

2015

Annual voting and
engagement report
Pensioenfonds PNO Media

In the following pages, we are pleased to report on the engagement, voting and public policy work carried out by Hermes EOS on behalf of Pensioenfonds PNO Media during 2015. These efforts to protect and enhance the value of client investments have covered a wide range of environmental, social, governance and strategic matters. Hermes EOS has worked with companies around the world to address the key risks and challenges that they face, including issues on environmental, social and ethical matters, corporate governance, strategy and risk. This report highlights an engagement case study relevant to each corporate engagement theme.* Hermes EOS has also provided systematic information on our engagement progress against the objective milestones we have set.

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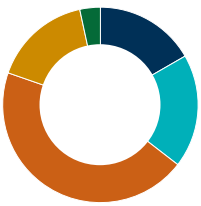
*Hermes EOS' usual policy is to keep engagements confidential while they are in progress. When the case studies included in this report feature private actions by Hermes EOS, such as private dialogues with senior directors, we have notified the company of our intention to publish them.

Engagement activity by region 2015

In the last year, Hermes EOS engaged with 261 companies in PNO Media portfolios on a range of 713 environmental, social and ethical, governance, strategy and risk issues. Hermes EOS’ holistic approach to engagement means that it typically engages with companies on more than one issue simultaneously.

Global

We engaged with **261** companies over the last year.



- Environmental 16.7%
- Social and ethical 18.8%
- Governance 44.9%
- Strategy and risk 16.3%
- Stewardship 3.4%

Australia and New Zealand

We engaged with **one** company over the last year.



- Governance 100.0%

Developed Asia

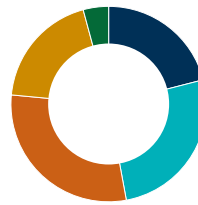
We engaged with **21** companies over the last year.



- Environmental 6.3%
- Social and ethical 24.1%
- Governance 40.5%
- Strategy and risk 19.0%
- Stewardship 10.1%

Emerging and Frontier Markets

We engaged with **43** companies over the last year.



- Environmental 21.0%
- Social and ethical 26.1%
- Governance 29.4%
- Strategy and risk 19.3%
- Stewardship 4.2%

Europe

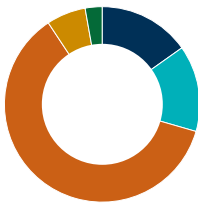
We engaged with **58** companies over the last year.



- Environmental 14.3%
- Social and ethical 16.2%
- Governance 40.3%
- Strategy and risk 26.6%
- Stewardship 2.6%

North America

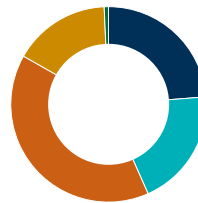
We engaged with **104** companies over the last year.



- Environmental 15.2%
- Social and ethical 14.3%
- Governance 61.3%
- Strategy and risk 6.5%
- Stewardship 2.8%

United Kingdom

We engaged with **34** companies over the last year.



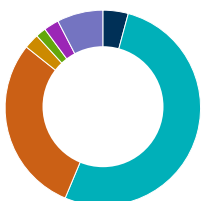
- Environmental 23.8%
- Social and ethical 19.6%
- Governance 39.9%
- Strategy and risk 16.1%
- Stewardship 0.7%

Engagement activity by theme

A summary of the 713 issues and objectives on which Hermes EOS engaged with companies in PNO Media portfolios over the last year is shown below.

Environmental

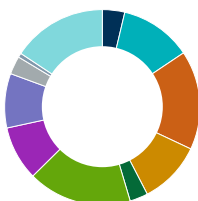
Environmental issues featured in **16.7%** of our engagements over the last year.



- Biodiversity **4.2%**
- Climate change/carbon intensity **52.1%**
- Environmental management **29.4%**
- Forestry **2.5%**
- Oil sands **1.7%**
- Waste **2.5%**
- Water stress **7.6%**

Social and ethical

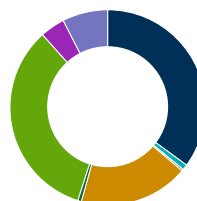
Social issues featured in **18.8%** of our engagements over the last year.



- Access to medicine **3.7%**
- Bribery and corruption **11.9%**
- Community relations **16.4%**
- Corporate culture **10.4%**
- Customer relations **3.0%**
- Health and safety **17.2%**
- Labour rights/employee relations **9.0%**
- Licence to operate **9.0%**
- Operations in troubled regions **3.0%**
- Political risk management **0.7%**
- Supply chain management **15.7%**

Governance

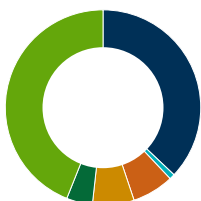
Governance issues featured in **44.9%** of our engagements over the last year.



- Board structure **35.0%**
- Committee structure **0.9%**
- Conflicts of interest **0.3%**
- Other governance **18.1%**
- Related-party transactions **0.6%**
- Remuneration **33.4%**
- Separation of chair/CEO **4.1%**
- Succession planning **7.5%**

Strategy and risk

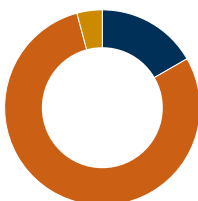
Strategy and risk issues featured in **16.3%** of our engagements over the last year.



- Business strategy **37.1%**
- Capital structure **0.9%**
- Reporting/disclosure **6.9%**
- Reputational risk **6.9%**
- Returns to shareholders **4.3%**
- Risk management **44.0%**

Stewardship

Stewardship issues featured in **3.4%** of our engagements over the last year.



- Accounting or auditing issues **16.7%**
- Shareholder communications **79.2%**
- Shareholder rights **4.2%**

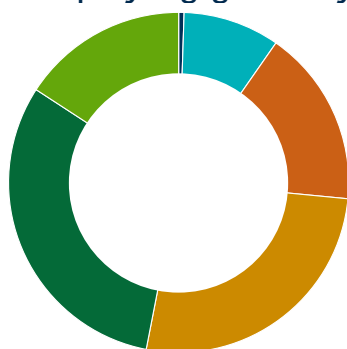
Engagement progress in 2015

Using its proprietary milestone system, Hermes EOS had engagements with 196 companies regarding 567 separate engagement objectives on behalf of PNO Media.

In this section we provide an overview of our global engagement activities.

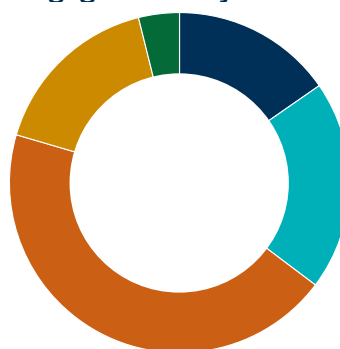
Global engagement activity

Company engagement by region (196)



- Australia and New Zealand 1
- Developed Asia 18
- Emerging and Frontier Markets 33
- Europe 52
- North America 61
- UK 31

Engagement objectives by theme (567)



- Environmental 87
- Social and ethical 113
- Governance 251
- Strategy and risk 94
- Stewardship 22

Approximately 44% of the engagement objectives focused on governance issues. In many cases, achieving success in board change is necessary to deliver beneficial change in environmental, social, governance and strategic issues.

