal from the Paris Agreement and pandemic-induced disruption, COP26 reaffirmed that global climate policy will only tighten.

Berkshire Hathaway shareholder resolution

In conjunction with California Public Employees' Retirement System (CalPERS) and Caisse de Dépôt Et Placement Du Québec (CDPQ), we filed a shareholder proposal at Berkshire Hathaway, hoping to trigger a dialogue with the company on climate change. We co-lead on Berkshire Hathaway for CA100+.

The proposal asked Berkshire Hathaway's board to publish an annual assessment addressing how the company manages physical and transitional climate-related risks and opportunities. Tim Youmans, the EOS lead for North America, spoke at the 2021 shareholder meeting on behalf of the proposal.

While the company has performed well historically, simply asking shareholders to "trust" the company on its capital deployment decisions without climate risk being adequately disclosed is concerning. For example, Berkshire Hathaway Energy is now the largest US power company without a net-zero goal. Berkshire Hathaway insiders, including the chair and CEO Warren Buffett, control 35% of the company's voting power. With Berkshire Hathaway opposing the shareholder proposal, it was defeated, but when adjusted for non-insiders, the vote results were close to 60% in favour of the proposal.

EOS has engaged on climate change with POSCO – one of the world's largest steel producers – directly since 2016, and as a co-lead for the company under CA100+.

Voting for ambition

The 2021 voting season was notable for a number of 'say on climate' votes where shareholders were given the opportunity to vote on a company's climate transition plan. EOS supports the concept but applies rigorous scrutiny to company plans before making its vote recommendations. In our role as the CA100+ co-lead for the French oil and gas major TotalEnergies, we led a group of 35 institutional investors to move a collective statement at the annual shareholder meeting and recommended voting against Total's climate transition plan. However, only 8% of shareholders did so, suggesting that some investors lacked the technical skills or the time to evaluate the plan properly. Without this level of scrutiny, 'say on climate' votes are at risk of becoming a greenwashing tool rather than an opportunity for investors to drive climate ambition.

A shareholder resolution brought by Follow This requiring Scope 3 targets at Chevron, another US oil major where we co-lead for CA100+, gained 61% support from investors. We had recommended support for the proposal, noting that Chevron's existing strategy in relation to the energy transition appeared to assume that it would not need to shrink in the short, medium and possibly long term, which introduces risks in a 1.5°C world. Accordingly, it had set emission intensity targets for its Scopes 1 and 2 emissions only.

No sector left behind

Another takeaway from the COP26 conference was a recognition of the enormous scale and pace of decarbonisation that is required for 1.5°C to remain within reach. Even the hard-to-abate sectors must reduce emissions immediately. Steel production is one such sector, accounting for 9% of total energy sector emissions in 2019. Low-carbon technologies are still in their infancy for steel production, yet the International Energy Agency's Net Zero by 2050 scenario indicates that Scope 1 emissions from the steel industry must fall by 29% by 2030.

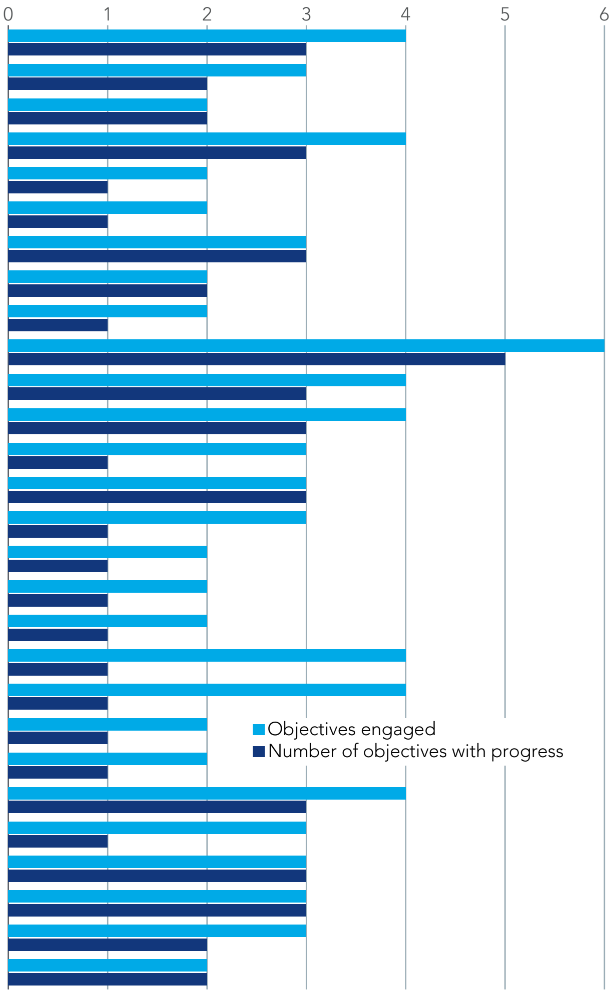
EOS has engaged on climate change with POSCO – one of the world's largest steel producers – directly since 2016, and as a co-lead for the company under CA100+. We had asked the company to set science-based, short-, medium-, and long-term emissions reduction targets. These requests were met in late 2020 when the company set targets that require short-term action and a transformation of the business to align with 1.5°C in the long term. Its work driving hydrogen-based steelmaking to reach these targets may also serve as a catalyst for decarbonisation of the whole sector.

While CA100+ is focused on 167 of the world's biggest corporate emitters, it is vital that decarbonisation is achieved across the entire economy. This year EOS contributed to the new CA100+ Global Sector Strategies workstream,[4] which will provide transition roadmaps for key sectors and identify the priority actions that companies, industries and investors should take. The aim is to help transform entire sections of the economy that require coordinated action. EOS contributed to the first Global Sector Strategy Reports on the steel sector and the food and beverage sector, highlighting the cross-sector actions needed to reach net zero.

[4] https://www.climateaction100.org/approach/global-sector-strategies/

Progress of environmental objectives for selected CA100+ companies engaged by EOS, 2021

Company Name	EOS Sector	Participation
LyondellBasell Industries	Chemicals	Co-Lead
BASF	Chemicals	
Air Liquide	Chemicals	Co-Lead
Rolls-Royce Holdings	Industrials	Co-Lead
Siemens	Industrials	Lead
Boeing	Industrials	
Anglo American	Mining & Materials	Co-Lead
CRH	Mining & Materials	Co-Lead
Glencore	Mining & Materials	
Exxon Mobil	Oil & Gas	
TotalEnergies	Oil & Gas	Co-Lead
Equinor	Oil & Gas	
Repsol	Oil & Gas	Co-Lead
Occidental Petroleum	Oil & Gas	
Royal Dutch Shell	Oil & Gas	
BP	Oil & Gas	Co-Lead
Chevron	Oil & Gas	Co-Lead
PetroChina	Oil & Gas	Co-Lead
Walmart	Retail & Consumer Services	Co-Lead
AP Moller – Maersk	Transportation	Co-Lead
Bayerische Motoren Werke	Transportation	Co-Lead
Daimler	Transportation	Lead
American Electric Power	Utilities	
Dominion Energy	Utilities	
Duke Energy	Utilities	
Engie	Utilities	
PPL	Utilities	
CEZ	Utilities	



Source: EOS data

Lobbying and auditing

The political lobbying and public policy advocacy conducted by companies directly or through the trade associations to which they belong can have a significant influence on the structural policy environment. We ask companies to assess their industry memberships and identify any areas of climate policy misalignment. For example, after three years of specific engagement by EOS, BMW, another company where we co-lead for CA100+, published its first policy in relation to its trade association memberships. This describes how the company monitors the climate policy positions of its trade associations and its new, proactive approach to membership that seeks to influence the positions taken by these organisations.

Another important issue is whether and how companies have reflected climate risk in their financial reporting and accounts. At the COP26 Fringe Festival, Carbon Tracker hosted a panel event on climate accounting,[5] which highlighted recent research showing that 80% of auditors[6] do not provide evidence that climate is considered in the audit reports of carbon-intensive public companies, despite the materiality of climate change to these businesses. We have raised this topic across our engagement programme companies, and in November signed a letter to the Big Four audit firms asking that material climate risks be included in company audits. The letter also warned that investors would consider voting against the reappointment of the auditor if this was not addressed.

[5] COP26 | Dialogue Meeting: Accounting for Climate – YouTube
[6] The new hot topic: accounting for climate | Climate Action 100+

Looking ahead

In March 2022, the second assessment of CA100+ companies against the net-zero benchmark will be published. This will initiate another round of engagement to bring companies onto a net-zero pathway before the 2023 CA100+ deadline for benchmark alignment. This year's assessment will include new indicators for the just transition, climate accounting and audit, and climate policy engagement alignment, to spur intensified dialogue with companies.

As the transition gains momentum, EOS will continue to engage to ensure that companies recognise the reality of a net-zero economy, that they factor this into their financial and strategic planning, and that they deploy capital to address the risks and capture the opportunities presented by the transition.

Q&A: Biodiversity

Sonya Likhtman
Theme co-lead: Climate Change

Biodiversity loss was recognised as an urgent challenge in 2021 given the importance of ecosystems for sustaining global food supplies, providing clean water and air, and absorbing harmful carbon dioxide to help mitigate global heating. In early 2021 we published a white paper, *Our Commitment to Nature*, which set out our engagement priorities and expectations for sustainable land use. We built on this in Q2's Public Engagement Report with an article examining the threats to marine ecosystems, and online through our EOS Insights series on sustainable food systems.

Throughout 2021 we advocated for better public policy frameworks through our work with the Finance for Biodiversity Foundation and other collaborative initiatives. We also presented our work at our Further, Faster conference at COP26 in November. In the wake of some notable announcements at COP26 on deforestation and natural capital, we look ahead to the COP 15 on biodiversity and assess the progress to date.

Q. We set out a clear framework for our engagements on biodiversity in 2021 when we launched our white paper. How was this received, and how did we build on that work?

A. Our white paper highlighted the extent to which investors' and companies' current approaches to nature are unsustainable. It made the business case for action and outlined how investor engagement with companies is a key route by which biodiversity loss can be halted and reversed. We continue to call on companies to commit to having a net-positive impact on biodiversity throughout their operations and supply chains by 2030 at the latest. We expect this goal to be accompanied by strong governance, effective measurement, an impactful strategy, and regular disclosure. The framework and white paper have been well received by peers, companies and others.

Sonya Likhtman presenting at our Further, Faster event at COP26.

Subsequently, we looked at the role that marine ecosystems play in regulating our climate and providing key services, such as the production of oxygen, and carbon sequestration. Sectors such as shipping, tourism and fishing are highly dependent on the oceans, with most global trade occurring by sea and about 80% of tourism occurring in coastal areas. It is estimated that over three billion people depend on the oceans for their livelihoods and that the natural capital of our oceans is valued at US$24tn.

Yet after centuries of treating marine habitats as an inexhaustible resource, at least a third of fish stocks are now depleted, while microplastic pollution has become endemic and is working its way up the food chain. We identified five engagement themes for ocean sustainability: addressing the climate crisis, tackling pollution, transitioning to sustainable food systems, reversing the loss of biodiversity and protecting human rights.

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We also delved deeper into the sustainable food systems theme through an EOS Insights series. This highlighted how the food system is currently a principal driver of biodiversity loss, even though biodiversity and ecosystem services underpin farming and food production. Food producers need to shift to regenerative agricultural practices to preserve soil health, arrest pollinator species decline, and transition to more sustainable product portfolios.

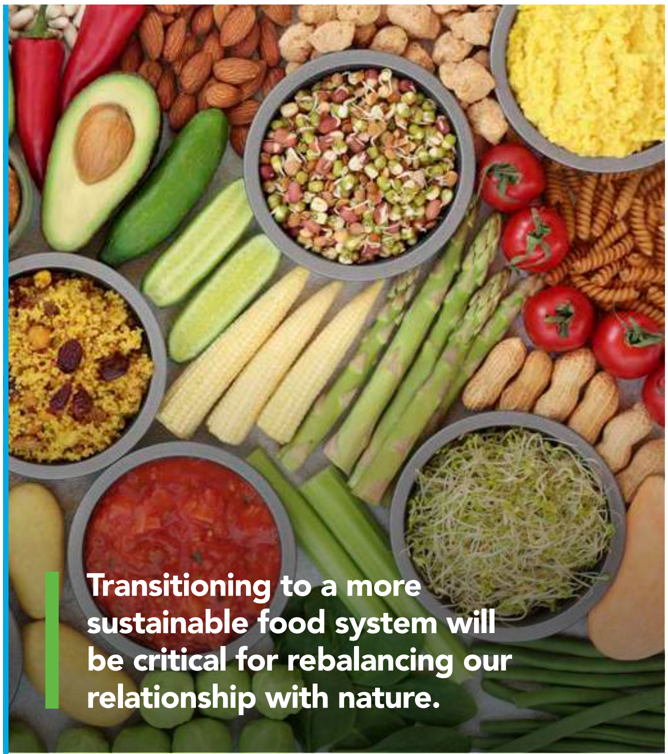
Q. How have we engaged with companies on these issues and what outcomes have we seen?

A. We continue to engage with companies across a range of sectors on how they can reduce their contribution to the five drivers of biodiversity loss, including climate change, pollution, and land and sea use change. For example, as pharmaceutical companies are highly dependent on nature, we asked Novartis to join global efforts to reverse nature loss by 2030. At the company's 2021 shareholder meeting, we asked the board for an assessment of the company's impacts and dependencies on nature, and for a commitment to having a net-positive impact on biodiversity across the full value chain.

Tackling deforestation is key to addressing biodiversity loss and climate change. In 2021, we recommended voting against directors at companies that were failing to address deforestation risks, including at Yakult Honsha, Li Ning Company, and WH Group. We have also been engaging with Cargill, a major commodity trader, on accelerating its efforts to tackle deforestation associated with soy production in South America. We asked the company to bring forward its time-bound deforestation- and conversion-free commitment by 2030 to 2025 at the latest, and to continue to improve its disclosure related to deforestation including a more transparent and sustainable soy supply chain.

The fashion industry has a major impact on biodiversity through its significant land footprint and raw material inputs. We are engaging with companies such as H&M and Burberry on this topic. At Burberry, we suggested to the head of sustainability in a meeting in September 2021 that the company could conduct a comprehensive biodiversity impact and dependence assessment that covers its operational and supply chain activities, and commit to having a net-positive impact on biodiversity throughout its operations and the supply chain.

We also asked Primark if it had mapped its current impact on biodiversity so that progress can be tracked. In 2020, Primark, CottonConnect and the Cambridge Institute for Sustainability Leadership collaborated to develop indicators to measure the environmental impact of the Primark Sustainable Cotton Programme (PSCP). These metrics assess the practices employed by PSCP farmers that have been proven to benefit biodiversity, soil and water.



To address plastics pollution, we have asked retailers to set targets for the reduction of single-use plastics, and for recyclability, recycled content and recycling rates.

Transitioning to a more sustainable food system will be critical for rebalancing our relationship with nature. We have begun discussions on biodiversity with Tesco, asking it to consider making a net-positive contribution to biodiversity across its supply chain, supported with time-bound commitments.

We have also engaged with UK supermarket chain Sainsbury's and food producers such as Kerry Group, General Mills and Tyson Foods on developing more plant-based product offerings. We have asked them to demonstrate a comprehensive approach to protein diversification covering commercial strategy, resilience of protein sourcing strategies, nutritional profile improvements, and tracking their exposure to animal and plant-based proteins.

