Stewardship Report 2022

April 2023

Federated Hermes Limited

www.hermes-investment.com
For professional investors only

On behalf of and in the interests of the investors it serves, the investment industry can be a powerful force in building resilient companies in resilient economies that create wealth sustainably – and at Federated Hermes Limited (FHL), we believe active stewardship is the best way to achieve this objective [1].

[1] Federated Hermes Limited was formerly known as Hermes Fund Managers Limited. For purposes of this report, references to "Federated Hermes Limited", "FHL", "our", "we", "our firm" and, unless the context indicates otherwise, "firm" include Federated Hermes Limited and its consolidated subsidiaries, other than Hermes Equity Ownership Services Limited. Hermes Equity Ownership Services Limited ("EOS at Federated Hermes" or "EOS") will report separately. The statements, references to officers, practices and policies, and discussions in this report pertain to Federated Hermes Limited, and not to other business engaged in by Federated Hermes, Inc. and its other consolidated subsidiaries. Certain statements in this report constitute forward-looking statements, which involve known and unknown risks, uncertainties, and other factors that may cause the actual results, activities or levels of activity, performance or achievements of FHL to be materially different from any forecast results, levels of activity, performance or achievements expressed or implied by such forward-looking statements.

In 2022, the recovery of economies around the world from the impacts of the Covid-19 pandemic was threatened by a series of geopolitical and macroeconomic challenges.

Russia's invasion of Ukraine created huge disruption in trade, resulting in a surge in fuel and food prices. Intensified by other issues such as labour and component shortages after the pandemic, soaring inflation and corresponding increases in interest rates have driven up the cost of living, impacting companies, employees, customers and suppliers. The war in Ukraine has also displaced a huge number of people and created human and labour rights concerns for companies operating in the region. Against this backdrop, the investor community has continued to place more emphasis on social themes in its stewardship and advocacy activities. In acknowledgement of these issues, we engaged with companies on their response to the Russia-Ukraine war and the cost of living crisis, and supported a number of shareholder resolutions on social issues such as paid sick leave and human rights impact assessments.

Whilst companies faced increasing social pressures, environmental issues did not disappear. Europe faced record-breaking temperatures during the summer, whilst Pakistan suffered extensive flooding that devastated large swathes of the country. These events reinforced the need to address the current geopolitical issues in a way that is aligned to the goals of the Paris Agreement on climate change. In our advocacy and stewardship activities, we emphasised the need to address the climate, energy, security and cost of living crises together.

Amidst all of this, investors faced an increasingly complex regulatory landscape, whilst in some markets views on ESG integration became highly polarised. This underlined the need for transparency from investors on communicating how the approaches we take are focused on the delivery of long term financial returns in line with the long-term interests of our clients and beneficiaries.

Coming at the end of a challenging year, the outcomes of COP15 on biodiversity sounded a more positive note. Almost 200 countries adopted the Kunming-Montreal Global Biodiversity Framework in December, which features a target to protect at least 30% of land and seas by 2030. At FHL, we continued to work towards meeting our own ambitious commitments to climate, biodiversity and nature.

As a business dedicated since our 1983 inception to delivering sustainable wealth creation that enriches investors, and, where possible, society and the environment over the long term, we will continue to invest, engage and act to support the change needed by the planet, its people and the generations to come consistent with client objectives and applicable requirements.

David Stewart
Chair,
Federated Hermes Limited

Saker Nusseibeh, CBE
CEO,
Federated Hermes Limited

Eoin Murray
Head of Investment,
Federated Hermes Limited

Leon Kamhi
Head of Responsibility,
Federated Hermes Limited

Executive summary

Stewardship: 'The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'. [UK Stewardship Code 2020]

Following on from our 2021 Stewardship Report, this report describes our continued stewardship work across asset classes during 2022 and the outcomes of these activities. We have followed the structure of the UK Stewardship Code, reporting principle by principle to communicate our policies, processes, activities and outcomes to clients and wider stakeholders.

Building on last year's reporting, we now include the stewardship activities of our infrastructure and private equity investment teams. We have also included information on our Climate Action Plan which was published in 2022 as part of our net zero commitment, including our interim targets. We also summarise our approach to deforestation after we committed at COP26 in 2021 to strive to eliminate deforestation from our portfolios through engagement.

We begin once again by setting out our purpose, our beliefs and our values that drive our strategy and business model. Our stewardship activities flow from this overarching structure, demonstrating how we contribute to building a global financial system that delivers improved long-term returns for investors, as well as, where possible, better, more sustainable outcomes for society.

All of the work we do as responsible stewards of capital is underpinned by our purpose, values and investment beliefs which we describe under Principle 1. From our 1983 inception through to the present day, our purpose has been to deliver sustainable wealth creation for investors over the long-term. We believe there are four mutually reinforcing strands of being a responsible investment manager: ESG-integrated investments; active ownership and management; advocating in beneficiaries' interests; and behaving as a responsible business. Together, these aim to generate sustainable wealth creation for the end beneficiary investors, encompassing investment returns and their social and environmental impact.

This drives our governance structures – designed to put our clients and beneficiaries at the heart of everything we do – and our investment and engagement activities, through which we seek to provide strong risk-adjusted investment performance for clients and in doing so achieve positive outcomes for society and the environment, consistent with client objectives and applicable requirements. It is our contention that long term investment returns and beneficial outcomes for society are often mutually reinforcing.

We continuously strive to reflect on our efficiency and the outcomes we are delivering in order to identify further ways in which we can enhance our approach. Throughout the report we reflect on enhancements made to our approach during 2022, as well as areas identified for further improvement in 2023.

In collating this report, we have taken steps to ensure it is fair, balanced and understandable. We have provided information across asset classes, with the representation reflecting the makeup of our assets under management ("AUM"). In doing so, we have communicated our successes, reflected on our learnings and highlighted the changes we will make in the next 12 months. We also provided examples and case studies throughout the report to demonstrate how our investment approach works in practice. Each section of the report has been reviewed by the relevant business areas, as well as by our Governance Committee. The report has been approved by our Board.

This report also fulfils some of the entity-level reporting requirements for Federated Hermes Limited – which includes its subsidiaries Hermes Investment Management Limited, Hermes GPE LLP, Hermes Fund Managers Ireland Limited and Hermes Alternative Investment Management Limited (together "FHL Entities" and each an "FHL Entity") – under Annex C of the EU Shareholder Rights Directive and as required by the FCA Conduct of Business Sourcebook 2.2B.

The approach set out in this document applies to products and strategies managed by Federated Hermes Limited Entities. This includes all funds in the Federated Hermes Investment plc range. Money market funds are excluded as the investment manager for these funds is not an FHL Entity.

EOS at Federated Hermes will report separately under the Stewardship Code as a service provider.

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Principle 1

Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Our goals are to help individuals invest and retire better, to help clients achieve better risk-adjusted returns and, consistent with client objectives and applicable requirements, to strive to contribute to positive outcomes in the wider world.

Who we are

From when our first CEO openly challenged a major UK company to improve its governance to when our current CEO Saker Nusseibeh was awarded a CBE for services to responsible business, Federated Hermes Limited (FHL) has always been at the forefront of responsible investing. We are guided by the conviction that responsible investing is the best way to create long-term wealth for investors.

We are an active asset manager with a difference. We were set up to manage the pension funds of British Telecommunications ("BT") and the Post Office in September 1983 and have engaged with companies from day one. In 1983, our first CEO, the late Ralph Quartano, admonished the Marks & Spencer Board for the special loans they made available to directors. He made it clear we were committed to serving the needs of our clients – the 400,000 beneficiaries whose money we part-managed – and that we understood that the investment decisions we made on their behalf helped to determine the shape of the future society in which they would live.

In 1996, we set up a dedicated corporate governance team to engage with companies and advise on all aspects of corporate engagement and environmental, social and governance ("ESG") policy development, research and analysis, voting recommendations and engagement. In 2004, this team evolved into our stewardship business, now EOS at Federated Hermes ("EOS"). EOS was set up in response to demand from pension funds that wanted to be more active owners of the companies in which they were invested.

Our client base has since expanded rapidly, with growth in third-party AUM and stewardship assets under advice ("AUA"). These origins have driven our purpose, investment beliefs and strategy throughout our history, from when we established our Focus Funds business in 1998, to our work challenging boards and pushing for corporate-governance reform, to when we founded EOS in 2004.

Since our beginnings, we have helped clients achieve strong risk-adjusted returns through our specialised equity, fixed-income and private-market strategies and, more recently, our multi-asset and proven liquidity-management solutions. Through these strategies and solutions, we continue to aim to help individuals to save and retire better over the long-term.

Figure 1. FHL's investment capabilities

	1 LISTED EQUITIES	2 SPECIALIST FIXED INCOME	3 PRIVATE MARKETS	4 THEMATIC
Strategies	Global Equities (including Global Equity ESG) Global Emerging Markets Asia ex Japan European Equities SMID Impact Opportunities SDG Engagement Equity Biodiversity	Global High Yield Multi Strategy Credit Absolute Return Credit Direct Lending Real Estate Debt Unconstrained credit SDG Engagement High Yield	Real Estate Infrastructure Private Equity	Socially Responsible Investment ESG Driven Investing Impact Investing (e.g., Impact Opportunities) Impact through Engagement (e.g., SDG Engagement High Yield, SDG Engagement Equity)
AUM*	**US$23.0bn** £19.1bn / €21.6bn	**US$6.3bn** £5.3bn / €5.9bn	**US$16.0bn** £13.3bn / €15.0bn	**US$4.6bn** £3.8bn / €4.3bn Thematic AUM is also included under equities, credit and private markets
Approach to ESG Factors	Investment process integrates ESG leveraging quantitative ESG analysis and EOS engagement		Responsible and sustainable investment approach across all private markets capabilities	Tailored, specialist strategies designed to meet specific SRI, ESG and Impact-related objectives

5 Stewardship			
	Investment insights generated by EOS through its range of active ownership services:		
	Stewardship and stakeholder engagement services	Public policy advocacy	Hybrid investment and stewardship mandates
	US$1,340.7bn £1,144.0bn / €1,302.6bn		

Key: Investment strategy: Strategies that contribute to Thematic investing

AUM does not include assets under sub advice.
Source: FHL, as at 31 December 2022.

Federated Hermes, Inc. acquires remaining stake in Federated Hermes Limited

In August 2021, Federated Hermes, Inc. ("FHI") purchased the remaining 29.5% interest of Federated Hermes Limited ("FHL") held by the BT Pension Scheme ("BTPS"). Following the transaction, FHI owned approximately 90% of FHL's shares, with the remainder held by senior members of FHL staff through the FHL Long Term Incentive Plan (LTIP) scheme. On 14 March 2022, FHI completed the acquisition of the remaining 10% stake in FHL, effected by way of a tender offer, with the FHL LTIP plan generally being replaced with the equivalent award of restricted stock in FHI.

Since the initial acquisition in 2018, FHI, which has a history of backing and investing in the talent and the businesses it acquires, has made substantial investments in FHL including: acquisitions by FHL of MEPC Limited ("MEPC") (a wholly owned development and asset management subsidiary) and the team from Argent Birmingham (the team working on the Paradise, Birmingham real estate scheme); the build out of the business in the Asia Pacific region; and the investment and the build out of the EOS team in the US.

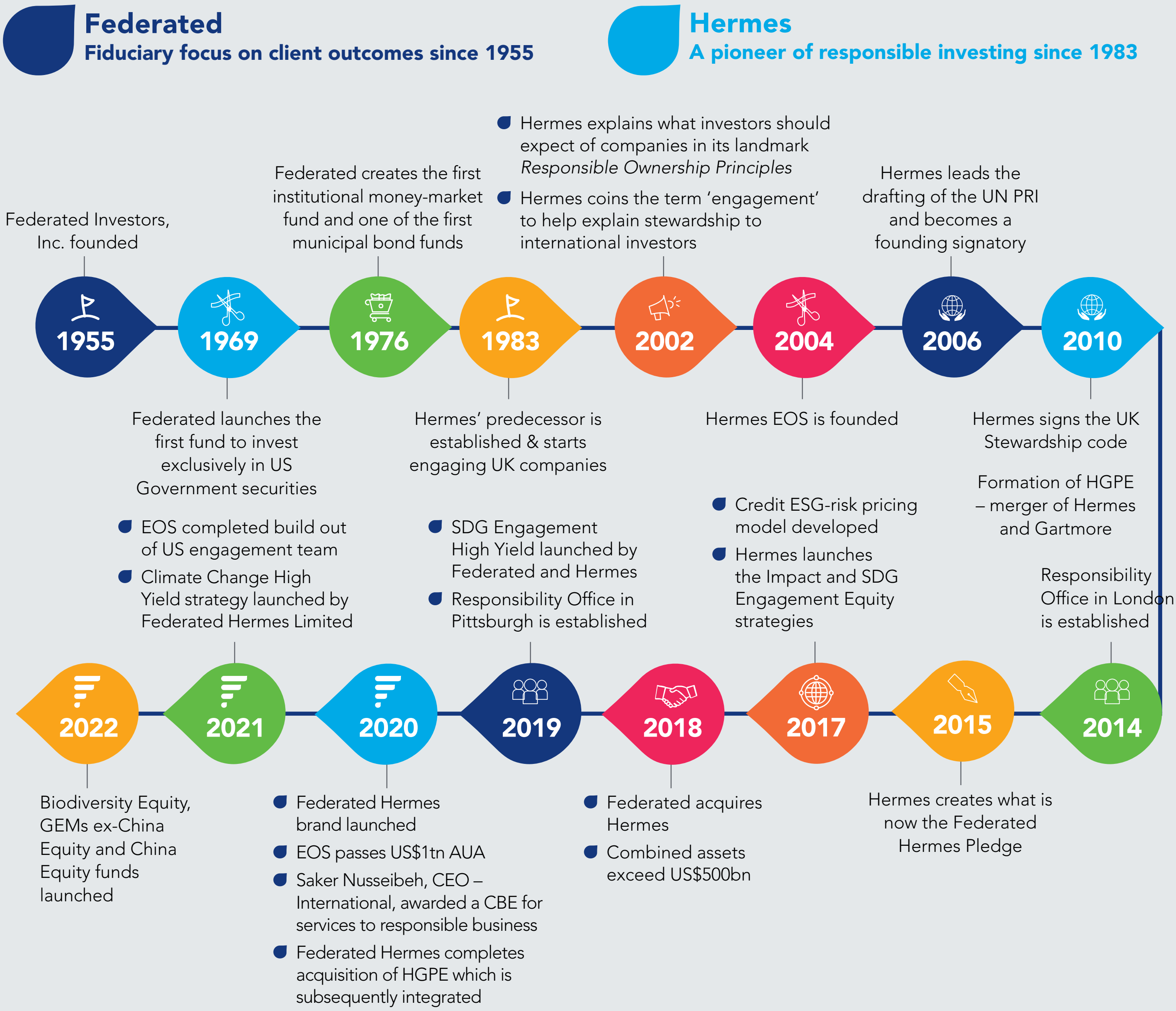
Its commitment could not be better demonstrated than by its decision to change its own name to "Federated Hermes, Inc.". This was an important step and a powerful illustration of the high regard it has for FHL's talent, expertise and client proposition.

FHI and FHL are united by a shared commitment to client-centric responsible investment and long-term business growth.

FHI completes the acquisition of Hermes GPE LLP

Hermes GPE LLP ('HGPE') became a subsidiary of FHI following the completion of the acquisition of HGPE Capital Limited and GPE Partner Limited (together 'HCL') on 5 March 2020, effective 1 March 2020. HGPE acts as an investment manager and advisor, specialising in developing bespoke and diversified portfolios for clients that provide access to global private markets via fund investments, co-investments and direct investments in buyouts, growth businesses, infrastructure and renewables assets.

Figure 2. Our history as a leading responsible investor has been decades in the making



Source: FHL, as at 30 April 2023.

Our values

We believe that investing responsibly is the best way to sustain long-term outperformance. and contribute to beneficial outcomes for investors and companies, as well as, where possible, society and the environment.

Since our business began in 1983, we have advocated for and sought to embody a way of investing that enriches investors and companies, as well as, where possible, society and the environment. Sustainable wealth creation is our way of ensuring the capital we invest generates financial outperformance and, where aligned and performance enhancing, environmental and social outcomes – not only for our clients and their investors but for the generations that will follow.

> **Since our business began in 1983, we have advocated and sought to embody a way of investing that enriches investors and companies, as well as, where possible, society and the environment.**

In an industry where many competitors are awakening to the appeal of sustainable investment, we are energised by the opportunity to advance the leadership position we have long held by driving further change.

Despite the challenges of the pandemic, we have continued to develop and increase the sophistication of our approach to stewardship on themes, sectors and regions in consultation and agreement with our clients. Our clients, the companies we engage and the policymakers we seek to influence know us first and foremost as a professional voice for investors on sustainability.

> **Despite the challenges of the pandemic, we have continued to grow revenues, AUM and stewardship, and to invest in our future growth.**

We aim to act with integrity in everything we do. The Federated Hermes Pledge, first established by FHL in 2015 and adopted by FHI in 2018, compels us to put clients' interests first and to act responsibly. It is a clear expression of our values and has been signed by 98% of employees at FHL. The pledge is as follows:

I pledge to fulfil, to the best of my ability and judgment and in accordance with my role, this covenant:

- I will act ethically, responsibly and with integrity.
- I will put the interests of our clients first, consistent with our fiduciary responsibilities.
- I will encourage responsible behaviour in the firms in which we invest and on which we engage.
- I will act with consideration for our community and the environment both now and in the future. I will encourage others to do the same.
- I will work with industry colleagues and other key stakeholders to develop and improve our industry's contribution to society.
- I will treat my clients, my colleagues and all other stakeholders with dignity and respect and as I would wish to be treated.
- I will deal with our regulators in an open, co-operative and timely way.
- I will communicate clearly and honestly with all parties inside and outside our firm.
- I will manage conflicts of interest fairly between all parties.

Our fiduciary heritage and expertise in responsible investment ensure that our clients' interests come first.

Our investment beliefs

We believe the purpose of investment is to create wealth sustainably for investors over the long term.

That's why focusing on wealth creation at the expense of the planet and society – the very future for which investors are saving – is counterproductive. Our world faces multiple challenges, including climate change, inequality and navigating the ever-pervasive growth of artificial intelligence.

> **Successful sustainable wealth creation should provide investors with income to spend as they get older, an ability to buy goods and services and help to build a world in which investors are happy to live.**

Investment management has a key role in addressing those challenges and the industry must behave in a way consistent with solving the world's problems rather than compounding them. This will have notable positive financial implications for investors and society, guarding against significant risks to the long-term health of the economy. Successful sustainable wealth creation should provide investors with income to spend as they get older, an ability to buy goods and services and help to build a world in which investors are happy to live.

We view responsibility through three lenses. Acting as a:

- **Responsible Investor** – how we integrate engagement insights and ESG considerations including the delivery of sustainable outcomes into our investment decisions.
- **Responsible Owner** – our stewardship activities: engagement, voting, public policy and screening.
- **Responsible Firm** – ensuring we lead by example, be that our commitment to net zero, our approach to diversity, equity and inclusion amongst colleagues and other stakeholders and our charity initiatives and programmes supporting the local community.