Engagement methodology and progress in 2015

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

- Milestone 1 Concern raised with company at appropriate level
- Milestone 2 Acknowledgement of the issue
- Milestone 3 Development of a credible strategy or plan to address the concern
- Milestone 4 Implementation of a strategy or measures to address the concern

The information below sets out the status of these engagements relative to our engagement objectives and our progress in the past year.

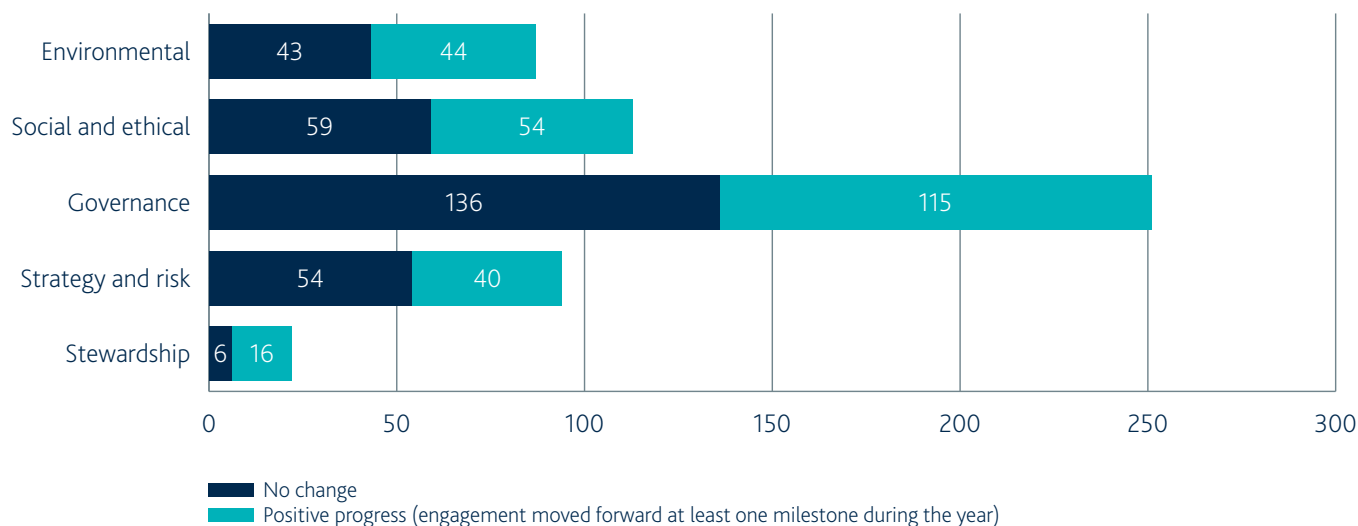
Milestone status of engagement

The chart below shows the milestone status of the Hermes EOS' engagement objectives by theme.

Theme	Total engagement objectives	Engagement objective status				Completed engagement objectives	
		Objective set	Concern raised	Concern acknowledged	Plan established	Completed	Discontinued
Environmental	87	4	10	35	26	6	6
Social and ethical	113	9	8	26	46	19	5
Governance	251	6	59	75	68	36	7
Strategy and risk	94	8	17	25	30	11	3
Stewardship	22	0	8	6	4	3	1
Total engagements	567	27	102	167	174	75	22

Engagement progress in 2015

Hermes EOS made solid progress in delivering engagement objectives across regions and themes for PNO Media. The following chart describes how much progress has been made in achieving the milestones set for each engagement.



Environmental: Environmental progress

In 2015, 15% of Hermes EOS' engagements on behalf of PNO Media included an environmental objective. In this section, Hermes EOS summarises some of the major environmental themes on which it engaged in 2015 and provides a case study illustrating a successful outcome to an engagement on environmental concerns.

Status of environmental engagement objectives

The table below shows which milestones have been achieved in the course of related engagements.

Theme	Total engagement objectives	Engagement objective status				Completed engagement objectives	
		Objective set	Concern raised	Concern acknowledged	Plan established	Completed	Discontinued
Environmental	87	4	10	35	26	6	6

Corporate engagement

We encourage companies to develop plans for managing their carbon footprint, set appropriate targets, monitor and disclose progress.

In the run-up to and the aftermath of the Paris Agreement reached at the UN climate summit, the 21st Conference of the Parties (COP 21), in Paris in December 2015, we focused our engagement on emission reductions by companies.

Through the Carbon Asset Risk Initiative, a project by the Institutional Investors Group on Climate Change (IIGCC) and sustainability leadership organisation Ceres, we have engaged with over 50 global, carbon-intensive companies and continue to work with them to understand and address their exposure to climate change risks. We also urged them to produce public statements on emissions reductions and carbon pricing, particularly in the lead-up to COP 21.

As part of our involvement in the Aiming for A investor coalition, we co-filed shareholder proposals at four oil and gas companies, seeking greater disclosure of their exposure to climate change related risks. We also supported similar shareholder proposals at their peers and have since seen progress on how the companies address and disclose the climate change risks they face. In addition, we intensified our engagement with mining companies, where we prepared proposals on the same subject for their AGMs in 2016.

In a similar context, we engaged with companies to end the practice of flaring of methane. Over a 20-year horizon, methane has far greater greenhouse gas effects than CO₂ until it begins to largely break down. Cuts in methane emissions can therefore lead to important and quick reductions in global warming.

We intensified our engagement with Volkswagen on the emissions scandal embroiling the company. The German car manufacturer is accused of installing defeat devices in 11 million of its vehicles. The cars would switch on emissions-control devices for tests in laboratories but on the road emit much higher levels of nitrogen oxide. We discussed the impact of the emissions scandal with other car manufacturers, which widely acknowledged a significant difference between the amount of emissions measured in laboratories and those emitted under real driving conditions.

We advocate the sustainable production of palm oil and were pleased with the efforts made by some palm oil producers to address the various challenges associated with this. We also continued our engagement on genetically modified trees.

Furthermore, we encourage sustainable water management at the companies we engage. We pressed for the setting and disclosure of targets to manage water stress, contamination and pollution.

Public policy and best practice

In the run-up to COP21, we engaged equally intensively on carbon emissions reductions in the public policy sphere.

We supported the secretariat of the UN climate negotiations, meeting the UNFCCC executive secretary to summarise investor concerns and attending roundtables to engage with the CEOs of the world's largest companies as part of the CEO dialogue in New York in September 2015, at a smaller group meeting in London in October 2015 and in Paris in December 2015. We co-authored an investor letter to the leaders of the G7, explaining the need for a long-term goal on climate change, which was successfully adopted and formed the basis for the decarbonisation goal in the Paris negotiations. Furthermore, we are core supporters of the IIGCC, acting as lead author of its publication summarising investor expectations of mining companies. We also joined the Aiming for A coalition of investors which acts at the forefront of climate change engagement.

