TheCorporateCounsel.net

"Shareholder Insights: 2022 Priorities"

Wednesday, March 23, 2022

Course Materials

“**<u>Shareholder Insights: 2022 Priorities</u>**”

Wednesday, March 23, 2022

2:00 – 3:00 pm, eastern [archive and transcript to follow]

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There continues to be a great deal of uncertainty around how the 2022 proxy season will play out — and that isn't comfortable for companies or their boards. Stay in the know by hearing directly from a group of investors about key priorities, voting policy adjustments and how to maximize engagement opportunities during the heart of proxy season. This panel includes:

- **Amy Borrus**, Executive Director, Council of Institutional Investors
- **Kristin Drake,** VP & Head of Investment Stewardship, Dimensional Fund Advisors
- **Rob Main**, Managing Partner & COO, Sustainable Governance Partners
- **Tim Youmans**, Lead-North America, EOS, Federated Hermes – International

This program will cover:

- Key ’22 priorities
- Changes to voting policies
- ESG expectations for issuers
- In-season engagement tips

“Shareholder Insights: 2022 Priorities”

Course Outline / Notes

1. Key '22 priorities

2. Changes to voting policies

3. ESG expectations for issuers

4. In-season engagement tips

“Shareholder Insights: 2022 Priorities”

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Checklist: Shareholder Engagement - Considerations

By TheCorporateCounsel.net

1. Know Your Shareholders (& Who Votes Their Proxies): Traditionally, shareholder engagement often meant management's willingness to interact with shareholders on quarterly earnings calls and at annual shareholders meetings. For many shareholders, limiting engagement to these types of interactions and forums is no longer deemed adequate – they want more information about the board's oversight of long-term strategies & risks, and more robust engagement efforts to ensure their voices are heard.

The first step toward implementing today's form of shareholder engagement is to regularly figure out and monitor who your shareholders are. Most companies know their largest shareholders - but they may just know the contacts within those large shareholders who are responsible for investment decisions, not those responsible for voting decisions. And if you are in touch with those responsible for voting decisions, do you know if they have their own guidelines, as well as which proxy advisors they follow and whether they are willing to deviate from those advisors' recommendations? You need to be in touch with the proxy committees, etc. of your largest holders.

Depending on the makeup of your shareholder base - and how vulnerable you think the company is to a negative vote - you may want to drill down further into your large shareholder list than you have previously. You may be drilling 50 shareholders deep rather than 20 - probably with the help of a proxy solicitor. And if you have a large retail base (or you expect a very close vote), you may need to engage retail holders on a large scale. And don't forget to engage your employee-shareholders – they are often overlooked in an engagement effort.

2. Be Clear About Who Speaks for the Company: One issue that companies have to address internally is who is the spokesperson for the company in the governance area? The CEO and CFO are not ideally suited to talk about some governance issues since they may not be sufficiently knowledgeable. And this is particularly true when it comes to addressing their own compensation, as shareholders typically discount management's views - instead seeking the kind of objective perspective that can come only from dialogue with the independent directors.

Depending on each company's circumstances, the general counsel, chief governance officer, corporate secretary, CHRO, and/or the investor relations chief may be tapped as governance spokespersons. Find out who already has relationships with your large holders' compliance side; you may already have staff that knows who the key voting decision makers are. Obviously, whomever is tapped must be fully up-to-speed on both the company's practices and the hot button issues of the particular shareholders that the company engages (as each shareholder has their own pet peeves).

The most successful governance spokespersons tend to have regular interaction with the board. This also can help the board, as the spokesperson can relay information about shareholder perspectives, which helps keep the board and compensation (or other) committee informed. (Note that some boards have created special shareholder engagement committees devoted solely to shareholder engagement efforts - see our separate checklist on shareholder engagement committees posted in the “Shareholder Engagement” Practice Area on TheCorporateCounsel.net.)

Subject to ensuring with the board/committee that particular issues are ripe for discussion, regular board interaction also allows this spokesperson to highlight areas of the board's and management's work that are likely of interest to a particular shareholder, even if these items aren't on a pre-established agenda when the company meets with the shareholder.

A spokesperson who meets with key shareholder about governance issues should also be fully aware of all of those shareholders’ priorities. For example, the holder might ask questions about a recent board initiative relating to environmental sustainability—a topic that a CHRO may not be able to field as well as a corporate secretary or sustainability officer. It’s important to know the shareholders’ priorities – and ideally, an agenda – in advance of the meeting so that you can know who from the company should attend.

Some shareholders may want to from the compensation committee chair (and/or a nonexecutive chair or lead director) to ensure that they are actively involved in the pay-setting process. Having multiple members of the board involved may or may not be a sound strategy depending on the company's facts and circumstances - having too many directors involved can impede meaningful interaction with shareholders and increase the likelihood of a muddled message. If shareholders know that the board spokesperson regularly carries their comments back to the board/committee, their demands to engage with the full board likely will decrease.

Annual director surveys – posted in the “Corporate Governance” Practice Area of TheCorporateCounsel.net – show that directors are now more comfortable with being involved in shareholder meetings, compared to when the practice was emerging. Likewise, investor surveys show an expectation that shareholders will have the ability to directly communicate with directors. Institutional investors consider this a matter of effective stewardship. If access isn't permitted, they may engage further with the company to try to change that policy, vote against the governance committee chair, or collaborate with other shareholders on governance initiatives.

Note that the Corp Fin Staff has issued Reg FD CDI—Question 101.11—which clarifies that directors are not prohibited from speaking privately with shareholders. This CDI should give directors comfort that private meetings are not intrinsically problematic so that they can participate in these governance engagement efforts if they are authorized and adhere to Reg FD limitations.

3. <u>Engage Year-Round:</u> The biggest challenge in the shareholder engagement process is finding shareholders with the time, resources - and willingness - to engage. Trying to engage shareholders in the midst of proxy season will be particularly tough, given that most investors have stakes in numerous companies. Plus, most institutions haven't devoted much in the way of resources to the proxy voting side of their house; the fact remains that it's not a profit center and thus they are not likely to devote more resources to making voting decisions anytime soon.

Knowing your shareholders well will help in your decision about when to engage. Some shareholders have a strict "check the box" set of governance guidelines (*e.g.*, CalPERS) - so trying to explain the rationale for your deviances likely is a waste of time. Some shareholders may refuse to discuss their concerns until they have reviewed the company's proxy statement. And some shareholders refuse to engage during the proxy season due to a lack of time availability—but these holders may be willing to engage during other times of the year. It can be useful to keep a chart or spreadsheet of your largest holders, with one column devoted to when to contact them.

Even though it may not work for some shareholders, the engagement process should now be considered a year-round (and every year) process and not solely tied to the proxy season. Desperate attempts to contact your largest holders are not likely to be successful right before an annual meeting if you have not attempted to contact them at some point earlier in the year. That "old school" of solicitation doesn't work well anymore.

Besides earlier and ongoing engagement, the other key is to be informed. Smart companies will check with proxy solicitors (or compensation consultants for say-on-pay) beforehand to get a feel for how their large holders tend to vote - and what their hot button issues are - so that they don't go into a meeting blind. Executive pay in particular is always a hot topic. Make sure you understand your shareholders' sensitivities and voting policies – and where you might fall short – before you engage. See our "Proxy Solicitation" & "Proxy Advisors" Practice Areas on TheCorporateCounsel.net for helpful checklists & handbooks on these topics.

It can be helpful to join organizations and attend gatherings where shareholder representatives are present, such as the Council of Institutional Investors and the International Corporate Governance Network. While you likely won't have the opportunity at these gatherings to discuss with them your company's particular issues, you can begin the process of getting to know them—and if they speak on a panel, their public remarks can be helpful as you assess their perspective on the issues of the day.

4. <u>Form of the Engagement:</u> Of course, it doesn't make sense to engage if you can't determine shareholders' real concerns. Companies should experiment with what engagement tactics work best with their shareholders - as some methods may work well for some shareholders, but not others. Multiple avenues of engagement should be considered and experimented with, such as:

– **<u>Surveys:</u>** This isn't too common, but some companies formally survey their shareholders about pay practices to gather feedback well in advance of the proxy season (see the post noting the differences between the survey approaches of Schering-Plough, Lockheed Martin and Northrop Grumman on CompensationStandards.com's "The Advisors' Blog"). Some shareholders may be willing to complete a survey - some not, and some may do so depending on the nature and length of the survey. And some may take the time to complete the survey but fail to list their real concerns.

– **<u>One-on-One Meetings:</u>** The main problem with one-on-one meetings is that they are time-consuming and resource intensive. Even if a shareholder is willing to engage one-on-one, your key spokespersons may not have time. In fact, one of the key benefits of naming a governance officer and making shareholder engagement part of their job is that engagement becomes part of the regular routine, just like investor relations and media outreach. Most experienced governance spokespersons believe that the benefits of one-on-one meetings are significant as - unlike other approaches - you are perfectly positioned to drill down beyond an investor's platitudes (*e.g.*, "we want to see pay-for-performance") and ask more pointed questions about what type of design features they will accept.

You are much more likely to learn in a one-on-one discussion versus other engagement strategies whether the investor's previously-stated concern - or something else - is at the heart of their discontent. It wouldn't be surprising to see shareholders make noise about your executive pay practices in order to secure a private meeting to voice other concerns—something that happens in the Rule 14a-8 shareholder proposal process routinely.

– **E-Forums:** Intel and Verizon were the first large companies to implement e-forums to allow shareholders to vent. This type of engagement may help spot common concerns and potentially could be useful with retail holders who can't be reached directly without hiring Broadridge. The problem with these forums is that large holders likely won't participate—or even if they do, they may not be willing to disclose their real concerns on a web site.

See our separate checklist on shareholder engagement policies – posted in the “Shareholder Engagement” Practice Area on TheCorporateCounsel.net.

5. Acting on Shareholder Concerns: Once you understand the real shareholder concerns, the difficult decision is what to do about them. Merely meeting with shareholders normally doesn't cut it; there needs to be follow-up and follow-through. Formulating a game plan should take into account input from many quarters, and that can be a challenge - particularly as there may be conflicting concerns.

To back up a little, the company should ask itself as part of the overall planning process: "How does engagement fit into the governance and compensation decision-making processes in this company?" And, "Do we intend to obtain investor input sufficiently early in our compensation design and governance policy design processes to realistically allow them to influence our compensation program for the upcoming proxy season?"

If the answer is "yes," a realistic calendar should be created that allows investors plenty of time to provide input and also allows the appropriate persons within the company to fully process all the inputs, propose changes and slot time on the compensation (or other) committee and board meeting calendars - as well as the annual meeting schedule - to meaningfully integrate that input into the company's plans. This is not an easy task. See our separate checklists addressing board and committee meeting scheduling & agendas – posted in the “Board Meetings”

Practice Area on TheCorporateCounsel.net - and our sample annual meeting timing & responsibility schedules - posted in the “Annual Shareholders’ Meeting” Practice Area on TheCorporateCounsel.net.

Once the company decides to make changes (if it indeed decides to do so), run them by the shareholders who raised concerns to ensure that the changes satisfy them – before announcing new/modified plans. This is particularly necessary if the proposed changes don't squarely address their concerns and you need to explain to those shareholders why the company went a different direction. As with any human interaction, showing respect, building trust and being transparent when communicating can help quite a bit - even if complete alignment is not possible.

6. <u>Overcoming Reg FD Concerns:</u> Having just noted that companies should consider running proposed changes by shareholders before publicly announcing them, it's useful to address the elephant in the room - Regulation FD. For some time, a fairly common practice among "enlightened" companies that routinely communicate with their larger shareholders has been to "test the waters" before making a final plan design decision. This happens all the time before a company places a new equity plan on the ballot for shareholder approval. (Experience proves that shareholders are not willing to sign a confidentiality agreement—which is permitted under Reg FD—mostly because that doesn't solve potential tippee liability if the shared information proves material.)

To avoid a Regulation FD violation, the key is to not share material nonpublic information (e.g., earnings targets). For example, some practitioners have gotten comfortable with the practice of "walking the plan around" in which a draft compensation plan is shared with key investors for their input, particularly if the company is in the early stages of developing a working draft of the plan. Other practitioners believe it's safer to not share a plan document—but rather limit the discussion to a list of proposed design changes. The reality is that most investors don't have the resources (or desire) to review an actual plan document even if you are comfortable sharing it with them.

For the most part, many practitioners are comfortable that most governance modifications aren't considered "material" and thus don't pose Reg FD concerns. The bigger concern is that in the midst of a conversation about governance, a question is asked about financial performance - thus teeing up a potential Regulation FD problem.

Spokespersons must be well versed in how Reg FD is applied in practice, so they don't slip and inadvertently say something that triggers a Reg FD violation. Fresh compliance training and reminders may be necessary (involving securities counsel and including Rule 10b-5 concerns)—particularly debriefing new spokespersons that weren't acting in that role before and are now being trotted out to explain the compensation program.

Another technique some companies have used successfully is to have a proxy solicitor run plan design and award payout scenarios by key shareholders without using a company's name. While the feedback is not as reassuring as a direct company-to-shareholder discussion with all facts spelled out, it often is sufficient to be confident that the new plan design is—or is not—on the right track.

Dimensional

2021 Annual Stewardship Report

2021 Annual Stewardship Report

Reporting Period: July 1, 2020–June 30, 2021

The Annual Stewardship Report highlights Dimensional's efforts to protect and enhance shareholder value through investment stewardship activities over the prior proxy year, including outcomes and observations from engagement with portfolio companies, proxy voting, and industry participation and advocacy.

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Click on section title or page number to advance to section.

It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities in this Report.

The case studies in this Stewardship Report reflect the reporting period from July 1, 2020, to June 30, 2021, and do not incorporate or reflect changes in portfolio company governance following the reporting period.

"Dimensional" and "we" refer to the Dimensional separate but affiliated entities generally, rather than one particular entity. These entities are Dimensional Fund Advisors LP, Dimensional Fund Advisors Ltd., Dimensional Ireland Limited, DFA Australia Limited, Dimensional Fund Advisors Pte. Ltd., and Dimensional Japan Ltd.

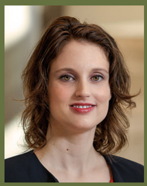
Letter from Our Head of Investment Stewardship

We proudly present Dimensional's 2021 Annual Stewardship Report, which highlights our commitment to serve as responsible stewards of the assets our clients entrust to us. Through our stewardship efforts, we strive to enhance and protect shareholder value by focusing on foundational governance principles, including board structure and composition, risk management, shareholder rights, and executive compensation. As this report details, our stewardship team held 605 direct engagements, conducted a letter campaign on climate risk disclosure, and voted on 171,904 proposals at 19,246 meetings globally in proxy year 2021.

Environmental and social issues, especially climate change, were a key focus for our stewardship team as well as for many portfolio companies and clients. Our team expanded on our work from last year, nearly doubling the number of climate change-related engagements in proxy year 2021. This year, we organized a global letter campaign advocating for improved climate risk disclosure, sending letters to over 150 portfolio companies around the globe during the reporting period. Addressing regulators and policy makers, we advocated for an approach to climate change risk disclosure that would benefit shareholders. You can read more about how we approach climate change risk management and other focused stewardship efforts in this report.

I invite you to learn more about our team and our approach to investment stewardship. You can find our policies and procedures, voting rationale documents, and other stewardship-related information on the "Investment Stewardship" section of our public website, or you can contact us directly through your Dimensional representative.

Sincerely,



Kristin Drake
Head of Investment Stewardship

Our Core Beliefs

Dimensional advocates for stronger governance practices at the companies in which we invest on behalf of our clients because we believe it can improve returns for our clients.

Dimensional believes that, in well-functioning markets, prices quickly incorporate information and reflect the aggregate expectations of market participants. This includes information about a company's strategy, financial and non-financial performance, capital structure, risks, social and environmental impact, and corporate governance. As such, Dimensional believes improvements to a company's governance practices may be reflected in increased valuations through a combination of lower discount rates and higher cash flows to shareholders.[1]

Our efforts focus on areas of governance that we believe can improve shareholder value. In 2021, this resulted in a concentration on board composition and structure, disclosure of material environmental and social risks, shareholder rights, and executive compensation.

Our stewardship activity is not, however, limited to these priorities. We often engage with or vote on other governance topics that can impact shareholder value. Throughout our stewardship report, you can read about our engagements and activities within and beyond these stewardship priorities.

2021 Investment Stewardship Priorities

Board Composition and Structure	We expect a board of directors to represent the interests of shareholders. Board independence and diversity of backgrounds, experiences, and skill sets are important issues in assessing board composition.
Material Environmental and Social Risks	We expect portfolio company boards to exercise oversight of material environmental and social risks that may have economic ramifications for shareholders. We believe portfolio companies should disclose these risks and related oversight to shareholders.
Shareholder Rights	We expect portfolio companies to maintain mechanisms for shareholders to raise concerns and hold companies accountable.
Executive Compensation	We expect compensation plans to be based on rigorous and transparent metrics that display a clear link between pay and long-term performance.

1. More information on Dimensional's stewardship philosophy and approach can be found on the "Investment Stewardship" section of our public website, or you can contact us directly at *corporategovernance@dimensional.com*.

People and Implementation

Investment stewardship at Dimensional is a global effort supported by many teams and departments. Dimensional's Investment Stewardship Committee, a subcommittee of the Investment Committee, is responsible for developing our policies and approach to investment stewardship, which are then executed by our Investment Stewardship Group in coordination with other groups across the firm.

Jim Whittington, a Senior Portfolio Manager and Vice President in our London office, was named Dimensional's new Head of Responsible Investment as of November 2021. Lacey Huebel, a Portfolio Manager and Vice President in our Austin office, was named Head of Responsible Investment, North America.

Dimensional's Investment Stewardship Committee[2]

William Collins-Dean	Chair of Investment Stewardship Committee, Senior Portfolio Manager
Eugene Fama	Consultant and Dimensional Director[3]
Kenneth French	Consultant and Dimensional Director[3]
David Booth	Executive Chairman
Dave Butler[4]	Co-Chief Executive Officer and Dimensional Director[3]
Gerard O'Reilly	Co-Chief Executive Officer, Chief Investment Officer, and Dimensional Director[3]
Kristin Drake	Head of Investment Stewardship Group
Joel Schneider	Deputy Head of Portfolio Management, North America
Jim Whittington	Head of Responsible Investment, Senior Portfolio Manager
Selwyn Notelovitz	Global Chief Compliance Officer
Valerie Brown[4]	Deputy General Counsel

2. Committee membership and titles as of November 10, 2021.
3. References to Dimensional Directors are to the Board of Directors of the general partner of Dimensional Fund Advisors LP.
4. Ex officio.

Global Implementation

Global stewardship activities are supported by a global staff of over 25 in seven offices and cover thousands of portfolio companies across 40 countries.

- INVESTMENT COMMITTEE
- INVESTMENT STEWARDSHIP COMMITTEE
- INVESTMENT STEWARDSHIP GROUP
- STEWARDSHIP-FOCUSED PORTFOLIO MANAGEMENT PROFESSIONALS

Investment Committee

Responsible for setting Dimensional's proxy voting policy and guidelines for voting and overseeing each Dimensional entity's proxy voting process.

Investment Stewardship Committee

Responsible for recommending changes to Dimensional's proxy voting policy, considering complex proxy voting cases, and overseeing the Investment Stewardship Group.

Investment Stewardship Group

Implements stewardship efforts by conducting engagements, instructing proxy votes, and making recommendations to the Committee on potential enhancements to stewardship policies, procedures, and operations.

Stewardship-Focused Portfolio Management Professionals

Provide the Investment Stewardship Group with insight into region-specific investment and client considerations that may impact our stewardship activities, as well as undertake engagements with our portfolio companies globally.

By the Numbers: 2021 Investment Stewardship Summary

The goal of Dimensional's investment stewardship efforts are to improve governance practices at portfolio companies in a way that we believe may increase expected cash flows to investors or reduce risks to shareholders. To the extent these efforts do result in improved governance practices, we expect shareholders to benefit from increases in company valuation. The following statistics provide a broad overview of Dimensional's engagement and proxy voting activities during the 2021 proxy year.

Global Engagement

605
Engagements[5]

168
Letters Sent

Global Proxy Voting

19,246
Meetings Voted

171,904
Proposals Voted

5. Includes calls with portfolio companies and proponents of shareholder proposals.

Dimensional discusses governance matters with portfolio companies to represent client interests; however, regardless of such conversations, Dimensional, on behalf of its clients, acquires securities solely for the purpose of investment and not with the purpose or intended effect of changing or influencing the control of any portfolio company. Dimensional may engage with shareholders and other dissidents as part of its due diligence on specific shareholder proposals.

Global Stewardship Highlights

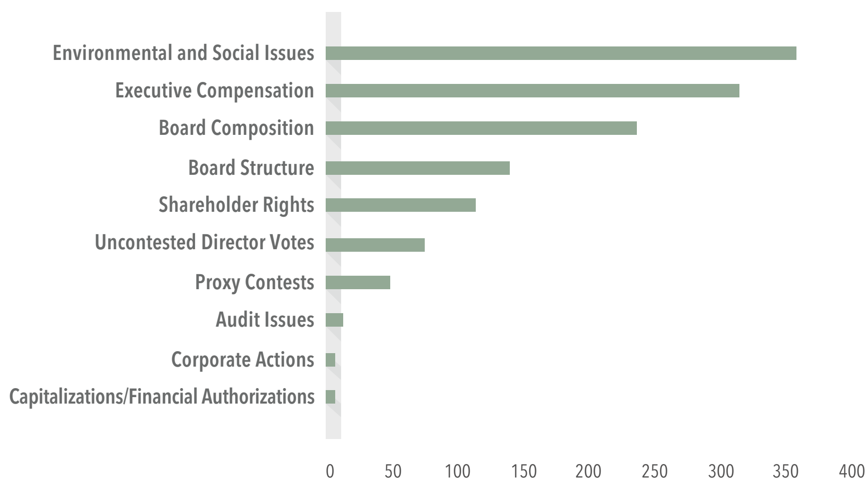
The following statistics demonstrate the breadth of Dimensional's engagement and voting activities during the 2021 proxy year.

Company Engagements

Dimensional engages with companies held in the portfolios we manage to better understand their governance practices and advocate for strong corporate governance.

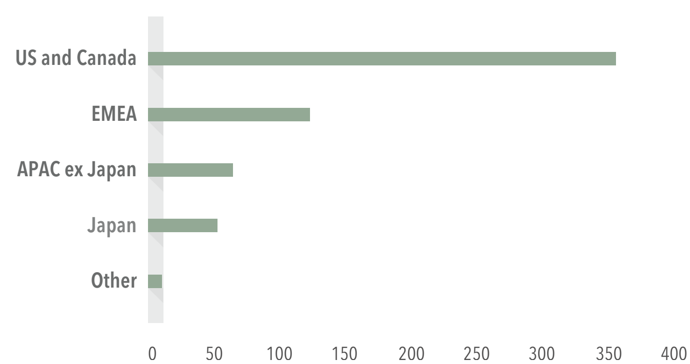
In proxy year 2021, over half of engagements included discussion of material environmental and social risks.

ENGAGEMENTS[6] BY TOPIC



Engagements outside of North America grew as a percentage of total engagements over each of the past three proxy years and now represent over 40% of total engagements.

ENGAGEMENTS BY REGION



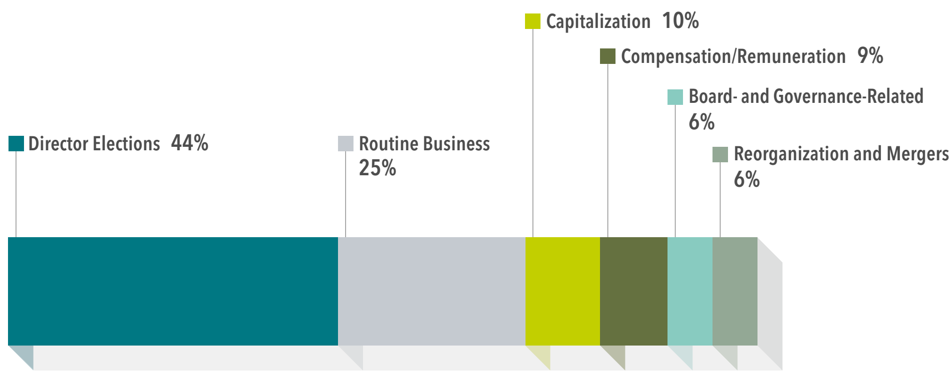
6. Engagements may cover multiple topics. Total number of topical discussions will exceed total number of portfolio company discussions due to many discussions covering multiple stewardship topics.