> **We firmly believe that our ability to mitigate ESG risks and capture the investment opportunities arising from material ESG considerations and engagement insights is essential to achieving consistent investment outperformance for our clients.**

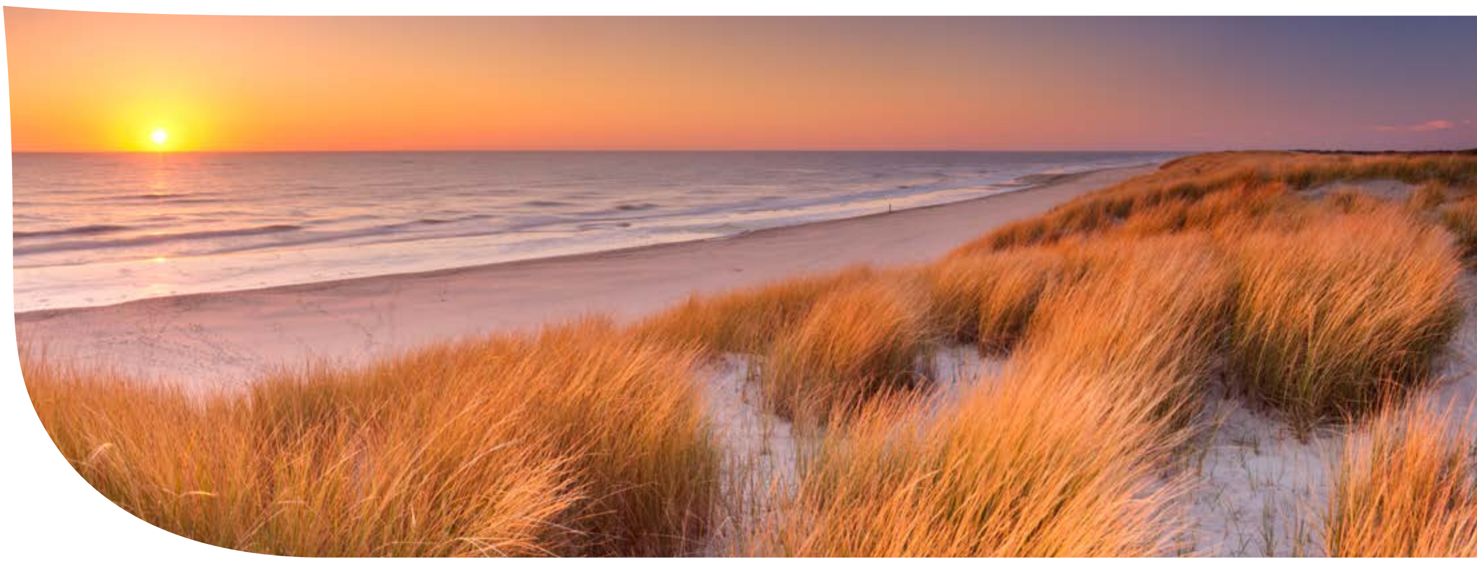
As responsible investors, we embrace high-active-share investing. We take a holistic approach that integrates material ESG considerations and engagement insights into all of our investment products, something that offers our fund managers an additional vantage point with which to assess an asset's potential to deliver long-term sustainable wealth.

We firmly believe that our ability to mitigate ESG risks and capture the investment opportunities arising from these considerations is essential to achieving consistent investment outperformance for our clients.

Acting as responsible owners of the assets we manage on behalf of our clients, we actively engage through dialogue with companies including on ESG issues. We believe this is essential in order to build a global financial system delivering improved long-term returns for investors, as well as better, where possible, more sustainable outcomes for society.

The importance of environmental metrics was evidenced in the latest research from our Global Equities team, with the best placed companies performing ahead or in line with peers, while poorly ranked companies tended to significantly underperform[2]. This followed on from our previous research which confirmed the link between social and governance factors[3].

> **Acting as responsible owners of the assets we manage on behalf of our clients, we actively engage through dialogue with companies including on ESG issues.**



[2] Federated Hermes Limited, 'Despite headwinds, ESG continues to perform', (July 2022)

[3] Federated Hermes Limited, 'ESG investing: How Covid-19 accelerated the social awakening', (December 2020)

Successful engagement can also translate into outperformance: studies have shown how engagement can generate higher annualised returns[4], while also leading to lower downside risk[5]. There is no conflict between doing good and good investment management – they are one and the same thing.

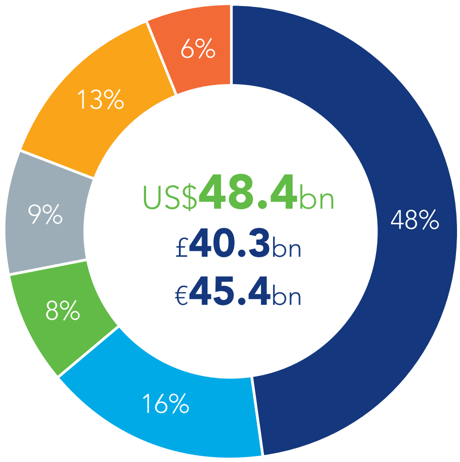
Our business model and strategy

FHL is committed to delivering superior risk-adjusted investment returns for our clients. In addition to our financial targets, we understand that the way we achieve our investment objectives will have wider societal impacts. As such, we seek to provide both a better financial future for our ultimate stakeholders and, where possible, a more sustainable society. The pursuit of sustainable wealth creation drives the execution of all of our strategies consistent with client objectives and applicable requirements.

Our heritage has enabled us to put this into practice since 1983. We did this first by managing the assets of the BTPS and subsequently by offering our skills to a broad and fast-growing range of global customers that includes institutions and advised private investors. Our specialist, high-conviction investment teams now manage £40.3bn / €45.4bn / $48.4bn (as at 31 December 2022) of assets across equities, credit, private debt, real estate, infrastructure and private equity.

> **Successful engagement can translate into outperformance: studies have shown how engagement can generate higher annualised returns[4], while also leading to lower downside risk[5].**

Figure 3. A diversified platform



Total AUM (Millions)	USD	GBP	EUR
Equity	**23,000**	19,121	21,551
Real Estate	**7,820**	6,501	7,327
Infrastructure	**3,660**	3,043	3,430
Private Equity	**4,541**	3,775	4,255
Fixed Income	**6,347**	5,276	5,947
Liquidity	**3,073**	2,555	2,880

'Liquidity' in the pie chart above includes our money market funds.
Source: FHL, as at 31 December 2022.

Through EOS – one of the largest stewardship resources of any fund manager in the world – we engage companies on strategic and material ESG concerns to promote investors' long-term performance and fiduciary interests. EOS offers a shared service model, engaging on behalf of both FHL and third-party clients.

[4] Dimson, E., Karakas, O. and X. Li. (2015). Active Ownership. The Review of Financial Studies, 28(12), 3225-3268. Past performance is not a reliable indicator of future performance.
[5] Hoepner, A.G.F., Oikonomou, I., Sautner, Z., Starks, L.T., and X.Y. Zhou. (2020). ESG Shareholder Engagement and Downside Risk. ECGI Finance Working Paper 671/2020.

EOS provides a platform for like-minded investors, creating a powerful force for positive change. The team works on behalf of long-term global investors who entrust us with the stewardship of approximately £1.1tn / €1.3tn / $1.3tn of AUA (as at 31 December 2022) invested in over 20,000 companies worldwide, working collectively in support of shared goals. This pooling of assets increases the influence we can have with companies, which means we can have a more meaningful impact on the issues of most collective importance to our clients.

Creation of three platforms

In order to continue to lead and oversee the public markets teams based in Europe, to further expand the private markets offering and to drive the responsible investing agenda for our firm, the Board of FHL has resolved to establish three distinct platforms:

- The **Public Markets** platform – incorporating our Equities and Fixed Income & Multi Asset products and solutions.
- The **Private Markets** platform – incorporating Private Equity, Private Debt, Real Estate and Infrastructure.
- The **Responsibility** platform – which includes EOS at Federated Hermes, our advocacy team, research, ESG integration and some client advisory activities.

These form the basis of how we will view our commercial offering and will be supported by all the existing functions necessary to deliver a great client experience – Audit, our Client Group, Compliance, Corporate Communications, Facilities, Finance, HR, Legal, Marketing, Product, Risk, Sales, Sales Support, Tax and Technology.

EOS provides a platform for like-minded investors, creating a powerful force for positive change.

In 2023, we are continuing to put in place a plan for the *sustainable* development and growth of this three-platform franchise, placing clients firmly at the heart of what we do.

Strategy

Our strategy is driven by a focus on delivering sustainable wealth creation for our clients and their investors. That means we aim to provide strong risk-adjusted investment performance for clients and in doing so achieve positive outcomes for society and the environment.

We seek enduring business growth and profitability, and to make a positive impact as a leader in investment and sustainability. These objectives are firmly aligned with the interests of our clients, the companies in which we invest and engage, and the societies in which they operate.

Our strategy is driven by a focus on delivering sustainable wealth creation for our clients and their investors.

Figure 4. FHL's growth framework

Our growth framework is therefore focused on areas where:

- There is enduring appeal from long-term investors.
- We have a differentiated approach to the way we manage assets.
- We can offer access to co-investment, segregated mandates, joint-venture and pooled opportunities in private markets alongside leading institutional investors.
- We enhance performance by integrating ESG factors and stewardship into our public and private markets strategies. Going further, to fulfil mandates or product objectives, we invest in and engage with assets so they generate growth by addressing enduring social and environmental needs.

Source: FHL, as at 30 April 2023.

The priority for 2023 will be to continue our integration efforts with FHI, our parent, whilst upholding our strong heritage. With the introduction of a new strategic pillar, Sustainable Careers, we will also be prioritising our attention on employee satisfaction, wellbeing and retention. We will also seek to achieve sustainable and profitable growth by demonstrating cost resilience and continuing to invest in our competitive strengths in responsible investing and stewardship.

How we have ensured a culture of effective stewardship

Our investment beliefs, strategy and culture ensure that stewardship is naturally at the heart of FHL. We believe that creating long-term wealth sustainably through active investment and ownership delivers the best outcomes for our clients. Throughout this report, we highlight some of the actions we have taken to ensure our investment beliefs, strategy and culture enable effective stewardship, including:

Governance: We have embedded the need for effective stewardship in governance structures across the business, as described under Principle 2. This sends a clear signal of its importance to our business.

Investment integration assessment: The ESG integration team within the Responsibility Office carries out annual assessment of the effectiveness of integration of material ESG and engagement insights in each investment strategy.

Integrated in our investment processes: Driving change through engagement is one side of the coin – effective integration of stewardship insights is the other. As we set out under Principle 7, we systematically integrate stewardship insights into our investment process so that our investment and engagement activities go hand in hand. This creates a holistic understanding of ESG issues and how they intertwine.

The priority for 2023 will be to continue our integration efforts with FHI, our parent, whilst upholding our strong heritage.

Embedded throughout the product lifecycle: Stewardship is incorporated into our product-development process right from the start. A product's relationship to responsible investment and active ownership is a key consideration at the concept development stage and we endeavour throughout the development process to ensure it delivers sustainable wealth creation for clients. A recent example is our Biodiversity Equity strategy, launched in early 2022. It seeks to invest in companies that are helping to protect and restore biodiversity or are reducing the threat to biodiversity through their measurable contribution to reducing land pollution, marine pollution and exploitation, unsustainable living, climate change, unsustainable farming, or deforestation. The strategy aims to deliver a compelling return by investing in global equities and also deliver measurable impact both through the activities of the companies we invest into and through engagement with those companies to improve further. Stewardship is also key to our client-service provision. We act as responsible stewards of all the capital in which we invest, through allocation, management and engagement with assets. Through EOS, we also provide broader stewardship services for our clients' public market equity and credit investments in third-party products. An increasing number of clients are enlisting these wider services as there is a growing recognition of the need for high-quality stewardship. As we set out under Principle 2, once a product is live, there is a strong governance process in place to continuously review the effectiveness of the integration of material ESG factors alongside traditional performance drivers and engagement insights for the product and to ensure it continues to deliver the necessary outcomes for our clients.

All of our investment teams integrate ESG and engagement insights into their investment decision making, as we explain in more detail under Principle 7.

Transparency: Transparency around our activities is key to enabling scrutiny and continuous improvement. We report annually as signatories of the UN-supported Principles of Responsible Investment (PRI) and UN Global Compact (UNGC) on our responsible investment activities as well as our work to ensure we behave as a responsible firm. We publish a Climate-related Financial Disclosures report annually which is aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). We continue to publish our EOS engagement plan and quarterly updates, as well as case studies from public and private markets, along with our Real Estate ESG report. More information is available under Principle 6.

We act as responsible stewards of all the capital in which we invest, through allocation, management and engagement with assets.

Expert support: Our Responsibility Office offers support to all our investment teams in their integration of ESG and engagement information, including through the development of proprietary tools enabling analysts to see ESG data and engagement information for individual companies and their portfolio as a whole. This reflects our core investment belief that responsible investment and stewardship lead to better financial results. More information on our progress during 2022 is available under Principle 7.

Long-term focus: A significant number of our engagements are longer-term efforts, and we carry out a continuous dialogue with companies. For example, 79% of our relationships with the companies in our core public-market engagement programme have been ongoing for at least five years. Our engagement team conducts thorough research and an assessment of each company to ensure the nature of our engagement is accurate. This allows us to build quality, trusting relationships with these firms. More information is available under Principle 9.

Collaboration: Our collaborative approach – described further under Principles 4 and 10 – acknowledges the significant quantity and quality of resource needed for effective stewardship and the importance of cooperation to deliver maximum impact across asset classes, sectors and geographies. We set out how we have worked with other stakeholders in the system under Principle 4.

What this means for our approach to investment and stewardship

The recognition that investors' interests lie in sustainable wealth creation over the long term cascades a series of decisions and actions that turns an investor into a responsible owner or steward of capital. We believe responsible, active ownership helps create businesses that are much more resilient to exogenous shocks. These firms are more likely to survive over the long term, and in and by doing so create better outcomes for our investors and society. Indeed, we believe this is the best way to sustain long-term outperformance and contribute to beneficial outcomes for investors, companies, society and the environment.

This is brought to life and complemented by bottom-up fundamental research on material ESG factors, which, of course, influences the decisions we make in our stewardship and investment processes. We place both stewardship and high-active-share investing at the heart of what we do. This ensures that we invest and engage with conviction: we build investment portfolios that we believe are meaningfully different from the market – and, as such, we expect to outperform in the long term[6].

Rather than betting on whether the market goes up or down, this combination of high conviction, high-active-share investing and stewardship means we focus on sustainable wealth creation for investors. In our investment decisions, we take into consideration both ESG data and fundamental research in assessing a company's performance. As responsible owners, we seek positive change in our engagement, not just information. While our engagements with investees cover a broad range of strategic (including ESG) issues, they share a focus on outcomes that create wealth sustainably. Principles 7 and 9 set out how we have continued to maintain high standards of stewardship and responsible investment during 2022 guided by our purpose.

CASE STUDY

Global Equities team research

The latest research from the Global Equities team at FHL indicates that despite market volatility and the energy crunch, ESG continues to be an effective performance indicator[7]. Our previous research confirmed the link between social and governance factors[8]. In the latest findings, the importance of environmental metrics is evidenced, with the best placed companies performing ahead or in line with peers, while poorly ranked companies tend to significantly underperform.

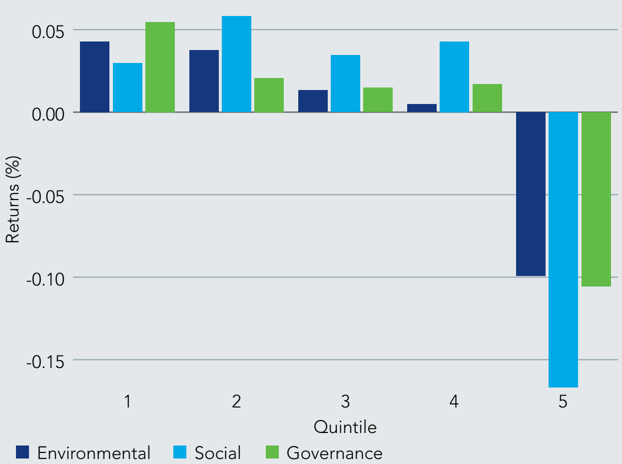
In our 2020 release, we demonstrated that governance and social factors were a statistically meaningful driver of shareholder returns. The pandemic cemented the importance of social impact, with more socially responsible companies tending to outperform[9]. Previously there was weak evidence that environmental factors had similar properties, but the historic relationship was volatile and did not reach the necessary hurdle to be considered significant. That has changed over the last two years, with environmental factors performing on a par with social and governance. This confirms that across the environmental, social and governance pillars, the link between ESG and performance is clearly in evidence.

In our inaugural ESG research, published in 2014, we demonstrated a striking aspect of the relationship between governance and shareholder returns, often overlooked in other studies. Namely, the relationship is non-linear. Companies with leading or improving corporate governance scores outperform peers with poor or worsening standards. However rather than performance deriving from the leaders outperforming, the governance premium is largely driven by the underperformance of the laggards. This same pattern exists for the social factor and for the environmental factor.

For investors, avoiding the ESG laggards, and those whose standards are slipping, is a crucial way to capture the ESG premium.

Figure 5: Companies with poor ESG practices have historically underperformed over the long term

Average monthly total relative returns of companies in each quintile, based on environmental, social and governance scores, from 31 December, 2008, to 30 June 2022. Figures are calculated using constituents of the MSCI World Index, assuming monthly rebalancing.



For illustrative purposes only. Source: MSCI, FHL, as at 30 June 2022.

[6] Outperformance cannot be guaranteed.
[7] FHL, 'Despite headwinds, ESG continues to perform', (August 2022)
[8] FHL, 'ESG investing: How Covid-19 accelerated the social awakening', (December 2020)
[9] FHL, 'ESG Investing: How Covid-19 accelerated the social awakening', (December 2020)

Our purpose in practice

REAL ESTATE CASE STUDY

Leeds – Meaningful placemaking in practice

The Real Estate team manages and developed an historic area in Leeds, amounting to £300m AUM across 116,610m² of lettable space.

Wellington Place is a hub of state-of-the-art offices, independent restaurants and landscaped gardens steeped in history, next to Leeds railway station. For this scheme, historically important sites have been repurposed, maintaining the link between the present and the past. The investment in the Wellington Place scheme has provided new employment opportunities across over 30 companies. With the development of an old retail warehouse site built on the former railway goods yard, this has brought a previously redundant area back into prominence, with new public areas, restaurants and employment opportunities. The provision of brand-new buildings that offer high specification space allows the whole of Leeds to attract important long-term employers, enhancing the opportunities for job creation, retention and growth.

Figure 6. United Nations Sustainable Development Goals (UN SDGs) in focus in our placemaking approach

Source: UN SDGs.

Our team manages the **Marshall's Mill & Round Foundry**, which includes an 18th century mill. The mill has been repurposed to high specification office space and the area has become a creative hub for games developers, filmmakers and advanced manufacturing. The place is a "neighbourhood of collaboration" supporting independent businesses and the local community. Both Wellington Place and Marshall's Mill & Round Foundry schemes have developed spaces both for the occupiers and the public with new routes and green spaces to linger. Looking to the future, FHL continues to support the development of Leeds with the continuation of these schemes and the development of new housing in the East of the city.

Figure 7. Wellington Place

Source: Bevan Cockerill

How effectively have we served clients and beneficiaries?

Throughout this report we seek to demonstrate the outcomes of our responsible investment and responsible ownership, which we believe are in our clients' best interests. This includes financial performance, stewardship outcomes and advocacy successes. We believe our investment approach helps us deliver sustainable long-term wealth creation by building a better world for our clients and future generations.

External evaluation: There are several external bodies that have validated our achievements and bolstered the credibility of our claim that we are serving the best interests of our clients.

We are founding members of the UN-supported Principles of Responsible Investment (PRI). In 2021 a revised PRI Reporting Framework was introduced with each module scored out of 100, which translated into a rating out of 5 stars. FHL received 5 stars in Investment & Stewardship Policy, Listed Equity Active Quant Incorporation, Listed Equity Active Fundamental Incorporation, Fixed Income Corporate, Fixed Income Securitised, Fixed Income Private Debt, and Real Estate modules, with HGPE also scoring 5 stars in the Investment and Stewardship Policy module. We scored 4 stars on the Listed Equity Active Quant Voting and Listed Equity Active Fundamental Voting modules, with HGPE also scoring 4 stars in the Infrastructure module. We scored 3 stars on the Private Equity module and as a result our private equity team conducted a review and upgraded their existing ESG integration processes. This covered enhanced ESG analysis at the point of investment as well as during the investment hold. Additionally, the team started tracking ESG KPIs with their first ESG report submitted to shareholders in 2022.