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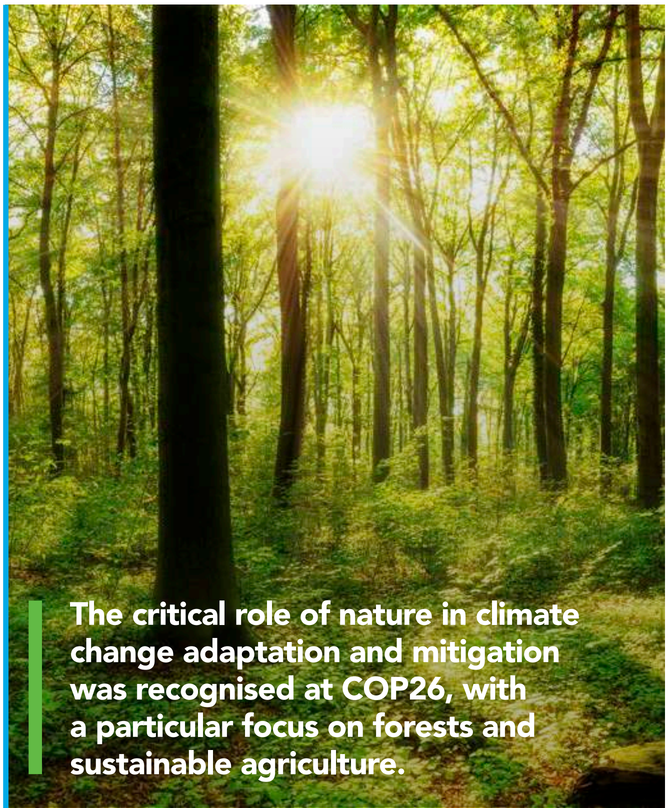
Engagement on biodiversity is growing and we are working in collaboration with others in the industry to strengthen and streamline approaches, including as co-chair of the Engagement Working Group within the Finance for Biodiversity Foundation. With a small group of investors, we are also working to establish a Nature Action 100 initiative, which would facilitate collaborative engagement with companies that have the greatest impact on biodiversity.

Q. What work have we be doing in the public policy sphere ahead of the COP 15 on biodiversity?

A. We have advocated for an ambitious Global Biodiversity Framework (GBF) that explicitly references the role of the financial sector in halting and reversing biodiversity loss to be agreed at COP 15 in Kunming in 2022. We contributed to the pre-COP 15 discussions on the GBF on behalf of the 28 financial institutions that are part of the Finance for Biodiversity Foundation. We made an intervention in the session focused on targets 14 and 15, which are most relevant to business.

We encouraged greater ambition and urgency, given the significant and systemic risk that biodiversity loss poses to society and the global economy. We also stressed that the framework should require the alignment of public and private financial flows with the goals and targets of the GBF. Finally, we asked governments to create an enabling regulatory environment so that the financial and private sectors can address biodiversity-related risks and opportunities. We were pleased that our proposal received support from the EU on behalf of its 27 member states.

We also played a key role in writing a statement, which was coordinated by the Finance for Biodiversity Foundation and Ceres, addressed to governments ahead of the biodiversity COP 15.[1] We signed the statement as both EOS at Federated Hermes and the international business of Federated Hermes, along with financial institutions representing over US$10tn in assets. The statement calls on governments to address biodiversity loss by agreeing an ambitious and transformative GBF, and through their national policies, including by introducing consistent and decision-useful corporate disclosure requirements.



Q. What progress has been made in 2021 and what's next?

A. It was great to see the critical role of nature in climate change adaptation and mitigation recognised at COP26, with a particular focus on forests and sustainable agriculture. Coordinated by the UK government, 130 countries agreed to halt and reverse forest loss and land degradation by 2030.[2] The international business of Federated Hermes, alongside 30 investors representing US$8.7tn,[3] committed to addressing the risks of commodity-driven deforestation in investment portfolios.

The commitment, which covers cattle products, palm oil, soy, and pulp and paper production, will be met primarily through due diligence, engagement and stewardship. This will mean stepping up engagement on deforestation and continuing to focus on this topic within our vote policy. The international business of Federated Hermes also joined the Natural Capital Investment Alliance, which aims to accelerate the development of natural capital as a mainstream investment theme.

> **The commitment, which covers cattle products, palm oil, soy, and pulp and paper production, will be met primarily through due diligence, engagement and stewardship.**

[1] COP15-Financial-Institution-Statement.pdf (financeforbiodiversity.org)
[2] Over 100 leaders make landmark pledge to end deforestation at COP26 – GOV.UK (www.gov.uk)
[3] DFF-Commitment-Letter-.pdf (unfccc.int)

Can climate litigation spur faster Paris-alignment?

The 2021 Dutch court judgment against Shell may open the door for fresh climate litigation citing human rights law. Could this accelerate the energy transition, forcing fossil fuel producers to go further, faster? By Claire Milhench.

When a Dutch court ruled in 2021 that oil and gas giant Shell must cut emissions deeper and earlier, it should have sent shockwaves through fossil fuel boardrooms. After all, some 88% of Shell's investors had just endorsed the company's climate transition strategy at its annual shareholder meeting, in a say-on-climate vote.

We had recommended a vote against the company's transition strategy because it appeared misaligned with the Paris Agreement goals. There was a lack of climate action safeguards such as absolute reduction targets before 2050 or commitments to align the company's capex with meeting the Paris goals. We had also recommended a vote against the company's financial reporting due to the lack of progress on aligning with Paris Agreement scenarios.

In the landmark case brought by the Dutch arm of Friends of the Earth, other NGOs and over 17,000 Dutch citizens, the judge ruled that Shell should materially update its strategy to align with the Paris Agreement's temperature goals. This included setting a target to reduce its net emissions by 45% by 2030 across its entire energy portfolio and the aggregate volume of all emissions including those of its products.

Shell is appealing the court's decision, but as it stands, it sets a legal precedent. In the meantime, Shell must comply with the judgment, which requires the company to accelerate its strategy. The ruling is significant, because NGOs have tried to win such cases against fossil fuel companies in the past – and failed. Despite this poor success rate, climate lawsuits and class actions are on the rise, particularly in the US, where litigation offers an alternative route to Paris alignment for frustrated investors.

Polluter pays

Big polluters have been forced to pay huge fines and settlements for causing environmental damage in the past. For example, BP paid out $65bn after the Deepwater Horizon blow out spewed millions of gallons of crude oil into the Gulf of Mexico for months, while Vale agreed to pay $7bn in compensation after the catastrophic collapse of its tailings dam at Brumadinho. But bringing lawsuits against polluters for their contribution to climate change is relatively new, although the volume of cases is rapidly rising.

According to a July 2021 report from the Grantham Research Institute on Climate Change and the Centre for Climate Change Economics and Policy, the number of climate change-related cases has more than doubled since 2015. Just over 800 cases were filed between 1986 and 2014, while over 1,000 cases have been brought in the last six years.[1]

The temperature goals set out under the Paris Agreement provide a strong basis for NGOs, investors, concerned citizens and local communities to challenge individual projects through planning consents, the climate strategies of national governments and even company strategy.

Despite this poor success rate, climate lawsuits and class actions are on the rise, particularly in the US, where litigation offers an alternative route to Paris alignment for frustrated investors.

[1] Setzer J and Higham C (2021) Global trends in climate change litigation: 2021 snapshot. London: Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy, London School of Economics and Political Science.

For example, the UK secretary of state approved the construction of the Drax 3.6 gigawatt gas-fired power plant in October 2019, over-ruling the advice of the planning inspectorate, which said that the project should not be approved on climate grounds. ClientEarth, a charity that specialises in environmental law, challenged the decision on the grounds that it was irrational, and that the secretary of state had failed to correctly interpret government policy and law. Also, she had failed to give adequate reasons for her assessment of the need of the project. Although the Court of Appeal later ruled in the government's favour, Drax subsequently scrapped the project.[2]

Climate change and human rights

In 2021, a group of young climate activists sought to bring a case against several countries including Brazil, Germany and France. They cited human rights violations as the countries had failed to cut greenhouse gas emissions to levels that would restrict global warming to 1.5°C. Although the case was rejected by a UN committee, this was on the grounds that they should seek redress in their national courts first.[3]

The Urgenda Foundation, a Dutch environmental group, was successful in its suit against the Dutch government, which argued that the state needed to do more to prevent global climate change. This was the first case where the courts ruled against a government on the basis that inadequate climate policy was a breach of human rights. The case was upheld all the way to the Dutch Supreme Court.[4]

The judgment against Shell demonstrates that climate cases against companies can succeed. The plaintiffs contended that Shell's climate strategy was insufficient to meet Shell's legal duty of care towards those residing in the Netherlands under the Dutch Civil Code. Although Shell's goal is to become a net-zero business by 2050, the court relied on human rights arguments to conclude that the company needed to take further action in order to meet the necessary standard of care.

This suggests that it may not be sufficient to consider climate-related financial risks based on the impacts from the energy transition and maintaining shareholder value. Investors and companies may also need to consider the real-world impact of each business on the environment and communities, including the future harms that may be caused by historical emissions from the products they sell.

Historical emissions

If a company's historical emissions can be used to assess its overall environmental impact, there could be a higher level of litigation risk, even if a company's net-zero plans are robust. For example, over 90% of RWE's capex is now going into environmentally-sustainable investments, but in the past, it was the largest emitter in the EU. One way to mitigate this risk might be for companies to set net-negative targets to reduce their past contribution.

The risk is more than hypothetical. In 2015, a case was filed against RWE by Peruvian farmer Saul Luciano Lliuya, who argued that the German energy giant must contribute to the cost of protecting his Andean home – at risk of flooding due to a swollen glacier lake.[5] Lliuya sued for just 0.47% of the costs he needed for protective measures – equivalent to the share of greenhouse gas emissions RWE is estimated to have contributed to the global total since industrialisation began.

It may not be sufficient to consider climate-related financial risks based on the impacts from the energy transition and maintaining shareholder value.

The aim is to establish a legal precedent, which could see the world's largest emitters held accountable for the carbon they have generated throughout their entire periods of operation.[6] The case, which has been delayed by the pandemic, is still in the evidence collection stage, for the courts to determine whether and how RWE's emissions have contributed to climate change-related risks near the claimant's home.

We have engaged with RWE on climate change since 2006, and spoke at the 2011 annual shareholder meeting, criticising the company's lack of progress on carbon emissions reduction. We expressed our concerns about the lack of

[3] https://www.clientearth.org/latest/latest-updates/news/climate-win-as-drax-scraps-gas-mega-plant-in-uk/
[2] https://www.theguardian.com/environment/2021/oct/20/young-climate-activists-vow-to-keep-fighting-despite-un-setback
[4] Urgenda Foundation v. State of the Netherlands – Climate Change Litigation (climatecasechart.com)
[5] https://www.theguardian.com/world/2017/nov/14/peruvian-farmer-sues-german-energy-giant-rwe-climate-change
[6] http://climatecasechart.com/non-us-case/lliuya-v-rwe-ag/

strategic focus on this important goal, and regarding the lawsuit RWE had filed against the German government for mothballing nuclear power plants in the wake of the Fukushima disaster in Japan.

We continue to press the company on its approach to mitigating carbon-related risks. Ahead of RWE's 2021 shareholder meeting, we raised concerns about the company's arbitration case against the Netherlands, where RWE is alleging that the Dutch government failed to allow adequate time and resources to transition away from coal.[7] We also expressed concerns about the acquisition of gas-fired power stations in Belgium, the continued operation of coal-fired power stations beyond 2030, and the use of biofuels to reach net zero by 2040.

In another example of how emitters are coming under pressure, in November 2021, German car manufacturer Volkswagen was sued by Greenpeace and climate activist Clara Mayer over its CO2 emissions.[8] Volkswagen was among four big automakers not to sign a COP26 declaration on accelerating the transition to 100% zero-emission cars and vans.[9] We are co-leading the engagement with Volkswagen for Climate Action 100+, but have also engaged directly with the company on climate for many years, including around the emissions scandal.

At the company's 2021 shareholder meeting, we submitted questions jointly with our CA100+ co-lead. We asked how VW is planning to demonstrate to investors that its short, medium and long-term capex allocations are aligned with its decarbonisation goals and the Paris Agreement objective of limiting global warming to 1.5°C. We also asked about the alignment of its lobbying activities with the Paris goals and challenged the company on how it plans to advocate for ambitious climate and energy policies, given the International Energy Agency's new net zero energy transition scenario.

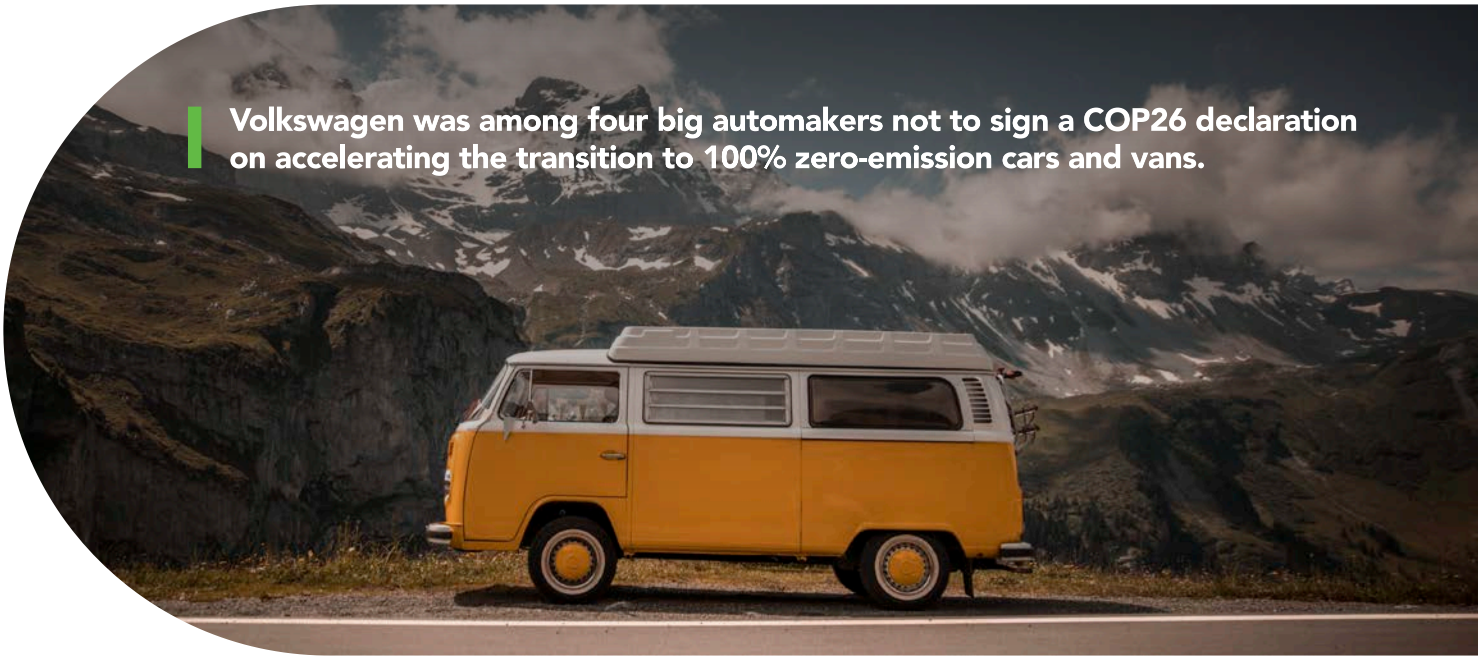
Asset stranding

Investors can also challenge companies directly through the courts if capex decisions are likely to lead to asset stranding, posing a financial risk. For example, ClientEarth brought a case against Poland's state-controlled energy group Enea over its decision to participate in the construction of a coal-fired power plant. When the Polish court ruled in ClientEarth's favour, shares in Enea rose, pointing to a market consensus that the investment would have been a poor one.[10] Enea subsequently decided not to proceed with the project.

> **We asked how VW is planning to demonstrate to investors that its short, medium and long-term capex allocations are aligned with its decarbonisation goals and the Paris Agreement objective of limiting global warming to 1.5°C.**

While many investors have tended to express their displeasure with climate change laggards through engagement, votes against directors, or statements at annual shareholder meetings, some are now losing patience. There is a growing consensus that time is running out and a company's failure to pick up the pace could prove value destructive. Increasing climate change litigation, particularly if successful, is an indicator that companies are in danger of losing their social licence to operate, which poses a significant risk to investors.