Together with investors representing \$1.5 trillion of assets, we signed an investor statement prepared by sustainability organisation Ceres in support of strong action by the US Environmental Protection Agency (EPA) to regulate methane emissions from the oil and gas sector. The statement was sent to the White House and the EPA.

We attended a roundtable by the International Petroleum Industry Environmental Conservation Association in Paris to explain how investors want to see oil and gas companies improve their reporting on climate change-related issues. Such reporting should be relevant either to the long-term strategy of the company or to current operational performance. We explained that investors not only want to know that current and future capital investment will deliver long-term returns, but that the public policy position of oil and gas companies is aligned to the desire of investors to see climate change limited to 2°C.

Progress against environmental objectives



Case study: BP



A Q&A with Bruce Duguid of Hermes EOS about oil major BP

Q: Why is Hermes EOS engaging with BP?

A: As one of the oil and gas super-majors, we have engaged with BP over many years on numerous issues, including its response to and learnings from the 2010 Deepwater Horizon incident in the Gulf of Mexico. We welcomed that the company implemented the last of the 26 health and safety recommendations made in the Bly report, which was commissioned following the incident, by the end of 2015.

More recently, the focus of our engagement has turned to the oil and gas industry's long-term exposure to climate change. Investors have become concerned that if climate change is to be limited to 2°C or less, in line with the deal agreed at the 2015 COP21 UN climate change summit, demand for fossil fuels could significantly decline over time compared to current projections and, if not fully anticipated, lead to material impairment of assets, with a risk of some assets becoming stranded or retiring early.

Investors also want to see oil and gas companies support public policy to successfully limit climate change to safe levels and to demonstrate leadership on the best means to achieve this. To this end, Hermes EOS supported the shareholder resolution presented at BP's AGM in April 2015, which called for enhanced reporting on its climate change risks, including on its asset portfolio resilience to climate change and public policy position on the subject. We have since engaged extensively to ensure that the company meets investor concerns by reporting in sufficient detail on this issue and demonstrates appropriate leadership on climate change.

Q: What has Hermes EOS done to seek the necessary disclosure?

A: We first raised the topic with the chair of BP prior to the April AGM in 2015 and were pleased to hear of his conviction that the company is resilient to lower-carbon scenarios and a lower oil price. We acknowledged the difficulties associated with promoting a public policy position on climate change, including the appropriate role of companies and governments in this debate,

but continued to encourage the company to play a leadership role. We then developed and shared with the company a more detailed view of the nature of disclosure that we would like to see on behalf of investors regarding the company's resilience to low-carbon scenarios. We discussed the nature of the disclosures required in meetings with senior strategy executives on a number of occasions. We also presented our views on climate risk disclosure to the sustainability working group of IPECA, the global oil and gas industry association for environmental and social issues, which included representatives of each of the oil and gas majors.

Q: How successful has the engagement been to date?

A: At the company's AGM in April 2015, the chair welcomed the shareholder resolution on climate change, saying it is helpful in highlighting the concerns of long-term shareholders about the risks and opportunities on climate change. BP has been a prominent member of the Oil and Gas Climate Initiative (OGCI), which is a gathering of 10 of the world's top oil and gas majors committed to working together to lend collective support to the global efforts to tackle climate change.

In October 2015, we welcomed BP and other members of the OGCI committing to support the public policy goal of limiting climate change to 2°C. BP was also part of a subset of OGCI members which has publicly supported the adoption of a widespread price on carbon and is collaborating with the UN and governments to find ways to best implement this.

In November 2015, at its annual Socially Responsible Investor presentation, the company explained its long-term strategy to ensure it remains resilient to low-carbon scenarios. This includes shifting the mix of its fuels increasingly towards gas – the lowest carbon fossil fuel – and continuing to invest in wind and biofuels projects, while avoiding more expensive oil projects.

Although we are continuing our engagement to find a way for the company to present a more quantitative analysis of the risks to its current operating projects and the pipeline of future projects to which it has allocated capital, we welcomed this narrative.

We look forward to BP's enhanced disclosure on portfolio asset resilience to climate change, which is expected to be published close to the time of its next AGM in April 2016.

Social and ethical: Engagement progress

In 2015, 20% of Hermes EOS' engagements on behalf of PNO Media included a social and ethical objective. In this section, Hermes EOS summarises some of the major social and ethical themes it engaged on and provides a case study illustrating a successful outcome to an engagement on social and ethical matters.

Status of social and ethical engagement objectives

The table below describes which milestones have been achieved during their respective engagements.

Theme	Total engagement objectives	Engagement objective status				Completed engagement objectives	
		Objective set	Concern raised	Concern acknowledged	Plan established	Completed	Discontinued
Social and ethical	113	9	8	26	46	19	5

Corporate engagement

We engaged with companies on their supply chain to ensure they mitigate the risks that could expose them to a range of reputational, regulatory, financial and operational risks. We focused on supplier policies and standards, the transparency regarding the suppliers' operations, auditing and independent verification of suppliers and training.

Several companies we engaged with improved the transparency of their supply chains. This included progress in the work undertaken by an electronics company towards eliminating conflict minerals from its supply chain. After surveying 1,500 suppliers in 2015, no conflict minerals were found. Following on from our 2014 Bangladesh trip, we were also pleased that a US retailer now has a credible reform programme in place relating to its supply chain in Bangladesh and beyond.

We engaged on community relations, including those with indigenous peoples, as effective management of these relationships is crucial for companies to gain and maintain a social licence to operate. In a similar context, we spoke to companies about improving their relations with labour unions and welcomed the progress made by some of them. We also addressed effective health and safety policies and systems, as they are core to the management of human capital.

In 2015, we pushed for increasing diversity at companies, at the board level and beyond, as we believe a higher level of diversity can help avoid groupthink and unconscious bias on the board and ultimately improve its performance. We witnessed the rolling out of extensive programmes by companies seeking to improve their diversity.

After several hacking incidents at major companies, cyber crime continued to move up the board agenda. We seek companies to have adequate risk management measures to address this and gained assurance from companies that appropriate systems had been put in place. As part of our engagement, we discussed the preparedness of companies to combat cyber attacks, including their programmes for remedial action. Boards need to discuss cyber security regularly and oversee investment in security technologies. Companies should also increase their communications to shareholders when they have suffered a security breach to restore trust and confidence in their management teams.

Bribery and corruption have a negative impact on local communities and economies and on long-term shareholder value, which is why we

advocate a zero tolerance approach. During our engagement in 2015, we saw several companies improve their risk management in relation to bribery and corruption.