> **FHL received 5 stars in PRI's Investment & Stewardship Policy, Listed Equity Active Quant Incorporation, Listed Equity Active Fundamental Incorporation, Fixed Income Corporate, Fixed Income Securitised, Fixed Income Private Debt, and Real Estate modules, with HGPE also scoring 5 stars in the Investment and Stewardship Policy module.**

We won a range of awards based on our activities during 2022 in recognition of our leadership in responsible investment, including:

- Excellence in ESG winner at the Fund Selector Asia Singapore House Awards 2023.
- Best ESG/Sustainable Bond Fund Provider award for the SDG Engagement High Yield Credit fund at the Asian Private Banker Asset Management Awards for Excellence.
- Best Asset Manager ESG Boutique for Germany, Austria and Switzerland at the Scope Awards 2023.
- IJGlobal ESG Corporate Transition Award in the Infrastructure category won by Scandlines, one of our infrastructure portfolio companies.

We conduct post-implementation annual reviews on an ongoing basis to confirm that all products continue to meet a customer need, perform in line with their stated objectivesand have continued commercial viability.

Client input: We seek client views through a number of fora to ensure we understand how we can best meet their needs. This is set out in further detail under Principle 6.

Continuous review of client outcomes: We have a number of governance structures in place (described under Principle 2) to ensure fairness to clients and beneficiaries, including through our Customer Outcomes Group ("COG")[10]. The COG supports product governance by providing a forum through which products (including funds and segregated mandates) are reviewed and assessed through a client-centric lens.

We also conduct post-implementation annual reviews on an ongoing basis to confirm that all products and strategies continue to meet a customer need, perform in line with their stated objectives and have continued commercial viability. Each product and strategy is viewed holistically, with data collated across the business using a standard template. Information collated for the annual reviews includes performance figures, client demand and peer-group comparison analysis. Customer feedback may be obtained by a third-party market research agency or directly through the sales and client teams, and this feedback will be considered as part of the review. Any products or strategies that have not met marketed performance targets, do not continue to meet a customer need or have failed to attract assets will be flagged with the COG for consideration. One-off or ad-hoc reviews may also be conducted in response to market events to ensure the product range remains appropriate within the context of our broader investment and corporate strategy.

We also have pricing committees and complete an internal mapping exercise every year. This considers factors such as each client's AUM in order to identify and address material anomalies between clients. During 2022, there were a number of cases where an investor increased their holding in a fund and subsequently reached the required AUM for a lower-fee institutional share class. At this point, they were able to move into this share class so that they could benefit from lower fees.

Plans for the future: We always strive to improve the outcomes we deliver for clients. We recognise this process is never complete, and that continuous improvement and innovation is required if we are to remain market leaders.

Over the coming year, we intend to continue to enhance investment decision-making and engagement effectiveness by further enhancing our thematic approach to deforestation, biodiversity and human rights in relation to our investments through targeted portfolio, sectoral and issuer analyses. We also plan to continue to develop our client reporting and to continue to advance our diversity, equity and inclusion efforts across the firm.

[10] HGPE is not within the remit of the COG. For our infrastructure and private equity products, these processes are therefore managed separately within HGPE.

Principle 2

Signatories' governance, resources and incentives support stewardship.

Our governance structures

Figure 8. FHL's three-platform structure

Federated Hermes, Inc. (FHI)

Federated Hermes Limited (FHL)

Responsibility	Public Markets	Private Markets
Sales	Sales	Sales
EOS	Investment Management	Investment Management

Sales Support
Client, Product, Marketing and Communications

Risk & Compliance

Internal Audit

Operations
IT, Finance, HR, Ops, Legal, Change programmes and Procurement/Office Mgmt

Source: FHL, as at 30 April 2023.

All of our staff are responsible for implementing our stewardship approach, although there are several functions within the business that play a particularly significant role:

Responsibility Office. Established in 2014, our dedicated Responsibility Office reports through the Head of Responsibility to our CEO and acts as a hub of expertise and support to assist every employee in our business to work towards our core purpose of delivering sustainable wealth creation over the long term. The Responsibility Office houses EOS (see below), FHL's third party stewardship service provider. It coordinates and supports the integration of our responsibility approach and activities across our funds and stewardship services. This includes quarterly meetings with each of the investment teams to review their ESG and engagement integration activities, as well as asset and issuer-specific discussions related to ESG and engagement. The Responsibility Office is also responsible for leading our advocacy work, as well as holding each department accountable for ensuring that we act as a responsible company. By doing so, it keeps the interests of clients and their beneficiaries at the centre of what we do. To ensure responsibility is embedded in all of our firm's business decisions, Responsibility Office colleagues are members of our firm's key committees (the key committees which oversee our stewardship approach are described in further detail later in this section). The Head of Responsibility is a member of FHL's Senior Management Team ("SMT").

Investment Office. Our Investment Office, covering both our public and private markets platforms, is the guardian of the investment outcomes we deliver to clients. It acts independently to ensure our strategies are performing in the best interests of clients and embodies our commitment to acting as a responsible and transparent asset manager. The Head of the Investment Office is a member of FHL's SMT.

Portfolio managers and investment analysts: Each of our investment teams has formulated their own responsibility plans that explain how, in the context of their particular strategy and investment universe, they

The Responsibility Office acts as a hub of expertise and support to assist every employee in our business to work towards our core purpose of delivering sustainable wealth creation over the long term.

incorporate ESG factors and engagement into their investment process. Each team is responsible for undertaking its own fundamental ESG research and the team members are accountable through the performance appraisal system for their part in delivering on our mission.

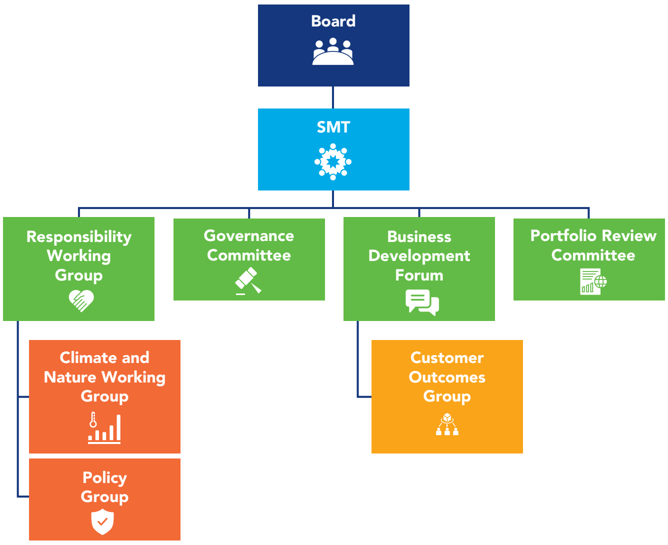
EOS. EOS is a limited company wholly owned by FHL. Its activities and direction are overseen by a board of directors, comprising members of FHL's SMT and a member of FHI's Executive Committee (aka. Executive Staff). Day-to-day operations are directed by the Head of Responsibility as Chair of EOS, and managed by the Head of Stewardship, and directors of the client and business development team and operational management. EOS also has a Client Advisory Board (CAB) which contains client representatives who provide insight, advice and guidance on EOS' business strategy and service offering to ensure that the EOS service is and remains a client-focused offering. The EOS team boasts one of the largest stewardship resources of any fund manager in the world. The team is composed of individuals with a diverse mix of backgrounds, skills and perspectives and has been at the forefront of the development and evolution of responsible investment practices globally. The EOS team leads our public-markets engagement activity.

Risk and Compliance. The Risk and Compliance teams work alongside the Responsibility Office to ensure that our business continues to, authentically and accurately, report on our ESG objectives and activities. Reputational and sustainability risk frameworks are in development which will enable the team to identify material ESG risks and monitor progress across all key ESG commitments, including the implementation of sustainable finance regulation and scanning for other emerging regulations or standards.

Internal audit function. The Internal Audit team's primary role is to help the Board and executive management to protect the assets, reputation and sustainability of the organisation. The function is responsible for providing independent, objective assurance to management through a systematic and disciplined risk-based audit approach and assessment of the internal control framework. More information is available under Principle 5.

The Risk and Compliance teams work alongside the Responsibility Office to ensure that our business continues to, authentically and accurately, report on our ESG objectives and activities.

Figure 9. The internal structure of key stewardship oversight functions of FHL[11]



Source: FHL, as at 30 April 2022.

We have extensive oversight of our responsible investment and stewardship processes, activities and outcomes across our firm – something that is indicative of their importance to our business and how they form a core part of our approach. Accountability for delivering effective stewardship across asset classes is integrated at every level of our governance, including:

Board. We have a well-established governance structure led by the Board of FHL. The Board is responsible for the governance of the organisation and ensuring its effective operation. It also endeavours to consider all stakeholders when establishing objectives and policies. Among the Board's responsibilities is the implementation of the strategy set by our parent company, FHI. The Board is also responsible for overseeing our approach to climate change.

Senior Management Team ("SMT"). The SMT is responsible for the day-to-day management of the business and ensuring the objectives agreed with the Board are met. Our CEO leads the development and implementation of our mission and responsibility goals. We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large – tasks that our CEO actively leads and contributes to. In particular, our CEO is the founder of the 300 Club, an independent forum that challenges the orthodoxy of the investment industry and puts forward approaches to align the industry more closely to the goals of beneficiaries. He is also a member of the Financial Services Culture Board (previously the Banking Standards Board), the FCA-PRA Climate Financial Risk Forum and the Integrated Reporting and Connectivity Council (previously the International Integrated Reporting Council).

Responsibility Working Group ("RWG"). Meeting every quarter, the RWG is made up of senior representatives from across the business and is chaired by our Head of Responsibility. This group discusses a comprehensive range of topics that relate to the delivery of sustainable wealth creation for our clients and beneficiaries and shares best practice across the organisation, including on climate change.

Climate and Nature Working Group ("CNWG"). The CNWG reports to the RWG and meets every quarter. With authorisation from the Board or SMT as appropriate, its aim is to develop and implement a formal business-wide climate-change strategy. This includes overseeing progress in meeting our commitments as a member of the Net Zero Asset Managers' Initiative. The CNWG is also a formal Task Force on Climate-related Financial Disclosures ("TCFD") Working Group that is responsible for – but is not limited to – developing a new climate risk-management approach and enhanced product and engagement offerings.

[11] This chart covers key functions overseeing stewardship and is not an exhaustive representation of the internal governance structure of Federated Hermes Limited.

Policy Group: The Policy Group brings together senior members of the Responsibility Office, EOS, Marketing and Communications teams to discuss our policy and advocacy work.

Governance Committee. The Governance Committee is a formal oversight committee responsible for overseeing the formulation and delivery of our engagement, voting and climate policy. The committee is accountable to and reports to our CEO. The members include the Head of Responsibility, Head of Investment, Head of International Client Group, Managing Legal Counsel, Chief Regulatory Officer & Head of Government Affairs and Managing Director, Private Markets.

Business Development Forum ("BDF"). The BDF is responsible for approving or rejecting new products. Its members consider how desirable and suitable a product is from a commercial, customer and portfolio-management perspective. This includes looking at how it is aligned with our responsible investment and ownership approach. The forum is also responsible for setting fees and pricing and reviewing ongoing product and range suitability, target markets and profitability[12].

Customer Outcomes Group ("COG"). The COG meets every month and supports product governance by providing a forum through which products (including funds and segregated mandates) are reviewed and assessed through a client-centric lens. Good product governance is aligned with our focus on responsible investment management and we aim to put the customer at the heart of product design and management. The COG makes use of a customer-centric view when reviewing investment products and considering our obligations to investors (both directly and indirectly via distributors). The group reviews every strategy at least annually, which includes looking at how well the fund integrates ESG and its engagement progress.

Portfolio Review Committee ("PRC"). The PRC supports the SMT by assessing and managing the investment teams, their corresponding processes and related activities. It reviews investment performance across all of our firm's portfolios and carries out monthly deep dives into specific investment strategies. As part of this review, the PRC considers the investment implications – at a portfolio and issuer level – of the ESG performance of holdings and the level and progress made in engagement with the portfolio's assets.

Responsible Property Management ("RPM") oversight. The Real Estate team have a Net Zero working group and an ESG working group with relevant representatives from the business to ensure the decision-making process is inclusive and transparent. External experts are also included in these forums as appropriate to ensure project decisions are made with the help of investment managers, delivery counterparts and the Real Estate ESG team.

Infrastructure Oversight. The Head of Infrastructure, Infrastructure Investment Committee (IIC) and the HGPE Governing Body are ultimately accountable for all sustainability matters related to infrastructure.

Private Equity Oversight. In the Private Equity team, the Private Equity Investment Committee (IC) is responsible for all investment risks, including climate change risk. The Portfolio Review Committee assesses portfolio-level ESG risks including climate change risks quarterly to inform GP engagement. These Committees and the HGPE Governing Body are ultimately accountable for all sustainability matters related to private equity.

Sustainability Investment Centre ("SIC"): The SIC supports the development of our firm's responsible investment capabilities. It facilitates monthly conversations between teams across the business to pool the best ideas in the sustainable space and supports our focus on long-term sustainable wealth creation.

Accountability for delivering effective responsible investment and ownership outcomes for all clients resides with the investment management/fund advisory companies within the FHL group. While the investment management/fund advisory companies of FHL and our parent company, FHI, are also clients of EOS, we have clear policies in place to identify, manage and mitigate potential conflicts of interest as described under Principle 3.

[12] HGPE is not within the remit of the BDF, COG or PRC. For our infrastructure and private equity products, these processes are therefore managed separately within HGPE.

Details of the specific governance we have around managing climate-related risks and opportunities are available in our Climate-Related Financial Disclosures report.

As well as formal governance structures, we have a structured approach to ensuring that we carry out effective engagement and integrate stewardship into our investment processes. This is evidenced in our reporting against Principles 7 to 12, particularly through our ESG and engagement integration approach, engagement selection process and milestone engagement tracking system.

Resourcing stewardship

All analysts and portfolio managers are responsible for ESG and engagement integration, and a meaningful amount of engagement takes place across all our funds. However, the Responsibility Office plays a key role in facilitating them being informed on material ESG issues for their investments as well as working with them to identify engagement opportunities. The Responsibility Office plays an oversight and support role in ensuring the investment teams have access to the right resources to efficiently integrate ESG and engagement (in conjunction with EOS for public markets).

While the above is the standard process across all of our strategies, we do have specific strategies which engage with all investee companies and where successful engagement is explicitly part of the ex-ante investment proposition. These include the SDG Engagement Equity and SDG Engagement High Yield Credit strategies. Given these strategies' additional focus on engagement and that some of their holdings overlap with other of our and EOS' third-party clients' portfolios, we have dedicated engagers who focus solely on these strategies and work closely with EOS to ensure a consistent approach. More information on these strategies is available under Principles 7 and 9.

We use a number of third-party data providers which support our efforts to integrate ESG and also inform our stewardship activities. These include Sustainalytics, Trucost, CDP, FactSet, MSCI, netpurpose, CRISIL and Bloomberg. We are also actively engaging with other data providers to ensure our teams have access to the latest and most relevant data for our investment approaches. More details on our use of service providers are available under Principle 8.

All analysts and portfolio managers are responsible for ESG and engagement integration, and a meaningful amount of engagement takes place across all our funds.

Training

Our investment teams attend regular education presentations and roundtables provided by EOS engagers, portfolio managers and external experts on ESG risks and opportunities in the context of sectors, themes or country. They are also provided with training on our proprietary ESG integration tools such as the carbon and the environmental tool.

Our investment teams attend regular education presentations and roundtables provided by EOS engagers, portfolio managers and external experts on ESG risks and opportunities in the context of sectors, themes or country.

Training sessions provided over the years include:

- A number of presentations on the latest sustainable regulation and related data points. These sessions were aimed at improving the knowledge of our investment teams on the key elements of EU Sustainable Finance Disclosures Regime ("SFDR"), how to apply the firm's approach to the different criteria required to be in line with the classification of the fund and to understand the relevant ESG data specified by the regulation.
- A number of bespoke training sessions for the investment teams on various ESG topics presented by our EOS thematic experts. In 2022, this included focused sessions on topics such as biodiversity, human capital management and human rights.
- A number of deep-dive sessions to support the investment teams in their integration of ESG factors, including on net zero and deforestation. The Sustainability Investment Centre is an internal forum open to colleagues from across the firm that meets on a monthly basis to discuss various topics related to sustainability. Recent examples include the presentation of a new ESG assessment framework presented by one of our investment teams, a panel discussion held on the uses and abuses of engagement and a focused session on our Climate Action Plan. These are discussed with participants across the investment teams, business development and EOS.

The most effective training in responsible investment and ownership in our view is 'on the job'. Portfolio managers and engagers regularly get together to discuss particular investments and often meet companies together. This benefits the engagement service as it can make the engagement more relevant and material. At the same time, the portfolio manager benefits by getting a deeper understanding of relevant engagement (including, but not only, ESG) issues to consider in a company's risk assessment and value opportunities. More information is available under Principles 7 and 8.

Finally, the PRI Fundamentals course continues to be offered to all new joiners, to increase the level of understanding and awareness of ESG integration topics, and our firm's approach to responsibility has been a formal part of all new joiners' inductions since the second half of 2017.

Diversity, equity and inclusion

As outlined above, all of our staff are in some way responsible for implementing our stewardship approach. Our firm-wide diversity, equity and inclusion ("DEI") approach is therefore of relevance to the diversity of those involved in our stewardship activities. We have a long-standing commitment to increasing diversity and inclusion in our business and acknowledge that we need to make further progress. We aim to foster and promote a culture of inclusion which celebrates all forms of diversity. We aim to appeal to, and retain, a diverse workforce. We encourage innovation and creativity, with a view to helping our employees maximise their potential.

In this area, our SMT endorsed our new DEI Strategy and Action plans in 2022.

Our employee resource group UNITY, the Inclusion Committee, our Corporate Citizenship team and our Human Resources team discovered new ways to support our workforce, especially as we transitioned to a more flexible working life in 2022. Activities undertaken over the year included the continuous development and support of our seven Employee Networks, who hosted several events including the City Hive Cross-Company Mentoring Scheme in collaboration with the #TalkAboutBlack programme, for which we were a lead sponsor.

Our Race Steering Group, which was set up to improve racial equity within the firm, continues to work through the recommendations outlined in the Insight Report. This report was generated for FHL by an external consultant from a series of listening and coaching circles with leadership colleagues on ethnic diversity and inclusion in 2021.

After signing the Menopause Workplace Pledge, we launched a Menopause Project Team set up to support female colleagues experiencing menopause symptoms and offer training for employees. The Team has trained Menopause Champions and Advocates and an SMT Menopause Champion. We continue support listening circles for Gender and Disability, and will expand to other protected characteristics of the Equality Act 2010. We also launched our Equality Data Campaign in the latter part of 2022 to capture the Equality Data of our employees.

In 2022, 274 employees from line managers to SMT members have attended Inclusive Leadership training and follow up focus groups. We have a programme of inclusion training including Cultural Competency workshops and Inclusive Recruitment workshops. For more information please see our website.

FHL remains fully committed to supporting the Women in Finance Charter and its objective of attaining gender balance across all levels of financial services.

Figure 10. Employed women across Federated Hermes Limited's business

Population	Target 2025	2022	2021	2020	2019	2018	2017	2016
Firm-wide	50%	42%	41%	44%	42%	40%	39%	34%
Board	50%	25%	31%	31%	31%	31%	29%	37%
Senior Management	50%	33%	29%	33%	31%	28%	23%	24%

Source: FHL, as at 31 December 2022.