Proxy Voting

Dimensional votes proxies at shareholder meetings globally to hold boards and management of portfolio companies accountable to shareholders and promote governance best practices

Of the proposals voted, 168,136 were management proposals and 3,768 were shareholder proposals.

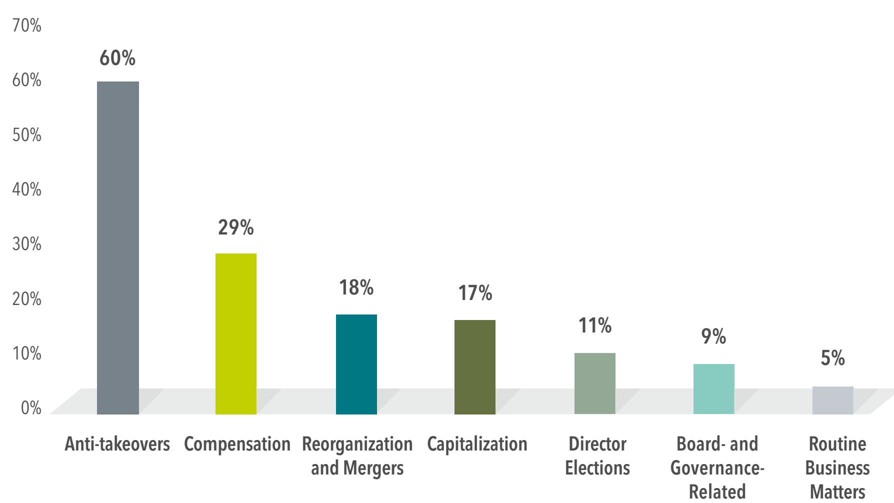
PROPOSALS VOTED BY TOPIC



Our views and voting guidelines on anti-takeover devices and executive compensation have led to a high relative percentage of votes against management proposals on these issues.

VOTES AGAINST MANAGEMENT BY TOPIC

Dimensional votes proxies in accordance with internal guidelines, which are designed to encourage portfolio companies to maintain governance policies consistent with maximizing shareholder value.



The "Director Elections" category includes the election of statutory auditors in Japan. "Board- and Governance-Related" includes proposals related to director compensation, board size and structure, voting standards, and shareholder access. "Routine Business Matters" includes a range of procedural matters as well as proposals calling for the adjournment of meetings, votes on the frequency of Say on Pay, and the election of auditors.

Viewpoint: Say on Climate

On this year's proxy ballots, investors were given the opportunity to vote on a new breed of climate change proposals—so-called "Say on Climate" votes. With these advisory proposals, portfolio companies ask investors for their "say" on the company's climate transition plans. Modeled after advisory votes on executive compensation ("Say on Pay"), "Say on Climate" proposals are typically submitted by management as non-binding proposals that seek shareholder approval of the portfolio company's climate transition plan. These proposals are different from shareholder proposals requesting planning and reporting related to climate change.

There is broad agreement amongst policy makers, business leaders, and investors that climate change has the potential to profoundly impact our environment and society and poses long-term systematic risk for many businesses. However, in our view, company boards are better situated than shareholders to oversee and manage the actual financial risks and opportunities specific companies face from climate change. We believe asking shareholders to directly evaluate the effectiveness of a portfolio company's climate transition plan has several challenges and drawbacks.

Read Dimensional's case study on Royal Dutch Shell *here*.

CHALLENGES OF "SAY ON CLIMATE" PROPOSALS

Climate transition plans are often complex strategic plans. In recent years, we have seen portfolio companies propose climate transition plans that would radically revise their business models. For example, in 2021, Royal Dutch Shell published a climate transition plan that included announcing its goal of reaching net zero emissions status by 2050, indicating the oil and gas giant would dramatically reduce operational and product emissions.[7]

In our view, any fundamental shifts in business strategy ought to be determined and directed at the board's discretion based on its duty to protect and enhance shareholder value. Our concern is that the structure of "Say on Climate" proposals can imply a delegation of authority in the oversight of this important strategic issue.

Read Dimensional's approach to Executive Compensation *here*.

The naming inspiration for these proposals—"Say on Pay"—offers a hint of the challenge ahead. In many markets, "Say on Pay" has not been effective at aligning executive pay with shareholder interests. Over 90% of "Say on Pay" votes passed at US-based companies included in the Russell 3000 Index in the first part of 2021,[8] suggesting that many shareholders are effectively rubber-stamping such pay plans.

While the issue of climate change is paramount for some investors, it is unlikely that most shareholders are well-positioned to evaluate a portfolio company's long-term strategic climate plan when even climate change experts disagree on what constitutes an effective climate plan. Often the costs and benefits are unclear, and even if they are clear, fiduciaries face challenging tradeoffs between protecting shareholder value and advancing environmentally friendly business policies and practices.

7. "*Shell Energy Transition Strategy*," Royal Dutch Shell plc, 2021 (accessed 15 April 2021).
8. "*An Overview of the Trends from the 2021 Proxy Season*," Freshfields, reporting as of January 1, 2021, through July 15, 2021.

Read Dimensional's case study on ExxonMobil *here* .

DIMENSIONAL'S APPROACH TO "SAY ON CLIMATE"

Dimensional believes climate change may pose material risks, uncertainties, and opportunities to portfolio companies that should be taken seriously by their boards. Shareholders can benefit from consistent and reliable information on the material impacts of climate change to the extent it can help them understand their investment's risk exposure. Given this benefit, we generally support disclosure proposals that we believe are in line with industry best practices and may add value for shareholders without imposing unreasonable costs.

We believe it is the board's role to have oversight of strategic climate plans. When considering "Say on Climate" proposals, we generally abstain from voting to indicate we do not believe they should be put to a shareholder vote. In proxy year 2021, Dimensional considered 19 "Say on Climate" management proposals related to approving climate transition plans and abstained in each case. We evaluated each proposal carefully, and in nearly every case we found that, in addition to our foundational concerns with the concept of "Say on Climate" votes, the portfolio company had not provided shareholders with enough information about the costs and benefits of a given climate plan. This meant that shareholders who did vote on the matter likely did so with insufficient information. To address our concerns with these proposals, we conducted 11 engagements with companies to better understand their motivations in presenting such proposals and voice our views on climate change risk oversight and the role of boards in such oversight.

Read Dimensional's approach to addressing climate change risk through stewardship *here*.

Shareholders hold boards accountable for their decision-making by choosing to elect or vote against board members. If we observe that portfolio company boards are either unqualified or fail to adequately guard shareholder value through strategic planning, we may vote against board members, as demonstrated in our support for two dissident-nominated directors at ExxonMobil this year. We believe that, in many cases, other stewardship tools—including director votes, engagement, and policy advocacy—can be more effective ways to address ineffective oversight of material climate change risks than "Say on Climate" proposals.

Stewardship Spotlight: Environmental and Social Priorities

To learn more about Dimensional's public policy advocacy efforts, read our Industry and Public Policy case studies *here*.

Climate Change

Dimensional believes portfolio company boards should address material climate risks that may have economic ramifications for shareholders and provide appropriate disclosure of such risks.

As investors, companies, and regulators increasingly focus on what constitutes effective management of climate change-related risks and opportunities, our stewardship efforts advocate for disclosure that provides reliable and consistent information at a reasonable cost to companies. This year, we advocated for effective climate change disclosures and oversight using multiple stewardship tools, including voting, engagement, and policy advocacy initiatives.

Key Statistics

185

Engagements Related to Climate Change

▶ Dimensional's Stewardship Perspective on Climate Change Disclosure

One goal of our stewardship efforts is to encourage effective oversight and disclosure of material risks at portfolio companies. When a portfolio company or recognized third party organization identifies climate change as a material risk for a company or an industry, Dimensional expects climate risk disclosure to identify specific risks that a company faces, the potential impacts of the risks, and policies and procedures related to risk management. Additionally, companies should disclose the metrics used to assess their handling of climate-related risks, and the methodology for measuring performance against these metrics should be clearly disclosed, particularly in instances where a recognized third-party framework, such as the Task Force on Climate-related Financial Disclosures (TCFD) or Sustainability Account Standards Board (SASB), is not being used. Furthermore, portfolio companies should disclose board and management level oversight of climate-related risks. For companies that face significant climate risks, we expect their directors to have the backgrounds, skillsets, and experiences needed to oversee relevant climate-related risks on behalf of shareholders.

Case Study on Climate Change Letter Campaign

Campaign Goal

Advocate for disclosure of board oversight of climate change risks at portfolio companies in industries likely to face physical or transitional risks from climate change.

Background

Dimensional identified over one hundred portfolio companies globally that we believe failed to meet our expectations for disclosure and oversight of material climate change risks. For this campaign, Dimensional identified portfolio companies where we did not observe publicly available information on the role of the company's board in overseeing climate risk and where SASB (Sustainability Accounting Standards Board) research identified climate change as a material risk for the company's industry.

LETTERS SENT BY REGION

65	55	38	8	2
North America	APAC ex Japan	EMEA	Japan	Other

Letters sent to portfolio companies requested:

- Information about material risks stemming from climate change
- A description of the process for identifying, prioritizing, and assessing material climate risks
- Policies and procedures governing the handling of each material climate risk
- Identification of the management-level roles or groups involved in climate risk oversight and mitigation
- A description of the metrics used to assess the effectiveness of mitigation efforts
- A description of how the board is informed of material climate risks and related metrics

Outcome[9]

Dimensional sent letters to 168 portfolio companies, and 57 responded. As a follow-up to the letters we sent, Dimensional further engaged with 35 of the companies. While responses varied, in general, companies provided updates and context related to their efforts to disclose climate risk-related information. Dimensional continued to monitor and assess related disclosure and noted 50 instances of improved public disclosure related to climate risk at companies included in the letter campaign, including improved website disclosure from **Hecla Mining Co. (USA, Metals & Mining)**, improved disclosure in the annual report from **John Menzies PLC (UK, Transportation & Logistics)**, the release of a sustainability report from **Matson, Inc. (USA, Marine)** in February 2021, and improved disclosure by **Ingles Markets Inc. (USA, Food & Staples Retailing)** in their 2021 proxy statement.

9. These outcomes are not necessarily a result of Dimensional's letters or actions.

CASE STUDY

Say on Climate Proposal at Royal Dutch Shell

United Kingdom, Oil, Gas & Consumable Fuels

Learn more about Dimensional's view on "Say on Climate" proposals in our *Viewpoint*.

Goal	Advocate for effective board oversight of material climate risks and strategic planning.
Background	Royal Dutch Shell proposed an advisory vote on its climate transition plan. Dimensional reviewed the plan and noted that it presented short-, medium-, and long-term carbon reduction targets and included substantially more detail than plans at many other companies. However, the proposal ultimately asked for shareholder approval of a plan that specified a fundamental re-imagining of Royal Dutch Shell's business as an oil and gas provider.
Outcome	Dimensional believes that strategic planning, including mitigation of climate change risks and oversight of opportunities presented by climate change, is the responsibility of the portfolio company board and should not be delegated or transferred to shareholders, regardless of the level of detail contained in the plan. In keeping with our view that "Say on Climate" proposals may represent an inappropriate transfer of strategic planning responsibilities to shareholders, Dimensional abstained from voting on the proposal, which ultimately passed with 88% support at the company's May 18 shareholder meeting. However, later that month, a Dutch court ordered Royal Dutch Shell to make more drastic emissions cuts, further criticizing that Shell's transition plan was "not concrete."

CASE STUDY

Green Dividend at Alstria

Germany, Real Estate Investment Trusts (REITs)

Goal	Advocate for improving shareholder value and gain understanding of Alstria's green dividend concept and approach to navigating the tension between maximizing shareholder value and mitigating climate impact.
Background	Alstria, a German-listed REIT, proposed a so-called "green dividend" to shareholders at its May 2021 shareholder meeting. The proposal offered a €0.01 per share dividend and asked shareholders whether the dividend should be paid to shareholders or be invested into pre-identified climate-mitigation projects. The firm already pursues climate mitigation efforts as part of its normal business activities – such as purchasing 100% of its energy from renewable sources and undertaking an extensive carbon reduction plan. According to the company, what set these additional climate mitigation projects apart is that they would not have made compelling investments for the company to pursue from a purely financial perspective. The board said that if shareholders supported the project investments, they would treat this as "a clear mandate to invest outside the financial norms."
Engagement	Dimensional engaged twice with Alstria's CEO to discuss the green dividend proposed by the company. In our first engagement, we sought to better understand the green dividend and selection of the "green" projects while clarifying the portfolio company's motivation for this proposal. Our second engagement focused on better understanding how the company's decision-making process for evaluating green projects considered the goals of maximizing shareholder value and having an environmental impact. We emphasized our view that the duty of the board is to maximize shareholder value and that we appreciated that the company proposal was put in quantifiable, financial terms.
Outcome	**Dimensional's stewardship efforts are focused on protecting and enhancing shareholder value. Given that the company's own evaluation showed the "green" project investments were unlikely to enhance shareholder value, Dimensional voted against the proposal, which ultimately passed with 85% support.**

Director Votes at ExxonMobil

USA, Oil, Gas & Consumable Fuels

Goal	Elect qualified directors with sufficient skills to oversee material risks related to climate change and core governance matters.
Background	At ExxonMobil's 2021 shareholder meeting, investors were faced with a choice to vote on a slate of four dissident director candidates nominated by Engine No. 1, an activist hedge fund investor. Engine No. 1 argued that the slate of management nominees lacked expertise in oil and gas, energy transformation, and technology and argued that the addition of the dissident's candidates would improve ExxonMobil's ability to manage the shift from fossil fuels to renewable energy. Dimensional engaged with ExxonMobil and Engine No. 1 separately to understand both parties' perspectives on the dissident and management nominees.
Outcome	Ultimately, Dimensional voted for the election of two dissident director candidates, Gregory J. Goff and Alexander A. Karsner. We supported these directors because we believed that they each brought needed skills and expertise to the board and also that the addition of these two independent voices on the board would help address persistent compensation concerns. ExxonMobil's short- and long-term plans, as disclosed in the proxy statement, have a heavy reliance on compensation committee discretion in making incentive pay determinations. Dimensional has repeatedly raised concerns with management over disclosure and structural issues in the incentive programs. Both Goff and Karsner were elected along with a third dissident candidate, Kaisa Hietala.

Key Statistic

275

Engagements Related to Social Issues

Oversight and Disclosure of Social Risks

In proxy year 2021, Dimensional advocated for improved oversight and disclosure of material social risks through our engagement and voting. Portfolio companies can face a wide-range of material social risks, such as human rights, data privacy, and community impacts.

SOCIAL ISSUES ENGAGEMENTS BY REGION

176	42	37	14	6
North America	Japan	EMEA	APAC ex Japan	Other

▶ Dimensional's Stewardship Perspective on Material Social Risks

Dimensional believes that portfolio company boards are responsible for overseeing material social issues. If a portfolio company is unresponsive to material social risks that may have economic ramifications for shareholders, Dimensional may vote against directors individually, members of a specific committee, or the entire board. We may engage with portfolio companies to better understand the alignment of the interests of boards and management with those of shareholders on these topics.

Dimensional evaluates shareholder proposals on social issues consistent with its general approach to shareholder proposals, paying particular attention to the portfolio company's current handling of the issue, current disclosures, the financial materiality of the issue, market practices, and regulatory requirements. Dimensional may vote for proposals requesting disclosure of specific social data, such as information about board oversight, risk management policies and procedures, or performance against a specific metric, if we believe that the portfolio company's current disclosure is inadequate for shareholders to effectively assess the company's handling of a material issue.

EMEA Human Rights in Supply Chain Outreach Campaign

Campaign Goal

Understand how portfolio companies are addressing material human rights risks within their supply chain to inform the development of our proxy voting policy on the issue.

Background

To gain a deeper understanding of how portfolio companies can work to avoid material failures in their supply chain, Dimensional reached out to over 20 EMEA-based portfolio companies where SASB Standards identified human rights risk as likely to be material for their industry and where their human rights audit disclosure fell short of best practices. During these engagements, Dimensional gained insight into what policies and practices are standard versus best-in-class through learning how these portfolio companies are currently addressing this issue and what challenges they face.

This outreach campaign is one component of our ongoing proxy voting policy development process, which also considers inputs from academic research, internal analysis and feedback, and industry practices.

Proxy Voting Policy Development Process

When developing new areas of our proxy voting policy, Dimensional's Stewardship group may conduct a range of activities to inform our policy, including:

Research Review: Reviewing academic research from the disciplines of law, economics, and environmental sciences
Internal Analysis: Conducting internal research and analysis
Portfolio Company Outreach: Engaging with portfolio companies across relevant industries and markets to understand current practices and best-in-class governance practices
Collaborative Feedback: Soliciting feedback from internal stakeholders, such as portfolio managers and client service representatives, and understanding client concerns and priorities
Industry Review: Reviewing positions taken by industry groups, proxy advisors, non-profits, regulators, and investors, both globally and regionally, and participating in industry and policy discussions

(continued)

EMEA Human Rights in Supply Chain Outreach Campaign (continued)

Outcome and Next Steps

Dimensional conducted in-depth discussions with 21 of the EMEA-based portfolio companies we reached out to on this topic. These engagements suggested that some best-in-class approaches demonstrated by certain portfolio companies included detailed human rights risk disclosures, designated board committee oversight of human rights risks, and well-established auditing practices. However, some companies' practices were less well-developed, with limited disclosure and unclear lines of board oversight specific to human rights issues.

To continue developing our understanding of the issue, Dimensional launched a similar effort involving US portfolio companies, resulting in 10 engagements as of June 30, 2021. Dimensional will consider the information gathered during our calls as we continue to develop our proxy voting guidelines and engagement standards related to oversight of material human rights risks in supply chains.

CASE STUDY

Shareholder Proposals on Human Rights Risks with Surveillance Technology

Summary

In proxy year 2021, a number of technology companies received shareholder proposals requesting additional disclosure on the management of human rights risks associated with facial recognition technology. In assessing these proposals, Dimensional paid particular attention to portfolio company responsiveness to shareholder concerns and disclosure relative to peers.

Thomson Reuters Corporation

Canada, Business Information Services

Thomson Reuters Corporation recently began a transition from a content-focused company to a technology-focused company and is now marketing artificial intelligence (AI) products used for surveillance activities by law enforcement. Human rights issues related to surveillance activities present new regulatory and legislative risks, and these risks have been the subject of several recent shareholder proposals. In 2020 and 2021, Thomson Reuters received shareholder proposals requesting additional reporting on the company's management of these human rights risks. While the 2020 proposal received only 7% overall shareholder support, a significant portion of company shares are held by company insiders. Of independent shareholders, over 30% voted in favor.

Ahead of voting on the 2021 shareholder proposal, Dimensional engaged with Thomson Reuters on this issue. Our evaluation indicated that the company lacked clear board oversight of the human rights risks related to their surveillance technology and maintained only vague policies related to AI product risks. Furthermore, the company's commitments to follow international human rights standards lagged technology sector peers, and the company was not responsive to concerns voiced by independent shareholders through the 2020 proposal vote. These concerns led Dimensional to vote for the 2021 proposal. Although the proposal was supported by 70% of independent shareholders, it failed to receive the support of a majority of shareholders as the majority of shares were held by company insiders.

(continued)

Shareholder Proposals on Human Rights Risks with Surveillance Technology (continued)

Amazon

USA, Internet Retail

Dimensional engaged with management at Amazon in 2020 and 2021 regarding human rights issues, particularly in the management and oversight of risks related to Amazon's facial recognition technology, Rekognition. In 2017, law enforcement entities began using Rekognition, particularly federal immigration agencies and the FBI.

In 2021, Dimensional engaged with Amazon to discuss a shareholder proposal requesting additional reporting on the human rights risks associated with the sale of Rekognition. At Amazon's 2020 shareholder meeting, a similar proposal had received 32% support, and Amazon subsequently announced a one-year moratorium, which they later extended indefinitely, on selling the use of Rekognition to law enforcement. During our engagement, Amazon provided details on the role of the board in overseeing human rights risks related to its technology products and services, including facial recognition technology. Amazon also discloses guidelines for customer use of facial recognition technology, which specifically address use by law enforcement. We concluded that Amazon's disclosure and handling of human rights risks related to facial recognition technology was in line with peers and provided adequate information for shareholders. Dimensional voted against the proposal at the company's May 2021 shareholder meeting. The proposal did not pass.

CASE STUDY

Material Social Risks at Facebook

Goal	Advocate for improvement in Facebook's handling of risks related to child sexual exploitation through its platform.
Background	Facebook received a shareholder proposal at its 2021 shareholder meeting requesting that it prepare a report assessing the risk of increased online child exploitation on its platform. Facebook had received the same proposal in 2020 and had stated that it had taken steps to address the issue, including the creation of an advisory board comprised of independent experts. Nonetheless, reports by independent third-party groups continued to identify instances where Facebook-owned applications were used in cases of child abuse and exploitation.
Engagement	In May 2020, Dimensional engaged with Facebook to understand the role of its board in overseeing human rights risks and to evaluate whether its board members were appropriately qualified to oversee such risks. Ahead of Facebook's May 2021 shareholder meeting, Dimensional requested an engagement with the company on the child sexual exploitation proposal but did not receive a response.
Outcome	**Although Facebook has taken steps to address misuse of their platform, the efficacy of these efforts is unclear in light of continued reports of child sexual exploitation on their platform, so Dimensional voted for the shareholder proposal requesting additional disclosure. While a significant share of independent shareholders supported the proposal, the proposal failed to receive majority support, in part due to the company's dual class voting rights structure.**

CASE STUDY

Social Risk Oversight at Rio Tinto

Australia, Metals and Mining

Goal

Evaluate board oversight of material social risks from the portfolio company's operations.

Background

In May 2020, as part of its expansion of an iron ore mine, Rio Tinto detonated blasts that severely damaged significant indigenous cultural sites at Western Australia's Juukan Gorge. While the destruction was not deemed illegal by local authorities, it raised questions about the social risk oversight and governance practices within Rio Tinto.

Following the release of an independent board review of the incident in August 2020, the board of Rio Tinto announced compensation consequences for several executives. In the year following, the CEO, Head of Corporate Relations, and Head of Iron Ore left the company, and it was announced that the chair would retire at the 2022 annual shareholder meeting. Despite these changes, Dimensional observed that compensation practices for the departing executives, which resulted in significant payouts, left room for improvement in the company's governance practices.

Engagement

Since the damage at the Juukan Gorge, Dimensional has engaged several times with Rio Tinto to understand how the company's governance practices addressed material environmental and social risks.

Outcome

In light of ongoing concerns about Rio Tinto's oversight of material environmental and social risks and given the company's Sustainability Committee's role in the governance related to these risks, Dimensional voted against the re-election of the chair of the Sustainability Committee at the April 2021 shareholder meeting. While the director was ultimately re-elected, the board acknowledged reduced support of that director in the vote. Dimensional also voted against the compensation report, which details the compensation, payments, and policies for directors and management. The plan was ultimately rejected.

Viewpoint: Board Diversity

Strong, independent, and qualified boards of directors are the foundation of sound corporate governance practices. Shareholders rely on boards to protect and represent their interests effectively. Increasingly, industry participants have made board diversity a key area of scrutiny when assessing company boards. In varying jurisdictions, board diversity quotas are being implemented, such as a quota enacted by recent legislation in California and through listing requirements for companies listed on Nasdaq. Given the foundational importance of effective boards for advocating and protecting shareholder interests, we believe that board diversity should be viewed within the broader context of encouraging strong board structure, composition, and refreshment.

ASSESSING BOARD DIVERSITY AS A MEASURE OF BOARD EFFECTIVENESS

There are many characteristics and qualifications that may impact board and director effectiveness, including level of independence, director skill sets and experiences, and board structure. Further, these qualities are likely to vary by country, industry, and company. When scrutinizing board diversity as a proxy for, or component of, board and director effectiveness, diversity may be defined in different ways, including gender, age, ethnicity, skills, and experiences. Focusing primarily or solely on one metric, such as a particular aspect of board diversity—like director gender—may be attractive given its simplicity; however, such a focus is unlikely to provide a holistic representation of a board's fitness to represent shareholder interests. In theory, such an approach could even inadvertently result in reduced board effectiveness, to the extent a company adds directors to simply comply with mandated quotas or improve diversity-focused evaluations rather than focusing on selecting the most qualified director candidates.