Public policy and best practice

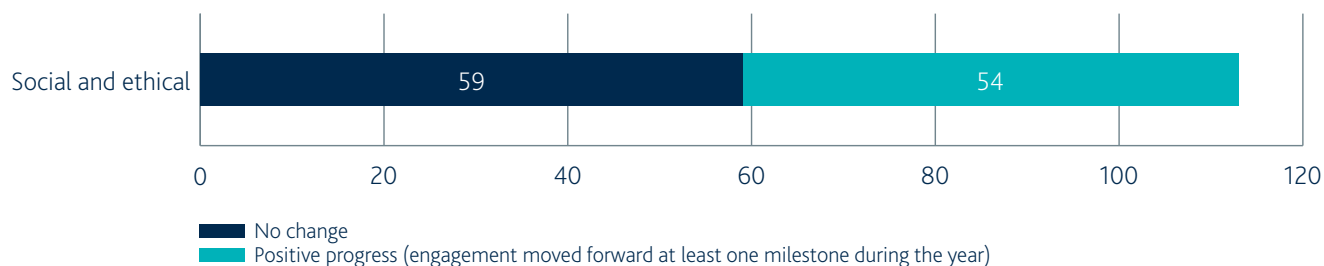
Together with over 50 other large institutional shareholders, we conveyed our support to the US House of Representatives and Senate for the introduction of the Business Supply Chain Transparency on Trafficking and Slavery Act of 2015. The legislation will require companies to disclose measures they have taken to identify and address the risks of forced and child labour and human trafficking throughout their supply chains.

We were pleased that the European Parliament voted to require all EU importers of four specific minerals – gold, tin, tungsten and tantalum – to be certified to ensure they do not fuel conflicts and human rights abuses. We had previously called on the European Commission to consider introducing such legislation and go beyond the much weaker and more limited voluntary rules it had proposed earlier. We were part of a group of global investors that urged the European Parliament to strengthen its proposal by expanding the scope of the legislation to ensure that all companies placing minerals on the market, be they raw, semi-finished or finished goods, are legally required to source responsibly. We also petitioned the European Commission to respect the outcome of the European Parliament's vote by taking steps to enact a mandatory conflict mineral due diligence reporting framework for all companies placing conflict minerals on the European market.

Representatives from the asset manager and owner community in London, together with associated NGOs, attended a Hermes EOS-hosted event by First Peoples Worldwide (FPW). FPW seeks to work with investors to highlight risks to their portfolios posed by strained community relations and encourages them to engage their investee companies to better manage the risks associated with the rights of indigenous peoples.

The fair and affordable pricing of drugs is a key topic for the pharmaceuticals industry, policy-makers and long-term institutional investors. We participated in a panel discussion organised by the PharmaDiplomacy initiative on the newly developed checklist for collaborative, mutually acceptable drug pricing.

Progress against social and ethical objectives



Case study: Hon Hai Precision Industry



A Q&A with Hans-Christoph Hirt of Hermes EOS about Taiwanese technology hardware and equipment manufacturer Hon Hai Precision Industries, also known as Foxconn

Q: Why is Hermes EOS engaging with Hon Hai?

A: Since 2010, we have had constructive dialogue with Hon Hai Precision Industry – also known as Foxconn – on a wide range of topics and issues. Following employee incidents at the company's sites, human capital management has been one of the key areas of our engagement, with a focus on the working environment and conditions in factory towns with hundreds of thousands of employees. We continue to engage with Hon Hai on the ongoing measures that it is taking to ensure the welfare and safety of its over one million employees globally. In recent years, the company has started to diversify, seeking growth opportunities in businesses not closely related to its core experience and know-how and away from its home market China. In light of this, we have also raised questions about the limited transparency regarding the company's objectives, strategy and developing business model, as well as its communications with and reporting to investors on these issues.

Although Hon Hai continues to deliver good financial results, we have some concerns about the board's ability to effectively challenge the powerful founder and chair/CEO. The board does not appear to have members with an appropriate diversity of backgrounds, experience and skills. It is also unclear whether the board is adequately preparing the company for the eventual succession of the chair/CEO. While the chair/CEO could continue for many years, this is the biggest governance risk for the company.

Q: How have you engaged with the company?

A: We have had a series of meetings, calls and written communications with senior executives and undertook some site visits to the company's Shenzhen operations. Importantly, we had contact with senior management and specialists and have built up mutual respect and a strong working relationship with the head of investor relations and the adviser to the chair/CEO. We also led a collaborative engagement, which included a statement at the company's 2014 AGM, on behalf of a group of investors owning more than 300 million shares, around 2.3%, of the company. We produced our own statement at the 2015 AGM, again using the opportunity to put our concerns and suggestions directly to the chair/CEO.

We reached the peak of our engagement with Hon Hai to date when the adviser to the chair/CEO joined us via teleconferencing at our Client Advisory Council in September 2015. His presentation about the company's human capital management, its recent development and future plans and corporate governance has been the most useful presented to investors so far, demonstrating Hon Hai's progress and willingness to being more open on all of the concerns we have raised. The adviser credited Hermes EOS' feedback with contributing to the improvements Hon Hai has made.

Q: What progress has the company made so far?

A: The company has made good progress on employee relations, which was verified independently by the Fair Labor Association (FLA), although a few of the FLA recommendations, particularly in relation to working hours, remain outstanding. We confirmed that the company has taken a series of measures to improve its working environment and conditions, such as increasing wages, adjusting work schedules and introducing job rotation, moving production sites inland and closer to the families of workers. In addition, Hon Hai now provides more off-campus housing and 24/7 counselling and invests in automation and robotics.

Following our intensive – robust but friendly – engagement, the company has also progressed on transparency and communications. For example, it enhanced its disclosure and communications at its 2014 and 2015 AGMs, launched its vision and strategy website in March 2015 and produced a revamped and improved sustainability report in 2015, incorporating the suggestions we have made during our engagement. Furthermore, it has provided us with increased and better access to its senior executives. However, with regard to board composition and effectiveness and succession, we have so far only been given limited assurance, mainly through question and answer sessions at the company's 2014 and 2015 AGMs.

Q: What are the next steps?

A: We continue to engage the company on its overall approach to the management of human capital, given the declining availability and rising costs of factory workers in China and its plans to move to India, and will continue to provide feedback on its disclosures and communications, including on its strategy and investments. We will also encourage Hon Hai to demonstrate more clearly how it is preparing for succession. This will include discussions about board composition. We are pleased about the willingness of the CEO's adviser to speak to other investors about the company's response to controversies and business challenges and the tangible improvements we have seen.

Governance: Engagement progress

In 2015, 44% of Hermes EOS' engagements on behalf of PNO Media included a governance objective. In this section, Hermes EOS summarises some of the major governance themes it engaged on in 2015 and provides a case study illustrating the successful outcome of an engagement.

Status of governance engagement objectives

The table below describes the objectives of each engagement and the milestones reached in pursuing them.

Theme	Total engagement objectives	Engagement objective status				Completed engagement objectives	
		Objective set	Concern raised	Concern acknowledged	Plan established	Completed	Discontinued
Governance	251	6	59	75	68	36	7

Corporate engagement

Good corporate governance is often the first area that needs to be addressed before trying to engage on environmental, social, strategy and stewardship issues. Having the right board composition is at the heart of good governance and key to introducing change at companies. Board members should be diverse with the right mix of skills, backgrounds, experience, nationalities, ethnicities, independence and gender. In 2015, companies in our engagement programmed appointed more of these individuals and made other changes to the composition of the board in line with our engagement objectives.

While we advocate the roles of CEO and chair to be split, where this is not feasible, we push for a strong lead independent director to be in place with powers equivalent to those of an independent chair. We pressed companies for a strong specification for this role and the disclosure of it in 2015.