With lawyers poring over company documents looking for a smoking gun – such as evidence that a company knew about the link between its greenhouse gas emissions and global heating and did not disclose this – the stage could be set for a decade of large punitive damage awards, similar to the Big Tobacco litigations of the late 1990s.



[7] http://climatecasechart.com/non-us-case/rwe-v-kingdom-of-the-netherlands/
[8] https://www.reuters.com/article/climate-change-germany-court-idCNL1N2S00K7
[9] https://www.bbc.co.uk/news/business-59236613
[10] https://www.ft.com/content/e43d96a6-b44c-11e9-bec9-fdcab53d6959

Q&A: Fast Fashion

Lisa Lange
Theme lead: Pollution, Waste & Circular Economy

The fashion industry has undergone a rapid transformation in recent years, with young consumers encouraged to buy cheap items to wear a handful of times at most, before they are thrown away. This constant refreshment of product lines, combined with the tendency for discarded garments to end up in landfill sites or incinerated, has a significant environmental impact. According to updated statistics from the UN Environment Programme, the fashion industry accounts for 2-8% of global carbon emissions.[1]

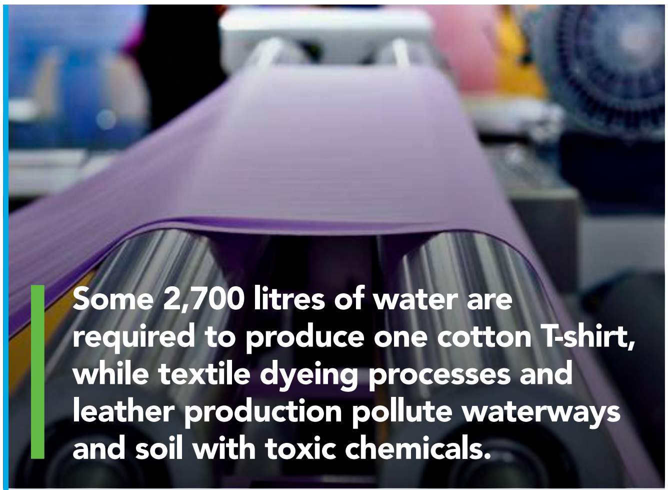
We addressed this problem in our investor expectations white paper, *Fixing Fast Fashion*, which examines why the fashion industry's linear model is unsustainable, and how companies can adopt circular approaches. We used this paper in our engagements with clothing and footwear companies in 2021, as it sets out a best practice framework and identifies key performance indicators to measure progress. We also presented our work on this topic at our Further, Faster conference at COP26 in November.

Q. During the pandemic, the closure of high street retailers during national lockdowns encouraged more people to shop online, perhaps embracing fast fashion brands for the first time. But what are some of the problems associated with this sector?

A. The fast fashion model has a detrimental environmental impact on biodiversity and ecosystems by contributing to the climate crisis. In order for the industry to be aligned with a 1.5°C scenario, McKinsey estimates that it needs to reduce its emissions by half to 1.1 billion tonnes by 2030.[2]

Water consumption and pollution are also key issues. Some 2,700 litres of water are required to produce one cotton T-shirt, while textile dyeing processes and leather production pollute waterways and soil with toxic chemicals. Synthetic fibres, such as polyester, are a source of microplastics pollution in the oceans.

The current take-make-dispose model is also uneconomical as consumers don't always wear items for the length of time that would justify the resources employed in production. Around 73% of the garments produced end up in landfill or are incinerated, while less than 1% are recycled, representing a loss of over US$100bn a year in material value. These trends are exacerbated by online shopping trends, which add to carbon emissions through delivery and packaging waste.



Some 2,700 litres of water are required to produce one cotton T-shirt, while textile dyeing processes and leather production pollute waterways and soil with toxic chemicals.

Q. How do we get away from this linear approach? What are we asking for instead?

A. Investors want companies to understand and manage their environmental impacts and to invest in innovative materials, processes and circular business models. We expect apparel companies to make a clear public commitment to such approaches, and to demonstrate how they collaborate with peers, and advocate for regulation to support the transition.

We want to see evidence from companies that they have assessed the risk of tightening regulation focused on environmental impacts and changes in consumer preferences. They should be addressing these risks by developing and implementing strategies through which they can shift to sustainable business models.

Companies should also demonstrate their ambition to reduce the environmental impact of their operations with specific, time-bound targets. These should include ambitious targets for net-zero greenhouse gas emissions and zero waste, aligned with the Paris Agreement goals. Critically, we want companies to set targets that are linked to retaining the value of the resources used in the materials, such as recycled content targets and targets for natural fibres grown using regenerative agricultural techniques. Companies should also invest in innovative materials and end-of-life management, such as recycling, reuse, and alternative ownership models.

Lisa Lange presenting at our Further, Faster event at COP26 in Glasgow.

[1] Putting the brakes on fast fashion (unep.org)
[2] https://www.mckinsey.com/~/media/mckinsey/industries/retail/our%20insights/fashion%20on%20climate/fashion-on-climate-full-report.pdf

Finally, we want companies to report on their progress so that we can assess their performance. This includes disclosing key indicators on a comparative year-on-year basis in line with reporting guidance from the Task Force on Climate-related Financial Disclosures (TCFD), the CDP and the Science-Based Targets initiative.

Q. How was the white paper and its recommendations received?

A. The response from companies was very positive, as it is helpful to understand investor expectations. Some more advanced companies have already set targets for the reduction of carbon emissions and the use of recycled materials in their products. They appreciate that we understand the complexity of their environmental and social impacts – and that it remains a challenge to change consumption patterns within the industry. But if companies want to be sustainable in the long run, they need to face this challenge.

> **We focus our engagements on five key areas – forced labour and modern slavery, child labour, living wages and purchasing practices, worker voice, gender-specific issues, and health, safety and wellbeing.**

Q. Can you give some examples of company engagements on this issue?

A. We have engaged with fashion retailer Primark, and its parent company Associated British Foods (ABF), including the CFO of ABF and the sustainability team at Primark. The company held its first ESG event in March 2021, which was followed by a deep dive on Primark in September 2021, at which its new strategy "Primark cares" was introduced. We have pushed Primark on circularity and the management of its environmental impacts, so we are pleased that the company has begun to set targets to this end. These include a target to strengthen the durability of its clothes by 2025, making clothes recyclable by design by 2027, and aiming for all clothes to be made from recycled or sustainably sourced materials by 2030.

Primark has also set a target to halve carbon emissions across its value chain by 2030, to eliminate single-use plastics and all non-clothing waste by 2027, and to introduce regenerative agricultural practices in its sustainable cotton programme by 2030.

We have also engaged with Adidas on setting a science-based emissions reduction target since the start of 2020. We are pleased that the company has now committed to reducing both its own and its suppliers' greenhouse gas emissions by 30% by 2030, from a 2017 baseline, and to achieving climate neutrality by 2050.

> **Fashion supply chains are increasingly outsourced and fragmented, meaning that poor working conditions can be hidden or ignored.**

Q. The low price tags on some clothing encourage people to wear items a few times and then throw them away. But this points to another issue with the fast fashion sector – why are these brands able to price their lines so cheaply?

A. Fashion supply chains are increasingly outsourced and fragmented, meaning that poor working conditions can be hidden or ignored. For many years, global fast fashion brands have committed to the payment of living wages, but the reality is that workers often do not even receive the minimum wage.

Modern slavery is a well-documented issue across many sectors' supply chains and regulation seeks to address this, but modern slavery thrives on poverty and vulnerabilities caused by exploitative business models. Many fast fashion companies have acknowledged this in making commitments to improve their purchasing practices.

Q. How are we trying to address these problems through our engagements?

A. We've seen how companies have tried to enshrine decent, safe and fair working conditions in codes of conduct, against which they carry out factory audits. However, there is a growing consensus that these compliance programmes have failed to identify and address the root causes of exploitative working conditions, such as sweatshops, bonded labour and poverty wages.

We focus our engagements on five key areas – forced labour and modern slavery, child labour, living wages and purchasing practices, worker voice, gender-specific issues, and health, safety and wellbeing.

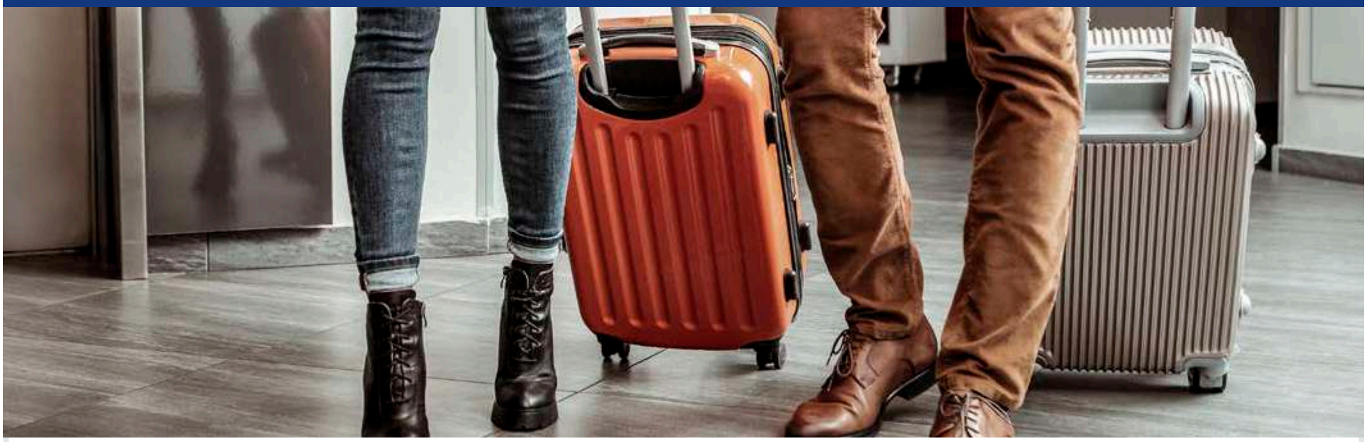
For example, we have engaged with Nike, which said that traceability of its supply chain is a core element of mitigating the risk associated with global human rights abuses. While on-site auditing was challenging during the height of the pandemic, the company confirmed that all suppliers underwent multi-day, on-site audits with accredited auditors. It is working on tracing raw materials to the source, despite not sourcing these directly, and has a goal to responsibly source all materials.

In 2022 we will take a more integrated approach to our fast fashion engagements, focusing on different social impacts alongside the environmental issues.

CASE STUDY

Samsonite

We engaged with luggage manufacturer Samsonite on climate change, product innovation and circularity. It has now launched a sustainability strategy to 2030, which includes plans to use 100% renewable energy and achieve operational carbon neutrality by 2025.



We began discussions with the company about waste, product innovation, and circular design and production in 2018 when we spoke with the newly-appointed CEO. The CEO agreed this was important and told us that a range of products using recycled materials would be trialled soon. When we enquired about end of life and recyclability of products, the CEO explained that a sustainability director was to be appointed who would be responsible for reviewing the strategy across all material sustainability issues.

In 2018 we spoke to the sustainability director, and the research and innovation director of Samsonite Europe, who explained how sustainability and circular economy issues were incorporated into the company's product development process. We discussed the company's eco-range of suitcases made using production waste and continued our conversations on this in 2018 and 2019 with various members of the senior management team.

We were pleased to see a commitment to circular economy as one of the key pillars of the company's sustainability strategy in 2020, in line with our discussions. This includes increasing materials with sustainable credentials, but also developing end-of-life solutions for products, seeking to divert products from landfill. Samsonite will collect and recycle products for up to 20 years post-purchase. It has also launched its first range of backpacks made entirely from recycled fabrics. The company calculated that the carbon footprint of the backpack is less than half that of a conventional backpack.

Samsonite will collect and recycle products for up to **20** years post-purchase.

Climate change commitments

Although Samsonite measured and disclosed emissions, prior to 2020 the company did not have any clear public targets and commitments to address climate change. In the company's strategy launched in 2020, we were pleased to see the company outline specific carbon management commitments and quantitative targets.

These include:

1. To use 100% renewable energy.
2. To achieve operational carbon neutrality by 2025.
3. To reduce carbon intensity of operations 15% by 2025 (compared with 2017).
4. To estimate, track and support actions to reduce Scope 3 emissions.

During 2020, absolute emissions fell significantly as a result of Covid-19-related reductions in production. More important, however, was the group's recognition that its principal carbon footprint is upstream in its supply chain. It is positive that in 2021 Samsonite conducted a pilot effort to estimate, track, and reduce Scope 3 emissions through engagement with key suppliers.

We will continue to engage on the challenge of Scope 3 emissions upstream in the supply chain, as well as how Samsonite might begin to consider the use of its products within Scope 3. We would also like to see the company consider science-based targets for its climate change commitments.

Hannah Shoesmith
Theme co-lead: Human Rights

Social & ethical

Social inequalities and the pandemic

The pandemic widened existing social and economic inequalities, with women, ethnic minorities, and those in contract or frontline roles hit the hardest. In 2021 we engaged with companies on areas such as paid sick leave and safety measures to ensure that workers were adequately protected.

As the pandemic rolled on through 2021, it became clear that key workers in retail, healthcare, logistics and other people-facing roles were significantly worse off than office workers who could work from home. Gig workers, who are often excluded from benefits that full-time or part-time employees receive such as paid sick leave, were particularly hard hit, even as demand for their labour increased. A lack of sick pay provision means that if workers fall ill, they may have to choose between losing their income or going to work while sick, increasing the risk of passing on the infection to others.

Existing social and economic inequalities affecting women and people of colour were also exacerbated by the pandemic. Home schooling meant that unpaid care work increased, with the burden impacting women to a greater degree, while racial and ethnic minorities were disproportionately represented in key sectors such as retail, healthcare and manufacturing, putting them at greater risk of exposure to Covid-19. We investigated these issues, and how they could be addressed, in a series of EOS Insights published throughout 2021.

During the pandemic our engagement has centred around company management of the most material human capital issues as we believe that increased productivity and business sustainability is achieved through investment in the workforce.

> **Companies have a responsibility and an obligation to provide a safe working environment, and policies around Covid-19 testing and vaccines need to consider a disproportionate impact or burden along with safety.**

Emily DeMasi
Theme lead: Human Capital Management

Our engagement expectations

Safe treatment of workers

The safe and equitable treatment of employees and contract workers is vital. Companies have a responsibility and an obligation to provide a safe working environment, and policies around Covid-19 testing and vaccines need to consider a disproportionate impact or burden along with safety. Sick pay provisions help to mitigate the spread of Covid-19, and for these provisions to be effective it is important that companies continue to compensate workers when they need to take time away from work to care for themselves, a household member, or another dependent.

Broader health and safety measures should consider impacts on frontline and vulnerable workers and be evaluated for their implementation and effectiveness. Additionally, workers should have the ability to raise concerns, feel comfortable doing so, and be heard by a management team that investigates and responds to these concerns. Within the sectors hit hardest by the pandemic, we believe that companies that benefited more from government stimulus have a greater responsibility to ensure that workers remain safely employed.

Keeping frontline workers safe and supporting their families was a primary focus for HCA Healthcare in 2021. Through our engagement on the impacts of Covid-19 on its operations, the company let us know that it had suspended capital expenditure and dividends and had guaranteed paid time off and flexibility for caregivers. It also sponsored a hotel programme to keep frontline workers safe from spreading Covid-19, and provided financial support to families.

Gig and contract workers

For gig and contract workers, we have specific expectations. Companies should ensure that there are measures in place to compensate workers for lost pay if they are unable to work during the pandemic, for example due to their own health vulnerabilities, or if there is reduced demand for work on platforms (such as ride-sharing).

This could be through emergency funds that are accessible to contract or gig workers, which could be funded by employees or the company, or a combination of the two. Additionally, companies should consider if it is appropriate to award additional hazard pay for those working in frontline positions and provide support for workers to access government financial relief schemes if they are available.