Currently, academic research is inconclusive on the relation between board diversity and shareholder value.[10] We continue to review and consider academic findings in our approach to evaluating management and boards.

DIMENSIONAL'S APPROACH TO BOARD DIVERSITY

Given the potential limitations of focusing primarily on board diversity as a measure of board effectiveness, Dimensional takes a broader approach. Our focus is to encourage board composition and structures that are likely to result in more robust oversight of management on behalf of shareholders. We advocate for strong, independent boards that have the diversity of backgrounds, skills, and experiences relevant to a portfolio company's business to effectively oversee and monitor management and best represent shareholder interests. A key element of assessing a portfolio company's board structure and composition is evaluating the company's board assessment and refreshment approach. We ask portfolio companies to disclose information about their board assessment and refreshment approach, including how they identify key competencies for directors, and we encourage companies to publish a skills matrix that illustrates which of the key competencies each director possesses.

10. See, for example, Post and Bryon (2015), Bernile, Bhagwat, and Yonker (2018), and Adams and Ferreria (2009). Note these studies, generally, do not control for known drivers of expected returns (size, value, or profitability) and have relatively short sample periods.

While we generally do not vote against directors for lack of board diversity alone, we do consider a lack of gender, racial, or ethnic diversity on a board as a reason to apply further scrutiny of the portfolio company's board assessment and refreshment processes. We believe that an effective board refreshment and assessment process should be rigorous and objective and draw from a representative pool of qualified candidates. A lack of diversity among directors may indicate that a portfolio company's refreshment process is not sufficiently robust; for example, directors join the board and remain in leadership, even when their skills no longer align with the skill set best suited to monitor the company. In short, rather than targeting board diversity as the sole measure of board effectiveness, we use board diversity as an input into our holistic assessment of board composition and structure.

STEWARDSHIP IN PRACTICE

The primary goal of Dimensional's stewardship activities is to enhance and protect shareholder value, and we believe strong, independent portfolio company boards are best positioned to represent shareholder interests. Our ongoing stewardship activities place a strong emphasis on advocating for qualified, competent boards and governance practices that align shareholder and board interests. In proxy year 2020, we conducted a letter campaign focused on portfolio companies with insufficient board refreshment and assessment practices or insufficient disclosure of their practices. In the letter, we referenced our approach to board diversity and emphasized that insufficient disclosure of board assessment and refreshment practices may result in votes against individual directors, committees, or the entire board. As a result of Dimensional's letter campaign, we have engaged with 44 companies and observed that 20 companies who received letters subsequently improved their disclosure around board assessment and refreshment processes. In cases where a portfolio company has not been responsive, has inadequate disclosure to reliably assess processes for establishing board composition, or has other governance structures that would indicate reduced board accountability and potential misalignment with shareholder interests (classified/staggered boards, or plurality voting on director elections, for example), we have taken voting action. Over the past proxy year (July 1, 2020–June 30, 2021) Dimensional voted against 23 directors at 19 US-based companies that received a letter on board assessment and refreshment from Dimensional but remained unresponsive. Beyond companies that received letters on this topic, Dimensional voted against 100 directors at 82 companies globally due to board assessment and refreshment concerns.

Stewardship Spotlight: Governance Priorities

Key Statistics

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Engagements Related to Executive Compensation

Executive Compensation

Dimensional believes compensation plans should be based on rigorous and transparent metrics that display a clear link between pay and long-term performance. Executive compensation is a perennial stewardship priority for Dimensional because poorly designed compensation packages can lead to pay that is not aligned with shareholder interests, resulting in not only excessive compensation but also poor strategic decision-making by management. For these reasons, we regularly monitor portfolio companies for problematic compensation arrangements, and may conduct engagements or take voting action to address our concerns.

▶ Dimensional's Stewardship Perspective on Executive Compensation

Dimensional supports executive compensation that is clearly linked to a portfolio company's performance. We believe compensation should be designed to attract, retain, and appropriately motivate and serve as a means to align the interests of executives with those of shareholders. To the extent that Dimensional believes compensation is excessive and not aligned with a portfolio company's performance, Dimensional will not support such compensation. Additionally, Dimensional expects portfolio companies to follow local market practices with regards to the specific elements of compensation and the overall structure of the compensation plan. Therefore, Dimensional closely reviews proposals seeking approval of a portfolio company's executive compensation plan, taking into account the level of pay, company performance, and the structure of the plan relative to market norms.

Dimensional supports compensation plan metrics that are quantifiable and clearly tied to portfolio company strategy. In evaluating a company's executive compensation, Dimensional considers whether the company is disclosing what each metric is intended to capture, how performance is measured and respective targets, and actual performance against the targets set.

At portfolio companies that have a history of problematic pay practices or excessive compensation, Dimensional will consider the company's responsiveness to shareholders' concerns and may vote against or withhold votes from members of the compensation committee if these concerns have not been addressed.

Compensation Considerations Following Governance Concerns

Summary

Dimensional believes executive compensation should align management interests with shareholder interests. If management has failed to protect shareholder interests through poor corporate governance, this should be reflected in executive compensation.

Opioid Lawsuit Settlements at AmerisourceBergen

USA, Health Care Providers & Services

In November 2020, US-based medical distribution company AmerisourceBergen agreed to pay $6.6 billion to settle lawsuits brought by government entities related to the company's role in the opioid epidemic. The company reported net losses of $3.4 billion for 2020. In calculating compensation-related performance metrics, the board excluded the opioid settlement costs and recommended executives receive above-target payouts, citing strong performance by management. Had the settlement costs been considered, it would have significantly reduced executive payout recommendations.

Dimensional engaged with AmerisourceBergen and ultimately voted against its compensation plan, which passed with a close vote of approximately 52% support. Additionally, we voted against members of the Compensation Committee for failing to exercise appropriate discretion to adjust executive payouts in light of the settlement charge.

COVID-19 Impacts at The Star Entertainment Group Limited

Australia, Hotels, Restaurants & Leisure

In October 2020, Dimensional engaged with Star Entertainment Group, an Australian casino and resort company, regarding its use of board discretion when determining executive pay. In fiscal year 2020, the company announced significant losses and received large government wage subsidies. The board stated that the executive team did not meet their financial targets because of the COVID-19 pandemic but decided to exercise discretion to award short-term incentive bonuses despite the company not achieving the required financial targets. The board cited the company's above-target performance prior to COVID-19, the team's response to the pandemic and achievement of strategic goals, and the retention of key talent as reasons they exercised discretion.

Consistent with our view that executive compensation should be linked to portfolio company performance, at the October 2020 shareholder meeting, Dimensional voted against both the compensation report and the issuance of restricted shares to the CEO. The proposals were supported by 55% and 51%, respectively, which indicated a notable level of shareholder opposition to the compensation plans. We continue to monitor the company and will consider voting against the Chair of the Compensation Committee if the company's compensation practices do not improve.

(continued)

Compensation Considerations Following Governance Concerns (continued)

Shareholder Rights at NextDC Group Limited

Australia, IT Services

NextDC, an Australian IT services company, conducted a share placement in April 2020 by issuing stock to new investors at a discount to the then-current market price. Because the newly issued stock was issued at a discount, existing shareholders who did not receive an allocation were harmed through price-based dilution of their holdings. Dimensional was concerned with the dilution of existing shareholders' economic and voting interests and engaged with the company about our concerns.

At the company's annual meeting in November 2020, Dimensional voted against the incumbent board member up for election and against the grant of performance rights to the CEO given his role in the problematic capital allocation; however, both proposals passed. Dimensional also voted against one of NextDC's directors at another portfolio company's board where he was up for re-election. Dimensional continues to monitor NextDC's governance practices and will consider voting against incumbent directors at both NextDC and at outside boards.

Further, the company included a motion in the agenda for the annual general meeting to ratify the April capital raising allowing it scope to conduct further placements. Dimensional and others voiced concern about this motion, and the company withdrew its motion prior to the annual general meeting.

Regulation Linking ESG Considerations to Executive Compensation in Germany

Summary

Dimensional believes that compensation plan metrics should be clearly tied to company strategy and that portfolio companies should disclose what each metric is intended to capture, how performance is measured, and actual performance against the targets set.

In proxy year 2021, Dimensional engaged with 15 German companies regarding their compensation plans. Linking ESG metrics to compensation was a recurrent theme at these portfolio companies, as many looked to respond to recent legislative changes and a growing movement in Europe to link pay to ESG metrics. In executive compensation plans, Dimensional believes it is important to align executive compensation with shareholder interests in a transparent and quantifiable manner.

While material ESG issues can impact shareholder value, Dimensional believes linking ESG metrics to executive pay in a quantifiable and transparent manner can present challenges, as ESG metrics are often qualitative. Therefore, we evaluate such metrics carefully to assess whether companies are artificially increasing pay in circumstances where there may actually be underperformance when measured against objective metrics that are reliably tied to shareholder value, such as financials.

Bayerische Moteren Werke

Germany, Auto Manufacturer

Dimensional's evaluation of the Bayerische Moteren Werke (BMW) 2021 compensation policy revealed that 50% of the company's policy was calculated based on non-financial metrics and also provided poor disclosure as to how these metrics—some of which were ESG-related—were calculated.

Dimensional voted against the proposed compensation plan at the company's May 2021 annual shareholder meeting to signal our concerns with the lack of disclosure, transparency, and quantifiable metrics. The proposal nonetheless passed with 91% support.

Gerresheimer

Germany, Medical Instruments & Supplies

In September 2020, Dimensional engaged with Gerresheimer, a German medical instruments and supplies company, about its executive compensation plan, which included ESG metrics. Dimensional outlined our view that ESG metrics used in compensation plans should be quantifiable and transparent to shareholders.

In evaluating the revised policy presented to shareholders at the company's June 2021 meeting, we felt Gerresheimer had made improvements in establishing ESG metrics that were quantifiable, and Dimensional voted for the proposed compensation plan. We will continue monitoring the company's progress towards transparency and quantifiable metrics in its compensation policy.

Industry Participation and Public Policy Advocacy

Dimensional participates in industry groups to advocate for governance best practices across the industry. Additionally, we engage with regulators and policy makers to promote investor interests and well-functioning markets. Through these forums, we advocate for strong corporate governance practices and appropriate policy to facilitate efficient markets.

Industry Participation Groups

International Corporate Governance Network
Council of Institutional Investors
Investment Association
The Harvard Law School: Program of Institutional Investors
Investment Company Institute (including participation in Proxy Voting Group and ESG Working Group)
Task Force on Climate-related Financial Disclosures
Value Reporting Foundation (formerly Sustainability Accounting Standards Board)
Responsible Investment Association Australasia (RIAA)

Stewardship Codes

As part of our commitment to encouraging strong governance, certain Dimensional entities are signatories to stewardship codes in Japan and the United Kingdom.

Public Policy Advocacy

US SEC Climate Change Disclosures

Background

In March 2021, the US Securities and Exchange Commission (SEC) called for public input on US public company climate change disclosures. Since then, SEC Chair Gary Gensler has stated that he has asked the SEC staff to develop a mandatory climate risk disclosure rule proposal.

Response

Dimensional submitted a comment letter outlining our recommendations on how to enhance public company climate change disclosures in a way that considers both the costs and benefits to investors.

Read Dimensional's letter to the SEC *here*.

Dimensional has consistently dedicated time and resources to understanding the latest climate science and recognizes that climate change has the potential to profoundly impact our environment and society.[11] We believe that investors would benefit if public companies provided more consistent and reliable information about the material climate change risks that could impact their business. However, in determining whether to adopt new rules requiring climate risk disclosures, we think it is crucial that the SEC carefully considers whether the benefits to shareholders will outweigh the inevitable costs to public companies of complying with any new disclosure requirements, particularly when companies have differing exposure to climate risk. Disclosure costs can be high, and these costs are passed on to the company's investors, including funds and their shareholders. Our view is that the SEC should take a targeted approach and require disclosure of climate change information only where climate change is a material risk to the company's business.

To promote consistency, companies that do face material climate risks should be required to disclose a specific set of objective metrics—specifically Scope 1 and Scope 2 greenhouse gas (GHG) emissions—combined with narrative disclosure of the climate change risks faced by the company and how they are managed. We believe this targeted approach would provide investors with consistent and reliable information to help them evaluate the impact of climate change on a company's business and operations.

(continued)

11. See, for example, Joseph Chi, Mathieu Pellerin, and Jacobo Rodriguez, "*The Economics of Climate Change*" (white paper, Dimensional Fund Advisors, 2020).

US SEC Climate Change Disclosures (continued)

Outcome

As of December 31, 2021, the SEC had not yet proposed rules requiring specific climate change-related disclosures. In our commitment to productive regulatory evolution, Dimensional has and plans to continue to engage with government agencies, industry groups, and subject matter experts on climate change-related governance improvements.

Dimensional's Key Views on Climate Change Disclosures

- The SEC should carefully consider the costs of requiring all public companies to disclose climate change-related metrics and information.
- Only public companies that have determined that climate change is a material risk to their business should be required to include specific climate change disclosures.
- If climate change is a material risk to a public company's business, it should be required to disclose Scope 1 and Scope 2 GHG emissions and certain narrative descriptions.

US Proxy Distribution Fee Schedule

Background

In December 2020, the New York Stock Exchange (NYSE) filed with the US Securities and Exchange Commission (SEC) a proposed rule change to delete the maximum fee rates for forwarding proxy and other materials to beneficial owners. NYSE members that hold securities for beneficial owners in street name are required to deliver proxy and other disclosure materials to beneficial owners on behalf of issuers. Issuers reimburse NYSE members for the costs they incur in providing this service, and NYSE's fee schedule establishes the maximum rates at which a NYSE member may be reimbursed for such costs. Funds are almost always charged the maximum fee allowed, regardless of market cost, which the Investment Company Institute estimates cost fund shareholders millions of dollars per year.[12]

Response

Dimensional wrote a comment letter to the SEC urging the SEC to reform the framework regulating fees that intermediaries charge funds for distributing fund materials to investors. We recommended that the SEC create a more market-driven and competitive landscape by permitting funds (rather than intermediaries) to select a vendor to deliver fund materials on their behalf. This would allow funds to negotiate prices directly with vendors, which would likely result in lower costs to shareholders.

Outcome

In August 2021, the SEC issued an order disapproving the NYSE's proposed changes to the proxy distribution fee schedule, leaving the current structure in place. In its order, the SEC acknowledged that almost all comments urged comprehensive reform to the current reimbursement structure but noted that such reform was outside the scope of NYSE's proposed rule change.

12. The ICI estimates that changing the fee structure in line with their recommendation would save shareholders $101 million in the first year and $182 million annually thereafter in the letter from Paul Stevens, President and CEO, Investment Company Institute, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, dated March 14, 2016, available at *https://www.sec.gov/comments/s7-08-15/s70815-581.pdf*

EU Sustainable Corporate Governance Consultation

Background

In conjunction with the European Green Deal and its Communication on the (COVID-19) Recovery Plan, the European Commission (EC) announced a call for submissions related to sustainability in corporate governance, including environmental, social, human, and economic sustainability.

Response

Dimensional responded to the questionnaire, providing our opinions and relevant research on the most effective ways to incorporate sustainability in corporate governance. Dimensional agrees with many of the objectives of the United Nations Sustainable Development Goals (UN SDGs) and supports effective, proportionate regulation to support these goals. However, several academics have criticized the study on sustainable corporate governance that has informed the approach of the EC, citing a misplaced understanding of markets and actors as short-termists and a lack of balanced research.[13,14]

Dimensional advocates for corporate governance practices and structures that promote long-term value creation alongside the short-term financial gains for shareholders. However, board management has for years been tasked with balancing these dual goals, and overly restrictive legislation can be harmful to both objectives. We believe portfolio company boards should be incentivized to increase shareholder value within ethical and legal bounds.

Outcome

As of December 31, 2021, the European Commission is still deliberating how to develop regulation that effectively promotes sustainable corporate governance.

13. Mark J. Roe, Holger Spamann, Jesse M. Fried, and Charles C. Y. Wang, "*The European Commission's Sustainable Corporate Governance Report: A Critique*," European Corporate Governance Institute - Law Working Paper 553/2020, Harvard Public Law Working Paper No. 20-30, Yale Journal on Regulation Bulletin, 2020.

14. "*Response to the EU Commission Study on Sustainable Corporate Governance*," Professor Alex Edmans, London Business School, 2020.

Australia Proxy Advice Reform

Background

In April 2021, the Australian Treasury published a consultation paper proposing an option to mandate that proxy advisory firms release their research and voting recommendations to applicable firms five days ahead of distribution to their clients. The paper argued that these proposals could increase transparency, quality, and accuracy in proxy advisor publications. The new proposed regulations would impose a significant time burden on proxy advisors, which could limit their ability to develop timely and actionable insights and recommendations to their clients. Additionally, the current structure supports independence between proxy advisers and applicable companies, supporting impartial reports from advisors. The new proposed timeline could alter this relationship.

Response

Dimensional made a submission to the Australian Treasury stating our opposition to the proposal to require proxy advisors to provide their advice to the relevant issuer five days before it is provided to the client, as this could ultimately harm shareholders. In our view, the proposed requirement could risk proxy advisors losing their independence, will cause delays in investors receiving reports from proxy advisors, and will increase costs to shareholders. Moreover, the impact on time frames could lead to less informed or uninformed voting.

Outcome

In December 2021, the Treasury issued final regulations on the Greater Transparency of Proxy Advice. The final rules require proxy advisory firms to provide their advice to the relevant issuer on the same day that reports are provided to clients, rather than five days in advance as originally proposed.

Appendix: Portfolio Companies Engaged in 2021

Dimensional conducted at least one engagement with each of the following global portfolio companies during proxy year 2021.

Company Name

AAR Corp.
Aareal Bank
AC Energy Corp.
Activision Blizzard Inc
Acuity Brands, Inc.
Adecco Group AG
Adient plc
Adtalem Global Education
ADVA Optical Networking SE
Adverum Biotechnologies, Inc.
AECOM
Aegean Airlines SA
Aena S.M.E. SA
Affiliated Managers Group, Inc.
AGCO Corp.
AGL Energy Limited
Air Transport Services Group, Inc.
Alaska Air Group Inc
Albemarle Corporation
Alexandria Real Estate Equities, Inc.
Alexion Pharmaceuticals, Inc.
Allegheny Technologies Inc
Allegiant Travel Co
Allreal Holding AG
Alphabet Inc.
Alps Alpine Co., Ltd.
alstria office REIT-AG
Alten SA
Altria Group, Inc.
Amazon.com, Inc.
Ambac Financial Group Inc
Ambarella, Inc.
American Express Co
American International Group Inc
American Outdoor Brands, Inc.
America's Car-Mart, Inc.
AmerisourceBergen Corporation
AMMB Holdings Bhd.
AMP Ltd
Ampol Ltd
Anglo American Plc
Anglo Pacific Group Plc
AngloGold Ashanti Ltd
Ansell Limited
Apache Corporation
Apartment Investment Management Co.
Aperam SA
Apogee Enterprises, Inc.
Apple Inc
Applied Optoelectronics Inc.
ARB Corp Ltd
ArcelorMittal SA
Archrock, Inc.
Argo Group International Holdings, Ltd.
Aristocrat Leisure Limited
Armstrong Flooring Inc.
Arrow Electronics, Inc.
Aryzta AG
Associated Banc-Corp
Assurant Inc
Atara Biotherapeutics, Inc
Atlas Air Worldwide Holdings Inc
Atos SE
Atsugi Co., Ltd.
Aurubis AG
Aviva Plc
BancFirst Corporation
Bank of America Corp
Bank of Marin Bancorp
Bank of Queensland Ltd
Barnes & Noble Education Inc
Bauer AG
Bayerische Motoren Werke AG
BE Semiconductor Industries NV
Bed Bath & Beyond Inc.
BHP Group Limited
BJ's Wholesale Club Holdings Inc
Blackbaud, Inc.
Blucora, Inc.
Bluescope Steel Limited
Boliden AB
Boohoo Group PLC
Booking Holdings Inc
Boral Ltd
Bouygues SA
Brenntag AG
Brickworks Limited
The Brink's Company
Brooks Automation, Inc.
Bucher Industries AG
Bunge Limited
Business First Bancshares, Inc.

Cabot Oil & Gas Corporation
Canadian Pacific Railway Limited
Cardinal Health Inc
Cars.com Inc
CCR SA
Centerra Gold Inc.
CenturyLink Inc
CF Industries Holdings, Inc.
Chevron Corp
The Children's Place
Chimerix, Inc.
The Chugoku Electric Power Co., Inc.
Cineworld Group PLC
Citigroup Inc
Clarkson PLC
Cleanaway Waste Management
Cleveland-Cliffs Inc
CNB Financial Corp/PA
CNO Financial Group Inc
CNX Resources Corporation
Coats Group Plc
Coeur Mining Inc
Coface SA
Coles Group Ltd.
Collins Foods Limited
Comcast Corp
Commercial Metals Co
Community Bank System, Inc.
CommVault Systems Inc
Compagnie Financiere Richemont SA
CoreLogic, Inc.
CORESTATE Capital Holding SA
Cornerstone OnDemand, Inc.
Covestro AG
Covivio SA
Cowen, Inc.
Cracker Barrel Old Country Store Inc
Credit Acceptance Corporation
Cromwell Property Group
Crown Resorts Ltd
CSG Systems International, Inc.
Cubic Corp
CVS Health Corp
Daelim Industrial Co., Ltd.
DAI-ICHI LIFE HOLDINGS
Daimler AG
Daio Paper Corp
The Daito Bank, Ltd.
Daishi Hokuetsu Financial Group
DaVita Inc
Delek US Holdings, Inc.
Delta Air Lines, Inc.
Denki Kogyo Co Ltd
Deutsche Pfandbriefbank AG
DEUTZ AG
Devon Energy Corporation
Dexus
Dicker Data Ltd
DNO ASA
Domtar Corp
dormakaba Holding AG
Douglas Emmett Inc
Dover Corp
DRDGOLD Ltd.
Dufry AG
Duke Energy Corporation
DuPont de Nemours, Inc.
DXC Technology Co.
DXP Enterprises, Inc
Eagers Automotive Ltd
Eagle Bancorp Inc
Eagle Pharmaceuticals Inc/DE
Eastman Chemical Company
Ebix, Inc.
eHealth, Inc.
Elementis Plc
Elf Beauty, Inc.
Empire State Realty Trust Inc
Endo International PLC
ENEOS Holdings, Inc.
Ennis, Inc.
Enplas Corp
Euronext NV
Evolent Health, Inc.
Exterran Corp
Extra Space Storage Inc.
ExxonMobil Corporation
First American Financial Corporation
First Financial Corporation
First Hawaiian, Inc.
First Pacific Co.
First Solar, Inc.
First United Corporation
Firstgroup PLC
Fleetwood Corporation Ltd
FNB Corp/PA
Foot Locker, Inc.
Fortescue Metals Group
Fourlis Holdings SA
Frasers Group Plc
freenet AG
FreightCar America, Inc.
Frontdoor, Inc.
Fuchs Petrolub SE
Fujitec Co., Ltd.
Gamesys Group Plc
Gannett Co., Inc.
The Gap Inc.
General Motors Co
GEO Group, Inc.
Georg Fischer AG
German American Bancorp, Inc
Gerresheimer AG
GFT Technologies SE
G-III Apparel Group, Ltd.
Gilead Sciences Inc
Glanbia Plc
Glencore Plc
Globant SA