Proxy access – the right of shareholders to nominate candidates for the board – dominated some of our discussions with companies in the US. We supported shareholder resolutions on the subject and succeeded in companies discussing it and implementing this important shareholder right.

Remuneration meanwhile should align the interests of company executives with those of shareholders. We engaged heavily with companies on this issue and continued to promote the Hermes EOS Remuneration Principles for Building and Reinforcing Long-term Business Success.

We believe equal voting rights should be attached to shares regardless of the total holding or other characteristics of an investor. We therefore support the principle of one-share one-vote, which ensures proportionality between equity ownership and voting powers, and thus economic risk bearing. In this context, we advocated equal shareholder rights through the implementation of a single class share structure where this is not the case and where national legislation – such as in France – promotes double voting rights.

We also pressed for enhancements to sustainability reports throughout 2015. Ideally, we want companies to produce integrated reports, in other words reports that complement traditional financial statements with material sustainability analysis in a comprehensive manner to demonstrate the interconnectivity of strategy, performance, risk and incentives and help identify sources of value creation.

Public policy and best practice

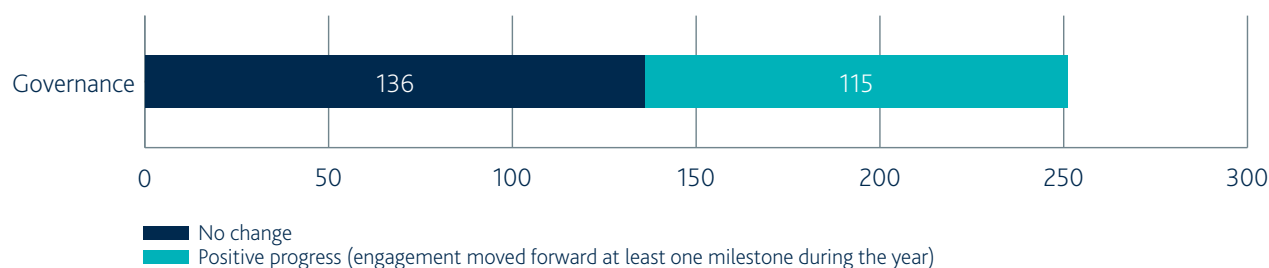
We responded to the consultation by the Financial Services Agency and the Tokyo Stock Exchange on Japan's first Corporate Governance Code after pushing for its introduction for a number of years. We welcomed and supported the general principles proposed by the code and its comply-or-explain approach. In our response, we highlighted the importance of meaningful and good quality explanations if a company chooses not to comply with the code's recommendations. We also presented our views on issues relating to board effectiveness and shareholder communications.

Following our engagement, speeches and workshops in Taiwan over a number of years, the local stock exchange published the draft of its stewardship code. This means that another leading Asian capital market is likely to introduce stewardship guidance for institutional investors in the near future, following in the footsteps of Japan and Malaysia. Our contribution to the process leading to the publication of the local code was acknowledged by the stock exchange.

As a result of our engagement in Singapore on the topic in 2014, we were invited to join the Singapore stewardship code working group, chaired by the think tank the Stewardship Asia Centre, to develop a stewardship code for the city state. We participated in a series of conference calls throughout 2015 and provided extensive written feedback based on our international experience with stewardship codes. We were pleased that our feedback contributed towards the code being set up to primarily target institutional investors and including an additional principle on collaboration between investors, which we strongly pushed for.

Furthermore, we launched a project aimed at developing guidelines and best practice in the dialogue between investors and non-executive directors in Germany.

Progress against governance objectives



Case study: KDDI



A Q&A with Sachi Suzuki of Hermes EOS about Japanese telecommunications company KDDI

Q: Why is Hermes EOS engaging with the company?

A: We were concerned about a lack of independent oversight on the board of KDDI. At the start of our engagement in 2012, the board consisted of 12 directors, made up of 10 executive and two non-executive directors. While presented as outsiders by the company, in reality the two non-executive directors represented the two major shareholders of KDDI, each of whom holds over 10% of KDDI's issued capital and has conducted significant business transactions with the company. We believed that the interest of minority shareholders would therefore not be adequately addressed. The board also lacked diversity, which added to our concerns.

Q: What did the engagement entail?

A: We had a number of meetings and calls with the company where we highlighted the importance of independent oversight. Initially, KDDI was of the opinion that the presence of the two non-executive directors sufficed to bring an outside perspective to board discussions and insisted that there was no need to change its board structure. We however argued persistently that the interests of the affiliated directors could differ from that of minority shareholders and that the board needed genuinely independent elements to protect the latter. At KDDI's AGMs, we continued to withhold support for the affiliated directors.

We also pointed out the importance of having independent oversight to provide checks and balances, particularly after a

series of negative news about the company, which included false statements about its network coverage and a number of flaws in its communications system. In addition, we encouraged the company to consider increasing the diversity on its board to reflect its customer base and add a variety of views to discussions.

Q: What success has the engagement had?

A: In our meeting in 2013, KDDI for the first time told us that its board was considering appointing independent directors. This was a reflection on the result of the previous AGM where the two affiliated directors received a significantly lower level of support than the rest of the board members.

As the company said it struggled to find suitable candidates from the telecoms industry, we shared our views that non-executive directors do not necessarily need to have industry experience. We explained that individuals with backgrounds in different business sectors could in fact add significant value.

In 2014, we welcomed the appointment of KDDI's first truly independent director. Pleased to learn that messages from investors and other stakeholders, including ourselves, had influenced the decision, we encouraged the company to consider enhancing the level of the board's independence further. At the AGM of the same year, we supported by exception the re-election of the two affiliated directors to acknowledge the improvement in board structure – although we do not normally lend our support to directors with such affiliation.

We applauded the subsequent appointment of a new female independent director to the board in 2015, which was in line with our request to increase board independence and diversity. Because of the appointment, KDDI now also meets the independence requirement of Japan's Corporate Governance Code, which came into force in 2015. We had for several years called for the introduction of this code and worked with the relevant policy-makers to ensure its implementation in 2015.

Strategy and risk: Engagement progress

In 2015, 17% of Hermes EOS' engagements on behalf of PNO Media included a strategy and risk objective. In this section, Hermes EOS summarises some of the major strategy and risk themes it engaged on in 2015 and provides a case study illustrating the successful outcome to an engagement on strategy and risk issues.

Status of strategy and risk engagement objectives

The table below describes the objectives of each engagement and the milestones reached in pursuing them.

Theme	Total engagement objectives	Engagement objective status				Completed engagement objectives	
		Objective set	Concern raised	Concern acknowledged	Plan established	Completed	Discontinued
Strategy and risk	94	8	17	25	30	11	3

Corporate engagement

We spoke at the AGMs of several companies in 2015 in support of our engagement and to commend the progress made, as well as to challenge the areas that in our view still need to be addressed.

One of the highlights of the year was when an influential company representative presented to us at our Client Advisory Council, which was the result of our longstanding engagement with the firm. This allowed us to gain valuable insights into the company's strategy involving diversification and overseas expansion, as well as its corporate governance.