We have seen an increase in women at the senior management level and a more modest increase firm-wide in 2022. We have seen the number of women decrease at Board level during the survey period, though we expect this to be at 50% in very short order which will be reflected in our 2023 submission.

We recognise that we need to be even bolder and more courageous in our approach so we have set stretching targets, which will help the business to focus its efforts on reaching complete gender parity by the end of 2025.

Later in this section we include more information on how we seek to support greater gender diversity in the workplace and our 2025 commitments to achieving equal gender balance across our workforce.

> **We recognise that we need to be even bolder and more courageous in our approach so we have set stretching targets, which will help the business to focus its efforts on reaching complete gender parity by the end of 2025.**

Stewardship resources – public markets

We have one of the largest dedicated stewardship resources of any fund manager in the world, in the form of our public-markets engagement team, EOS. EOS also draws on the expertise of the Responsibility Office of FHL and others within our firm, a number of whom have had direct engagement experience having previously worked within EOS. There are policies, processes and controls in place to ensure the management of conflicts of interest, as described under Principle 3.

EOS has intentionally built a diverse, international team of experienced voting and engagement professionals who have the expertise, language skills and cultural knowledge to deliver real beneficial change within companies.

The ability to engage in the native language is critical to successful engagement, and within the EOS team we have nationals from

19 countries and fluency in **19** languages.

Our diverse engagement team draws on a number of skillsets and our senior engagers come from a range of backgrounds. These include – but are not limited to – banking, law, sciences, academia, climate change, corporate governance and corporate strategy. The team also has strong gender diversity (63% female / 37% male for permanent staff as at 31 December 2022).

> **We have one of the largest dedicated stewardship resources of any fund manager in the world, in the form of our public-markets engagement team, EOS.**

The ability to engage in the native language is critical to successful engagement, and within the EOS team we have nationals from 19 countries and fluency in 19 languages. The combination of our ability to engage in the local language and our understanding of local culture and business practice are critical to the success of our engagement work. The EOS team is well placed to draw upon and, where appropriate, conduct additional research. It is also well placed to make judgments about the degree to which companies can reasonably comply with local best practice and where exceptions are appropriate. On a regular basis we update our public voting guidelines and regional corporate governance principles to reflect best practice across over 20 markets.

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. The depth and breadth of this resource reflects our philosophy that stewardship activities require an integrated and skilled approach. Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility.

Our EOS engagement professionals are divided into designated teams covering ESG and strategy-related themes, sectors and regions. This ensures we have experts who can educate the wider team on developments and best practice in their respective areas. Each engager is responsible for engagement, voting recommendations and ESG analysis, focusing on the combination of regions, sectors and themes that they have been appointed to cover.

The team is based in the UK and the US. London (UK) staff cover engagement in Europe, Asia and emerging markets and staff in Pittsburgh (US) cover engagement in North America. Our professionals frequently travel to undertake engagements in person where possible at company headquarters, as we believe this is most effective. EOS also has a number of senior advisers who provide additional resource and expertise specific to some local markets including Japan, the Netherlands and the UK.

Given that the EOS engagement resource operates across our funds, it is critical that engagers integrate effectively with fund managers. Our approach to ensure this is described further under Principle 7.

In 2022, we also redeveloped our systems and processes to ensure effective stewardship as part of a wider EOS operating model project. The new online system allows us to accurately record, track and report on our engagement work. It also ensures that the history of our engagement is available for any member of the team who may be new to leading a company engagement. Our investment teams are also able to access this database, which affords them a full and instantaneous view of the engagement history with the company.

Stewardship resources – private markets

The Real Estate business follows an integrated approach in stewardship using tools and procedures that allow investment managers to supervise and effectively manage Federated Hermes' real estate portfolio. With regards to ESG, the team contains a four-person ESG sub-team who work closely with both internal and external stakeholders, including investment managers, external delivery counterparts for technical expertise, property managers and facility managers. The team ensure ongoing engagement with investment managers, occupiers and contractors to deliver the ESG plans successfully. The team collaborate with a number of industry working groups such as the Better Buildings Partnership (BBP), UKGBC, IIGCC, to ensure it remains aware and contributes to industry trends, best practice and innovation. We recognise the importance of collecting and sharing ESG information among the various organisational levels of our investment and asset-management process. As a result, we have developed and integrated a series of ESG tools and procedures that link our strategic investment targets for portfolio strategies and the management of a property's technical characteristics and operational performance.

Our infrastructure team takes a fully integrated approach to sustainability and stewardship, with each member of our team having a duty to ensure a responsible approach is applied to all team activities. As owners, we see ourselves as stewards of infrastructure assets, not only for this generation but also for future generations.

Our private equity team includes one ESG specialist who supports the investment team, which is responsible for assessing ESG risks and opportunities, and ensuring proper process is followed. Our private equity team co-invest both directly in a selection of companies alongside other General Partners (GPs) and indirectly through fund investments. Typically we are a minority investor for direct co-investments. For a small proportion of our assets where our team have some control and/or the ability to influence company decisions directly, we seek to work closely with investee companies to monitor, challenge and improve ESG performance. However, in almost all cases our team has limited control and/or ability to influence decisions directly (whether for direct or indirect co-investments). In these instances the team will work closely with the lead GPs to assess, monitor, and seek to improve ESG performance of the underlying investee companies. As private equity investors, we have a long history of investing in growing businesses across the world. We believe building better business not only translates into better financial performance, but also positive outcomes for individuals, communities and societies as a whole.

Our private debt team directly engages with the sponsor and management team to remedy any ESG issues that arise during the life of a loan. This engagement is frequently conducted in collaboration with EOS to strive to ensure that the engagement is outcomes -focused and impactful.

Performance management

Through our performance management process and behaviour framework, that explicitly sets out the visible manifestations of our Federated Hermes Pledge, we look to ensure that our cultural aspirations are reinforced. As such, our philosophy is to reward individual contribution, as demonstrated by the delivery of sustainable results (the 'what') aligned with our business strategy, values and behaviours (the 'how'), which serve the best interests of our clients, their investors and our shareholder while enabling the business to grow to its potential[13].

As part of the process, performance objectives are set at the start of the performance year and reviewed biannually to assess progress, achievements, and areas for development and growth, ultimately helping to improve organisational performance. To encourage a focus on meeting the needs of clients, their investors, and our shareholders, all individuals are rated equally on their technical performance and their behaviours.

We are committed to our business purpose of sustainable wealth creation that enriches investors, and, where possible, society and the environment while being at the forefront of developing industry best practice. Part of this is ensuring that our performance management process, behaviour framework and Remuneration Policy incorporates consideration of stewardship and the integration of sustainable performance and risk in both our firm's investment activities and its wider operations. This is further supported by the co-investment of deferred bonuses in funds to align employees to longer term investment performance after the bonus has been awarded.

In particular we aim:

- To incentivise senior management to drive our strategy and initiatives in line with our business purpose of sustainable wealth creation and ensure that through appropriate stewardship it informs all of our firm's key business and operational processes.
- To promote best practice integration of investor stewardship and ESG factors including the delivery of sustainable outcomes in the investment process and decision making.
- To encourage all employees to develop responsibility objectives as appropriate for their role.
- For sustainability risks to be considered as part of our risk reporting, and for performance against risk appetite and sustainability risks to form part of the Chief Regulatory Officer & Head of Government Affairs annual risk adjustment report. Also to ensure that adjustments can be made to bonus pools and individual outcomes where the company is operating outside of its risk appetite.

Reflecting on our governance structures

The efficiency of our governance structure is reflected in the outcomes we deliver for clients, which are evidenced throughout this report.

Assurance and oversight: Oversight of effective stewardship is integrated into all levels of our governance and the structures and processes detailed earlier help us reflect on improvements to support effective stewardship. Our external assurance providers undertook their second limited assurance engagement on the information disclosed as part of the sustainability reporting of FHL in the period from June 2021 to July 2022. Their conclusions are not yet available, however once released, we intend to reflect on these during 2023 in order to enhance our existing approach where needed.

[13] For more information, please see our Remuneration Policy: https://www.hermes-investment.com/ukw/remuneration-policy/

Our external assurance is complemented by our internal oversight structures. For example, our Governance Committee continued to provide oversight of the formulation and delivery of engagement and voting approaches throughout 2022 by reviewing items such as:

- Several policies relevant to stewardship – as described further under Principle 5 – to ensure our stewardship processes were supported by effective governance. This included approving updates to the Global Voting Policy and Guidelines, which included developments in the climate change policy and a voting policy on human rights, and an update to the Engagement Policy to meet the requirements of SFDR.
- The SFDR Sustainability Risks Policy and Statement on Principal Adverse Impacts.
- The EOS Conflicts of Interest Register and the Stewardship Conflicts Log.
- Approach to Controversial Activities.
- The EOS Engagement Plan.
- The FHL 2022 Stewardship Report.

This is also closely connected with Principle 5, where we provide more detail on the internal and external reviews and assurances we have to support continuous improvement.

As disclosed in our last report, following the 2021 internal audit of the Responsibility Office we introduced additional oversight to commitments we make as a business in relation to our investment and stewardship activity – including advocacy work – through external initiatives. During 2022, the Governance Committee reviewed progress every six months against commitments we have made, such as the Net Zero Asset Managers initiative and the Finance for Biodiversity Pledge. An annual update was also provided to SMT and to the Responsibility Working Group. This ensures we have appropriate oversight of our progress against such commitments to ensure we remain on track.

As set out under Principles 3 and 4, we have managed all potential conflicts of interest arising during 2022 and our teams have worked hard to develop an effective approach to the systemic risks the industry is facing.

The turbulent geopolitical and economic landscape in 2022 served to solidify our existing engagement priorities, while placing them in a new context.

System improvements: In 2022, as part of a project to improve and enhance EOS's operating model, EOS redeveloped the underlying systems in which we capture, measure, manage and then express our stewardship activity and outcomes. Not only can our engagement professionals better capture their progress, momentum, challenges and next steps and general workflow, but our clients are able to absorb the information in ways and through lenses that suit them. We have also developed the system to capture our Responsibility Office's advocacy work, which will allow us to better share information internally with EOS and the investment teams, as well as to capture and report the levels of our advocacy activity.

Continuous improvements: EOS' engagement plan is reviewed every year to ensure it is up to date and reflects its clients' priorities. The turbulent geopolitical and economic landscape in 2022 served to solidify our existing engagement priorities, while placing them in a new context. In addition to our priority themes, we maintained a comprehensive engagement plan including seeking to avoid the emergence of 'superbugs' through anti-microbial resistance, increasing resource efficiency through the circular economy, reducing all forms of harmful pollution and seeking positive wider societal outcomes through increased corporate responsibility. The feedback we received from clients confirmed we were broadly striking the right balance on priorities for the different themes, however, we will further intensify in certain areas which we have reflected in our engagement plan for 2023.

As described earlier in this section, we conducted a review and upgraded the ESG integration processes of our Private Equity team in 2022. This covered enhanced ESG analysis at the point of investment as well as during the investment hold. Additionally, the team started tracking ESG KPIs with their first ESG report submitted to shareholders in 2022.

Under Principle 6 we describe further how we gather and use client inputs into our work, as well as the improvements we have made to our client reporting on ESG factors and engagement.

Diversity, equity and inclusion (DEI): Our key focus areas relating to DEI are race, gender, disability and mental wellbeing with an intersectional thread running through. We want to be the employer of choice and be the vanguard of DEI in our industry for inclusion.

With the support of our Employee Networks, we embarked on an Equality Data Collection Campaign in the latter part of 2022 in order to increase the number of employees sharing equality and diversity data. By collecting and analysing equality and diversity data, we will be able to see if practices are providing fair access and opportunities for all and reducing inequalities. Taking a data-led approach will allow us to see to what extent different people and characteristics are under-represented at senior levels, are less engaged or face higher incidences of racism, discrimination, bullying and harassment. Data collection is paramount in highlighting these disparities – but it is also important that we act on the data we collect. We will look at data through the intersectionality lens, so we can analyse and understand employees' individual experiences in a more nuanced way rather than looking at characteristics in isolation.

With the support of our Employee Networks, we embarked on an Equality Data Collection Campaign in the latter part of 2022 in order to increase the number of employees sharing equality and diversity data.

In our last report, we set out some of the steps we are taking in an effort to achieve greater diversity, equity and inclusion in the workplace and support our 2025 commitments to achieve equal gender balance across our workplace. These actions are ongoing in 2023. Other DEI activities planned for 2023 include further cultural competency and inclusive recruitment workshops; completing inclusion leadership training for line managers and senior colleagues; and rolling out inclusion training for the rest of the firm. We will be delivering the DEI Strategy and Action Plan, working with our Employee Networks which have planned activities including menopause training for line managers and colleagues and training on improving accessibility and inclusion for deaf colleagues.

In our last report, we set out some of the steps we are taking in an effort to achieve greater diversity, equity and inclusion in the workplace and support our 2025 commitments to achieve equal gender balance across our workplace.

Principle 3

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Our public Conflicts of Interest Policy sets out our commitment to act professionally at all times. We commit to keeping the best interests of our clients and their beneficiaries in mind and to take appropriate steps to identify circumstances that may give rise to conflicts of interest with a risk of damage to our clients' interests. It includes examples of conflicts of interest – such as the receipt of confidential information, conflicts of interest between clients, personal conflicts and conflicts between our business and clients – and the appropriate procedures we have established to manage any conflicts of interest identified and to prevent damage to client interests.

Due to the importance of stewardship to our business, we have also developed a specific Stewardship Conflicts of Interest Policy. We acknowledge our position as a fiduciary for our clients and their beneficiaries and seek always to act in their best interests. Accordingly, we take all reasonable steps to identify actual or potential conflicts of interest. We also maintain and operate arrangements to minimise the possibility of such conflicts giving rise to a material risk of damage to the interests of our clients.

FHL employees are also subject to FHI's Code of Business Conduct and Ethics.

Across the firm we take all reasonable steps to identify conflicts of interest between:

- FHL, including its managers, employees and appointed representatives or any person with a relevant direct or indirect link to them – and our clients; and
- Any one client of Federated Hermes and the other clients.

We have summarised key aspects of our policy below and the full version is publicly available online. In addition, we have identified a set of conflicts of interest that are likely to arise in connection with engagement activities and have put in place controls to manage such instances.

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Potential conflicts of interest

Ownership

EOS is fully owned by FHL and the Head of Responsibility who leads EOS reports to the CEO of FHL. Any conflict which may arise between clients of the EOS service and other clients of FHL will be addressed in a similar way to conflicts between any of our clients.

In the instance of EOS clients having the right to vote at an FHI meeting, EOS would not provide a recommendation, but rather would alert EOS clients of the conflict, provide the ISS policy recommendation and enable the client to make their own decision in this circumstance.

Clients and prospects

FHL sub-advises a number of FHI products, but also provides services to other institutional investors, including a number of pension funds sponsored by corporations, governments and other organisations, and fund-manager clients. These services include voting recommendations and engagement with companies in which FHL's clients are equity shareholders and/or bond investors.

As a result, the following real or perceived conflicts may arise:

- We may engage with or vote the shares of, or EOS may recommend to a voting services client to vote the shares of a company which is the sponsor of one of our pension-fund clients or is a company within the same group as one of our clients or prospects.
- We may engage with a government or government body that is the sponsor or associate of the sponsor of one of our clients or prospects.
- We may engage with a company which is a tenant of our Real Estate division's property investments.
- We may engage with a company which has a strong commercial relationship, including as a service provider, with FHL and/or with clients or prospects.

- We may vote, or EOS may recommend to a voting services client to vote, on a corporate transaction, the outcome of which would benefit one client or prospect more than another.
- We may engage with a company where certain clients or prospects are equity holders and others are bond holders.
- We may hold meetings with companies for the dual purpose of delivering both our fund management and engagement services.
- We may otherwise act on behalf of clients who have differing interests in the outcome of our activities.

> **We take all reasonable steps to identify actual or potential conflicts of interest. We also maintain and operate arrangements to minimise the possibility of such conflicts giving rise to a material risk of damage to the interests of our clients.**

Individuals

At the individual level, engagers may have a personal relationship with senior staff members in a company in the stewardship programme or personally own the securities of that company.

Stock lending

FHL does not engage in stock lending.

Short Selling

Although FHL's investment teams do not generally hold short positions, those teams which regularly have short positions are prohibited from being involved in any engagement activities for companies where they hold a short position.

> **In all our activities, we seek to promote the long-term value and success of the companies in which our clients invest.**

Managing and monitoring potential conflicts: a singular focus

In all our activities, we seek to promote the long-term value and success of the companies in which our clients invest. As such, we engage with market regulators and other actors to influence public policy and regulation to enable this outcome.

Stewardship activities are exercised with the aim of influencing the company's behaviour. However, these activities are not carried out with the intention of obtaining non-public information, nor is information obtained intended to manipulate the market.

In the event that material non-public information is obtained through stewardship activities, our compliance department is informed, and an information barrier is created for 'insiders' until the information is publicly disseminated. Stewardship professionals are not allowed to act upon or share the non-public material information.

While we welcome client input and suggestions for engagement, all of our engagements are selected and pursued on the basis of an objective assessment of the severity of the problems faced by the companies engaged or the opportunities available to them, the likely effect of public policy and regulation and the likelihood of success in achieving value-enhancing change or mitigating value-destroying change. We give due regard to the value of the company to our clients and the value at risk given the issues in question.

In our engagements with companies which are the sponsors of (or in the same group as) our clients, we are careful to protect and pursue the interests of all of our clients by seeking to enhance or protect the long-term value of the companies concerned. In the first instance, we make clear to all pension-fund clients with corporate sponsors that we will treat their sponsoring parent or associated companies in the same way as any other company.

> **In our engagements with companies which are the sponsors of (or in the same group as) our clients, we are careful to protect and pursue the interests of all of our clients by seeking to enhance or protect the long-term value of the companies concerned.**

In addition, we ensure that in such situations the relevant client relationship director or manager within FHL, including EOS, is not leading the engagement or making the voting recommendation to clients. This same approach would hold true with respect to any engagement with a company with whom we, our owners or our clients have a strong commercial relationship, including suppliers. If we become aware of potential conflicts, they are disclosed, if necessary, to the companies to enable them to be managed effectively. Members of our investment teams have separate processes and management but are encouraged to join engagement meetings with their stewardship colleagues and discuss the implementation of our voting policies. EOS' external clients are also invited to join upcoming engagement meetings on a sustainable and appropriate basis.

The engagement objectives are set out and the voting recommendations made and provided by our stewardship team in line with FHL's voting guidelines, policies, corporate governance principles and engagement plan (or, where agreed, client-specific policies). While carrying out joint engagements may mean that investment teams have access to certain (non-inside) information before it is disseminated to our stewardship clients, we believe the benefits to clients of these joint meetings is substantial. In particular, it produces an enhanced engagement process that focuses on the relevant and material ESG risks and results in a better appreciation of ESG risk in investment decisions.

We have well-established, publicly disclosed voting principles and guidelines. Based on these and the judgements reached through engagement with individual companies, we provide voting recommendations to our third-party stewardship clients who request to receive our voting recommendation service.

There may be occasions where one of our third-party clients seeks to influence the voting recommendations advice we give to other institutional clients. In such circumstances there would be director-level involvement and an objective judgement reached based upon what we believe to be in the best long-term interest of our clients. All third-party clients retain full discretion over their final voting decision.

Clients and internal investment teams may at times have different immediate interests in the outcome of certain corporate activities, most notably in the result of a takeover bid involving two public companies. In addressing such situations, we are open with clients about the conflict and disclose it where practically possible.

As in other cases, we consider through our company engagements and voting recommendations not so much the financial effect of a deal for any one client, and more the long-term value that could be created or is at risk of being destroyed for our clients.

For our internal investment teams, the voting recommendation provided by our stewardship team will inform their assessment. However, they will make their final judgement independently with a view to their fiduciary obligations to their clients. On the rare occasion that the investment team and EOS disagree on the appropriate voting action, the matter is logged and escalated for consensus to be reached at the Governance Committee (see below).