Goldman Sachs Group Inc/The
Goodman Group
Goodyear Tire & Rubber Co/The
GR Sarantis SA
Grafton Group PLC
Great Eastern Shipping Co. Ltd.
Grupo Mexico S.A.B. de C.V.
Hanesbrands
Hanmi Financial Corporation
Harley-Davidson, Inc.
Hawaiian Holdings Inc.
Hazama Ando Corp
Hecla Mining Company
Heiwa Real Estate Co., Ltd.
Helios Technologies, Inc.
Henry Boot PLC
Heritage Commerce Corp
Heritage Insurance Holdings, Inc.
Hewlett Packard Enterprise Company
Hitachi Transport System, Ltd.
Hitachi Zosen Corp
Hochschild Mining PLC
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Howmet Aerospace, Inc.
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Hubbell Incorporated
Hunting PLC
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Implenia AG
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Invacare Corp
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IPG Photonics Corporation
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JFE Holdings, Inc.
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Johnson & Johnson
Johnson Matthey Plc
JPMorgan Chase & Co
Kaiser Aluminum Corp
Keihanshin Building Co., Ltd.
Kemira Oyj
Kenedix Inc.
Kennedy-Wilson Holdings Inc
Kilroy Realty Corp
Kimco Realty Corp
Kingspan Group Plc
Kogan.com Limited
Korean Air Lines Co., Ltd.
KPMG
The Kraft Heinz Company
The Kroger Co.
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KVH Industries, Inc.
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Lear Corporation
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Lenzing AG
Leopalace21 Corp
Lifetime Brands, Inc.
Ligand Pharmaceuticals Incorporated
Lincoln National Corp
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Lopez Holdings Corporation
Macmahon Holdings Limited
Maeda Corp.
Manitex International, Inc
Manitowoc Company, Inc.
Marudai Food Co., Ltd.
Matson, Inc.
McKesson Corp
MEDNAX, Inc.
Medpace Holdings, Inc
Meggitt PLC
Mercantile Bank Corporation
Mersen SA
Meta Financial Group Inc
Micron Technology Inc
The Middleby Corporation
Mitsui-Soko Holdings Co., Ltd.
Miyakoshi Holdings, Inc.
MLP SE
Mondelez International Inc
Moodys Corporation
Morgan Advanced Materials PLC
Morgan Stanley
The Mosaic Company
Movado Group Inc
Myer Holdings Ltd.
N Brown Group Plc
Nabors Industries Ltd.
National Australia Bank Ltd
National Express Group PLC
Natural Gas Services Group, Inc.
Nestle SA
New York Community Bancorp, Inc
Newmark Group, Inc
Newpark Resources Inc
News Corporation
Nexity SA

Nexstar Media Group Inc
NextDC Ltd
NexTier Oilfield Solutions, Inc.
Nielsen Holdings Plc
Nippon Chemi-Con Corp
Nippon Yakin Kogyo Co., Ltd.
Nippon Yusen KK
The Nisshin OilliO Group, Ltd.
Nomura Holdings Inc
Nordex SE
Northwest Pipe Company
NOW Inc
Nuance Communications Inc
Occidental Petroleum Corp
Oceaneering International, Inc.
The ODP Corp
OFG Bancorp
Oil Search Ltd
Old Mutual Ltd.
Old Republic International Corporation
Olympic Steel, Inc.
OneSpan Inc
Ontex Group NV
Opiant Pharmaceuticals, Inc.
Oracle Corp
O'Reilly Automotive, Inc.
Orica Ltd
Orient Cement Ltd.
Origin Energy Limited
Orrstown Financial Services, Inc.
Ozu Corp.
PACCAR Inc
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Park Hotels & Resorts, Inc
Patterson-UTI Energy, Inc.
PBF Energy, Inc.
PDC Energy Inc
Peabody Energy Corporation
Peapack-Gladstone Financial Corporation
Penns Woods Bancorp, Inc.
Perenti Global Limited
Petra Diamonds Ltd
Pfizer Inc
Phillips 66
Piper Jaffray Cos
Piraeus Port Authority SA
Plexus Corp
POSCO International Corp.
Precision Drilling Corporation
Premier Oil PLC
Procter & Gamble Co/The
Prologis, Inc.
QAD Inc.
QBE Ltd
QTS Realty Trust, Inc.
Quadient SA
QUALCOMM Inc
Quanta Services, Inc
Qurate Retail, Inc.
Radiant Logistics, Inc
RadNet, Inc.
Ralph Lauren Corp
Range Resources Corp
Rayonier Advanced Materials Inc
RCI Hospitality Holdings, Inc.
Realogy Holdings Corp
Regions Financial Corp
Rent-A-Center, Inc.
Republic Services Inc
Rheinmetall AG
Ricoh Company, Ltd.
Rio Tinto Limited
Rio Tinto Plc
Royal Caribbean Group
RPT Realty
Ruth's Hospitality Group Inc
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Sabana Shari'ah Compliant Industrial REIT
Sacyr SA
Safety Insurance Group, Inc
SAF-HOLLAND SE
Sanderson Farms, Inc.
Sanmina Corp
Sasol Ltd.
Schnitzer Steel Industries Inc
Scor SE
SeaWorld Entertainment Inc
Sekisui House, Ltd.
Seven West Media Limited
Severn Trent Plc
Shibaura Machine Co., Ltd.
Shinhan Financial Group Co., Ltd.
Shoe Carnival
Signature Bank/New York NY
Simon Property Group Inc
Skyworks Solutions Inc
Sojitz Corp.
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Southside Bancshares, Inc
Southwestern Energy Co
Spectrum Brands Holdings, Inc.
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Standard Bank Group Ltd.
The Star Entertainment Group Limited
Steadfast Group Ltd
Sterling Bancorp
STORE Capital Corp
Stratus Properties Inc
Sumitomo Corp.
Summit Materials, Inc.
SunRun Inc.
Superdry Plc
Superior Industries International, Inc.
Synalloy Corporation

SYNNEX Corporation
Synthomer Plc
Tabcorp Holdings Ltd
TAG Immobilien AG
Taiwan Cement Corp
Taiyo Holdings Co Ltd
Tanger Factory Outlet Centers, Inc.
Targa Resources Corp
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Toll Brothers Inc
Toshiba Corp.
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Toyo Construction Co., Ltd.
TransAct Technologies Incorporated
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Tronox Ltd
TrueCar, Inc.
Tullow Oil Plc
Turquoise Hill Resources Ltd.
Tyson Foods, Inc.
U.S. Silica Holdings, Inc.
UDR Inc
Unibail-Rodamco-Westfield SE
Uniden Holdings Corp.
Unieuro SpA
Unilever Plc
Union Pacific Corporation
Unipol Gruppo SpA
United Airlines Holdings, Inc.
United Natural Foods Inc
United Therapeutics Corp
Universal Insurance Holdings Inc
Upland Software, Inc.
Urban Outfitters, Inc.
Vale SA
Valley National Bancorp
Venator Materials Plc
ViaSat Inc
Vicat SA
Victrex Plc
Virtusa Corp
Visa Inc.
Vornado Realty Trust
Walt Disney Co/The
Waterstone Financial
Wells Fargo & Co
Wendy's
Wesfarmers Ltd
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Western Digital Corp
Westwood Holdings Group, Inc
White Mountains Insurance Group Ltd
Whitehaven Coal Limited
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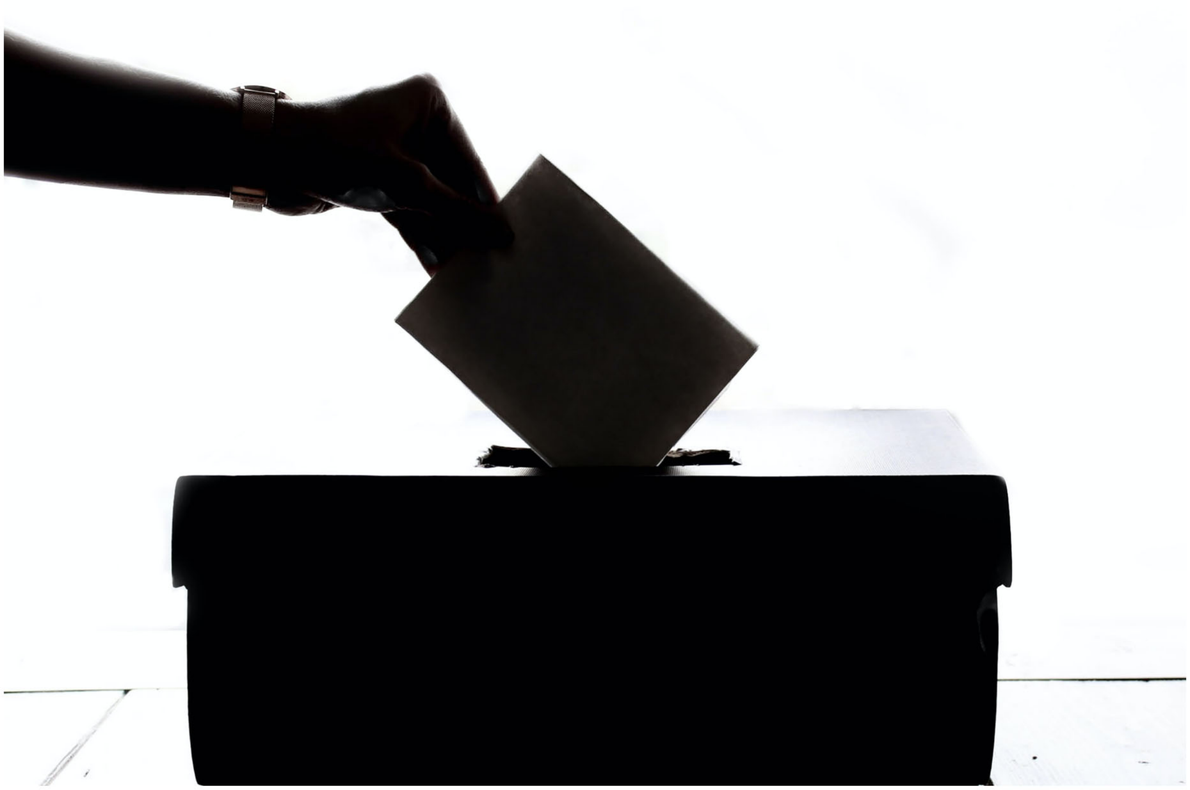
NOVEMBER 15, 2021

2021 Offseason Engagement: What's Changed, and What to Do Next



As the great philosopher Mike Tyson once said, "everyone has a plan until they are punched in the mouth", and the 2021 proxy season was an uppercut that caught many companies by surprise. Not only did companies see a record number of shareholder revolts, but – in many cases –adverse votes came after seemingly positive discussions with those same shareholders. Indeed, companies were confronted with a number of significant – and we think lasting – shifts:

As we described in our Key Themes from 2021 Proxy Season, growing consensus on the value implications of key environmental, social, and governance factors (ESG) – combined with increased pressure on investors themselves to take a more aggressive approach – drove a "sea change" in voting approaches and results.

Shareholders increasingly relied on bright-line voting policies, were less receptive to making exceptions to this one-size-fits-all approach, and were less likely to be swayed by last-second "in-season" engagements

Activist hedge funds began using more E&S critiques as the 'tip of the spear' in their campaigns, which served to bring more shareholders into the tent at contests like ExxonMobil.

Now that the initial shock from these changes has passed, it is crucial that companies activate a strategic plan to address governance vulnerabilities, refine ESG strategy & disclosure, and reimagine how they approach "off-season" shareholder engagement under this new world order. For companies that want to optimize shareholder support and ensure directors aren't targeted at the next annual shareholder meetings, here are several SGP recommendations informed by recent dialogue with our clients, industry leaders, and institutional investors representing over $25 trillion in assets under management:

1) FIRST IMPRESSIONS MATTER

In many shareholder engagements, investment stewardship teams are making decisions in the first few minutes of an engagement. They are instantly evaluating whether a company is prepared, credible, and authentic on the relevant ESG issues in question. In today's Zoom world, time is short and attention spans are shorter. And the members of the stewardship teams are sharing these impressions with each other in real time , which influences the tenor and direction of the conversation. Long-term, this initial impression may linger and ultimately sway an investor on a close voting decision.

Action: Companies need to ensure meetings get off to a good start and that participants strike the right balance of expertise and humility, while authentically soliciting investor feedback on the issues that matter.

2) TAILOR THE CONVERSATION TO THE INVESTORS' PRIORITIES AND POLICIES

The days of thinking of "off-season" engagement as simply an opportunity to check in with investment stewardship teams, read out on the company's accomplishments, and build a long-term relationship, are gone. Today, "off-season" engagements may be the only time that companies can get investors' full attention, which means companies must be prepared to discuss and receive feedback on the ESG issues that are the highest priority for each respective investor. Moreover, with institutional investors increasingly relying on bright-line voting polices, companies must be proactive in identifying – and alleviating – friction areas between investor priorities and company practices. Fortunately, investor transparency has been greatly enhanced in recent years as investors have published perspectives, policies, and voting rationales that highlight their hot-button issues, philosophy, and decision making.

Action: Companies need to ensure they are targeting the right issues in each engagement by leveraging enhanced investor transparency and the guidance of trusted advisors.

3) INVITE THE RIGHT PEOPLE

As investment stewardship teams cover a broader set of ESG topics in greater depth than ever before, it is crucial that companies include the right subject matter experts and potentially independent directors who can discuss the boards' oversight role . Though it is impossible to predict every topic that could come up on a shareholder engagement, by focusing on each investors' priorities, companies should be able to anticipate most of the core topics and include the right company participants. Also, keep in mind that director engagement is a now-established best practice, and that passive as well as active managers might appreciate the opportunity to engage with board members tasked with representing shareholder interests.

Action: Companies must invest in designing the agenda, selecting the right internal participants, and preparing them with points to highlight and questions to expect. Be flexible; it is likely that the list of participants at the board- and management level will change based on the investor.

4) ENGAGE IN A REAL CONVERSATION

Off season engagement is not the time to audition for a TED talk. Most investors will expect a few comments at the beginning of the conversation to set the stage, but increasingly want to engage in dialogue, not receive a lengthy dissertation on the company's priorities. Further, most companies will have no more than 1-2 conversations with the proxy voting teams from some of their largest, passive investors each year, so it is vital that companies ask questions, listen, and engage in an authentic dialogue. Though this may be uncomfortable because the engagement won't be as scripted as in years past, this is the new norm and leading companies will quickly adapt.

Action: Engage in back-and-forth dialogue with investors, solicit feedback, ask questions about ESG priorities, and be responsive as appropriate. If an investor voted against management on a specific issue, be willing to address it directly and gain insights into possible ways to address the investor's concern.

5) ASK FOR SUPPORT

In past years, leaders and directors became adept at "reading the room" to determine if their message was resonating and investor support was secure. Unfortunately, the combination of investor policy & people changes, extensive use of video conferencing, and investors' tendency to avoid adversarial conversations has rendered such "investor radar" less accurate. Further, we have seen the diminishing effectiveness of last-minute shareholder engagement as investors increasingly believe that the time for companies to be responsive to investor feedback is prior to the printing of the proxy, not a few days before the shareholder meeting. In other words, the time for crucial conversations is now, not next April or May.

Action: Close the shareholder engagement by confirming that the investor will be supportive. If there is hesitancy, probe the investor to uncover points of concern. It is better to uncover points of contention now, rather than to be potentially blindsided in the spring.

CLOSING THOUGHTS

The 2021 proxy season should serve as a wake-up call for companies that company-investor interactions have fundamentally changed. Today, under increasing pressure from their own clients, investors look at a broader universe of relevant ESG topics, analyze issues in greater depth, and are more willing to vote against directors who fail to live up to their rising expectations. As investors pivot in their approach, companies must do so as well.

Let's discuss how we can help you build long-term value. **Sustainably.**

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SUSTAINABLE GOVERNANCE PARTNERS

Sustainable Governance Partners LLC (SGP) is an independent, practitioner-driven advisory firm established in 2020 by a group of investor experts on corporate governance and ESG strategy.

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EOS Engagement Plan

2021-2023

Public version

Federated Hermes
EOS

www.hermes-investment.com
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EOS – Our approach to Engagement

EOS at Federated Hermes is a leading stewardship service provider. Our engagement activities enable long-term institutional investors to be more active owners of their 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$1.3tn as of 31 December 2020. The team's skills, experience, languages, connections and cultural understanding equip them with the gravitas and credibility to access and maintain constructive relationships with company boards.
- **Client focus** – EOS pools the priorities of like-minded investors, and through consultation and feedback, determines the priorities of its Engagement Plan.
- **Tailored engagement** – EOS develops engagement strategies specific to each company, informed by its deep understanding across sectors, themes and markets. It seeks to address the most material ESG risks and opportunities, through a long-term, constructive, objectives-driven and continuous dialogue at the board and senior executive level, which has proven to be effective over time.

EOS focuses its stewardship on the issues with greatest potential to deliver long-term sustainable wealth for investors and positive societal outcomes.

Stewardship outcomes

We believe the purpose of investment is to create wealth sustainably over the long term. Effective stewardship is the principal activity for institutional investors to deliver this for investors. Our engagement is therefore focused on ensuring companies are responsibly-governed and well managed to deliver sustainable long-term value as well as improving the lives of employees, promoting diversity and supporting communities. Companies should do this while contributing to wider society by paying taxes and promoting improvements to, and safeguarding the environment and health. When material and relevant, these factors will drive improved financial performance by companies to the benefit of investors[1].

Specific environmental and social outcomes, aligned to the UN's Sustainable Development Goals (SDGs) that we seek include:

- **Climate change:** ensuring company strategies and actions are aligned to the goals of the Paris Agreement to limit climate change to well below 2°C and, ideally to 1.5°C.
- **Natural resources:** building a circular economy to achieve sustainable levels of consumption to ensure affordable access to food, clean water and critical natural resources, while protecting biodiversity.
- **Pollution:** controlling pollution of air, land and water to below harmful levels for humans and other living organisms.
- **Human rights:** respecting all human rights linked to a company's operations, products and supply chains, including through the provision of affordable essential goods and services to help reduce poverty.
- **Human capital and labour rights:** improving human capital and safeguarding labour rights to achieve a healthy, skilled and productive workforce inclusive of the full diversity of wider society, in the context of rapid technological disruption.
- **Conduct, culture and ethics:** developing a corporate culture that puts customers first and treats material stakeholders fairly to help build a stronger, fairer and more equal society.

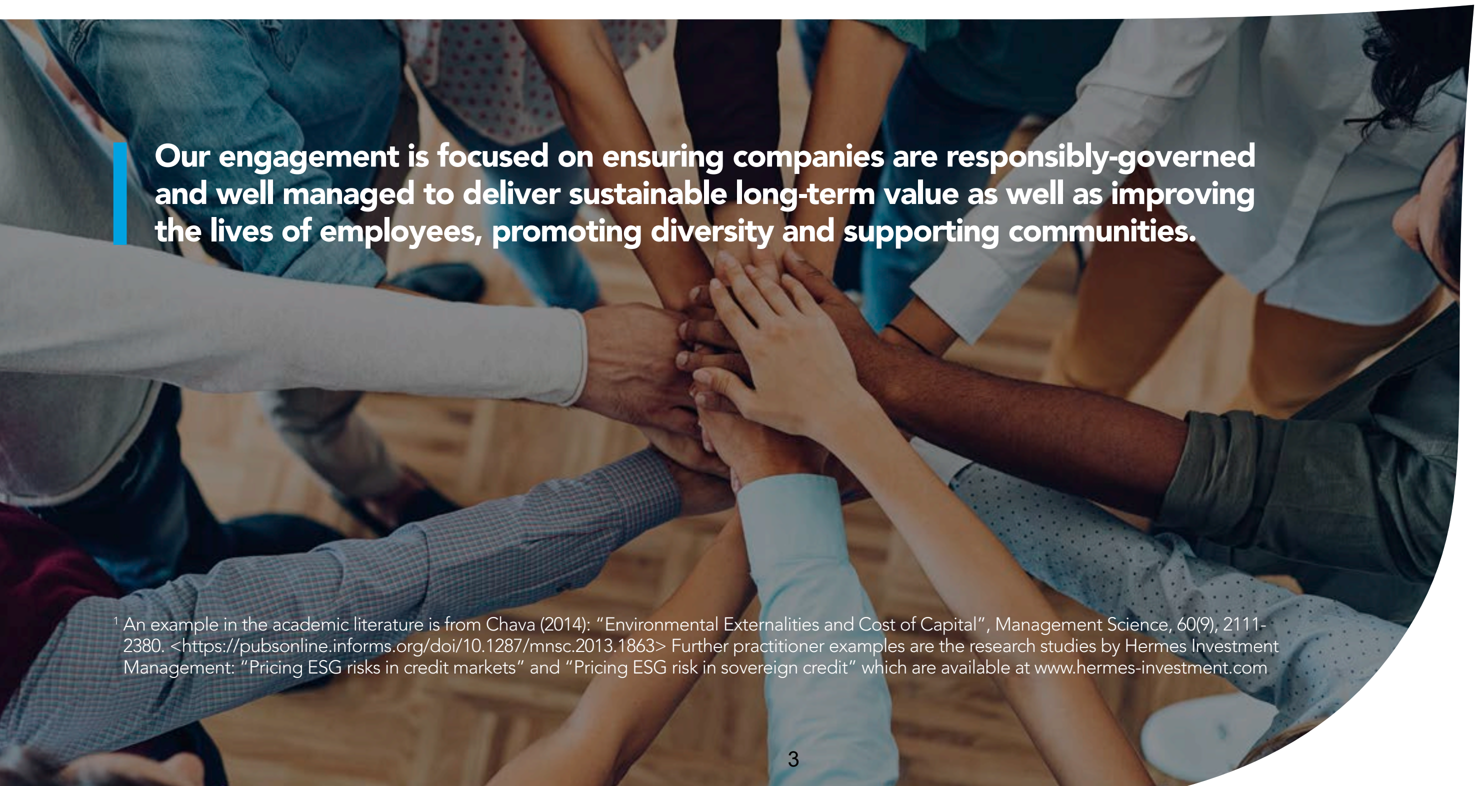
To enable delivery of these outcomes, we seek robust governance and management by companies of the most material long-term drivers of wealth creation, from both a company value and societal outcome perspective, including:

- **Corporate governance** – encompassing effective boards composed of primarily independent individuals representing the diversity of stakeholders the company serves; the alignment of executive remuneration with the creation of long-term value while paying strictly no more than is necessary; and the establishment and protection of all material shareholder rights.
- **Strategy, risk and communications** – the clear articulation of a company's purpose in order to deliver long-term value to all stakeholders, supported by a sustainable business model and strategy that addresses the needs of its different stakeholders; robust risk management practices to protect long-term value; and transparent, timely disclosures of reliable information sufficient for investors and wider stakeholders to make informed decisions on long-term investment.

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

- Monitoring companies' performance and identifying the most material issues to be escalated for action
- Engaging companies in pursuit of meaningful objectives, measuring and reporting on outcomes
- Exercising shareholder rights including voting on all relevant shareholdings
- Integrating stewardship into investment decisions
- Advocating for necessary changes in public policy and market best practice.

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



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

[1] An example in the academic literature is from Chava (2014): "Environmental Externalities and Cost of Capital", Management Science, 60(9), 2111-2380. <https://pubsonline.informs.org/doi/10.1287/mnsc.2013.1863> Further practitioner examples are the research studies by Hermes Investment Management: "Pricing ESG risks in credit markets" and "Pricing ESG risk in sovereign credit" which are available at www.hermes-investment.com

Our focus of engagement for 2021

The global coronavirus pandemic dramatically changed the business landscape, as well as our own approach to engagement. The human and economic cost of the pandemic has been staggering, with nearly 2m deaths by the start of 2021, global GDP forecast to be 4.4% lower, public debt at record levels and rapidly rising unemployment. For most of 2020, we were not able to travel or meet with companies in person. Instead, we rapidly shifted to face-to-face video-calls, which enabled us to achieve our planned level and seniority of engagement. With some exceptions, we have been impressed by the response of most companies to the challenges of the pandemic. In addition, despite the pandemic, many larger companies have also maintained a focus on long-term drivers, with for example over 1,500 companies now reported to have net-zero emissions commitments. Over the next year, we will continue our focus on the most material drivers of long-term value, with a focus on four priority themes:

- **Climate change:** With the UN COP 26 meeting in Glasgow postponed until November 2021, we will continue to focus on climate change as our number one priority, seeking to achieve robust net-zero corporate strategies. We will expand our focus beyond traditional energy intensive sectors such as energy supply and transportation by seeking Paris-aligned net-zero strategies at the providers of capital, focusing on the banks and encouraging the shift to sustainable food systems that avoid deforestation and protect biodiversity, among other factors. We will also seek to ensure sustainable approaches to carbon offsetting via natural carbon sinks and seek to advance shareholder scrutiny of climate transition plans, supported by robust benchmarking of their quality and performance to date and shareholder votes at relevant companies.
- **Human and labour rights:** As we continue to engage on this enduring priority theme, we will seek to ensure increased vigilance in the protection of human and labour rights during and following the coronavirus pandemic, which is exacerbating inequalities, increasing the risks of unacceptable working conditions such as modern slavery and low pay and limiting access to fundamental needs such as food and medicine, including effective coronavirus vaccines. We will further focus on digital rights, such as challenges to the right to data privacy and freedom of expression through the development of artificial intelligence. We will continue to promote corporate application of the "UN Guiding Principles (UNGPs) on Business and Human Rights at 10" – the next decade of implementation of the UNGPs.
- **Human capital management:** The coronavirus pandemic has shone a light on how well employers treat and engage their workforce. In addition, the tragic death of George Floyd has re-energised the anti-racism movement in the US and around the world. In 2021, new areas of focus include asking for a strategy and action plan to close the ethnic pay gap and achieve proportionate ethnic representation at all levels. Advancing gender equality in company leadership, senior management and throughout organisations also remains critically important, with many companies still falling short of equal opportunity. It is also important for companies to establish a culture which promotes inclusion in all forms and ensures that no form of prejudice is allowed. Companies should also develop the desired culture and employee proposition to improve workforce loyalty and wellbeing in the post-pandemic environment.
- **Board effectiveness:** In 2021, 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, with the goal to achieve representation reflective of the diversity of the stakeholders it aspires to serve. We will also ask boards to react to the lessons learned from the coronavirus 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.