We discussed new business strategies with companies in the wake of changing parts of their businesses and revised growth strategies. These included strategies that were amended as a result of integrating the risks climate change poses to the business. We encouraged the adoption of best practices in risk reporting and risk management and pressed companies to integrate sustainability into their business models.

We heavily engaged with companies in the financial sector on their strategy, business models and compensation ratios. As part of this, we also engaged on culture change as reforming behaviour at banks continues to be challenging. However, in 2015, we welcomed the roll-out of new codes of conducts by several companies.

We were pleased that the two candidates we co-nominated to represent minority shareholders were elected to the board of an emerging markets company at its AGM. The new directors replaced the outgoing shareholder representatives who opted not to stand for re-election.

Furthermore, we promoted best practice in enhanced audit committee and auditor reporting. We also urged for more disclosure on audits, including transparency on non-audit fees paid to auditors.

We pushed for better access to medicine programmes with the pharmaceutical companies in our engagement programme. The programmes are strategically important, as they help companies set foot in potential new markets.

While our role as investors is not to question the technicalities of a company's tax practices, we can encourage best practice in terms of how companies consider and manage the risks associated with their approach to tax. To that end, we advocated an appropriate level of disclosure from companies on their strategy, policy and management of key risks in relation to tax.

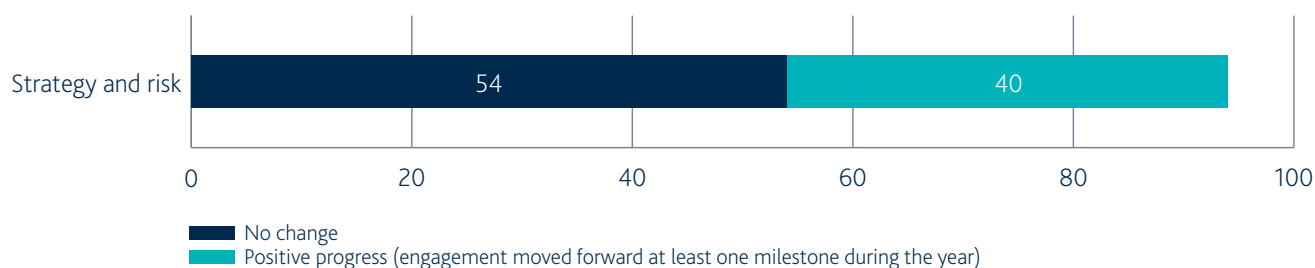
Public policy and best practice

At a conference organised by the European Commission, we pressed for concrete and rapid improvements of the voting chain. The event brought together relevant stakeholders to exchange experiences with the digitalisation of company law and corporate governance. We welcomed the review of the Shareholder Rights Directive which seeks to encourage long-term investment by giving companies the rights to identify their shareholders and by granting voting confirmation to investors. We explained the current broken voting system and the necessary changes to sustain stewardship practices.

We responded to a consultation paper issued by the Financial Reporting Council (FRC) on auditing and ethical standards, specifically on the implementation of the EU Audit Directive and audit regulation. We are supportive of the FRC's aims to ensure the roles and responsibilities of auditors and audit committees are clear and aligned with the interests and needs of investors, that audit and auditors are trustworthy, act with integrity, serve public interest and consistently meet the objectives of audit and audit standards given changing business and economic conditions.

We also submitted our response to the US Securities and Exchange Commission to its consultation on audit disclosure. We explained our views on how it might enhance the level and quality of disclosures provided by company audit committees.

Progress against strategy and risk objectives



Case study: Bank of America



A Q&A with Tim Goodman of Hermes EOS about Bank of America

Q: What is the background to the engagement?

A: We embarked on an intensive engagement with the banking industry, in particular in the US, Europe and the UK in the aftermath of the financial crisis of 2007-2008. We also stepped up our engagement with banks in other parts of the world to encourage those in regions such as Asia and countries like Canada that had avoided the worst of the crisis to ensure that they also learned the necessary lessons.

The financial crisis resulted in a significant loss of value for investors, including our clients, from the fall in value of bank shares, particularly the shares of banks that had to be bailed out by the governments of their home country. Moreover, as universal owners, our clients suffered from the widespread and deep economic recession that the crisis triggered.

Our sector engagement has therefore focused on encouraging the boards of banks to better manage the risks that crystallised during the financial crisis and to deepen, broaden and improve their oversight to avoid or at least mitigate developing systemic risks or specific risks outside of a bank's risk appetite.

Q: What did the engagement entail?

A: Our engagement with Bank of America has focused on board composition, risk management and culture, in particular the culture and pay of employees who are capable of obtaining large personal rewards. We engaged closely with the company on its leadership structure when it appointed the CEO as chair in 2014, in the wake of the departure of the independent chair from its board. This was in sharp contrast to the binding shareholder vote from 2009 to split the roles of chair and CEO. Overall, we have engaged on issues that will help the bank to better manage the risks that it faces as a large retail, commercial and investment bank.

Following the recombination of the chair and CEO roles our engagement regarding the bank's leadership – both on paper and

in practice – gained in intensity. In the run-up to the shareholder vote to ratify the decision to amend the company's by-laws to provide the board flexibility in determining its leadership structure, we had a number of meetings and calls with various members of senior management and two meetings with the lead independent director. We discussed the reasons behind the decision, the formal responsibilities of the lead independent director and his role in practice, as well as the functioning of the board.

We voted against the ratification because we were concerned that the board had decided to overturn the binding shareholder vote from 2009 without seeking shareholder approval first. Also because we prefer chair and CEO roles to be split to ensure good checks and balances. However, we explained in a letter to the lead independent director, which was shared with the board, that we acknowledged that the written specification for his role is the strongest we have seen in the US to date and importantly effectively equivalent to that of an independent chair. Through our meetings, we also gained the sense that the lead independent director appears to fulfil the role in line with our expectations.

Since the shareholder meeting we have met another director of the bank who reconfirmed our positive impression of how the board is now working in practice.

Q: What progress have you seen?

A: We are pleased with the way the bank has reformed in the years since the crisis. The board itself has improved and we have seen evidence of real efforts to improve risk management and culture at the bank.

Nevertheless, we were disappointed with its decision to recombine the role of chair and CEO. While we understand the board's arguments for this move, we find it difficult to agree with the decision. However, out of this significant setback, we have seen progress, in particular the willingness of the directors to step up their engagement with us and other investors. As a result of our engagement, we now have a deeper relationship with the board and the governance management which will be mutually beneficial.

Additionally, we will encourage companies in a similar position to review and strengthen their specifications for the lead independent director role.