We consider through our company engagements and voting recommendations not so much the financial effect of a deal for any one client, and more the long term value that could be created or is at risk of being destroyed for our clients.

It is expected that votes cast by our investment teams would be consistent with the voting recommendations we provide to our stewardship clients who request to receive voting recommendations other than in limited circumstances. In such cases, the rationale for divergence will be documented.

Review of conflicts of interest

In addition to the broader measures set out above, staff members must flag to their line managers any potential conflict of interest they recognise with a company they are engaging with. We also have policies that seek to avoid any potential conflicts for individual staff members of FHL that arise from engagements with companies in which individuals have personal investments or some material personal relationship with a relevant individual. Where a staff member has a personal connection with a company, they are required to make this known and they are not involved in any relevant engagement activities.

Recording and escalation

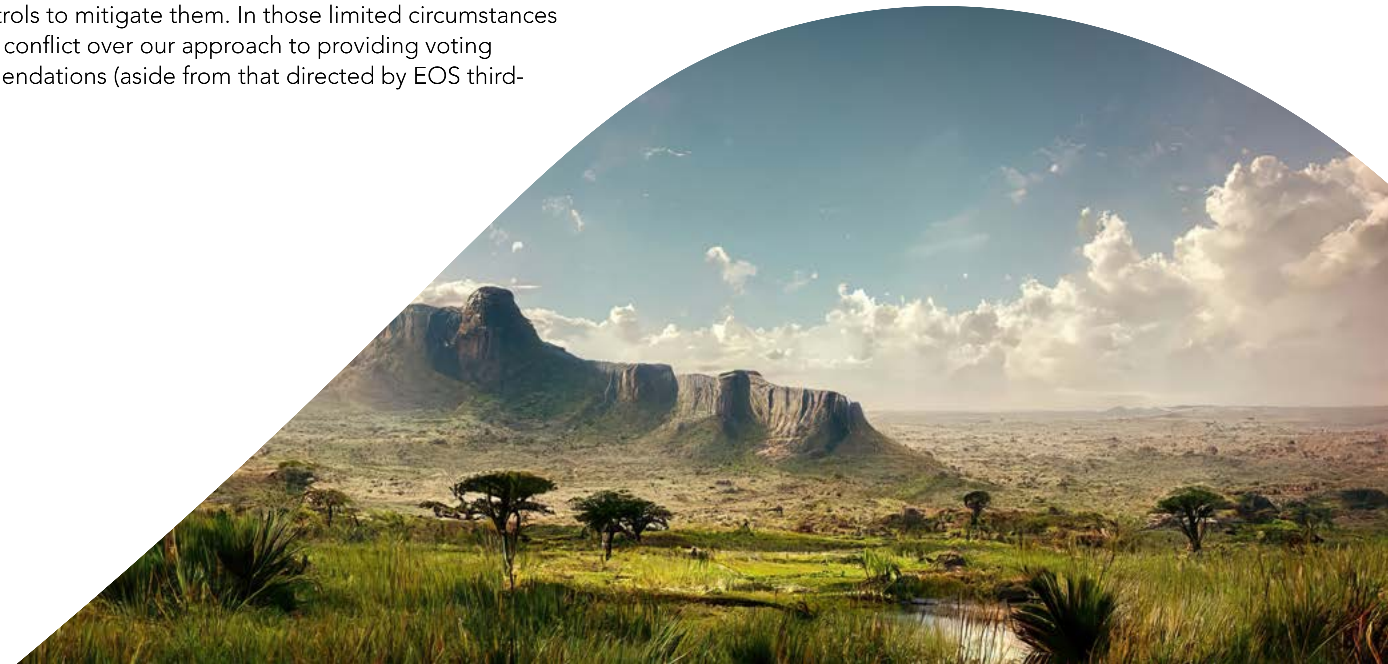
We maintain a register of potential conflicts of interest and the controls to mitigate them. In those limited circumstances where a conflict over our approach to providing voting recommendations (aside from that directed by EOS third-party client-specific policies) or engagement arises which is not able to be resolved in the manner set out above, the matter is referred to an escalation group whose composition is the same as our Governance Committee. The Governance Committee is comprised of our Head of Responsibility, Head of Investment, Head of International Client Group, Managing Legal Counsel, Chief Regulatory Officer & Head of Government Affairs and Managing Director, Private Markets. The group is guided by our mission to deliver sustainable wealth creation, our published corporate governance principles, voting guidelines and policies and other appropriate industry-endorsed guidance. If there is no majority view in the group, the CEO will make a final decision.

> **On the rare occasion that the investment team and EOS disagree on the appropriate voting action, the matter is logged and escalated for consensus to be reached at the director level.**

All such instances would be documented and reported to the Risk, Compliance and Financial Crime Executive which is an independent sub-committee of the FHL Board.

Real estate

Our real estate business has formal procedures to deal with conflicts of interest. There is a potential for conflict in the allocation of real estate investments between client portfolios. However, it is important to note that each portfolio has its own geographical and structural bias and specific investment objectives in terms of risk, income profiles, hold periods and target lot size. This separation is also compounded by the different timings in liquidity between the various client portfolios. As not all are in the market for new products at any given time, in practice this is rarely an issue.



Investments are allocated on a first-past-the-post basis. This means that the investment team that first receives the introduction has the first opportunity to acquire the investment. If the property fits into more than one portfolio managed by that Fund Manager or Director, then they will allocate the property on a principle of rotation. The rotation order is determined by when the mandates were awarded and once the mandate at the top of the list has a property allocated then it will go to the end of the list. If a property meets all the requirements but the mandate declines that property, then that mandate will go to the end of the list.

If the opportunity is not a fit for the particular fund, it is made available for other clients managed by FHL. In most cases, it will be clear when a particular investment should be placed between client funds, but where there is any doubt, the allocation decision will be approved by the CEO of our real estate business and the rationale for the allocation set out in the papers presented to the investment executive for formal approval.

Any other type of potential conflict of interest would be reported to and dealt with by our real estate Board, or the appointments committee for matters relating to our FHPUT fund.

Annual review

We review our Stewardship Conflicts of Interest Policy annually so it adequately reflects the types of conflicts that may arise. This is to ensure they are appropriately managed and as far as possible mitigated. The Policy is publicly available on our website.

Our conflicts-of-interest approach in practice

Our policy on conflicts may be best understood by considering its impact in practice.

Our EOS conflicts of interest register contains a description of stewardship conflicts, what mitigation procedure and controls were put in place, whether it was then reported to the escalation group if necessary and any follow-up actions and conclusions. It is reviewed by senior management on a regular basis. The following are examples of potential stewardship conflicts which we identified and managed in 2022:

- An EOS engager had a prior relationship with an executive who had recently assumed the role of Chief Legal Officer in a company for which the engager had taken the lead role in 2022. To avoid potential perception of conflict of interest, the company was re-assigned to an alternative engager.
- We made voting recommendations for the items on the agenda at a company's 2022 AGM. As EOS had a number of clients within the company's wider group, the vote was escalated to the Escalation Group, where it was decided to recommend support for all items. The clients did not speak to the EOS team about the vote or influence EOS' voting recommendations.
- A potential conflict of interest arose between the EOS voting policy and the views of our investment team. The EOS vote policy suggested to recommend voting against the re-election of a company chair due to the tenure exceeding nine years and concerns over shareholder rights. The EOS template also recommended support for the remuneration policy. After discussions between EOS and the investment team, it was agreed to recommend supporting the chair's re-election, as the investment team's engagement with the company suggested that sufficient plans were in place. It was also agreed to recommend voting against the remuneration policy due to the substantial increase in the annual bonus as a percentage of base salary.

Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

We believe identifying and responding to market-wide and systemic risks will deliver benefits for the economy, environment and society and will ultimately improve outcomes for clients and beneficiaries. As the world becomes more globalized and interconnected, the ability to transmit risks across geographies can cause further global crises to materialise. To truly address systemic risk, collective and coordinated action will be required to provide systemic solutions. Asset managers, working in conjunction with other stakeholders, must join forces to prevent systemic risk and to ensure a well- functioning financial system.

Global Risks Framework

The key systemic risks we take into consideration across our investment risk, engagement and advocacy work are informed by the latest academic research from the World Economic Forum Global Risks Report and the Centre for Risk Studies at Cambridge University[14].

We seek to take an integrated systems-based approach and prioritise and respond to the risks that are most likely, impactful and interconnected in nature. The figure below illustrates how climate change, our top engagement and advocacy theme, is interconnected to a range of other issues.

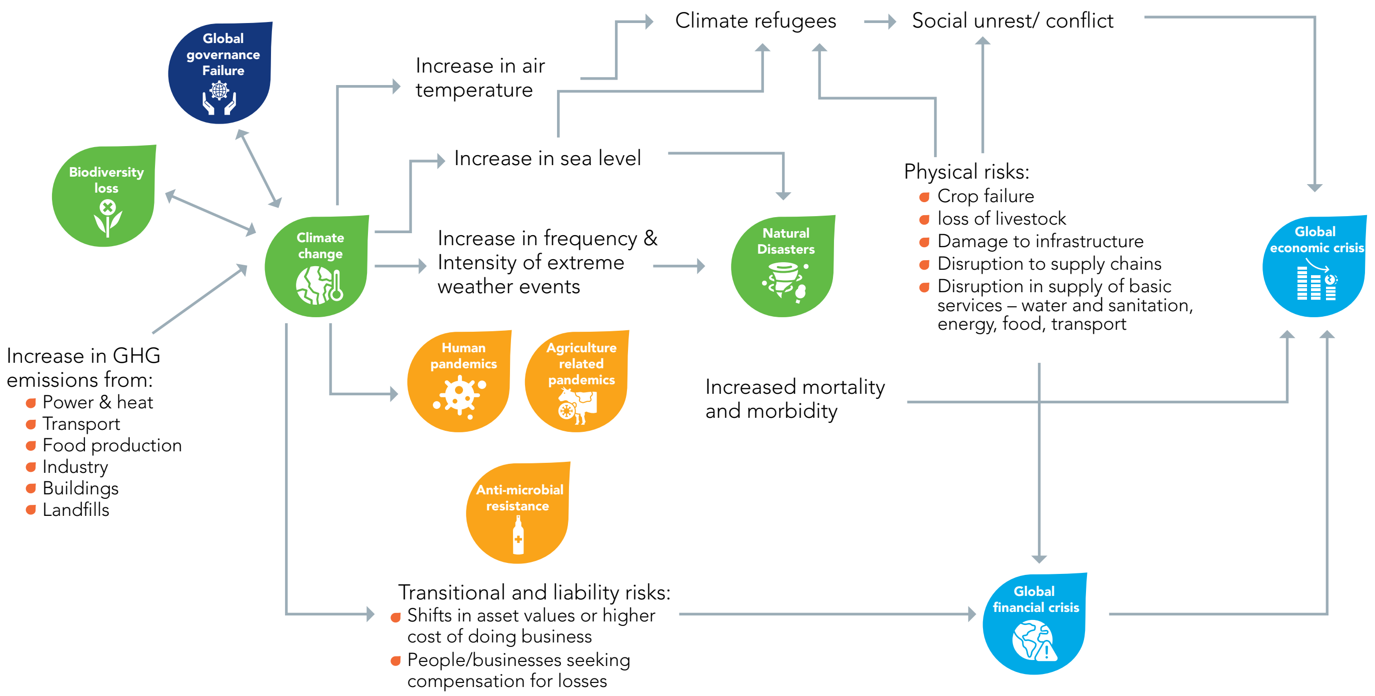
Figure 11. Global risks framework

Category	Risks
Economic	Ability of macroeconomic policy to prevent a global financial crisis, structural imbalances, chronic inflation, supply chain collapse, stability risks and related dislocations
Environmental	Ability of governments and businesses to address climate change, biodiversity loss and natural disasters
Societal	Human pandemics, agricultural-related pandemics, inequality and livelihood crises, large scale involuntary migration, human rights, antimicrobial resistance, mental health deterioration
Geopolitical	Implications of rising populism, protectionism, interstate conflict and threats to free trade resulting in global governance failure
Technological	Risks and opportunity associated with technological advances, inadequate infrastructure and networks, cyber security artificial intelligence and other frontier technologies
Governance	Unethical business practices, bribery and corruption

Source: FHL, using World Economic Forum Global Risks Report 2023 and University of Cambridge and Citi GPS Systemic Risk Paper, as at 31st December 2022.

We examine the interlinkages between risks, for example, how climate change can drive biodiversity loss, with the potential to impact global food chains, health and wellbeing, social inclusion/unrest and thereby generate financial and economic crises.

Figure 12. Cambridge University diagram of the cascading effects between systemic risks



Source: University of Cambridge and Citi GPS Systemic Risk Paper, as at 30 April 2021.

[14] SYSTEMIC RISK: Systemic Solutions for an Increasingly Interconnected World (cam.ac.uk)University of Cambridge and Citi GPS, 'SYSTEMIC RISK: Systemic Solutions for an Increasingly Interconnected World', (April 2021); World Economic Forum, 'Global Risks Report 2023', (January 2023)

Identifying and responding to risks

The Investment Office is responsible for the daily oversight of market risk across FHL, as well as the oversight of the underlying portfolio managers' adherence to their pre-defined/client-agreed investment processes.

The Investment Office's main remit is to act as an independent investment risk consultant on behalf of our clients. While the Investment Office can challenge our portfolio managers' decisions, positioning and risk exposures, it cannot force change.

What the Investment Office can do, if the issue is sufficiently serious enough, is to escalate the matter to the Portfolio Review Committee (PRC). The PRC would then meet with the portfolio manager, consider the issue and then, along with the Investment Office and the portfolio manager, agree a resolution.

If no resolution can be agreed, the matter can be escalated to a sub-committee of the FHI Executive team, where the Investment Office can advocate for client communications/disinvestment. The members of our Investment Office take the time to understand individual fund managers' styles so that they can aid and enhance their process.

For our infrastructure team, all risk related matters are considered by the investment teams and are escalated to the IIC (Infrastructure Investment Committee) and if necessary to the HGPE Governing Body. The private equity team has a separate PRC (Portfolio Review Committee) which will consider issues the investment teams and the private equity ESG specialist decide to raise.

The Investment Office and portfolio managers have several regular fora where they identify and discuss macro risks and their possible investment implications. Sessions are typically centred around a discussion of market-level investment strategy and shared risk insights from across the investment floor.

The Investment Office's main remit is to act as an independent investment risk consultant on behalf of our clients.

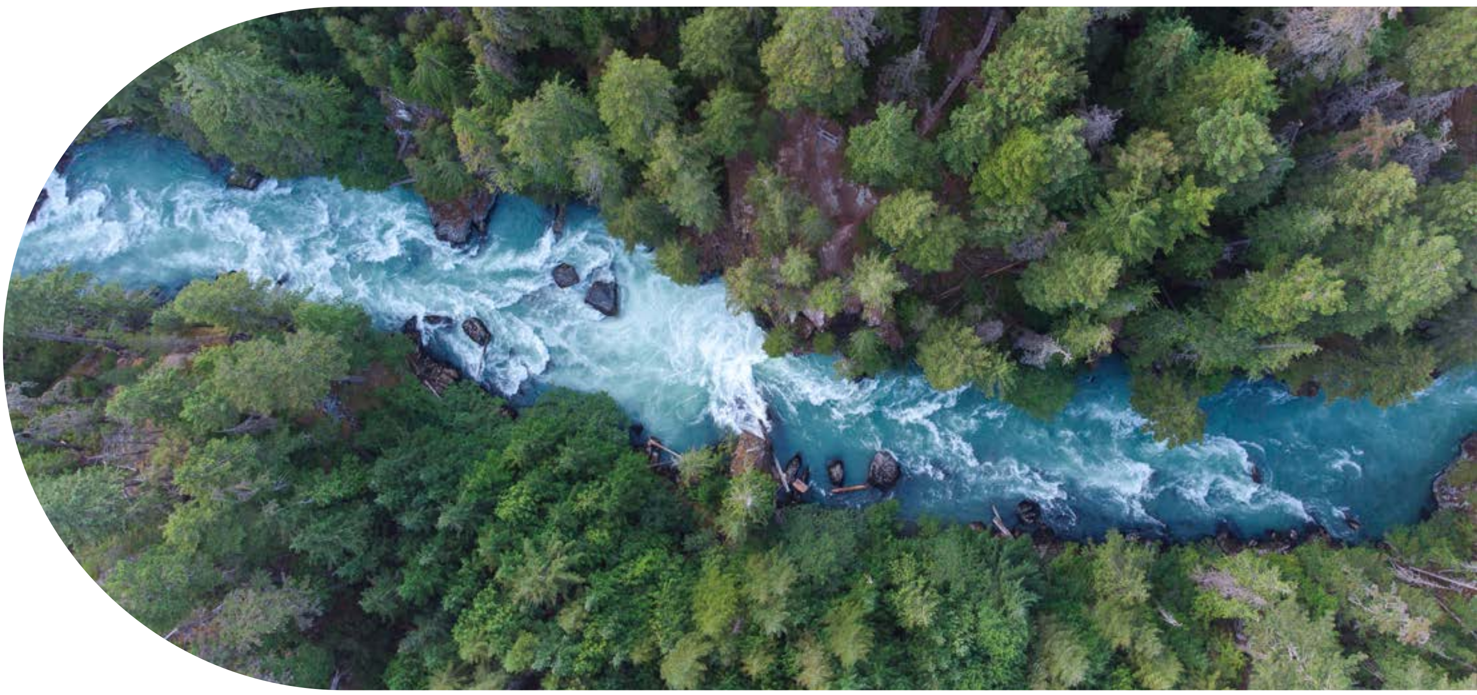
Discussions are pinned on a set of investment scenarios, with the aim of ensuring that insights are broadly aired and that we have a risk-aware culture across the floor.

Based on the main risk scenarios we identify, we run a series of both hypothetical and historical stress tests across our portfolios that vary according to the asset class and strategy. This includes geopolitical events and shocks to markets, interest rates and currencies.

Given the long-term nature of our investment approach, the purpose of these tests is not to push portfolio managers to make immediate portfolio changes but to enhance their analysis and strategy. The crisis induced by the Covid-19 pandemic has reinforced the importance of such tests.

Over 2022 we continued to closely monitor the evolution of inflationary risk, following on from the work we carried out in 2021. We continued to consider different macro scenarios (we adapted our baseline scenario to reflect more protracted inflation) and their investment implications across asset classes and funds. We provided an update to our inflation analysis in a cross-team publication at the end of the year.

Based on the main risk scenarios we identify, we run a series of both hypothetical and historical stress tests across our portfolios that vary according to the asset class and strategy. This includes geopolitical events and shocks to markets, interest rates and currencies.



From a second line of defence perspective, our risk identification processes set out in our risk management framework recognise thematic emerging and principal risks. In 2022, sustainability and ESG risks were integrated further into our risk taxonomy as principal risks as well as setting risk appetite statements and metrics to monitor reputation, sustainability and ESG risks more broadly.

In particular, updates to the risk management framework included changes to our non-financial risk appetite statements to consider drivers of reputation, sustainability and ESG risks through a stakeholder lens. This stakeholder-focused approach recognizes the importance of considering ESG issues, including climate change, from the perspective of both their impact on our firm but also the impact on our clients and wider stakeholders.

During 2022, our Risk, Compliance and Financial Crime Executive received updates on key ESG-related risks, and the firm's exposure to these risks and subsequent management activities.

> **In 2022, sustainability and ESG risks were integrated further into our risk taxonomy as principal risks as well as setting risk appetite statements and metrics to monitor reputation, sustainability and ESG risks more broadly.**

With respect to sustainability risk, significant work was carried out during the period in relation to complying with the EU's Delegated Acts requirements and implementation of SFDR. Sustainability Risks were embedded within our Business Plan, governance arrangements and various risk oversight fora including executive reporting. Enhancements focusing on ESG-risks were integrated within our risk appetite, risk framework and investment risk frameworks, which were approved by our Fund Boards.