In addition, following the pandemic, we will focus on companies putting in place a business purpose and sustainable business model:

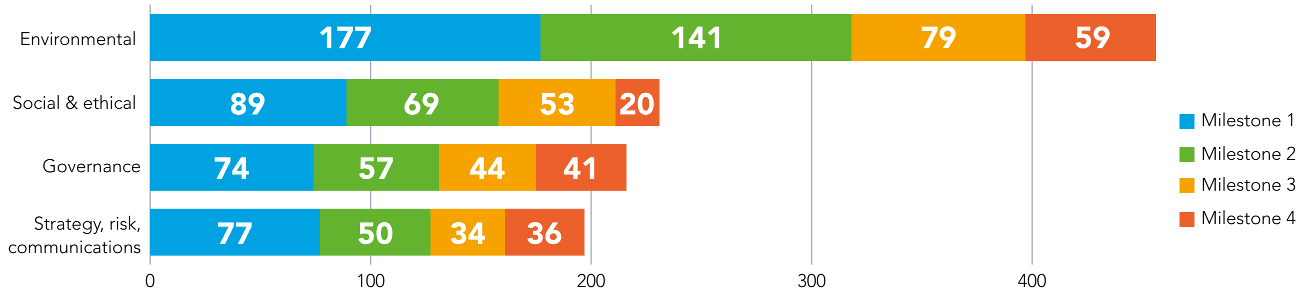
- **In the near term – corporate response to the pandemic:** The pandemic has highlighted the critical interdependence of business with key stakeholders including government and employees, yet these are now at risk from the perceived need to achieve shorter-term financial returns. We will encourage and support companies to set a clear and meaningful business purpose, which helps guide strategy and identify the actions in the short term to deliver value over the long term. Meanwhile, following unprecedented government support for business via schemes such as furlough support and central bank intervention, we will urge companies to act responsibly in critical areas such as good employment practices, the payment of appropriate levels of corporate taxation and justifiable levels of executive remuneration.
- **In the longer term – avoiding the next crisis:** The pandemic has also highlighted the risks to business as human activity pushes towards and even beyond planetary boundaries. Therefore, in addition to tackling the climate crisis, we now expect companies to put in place strategies to achieve a net-positive impact on biodiversity, eliminate deforestation and to avoid contributing to the development of antibiotic-resistant "superbugs". Finally, companies must put in place more comprehensive risk management systems to support long-term resilience to the risks of unforeseeable business impacts.

In addition to the above, we will also continue to build on our work in recent years in fast-growing areas of concern including plastics, the governance and ethics of **data management and artificial intelligence, sustainable land use and biodiversity** and **fast fashion**. These present a full range of engagement priorities which we believe continue to advance our clients and their beneficiaries towards our shared goal of delivering more resilient long-term returns on investment and better, more sustainable outcomes for society.

Engagement progress in 2020

During 2020, we engaged with 1,245 companies (2019: 1,043), covering 3,965 identified objectives or issues (2019: 2,854). In 2020, 738 objectives advanced by at least one milestone (2019: 615).

	# of companies engaged	# of issues and objectives engaged	# of objectives engaged	# of objectives completed
Engagement programme	378	2013	913	139
Other companies	867	1952	339	16
Grand Total	**1245**	**3965**	**1252**	**155**

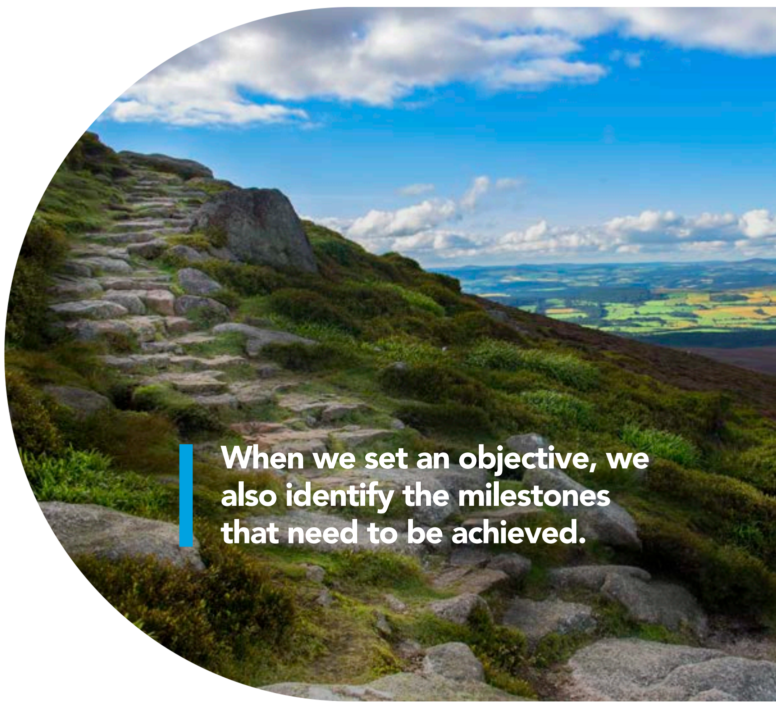


Corporate engagement objectives and progress 2020

In addition, in 2020 we made 52 public policy consultation responses or proactive equivalent such as a letter (2019: 36) and held 173 discussions with relevant regulators and stakeholders (2019: 182).

Measuring progress – Milestones

Our four-stage milestone system allows us to track the progress of our engagement, relative to the objectives set for each company. When we set an objective, we also identify the milestones that need to be achieved. Progress is assessed regularly and evaluated against the original engagement proposal.



The Engagement Plan's support for the UN Sustainable Development Goals

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

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

There is no universally accepted standard or benchmark for reporting on the SDGs, therefore, we have developed our own approach in alignment with our Engagement Plan.

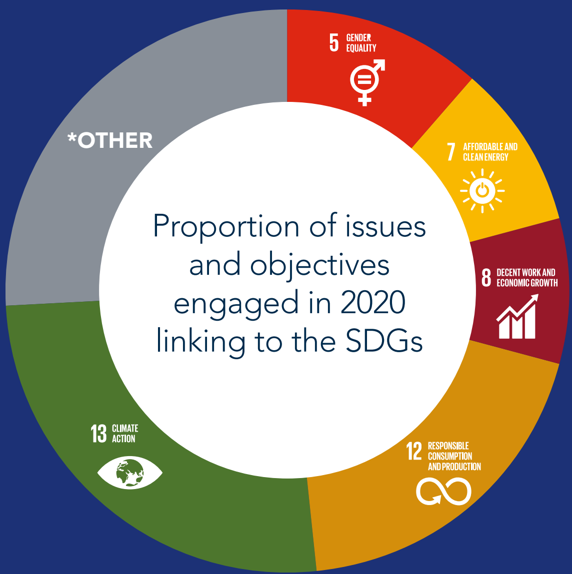
This attributes a direct link between one of our engagement themes and an SDG if we believe our engagement objective at a company directly supports at least one of the UN's targets underpinning the relevant goal or is aligned with the spirit of the goal. It does not include in our reporting the many engagements which would more indirectly support the ambition of other SDGs or corporate governance more broadly.

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

- **SDG 3 Good health and wellbeing:** we engage across the pharmaceutical and healthcare sector on access to medicines and healthcare to support this goal.
- **SDG 5 Gender equality:** we engage to improve gender equality and increase female representation across all levels of organisations, in particular at board and executive leadership levels.
- **SDG 7 Affordable and clean energy:** much of our work under the climate change theme supports this goal, in particular, efforts to increase plans to invest in or purchase renewable energy.
- **SDG 8 Decent work and economic growth:** our engagement on human capital management and human rights in the supply chain supports this goal, particularly by addressing equal pay, labour rights and health and safety concerns.
- **SDG 12 Responsible consumption:** work to improve energy or natural resource efficiency, including efforts to build a circular economy, support this goal.
- **SDG 13 Climate action:** all our engagement under the climate change theme, in support of action aligned to the goals of the Paris Agreement, supports this goal.
- **SDG 16 Peace, justice and strong institutions:** engagements on human rights which aim to protect fundamental freedoms, reduce bribery and corruption and eliminate child and forced labour support this goal.

Engagement themes for 2021-23

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



1,849 of the issues and objectives engaged in 2020 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

Engagement themes for 2021-23

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

Environmental themes

Climate change

Climate change continues to be the biggest single issue of concern for long-term investors. Global emissions must reduce to net-zero by 2050 to limit climate change to well below 2°C above pre-industrial levels, and ideally to 1.5°C. Yet currently the world's economy is on track to deliver over 2.7°C of warming. Society is facing a climate emergency, with only around a decade in which to take the necessary action to avoid the worst of the impacts which threaten societal welfare and stability. The required pace of transition brings many risks, as well as opportunities, to traditional business models through new forms of competition, regulation and physical risks. This is already affecting many sectors including the energy sector, with coal-based utilities being replaced by renewables; the shift from diesel to hybrid and electric vehicles; and the transition to more sustainable sources of food.

Corporate engagement

Long-term outcomes we seek include: all companies to have a business model consistent with net-zero emissions and an effective transition plan to achieve this by 2050.

Near-term corporate objectives include: development of a strategy consistent with the goals of the Paris Agreement, including that each new material capex investment is consistent with the Paris goals; science-based emissions reduction targets for Scope 1 and 2 emissions and Scope 3 emissions (where a methodology exists, or the equivalent ambition); a public policy position supportive of the Paris goals and alignment of both direct and indirect lobbying activity by member industry associations; board oversight and understanding of climate risks and opportunities; and adoption and implementation of the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.

Public policy and best practice

We support the Climate Action 100+ investor collaboration by acting as the engagement lead for a considerable number of the top systemically important emitting companies. We apply escalated engagement techniques, including raising issues at annual shareholder meetings and supporting shareholder resolutions which support positive change. We also support effective policy making aligned to the goals of the Paris Agreement, including support of net-zero greenhouse gas reduction targets by national governments.

Natural resource stewardship

Our societies and economies depend on the availability and continued supply of natural resources and ecosystem services. However, climate change and unsustainable land use, amongst other drivers, are causing the depletion of natural capital – one million species are at risk from extinction, increased incidence of drought and water stress, and significant environmental impacts from the current food system. This theme covers all aspects of the protection, preservation and restoration of natural resources, including water, healthy soils, biodiversity, tropical rainforests and other ecosystems. It also highlights the importance of transitioning to sustainable food systems and taking measures against antimicrobial resistance (AMR), including through diversification from animal to plant-based and sustainable protein.

Corporate engagement

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

Near-term corporate objectives include: assessment of impacts and dependencies on biodiversity and ecosystem services; the ambition to have a net-positive impact on biodiversity, including throughout the supply chain; strategies to eliminate contributions to deforestation and source high impact feedstocks (eg palm oil, soy, beef) sustainably; a long-term sustainable food strategy and supporting targets, including diversification from animal to plant-based protein and a plan to address AMR; and ambitious strategies to manage water use, especially in water-stressed areas, to maintain operational resilience and a social licence to operate.

Public policy and best practice

We have signed up to the Finance for Biodiversity Pledge, through which we will collaborate and share knowledge with financial sector peers on halting and reversing biodiversity loss. We will continue engagement and collaboration with the FAIRR network on sustainable use of antibiotics within animal farming and protein diversification. We have also signed up to the Investor Action on AMR initiative. We will continue to participate in a range of collaborative investor initiatives that are focused on tackling deforestation.

Pollution, waste and circular economy

There is increasing need and opportunity for a shift from linear to circular business models, which is central to future-proofing businesses and reducing negative impacts on the environment. Key areas of concern are plastics pollution, fast fashion and electronic waste. Environmentally harmful pollution and waste, whether from operations, supply chains or products is inconsistent with a long-term sustainable business model. Investor concerns, reflecting the threat of fines and loss of social licence to operate, as well as the harm done to wider society and investments including air pollution, the leakage of single-use plastics into the ocean and catastrophic oil spills or tailings dam leaks is rising.

Corporate engagement

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

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

Public policy and best practice

We will seek to improve investor engagement on this theme by: promoting investor expectations for plastics and packaging in the chemicals, consumer goods and retail sectors and fast fashion in the apparel sector; encouraging sign up to the Ellen MacArthur Foundation New Plastics Economy Global Commitment; continuing to be an active member of the PRI plastics working group; and encouraging mining companies to follow best practice tailings management and other pollution controls of the International Council on Mining and Metals.

Social themes

Conduct, culture and ethics

We expect every company to aspire to the highest ethical standards and to go beyond legal compliance. Conduct, culture and ethics underpin how companies conduct business and interrelate with their stakeholders. This has a profound effect on vital aspects of corporate life including: corporate purpose, board and management performance, health and safety, human capital, diversity and inclusion, corporate advocacy and lobbying for good public policies and governmental action to support more sustainable business practices, and the approach to taxation policy and practice. The trend of digitalisation has created big data which is now combined with powerful computing capacity and machine learning techniques, commonly referred to as artificial intelligence (AI), now requires oversight to ensure ethical outcomes. In addition, companies should adopt responsible tax practices to preserve their reputation and social licence to operate.

Corporate engagement

Long-term outcomes we seek include: corporate decision making taken through an ethical lens, with development and maintenance of the highest ethical standards and an end to corporate bribery and corruption and other non-compliance; the ethical use of data; and fair tax paid, putting an end to tax arbitrage and aggressive tax avoidance.

Near-term corporate objectives include: a public statement and board responsibility to aspire to the highest ethical standards; disclosure of principles for the effective management of AI, together with a clear action plan to implement policies on data ethics, security and privacy issues; and a policy commitment to pay tax in each country in line with the spirit and intention of the law.

Public policy and best practice

We support the development of market best practices recommended by reputable corporate ethics organisations such as the Institute of Business Ethics and anti-bribery and corruption organisations such as Transparency International. We will continue to advocate public policy efforts at an international level and individual country levels to achieve greater tax transparency.

Human capital management

In a knowledge economy where intangible assets such as human capital are estimated to comprise on average more than 52% of a company's market value (according to EY's Embankment Project for Inclusive Capitalism), it is vital that companies look beyond physical assets to understand the sources of long-term value. The coronavirus pandemic and social movements such as Black Lives Matter have magnified the focus on how employers treat and engage their workforce. Our engagement focuses on all aspects of employment and the future of work. The UN SDGs bring additional leverage through three goals focused on the pursuit of gender equality, reduced inequalities and decent work and economic growth. Important aspects of successful human capital management include: diversity, inclusion and full representation of workers; fair wages, incentives and benefits; and health, safety and wellbeing.

Corporate engagement

The long-term outcomes we seek are: equal representation and inclusion throughout the organisation across all dimensions of diversity; fair wages and benefits paid so all employees can afford a decent standard of living; and zero serious work injuries.

Near-term corporate objectives include: a strategy and action plan to close the gender and ethnicity pay gap and achieve appropriate representation at all levels of an organisation; implementation of a minimum real living wage across operations and the supply chain or evidence of an equivalent total reward package similarly valued by employees; a policy that permits freedom of association of workers in trade unions and protects labour rights recognised by the International Labour Organization; commitment to provide sufficient paid sick leave; and development and implementation of a human capital management strategy for the promotion of best practice physical and mental wellbeing in the workplace.

Public policy and best practice

We support government backed initiatives to increase the diversity of executive management, such as via the local chapter of the 30% Club, with a focus on developing markets. We will also support stakeholder collaboration to define useful standards, through active contribution to initiatives such as the Workforce Disclosure Initiative (WDI) and the US Human Capital Management Coalition.

Human and labour rights

Respect for human and labour rights is a priority on the investor agenda as it underpins a company's wider corporate culture, business ethics and enterprise risk management, all of which affect the creation and preservation of long-term value. All companies have a responsibility to respect human rights which can include decent work such as no forced labour, no child labour and payment of living wage; the safeguarding of indigenous communities and those living in high-risk environments (such as conflict zones); and the protection of basic human rights.

Corporate engagement

The long-term outcomes we seek include: no company causing or contributing to human or labour rights abuses whether in their own operations or supply chain and effective remedy is provided in case of any harm; access for all people to basic human needs such as affordable nutritious food, healthcare and the internet; and full respect for the human rights of all indigenous people including those living in high risk zones such as occupied territories.

Near-term corporate objectives include: the development of a business model aligned to the elimination of human and labour rights abuses including modern slavery and fair pay; development of food product formulations that can support a balanced diet; and the adoption of human rights policies and procedures in line with UN Guiding Principles on Business and Human Rights.

Public policy and best practice

We will continue to work with key stakeholders such as the Organisation for Economic Co-operation and Development Responsible Minerals Initiative and Better Cobalt on the responsible sourcing of cobalt. We will work with the Find It, Fix It, Prevent It investor collaboration to tackle modern slavery. We will support the adoption of guidance on how companies can implement higher wages aligned to their commitments to pay a living wage to supply chain workers and promote best practices in the use of technology to improve supply chain transparency and to provide data on working conditions. We will liaise with the Global Network Initiative on how we can integrate the Principles on Freedom of Expression and Privacy into our engagements with ICT companies.

Corporate governance themes

Board effectiveness

There is considerable evidence that the performance of the board is vital to the long-term success of a company, with a range of factors contributing to this. Boards should be composed of directors with technical skills aligned with the strategic needs and direction of the company and a diversity of perspectives (including across gender, age, ethnicity, nationality, background, skills and experience) to improve decision making. Equally important is that boards contain enough independent directors to challenge management and that directors are able to dedicate sufficient time to fulfil their duties. Board effectiveness also requires robust supporting structures and processes, such as a proper induction upon appointment and ongoing training, a separate chair and CEO with clearly defined responsibilities, and effective committees with accurate, timely and clear information. An effective board should be involved in constructive dialogue with investors, the workforce and other key stakeholders. It should also be subject to regular independent evaluation.

Corporate engagement

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

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

Public policy and best practice

We will continue to promote our *Guiding Principles for an Effective Board* paper in different markets via conferences and local market best practice engagement. We support initiatives to promote board gender diversity, including initiation of local chapters of the 30% club. We will advocate for minimum levels of racial and ethnic diversity, as well as encouraging improved disclosure and ethnicity pay gap reporting, in local corporate governance codes and authoritative guidelines.

Executive remuneration

Pay structures are a critical tool for aligning the activities of management with a company's purpose, strategy and performance. In some markets we believe that compensation

structures and practices are generally not fit for purpose, with some recent practices, such as introducing structures to gear the majority of pay towards performance-based pay, may have been well-intentioned but have proved ineffective with unintended consequences such as escalating quantum and encouraging short-termism or financial engineering. The pandemic in 2020 served as a reminder of the limitations of pay schemes reliant on stock options or performance-based incentives schemes. We therefore wish to see simpler, more transparent pay schemes with the reduction of variable, performance-based elements in pay, replacing these with higher fixed pay, paid primarily in shares held for the long term.

Corporate engagement

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

Near-term corporate objectives include: pay schemes designed to support the desired culture of the organisation, including consideration of whether behaviours and decisions incentivised are sufficiently long-term and aligned to fulfilling the organisation's purpose; alignment of incentive plans to the strategic drivers of long-term value, rather than over-reliance on relatively short-term measures such as total shareholder returns or earnings; simple pay structures, seeking at most two forms of concurrent variable pay schemes; full disclosure of pay structures, including metrics and potential award size; and clear and timely reporting of targets, performance and pay outcomes, enabling investors to judge the appropriateness of awards.

Public policy and best practice

In the US and UK, we will work with groups such as the US Council for Institutional Investors and the UK Corporate Governance Forum to set best practice guidelines for higher shareholdings, reduced variable pay and the adoption of restricted stock models. In Europe, we will encourage further alignment on higher shareholdings and greater disclosure of pay structures and outcomes, particularly in France, Sweden

and Denmark. In Asia and emerging markets, our focus is on improving disclosure, demonstrating a clear link between pay and performance and discouraging use of share options, particularly in China and Hong Kong.

Shareholder protection and rights

Protecting and enhancing shareholder rights is critical to the long-term success of companies, as it ensures that companies remain accountable to long-term investors, rather than becoming ownerless. Shareholders exercise control over the future direction of a company through rights such as the ability to propose candidates for election to the board, sometimes referred to as proxy access; or proposing shareholder resolutions (whether advisory or legally binding). It is also important to protect minority rights of investors, through measures such as: the avoidance of poison pill arrangements that limit potential changes of control; the elimination of strategic cross-shareholdings between companies (common in Japan); and avoiding dual or multi-class share structures with unequal voting rights.

Corporate engagement

The long-term outcomes we seek include: the protection of basic shareholder rights to ensure confidence to invest capital over the long term with favourable returns; the protection of minority shareholder rights to ensure confidence to invest in companies controlled by larger shareholders; and good access for investors to boards and management, so as to influence companies to act in their long-term interests.

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

Public policy and best practice

We will continue to: resist proposals to allow premium listings of multiple class shares at various stock exchanges around the world; push Japanese regulators for tighter disclosure requirements on cross-shareholdings; advocate for the US Securities and Exchange Commission to regulate proxy advice in a way that could increase the independence of such research; and encourage and support implementation of ambitious stewardship codes and effective EU member state transposition of the amended Shareholder Rights Directive.

Strategy, risk and communication themes

Business purpose and strategy

This theme covers all aspects of how a company creates and preserves value over the long term. It includes business purpose, long-term strategy and sustainable business model, and capital allocation policy. These then guide a company's key choices around how to deploy limited resources, including financial and human capital, and its chosen operating behaviours and underlying culture. Recent events, such as the pandemic and the 2019 Business Roundtable Statement of Purpose, have intensified the focus on business purpose and the role of corporations in society.

Corporate engagement

The long-term outcomes we seek include: an enduring business purpose that explains why the company exists and which meets the needs of society profitably; a long-term strategy and sustainable business model that creates and preserves value for shareholders and wider stakeholders by delivering positive societal outcomes; and a capital allocation policy that delivers optimal returns over the long term for investors and wider stakeholders.

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

Public policy and best practice

We identified over 60 potential corporate leaders in business purpose, and invited their board directors to join the steering groups of the Enacting Purpose Initiative, which will produce guidance on how business purpose should be formed and used to guide long-term strategy and capital allocation. We continue to support the Chief Executives for Corporate Purpose (CECP) and Focusing Capital on the Long Term Global (FCLT Global). In the US, we are asking companies how they plan to comply with the Securities and Exchange Commission's 8 April 2020 guidance on the need for disclosure of forward-looking health and welfare strategies.

Corporate reporting

Corporate reporting covers all aspects of reporting by companies to their stakeholders, whether financial or non-financial information, statutory or voluntary. Transparent reporting is essential to enable shareholders and wider stakeholders to understand and assess the companies in which they have an interest and to measure performance over time. Over the last decade, we have seen an increase in voluntary and mandatory reporting frameworks such as the guidelines of the TCFD and the Sustainability Accounting Standards Board (SASB) standards. Further regulatory requirements for enhanced non-financial reporting are expected.

Corporate engagement

The long-term outcomes we seek include: timely, reliable and comprehensive reporting which enables investors and other stakeholders to accurately appraise past performance and future prospects of a company; comprehensive reporting of all material elements of a company's impact on wider society; company explanations through integrated reporting on how value is created over time.