Public policy work

During 2015 on behalf of PNO Media Hermes EOS formally responded to 16 consultations, or a proactive equivalent to this, and held 294 discussions to press its views with the relevant regulators and stakeholders. The breakdown of these was:

Region	Consultations or proactive equivalent*	Meetings and discussions
Global	0	79
Developed Asia	2	46
Emerging and Frontier Markets	1	27
Europe	3	46
North America	6	27
UK	4	69
Total	16	294

*for example a letter in absence of regulatory reform

Our key activities and achievements in the year were:

Global

- We played a vital role in ensuring that the approach to UK and European oil and gas majors, which is delivering results on their disclosure on climate change risk, is not lost as the **Aiming for A** coalition of investors, which Hermes Investment Management joined in 2015, begins to work in the US. We worked on a less confrontational proposal than those often filed on environmental issues in the US in favour of the collaborative, long-term approach promoted by Aiming for A.
- At a meeting of the **Carbon Asset Risk Group** by the Institutional Investors Group on Climate Change, we shared experiences of how best to achieve a positive response from companies on climate change risk mitigation. The focus was on portfolio asset resilience and the need for companies to ensure that assumptions about the oil price up to 2035 are communicated as part of the stress-testing of various climate change scenarios.
- We met the **Climate and Clean Air Coalition's Oil & Gas Methane Partnership** to discuss best practice engagement with oil and gas companies to reduce methane leakage in their operations. Implementing cost-effective methane emissions reductions could have a greater impact on global warming leading to 2050 than taking action on carbon dioxide. To do this, companies must focus on measuring and reporting their methane leakage rates.
- Our meeting with the executive director and programme manager of the new **Corporate Human Rights Benchmark** gave us insights into the mission and operating model of the initiative. The benchmark aims to incentivise a better human rights performance by businesses through improved disclosure and transparency.
- Hermes EOS co-signed the **UN Guiding Principles Reporting Framework Investor Statement**. Hermes EOS hopes this framework will encourage companies to assess and manage human rights risks, which could pose financial and legal risks to their business.

Developed Asia

- We gained insights into the market response to the **ESG comply-or-explain reporting guidelines consultation** at a meeting with the Hong Kong Stock Exchange. Although the responses from investors, including our own, have been mostly positive, large asset managers still prefer to remain anonymous when the responses are published, reflecting a cautious approach to the subject matter.

- We replied to the consultation by the Securities and Futures Commission of Hong Kong on the proposed **Principles of Responsible Ownership**, the country's version of a stewardship code. We were supportive of the Principles.
- We were the only representative of non-Asian institutional investors to address the inaugural forum of **Stewardship Asia**, a Singaporean think tank set up by one of the local sovereign wealth funds. We explained the reasons for the surge in interest in stewardship codes by institutional investors and reflected on adjustments to their role in Asia, where family and state-ownership is widespread among listed companies. We also highlighted potential conflicts of interest between asset owners and fund managers.

Emerging and Frontier Markets

- During a call with the head of the **Bangladesh Accord on Fire and Building Safety**, we received confirmation that the remediation process is behind schedule. The Accord was established by European retail brands following the Rana Plaza factory collapse in 2013 in an attempt to lead improvements in the ready-made garment industry. The key obstacles appear to be resistance by the Bangladeshi government, which has strong ties to the garment industry, to the Accord's mandate and a related lack of will on the part of factory owners to undertake improvements.
- We provided feedback on the proposed programme aimed at implementing best practices of transparency, internal controls and management of **Brazilian state-controlled companies** by the BM&F Bovespa stock exchange. In view of recent corruption scandals and abuse of the power of controlling shareholders, this programme may play an important role in restoring confidence and recovering value through the adoption of corporate governance best practices. Companies joining the programme will be scored against a number of requirements and awarded a seal of quality, if they achieve a minimum score.
- In a meeting with the chair of the Brazilian Institute of Corporate Governance, we gained an insight into its revision of the **Code of Best Practices** and the public consultation. The fifth edition of the Code has a principles-based approach and is less prescriptive on subjects such as criteria for independent directors.
- We were invited by the OECD to speak at a panel about the **corporate governance priorities of investors in Russia**. The focus of the roundtable was the implementation of the 2014 Corporate

Governance Code. The main topics covered were comply-or-explain reporting, the level of board independence and harmonisation of the code and listing rules. We highlighted the importance of engagement between companies and investors and the role of corporate governance best practices in promoting long-term value creation.

- We welcomed the amendments to the **listing requirements of Bursa Malaysia**, which we believe will promote improved reporting on sustainability by listed companies, thus better addressing the interests of their long-term owners. We firmly endorsed the notion that issuers should disclose their management of material economic, environmental and social risks and opportunities, moving away from reporting merely on their corporate social responsibility activities.
- We participated in the inaugural meeting of **Malaysia's Institutional Investor Council** which was set up to oversee and support the development of corporate governance and stewardship policies and practice in the market. We also took part in the first meeting of the Institutional Investor Council's working committee, which will support the Council's work and effectively drive its agenda, and used the opportunity to put stewardship code implementation and training on its agenda.

Europe

- We jointly signed a letter to the EU vice president and commissioner, encouraging the **Capital Markets Union Action Plan** to expand its existing fourth principle to include full disclosure of the exposure to material environmental, social and governance risk. We also called on them to set up a high-level commission to investigate and report on the materiality of climate risk to capital market stability.
- We hosted a roundtable in Switzerland for companies and investors on the **implementation of the country's Minder law**, which has introduced binding votes on pay packages for board members and executive management. Positively, the implementation of this significant legal change, which entails moving the decision-making power on remuneration from the board to shareholders, seems to be smoother than many had predicted.
- We met the Spanish regulator CNMV to discuss the changes it made to the **Spanish Corporate Governance Code**. We were pleased to see a number of positive additions to the Code – such as extending the duties of directors to include tax-related responsibilities, restrictions on board size, the introduction of a minimum independence level of 50% for the board and reducing the maximum terms for directors from six to four years – against which companies will have to report from 2016.

North America

- We signed a petition to the Federal Drug Administration to encourage the wider use of cheaper **biosimilar drugs** in the US. We believe that the wider availability of biosimilars will encourage fairer competition in the pharmaceutical industry and reduce the costs, while not damaging the standards, of healthcare in the US.
- We co-signed a letter signed by a number of US pension funds calling on the US Securities and Exchange Commission to go further on its proposed rule on **clawing back variable pay**. We encouraged it to include clawbacks for misconduct and to improve its intended disclosure rules on clawbacks.
- We responded to a consultation by the US Securities and Exchange Commission on the disclosure of the **hedging of shares** – the act of insulating against a lack of financial rewards at times of

underperformance. We argued that there should be a ban of this practice by all directors and senior employees of listed companies so that their ownership of shares is aligned to the experience of long-term investors. We widened our response to include the pledging of shares, the act of using shares as a security for other financial transactions. We argued for disclosure of all hedging and pledging by directors and senior management, while accepting that on occasion temporary pledging of limited numbers of shares may be permissible. We also called for disclosure of how the decision-making on hedging and pledging is made.

- We successfully persuaded the influential Environmental Defense Fund (EDF), a large environmental NGO, to include our suggestions on commentary on its largely data-driven reporting requirements on **methane reporting** in the oil and gas industry. We believe that narrative can provide a richer picture of the activity of companies than only using data.