> **We engage constructively with regulators and policymakers globally to address environmental, social and other market failures that may prevent the financial system from operating in the best interests of its ultimate asset owners.**

As noted above, regular and ongoing monitoring of product-related ESG metrics and analysis is conducted and embedded within the business and second line of defence. Extensive engagement and collaboration between the risk function and the business was required to ensure a consistent interpretation of sustainability risk and common understanding of ESG integration across our product range. Furthermore, the development of expanded investment risk reporting has allowed for multiple views and articulations of key investment risks at both a product and firm level to support senior management's decision making on ESG matters.

Advocacy and involvement in industry initiatives

We recognise that as investors we have an opportunity and a responsibility to help address market-wide and systemic risks. We engage constructively with regulators and policymakers globally to address environmental, social and other market failures that may prevent the financial system from operating in the best interests of its ultimate asset owners. This includes addressing barriers to responsible investment and stewardship. We seek to go beyond the minimum standards set by regulators and to demonstrate and share best practice.

We have a public policy and advocacy sub-team in the Responsibility Office, who work with experts across our firm to ensure our advocacy work is well informed, relevant and impactful.

Our stewardship service provider, EOS, also undertakes a comprehensive programme of engagement with legislators, regulators, industry bodies and other standard-setters to help shape capital markets. Members of our investment teams contribute their expertise through collaboration with the Responsibility Office and EOS, as well as direct involvement in external industry initiatives. The result is an advocacy approach that aims to lead rather than follow the policy debate. Given the global nature of our investments, this work spans asset classes and geographies.

Our public policy advocacy can cover a range of themes to help shape capital markets in the interests of our clients and end beneficiaries. We engage on regulation relating to the investment industry and the assets in which we invest. This work may be on a country-specific basis or regulations and codes with a global remit. We identify areas for more in-depth advocacy and engagement where we feel significant change is needed and where we can add value. When this is the case, we will identify the relevant policymakers to engage with on the topic. In 2022, this included climate change and nature. More information is included later in this section.

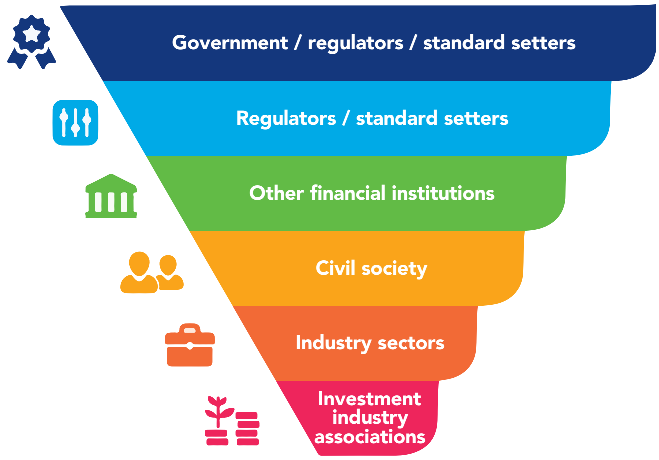
Figure 13. Tools of public policy advocacy

Source: FHL, as at 30 April 2023.

We often engage directly with regulators and policymakers and aim to be a progressive and constructive voice in the debate. We provide practical insights about how proposed policies might play out in practice and help to identify suggested alternatives that might better achieve their responsible-investment policy aims. We also respond to consultations from policymakers to provide constructive feedback, using a networked approach to gain relevant input from teams across the business.

We contribute to policy discussions both directly and in collaborative fora and initiatives. We are a member of several industry bodies and initiatives around the world and are co-founders of many of them. Through these initiatives we engage with others both within and beyond the investment industry to promote responsible investment, including ways that the industry and our investees can respond to market-wide and systemic issues such as climate change. Colleagues from across the business – including the Responsibility Office, EOS, Risk and the investment teams – take on advisory roles in many of these organisations to share our practical expertise.

Figure 14. We engage with a range of audiences in our public policy advocacy



Source: FHL, as at 30 April 2023.

Over the course of 2022, we responded to 33 consultations or proactive equivalents from regulators, policymakers and industry initiatives. In addition to the advocacy work of the Responsibility Office, EOS also had 75 interactions with regulators, standard-setters and other third parties in the pursuit of public policy and market best-practice objectives.

In the following table, we have categorised our memberships of investment and stewardship-related initiatives or those at which we hold advisory roles[15].

Tier 1 represents the initiatives in which we play a leadership role, for example chairing a working group; holding a formal advisory role such as on an advisory committee or Board; taking a leading role in preparing or actively contributing content to position papers and joint statements; shaping the strategic direction or leading collaborative engagements.

Tier 2 represents those initiatives in which we actively participate through membership of working groups, contribution to collaborative engagements, reviewing content or position papers, or lending support to joint statements.

And, finally, Tier 3 represents the remainder of the initiatives in which we are involved where we have light-touch participation such as attending meetings to be informed of developments. There are other organisations that we may collaborate with on an ad-hoc basis. In 2022, this included the climate think tank E3G, ShareAction and the Interfaith Centre on Corporate Responsibility

[15] This table is not exhaustive and does not cover all memberships of FHL.

Figure 15. Investment and stewardship organisational memberships

Tier 1	Tier 2	Tier 3
Advance	30% Club	British Council for Offices
Asia Investor Group on Climate Change	Asian Corporate Governance Association	Canadian Coalition of Good Governance
Associação de Investidores no Mercado de Capitais	Best Practice Principles Group for shareholder voting research (BPPG)	CDP
Association of Foreign Investors in Real Estate	Better Buildings Partnership	CECP: The CEO Force for Good
British Private Equity & Venture Capital Association	Biopharma Sustainability Roundtable	Dansif
CFA UK	British Property Federation	Eurosif
Climate Action 100+	Central Bank of Ireland Climate Risk and Sustainable Finance Forum	Financing UK Nature Recovery Initiative
Construction Leadership Council	Ceres	French Social Investment Forum (FIR)
Council of Institutional Investors	Energy Efficiency Financial Institutions Group (EEFIG)	Global Alliance for Buildings and Construction
CREFC	Eumedion	Global Impact Investing Network
Enacting Purpose Initiative	Financing a Just Transition Alliance	Global Infrastructure Investor Association
European Leveraged Finance Association	Focusing Capital on the Long-Term (FCLT)	Global Institutional Governance Network
FAIRR	Glasgow Financial Alliance for Net Zero (GFANZ)	Initiative Climat International
FCA-PRA Climate Financial Risk Forum	Global Canopy Forest IQ Project	Global Real Estate Sustainability Benchmark (GRESB)
Finance for Biodiversity Foundation	Global Network Initiative	INREV
Finance Sector Deforestation Action initiative	HMT Asset Management Taskforce	International Corporate Governance Network
Financial Services Culture Board	Human Capital Management Coalition	Japan Climate Initiative
HACT	Impact-Weighted Accounts Initiative	Japan Corporate Governance Network
Impact Investing Institute	International Sustainability Standards Board (ISSB) Investor Advisory Group	JapanSIF
Institutional Investors Group on Climate Change (IIGCC)	Investment Association	Loan Market Association
Integrated Reporting and Connectivity Council	Investor Action on Antimicrobial Resistance	Pensions and Lifetime Savings Association
Invest Europe	Investor Alliance for Human Rights	Revo
Investors and Indigenous Peoples Working Group	Investor Forum	Supporter Network of SPOTT
Land, Nature and Adapted Systems Advisory Group	Investors for Opioid and Pharmaceutical Accountability	
Natural Capital Investment Alliance	Investors Policy Dialogue on Deforestation in Brazil	
OECD Biodiversity Advisory Group	Net Zero Asset Managers Initiative	
PCAF UK (Partnership for Carbon Accounting Financials)	One Planet	
Quoted Companies Alliance	PBAF (Partnership for Biodiversity Accounting Financials)	
Reading Real Estate Foundation	Thinking Ahead Institute	
RENEW Project	Transition Pathway Initiative (TPI)	
Sustainability for Housing Standards	UK-China Green Finance Task Force	
The 300 Club	UK Green Building Council	
UK Sustainable Investment and Finance Association (UKSIF)	Workforce Disclosure Initiative	
UN Global Compact		
UN Principles of Responsible Investment (PRI)		

Source: FHL, as at 31 December 2022.

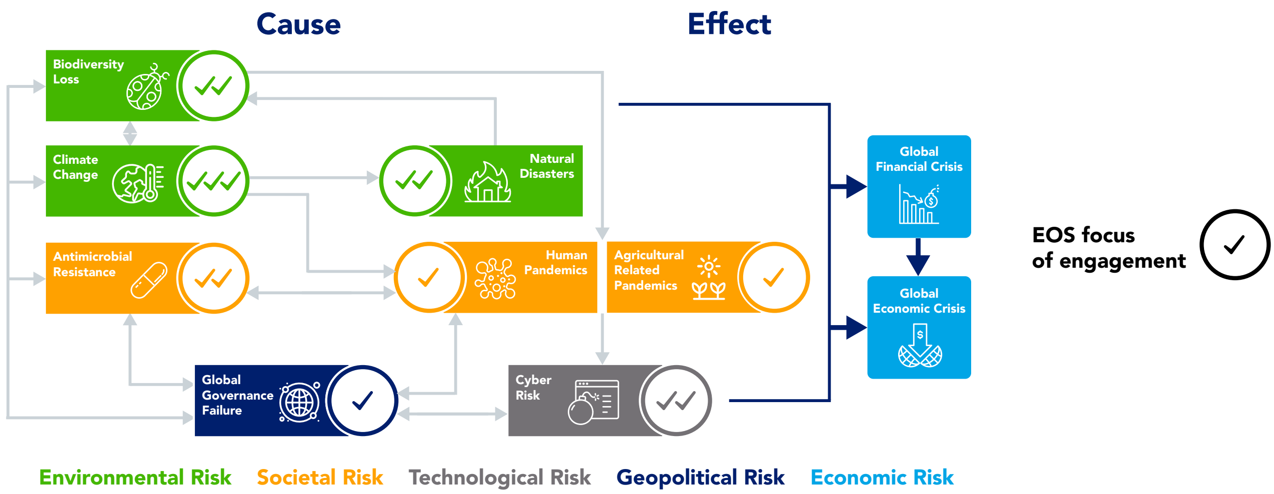
In 2022, we joined 5 new initiatives and remain an active member in over 95 different efforts. Examples of our involvement from each of these three tiers are included in our following 'In focus' sections. We also describe in further detail how we have been involved in collaborative engagement with individual issuers under Principle 10.

Engagement with investees

We take into consideration the most important systemic risks when developing our Engagement Plan and prioritising our engagement action. We have examined how the systemic risks highlighted above are interlinked, and often have cascading effects, and overlaid these with the focus areas in our engagement plan. For example, the three big causal systemic risks illustrated in the diagram below – biodiversity loss, climate change and anti-microbial risk – which have cascading causal effects, are important themes in our engagement plan. For example, the three big causal systemic risks illustrated in the diagram below – biodiversity loss, climate change and anti-microbial risk – which have cascading causal effects, are important themes in our engagement plan.

In 2022, we joined **5** new initiatives and remain an active member in over **95** different efforts.

Figure 16. Risks: Cause and Effects and EOS Engagement Priorities



Source: University of Cambridge and Citi GPS Systemic Risk Paper, and EOS data, as at 31st December 2022.

In addition, the United Nations (UN) identified systemic risks and developed these into 17 Sustainable Development Goals (SDGs), adopted in 2015 as a global call to end poverty, protect the planet and ensure that everyone enjoys peace and prosperity by 2030. Our view is that the long-term success of businesses and the success of the SDGs are inextricably linked. We believe that all of our engagement and advocacy work is aligned to the delivery of the SDGs either directly or indirectly, enhancing our response to systemic risks.

Figure 17. 2,744 of the issues and objectives engaged in 2022 in public markets were linked to one or more of the SDGs[16]

13 Climate action	486	9 Industry, innovation and infrastructure	187	14 Life below water	46
12 Responsible consumption and production	449	3 Good health and well-being	141	6 Clean water and sanitation	39
8 Decent work and economic growth	276	16 Peace, justice & strong institutions	128	4 Quality education	24
10 Reduced inequality	268	11 Sustainable cities and communities	79	17 Partnerships to achieve the goal	23
5 Gender equality	257	1 No poverty	72	2 Zero hunger	16
7 Affordable and clean energy	187	15 Life on land	66		

2,744 of the issues and objectives engaged in 2022 were linked to one or more of the SDGs

Source: FHL, as at 31 December 2022.

[16] This is the total of unique SDG-linked objectives and issues engaged. Some of the objectives and issues may be linked to more than one SDG.

Where we have identified market-wide and systemic risks, we intend to engage with our investees to ensure they have appropriately assessed, managed and mitigated the risks. This may be through collaborative engagement alongside other investors or industry initiatives, which we discuss in more detail under Principle 10.

EOS focuses its public-markets stewardship on the issues with the greatest potential for long-term positive outcomes for investors and their beneficiaries. Generally, EOS' work is embodied in a response to systemic risks but linked to this are market-wide risks it must consider. The full taxonomy under Principle 9 identifies 12 key themes and 32 related sub-themes for engagement, many of which could be considered systemic risks as mapped in Figures 10 and 11 above. Within this, our work maintains a focus on the most material themes.

EOS reviews its engagement plan every year to ensure it is up to date and reflects client priorities. The turbulent geopolitical and economic landscape in 2022 served to solidify our existing engagement priorities, while placing them in a new context. In addition to our priority themes, we maintained a comprehensive engagement plan including seeking to avoid the emergence of 'superbugs' through anti-microbial resistance, increasing resource efficiency through the circular economy, reducing all forms of harmful pollution and seeking positive wider societal outcomes through increased corporate responsibility. The feedback we received from clients confirmed we were broadly striking the right balance on priorities for the different themes, however, we will further intensify in certain areas which we have reflected in our engagement plan for 2023.

Based on EOS' review, in 2022 we continued to focus on the same four priority themes as 2021. However, we continuously updated our work in each area as follows:

Climate change action: In 2022, we intensified engagement on aligning corporate targets to the goals of the Paris Agreement to limit climate change to 1.5°C.

Human and labour rights: We continued engagement on human rights in the supply chain, in particular the integration of human rights issues into business models and purchasing practices, and how this impact is evaluated and assessed. We elevated our focus on digital rights, which are human rights specific to digital products and services and began engagement on online privacy rights, online freedom of expression, and negative societal impacts of digital products and services based on our investor expectations.

Human capital: We increased our focus on diversity and inclusion, freedom of association, and health and safety, with a particular reference to the employee value proposition in the context of a tightening labour market.

Board effectiveness and ethical culture: We launched a report in 2020 setting out our expectations on how best to improve the dynamics of a board, which was used as a platform for engagement in 2021.

In addition to the above priority themes, we pursued further engagement on three cutting edge topics in 2022: biodiversity, fast fashion (in 2022 we focused on engaging with apparel companies on their environmental and social impacts) and digital rights. Based on our review, for our 2023 engagement we have updated these cutting edge topics as follows:

Biodiversity: In 2023, we will focus our engagement on halting and reversing marine and terrestrial biodiversity loss at companies that are involved in the production and selling of food. Other key challenges include antimicrobial resistance and deforestation. As we outlined in our white paper on biodiversity, published in February 2021[17], 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 issues including deforestation, water stress, regenerative agriculture, sustainable proteins and chemical runoff management.

Digital rights: In 2023, we will engage companies on our Digital Rights Principles, which we published in 2022[18]. Digital products and services can play a critical role in strengthening human rights but have also brought unanticipated harms and new challenges. We engage companies on negative societal impacts including problematic content on social media, misuse of artificial intelligence, health and safety impacts on children and young people, environmental and social impacts in hardware supply chains, and the growing digital divide. We expect companies to balance freedom of expression with their obligations to remove problematic content and take action to respect privacy rights online.

Tax: In 2023, we will publish our Responsible Tax Principles and our engagement expectations will focus on four critical areas: tax policy, governance, stakeholder engagement and transparency. Tax systems and revenue are vital to the functioning of wider societal services such as health, welfare, justice, emergency services, education and environmental protection. Public services are under tremendous strain in the wake of the pandemic and soaring inflation has only added to the pressure. Companies that seek to aggressively minimise their tax payments will face increasing legal, financial and reputational risks as regulation tightens.

In 2022, we intensified engagement on aligning corporate targets to the goals of the Paris Agreement to limit climate change to

1.5°C

[17] FHL, 'Our Commitment to Nature', (February 2021)
[18] FHL, 'EOS Digital Rights Principles', (April 2022)

We also use our voting rights as a means of addressing systemic risks. For example, EOS introduced a voting policy on human rights in 2022, targeting companies in clear breach of applicable regulatory requirements or where company has caused or contributed to egregious, adverse human rights impacts or controversies and has failed to provide appropriate remedy. More information on how we use our voting rights is available under Principle 12.

We track the progress of our engagement with investees, including on systemic issues, using our proprietary milestone system. The outcomes of our engagement with investees are described under Principles 9, 10 and 11. We also publish regular case studies from EOS and our investment teams to document our engagement outcomes in more detail.

Throughout this report we have sought to provide a range of outcomes, including where we have not seen the desired outcomes of engagement. Below, we set out in more detail how we have responded to three of the key market-wide and systemic risks in 2022: climate change, biodiversity, and human and labour rights.

These are examples of how our response to identified market-wide and systemic risks can result in changes to our investment portfolios, our engagement with companies and our advocacy efforts. The sections below are also therefore relevant to Principles 7 and 9-12.

Our Climate-Related Financial Disclosures report sets out in more detail how we have integrated an assessment and management of climate-related risks and opportunities into our investment decision making.

In focus: climate change

We aim to understand both a company's contribution to climate change and its exposure to related risks and opportunities, which should allow us to play a positive role in encouraging firms to generate lower emissions and reduce the risks arising from climate change.

Our Climate-Related Financial Disclosures report sets out in more detail how we have integrated an assessment and management of climate-related risks and opportunities into our investment decision making. This includes the governance structures we have in place to ensure climate-related risks and opportunities are appropriately managed and that the outcomes of our risk-management processes feed into our business strategy. Our assessment of, and response to, the systemic risk of climate change spans our top-down investment risk and asset-level analysis, our engagement activities and our operational risk management.

In 2022, the CNWG focused its work on developing an enhanced business-wide climate change approach, the Climate Action Plan (CAP), which included interim targets validated by the Institutional Investors Group on Climate Change (IIGCC). This fulfilled our commitment to publish interim 2030 targets as a member of the Net Zero Asset Manager Initiative (NZAMI). It set out how we will measure our progress, and the actions we will take to drive improvements. Our approach is focused on driving decarbonisation in the real economy. We have therefore set targets for the proportion of our holdings that will be aligned with a 1.5°C trajectory; these will drive our engagement with portfolio companies to achieve decarbonisation at the company level and not just in our portfolios. The CAP also covered our approach to tackling our own operational and travel emissions.

Figure 18. Our interim 2030 targets

Source: FHL, as at 30 April 2023.

Our Climate Action Plan sets out the way we categorise our investees based on their alignment to a 1.5°C world. We use an in-house Paris-alignment methodology for this assessment. We will be asking our investee companies to set credible targets and strategies validated by the latest climate science, seeking to increase engagement to 90% of financed emissions by 2025.

Through this initiative, we commit to work in partnership with clients on their decarbonisation goals. We intend to report annually on our progress toward this commitment from 2022.