> **Companies should also strive to put in place sick pay provisions for contractors and include pay for caring responsibilities, as well as extension options for employees who may be hospitalised with Covid-19.**

Companies should have measures in place to ensure that the appropriate type and amount of personal protective equipment (PPE) is readily available at no net cost to workers. Companies should also strive to put in place sick pay provisions for contractors and include pay for caring responsibilities, as well as extension options for employees who may be hospitalised with Covid-19.

Finally, companies should ensure that Covid-19 policies and processes are clearly communicated to workers. There should be independent channels for employees to raise their concerns, and companies should seek to engage with worker associations and unions to understand and respond to worker safety concerns.

We engaged with supermarket chain Tesco on paying its UK employees a living wage. While the retailer is not certified by the Living Wage Foundation, we were satisfied that Tesco's approach to pay was a reasonable alternative. This was on the basis that it appears broadly equivalent in value, that employees influence the composition of the package, and that they report relatively high levels of satisfaction with its competitiveness.

> **We engaged with supermarket chain Tesco on paying its UK employees a living wage.**

Gender equality

Companies should consider adopting formal policies, such as providing gender-equal parental leave and encouraging and supporting male employees to use this, or improve managers' sensitivity towards these issues through training. This could lead to changes in working arrangements, the fostering of more inclusive cultures, and a consideration of hidden labour burdens in performance reviews.

The disruption caused by the pandemic offers a chance to reset working habits, so companies should be prepared to consider how their work practices can become more inclusive and effective. Companies should be careful not to transfer presenteeism to the online world, but instead redesign work by setting clear objectives and empowering employees to deliver in a way that suits their personal circumstances and preferences.

Employers also need to address persistent gender discrimination that can be replicated in the virtual world. When companies consider a partial return to the office with hybrid arrangements, they should acknowledge and mitigate the risk to homeworkers of being left out of decision-making, which could negatively impact their career prospects.

As part of a concerted effort to increase gender diversity across the Japanese companies in our engagement programme, we welcomed the significant improvement that Nifco made in its disclosure of data on human capital management and gender diversity. While the company was unable to meet its target to improve the proportion of female managers to 8% by the deadline, it described various measures to improve this. For example, it has appointed a female executive officer from outside, changed its personnel system and is focused on identifying and developing young talent as management candidates.

We systematically asked engagement companies about the impact of Covid-19 on the women in their workforces given that an estimated

2.5m women left the US workforce during the pandemic.

We systematically asked engagement companies about the impact of Covid-19 on the women in their workforces given that an estimated 2.5 million women left the US workforce during the pandemic.[1] Responses from companies varied, but we found that regardless of sector, those companies that offered flexibility, childcare support and other expanded benefits like mental health and wellness were able to retain their staff.

For example, Royal Bank of Canada attributed the stability of women in its workforce to the expanded remote working opportunities and a focus on mental health awareness and resources. This bank tailors its human capital management and employee support to the various geographic regions in which it operates. For example, in the Caribbean, the bank promotes awareness on LGBTQ+ across the workforce to encourage safety and allyship for employees and communities.

> **For fuller inclusion, companies should consider and address the potential inequitable impacts of their products and services and use innovation to expand the economy for all stakeholders.**

Medtronic said it had not experienced a disproportionate decline in women in its workforce due to the impacts of Covid-19. It has been monitoring this data since October 2020 and asserts that its employee resource groups and additional support, including back-up childcare, have helped significantly with talent retention.

In a 2020 call with biotech company Galapagos, we explored the impact of the ongoing pandemic and lessons learned. Due to its growing global footprint, the company has been a digital organisation for many years, which enabled it to rapidly transition employees to working from home and ensure that clinical trials progressed.

A survey launched during the early days of the pandemic indicated that balancing workload with challenges in employees' private lives – particularly managing childcare – was causing high levels of stress among staff. Management introduced flexible working arrangements, set up stress management programmes to support mental health and clearly communicated that it respected and supported employees' needs during this challenging period.

Racial and ethnic representation

Companies should consider racial and ethnic representation within their workforce. Companies with higher diversity among frontline workers versus more senior office-based roles need to be mindful of, and work to address, the disproportionate racial and ethnic safety implications that arise. In engagement we ask how a company is building a diverse and inclusive workplace at all levels from job creation and hiring to retention and promotion.

Through engagement with Sherwin-Williams, we were pleased to see the company publish its first diversity, equity and inclusion report. This included a commitment from the CEO, numeric goals to increase diverse representation in management roles, and employee testimonials. At Walt Disney, we were encouraged to see the company update its compensation committee board charter to include human resources oversight. We also welcomed the company's six pillar diversity and inclusion strategy and its intention to report EEO-1 employment data in the future.

For fuller inclusion, companies should consider and address the potential inequitable impacts of their products and services and use innovation to expand the economy for all stakeholders. For example, financial institutions should take steps to avoid unintended, indirect race-based discriminatory lending. Mining or extraction companies should consider the impact of pollution on communities of colour and obtain consent from indigenous peoples impacted by their projects. Companies in the telecommunications and technology sectors can help to close the digital divide that obstructed access to quality education during the pandemic and has the potential to perpetuate Covid's negative impacts on diverse communities for generations.

To this end, we engaged many of the banks in our engagement programme that are substantially leveraging artificial intelligence and digitisation to assess and address how bias might affect the products and tools used by its customers. We also encouraged them to seek opportunities to create positive impacts for stakeholders through advanced technology.

At Regions Financial, the bank protects against AI-related biases through three channels: formal and informal education for employees, cross-functional process oversight, and rigorous testing. We encouraged the bank to consider how these tools could be leveraged for the social good, such as through inclusive finance and responsible overdraft practices. At the large Canadian banks, such as BMO, Royal Bank of Canada and TD, we are engaging around the governance of AI to ensure that bias and the risk of race-based discriminatory lending and financing is being addressed.

[1] US Bureau of Labor Statistics data cited by US Vice President Kamala Harris, New York Times (nytimes.com).

We also engaged with Starbucks around setting a clear strategy for diversity and inclusion and combatting racism, including training for a larger percentage of employees and measuring the experience of racial minorities in its stores. The company appointed a global chief inclusion and diversity officer in 2020 and expanded its inclusion and diversity strategy in 2021, which mandated anti-bias training for vice president levels and above. The company said that it considered the experiences of racially-diverse customers by collecting feedback from external civil rights groups as a proxy for customer experience, in addition to feedback from customer helplines. Managers were expected to respond to concerns raised by employees through its anti-bias questions in its annual survey.

Family and medical leave in the US

In the United States, the lack of national paid family and medical leave underpins many difficult, often impossible, choices faced by disproportionately impacted worker populations.

The argument against national paid family and medical leave in the US has been mostly one of cost, but state programmes have demonstrated that in addition to increased morale, the majority of businesses do not suffer higher costs, while turnover generally falls.[2]

Without paid family or medical leave, we see women, particularly women of colour, leaving the workforce in record numbers. As the only industrialised nation without a mandated paid family leave policy for new parents, it should come as no surprise that the US lags its peers when it comes to women's labour market participation rates.[3]

Despite the growing focus on gender equality and women in the workforce in recent decades and the introduction of laws that provide protections against discrimination and promote pay equity, paid family leave policies have not kept pace with the changing economy or US workforce demographics. The lack of paid family leave policies prevents women and other marginalised workers from reaching their full potential.

Some companies are already advocating for national paid leave and support Businesses Advancing National Paid Leave.[4] Investors and their representatives can engage companies on paid leave by urging them to:

- Offer 12 weeks of paid parental leave and six weeks of family and medical leave as a minimum in order to meet the needs of employees during critical times and allow flexibility[5] – inclusive of lower-waged workers. The kind of low-wage jobs mostly performed by women, including working in retail and restaurants, often lack paid leave benefits and offer little flexibility.
- Expand benefits beyond the basic minimum paid family and medical leave outlined above to include childcare, elder care and back-up care – and make the benefits inclusive of all workers. In this way all employees regardless of gender, parental role, race and/or sexual orientation have access to them. In 2019, Target expanded its child back-up care to hourly and salaried team members at all stores and distribution centres, a service it expanded again during the pandemic. EOS has engaged the company on the inclusivity of its contracted Shipt workers who currently don't receive these benefits.
- Survey and engage the workforce. Evaluate whether women and/or people of colour are either leaving the workforce or reducing their hours. Evaluate if the demographics of company applicants have changed and create a strategy to attract, retain, develop, and promote diverse talent and become the employer of choice. Amgen cited its focus on employee wellbeing, expanding mental health resources, and childcare support as valuable for retention throughout Covid, particularly for the women in its workforce. EOS is consistently engaging companies on the impact that Covid is having on the most vulnerable members of their workforces, and their plans to assess and support them.

Without paid family or medical leave, we see women, particularly women of colour, leaving the workforce in record numbers.

In addition to engaging with retail and healthcare companies, we focused on meat production workers, an industry hit hard by the pandemic. Through our collaborative engagement with FAIRR, which raises the awareness of the material ESG risks caused by intensive livestock production, we sought to address the fundamental and structural human capital risks in the animal farming industry.

EOS engaged directly with Tyson Foods. We discussed the company's policies and practices on six main topics: grievance mechanisms, sick pay, distribution of workers across employment contracts, oversight of governance structure, worker representation, and the engagement of workers on industry trends, such as automation and climate change.

[2] https://www.nationalpartnership.org/our-work/resources/economic-justice/paid-leave/paid-leave-works-evidence-from-state-programs.pdf
[3] https://www.statista.com/chart/18943/women-labor-force-participation-rate/
[4] http://www.advancingpaidleave.org/business-supporters/
[5] https://paidleave.us/paidleave_faq

Q&A: Engaging with companies on Myanmar

Hannah Shoesmith
Theme co-lead: Human Rights

On 1 February 2021, Myanmar's military staged a coup d'état against the democratically-elected government. Aung San Suu Kyi's National League for Democracy party had won the general election by a landslide vote, but the military backed the opposition.[1] Pro-democracy protests were savagely suppressed by the military, leading to hundreds of deaths, while thousands more have been imprisoned and tortured. The military's actions have been widely condemned by the United States, the European Union, and other countries, with sanctions[2] placed on military officials and the military-owned businesses Myanmar Economic Holdings Ltd (MEHL) and Myanmar Economic Corporation Ltd (MEC).

Q. How did we initially respond to the coup? Did it impact any companies in our engagement programme?

A. Although there are no companies in our engagement programme registered or headquartered in Myanmar, some companies have joint ventures, partnerships, subsidiaries or important value chain partners there. We engaged with companies using our internal guidance for engaging on human rights in high-risk contexts, which is aligned to the UN Guiding Principles on Business and Human Rights.

Associated British Foods (Primark), Chevron, Coca-Cola, DSV Panalpina, Meta (Facebook), Infosys, KDDI, Kirin, Maersk, Posco, Siam Cement and TotalEnergies were among the companies with which we engaged.

After the UK and US governments imposed sanctions on MEHL and MEC, we reviewed our engagement programme companies with potential links to these. We did not take a position on whether a company should leave Myanmar, but sought to understand each company's particular operating context and the severity of possible adverse human rights impacts.

This might include how companies were working to ensure employee safety and welfare. For example, if a company operating strategic assets in Myanmar were to withdraw, would its employees be subjected to forced labour?

We engaged with companies using our internal guidance for engaging on human rights in high-risk contexts.

Q. What did we ask for in our engagements?

A. We expect companies to follow the UN Guiding Principles on Business and Human Rights' guidance for high-risk contexts. That includes carrying out enhanced – and rapid – due diligence, and liaising with experts, representatives of the affected stakeholders, peers and relevant multi-stakeholder initiatives. The company should decide how and if it can prevent, mitigate and remediate any human rights abuses or risks, and if not, responsibly disassociate. And it should disclose the results of this due diligence.

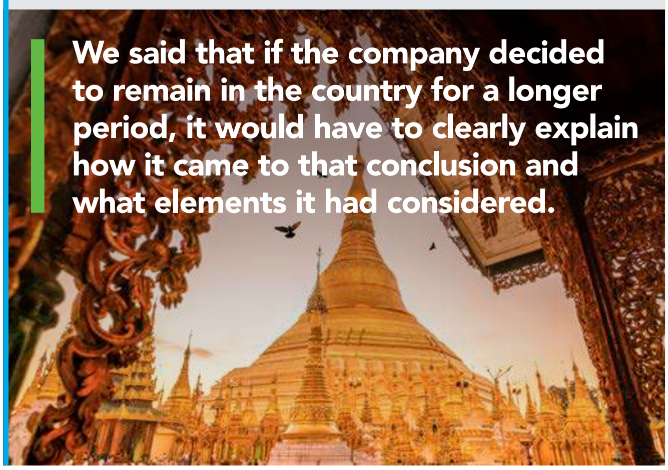
Q. Can you give some examples?

A. We engaged with French oil major TotalEnergies, which operates in Myanmar through a subsidiary under a production-sharing contract for natural gas from the Yadana field. The company said it was closely monitoring the situation, while continuing to operate the gas field, to maintain electricity supplies in the capital city Yangon.[3]

We said that if the company decided to remain in the country for a longer period, it would have to clearly explain how it came to that conclusion and what elements it had considered. We also discussed the importance of conducting heightened due diligence and of reporting transparently on this.

Subsequently, we welcomed increased transparency around its rationale for remaining in Myanmar. We also welcomed the reporting of tax payments[4] paid to the state and the equivalent sums that the company paid to local NGOs working to progress human rights in Myanmar. We continued to seek engagement with the company bilaterally on key topics such as international sanctions. We also signed a letter to the company, with investors, asking further questions about the potential human rights risks related to the company's business activities in Myanmar.

We also engaged with Chevron, whose affiliate – Unocal Myanmar Offshore Co – holds a minority, non-operated interest in the Yadana project. Following our engagement, Chevron updated its statement on Myanmar.[5]



[1] https://www.bbc.co.uk/news/world-asia-55902070
[2] https://www.gov.uk/government/news/uk-sanctions-major-military-business-interests-in-further-measures-against-myanmar-military-regime
https://www.state.gov/sanctions-on-two-burmese-entities-in-connection-with-the-military-regime/
[3] https://totalenergies.com/media/news/news/myanmar-totals-full-response-business-human-rights-resource-centre
[4] https://sustainable-performance.totalenergies.com/en/taxes-donations-myanmar

It explained that switching off the supply of gas, and therefore electricity, to a large section of the people of Myanmar could create further hardships for them. It also noted that the shareholders of its gas pipeline joint venture had voted to suspend the payment of monthly cash distributions.[6] Nonetheless we remained concerned about the human rights risks of the company's continued support for its local joint venture. We supported a letter from US-based investors seeking collaborative dialogue on this matter.

In late January 2022, TotalEnergies and Chevron said that they were exiting Myanmar.[7] Total issued a statement[8] saying that despite its earlier actions, it had not been able to meet the expectations of stakeholders who were calling for it to end the revenues going to the state from the Yadana gas field. It added that as the situation in Myanmar had continued to worsen, it had decided to initiate the contractual process of withdrawing.

We have also engaged with Siam Cement, a Thai investment holding company, which is in the business of industrial supplies and building materials. Its initial response was relatively compliance focused, rebutting the inclusion of one of its Myanmar sites on the UN list[9] of connections to military-owned businesses. We asked for more information and consideration of all its operations in Myanmar, in light of the coup.

We were pleased that the company could cite examples of due diligence and actions to prioritise employee safety and welfare. We shared our feedback on improving due diligence and disclosing the actions taken to identify and mitigate human rights risks, given that the company had decided to maintain its interests in Myanmar.

Subsequently, it sent us a statement about its approach, but we believe this did not go far enough in demonstrating heightened due diligence. We urged Siam Cement to do more.

Companies must address any negative human rights impacts, and regularly report on their efforts to prevent or mitigate these.