Near-term corporate objectives include: the adoption of prudent accounting standards; ensuring best practices in audit tendering and rotation; sustainability reporting aligned to best practice frameworks such as the Global Reporting Initiative, SASB and the TCFD; and analysis of how corporate activity is aligned to delivery of the SDGs.

Public policy and best practice

We will support the development and adoption of standardised reporting frameworks applicable to the most material long-term value areas, with particular emphasis on human capital, such as through the WDI.

Risk management

The management of risk is essential to creating and preserving sustainable long-term value. High-profile business failures (such as a harmful faulty product, an oil spill, a dam collapse and poor lending practices leading to major financial losses) and more recently the coronavirus pandemic have increased the attention to risk management by companies and their shareholders. Although pandemic risk was on the risk registers of many companies as a low-likelihood, high-impact event, the pandemic has shown that companies were not prepared for the full magnitude of government interventions in response to this type of public health risk, including the full lockdown of economies.

A board and management team must first articulate to investors the level of risk appetite, and then monitor and manage risks within this boundary. Management has the responsibility to implement an effective risk management framework, designed to identify, assess and manage the company's strategic, operational, compliance (including legal and regulatory risks) and financial risks. We focus on management frameworks to avoid and, if necessary, remediate operational risks which include: serious operational risks (including catastrophic risks); product risks; and as digital technology is increasingly critical to a company's operations – cyber security risks in various forms.

Corporate engagement

The long-term outcomes we seek include: risks assessed from the perspective not only of financial impact, but also maintenance of a social licence to operate, which is underpinned by a corporate purpose centered on being sustainable and creating long-term stakeholder value; an effective risk management framework, designed to identify, assess and manage the company's strategic, operational, compliance and financial risks; and a culture that seeks to apply the board's chosen risk appetite and which is established across all parts of the organisation.

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

Public policy and best practice

We will continue to support the PRI's collaborative initiative on cyber security.

Federated Hermes
EOS

Federated Hermes

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

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

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

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

Our investment and stewardship capabilities:

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

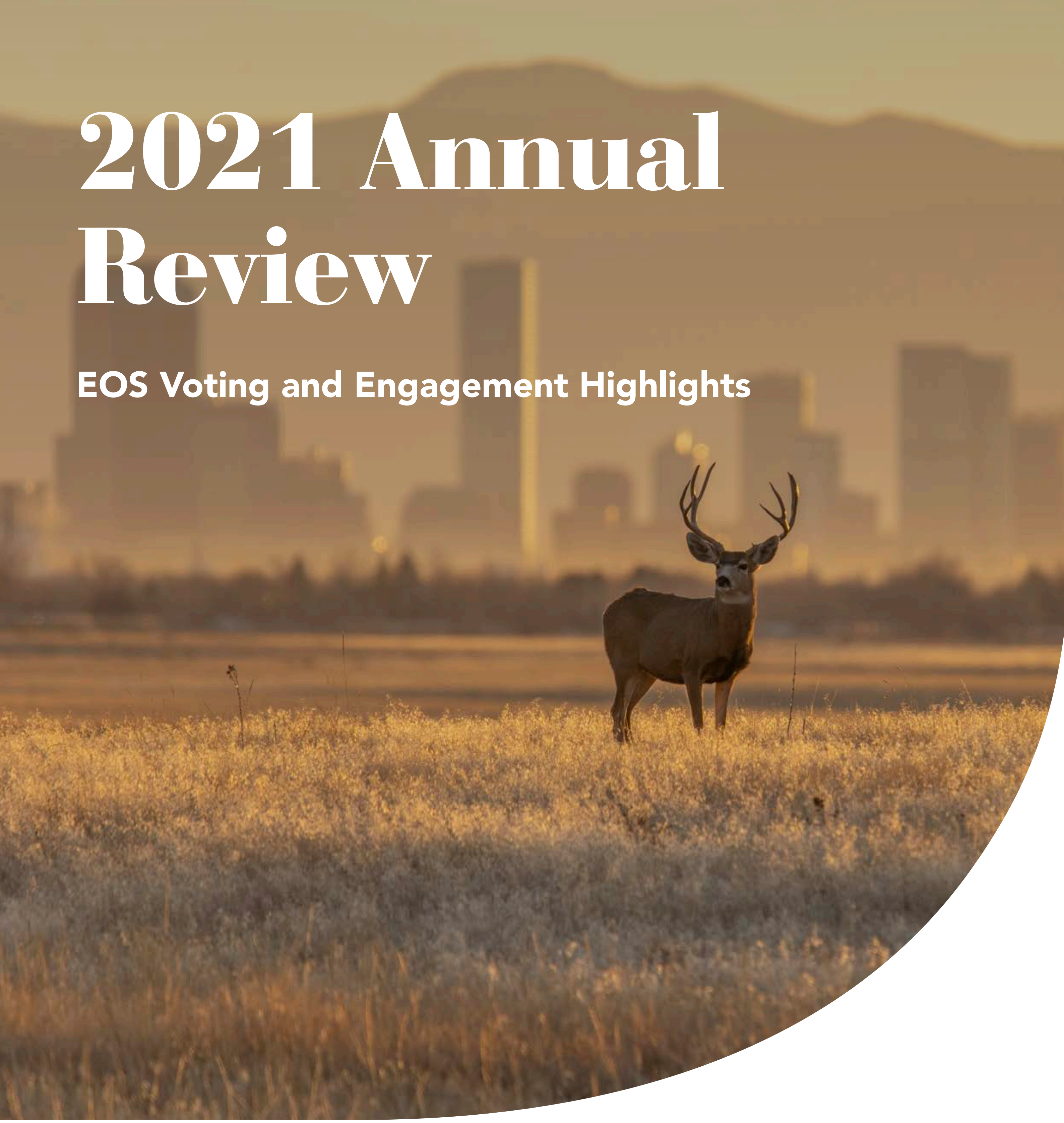
Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of their assets. EOS is based on the premise that companies with informed and involved investors are more likely to achieve superior long-term performance than those without.

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

2021 Annual Review

EOS Voting and Engagement Highlights



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www.hermes-investment.com
For professional investors only

Welcome to our 2021 Annual Review, which outlines the engagement, voting and public policy work carried out by EOS on behalf of our clients.

Although the Covid-19 pandemic continued to exact a heavy toll in 2021, the climate crisis returned to the fore with the IPCC issuing its starkest warning yet. In the run up to COP26, we set out our expectations of policymakers and then hosted our Further, Faster fringe event in Glasgow to complement our advocacy. In two in-depth articles, Bruce Duguid, our head of stewardship, reflects on the outcomes from COP26, while Owen Tutt assesses the progress made through our work with Climate Action 100+. We also hear from Sonya Likhtman and Lisa Lange on two other key environmental topics – biodiversity and fast fashion.

Throughout the year we continued to engage with companies on their response to the pandemic, which has exacerbated existing social inequalities. Emily DeMasi sets out our engagement expectations in areas such as paid sick leave, and explores the links to some of our other engagement themes, including diversity and inclusion. Meanwhile Hannah Shoesmith explains our engagement on human rights risks.

There's a full round-up of the 2021 voting season, and Laura Jernegan highlights the key changes we are making to our voting policy guidelines for 2022. We also explore the specific challenges of engaging in emerging markets and how these can be overcome. Alongside all this, we have continued to engage with policymakers, regulators and standard-setters to help improve market best practice.

We hope you find this review of our year useful and informative.

Claire Milhench
Communications & Content Manager, EOS

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.

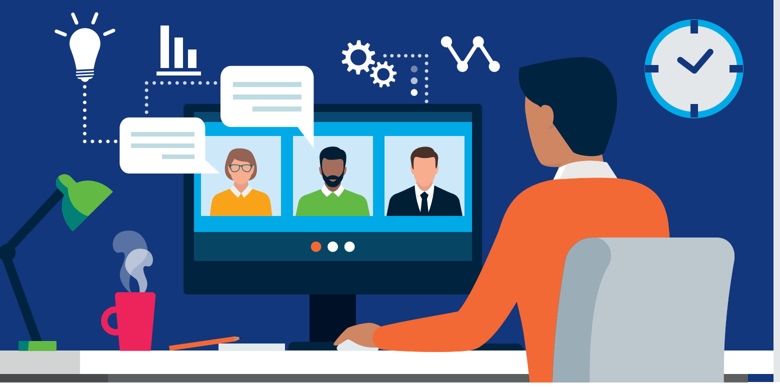
In 2022, companies' climate transition votes, which are becoming more common in certain markets, must be made to count. We will scrutinise companies' strategies closely and recommend votes against plans that fail to come up to scratch. Where necessary, we will recommend voting against the chair and other 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.

Engagement Activity



- Environmental **28.9%**
- Social and Ethical **19.4%**
- Governance **37.4%**
- Strategy, Risk and Communication **14.4%**

- Australia and New Zealand **55**
- Developed Asia **149**
- Emerging Markets **247**
- Europe **252**
- North America **406**
- United Kingdom **99**

Source: EOS data

Number of engagements:

2021 ■ **2020** ■

	2021	2020
Companies	1,208	1,245
Issues and objectives	4,154	3,965
Objectives engaged	1,373	1,252

69% year-on-year increase in assets under advice engaged

We engaged with companies that together account for **63%** of the value of the MSCI ACWI All Cap

$1.64tn assets under advice as of 31 December 2021

Ratings

For the international business of Federated Hermes:

PRI Rating: **A+** for stewardship, equity and private markets operations

Hirschel & Kramer's Responsible Investment Brand Index: **1st**

InfluenceMap Climate Engagement Score: **A+**

Public policy

Number of consultation responses or proactive equivalent made in 2021: **64**

Number of discussions held with relevant regulators and stakeholders: **71**

Source: EOS data

- Total meetings voted in favour **37.1%**
- Meetings where voted against (or voted against AND abstained) **61.2%**
- Meetings where abstained **0.5%**
- Meetings where voted with management by exception **1.2%**

- Board structure **48.4%**
- Remuneration **26.1%**
- Shareholder resolution **4.3%**
- Capital structure and dividends **8.4%**
- Amend articles **6.0%**
- Audit and accounts **3.5%**
- Investment/M&A **0.5%**
- Poison pill/Anti-takeover device **0.2%**
- Other **2.5%**

Source: EOS data

Voting Overview

84 companies in our core programme featured engagements with the CEO

67 companies in our core programme featured engagements with the chair

280 companies in our core programme featured engagements with senior management

We engaged with companies in our core programme in 2021 on average more than **4** times

Regional corporate governance principles **22**

92% of our relationships with companies in our core engagement programme have lasted 5 years or more

75% of our relationships with companies in our core engagement programme have lasted 8 years or more

Number of voting recommendations made in 2021: **128,858** resolutions

at **13,412** meetings

Number of recommended votes against: **20,665** resolutions

Key stewardship initiatives

We are an active participant in the following:

- Climate Action 100+
- Principles for Responsible Investment: founding member and chair of the drafting committee that created the PRI in 2006.
- Asian Corporate Governance Association
- Canadian Coalition for Good Governance
- CDP
- Investors for Opioid & Pharmaceutical Accountability
- Investor Alliance for Human Rights
- Investor Initiative on Mining & Tailings Safety
- International Corporate Governance Network
- The Institutional Investors Group on Climate Change
- UN Guiding Principles Reporting Framework
- US Council of Institutional Investors (CII)
- 30% Club

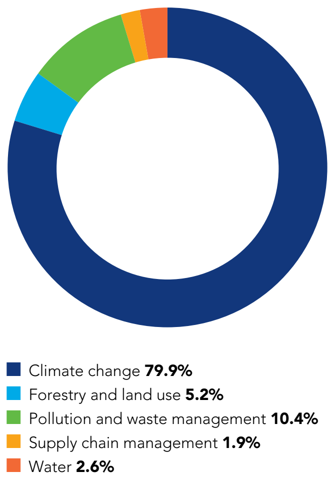
Source: EOS data

Engagement by theme

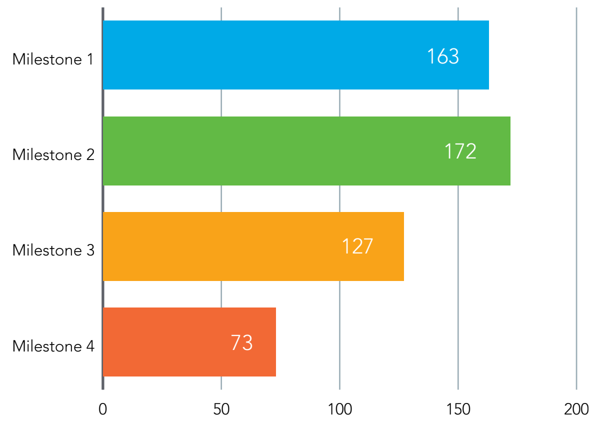
A summary of some of the key issues on which we engaged in 2021 is shown below. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

Environmental

Environmental topics comprised 29% of our engagements in 2021.



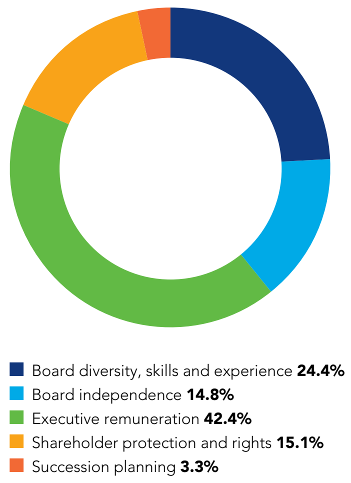
Progress against environmental objectives



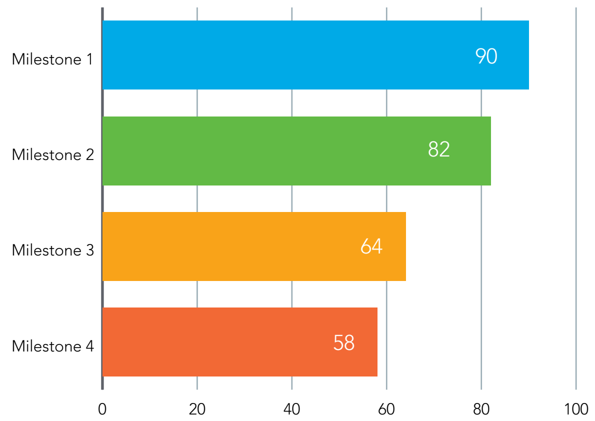
Source: EOS data

Governance

Governance topics comprised 37% of our engagements in 2021.



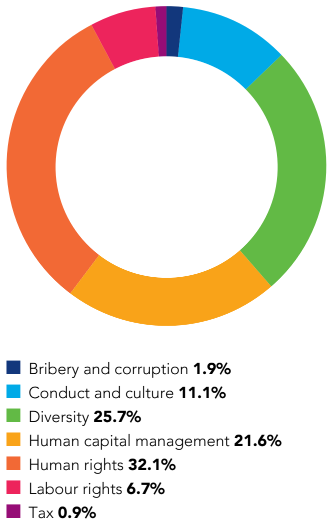
Progress against governance objectives



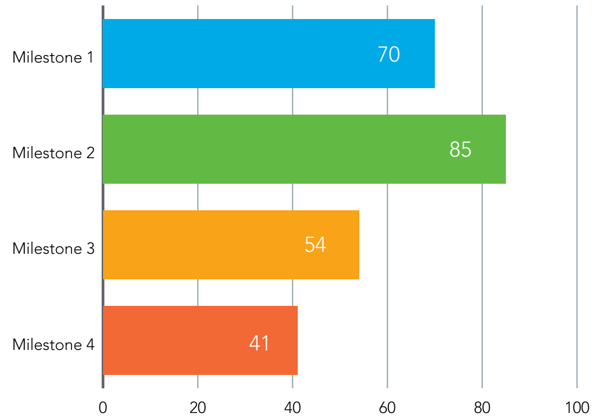
Source: EOS data

Social and ethical

Social and ethical topics comprised 19% of our engagements in 2021.



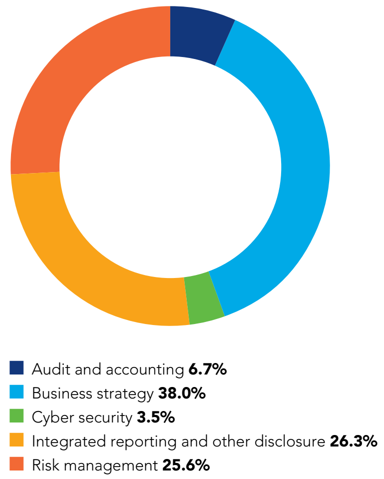
Progress against social and ethical objectives



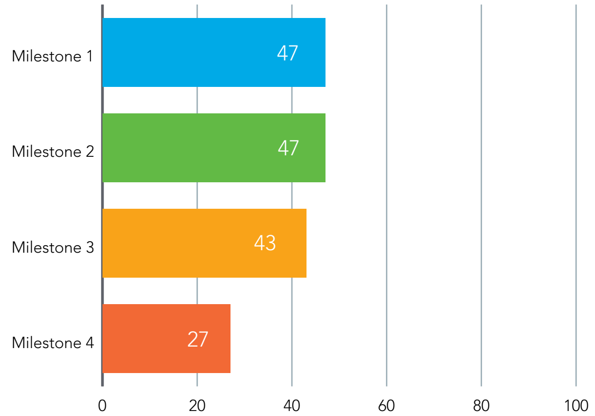
Source: EOS data

Strategy, risk and communication

Strategy, risk and communication topics comprised 14% of our engagements in 2021.



Progress against strategy, risk and communication objectives



Source: EOS data

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

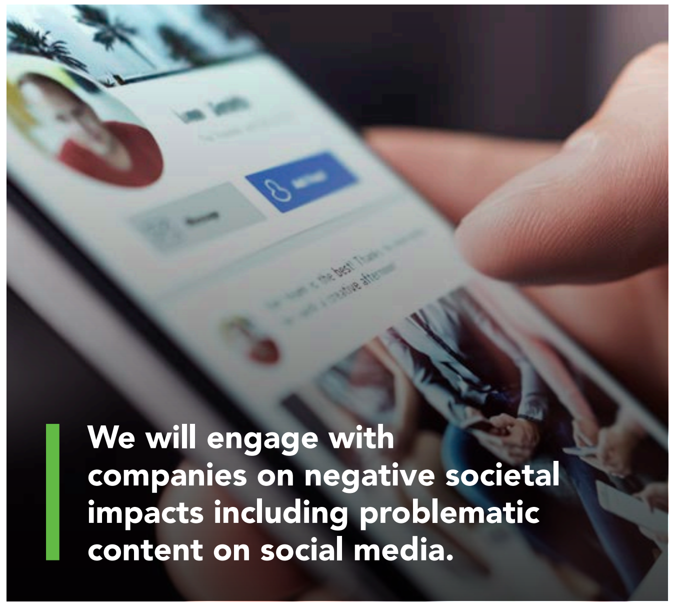
In addition to the priority themes, we will pursue further engagement in these fast-growing areas:

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.



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.

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.

Linking engagement and the SDGs

The UN Sustainable Development Goals encompass 17 goals, underpinned by 169 targets and 230 individual indicators of progress. How well did we engage on the SDGs in 2021?

The UN Sustainable Development Goals (SDGs) were developed and adopted in 2015 as a global call to end poverty, protect the planet and ensure that everyone enjoys peace and prosperity by 2030.

The goals are highly interconnected, so action and progress in one area will affect the outcomes in others. Whilst the goals were initially developed for governments and civil society, the private sector has an important role to play in helping to achieve the ambitious targets. Although progress has been made in some areas, this has been offset by growing food insecurity, deterioration of the natural environment, and persistent and pervasive inequalities.

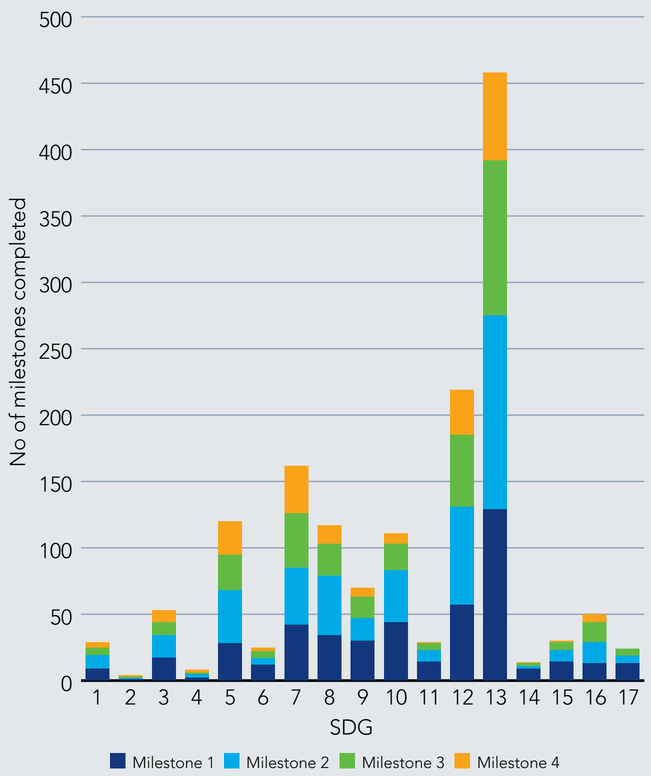
> **Investors and their representatives play a key role in supporting the delivery of the UN SDGs.**

Investors and their representatives play a key role in supporting the delivery of the UN SDGs. Our engagement with companies encourages them to act responsibly and reduce their negative impacts on society, across their value chains. We also suggest changes that could make a positive impact.

In 2021, SDG 13 – climate action, and SDG 12 – responsible consumption and production, remained the most linked SDGs across our engagements. As well as our direct engagements with companies, we participated in collaborative engagements on alignment with the Paris Agreement goals, governance of climate risks and opportunities, and disclosure.

Widening income inequalities due to the Covid-19 pandemic, and the advocacy of social movements such as Black Lives Matter, have emphasised the importance of our engagement on SDG 5 – gender equality, and SDG 10 – reduced inequalities. Many companies received racial equity shareholder proposals in the 2021 voting season and EOS recommended support to further companies' own commitments, increase the effectiveness of their programmes, and signal wider market support for meaningful action. You can read more about this in our voting season article later in this report.