Our approach to Paris-alignment and engagement prioritisation

With regard to climate change, we have developed our own in-house Paris Alignment methodology to assess the extent to which a company's climate change ambitions are aligned to the 1.5°C goal of the Paris Agreement. The methodology primarily assesses alignment of a company's GHG targets and associated emissions trajectory to a 1.5°C-aligned decarbonisation pathway, applicable to the relevant sector and geography where possible. The methodology uses authoritative benchmark pathways, such as those developed by the Science Based Targets Initiative (SBTi) and the Transition Pathway Initiative (TPI). Where sector-specific benchmarks are not available, we use the SBTi cross-sector pathway, which requires a 4.2% per annum linear reduction in absolute emissions in the near-term and at least 90% reduction by 2050 with residual emissions offset.

Companies will be placed into different categories of alignment:

Not aligned – includes companies that have not yet made a net zero commitment or have announced levels of ambition that are deemed inadequate to align with 2°C.

Committed to net zero – includes companies that have publicly announced a net zero ambition to reduce emissions by 2050 or sooner.

Aligning to 1.5°C – includes companies that have announced an ambition to reduce emissions sufficiently to align with 2°C or lower or have committed to align to 1.5°C. A commitment to set a SBTi-validated target is recommended (or an already validated 2°C or well-below 2°C target). These criteria are underpinned by the expectation that such companies will in future increase the ambition of targets to be 1.5°C-aligned.

Aligned to 1.5°C – includes companies that have demonstrated a coherent ambition to reduce emissions sufficiently to align with 1.5°C. An SBTi validated target is a preferred indicator of alignment. To remain in this category over time, companies must, since setting the targets, deliver emissions reductions substantially aligned to the relevant emissions reduction trajectory on a 3-year rolling average basis.

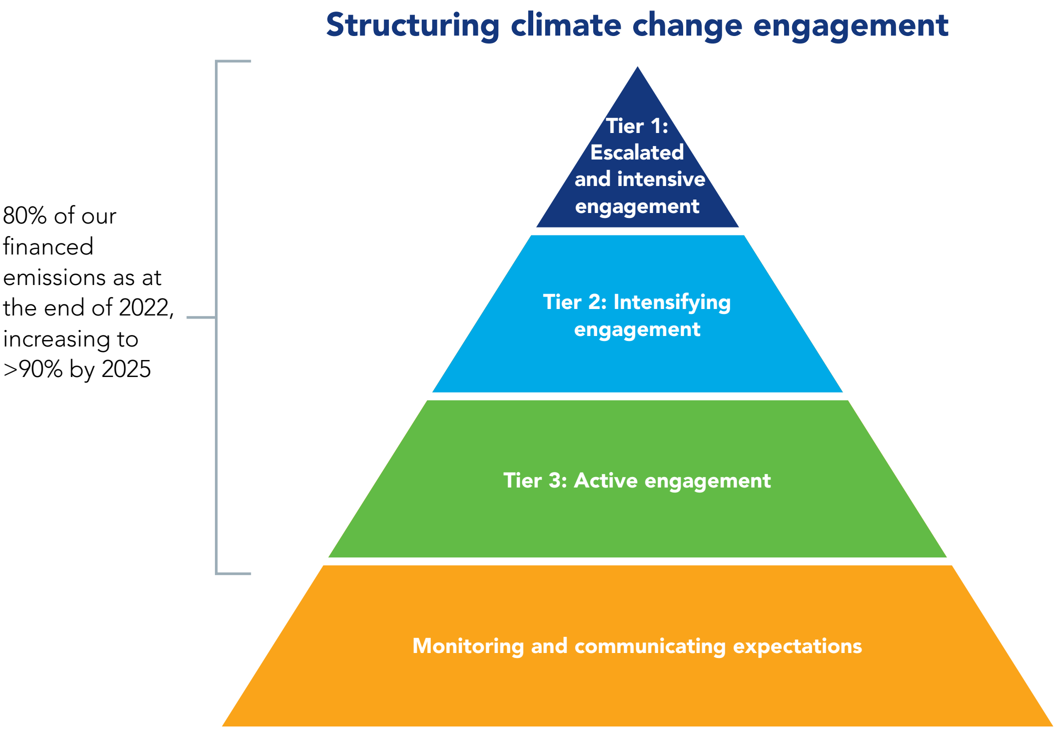
Unscored – includes companies that have demonstrated some ambition to reduce emissions but there is no robust methodology or data available to assess this ambition relative to a temperature outcome.

Companies identified as not aligned with 1.5°C will be flagged as priorities for engagement and escalation. Engagement strategies will be tailored to the region, sector and company context but will include a combination of approaches, such as letters to the board, one-to-one meetings, collaborative engagement, and escalation strategies where appropriate. We will engage in line with the expectations outlined in the EOS Engagement Plan, the Federated Hermes Climate Change Expectations for Investee Companies, and best-practice frameworks, such as the Climate Action 100+ Benchmark and the IIGCC Net Zero Investment Framework, Stewardship Toolkit and sector-specific climate change expectations.

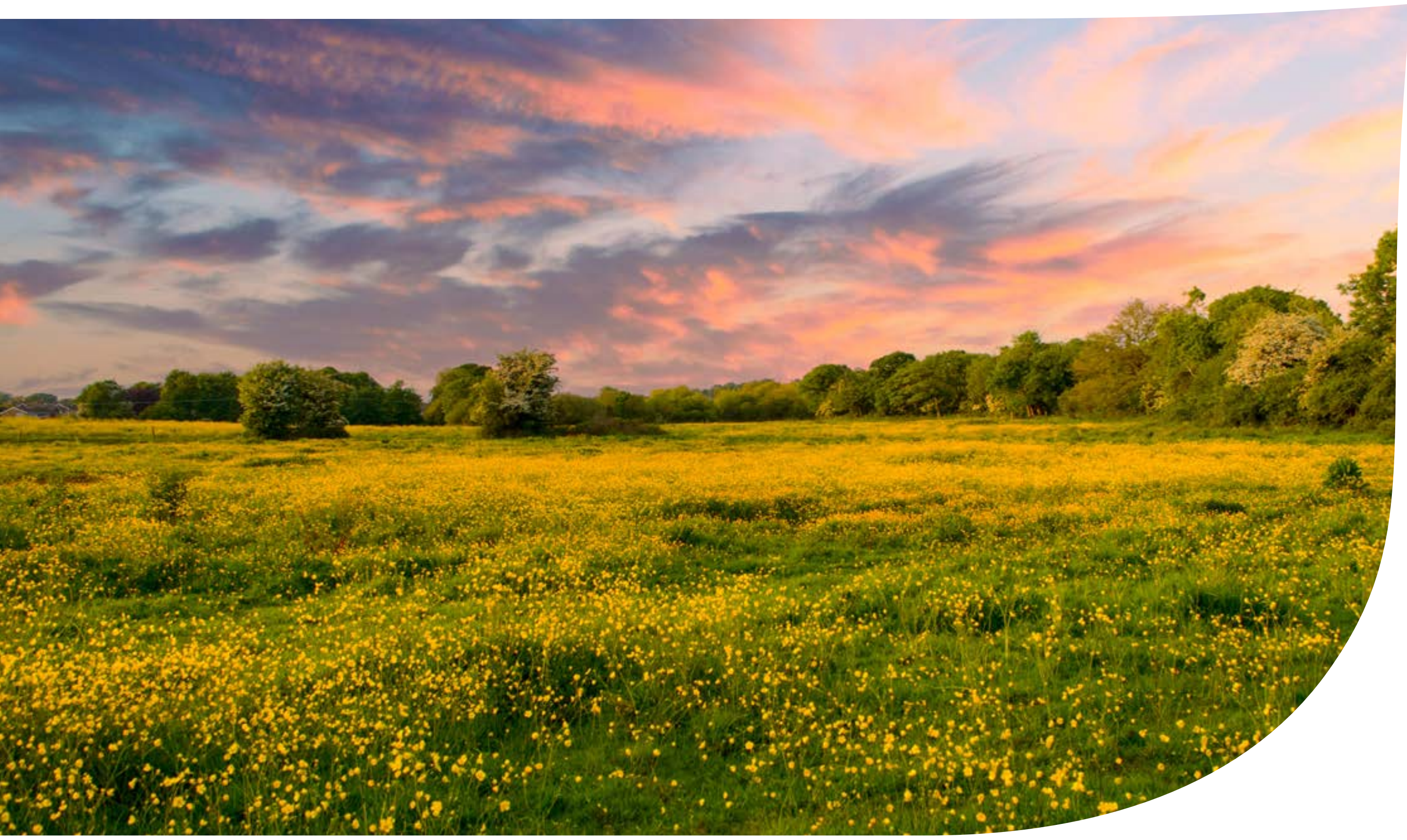
As an overview, we expect companies to actively demonstrate that their emission reduction targets and strategies are aligned to the 1.5°C goal of the Paris Agreement. Companies should commit to reaching net zero emissions by 2050 at the latest and set interim short and medium-term targets that are science-based, in line with what is required for a 1.5°C pathway. These targets should be backed up with a credible decarbonisation strategy, noting that targets should be met primarily through emissions abatement rather than offsetting. We expect risk management and disclosure to be in-line with the recommendations of the TCFD. Effective governance of climate-related risks and opportunities, including ensuring that direct and indirect lobbying activities are aligned to the goals of the Paris Agreement, is also critical. In the short-term, we also expect companies to deliver emissions reductions that correspond to their climate strategies and we will hold to account companies that fail to deliver on their targets, in the absence of mitigating circumstances, for example by voting against the reappointment of responsible directors.

Engagement will be prioritised based on the materiality of financed emissions and the degree of misalignment to the goals of the Paris Agreement. For instance, companies that are categorised as "Not Aligned" or "Unscored" will receive the highest intensity of engagement over the next few years, with engagement focused on asking companies to commit to net zero by 2050 at the latest and set supporting interim emission reduction targets. Meanwhile, companies that are already categorised as "Aligned" will receive less intensive engagement but will be monitored to ensure that they are not underdelivering. In general, we will allow approximately up to 2-3 years for companies to move from one level to the next level, depending on specific regional or sectoral challenges. If the pace of change is slower than expected, we will consider using a range of escalation tactics, such as voting against responsible directors.

Figure 19. Our climate change engagement approach



Source: FHL, as at 30 April 2023.



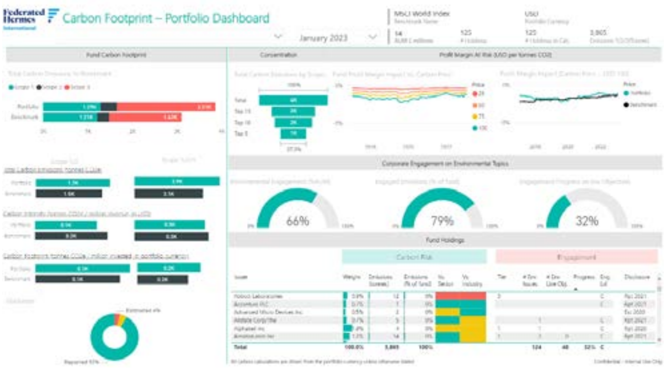
Assessing risk in public markets

Our integrated approach to managing climate risk and opportunities is based on our belief that we can create positive feedback loops between investment and stewardship. This should help reduce climate-related risks and maximise the opportunities for the companies and assets in which we invest.

The primary means through which we monitor and measure the climate-change exposure of our investment portfolios is through our proprietary carbon tool, which measures a fund's carbon footprint relative to its benchmark and calculates its carbon efficiency/intensity. As well as providing a carbon heatmap, the tool enables portfolio managers to stress-test the resilience of our portfolios to a range of carbon prices, identify whether high-emitting companies in the portfolio are being engaged with or whether engagement needs to be initiated, and understand the progress on any climate or wider environmental engagements already underway.

The information also helps increase our investment team's awareness of carbon-related risks, which can lead to updated valuations and potentially change investment decisions.

Figure 20. Carbon Footprint – Portfolio Dashboard

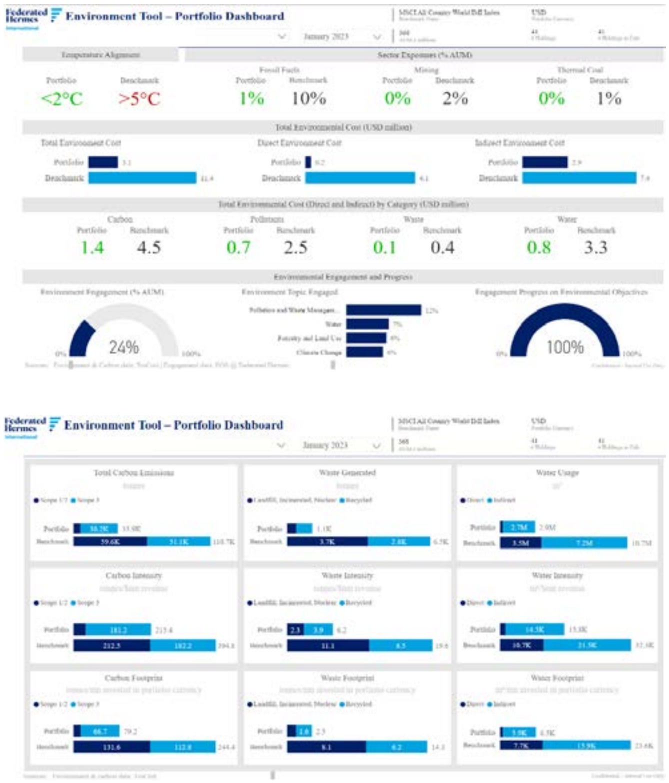


Source: FHL, as at 31 January 2023. For illustrative purposes only.

During 2021, we launched our environmental tool. Our environmental tool assesses both portfolios and companies on their carbon, water and waste performance. It also looks to quantify the environmental cost of the impact via the following six lenses; carbon, water, waste, air pollutants, land/water pollutants and natural resource use. In addition, we have incorporated the temperature alignment of portfolios and companies alongside exposures to carbon intensive sectors; namely fossil fuels, mining and thermal coal.

> **Our integrated approach to managing climate risk and opportunities is based on our belief that we can create positive feedback loops between investment and stewardship.**

Figure 21. Environmental Tool – Portfolio Dashboards



Source: FHL, as at 31 January 2023. For illustrative purposes only.

We also use other external tools, to assess sovereign polices on climate and corporate carbon targets and are currently exploring tools providing data on implied temperature rise and transition and physical risk across various scenarios. We are also expanding our analysis in the next year to look at our exposure to deforestation risk and the impact of our investments on biodiversity.

EOS: engaging on climate-change issues

Engagement is a crucial element of our approach to managing climate change risks and opportunities – and climate is a specific engagement focus in EOS' public-markets engagement programme. EOS aims for all companies to have a business model consistent with achieving net-zero emissions and an effective transition plan to deliver this by 2050 or sooner.

Our approach is tailored by sector. In EOS' Public Engagement Report Q1 2022 we described our engagement with the chemical sector on decarbonisation, whilst in our Public Engagement Report Q2 2022 we focused on the importance of reducing methane emissions to keep global heating within 1.5°C as well as providing examples of EOS' climate-related voting recommendations.

We continued to play a leadership role in the collaborative engagement initiative Climate Action 100+ (CA100+). Since 2017, CA100+ has grown to include 700 signatories representing over $68tn in assets under management – more than 50% of the global total[19]. Since the initiative's inception,

[19] Climate Action 100+ website as at January 2023.

EOS has advised on high-level governance and engagement strategy, as well as leading or supporting a significant portion of company engagement dialogues. In 2022 we acted as lead or co-lead engager for 24 companies, although EOS and CA100+ paused engagement at three Russian companies after the start of the Russia-Ukraine conflict.

In October 2022, the CA100+ Net Zero Benchmark revealed the impressive progress to date with 75% of focus companies committing to achieving net-zero emissions by 2050 or sooner. Some 92% have disclosed that there is board oversight of climate change, and 91% have aligned their climate disclosures with the TCFD recommendations. Also, the electricity utility Enel became the first company to score positively on all nine currently-assessed benchmark indicators.

However, companies still need to match their long-term ambitions with comprehensive 1.5°C-aligned short- and medium-term targets, and disclose credible strategies to achieve these. For example, only half of the CA100+ focus companies have net-zero targets that include material Scope 3 emissions, only half have disclosed decarbonisation strategies, and just 20% have medium-term targets that were assessed by CA100+ as aligned with 1.5°C. Also, only 23% of companies have committed to aligning their lobbying activities with the Paris Agreement, despite the importance of policy support for achieving company decarbonisation.

Under Principles 10 and 11 we provide further detail on our collaborative involvement in CA100+ with specific examples of company engagement.

> **In October 2022, the CA100+ Net Zero Benchmark revealed the impressive progress to date with 75% of focus companies committing to achieving net-zero emissions by 2050 or sooner.**

Real estate – building a better future

Our Real Estate team has integrated climate risk management throughout its investment decision-making and asset-management processes. An ESG checklist is used for every acquisition and this has been updated in the last year. It covers specific ESG issues like climate change, with a particular focus on flood risk and mitigation.

Our Real Estate team's Design Innovation Standard and Responsible Property Management Guide also sets out a series of guidelines and principles for our investment and development managers to follow. This ensures a consistent, start-to-finish approach to sustainable refurbishment and development, making use of key RIBA Stages[20]. The approach also follows BREEAM principles[21], which adopt sustainable methods of construction to deliver an operationally efficient and sustainable building or refurbishment.

In 2019, we joined the Better Building Partnership Climate Change Commitment (along with 22 other signatories) with the aim of achieving net-zero emissions across our real estate portfolios by 2050.

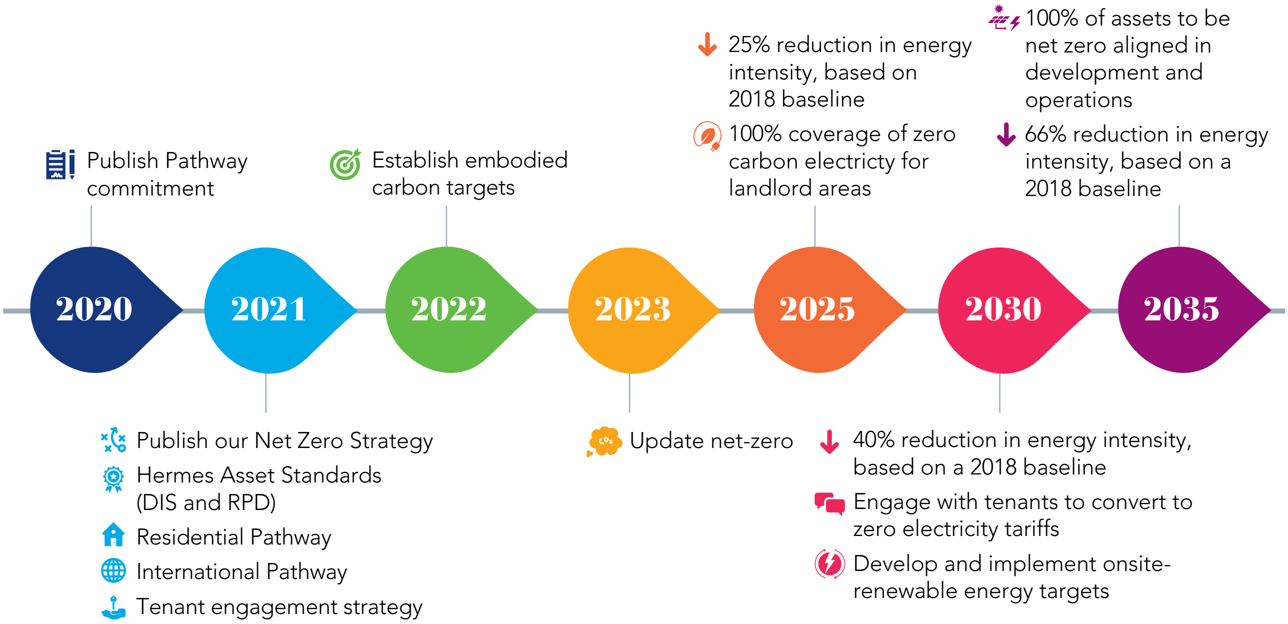
As part of this commitment, on behalf of our clients, during 2021, the Real Estate team issued the Net-Zero Pathway document which sets out both the targets and approach to reaching net zero emissions by 2035 across the managed assets included within our UK real estate portfolio. Since then, we have published pathways for our residential, International and real estate debt portfolios.