Q. Have we engaged with any other stakeholders on this topic?

A. We spoke with the Myanmar Centre for Responsible Business, a joint initiative of the Institute for Human Rights and Business and the Danish Institute for Human Rights, on how companies can 'know and show' heightened human rights due diligence. It was useful to understand a local perspective on the nuances and realities of the challenges that companies face.

Q. In June we signed up to the Investor Statement on Human Rights and Business Activities in Myanmar. Can you tell us more about this and what it calls for?

A. Yes, 77 investors and their representatives, with over US$3.9tn in combined assets under management or advisement, signed this statement, which calls on companies to uphold their corporate responsibility to respect human rights. The initiative was led by the Investor Alliance for Human Rights, alongside Storebrand Asset Management, Domini and the Heartland Initiative. The statement reminds companies that by contributing to violations of human rights, they are exposing themselves and their investors to material legal, financial and reputational risks.

It asks companies with business activities or relationships in Myanmar to immediately map these to identify and assess the human rights risks or harms they may be causing or contributing to. This may include military-owned, controlled or affiliated entities, as well as the revenues from business relationships and activities that may enrich military entities.

Companies must address any negative human rights impacts, and regularly report on their efforts to prevent or mitigate these. Support should be given to in-country employees to ensure their physical safety. We will continue to monitor the situation in Myanmar as it unfolds and follow up on engagements where companies have committed to improving their due diligence and their disclosure.

The statement reminds companies that by contributing to violations of human rights, they are exposing themselves and their investors to material legal, financial and reputational risks.

[5] https://www.chevron.com/stories/chevrons-view-on-myanmar
[6] https://www.reuters.com/business/energy/total-chevron-suspend-payments-myanmar-junta-gas-project-2021-05-27/
[7] https://www.theguardian.com/world/2022/jan/21/chevron-and-total-withdraw-from-myanmar-gas-project
[8] https://totalenergies.com/media/news/press-releases/totalenergies-withdraws-myanmar
[9] Microsoft Word – A_HRC_42_CRP_3.Corr.Clean.docx (ohchr.org)

CASE STUDY

Ahold Delhaize

Dutch food retailer Ahold Delhaize developed a new sustainable retailing strategy in 2016 following its formation as a merged entity, and began to identify material sustainability issues. These included human and labour rights, but we noted the absence of a human rights policy.

In 2017, we raised our concerns about the absence of a publicly available human rights policy. We asked the company to base its approach on the UN Guiding Principles (UNGPs) for Business and Human Rights. In 2018, we met the director for sustainable retailing and reiterated our expectations.

The website now included a page setting out the company's position on human rights, but this was not based on the UNGPs. We also discussed the company's scores in an Oxfam report assessing supply chain policies and the reported practices of food retailers. The company informed us that it would start working with an external adviser to identify its most salient human rights issues.

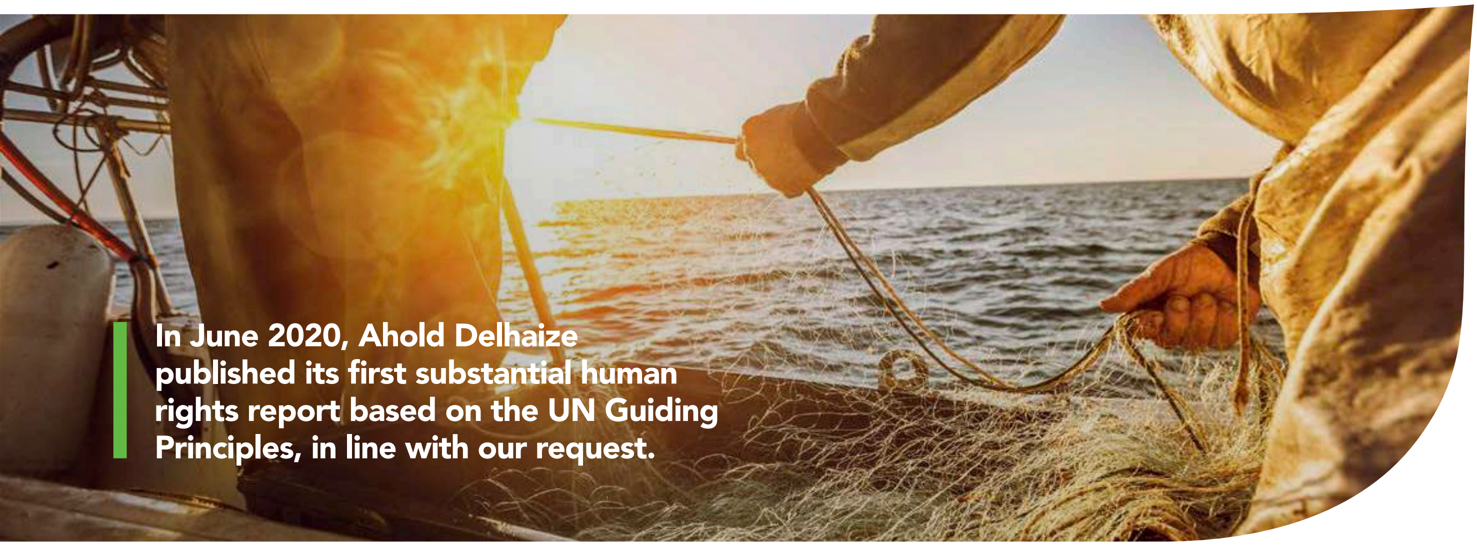
In June 2020, Ahold Delhaize published its first substantial human rights report based on the UNGPs, in line with our request. This identified six salient issues as initial priorities, followed by a further six, and its score in the Oxfam report improved.

During a call with the director of sustainable retailing in October 2020, we thanked the company for its progress, while encouraging a broader scope for its human rights due diligence. We also asked for a review of its efforts to uncover modern slavery. Many countries in Europe, for example, would not be considered high risk, and therefore would not be covered by the company's due diligence efforts, which cover own brand production units in high-risk countries. However, labour trafficking and exploitation have been on the rise in Europe.

Many countries in Europe, for example, would not be considered high risk, and therefore would not be covered by the company's due diligence efforts.

In an October 2021 meeting with the director in charge of human rights, she acknowledged that the social audit programme should not only focus on high-risk countries, because vulnerable migrant workers may also exist in low-risk countries, so this is being reconsidered. The company has also expanded the speak-up line and has been working with an external organisation to encourage a culture of open dialogue within the supply chain.

Pauline Lecoursonnois
Theme lead: Shareholder Protection & Rights



In June 2020, Ahold Delhaize published its first substantial human rights report based on the UN Guiding Principles, in line with our request.

Q&A: AMR and animal health

Dr Emma Berntman
Theme lead: Natural Resource Stewardship

Antimicrobial resistance (AMR) could be the next big public health crisis unless we can arrest the misuse of antibiotics in industrial livestock farming. To raise awareness of this issue, EOS's Dr Emma Berntman acted as a key adviser to the FAIRR report *Feeding Resistance: Antimicrobial Stewardship in the Animal Health Industry* and participated in a panel discussion at the launch event.

The FAIRR initiative is a collaborative investor network that raises awareness of the ESG risks and opportunities inherent in intensive livestock production. The report, which was published in July, explored the practices of the 10 largest publicly-listed players in the animal health industry and the actions required to ensure resilience of the companies' product portfolios and good AMR stewardship.

Q. What were some of the report's key findings?

A. Poor antimicrobial practices are endemic in the animal agricultural sector with antibiotics being misused and overused on such a scale that an estimated 70% of antibiotics are given to farmed animals. A multi-stakeholder approach is required to address these problematic practices, including those in the animal health sector, which manufactures and sells antibiotics for use in animals.

The FAIRR report found that opaque antibiotic manufacturing supply chains and lack of external oversight are allowing antibiotic residues in effluence to enter the environment at concentrations that increase the risk of AMR developing. The risk of poor manufacturing practices is exacerbated by the lack of global standards, as well as inadequate local regulation to restrict antibiotic concentrations in manufacturing effluence.

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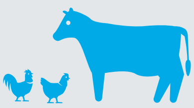


70% of antibiotics are given to farmed animals.

Among the companies assessed, certain sales and marketing practices were found to promote misuse and overuse of antibiotics, indicating a troubling lack of integration of good AMR stewardship practices within wider business strategies. For example, robust labelling is key to ensuring the responsible use of antimicrobials and deterring their use for growth promotion or prophylaxis, as well as ensuring the proper disposal or return of products so they are not released into the environment. This is particularly egregious in emerging markets as regulatory oversight of antibiotic use tends to be inadequate and this is where industrial farming practices are growing.

Q. How does the report support engagement with the industry?

A. It was good to see representatives from all the mentioned animal health companies attending the launch of the report, ensuring effective dissemination of our views on good practice to key industry actors. A challenge for investors and their representatives when engaging on AMR is the lack of transparency and determining how well sales, marketing and lobbying practices promote responsible antibiotic use. To overcome these challenges, we need to ask the right questions.

The report contains suggestions, which we helped to formulate, that comprehensively cover the material issues. These questions should be part of the investor dialogue with management and the board, to ensure that change is led from the top. Finally, escalation is necessary when companies are unwilling to act at the required pace. Investor collaborations, AMR shareholder proposals and voting implications are all important escalation tools to hold companies and boards to account.

Q. Can you give some examples of company engagements on this issue?

A. When engaging with animal health companies, we press them to credibly demonstrate their understanding of the material risks and opportunities linked to AMR, and their preparedness to meet these across their full value chain of manufacturing, sales, marketing, R&D and AMR stewardship. We have engaged with US food companies such as Tyson Foods and McDonald's, global soft commodities producer Cargill, Brazilian food supplier JBS, and animal health company Zoetis on these issues. For example, we have urged JBS to improve the transparency around its use of antibiotics, including the publication of a policy statement and the disclosure of usage data.

Q. What other work have we been doing in the public policy sphere?

A. A long-term sustainable food system is fundamental to the future of our society. Governments, companies and investors need to ensure that negative externalities, such as AMR, are removed from the agricultural practices that will feed our growing population. In addition to our continued engagement with companies on AMR, we have participated in a consultation with the Sustainability Accounting Standards Board (SASB) on early-stage research on the sustainability and business implications of AMR.

> **Governments, companies and investors need to ensure that negative externalities, such as AMR, are removed from the agricultural practices that will feed our growing population.**

We also provided input to the development of a One Health Priority Research Agenda on AMR, which is a tripartite collaboration between the World Health Organization, the Food and Agricultural Organization of the United Nations, and the World Organisation for Animal Health. In addition, we co-signed a public letter to the G7 finance ministers, asking that maximum antibiotic levels in wastewater from manufacturing facilities be included in the Good Manufacturing Practices and that alternative incentive models are put in place to drive R&D for new classes of antibiotics.

> **We will also continue to collaborate with other members of the Investor Action on AMR initiative to drive increased awareness of the risks and opportunities linked to AMR within the investor community.**

Q. What will we focus on in 2022?

A. We will continue to engage with companies across the antibiotic value chain to ensure sufficient ambition levels and that antibiotic policy commitments are fulfilled. We will also continue to collaborate with other members of the Investor Action on AMR initiative to drive increased awareness of the risks and opportunities linked to AMR within the investor community. This coalition is backed by the Access to Medicine Foundation, FAIRR, the PRI and the UK government.

Governance

Turning up the heat on company climate plans

Two themes dominated the 2021 voting season – whether companies' climate transition plans were adequate, and racial equity – with shareholders calling for swifter, more fundamental action on both.

The 2021 voting season saw the emergence of formal shareholder votes on companies' responses to the climate crisis. Now investors could scrutinise the promised action on climate and the rapid expansion in company net-zero commitments. Racial equity was also high on the agenda, with shareholder proposals filed at several US companies urging boards to oversee a dedicated audit analysing the company's impacts on non-white stakeholders and communities of colour.

In 2021, we made voting recommendations at 13,412 meetings, covering 128,858 proposed resolutions. This was up from 11,759 meetings in 2020 and almost 124,000 proposed resolutions. Overall, we made at least one voting recommendation against management at 63% of meetings, versus 55% in 2020. Some 3,267 of these were in North America, where we recommended against management on 6,551 proposals, or 23%, versus 21% in 2020. We 'attended' 66 shareholder meetings and asked questions at 44 of these, including Deutsche Bank, BP, Google owner Alphabet, Novartis, Amazon and Facebook, versus 24 in 2020.

2021 can be seen as a tipping point for investor engagement and voting on climate change, with the emergence of 18 "say-on-climate" proposals at companies spanning oil and gas, construction, aviation, and consumer goods.

In 2021 we recommended votes for

13,412 meetings, versus

11,759 meetings in 2020.

Votes on climate transition plans

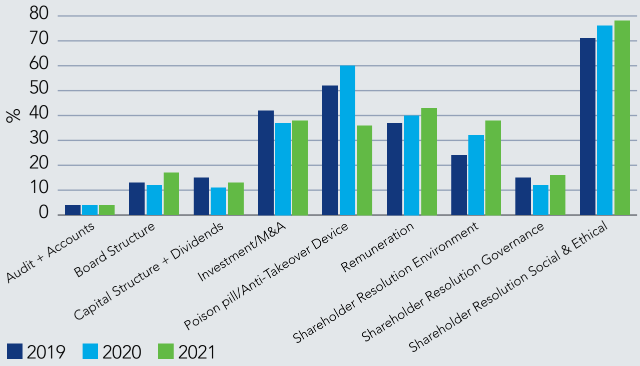
2021 can be seen as a tipping point for investor engagement and voting on climate change, with the emergence of 18 "say-on-climate" proposals at companies spanning oil and gas, construction, aviation, and consumer goods. Whilst we were supportive of the idea in principle, we had some initial concerns about the concept. The high level of support for transition plans suggests these concerns were justified. We noted a tendency for investors to vote in line with management, which may suggest they do not have the technical skills or the time to evaluate plans properly.

We applied a rigorous approach in our assessment of transition plans, setting a robust standard of alignment with the Paris Agreement goals for companies to pass. We recommended support for proposals that demonstrated robust target-setting, and that were aligned with external frameworks and accreditations such as the Science-Based Targets initiative. We also wanted to see a clear and credible strategy in place to achieve the stated targets, as at Unilever,

We applied a rigorous approach in our assessment of transition plans, setting a robust standard of alignment with the Paris Agreement goals for companies to pass.

Percentage of proposals voted against management per key market 2019-2021

Proportion of resolution type with recommended votes against management



Source: EOS data

Aviva and Nestlé. However, we opposed the proposed climate plans at Shell, Glencore and TotalEnergies, as these did not appear to be aligned with the Paris Agreement goals. We also recommended opposing the plan at airport operator Aena, due to a lack of targets for the Scope 3 emissions that are critical to its transport infrastructure.

Proxy battle at Exxon

In the US, oil major Exxon, another notable climate change laggard, partially lost a proxy battle with activist investor Engine No. 1. Three out of four directors proposed by Engine No. 1 were appointed against management advice, with a view to improving the company's stance on climate change.

EOS has had a formal climate change voting policy in place since 2019 targeting climate change laggards and we strengthened this again in 2021.

We recommended support for all four candidates, believing that additional board refreshment would preserve and enhance long-term shareholder value through the energy transition. We also recommended support for various shareholder resolutions that we believed would enhance transparency and action on climate change and related material issues.

EOS has had a formal climate change voting policy in place since 2019 targeting climate change laggards and we strengthened this again in 2021. We continued to use the Transition Pathway Initiative (TPI) assessment, setting a threshold of Level 4 for all European companies, coal mining companies or oil and gas companies, or Level 3 for all other companies. The policy identified over 250 companies in 2021 – versus around 130 in 2020 – including over 190 outside the EOS engagement programme. We wrote to companies setting out the reasons for our concern and requesting further engagement and saw a high level of response. This enabled us to successfully engage with over 45 companies beyond the core engagement programme. Ultimately, we recommended opposing the election of the responsible director for climate change (usually the chair) at over 100 companies, including Canadian Natural Resources and China Resources Cement Holdings.