United Kingdom

- We responded to a consultation paper by the Department for Business Innovation & Skills (BIS) on **Auditor Regulation** – implications of the EU and wider reforms. We believe it is important to rebuild lost confidence in the value and effectiveness of the audit process. In our view, this can in part be achieved by focusing on maintaining auditor independence through mechanisms such as mandatory tendering, increasing the accountability of auditors to the audit committee and by taking steps to improve the quality of audit reporting through enhanced disclosures and auditor commentary on matters significant to users' understanding of audited financial statements or the audit.
- We responded to a UK government consultation proposing the publication by companies of an overall **gender pay gap figure**. We believe a published figure is an important step forward. It may not be meaningful per se, but it will reflect different and specific circumstances for each organisation beyond a simple pay gap issue. The legislation has the potential to encourage companies to ask themselves the right questions, which are not necessarily directly related to the gender pay gap, but to their general approach to diversity and human capital management.
- Hermes EOS co-sponsored and attended a meeting at the UK Houses of Parliament on the **Modern Slavery Bill**. Participants included company representatives, NGOs, businesses and politicians from the main political parties.
- We provided feedback on the draft **Stewardship Disclosure Framework** for its members, which was finalised by the UK's National Association of Pension Funds. Overall, we welcomed the disclosure framework as an important mechanism to monitor adherence to the UK Stewardship Code principles and were generally supportive of the framework.
- We noted our concerns about the lack of transparency regarding corporate tax policies, the reputational and financial risks associated with companies' tax behaviour and the effects this can have on their operations in our response to a consultation on improving **tax compliance for large businesses**. We agreed that there is benefit in introducing measures that seek to improve companies' disclosure on tax strategies to allow key stakeholders, including investors, to assess the risks associated with tax behaviour. But we cautioned against the use of overly prescriptive legislation as it can have unintended consequences.

Overview

In the last year, Hermes EOS made voting recommendations at a total of 984 meetings around the world on behalf of PNO Media, analysing 12,347 resolutions in accordance with PNO Media’s voting policy. At 430 of those meetings, Hermes EOS recommended opposing one or more resolutions, while at five meetings, Hermes EOS recommended abstaining. Hermes EOS recommended voting with management by exception at 13 meetings and supported management on all resolutions at 536 meetings.

Global

We made voting recommendations at **984** meetings (**12,347** resolutions) over the last year.



- Total meetings in favour **54.5%**
- Meetings against (or against AND abstain) **43.7%**
- Meetings abstained **0.5%**
- Meetings with management by exception **1.3%**

Australia and New Zealand

We made voting recommendations at **three** meetings (**20** resolutions) over the last year.



- Total meetings in favour **66.7%**
- Meetings against (or against AND abstain) **33.3%**

Developed Asia

We made voting recommendations at **90** meetings (**709** resolutions) over the last year.



- Total meetings in favour **57.8%**
- Meetings against (or against AND abstain) **42.2%**

Emerging and Frontier Markets

We made voting recommendations at **371** meetings (**4,024** resolutions) over the last year.



- Total meetings in favour **52.8%**
- Meetings against (or against AND abstain) **45.8%**
- Meetings with management by exception **1.3%**

Europe

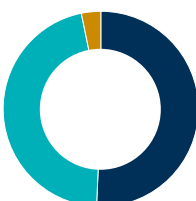
We made voting recommendations at **223** meetings (**3,415** resolutions) over the last year.



- Total meetings in favour **47.5%**
- Meetings against (or against AND abstain) **50.2%**
- Meetings abstained **2.2%**

North America

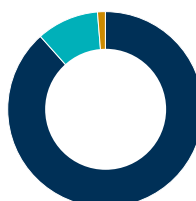
We made voting recommendations at **219** meetings (**2,848** resolutions) over the last year.



- Total meetings in favour **50.7%**
- Meetings against (or against AND abstain) **46.1%**
- Meetings with management by exception **3.2%**

United Kingdom

We made voting recommendations at **78** meetings (**1,331** resolutions) over the last year.



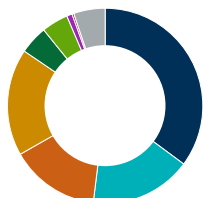
- Total meetings in favour **88.5%**
- Meetings against (or against AND abstain) **10.3%**
- Meetings with management by exception **1.3%**

Voting by issue

The resolutions where Hermes EOS recommended voting against management or abstaining on behalf of PNO Media are shown below.

Global

We recommended voting against or abstaining on **1,193** resolutions over the last year.



- Board structure **35.1%**
- Remuneration **16.8%**
- Shareholder resolution **14.8%**
- Capital structure and dividends **17.7%**
- Amend articles **4.7%**
- Audit and accounts **4.4%**
- Governance **0.9%**
- Poison pill/Anti-takeover device **0.3%**
- Other **5.2%**

Australia and New Zealand

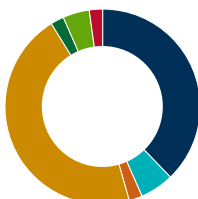
We recommended voting against or abstaining on **one** resolution over the last year.



- Remuneration **100.0%**

Developed Asia

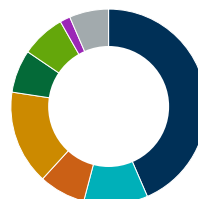
We recommended voting against or abstaining on **90** resolutions over the last year.



- Board structure **37.8%**
- Remuneration **5.6%**
- Shareholder resolution **2.2%**
- Capital structure and dividends **45.6%**
- Amend articles **2.2%**
- Audit and accounts **4.4%**
- Poison pill/Anti-takeover device **2.2%**

Emerging and Frontier Markets

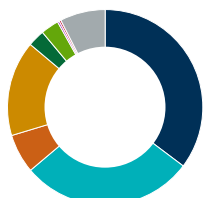
We recommended voting against or abstaining on **480** resolutions over the last year.



- Board structure **43.5%**
- Remuneration **10.6%**
- Shareholder resolution **7.7%**
- Capital structure and dividends **15.6%**
- Amend articles **7.1%**
- Audit and accounts **7.3%**
- Governance **1.7%**
- Other **6.5%**

Europe

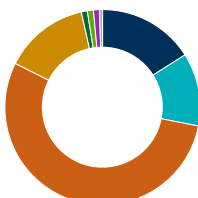
We recommended voting against or abstaining on **399** resolutions over the last year.



- Board structure **35.3%**
- Remuneration **28.6%**
- Shareholder resolution **6.5%**
- Capital structure and dividends **15.8%**
- Amend articles **2.8%**
- Audit and accounts **3.0%**
- Governance **0.3%**
- Poison pill/Anti-takeover device **0.3%**
- Other **7.5%**

North America

We recommended voting against or abstaining on **206** resolutions over the last year.



- Board structure **16.0%**
- Remuneration **12.1%**
- Shareholder resolution **54.4%**
- Capital structure and dividends **14.1%**
- Amend articles **1.0%**
- Audit and accounts **1.0%**
- Governance **1.0%**
- Other **0.5%**

United Kingdom

We recommended voting against or abstaining on **17** resolutions over the last year.



- Board structure **11.8%**
- Remuneration **29.4%**
- Capital structure and dividends **17.6%**
- Amend articles **41.2%**

Important information

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