Milestone progress of SDG-linked engagement objectives

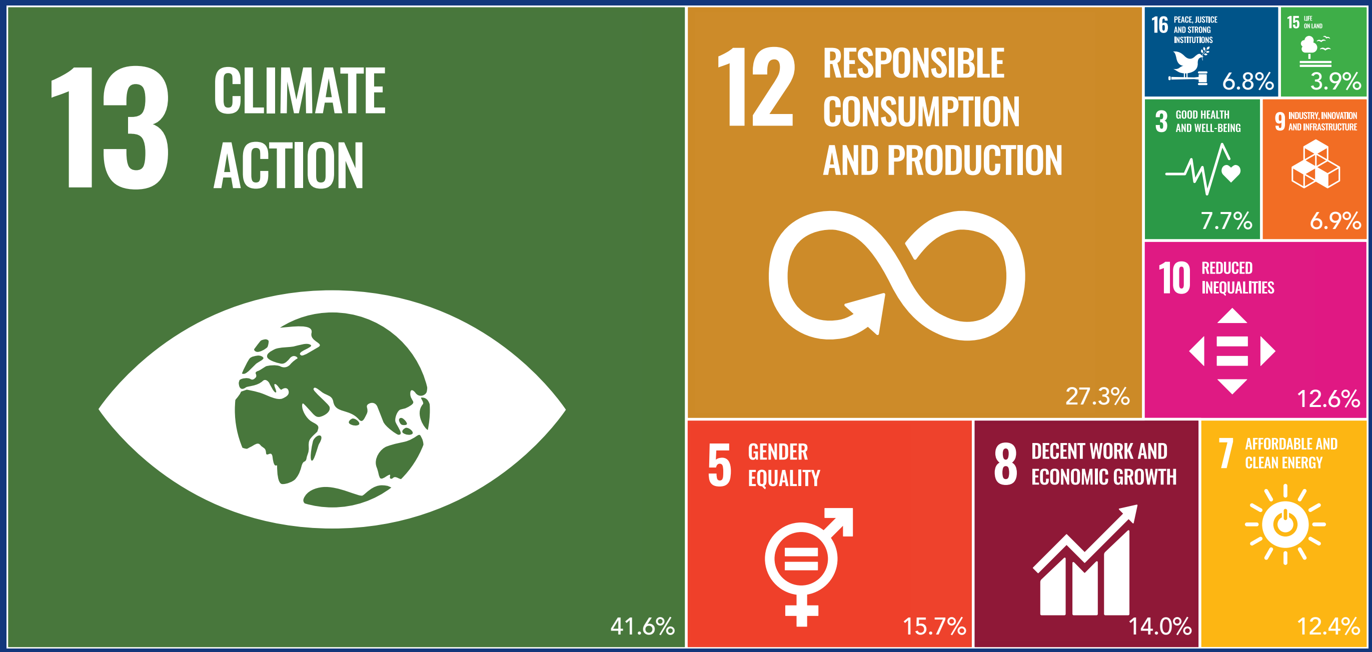


Source: EOS data for 2021

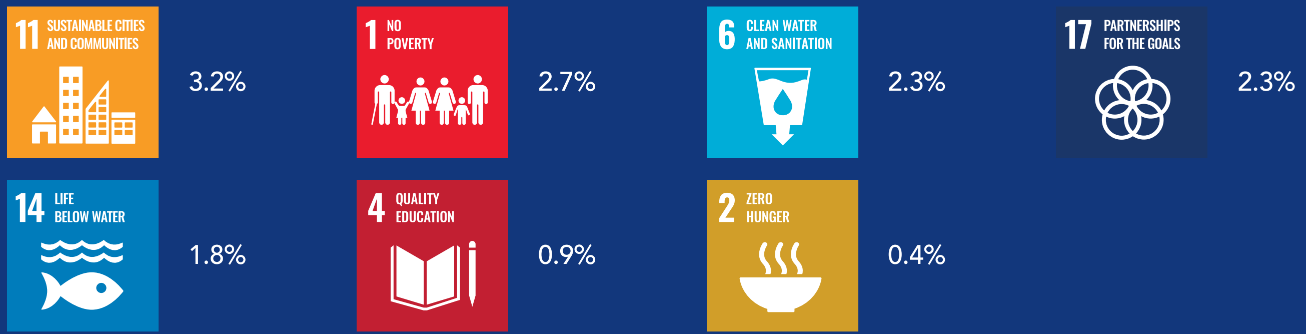
The Engagement Plan's support of the UN SDGs

The infographic 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).

Proportion of issues and objectives engaged in 2021 linking to the SDGs



Breakdown of other SDGs linked



2,457 of the issues and objectives engaged in 2021 were linked to one or more of the SDGs

Source: EOS data

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.

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.

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.

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.

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.

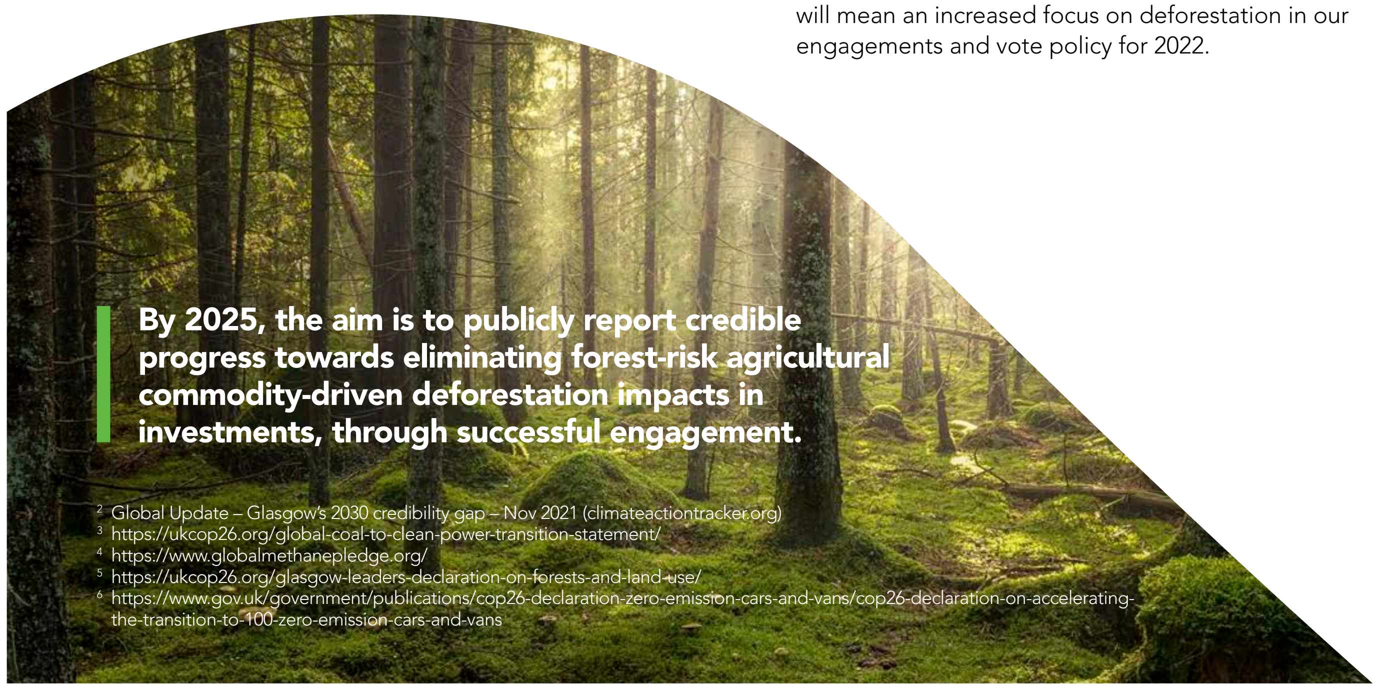
Stepping up

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]

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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.

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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.

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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+

1.5°C

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.

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.

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.

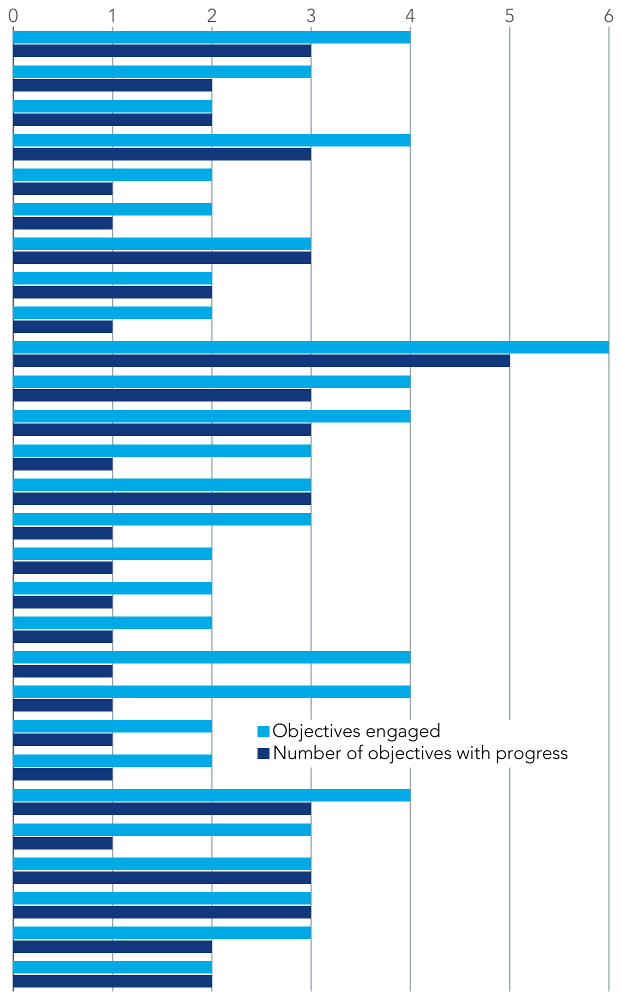
EOS has engaged on climate change with POSCO – one of the world's largest steel producers – directly since 2016, and as a co-lead for the company under CA100+. We had asked the company to set science-based, short-, medium-, and long-term emissions reduction targets. These requests were met in late 2020 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

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

governance, effective measurement, an impactful strategy, and regular disclosure. The framework and white paper have been well received by peers, companies and others.

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.

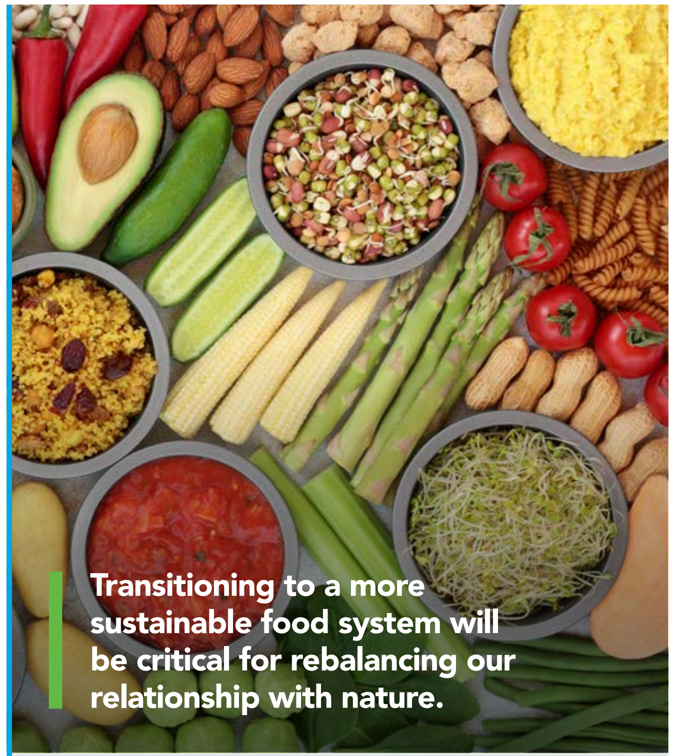
Q. How have we engaged with companies on these issues and what outcomes have we seen?

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.

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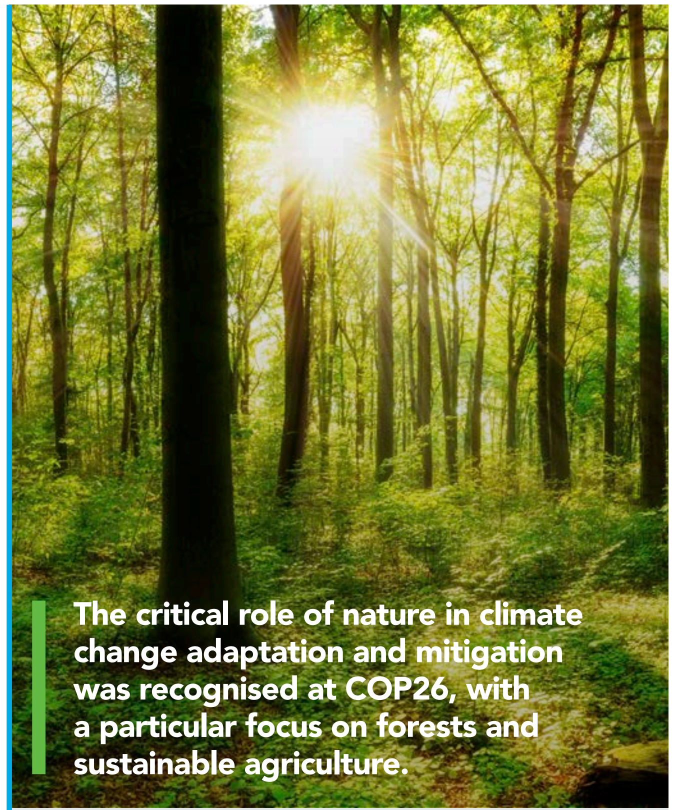


The critical role of nature in climate change adaptation and mitigation was recognised at COP26, with a particular focus on forests and sustainable agriculture.

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 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.

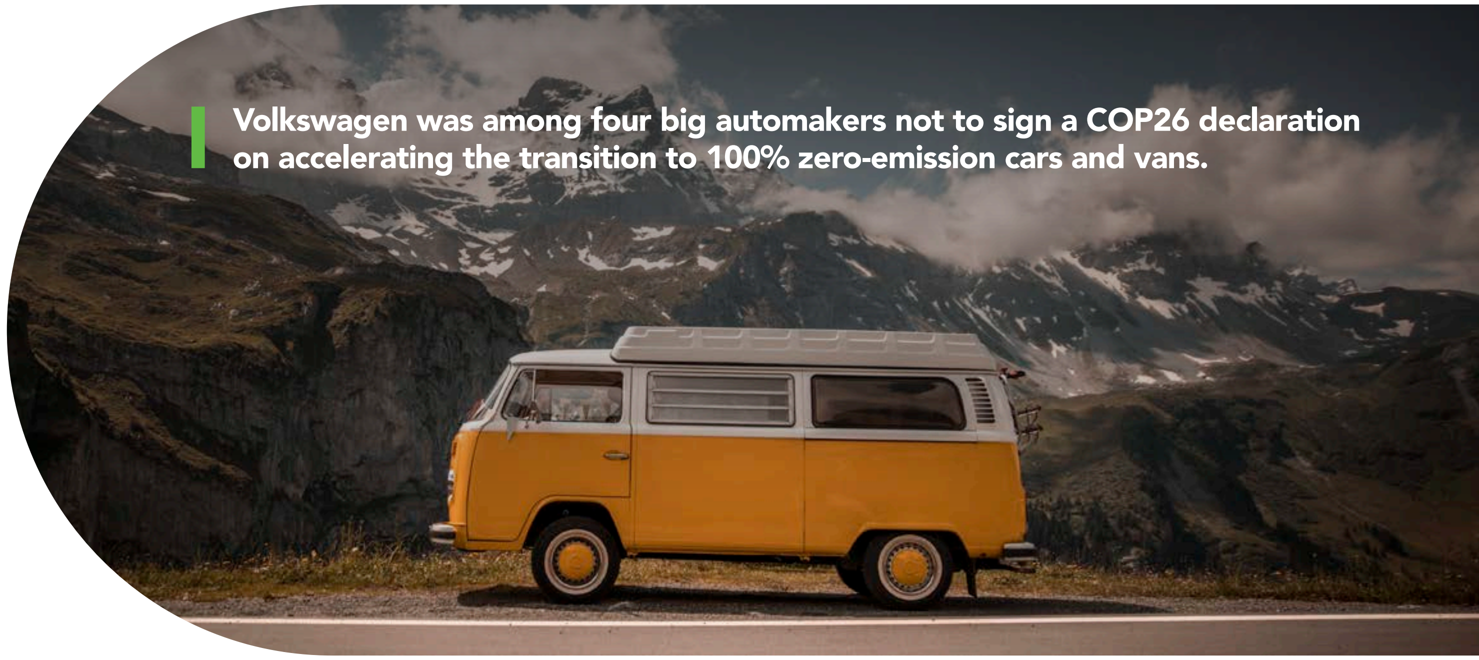
Asset stranding

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.



[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/

[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]

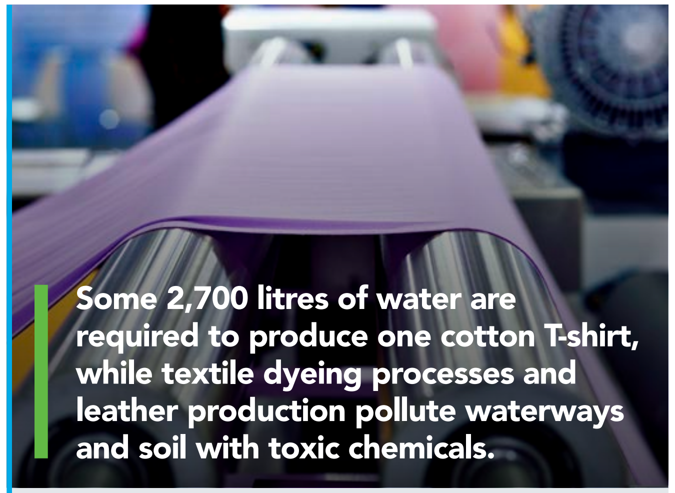
We addressed this problem in our investor expectations white paper, *Fixing Fast Fashion*, which examines why the fashion industry's linear model is unsustainable, and how companies can adopt circular approaches. We used this paper in our engagements with clothing and footwear companies in 2021, as it 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.



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.

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.

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.

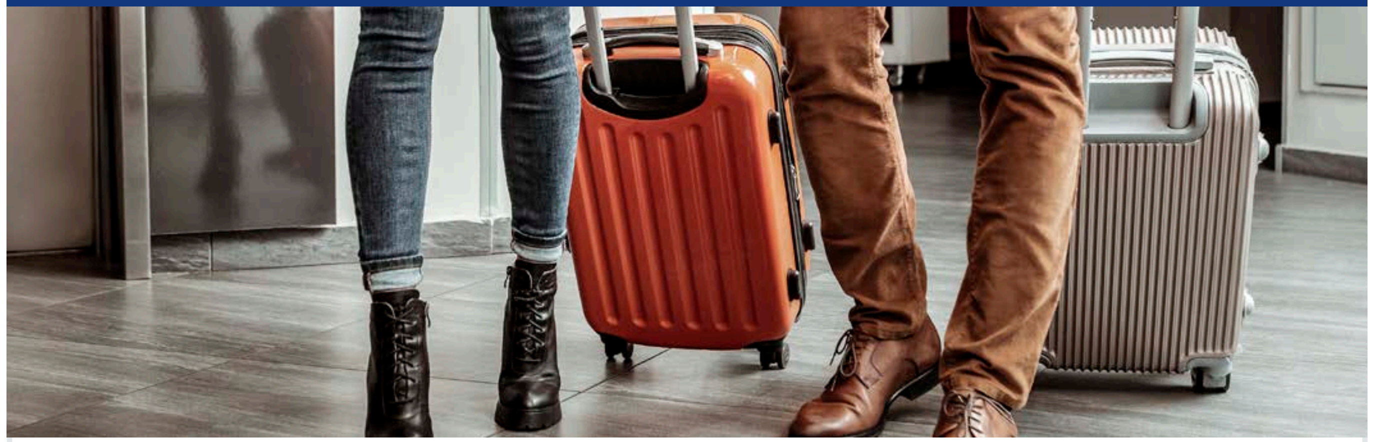
In 2022 we will take a more integrated approach to our fast fashion engagements, focusing on different social impacts alongside the environmental issues.

[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

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.

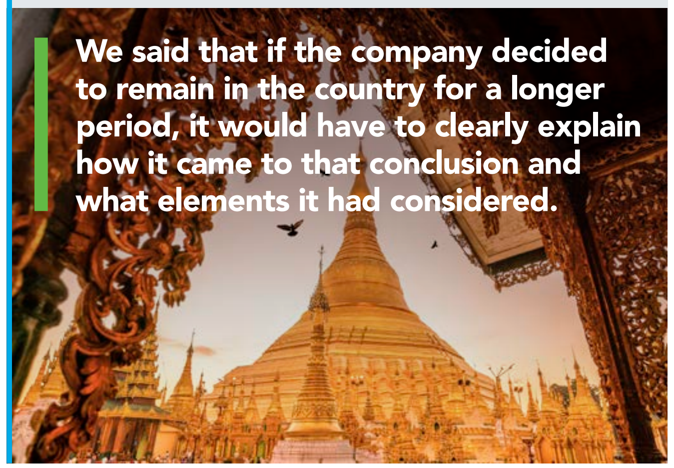
Q. Can you give some examples?

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]



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[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.

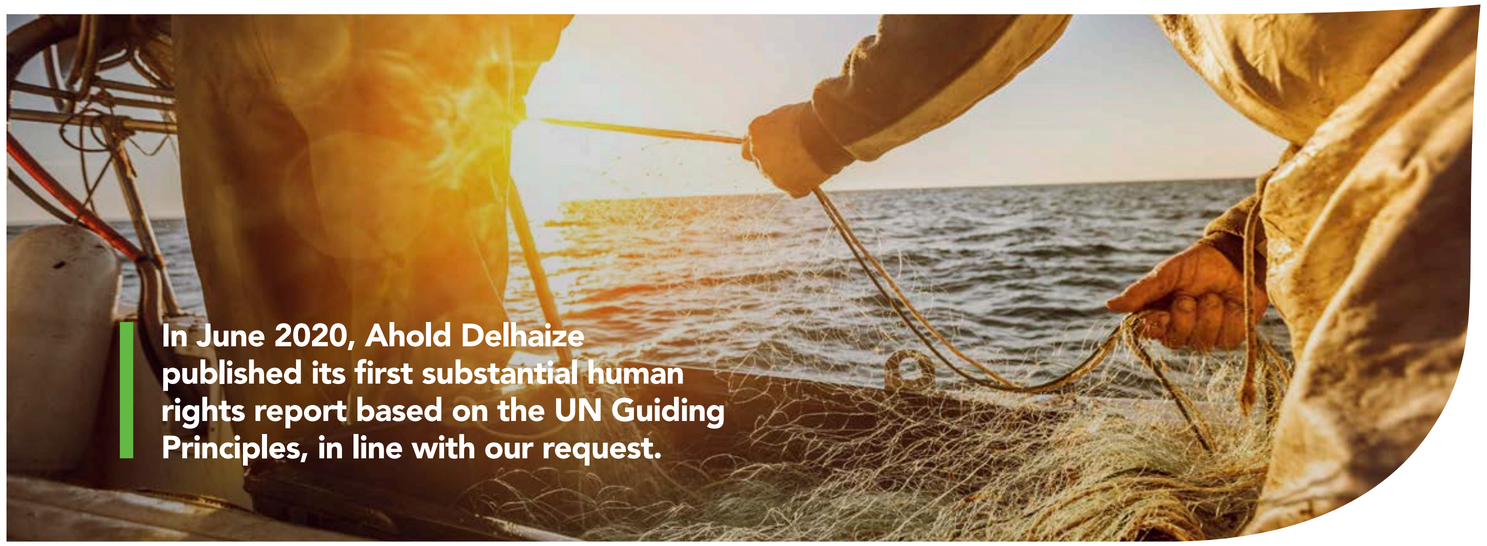
In June 2020, Ahold Delhaize published its first substantial human rights report based on the UNGPs, in line with our request. This identified six salient issues as initial priorities, followed by a further six, and its score in the Oxfam report improved.

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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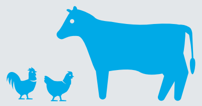


70% of antibiotics are given to farmed animals.

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 that 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.

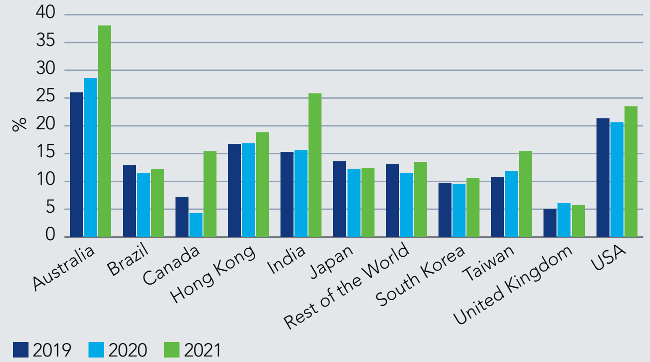
Votes on climate transition plans

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.

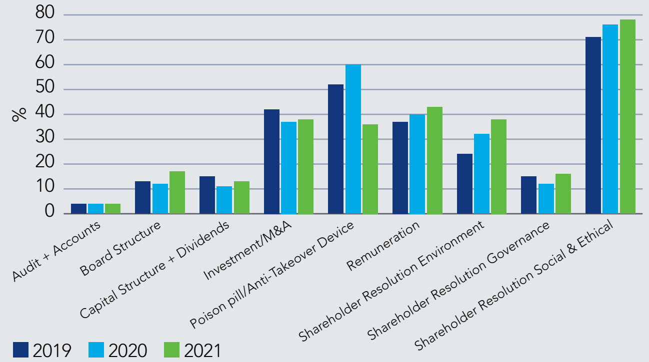
We applied a rigorous approach in our assessment of transition plans, setting a robust standard of alignment with the Paris Agreement goals for companies to pass. We recommended support for proposals that demonstrated robust target-setting, and that were aligned with external frameworks and accreditations 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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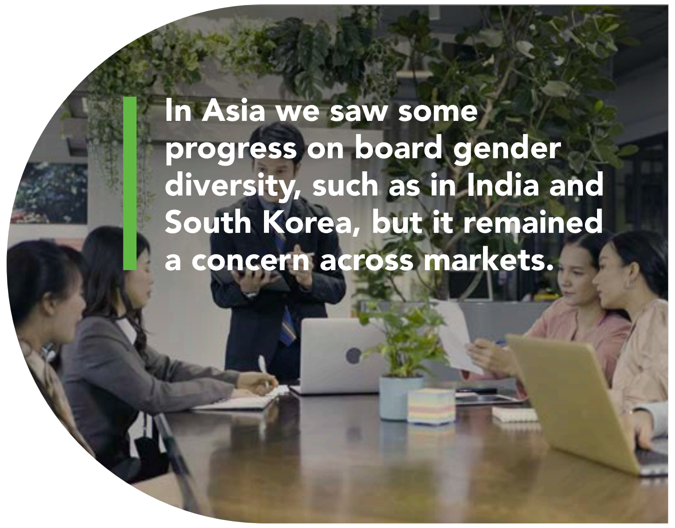


In Asia we saw some progress on board gender diversity, such as in India and South Korea, but it remained a concern across markets. In China, Hong Kong and Taiwan, we still regularly see all-male boards. We expanded our approach of recommending a vote against board chairs or nomination committee chairs 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.