Companies were also captured by our policy to recommend a vote against a responsible director for climate change due to their continued coal expansion in parts of Asia and a lack of disclosure on their approach to mitigating deforestation risks. For example, we recommended voting against directors at Yakult Honsha, Li Ning Company, and WH Group due to deforestation concerns and against directors at Yanzhou Coal Mining Company, Manila Electric Company, and First Pacific Company due to their coal expansion plans.

In another significant development, Japan saw its second and third shareholder resolutions on climate, after the first at Mizuho Financial Group in 2020. Two similar proposals were filed at Mitsubishi UFJ Financial Group and Sumitomo Corp, asking the companies to align their business strategies with the Paris Agreement goals. These companies were targeted for their significant exposure to fossil fuels, including coal. We accelerated our engagements with them, while also seeking views from the NGOs who had filed the proposals, then recommended support for both.

In another significant development, Japan saw its second and third shareholder resolutions on climate, after the first at Mizuho Financial Group in 2020.

Racial equity audits and gender diversity

We also saw a significant number of racial equity audit shareholder proposals in 2021, including at US banks Goldman Sachs and JPMorgan Chase. Resolutions requesting enhanced disclosure on the effectiveness of diversity and inclusion programmes were also filed at American Express, Berkshire Hathaway, Johnson & Johnson and others. Although we did not always agree with every aspect of the supporting statements, we broadly agreed with their substance, believing that racial equity audits would add substantial value beyond the actions the companies were already taking.

During engagement we explained that audits can provide additional insight into the root causes of complex problems that companies must address in order to develop enduring solutions. They also enable more rigorous performance evaluation against underlying challenges and increase a board's capacity to provide effective oversight. We subsequently recommended support for the racial equity audit shareholder proposals at Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase and Wells Fargo, among others, in order to drive momentum for closing racial equity gaps in society.

A few of these proposals were withdrawn, such as at BlackRock and Morgan Stanley, or were put to the vote with the support of management. At IBM the board recommended that shareholders support a resolution for a diversity, equity and inclusion report as it "aligns with IBM's goals of a diverse and inclusive workforce". We encouraged other companies to consider supporting proposals in this manner.

In 2021 we ramped up our voting action on ethnic diversity, having signalled this in our Corporate Governance Principles and engagement for several years. In addition, targets from the Parker Review came into force for UK boards to include at least one director from an ethnic minority background. We subsequently opposed five FTSE 100 chairs for failing to meet minimum expectations for racial diversity on boards. Overall in the UK, we opposed 37 proposals for concerns about insufficient diversity, including gender diversity, at board level and below, versus 35 proposals in 2020.

In the US, we opposed 1,322 proposals for insufficient gender and ethnic diversity, up from 945 in 2020, while in Canada we opposed 190 proposals on this issue, a leap from eight in 2020. On a global basis, we recommended voting against 2,693 proposals due to diversity concerns, up from 1,805 in 2020.

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In Asia we saw some progress on board gender diversity, such as in India and South Korea, but it remained a concern across markets. In China, Hong Kong and Taiwan, we still regularly see all-male boards. We expanded our approach of recommending a vote against board chairs or nomination committee chairs if they were up for election, to include any new male director if these two options were not possible (unless independence was a concern and the new male director improved that).

As a result of this policy, we recommended voting against a new male director due to concerns about the all-male board at China Mengniu Dairy Company and against directors at Techtronic Industries, Samsonite and Bharat Forge due to low gender diversity. For Hong Kong companies as a whole we made 378 recommendations against management due to diversity concerns in 2021, versus 333 for 2020. In India we recommended voting against 128 times, a jump from just four times in 2020.

Overall, we recommended a vote against

38% of pay proposals, compared with

35% in 2020.

Executive compensation

In 2021, shareholders in many countries were asked to vote on the decisions taken on executive pay for 2020, which heightened our concern given the backdrop of Covid-19. We set a clear expectation that boards should continue to use their judgement to ensure that executive pay could be justified in the context of the experience of other stakeholders, particularly for companies that had made redundancies, benefited from government support, or were otherwise in distress.

Overall, we recommended a vote against 38% of pay proposals, compared with 35% in 2020. In the US, where we believe there are substantial issues with executive pay practices, we opposed 88% of compensation proposals versus 81% in 2020. These concerns were exacerbated by decisions to insulate executives from the impacts of Covid-19, relative to other stakeholders.

We recommended a vote against the board chair at fast food chain McDonald's due to the board's failure to oversee a sufficient investigation into allegations of misconduct against the former CEO.

For example, at hotel chain Hilton, we recommended voting against the say-on-pay proposal and the chair of the compensation committee. The compensation committee had altered the performance metrics in the long-term incentive plan due to Covid-19 after the company realised that the performance stock units would not pay out. This meant that the long-term plan paid out much higher, appearing out of step with the company's decision to lay off 25% of its staff in mid-2020.

Elsewhere, we recommended a vote against the board chair at fast food chain McDonald's due to the board's failure to oversee a sufficient investigation into allegations of misconduct against the former CEO. We also recommended a vote against the executive compensation and compensation committee chair due to a failure in the company's clawback policies to recoup the severance awards made to the former CEO.

Similarly, at Disney we recommended a vote against the say-on-pay item and the compensation committee chair due to the high quantum of pay awarded to the CEO and executive chair. The company had not adequately adjusted the executive chair's pay when he stepped down from his CEO role in 2020 and did not provide a justification for continuing to pay the executive chair above the market rate.

In the UK, we opposed 53% of remuneration policy proposals versus 50% in 2020. We saw some good practices, with many companies repaying the money received from the government to furlough their employees or in business rates relief, and it was generally accepted amongst those not able to do so that they should not pay bonuses to executives.

Poor pay practices

However, we opposed pay proposals at French infrastructure company Vinci and UK hospitality firm Whitbread, where non-financial elements of the CEOs' bonuses were judged to have been fully achieved and were paid or rolled over to next year respectively. This was despite the fact that both companies used government support to furlough employees and made redundancies.

Likewise, we opposed the remuneration report and the re-election of the remuneration committee chair at publisher Informa, where the decision was taken to adjust pay-outs to executives from a long-term incentive scheme that would have lapsed, in the face of a significant negative impact from the pandemic. This follows several years of poor pay practices and an inadequate response to shareholder concerns. The company saw one of the biggest defeats on record, with 62% of votes cast against the remuneration report.

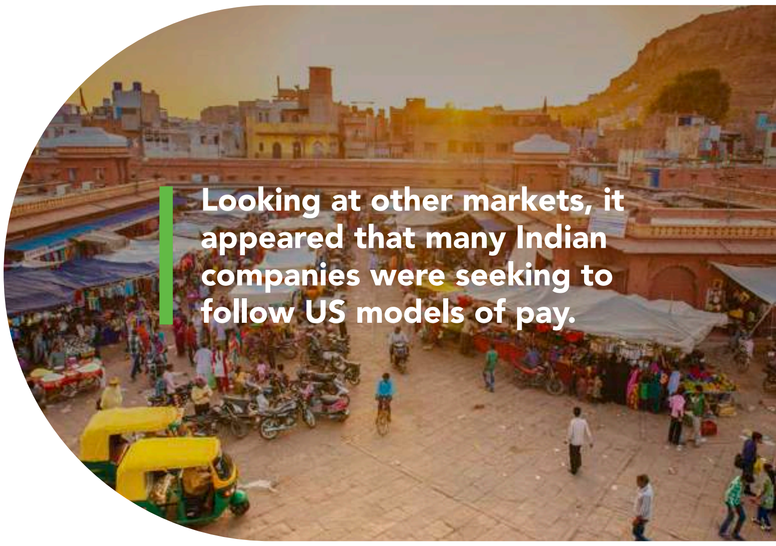
As well as scrutinising decisions taken against the backdrop of the pandemic, we continued to oppose pay where we judged it to be excessive or misaligned with the interests of long-term shareholders and other stakeholders.

At miner Rio Tinto, we opposed the remuneration report due to the heavy focus on shareholder returns in its pay schemes, with limited consideration of other, important strategic and stakeholder factors. We also had concerns about pay-outs to departed executives, which we believed did not sufficiently reflect the failures that led to the destruction of the Juukan Gorge caves in Western Australia. The company suffered a significant defeat with over 60% of shareholders opposing the remuneration report.

We also recommended a vote against at AstraZeneca, which proposed further increases to the already substantial incentive awards offered to its CEO, and where we opposed the previous schemes on the basis of excessive quantum. Around 40% of investors voted against, a sign of the growing discontent.

Looking at other markets, it appeared that many Indian companies were seeking to follow US models of pay, which can lead to excessive quantum and short-termism, rather than long-term sustainable value generation. We challenged cases of excessive quantum versus the median pay for employees, as well as the lack of metrics and performance hurdles in other cases.

We recommended voting against items related to executive pay at India's HCL Technologies for these reasons, but were pleased that the company was responsive in our engagement call and we hope to see improvements next year. We also recommended voting against the CEO compensation proposal at Oracle Financial Services Software, due to insufficient disclosure of the pay package. At Hero Motocorp, we recommended voting against the executive remuneration due to poor disclosure, the CEO's seat on the remuneration committee, and the CEO pay being 800 times more than the employee median pay.



Q&A: Key changes to voting policy guidelines

Laura Jernegan
Sectors: Financial Services, Pharmaceuticals & Healthcare

Each year we update our global voting policy guidelines, which inform our recommendations to proxy voting clients. Given the significant variation across markets, the global voting policy sets out our broad position on a number of key topics with general global applicability. Here we set out some of the key revisions for 2022 and highlight regional variations.

Q. What changes have we made to strengthen our voting policies on board diversity, given that there was reasonable progress in some markets in 2021, but others continued to lag?

A. In Europe and Australia we now expect women to make up 30% of boards at the largest companies, at a minimum, aligning expectations across markets. If boards fail to meet minimum thresholds, we will consider recommending voting against relevant directors, including the chair. In North America, we have also raised our expectations to a minimum of 30% women for the largest companies, up from 20%.

In global emerging markets and Asia excluding Japan and South Korea, we are looking for a minimum of 20% gender diversity. We will consider voting against relevant directors for inadequate disclosure of director gender identity. In the UK we continue to enforce the minimum standards set by the Hampton-Alexander Review, expecting FTSE 350 companies to have at least 33% women on the board. We also look at below-board gender diversity for the FTSE 100, and will consider opposing the chair where there is an all-male executive committee or fewer than 20% women in leadership positions.

For ethnic diversity, in North America we have moved from using a 10% minimum threshold to asking for one ethnically-diverse board member, or more. This echoes the approach taken by the Parker Review in the UK, which set a target for boards to include at least one director from an ethnic minority background by 2021. In light of this, we introduced a new policy from 2021 to oppose FTSE 100 chairs where there was no ethnic minority director, or no submission to the Parker Review and no commitment to do so in future. We will continue this in 2022.

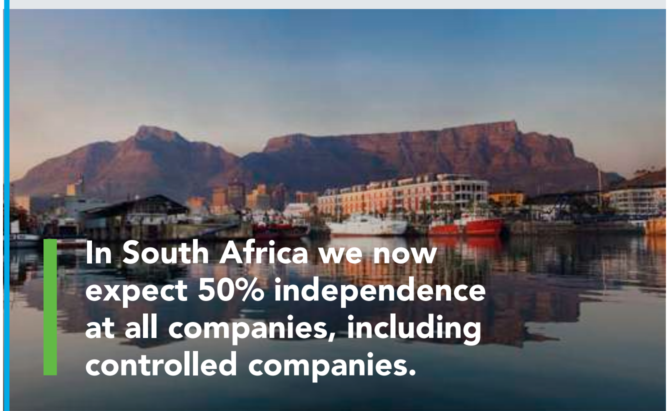
> **In global emerging markets and Asia excluding Japan and South Korea, we are looking for a minimum of 20% gender diversity.**

Q. Board independence remains a concern in some markets where the state or founding families play a bigger role, or where directors may have held their board seats for prolonged periods. Have we tightened these guidelines?

A. Yes, in Brazil we have raised the minimum expectation to 50% independence for the largest companies, up from 33% in 2021. In South Africa we also now expect 50% independence at all companies, including controlled companies. And in Hong Kong and China we will recommend voting against any executive up for election, apart from the CEO, CFO and chief operating officer, where board independence is below 50%.

We expect boards to meet minimum standards of independence so that they can hold management to account, and we may recommend voting against the election of directors whose appointment would cause independence to fall below these standards, and/or against the chair of the board where we have serious concerns.

In North America, we will now escalate our concerns about independence to, and consider recommending votes against, the chair of the nomination and governance committee rather than just the non-independent directors, where non-independent directors sit on key committees, including the nomination and governance, audit and compensation committees. In judging a director's independence, our considerations include length of tenure, concurrent service with other board members and whether they have any direct, material relationship with the company, its executives, or other directors.



Q. In 2021 we saw the advent of votes on climate transition plans. How did we approach these, and have we made any changes to our broader climate change voting policy for 2022?

A. In 2021, EOS was generally supportive of the concept of a vote on transition plans but applied a rigorous approach in our assessment, setting a robust standard of alignment with the goals of the Paris Agreement. We believe votes on transition plans can improve a company's focus on climate change and aid transparency. They can also improve investor scrutiny and engagement and provide a clear pathway to engagement escalation in the event of material opposition from shareholders. However, we remain cautious about the effectiveness of such votes, as consensus about how to assess Paris-alignment continues to evolve. We are also concerned about investors' capacity to rigorously evaluate these plans.

For the 2022 voting season, we will continue to assess climate transition proposals against the key criteria of alignment with the Paris Agreement goals and limiting global heating to 1.5°C; the quality of the company's plan to deliver this; and the commitment of the company to achieving its stated goals.

In our broader climate change voting policy, we will consider recommending voting against the chair and other relevant directors at companies where we consider a company's climate change response to be insufficient, or its activities and reporting, including its financial statements, to be materially misaligned with the goals of the Paris Agreement.

Particular areas of concern include the expansion of coal-fired power and a company's contribution to deforestation. Assessments will be informed by a range of indicators, including the Transition Pathway Initiative assessment and the Climate Action 100+ Benchmark.

Particular areas of concern include the expansion of coal-fired power and a company's contribution to deforestation.

While it won't be a voting red line, we will be looking for Paris-aligned financial disclosure, and we will expect companies to engage with their auditors around including climate change in their audit reports. In the US, we foresee new climate disclosure regulations being proposed in 2022, and we expect auditors to play a significant role in ensuring the alignment of company disclosures with the goals of the Paris Agreement.

Q. Have we made any other notable changes?

A. Given the growing investor concern about human rights issues, we have added a new expectation on this. Where we have significant concerns about company inaction relating to protecting or enhancing human rights, we will consider recommending a vote against the relevant directors, the discharge of management or other relevant resolutions. This decision will be informed by a range of indicators, such as a failure to comply with legislation or internationally-recognised guidance, such as the UN Guiding Principles for Business and Human Rights, or evidence that a company has caused or contributed to egregious, adverse human rights impacts or controversies and has failed to provide appropriate remedy.

We have also made some changes around pay. In Europe and Australia, we continue to push for higher shareholding requirements for executives. For 2022, the expectation in France is increasing to 400% of base salary, joining the UK and Switzerland, for the largest companies. Engagers will increasingly escalate concerns to the remuneration committee chair where there are major or persistent concerns. In Japan, we will recommend voting against the use of options with short exercise periods, and in North America, we will continue to engage on persistent pay for performance issues and stronger alignment with EOS pay principles.

In Europe and Australia, we continue to push for higher shareholding requirements for executives.

Q. Finally, virtual and hybrid annual shareholder meetings proliferated during the pandemic. If conducted well, these offered overseas shareholders greater access. But we also saw meetings where shareholder-board interactions diminished and shareholder rights were eroded. How did we address this?

A. Reflecting on our experiences and observations in 2020, we set out some good practice principles[1] ahead of the 2021 voting season. These covered virtual, hybrid and physical meetings and applied to most countries. The aim was to maximise the value of the meeting for both company and shareholder. We looked at the format and the experience for virtual attendees, to ensure that they had the opportunity to put live questions to the board, as well as company attendance. Ideally, all board members and top executives should attend the meeting and be available for answering questions, but some companies fell down on this even before the pandemic.

We want to see annual meetings protected as an important mechanism of stewardship, board-shareholder engagement, and board accountability. It is vital that good practice standards, fairness, order, integrity, and shareholder rights are upheld across markets. This transparency and accountability benefits stakeholders far beyond the attending shareholders.

Reflecting on our experiences and observations in 2020, we set out some good practice principles ahead of the 2021 voting season.

[1] https://www.hermes-investment.com/ukw/wp-content/uploads/2021/03/eos-principles-of-annual-meeting-good-practice-february-2021.pdf.

Strategy, risk and communication

Engaging in emerging markets

Emerging markets present specific challenges to engagement, such as powerful controlling shareholders and less familiarity with global best practice, notwithstanding some pockets of progress. How do we engage with companies in these markets?

We have engaged with companies in Asia and other emerging markets for many years and recognise that there are specific obstacles to overcome. In some of these markets, stewardship is at an early stage, while family-controlled or state-owned companies pose their own corporate governance challenges. Here we take a look at some of these issues and outline effective ways to engage in these markets.

Concentrated ownership

In Asian markets such as China, Hong Kong and India, family-controlled companies are quite common. Although this can mean companies are already thinking long term and considering their role in society over several generations, they present their own corporate governance challenges such as entrenched boards, inadequate board independence, and/or a lack of diversity.

In South Korea, where such companies are known as chaebols, there is often a circular and interlocking ownership structure controlled by the founding families. The fact that founding families may run companies unopposed for generations also partly explains some companies' unresponsiveness to investor requests, as they are still unused to engagement with shareholders.

The state can also play a key role in company management. In China, approximately 150,000 companies are state-owned enterprises. Questions arise as to the state's role, the extent of its involvement in the company's decision-making process, and whether this may hurt minority shareholder interests.

In Latin America, controlling shareholders of strategic companies may behave as a sole owner would, especially where foreign investors only hold the company's bonds, or there is a very limited amount of the stock in free float. These companies may also take the view that corporate governance is a burden, not a way to build a sustainable business. However, engagement with the controlling shareholder can accelerate change.

For example, in some Latin American markets, boards and senior management can be unresponsive to engagement requests, as they may be political appointees lacking industry experience. We have explored other routes to engagement, such as going through the country's finance ministry, which can bear fruit if the company needs to tap international debt markets. Similarly, if state-backed oil companies are reluctant to engage, opening a dialogue with the energy ministry can be productive.

In South Korea, where such companies are known as chaebols, there is often a circular and interlocking ownership structure controlled by the founding families.

We have engaged with Mexico's Pemex on behalf of Climate Action 100+ and bondholders, highlighting investor expectations around governance and board oversight of climate change, and fully embedding climate change considerations into strategy. However, a lack of responsiveness to direct engagement led us to try an alternative route.

In July 2021, we had a call with a senior official in the Mexican Ministry of Finance. We discussed the lack of progress in the engagement with Pemex and agreed on a plan of action. We explained how ESG factors are being integrated into investment processes, which limits the ability of many investors to hold Pemex's bonds, given the company's poor track record on climate change strategy and action, labour safety and compliance. We also outlined how we had been trying to engage with Pemex's senior management and board without success. The Ministry of Finance official offered to organise a call with Pemex's CFO and asked to be involved in the engagement. We were encouraged by the positive response.

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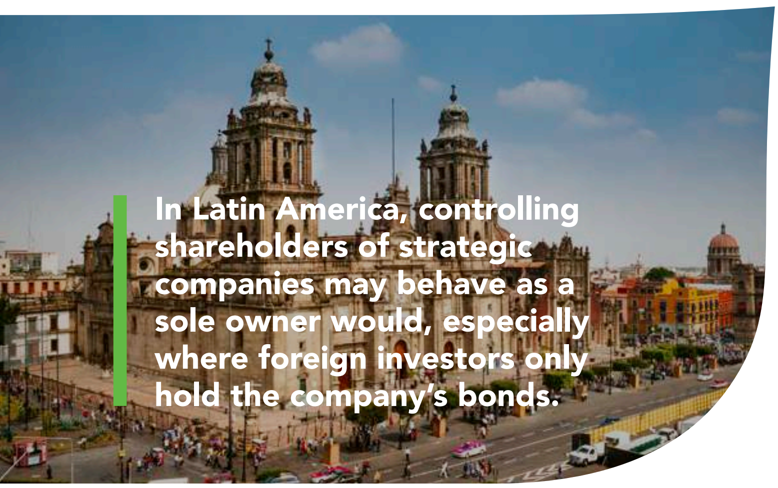
Nascent domestic stewardship

Local asset owner support for stewardship can help to drive engagement with companies. However, institutional investor participation in stewardship is fairly new in emerging markets. In some countries it is still mostly reactive and centred around annual shareholder meetings or a corporate action such as a merger or acquisition. Minority shareholders may find it difficult to ensure their voice is heard, and engagement may be seen as interference in company management.

In some markets companies may be wary of foreign shareholders due to aggressive action by activist investors in the past. However, this hesitancy may also be due to a lack of familiarity with ESG and stewardship. Instead of aspiring to leadership, companies may view ESG as a box-ticking exercise. This can lead to boilerplate explanations by companies in their reporting, where they fail to demonstrate that the board and senior management have had meaningful discussions. Coupled with the fact that emerging market companies can be laggards in ESG issues such as financial transparency, gender diversity, climate change and corporate governance, this makes it even more challenging to engage.



In Latin America, controlling shareholders of strategic companies may behave as a sole owner would, especially where foreign investors only hold the company's bonds.

CASE STUDY

Lukoil

We started engaging with Russian oil and gas producer Lukoil on an external board evaluation in Q1 2016, when we discussed the existing self-assessment framework and highlighted the benefits of an external evaluation.

In Q2 2017, we established a direct dialogue with the board, when we met the independent chair of the human resources and remuneration committee. We emphasised that an independent board evaluation would be a useful tool in identifying possible skill gaps and areas for improvement in the board's effectiveness, given that there were several directors with long tenures, including the major shareholder, and a non-independent chair.

In subsequent engagements with board members in Q1 2018 and Q4 2019, we continued to ask for an independent board evaluation. The directors were receptive to our request and assured us that it had been discussed. However, they concluded that more time was needed to implement an external board assessment framework, given that it was a new practice in the Russian market.

In 2020, an independent evaluation was commissioned by the board and we highlighted our expectations for disclosure of the main findings in the annual report and the action plan to address these. In the 2020 annual report published in Q2 2021, Lukoil disclosed details of the external board assessment procedure and the main findings, including areas for improvement, such as an increased focus on climate change action and adaptation, energy efficiency, risk management and sustainable development.

We were pleased with the outcome, but sought assurances about the evaluator's independence, as the assessment was carried out by the same company that provides external audit services. The chair of the human resources and remuneration committee explained that the board considered the potential conflict of interest when selecting the evaluator and said that there were safeguards to mitigate this. Also, the director underscored that the provider's institutional knowledge of Lukoil was valuable in performing the board assessment.

We will continue to engage on this topic, as the board implements the recommendations from the first evaluation, and continues the regular cycle of annual self-assessments, and external assessments once every three years.

Jaime Gornsztejn
Sector lead: Industrial & Capital Goods

In our engagements we try to reassure companies about our collaborative approach and our active development of market infrastructure to support stewardship and corporate governance. For example, given the compliance-driven mentality of some Asian companies, we work with regulators and policymakers to help shape policy direction. This includes responding to public policy consultations, but also engaging with regulators one-on-one and through collaborative networks.

For example, we responded to the China Securities Regulatory Commission consultation on ESG disclosure requirements for companies in their reporting. In general, we supported the proposal to include information such as environmental penalties, conflicts of interest with controlling shareholders, and board attendance. We also supported the review and approval of companies' interim and annual reports by the board. However, we recommended making the disclosure of carbon emissions, and any outcomes from poverty alleviation and rural revitalisation, mandatory. We also pushed for the inclusion of commentary on human capital management and human rights.

> **In our engagements we try to reassure companies about our collaborative approach and our active development of market infrastructure to support stewardship and corporate governance.**

We encourage local asset owners to improve their stewardship through education and knowledge-sharing, and work with local organisations dedicated to developing governance standards and shareholder rights. For example, in Brazil, as members of AMEC (the Brazilian Association of Capital Markets Investors), we have been engaging with regulators and the stock exchange on the improvement of shareholder meetings to encourage greater investor participation. The complexity of the proxy card in Brazil and possible changes to board nominees and the voting procedure just a few days before companies' annual meetings have been a source of controversy.

> **In Brazil we have been engaging with regulators and the stock exchange on the improvement of shareholder meetings to encourage greater investor participation.**

CASE STUDY

Vale

We engaged intensively with Brazilian miner Vale in the wake of the Brumadinho tailings dam disaster of January 2019, to ensure that a comprehensive response plan was put in place, including assistance for the victims and their families. Subsequently, we challenged the chair to seek ambitious improvements and commit to transforming Vale into a global leader in safety management.[1]

We also engaged with the company on board composition and succession. As Vale was transitioning from concentrated to dispersed ownership, the board succession model, based on nominations by the controlling shareholders, which prevails in most Brazilian companies, was not fit for purpose. We raised our concern with the chair, emphasising the importance of implementing a structured approach to board nomination, based on a skills matrix aligned with the strategic pillars and a board evaluation.

Subsequently, we engaged with the independent directors, the chair and the deputy chair on best practice in board composition and succession, led by a formally established, majority independent nomination committee. We highlighted that engagement with investors and other stakeholders is a key component of the board nomination process. In Q3 2020 the company created a nomination committee and committed to implementing a structured board succession process, in line with international best practice, aiming for the 2021 board election. In Q4 2020, we expressed our expectations to the nomination committee, for a majority independent board with a diverse range of skills, experiences and personalities, an independent chair and the elimination of the role of alternate director.

The nomination committee published its report in Q1 2021, outlining the target skills matrix, the search procedure and the 12 nominees, in line with our expectations, which warranted our recommendation for their election. A group of investors requested that the election be held under the cumulative voting system and presented four alternative candidates, who were elected together with eight of the nominees selected by the nomination committee.

Jaime Gornsztejn
Sector lead: Industrial & Capital Goods

[1] https://www.hermes-investment.com/ukw/wp-content/uploads/2020/02/eos-annual-review-2019.pdf

Benchmarking on environmental and social issues

The government's own agenda in certain markets may be out of step with investor expectations – for example, the attitude to climate change in India, Brazil, Russia and Mexico. But companies may use national policy as a reason to avoid stepping up their own net-zero ambitions.

Fortunately, companies with a large international investor base or those that are part of global supply chains may be keen to align with international best practice, regardless of their government's position. For example, Russia's Sberbank signed the Principles for Responsible Banking and the UN Global Compact in Q1 2021.

We first asked the bank to join the UN Global Compact in an engagement with the senior independent director in Q4 2016. In Q2 2020, we reinforced our request with the chair of the sustainability committee and also encouraged the bank to sign the Principles for Responsible Banking (PRB). We have engaged with the bank since, making suggestions about how to implement the PRB, which includes alignment with the goals of the Paris Agreement. We have also given feedback on the bank's draft sustainability policy, which the bank had invited.

The government's own agenda in certain markets may be out of step with investor expectations – for example, the attitude to climate change in India, Brazil, Russia and Mexico.

Another example is India's Reliance Industries setting a net-zero carbon emissions by 2035 target, significantly ahead of the government's commitments at COP26. We are engaging with the company on setting implementation targets and a credible strategy to deliver against these.

Companies that are part of global supply chains may be keen to align with international best practice, regardless of their government's position.

We have also engaged with Cemex on science-based targets. Although Cemex expressed a long-term ambition to be carbon neutral by 2050 and had developed medium-term targets, it had initially indicated to us that it would not seek validation from the Science-Based Targets initiative (SBTi). We highlighted that some of its peers had either committed to seeking such validation or had already published their science-based targets.

Subsequently, at a Cemex investor day, the CEO confirmed that Cemex would seek validation by the SBTi under the "well below 2°C" scenario; this validation was achieved in October 2021. The CEO also announced that the carbon intensity reduction target for 2030 had been set at 40% versus a 1990 base line. Previously, the target was a 35% reduction, which under the new plan should be achieved by 2025. The CEO explained that ambitious climate action is now a competitive differential in the cement industry.

The CEO also announced that the carbon intensity reduction target for 2030 had been set at

40% versus a 1990 base line.

Outlook for 2022

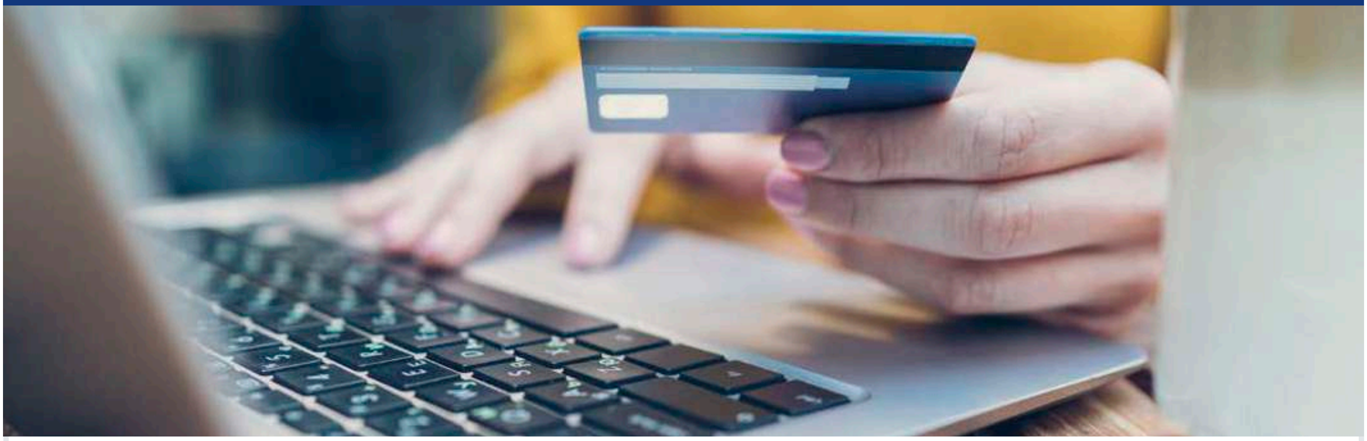
In 2022 we will seek to build on the nascent domestic stewardship in these markets by making targeted consultation responses, continuing our public policy advocacy work, and building the business case for stewardship and ESG in a local context. We will continue to take a regional approach to emerging markets, considering the huge opportunities to advance the social and environmental agendas, and ensuring that we target the most impactful sectors and companies to achieve progress.

However, engaging on social and environmental issues will not result in positive change without a strong governance foundation. Where progress is slow, we will consider ways to engender change through escalated engagement such as targeted voting policies. Finally, we will work with local asset managers and engage with policymakers and regulators to press for the adoption of international best practice to attract and retain foreign investment.

CASE STUDY

JD.com

Chinese e-commerce company JD.com published its first ESG report in April 2021 and its second sustainability report in June 2021. It also held its first shareholder meeting in June 2021 and appointed its first female board director.



EOS began engaging with JD.com on shareholder rights in December 2017. JD.com had not held an annual shareholder meeting since its initial public offering in 2014. This was partly because US-listed companies registered in the Cayman Islands were not legally required to do so. The lack of shareholder rights, the lack of diversity on a male-dominated board, and limited detailed ESG disclosure were key concerns for us.