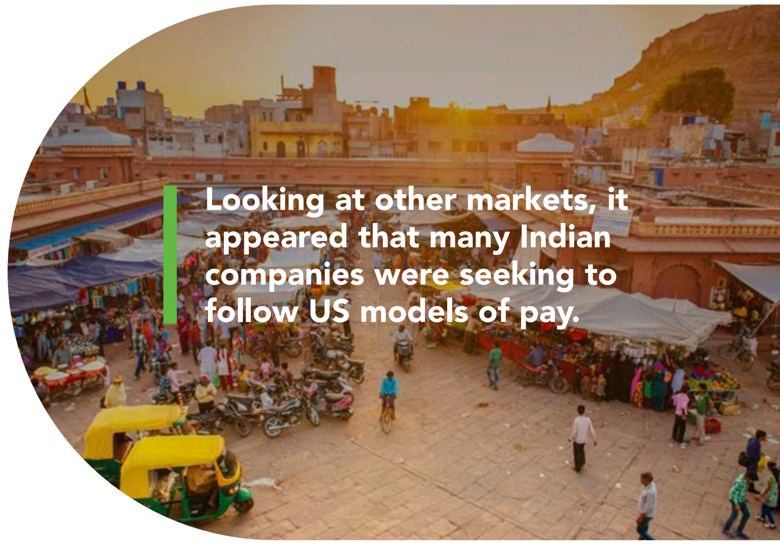
As well as scrutinising decisions taken against the backdrop of the pandemic, we continued to oppose pay where we judged it to be excessive or misaligned with the interests of long-term shareholders and other stakeholders.

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.

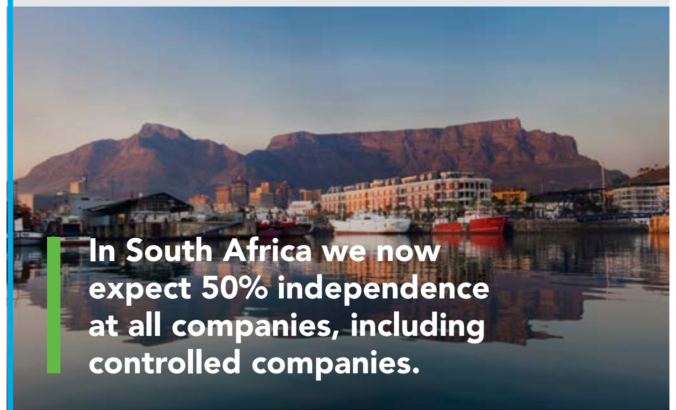
> **In global emerging markets and Asia excluding Japan and South Korea, we are looking for a minimum of 20% gender diversity.**

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.

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.

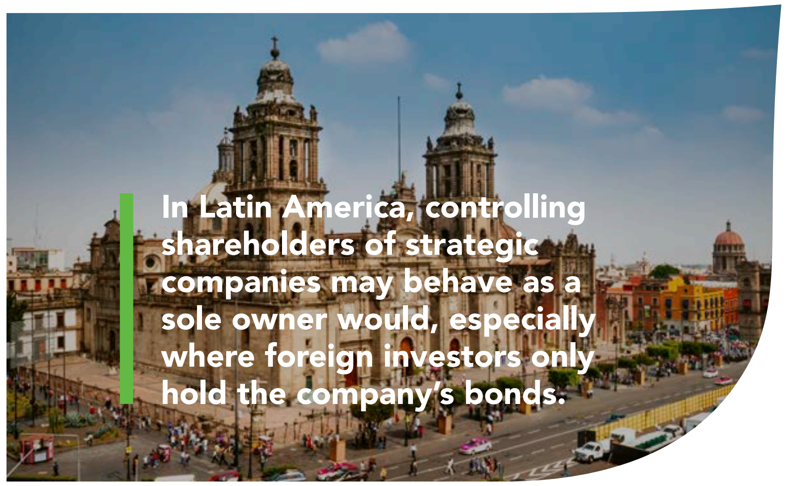
In July 2021, we had a call with a senior official in the Mexican Ministry of Finance. We discussed the lack of progress in the engagement with Pemex and agreed on a plan of action. We explained how ESG factors are being integrated into investment processes, which limits the ability of many investors 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.

> **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.**

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.

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

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

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.

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

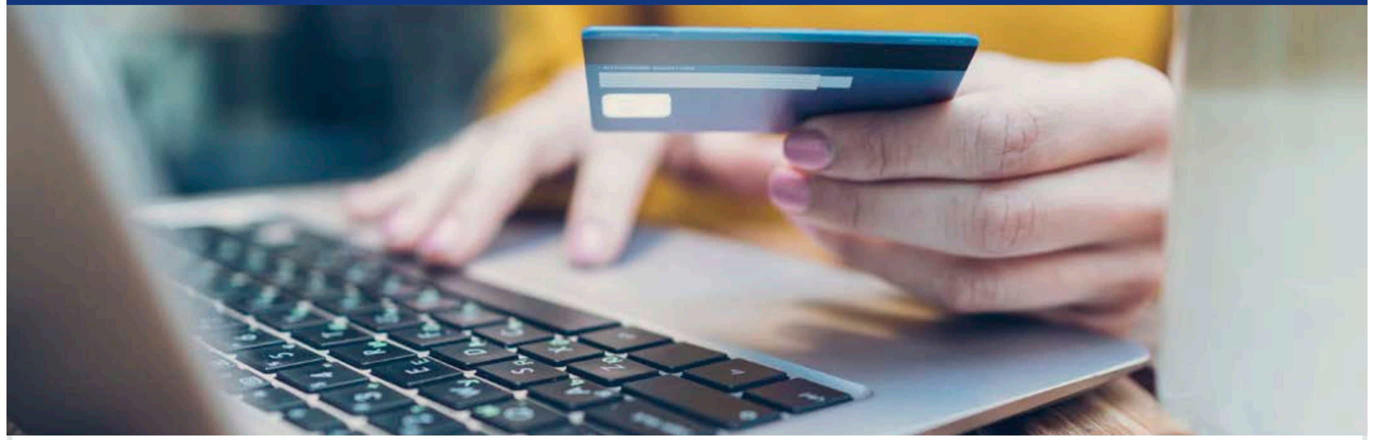
In 2022 we will seek to build on the nascent domestic stewardship in these markets by making targeted consultation responses, continuing our public policy advocacy work, and building the business case for stewardship and ESG in a local context. We will continue to take a regional approach to emerging 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.

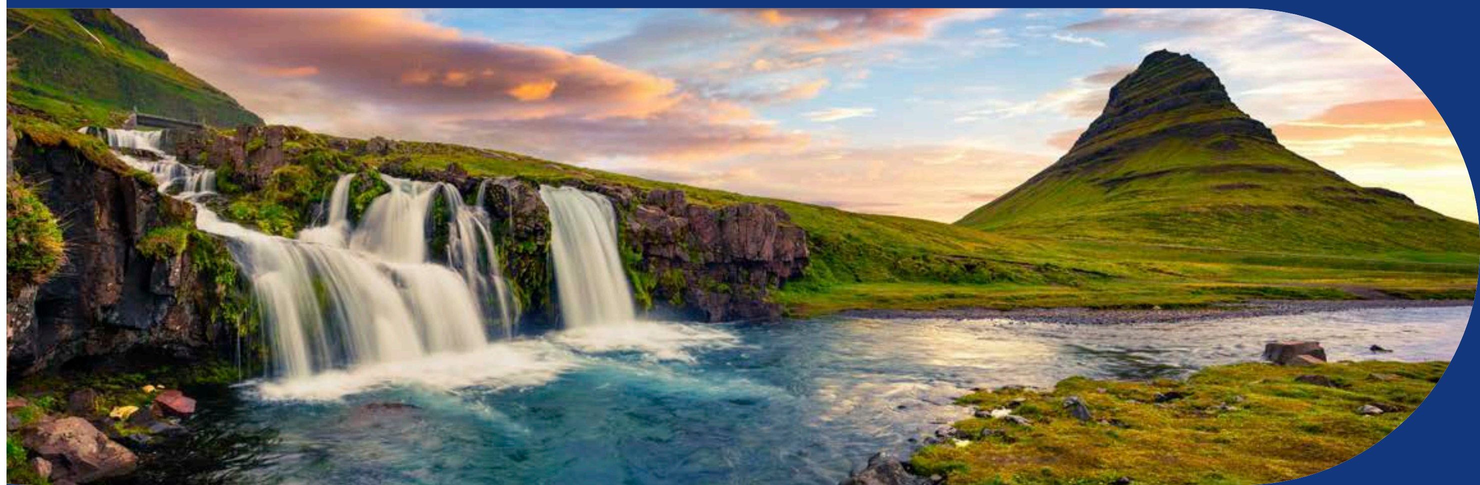
The good news is that the first steps on this path have already been taken – following the launch of the Net Zero Asset Managers initiative at the end of 2020, more than 220 asset managers have now committed to work in collaboration with their clients to achieve net zero across their portfolios by 2050 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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BOARD-EMPLOYEE INTERACTION: DISCLOSURE ON POLICIES AND PRACTICES

By Lucy Nussbaum

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Foreword

In recent years, as the U.S. economy has become more knowledge-based, many companies have come to view their employees as a valuable asset, not just an expense. Accordingly, corporate culture has become a key focus for management in shaping long-term strategy, and for investors in evaluating where to allocate their capital. And many boards of directors are elevating company culture in their oversight of corporate strategy and risk. For example, boards are dedicating more time to presentations from human resources personnel, visiting worksites and assessing top management's success in setting an appropriate "tone at the top."

Still, studies suggest there are gaps in the board's understanding of corporate culture. A 2020 National Association of Corporate Directors (NACD) survey of 500 public company directors found that 51% of directors said their boards could improve their oversight of organizational culture.[1] In a 2018-2019 NACD survey, 88% of directors reported a strong understanding of the tone at the top of their companies, yet less than half of the directors said they understood culture in the middle and only 27% of directors expressed a clear grasp of culture at the bottom of their organizations.[2]

Support is growing for explicit policies that encourage director interaction with rank-and-file employees as a way for boards to better oversee corporate culture. Site visits "not only serve to inform the individual directors about how things actually work in the field, i.e. the operating culture actually is (culture = what employees do when no one is looking), but also help the CEO understand what is going on in the parts of the field where he/she has not recently visited,"[3] says David Beatty, Conway Director of the Clarkson Center for Business Ethics & Board Effectiveness at the University of Toronto Rotman School of Business. Recent publications from KPMG, Deloitte and the NACD have also identified site visits and interaction with employees as options for boards looking to improve oversight of corporate culture.[4]

This report highlights thematic differences in public disclosures of how large U.S. public companies provide opportunities for board members to interact directly with employees, both at the management level and deeper within the organization.

Drawing on a CII-REF review of companies' disclosures and published corporate governance guidelines, the report focuses on the extent to which large U.S. companies disclose policies and practices for director engagement with their company's workforce, and key differences among those policies and practices. Thoughtfully developed mechanisms at the board level could be one of many steps a company can take to better oversee and mitigate risks related to corporate culture.

Methodology

CII-REF staff reviewed S&P 100 companies' most recent annual meeting proxy statements and corporate governance guidelines for disclosure on policies or practices related to director interaction with employees. We observed certain common approaches and catalogued them for this report. For example, some companies spoke of directors having generally open-ended access; others described specific ways board members interact with employees on a regular basis, suggesting a more structured effort. Some companies clarified whether board members may communicate directly with employees or if management must arrange the meetings. And some companies were not clear on the depth of directors' access, e.g. disclosure addressed board members' access to management, but not explicitly to other employees.

One challenge we faced is that disclosure may reside in any number of places, such as the annual shareholder meeting proxy statement, the corporate governance guidelines or elsewhere, such as stand-alone sustainability or human capital reports. Additionally, some companies may have policies or practices for director interaction with employees but may not disclose them. Our review, which involved searching for key terms in corporate governance guidelines and proxy statements, found disclosures at 97 companies.

Summary of Findings

Overall, we found 97% of companies in the S&P 100 had policies stating that board members have access to either employees generally or management. About half had policies specifically granting board members access to all employees. A little less than one-third (32%) of the companies had policies granting board members access to management without explicit mention of access to or interaction with other employees. More than one-third of the companies detailed some kind of board-employee interaction. About two-thirds of the companies had policies granting board members access to employees or specific guidelines for board-employee interaction and 20% of reviewed companies disclosed both policies on employee access and a discussion of specific circumstances where board members have the opportunity to speak with employees.

Examples of Disclosure

1. Companies that disclose both policies on board access to employees and interaction procedures

The following table shows examples of disclosure of both policies granting board members full access to employees, typically in the corporate governance guidelines, and some form of formal or informal process by which boards interact with employees, typically in the proxy statement. This often included site visits, although not all disclosures indicated that site visits provided board members with opportunities to communicate with employees. Many of the disclosed interaction procedures also include some reference to the value of this contact as a way for boards to oversee company culture.

Company	Disclosure
General Dynamics	Corporate Governance Guidelines: "The Company will provide each director with free and complete access to all members of management and employees of the Company and to information about the Company and its operations." Proxy Statement: "New directors also have the opportunity to visit business units within each of our segments and receive briefings from the respective executive vice president and members of business unit management teams. All directors also visit our business units periodically. These visits allow the directors to interact with the business unit management teams and employees and gain a firsthand view of our operations."
Intel	Corporate Governance Guidelines: "The Board has complete access to contact and meet with any Intel employee. Board members are encouraged, when traveling,

	to make arrangements in advance to visit Intel sites and meet with local management on a world-wide basis." Proxy Statement: "Officers regularly attend Board meetings to present information on our business and strategy, and Board members have worldwide access to our employees outside of Board meetings. Board members are encouraged to make site visits on a worldwide basis to meet with local management; to attend Intel industry, analyst, and other major events; and to accept invitations to attend and speak at internal Intel meetings."
Johnson & Johnson	Corporate Governance Guidelines: "Directors have full and free access to officers and employees of the Company. The Directors will use their judgment to ensure that any such contact is not disruptive to the business operations of the Company and will, to the extent not inappropriate, inform the Chief Executive Officer of any significant communication between a Director and an officer or employee of the Company." Proxy Statement: "The Board's oversight of strategy is enhanced by periodic engagements held outside the Boardroom. Independent Directors visit our business locations and research and development facilities around the globe to observe the implementation of our strategy. The Directors engage with senior leaders and employees at these sites to deepen their understanding of our businesses, their competitive environments and corporate culture."
Southern Company	Corporate Governance Guidelines: "Each director has complete access to management." Proxy Statement: "Board has full and free access to officers and employees."… "In 2019, we continued our focus on the construction of Plant Vogtle Units 3 and 4, which included the opportunity for Directors to visit the work site and meet with key personnel. We believe the first-hand experience gained through such site visits provides the Board with an enhanced appreciation of how Southern's core values inform its operations."
Walmart	Corporate Governance Guidelines: "Directors shall have full and free access to officers and other associates of the Company and the Company's outside advisors. Any meetings or contacts that a director wishes to initiate may be arranged through the CEO, the Secretary, or directly by the director. The directors will use their judgment to ensure that any such contact is not disruptive to the business operations of the Company. It is the expectation of the Board that directors will keep the CEO informed of communications between a director and an officer or other associate of the Company, as appropriate." Proxy Statement: "Our Board members are also expected to participate in other company activities and engage directly with our associates at a variety of events throughout the year. Examples of activities and

	events that members of our Board have participated in include: attending Walmart leadership meetings and traveling with senior business leaders on trips to domestic and international markets, touring facilities with our compliance associates, speaking at various culture, diversity, and inclusion events held at our home office in Bentonville, Arkansas and other locations, attending and speaking at meetings of Walmart business segments, divisions, and corporate support departments."

2. Companies that disclosed policies on board access to employees

The following are examples of disclosures of policies that afford boards full access to employees but are silent on procedures for, or the nature of, such interaction. Such disclosures were generally in the corporate governance guidelines, but were often restated in the proxy statement. Some were only in the proxy statement.

Company	**Disclosure**
Bank of New York Mellon	Corporate Governance Guidelines: "Management will communicate regularly with directors, who may also consult with other employees and independent advisors, such as independent auditors and outside counsel, as the Board or its committees deem appropriate, the fees of such advisors and the expenses of such consultation to be borne by the Corporation."
Chevron	Corporate Governance Guidelines: "Directors are encouraged and provided opportunities to talk directly to any member of management regarding any questions or concerns the Director may have." Proxy Statement: "Moreover, the Board does not believe that having the CEO also serve as Chairman inhibits the flow of information and interactions between the Board, management, and other Company personnel. To the contrary, the Board has unfettered access to management and other Company personnel."
Kinder Morgan	Corporate Governance Guidelines: "Each director shall have full access to: (a) senior management; (b) information about the Company's operations; and (c) any outside advisor to the Company."..."The Board or any committee may request any officer or employee of the Company or the Company's counsel or other advisors or consultants to attend a meeting of the Board or such committee, as the case may be, or to meet with any member of or advisor to the Board or such committee."... "In discharging his or her duties as a member of the Board or of any committee, each member is entitled to rely on the records of the Company and on such information, opinions, reports or statements, including financial statements and other financial data, that is prepared and presented by (i) any officer, employee or committee of the Company or (ii) legal counsel, external auditors, outsourced internal auditors, governance consultants, compensation consultants or other persons as to matters the member reasonably believes are within the person's professional or expert competence and who was selected with reasonable care by or on behalf of the Company, the Board of, or any committee of, the Company."
Medtronic	Corporate Governance Guidelines: "Directors have full and free access to members of management and employees of the Company. The Board and each of its

	standing committees has the authority to engage outside counsel, accountants, experts and other advisors as it determines appropriate to assist it in the performance of its functions."
McDonald's	Corporate Governance Guidelines: "In order to fulfill their oversight responsibilities, Directors shall have free access to Company management and employees."... "the Board of Directors shall provide a means by which persons, including shareholders and employees, may communicate directly with directors with regard to matters relating to the Company's corporate governance and performance."

3. Companies where policies on board access to employees require management arrangement

Some companies had policies allowing board members access to employees, but specified that any contact should be arranged or approved by management. Often the designated gatekeeper was the CEO, but at some companies it was the corporate secretary or other senior managers. There seemed to be a range of management involvement, some of which may be purely administrative to make it easier for the director to contact employees. Other policies stipulated that management take a more active role. Most of these disclosures were in the corporate governance guidelines.

Company	Disclosure
Boeing	Corporate Governance Guidelines: “The Company will provide each director with complete access to the management and employees of the Company.”…“The CEO and other officers are responsible for establishing effective communications with the Company’s stakeholders, including shareholders, employees, customers, suppliers, communities, governments, creditors and corporate partners. It is the policy of the Board that management speaks for the Company. Individual directors may, from time to time, meet or otherwise communicate with stakeholders. It is, however, expected that directors would do so with the knowledge of and, absent unusual circumstances or as contemplated by the committee charters, following prior consultation with the Company’s management.”
Charter Communications	Corporate Governance Guidelines: “Directors shall have full and unrestricted access to the Company’s management and employees in order to be informed about the Company’s business and for such other purposes as may be useful to the Board in fulfilling its responsibilities. Such meetings should generally be arranged through the office of the Company’s Chief Executive Officer (“CEO”).” Proxy Statement: “All directors have full access to all members of management and all employees on a confidential basis.”
Citigroup	Corporate Governance Guidelines: “Directors shall have full and free access to senior management. Directors are requested to arrange such meetings through the Corporate Secretary.” Proxy Statement: “Directors have full and free access to senior management and other employees of Citi.”
Comcast	Corporate Governance Guidelines: “Board members have access to the management and employees of the Company and to its outside counsel and auditors. Any meetings or contacts that a director wishes to

	initiate may be arranged through the Chief Executive Officer or his designee(s)."
UnitedHealth Group	Corporate Governance Guidelines: "Board members have access to the Company's management, other employees and outside advisors. Except in unusual circumstances, the Chief Executive Officer should be advised and consulted in advance of proposed significant contacts with senior management."

4. Companies with disclosed policies on board access to management

The following are examples of disclosed policies that grant board members access to management, but not other employees. In some cases this distinction is explicit, while in others the distinction is implied. Some examples specify that this access is only to senior management. These disclosures were generally found in the corporate governance guidelines, but at times were also stated in the proxy statement.

Company	Disclosure
American International Group	Corporate Governance Guidelines: "All directors are invited to contact the Chief Executive Officer at any time to discuss any aspect of AIG's business. It is expected that the Chief Executive Officer will keep the Chairman informed of all significant management, operational and other business developments as they arise. Directors also will have complete access to other members of management. The Board expects that there will be frequent opportunities for directors to meet with the Chief Executive Officer and other members of management in Board and committee meetings, or in other formal and informal settings."... "It is important that AIG speak to employees, investors and outside constituencies with a single voice and that management serves as the spokesperson."
Eli Lilly	Corporate Governance Guidelines: "Independent directors have direct access to members of management whenever they deem it necessary." Proxy Statement: "Our independent directors actively engage in board meetings, have direct access to management, and have sole discretion to hire independent advisors at the company's expense."
Facebook	Corporate Governance Guidelines: "Directors are encouraged to speak directly to any member of management regarding any questions or concerns the directors may have. In addition, the Board encourages members of management to be invited to attend Board meetings where they may share relevant information or insight related to business discussed at the meeting." Proxy Statement: "The oversight responsibility of the board of directors and its committees is informed by regular reports from our management team, including senior personnel that lead a variety of functions across the business, and from our internal audit department, as well as input from external advisors, as appropriate."

Lowe's	Corporate Governance Guidelines: "Board members have complete access to Lowe's Management and are encouraged to make regular contact. Board members shall coordinate such access with respect to matters relating to standing committees of the Board through the appropriate committee chair. Board members will use judgment to assure that this access is efficient and appropriate and not distracting to Management and the business operation of the Company. Directors shall refrain from giving strategic or operating direction to members of Management outside the scope of full Board or committee responsibility and accountability."
Nextera Energy	Corporate Governance Guidelines: "Directors have complete access to the Company's senior management."

[1] "2019-2020 NACD Public Company Governance Survey," NACD, 2020, p. 35.

[2] "Uncertain Regulatory and Economic Climate Tops List of Corporate Directors' Concerns for 2019," NACD, 2018.

[3] Beatty, David R., "Field Visits by Directors," Harvard Law School Forum on Corporate Governance, 2018.

[4] See "Board Oversight of Corporate Culture," KPMG, 2018 ("Directors discussed the importance of using a variety of methods to gain a better understanding of the corporate culture. Some common methods include…visiting company facilities and talking to employees below senior management …[and] walking the halls of corporate headquarters."); See "Culture Risk Oversight: Measures the Board Can Take," Wall Street Journal Risk & Compliance Journal, 2019 ("To address the gap, board members can conduct site visits and walk the halls"); "Culture as a Corporate Asset," NACD Blue Ribbon Commission, 2017, p. 15, ("Effective oversight of culture also requires directors to regularly spend time "on the ground" where business is being done, in order to gain exposure to a cross section of employees at different locations and levels of seniority. In the words of one Commissioner, "If directors think their jobs are done by virtue of meeting regularly with the CEO and senior management, they're seriously mistaken. Without firsthand visibility into how the culture is lived around the organization, the board's job is incomplete.")