Engagement was initially challenging due to the lack of wider market pressure in the region. However, following the scandal regarding alleged misconduct by JD.com's founder in 2018, EOS stepped up its engagement on governance, board composition and gender diversity.

We explained that holding an annual shareholder meeting would allow minority shareholders to vote and elect independent directors aligned with their interests, in addition to voicing concerns and posing questions directly to the company. We also raised our concerns about board composition, diversity, the lack of a structured feedback process and the lack of ESG disclosures.

Between 2018 and 2020, we had eight interactions with the company focusing on shareholder rights, diversity and ESG disclosure. We recommended that the company provide an explanation of how human capital management, plus diversity and inclusion (D&I), were linked to its core values and culture. We shared best practice examples of disclosure on governance and culture, D&I, and organisational health, safety and wellbeing.

The lack of shareholder rights, the lack of diversity on a male-dominated board, and limited detailed ESG disclosure were key concerns for us.

Changes at the company

The company acknowledged our concerns about the lack of diversity during a positive engagement in January 2019. The company informed us that prior to the IPO, it had looked for a female director, but the candidate had decided not to take up the opportunity.

After our engagement with a senior executive in April 2021, the company published its first ESG report, covering the topics we had discussed. We welcomed disclosures on the company's corporate governance structure, data privacy, and cybersecurity management, and its commitment to decarbonisation. The reports met international standards, and we expect further disclosure on human capital management and employee turnover rates.

After our engagement with a senior executive in April 2021, the company published its first ESG report, covering the topics we had discussed.

The company also confirmed its arrangements for its first annual shareholder meeting on 23 June, in line with our request. We welcomed the appointment of JD.com's first female board director in 2021, a good step towards improving board diversity, in line with our expectations.

We continue to encourage further disclosure on ESG topics including plastic recycling, climate change, human capital management, D&I, and JD.com's dual share structure.

Haonan Wu
Sectors: Transportation, Chemicals, Technology, Utilities

Revised UK Stewardship Code sets challenge for industry

In 2021, EOS was accepted as a signatory to the revised UK Stewardship Code, which set more challenging reporting requirements for respondents. As a service provider, we submitted our own Stewardship Report for the first time.

The original Stewardship Code was criticised by Sir John Kingman in his December 2018 review of the Financial Reporting Council (FRC) as well-intentioned but "not effective in practice". "If the Code remains simply a driver of boilerplate reporting, serious consideration should be given to its abolition," he said.

Following a public consultation, to which we contributed, the FRC revised the Code. The aim was to more clearly differentiate between those who could demonstrate excellence in stewardship and those that could not, by setting a more testing standard.

Under the revised principles, EOS made its own application for the first time, as a service provider. Our 2020 Stewardship Report explained our purpose and beliefs, how these are manifested in our approach to stewardship and the outcomes of our activities in 2020. It covered our engagement, voting recommendations, public policy, screening and advisory work carried out on behalf of our clients.

Both EOS and the international business of Federated Hermes, which made its own submission as an asset manager, were recognised by the FRC for producing "very good reports". The FRC also commented that they were "clear and engaging" and "effectively demonstrated thorough application of all the principles and reporting expectations of the Code in the reporting period".

However, of the 189 reports submitted in the first half of 2021, the FRC assessed only 125 applicants as successful. In its review of submissions – *Effective Stewardship Reporting*[1], published in December 2021 – the FRC said that it had seen some good reporting on governance, resourcing, the integration of stewardship with investment and on stewardship activities. But it wanted to see improvements to reporting on how signatories were managing market-wide and systemic risks as well as on their approach to stewardship in asset classes other than listed equities.

Challenging requirements

The revamped Code represents a real sea change, requiring a completely different level of reporting to the old boilerplate responses of the past. The more challenging requirements explain why a third of applicants were unsuccessful at their first attempt.

There are now 12 principles for asset managers and owners instead of the previous seven, with a much stronger focus on stewardship activities and their outcomes, not just policy statements. There are also new disclosure expectations regarding investment and stewardship integration, including material ESG issues. This represents an opportunity for those firms that have embedded stewardship into their activities to demonstrate how their approach works in practice and the tangible outcomes they have achieved.

Also, the Code effectively expands stewardship across all asset classes and to investments outside the UK, with a change in approach from 'comply or explain' to 'apply and explain'. The FRC said that those failing to make the list of signatories commonly did not address all the principles or sufficiently evidence their approach, instead relying too heavily on policy statements. It also wanted to see more focus on identifying areas for improvement.

We hope that the revised Code's challenging reporting requirements will trigger a more fundamental change across the asset management industry, helping to raise the bar for stewardship and acting as a beacon for other markets.

[1] https://www.frc.org.uk/investors/uk-stewardship-code

Regional public policy highlights

Throughout 2021 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 responded to a consultation by the Australian Treasury on reform options for proxy advisory services and suggested alternative solutions, such as the introduction of a demanding stewardship code. We did not support the Treasury's proposed reform options, believing they could compromise the independence of proxy advisory services, reduce the quality of advice, and reduce the competition.

Instead, we encouraged the Treasury to promote constructive, long-term engagement between companies and institutional investors that is not limited to the narrow framework of proxy voting. More direct and well-informed dialogue between companies and institutional investors and their advisers could ensure that each company's specific circumstances are taken into consideration by fiduciaries charged with exercising shareholder rights in the best interests of retirees and other investors. The imposition of burdensome procedural requirements on proxy advisory firms does not advance this purpose, and instead will inhibit effective shareholder engagement.

The imposition of burdensome procedural requirements on proxy advisory firms does not advance this purpose, and instead will inhibit effective shareholder engagement.

Brazil

In Brazil, new legislation now allows for the creation of multiple share classes with unequal voting rights for new listings. Through the Association of Capital Markets Investors (AMEC), we raised our concern about the impact on the quality of new listings and pressed for the adoption of mitigating measures. The legislation includes provisions such as a sunset clause triggered when the shares with super voting rights are sold, or after seven years are subject to renewal at the AGM. Through AMEC we are also engaging on ways to simplify the voting process in Brazil.

Continental Europe

We tightened our corporate governance expectations and related voting policy on diversity. In all markets in Continental Europe we now expect at least 30% female representation on boards and at least 20% in the top management team (often the executive committee) along with a target for a higher number in the medium term. We believe companies should have achieved these levels already and are likely to recommend a vote against the chair of the board or chair of the nominations committee where a significant gap remains.

We continued to push for greater access to board directors, including beyond the chair, in markets where this remains low, such as Scandinavia, Italy and Spain. We also argued for the strengthening of the lead independent director role in the case of executive chairs or combined chair/CEOs.

We saw companies in several markets, notably Denmark and Spain, request the authority for virtual-only annual meetings. In line with our published Principles of Annual Meeting Good Practice we only supported such proposals where we had confidence that the right was to be used solely in exceptional circumstances, and when the virtual meeting experience would be comparable to that for shareholders attending an in-person meeting.

Investor expectations for banks

We co-authored a paper setting out investor expectations on the alignment of the banking sector with the goals of the Paris Agreement. The paper focused on three areas: the actions banks should take to align their financing activities with the Paris goals and the achievement of net-zero emissions; steps to strengthen the governance of their climate strategy; and disclosure to demonstrate implementation.

Officially launched by the Institutional Investors Group on Climate Change (IIGCC) in April 2021, the paper was supported by 35 investors and their representatives, collectively representing $11tn in assets under management or advice. Participants sent a courtesy letter to 27 banks, with a copy of the paper. These banks were selected on the basis that they represent the largest fossil fuel financiers and are designated as globally systemically important. Subsequently, the group initiated collaborative engagements with these banks. EOS leads or co-leads the dialogue with eight banks and takes an active participating role with five other banks.

Separately, we engaged with the Club 21e Siècle in France, which promotes diversity in the workplace and in the educational system, on ways to lawfully measure the representation of employees with a diversity of origins and socio-economic backgrounds.

Greater China

We continued our market capacity building work in 2021. We responded to the Hong Kong Stock Exchange's consultation on the Corporate Governance Code and its related listing rules. We asked that companies be required to publish timelines for improving gender diversity at the board level and across the workforce, as well as arguing that the establishment of a nomination committee should become a listing rule.

We also responded to the China Securities Regulatory Commission consultation on ESG disclosure requirements for companies in their annual and semi-annual reporting. We largely supported the proposal to include information such as environmental penalties, conflicts of interest with controlling shareholders, and board attendance. However, we recommended making the disclosure of carbon emissions, and any outcomes from poverty alleviation and rural revitalisation, mandatory. We also pushed for the inclusion of commentary on human capital management and human rights.

Japan

With the implementation of Japan's updated Corporate Governance Code in 2021, we expect further improvements in board independence. Company disclosure of other governance issues has also improved significantly, and companies are increasingly open to investor dialogue. However, the perennial concerns about poor gender diversity and cross-shareholdings remain.

As part of 30% Club Japan, we encouraged companies to raise board gender diversity levels, with our policy of recommending a vote against companies where fewer than 10% of directors are women. Where our expectations for board gender diversity are not met, we expect companies to have set a time-bound target and outlined a plan to achieve this.

We had several meetings throughout 2021 with regulators including the Financial Services Agency, Japan Exchange and the Ministry of Economy, Trade and Industry (METI). 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, Japan Corporate Governance Network and Asia Investor Group on Climate Change, and provided a response to consultations on the revised Corporate Governance Code and the Sixth Strategic Energy Plan drafted by METI.

South Korea

Following a regulatory push for large companies to appoint at least one female board director by 2022, 33 women were appointed as new independent directors at the 2021 annual shareholder meetings. Although women still account for only 12% of total independent directors at the top 100 companies by market capitalisation, the regulatory drive resulted in a sharp increase in female representation, particularly among new independent directors, up from 18% in 2020 to 31% in 2021.

There was also an increase in the number of independent directors with a background in business, which accounted for 20% of elected independent directors in 2021 (up from 10% in 2020). In comparison, the number of professors and financiers fell. This is an encouraging development as we have engaged with large South Korean companies to encourage more directors with diverse backgrounds, to replace those with an academic background.

Another focus was climate change mitigation and adaptation. Most notably, we wrote to the Presidential Committee on Carbon Neutrality (CCN) in October 2021, encouraging it to outline a clear 2050 decarbonisation pathway to support South Korean companies in their transition to net-zero emissions. The letter was co-led with Climate Action 100+ investors, supported by an investor base of US$6.7tn in assets under management. Subsequently, the CCN announced a complete exit from coal-fired power plants by 2050.

UK

Companies continued to align with the expectations of the new UK Corporate Governance Code. Meanwhile, asset managers and asset owners responded to the guidelines of the revised Stewardship Code, which puts a greater emphasis on the outcomes of engagement and broadens the focus to all asset classes.

We responded to the Financial Reporting Council's (FRC's) consultation on its white paper, *A matter of principles: the future of corporate reporting*. This outlines a principles-based network of corporate reporting disclosures. We asked the FRC to collaborate more with key standard setters. We also emphasised the importance of companies stating their business purpose and using this to inform objective-led corporate reporting as intended by the white paper.

TCFD reporting

We responded to a consultation by the UK Department for Business, Energy & Industrial Strategy on mandatory Task Force on Climate-related Financial Disclosures (TCFD) reporting for listed companies, large private companies and limited liability partnerships. We promoted enhanced regulation around climate risk reporting in line with the TCFD recommendations.

Where material, we noted the importance of scenario analysis within the strategic report to demonstrate each company's awareness and preparedness for climate-related risks. We also stressed the importance of auditors in overseeing annual reports to ensure that the energy transition is properly considered.

We supported further improvements to diversity, equity and inclusion in a response to a discussion paper on diversity and inclusion in the financial sector issued by the Financial Conduct Authority, the Prudential Regulation Authority and the Bank of England.

Beyond the clear moral and ethical imperative, the system-wide benefits of social and economic inclusion and the risks of continued exclusion, a growing body of evidence supports the link between more diverse company leadership and financial performance.

US

We welcomed the decision by Nasdaq mandating that Nasdaq-listed companies should have at least two diverse directors (including at least one woman and at least one member of an underrepresented community). If companies do not, they must explain why they have failed to do so under a phased transition that started from 6 August 2021. Companies are also required to disclose board diversity in a prescribed way annually. In another encouraging development, the Securities and Exchange Commission (SEC) issued new guidance making it more difficult for companies to prevent ESG-related shareholder proposals appearing on proxy vote cards.

We continue to provide leadership to the Enacting Purpose Initiative by contributing to its latest report, *Directors & Investors: Building on Common Ground to Advance Sustainable Capitalism*. The report provides a US perspective on why corporate purpose matters.

> **In our view, the provisions of the draft bill would have a positive impact on accountability to investors, corporate performance, and the efficiency of the US capital markets generally.**

We also supported the discussion draft of a bill led by the Council of Institutional Investors (CII) to amend the Securities Exchange Act of 1934. The aim is to improve the governance of multi-class stock companies, and require issuers to make annual diversity disclosures. The CII draft bill is consistent with our corporate governance principles and reflects the sound legislative policy recommendations of the US SEC's Office of the Investor Advocate. In our view, the provisions of the draft bill would have a positive impact on accountability to investors, corporate performance, and the efficiency of the US capital markets generally.

Afterword

Stephanie Pfeifer
Chief Executive Officer, the Institutional Investors Group on Climate Change (IIGCC)

As we move into 2022 and reflect on some of the key moments from the past 12 months, it is clear that 2021 was a landmark year in the fight against climate change. It was a year that saw a number of milestone moments, from the publication of significant reports and scenarios by the Intergovernmental Panel on Climate Change (IPCC) and the International Energy Agency (IEA), to a COP that kept the prospect of 1.5°C alive, even if the pulse remains weak.

The IPCC's sixth assessment report on climate change highlighted the extent to which human influence has driven widespread and rapid changes to the climate and will continue to cause more frequent extreme weather events. Meanwhile, the IEA's energy outlook demonstrated that we still have quite some way to go to align with the much-needed scenario of net zero emissions by 2050.

Against this backdrop, institutional investors have a more important role to play than ever before in driving towards a net zero economy. Companies need to have credible corporate transition plans for this decade and take action to adapt to physical climate impacts, and engagement from investors is key to demonstrating the urgency in doing so.

The good news is that the first steps on this path have already been taken – following the launch of the Net Zero Asset Managers initiative at the end of 2020, more than 220 asset managers have now committed to work in collaboration with their clients to achieve net zero across their portfolios by 2050 or sooner. They have been joined by more than 50 asset owners, who have made similar commitments as part of the Paris Aligned Asset Owners group. Many of these investors are using the Paris Aligned Investment Initiative's Net Zero Investment Framework to support the implementation of these commitments.

Meanwhile, Climate Action 100+, the world's biggest collaborative investor engagement initiative on climate change, has seen net zero commitments from 110 of its 167 focus companies, demonstrating the impact of stewardship in driving the net zero transition. In addition, more than 700 investors came together through the Investor Agenda to make the strongest ever call to governments for climate action ahead of COP26.

But, of course, there remains much more to do. If 2021 was the year of net zero commitments, 2022 needs to be the year that those commitments are translated into tangible climate action. Investors and companies alike now need to demonstrate how these commitments are being implemented.

Stephanie Pfeifer is the CEO of the Institutional Investors Group on Climate Change (IIGCC). Stephanie has led the IIGCC since 2005 and has overseen its expansion into a pan-European investor group during that time. She sits on the Steering Committees for Climate Action 100+ and the Investor Agenda, the Executive Committee of the Paris Aligned Investment Initiative and currently chairs the Steering Committee for the Net Zero Asset Managers initiative.

Prior to her role at IIGCC, Stephanie worked in investment banking for over seven years, including as a senior economist at Morgan Grenfell and a vice president at Deutsche Bank in London. She holds an MSc with distinction in Environmental Studies, a BA in Philosophy, Politics and Economics from Oxford University and an MA in Economics from Exeter University.

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