By taking a proactive approach in developing and operating net zero buildings, we intend to reduce the risks of having stranded assets, asset value declines and potential so-called 'brown penalties' (a higher cost of capital for carbon-intensive buildings). Net zero also presents opportunities for market leadership: to generate income resilience for our clients; support and retain our occupiers; and provide long-term value to our stakeholders.

[20] The Royal Institute of British Architects (RIBA) Plan of Work organises the process of briefing, designing, constructing and operating building projects into eight stages and explains the stage outcomes, core tasks and information exchanges required at each stage.

[21] BREEAM is the Building Research Establishment (BRE) Environmental Assessment Method, first launched in the UK in 1990. It sets best practice standards for the environmental performance of buildings through design, specification, construction and operation.

Figure 22. Real Estate approach to net zero



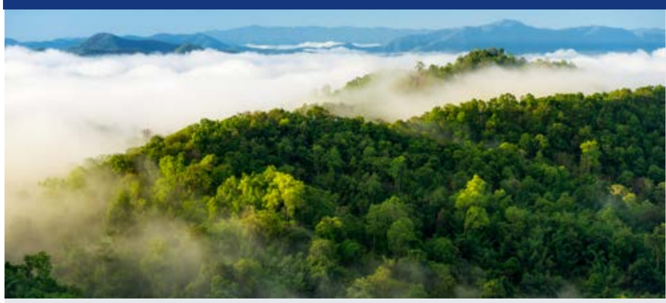
Source: FHL, as at 31 December 2021.

We aim to deliver on this aspiration in four specific areas:

1. **Decarbonisation.** Remove the use of fossil fuels, increase energy efficiency, use green tariffs and reduce embodied carbon in our new development and major refurbishments. This should support improvements in local infrastructure and emphasise best-practice innovation.
2. **Deliver energy efficiency.** Reduce energy use intensity by 66% in the years to 2035 against a 2018 baseline[22].
3. **Stakeholder engagement.** Work with occupiers, suppliers and other stakeholders to successfully transition to net-zero alignment.
4. **Utilise offset opportunities.** Use credible, permanent carbon-removal methodologies for residual carbon utilising schemes, such as natural-capital solutions for carbon sequestration to address embodied carbon.

REAL ESTATE DEBT CASE STUDY

Journey to Net Zero



In November 2020, we completed a loan to fund the development of two logistics properties located in Northampton and Leighton Buzzard, totalling 100,000 sqm of logistics space.

The credit fundamentals of the loan were very attractive but even more attractive was the Sponsor's credible business plan to have net-zero embodied carbon in the construction and to design the properties to minimise operational carbon emissions.

The two loans totalled £53m (€45m) and represented a 54% LTV or 63% loan to construction costs in both cases.

During construction the contractor tried to minimise carbon emissions. To off-set the remainder of carbon emissions from construction that were unavoidable, 18,000 trees were planted off-site. This was the first deal that FHL had completed with net-zero embodied carbon. Some of the energy efficiency and carbon reduction measures to reduce operation performance were:

- Electrical vehicle (EV) charging on site, as well as dedicated bicycle racks to enable low carbon methods of travel to the buildings
- Energy is generated on site from photovoltaic panels on the roof A Transparent roof and door panels to allow sunlight in, reducing the need for electric lighting
- Both properties were rated BREEAM "Very Good" and EPC rating "A".

The loans were repaid in March 2022 due to an early sale generating IRRs of 9.5% and 14.6% for the two loans respectively against an anticipated IRR of 6.7%. The greater than expected IRRs reflect the attractiveness of the real estate fundamentals of these assets.

[22] UKGBC, 'Net zero carbon: energy performance targets for offices', (January 2020)

We have developed this pathway using the UK Green Building Council's Advancing Net-Zero Framework and aligning the 2035 target with our clients' stated objectives and targets.

Our real estate clients' pathway to net zero excludes our corporate office and related activities and funds where we only have an advisory role. All of these will have their own targets and net-zero strategies and we intend to look to align our managed-asset portfolio's pathway.

Asset level deep dive net zero carbon audits are being undertaken across the portfolio. These are being prioritised on the basis of risk assessments (conducted as part of desktop modelling to support the development of fund-level net zero pathways) and near-term key intervention points such as refurbishments, planned maintenance and redevelopments. The key aim of the net zero audits is to provide critical asset net zero review to our investment teams to help with decision making during key asset lifecycle stages. Carrying out such audits help us consider the interventions that might be applied to an asset in order to deliver performance at or close to emerging standards that represent "net zero" or "Paris-proof" carbon and energy use intensity. The study takes a wider view of asset performance than a traditional energy audit, including high cost and long payback actions such as the upgrade and replacement of building fabric, or wholesale replacement of major plant items.

We continue to develop and implement initiatives across our real-estate portfolio that are designed to reduce carbon emissions and to improve efficiencies in our built environment portfolio, making use of new technology and best practice gleaned from our active engagement in peer-group benchmarking. A case study on our approach to improving the environmental impact of real estate assets is included under Principle 9.

The infrastructure team is targeting Paris alignment (limiting temperature increase to 1.5°C) of our portfolio by

2025

Infrastructure

Our infrastructure team's long-term investment horizon means that climate risk and climate opportunity are integral parts of our team's investment decision making.

Our Infrastructure team engages actively with our portfolio companies in our capacity as shareholder, board director and committee member on their approach to climate change. Transition and physical risks such as carbon pricing and extreme weather can be highly relevant to our infrastructure investments. We also see significant opportunity for infrastructure at the centre the transition to a net zero economy, including both 'greening' our existing infrastructure and allocating capital to transition solutions, such as renewable energy generation.

The infrastructure team is targeting Paris alignment (limiting temperature increase to 1.5°C) of our portfolio by 2025. Prospects for alignment will be factored into all new investment assessments and engagement with existing investee companies is focused on the adoption of 1.5°C aligned targets, as well as absolute emission reduction. Progress against Paris Alignment is monitored annually by the Infrastructure Investment Committee using the FHL proprietary test, developed in line with IIGCC guidance, which classifies companies on a scale of alignment subject to their satisfaction of certain criteria.

Our Infrastructure team engages directly and actively with our portfolio companies in our capacity as shareholder, board director and committee member on their approach to climate change. During 2021, our most recent reporting year, we engaged with 100% of our Infrastructure portfolio companies, with c.38% of our ESG-related interactions related to climate change.

In 2021 we also undertook whole portfolio scenario analysis, in collaboration with environmental adviser ERM, in order to deepen our understanding of transition and physical risk for our existing portfolio. The outputs of the exercise were shared with companies and are used as an ongoing stewardship tool.

Advocacy: delivering positive industry-wide change

Looking beyond investment and stewardship, we also believe that policymakers have a key role to play in determining the investment risks and opportunities created by climate change. In 2022, we carried out extensive advocacy work on climate-related issues.

Throughout 2022, 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 to facilitate the transition to a net zero carbon economy. The aim is to protect and enhance value for our clients by improving shareholder rights.

DEEP DIVE: UK Climate Financial Risk Forum

A key focus of our advocacy work over the past three years has been as a member of the UK Climate Financial Risk Forum (CFRF). The CFRF, co-chaired by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), builds capacity and shares best practice across financial regulators and industry, to advance our sector's responses to the financial risks from climate change. The CFRF plays a critical role in supporting firms as they get to grips with some of the more challenging aspects of climate change mitigation and adaptation by providing guidance by industry, for industry. Our CEO chaired the Disclosures Working Group (DWG) of the CFRF for two years during 2020 and 2021. We led the development of practical guidance on disclosures for financial institutions. The outputs of these two sessions have already been used widely both within and beyond the UK and referenced by the FCA as a useful guide for firms wishing to go beyond minimum regulatory disclosure standards.

During 2022, we were members of the Disclosure, Data and Metrics Working Group and the Transition to Net Zero Working Group. In the Transition to Net Zero Group, we co-led the development of Mobilising Investment into Climate Solutions report which provides recommendations for financial institutions to consider in how to most effectively finance climate solutions, with sector specific scoping notes on carbon capture usage and storage (CCUS), electric vehicle infrastructure and retrofitting commercial real estate. The group will build on this in 2023 with a focus on how financial institutions can tackle the challenges of financing these areas at scale.

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 with aligned domestic policies and deployment of required technologies. In the UK, we called for an ambitious Green Finance Strategy, in particular:

- For the UK to take a principles-based approach with a strong disclosure framework across the economy that allows for innovation;
- To create clear sectoral roadmaps with financing frameworks and aligned incentives to encourage investment in the transition and in green solutions;
- To work with the financial industry on public/private hybrid financing to crowd in private investors, as well as the use of public funding to support the development of early technologies to a point that they become credible investment opportunities;
- To increase incentives for financing both green solutions and the transition; and
- To ensure that stewardship is enabled and incentivised through recognition of outcomes-focused stewardship as a means of investor impact

We also joined a number of our peers in supporting calls for a UK Net Zero Investment Plan, as well as the need to address the energy security, cost of living and climate crises through accelerated action to meet UK climate commitments. We are supportive of strong disclosure frameworks to ensure comparability and transparency. For example, we have voiced our support for the development of international sustainability-related reporting standards by the International Sustainability Standards Board (ISSB). We responded to the ISSB's consultation on climate exposure draft supporting their efforts to drive reliable and consistent climate disclosures, with suggested areas for enhancement such as the inclusion of impacts to communities and workers, and the just transition.

We have also contributed to policy group of GFANZ (Glasgow Financial Alliance for Net Zero), which published a report in 2022 that reflected on the progress that had been achieved around the world this year on policies supporting the transition. The Call to Action: One Year On Report also offers recommendations to support governments in developing their own economy-wide transition plans, building on the policy levers identified in Glasgow the year prior[23].

[23] GFANZ 'The Call to Action: One Year On' (2022)

In focus: human and labour rights

The SDGs include the eradication of poverty and ensuring decent work for all – key foundations for building thriving societies and economies. Decent work is recognised in the Universal Declaration of Human Rights, while poverty erodes access to fundamental human rights and can make it impossible to seek justice to address human rights impacts.

Runaway fuel and food prices, and the Covid-19 pandemic, have pushed many people closer to the brink of destitution over the last two years. The climate crisis is also negatively impacting working conditions for millions of people around the globe. Low-income outdoor workers, such as those employed in agriculture or construction, are especially vulnerable to heat stress, making their working lives a misery, and vastly impacting productivity and output[24]. India and Pakistan suffered in near 50°C heat this spring, a foretaste of what is to come[25].

Against this backdrop, the business case for corporate action is compelling. Social inequality is a systemic risk that undermines political and economic stability. A commitment to wider stakeholders and economic sustainability must include helping to lift communities out of poverty and finding ways to reach the vulnerable and disenfranchised. Beyond the ethical case for respecting human dignity, and the fact that forced labour and child labour are illegal, being able to articulate human rights risks and implement effective human rights strategies is indicative of robust enterprise risk management.

Finally, decent labour standards and fair treatment have been enshrined in international standards for many years, through International Labour Organization (ILO) Conventions and corporate codes of conduct. A corporate responsibility to respect human rights is outlined in the United Nations Guiding Principles on Business and Human Rights (UNGPs). Building on these soft law expectations, current and pending regulations will pose significant challenges to businesses globally that may be unwittingly connected to human rights abuses in their operations and supply chains.

Engagement approach: Human and labour rights in supply chain

Many of the problems targeted by these two SDGs can be disproportionately found in supply chains and in part due to their complex, dynamic and opaque nature, poverty, modern slavery and inequalities persist. However, tough new US and EU regulations are coming into force to tackle human rights issues, adding to existing Modern Slavery Acts in the UK and Australia, and the French Duty of Vigilance Law. Investors and companies must get ahead of these, or run the risk of fines, lawsuits or reputational damage.

Our engagement with companies focuses on their responsibility to respect human rights as outlined by the UNGPs. This begins with aspects such as policy and governance, but also encourages companies to do more to document effective human rights due diligence that has identified supply chain impacts and provided remedy. We engage on how a company can provide meaningful grievance mechanisms that allow affected workers to be heard, and provide feedback for solutions.

We also encourage companies to move beyond the relatively standard process of auditing supply chains - which may identify concerns but not provide remedy - to consider how their own actions may be exacerbating poor working conditions, and how to address this. Falling under the umbrella term of purchasing practices[26], this challenges the common approach of pushing much of the burden for improving working conditions on to suppliers alone.

For modern slavery and child labour in a high-risk sector, or if the company has identified modern slavery as a salient risk, we engage on how companies can implement tailored due diligence. This should focus on how to identify the ILO's forced labour indicators[27] or use the Children's Rights and Business Principles[28]. We believe that companies in high-risk sectors should "find it, fix it and prevent it"[29] given the prevalence of modern slavery and child labour in some sectors[30].

[24] International Labour Organization, 'Occupational Heat Strain and Mitigation Strategies in Qatar', (2019)

[25] The Guardian, ''We are living in hell': Pakistan and India suffer extreme spring heatwaves', (May 2022)

[26] Better Buying, ' Better Buying Purchasing Practices Index'

[27] International Labour Organization, 'ILO indicators of Forced Labour', (October 2012)

[28] https://d306pr3pise04h.cloudfront.net/docs/issues_doc/human_rights/CRBP/Childrens_Rights_and_Business_Principles.pdf Unicef, The Global Compact, and Save the Children, 'Children's Rights and Business Principles', (2009)

[29] CCLA, 'Modern slavery'

[30] International Labour Organization, 'Forced labour, modern slavery and human trafficking' (September 2022)

We had updated our voting policy to consider recommending votes for relevant proposals or against directors where a company was in clear breach of its applicable regulatory human rights responsibilities or those outlined in the UN Guiding Principles on Business and Human Rights. We treated 2022 as a pilot, identifying the highest-risk companies in the EOS engagement programme and alerting them that we had updated our policy.

Companies should also use their leverage and collaborate with each other, recognising that transformative change requires collective action. For example, the Responsible Glove Alliance[31] was launched in 2022, following the imposition by US Customs of several Withhold Release Orders during the pandemic[32]. This highlighted some practices of concern within the medical supplies industry in Malaysia. The Alliance's aims are to work with buyers and suppliers to transform recruitment practices through collective influence, recognising that unless buyers are consistent in their desire for higher standards the incentives for forced labour will remain. We have engaged with glove manufacturer Ansell on labour issues (see case study).

Our engagement with companies focuses on their responsibility to respect human rights as outlined by the UNGPs. This begins with aspects such as policy and governance.

CASE STUDY

Ansell

Ansell is a leading manufacturer of industrial and medical gloves and other latex products.

We had 10 engagement interactions with Ansell in 2022 in addition to more traditional meetings with management. Interactions spanned calls with the chair and CEO, IR, General Counsel and Head of Sustainability in addition to visiting the company's headquarters.

Our primary topic of engagement has been and remains the labour conditions in its single-use glove supply chain (which is 80% outsourced). Several single-use Malaysian glove manufacturers have been subject to import bans from the US as a result of evidence of modern slavery since the beginning of 2020 – a number of whom were suppliers to Ansell.

In response to the greater focus on labour standards, Ansell committed last year to ensuring that no fees are levied for recruitment and the company has revamped its supplier management framework. As of the company's November 2022 AGM $30m of recruitment fees have been compensated to migrant workers across 98% of their Malaysian suppliers.

They also this past year further committed to supplementing their supplier due diligence with unannounced audits and use of Forced Labour Assessments.

We have the clear impression from our dialogues that the company is taking a much more hands-on, proactive approach to oversight of its suppliers. They will be reducing their supplier list and developing more strategic alliances with trusted suppliers. In addition, in the coming years the company will be insourcing a proportion of this currently outsourced manufacturing. The outcome of this shift in approach should be to reduce the risk of human rights abuses occurring in their name. Ansell will also have greater ability to ensure that decent work conditions are being provided and labour standards adhered to.

Beyond their individual actions, Ansell was also this year one of seven founding members of the Responsible Glove Alliance. This is testament to the company's desire to take a leadership role across its industry, not least when one recognises that there is a need for cross-industry action to address the sector's pervasive forced labour issues.

[31] Responsible Glove Alliance, 'RGA Overview'
[32] U.S. Customs and Border Protection, 'CBP issues Withhold Release Order on Malaysian glove producers', (April 2021)

Following Russia's invasion of Ukraine, EOS temporarily suspended engagement with Russia-listed companies and companies with the majority of their operations and assets in Russia, as we believed it was highly unlikely they would engage with us meaningfully at that time. We also contacted non-Russian companies in the EOS engagement programme with material connections to Russian clients, suppliers, or counterparties. We asked what actions they were taking to ensure the safety of employees and their families, whether they were being evacuated, and if salaries continued to be paid. We sought information on a company's increased due diligence to identify any connection to human rights violations, and the actions taken to remedy these. This should include the urgent mapping of supply chains or partners that could be involved in supporting the conflict through their products, services or finance. We also reminded companies to evaluate the risks associated with their ongoing operations and the Russia- Ukraine war, given the various sanctions imposed by Western governments that targeted Russian banks, individuals and businesses. Due to the human rights risks inherent in armed conflict, we began engaging on this issue before sanctions were announced, in the knowledge that these were likely to impact companies later. Some companies were quick to announce that they would cease operations in Russia, but withdrawing from Russia has proven difficult for those with sizeable assets there, such as oil and gas producers, for example.

Following Russia's invasion of Ukraine, EOS temporarily suspended engagement with Russia-listed companies and companies with the majority of their operations and assets in Russia.

EOS contacted 118 companies (not all of which are FHL holdings) in the month after Russia's invasion, and by May, 87 had responded, either via email or through voice engagement. Some 55% had a connection with Russia, and 73% of these said that they had severed this connection or had taken steps to support Ukraine. Among the others who responded, 40% said that they had very limited or no material connections to Russia, and only 5% were unwilling or unable to give a clear position.

Company reactions were mixed. Some sought to temporarily suspend their services or reduce their exposure in Russia, closing stores or exiting fully. For example, biopharmaceutical company AbbVie supplied essential medicines, while stating that it would donate any profits from these sales to support direct humanitarian relief efforts in Ukraine[33]. We engaged with AbbVie, which said that it was monitoring the safety of its employees in the region, helping them to flee if this was possible, and if not, making sure that they had basic essentials. Some companies continued operating to maintain a supply of essential products. More information on our engagement relating to the Russia-Ukraine war is available in the EOS Annual Review 2022.

Involvement in industry initiatives

We supported a number of industry initiatives relating to human and labour rights during 2022, including through our ongoing membership of groups such as the Human Capital Management Coalition, Workforce Disclosure Initiative and Investor Alliance for Human Rights.

EOS were part of the steering group for Advance, the stewardship initiative for human rights and social issues launched by the PRI in 2022

EOS were part of the steering group for Advance, the stewardship initiative for human rights and social issues launched by the PRI in 2022. The objective of the initiative is to advance respect for human rights, minimising negative outcomes and driving positive outcomes for people. The metals & mining and renewables sectors were selected as the initial focus based on an assessment of the highest risk sectors and the practicality of engaging with these sectors. 40 focus companies have been selected for engagement, 25 metals & mining and 15 renewables companies. Three key expectations have been set for the focus companies: to implement the United Nations Guiding Principles on Business and Human Rights (UNGPs), to align their political engagement with their responsibility to respect human rights, and to deepen progress on the most severe human rights issues in their operations and across their value chains. After the launch of the initiative, both FHL and EOS signed up as participants and committed to take on the role of lead engager with at least one company as well as supporting other engagements. As of 31st January 2023, FHL and EOS combined are leading engagements with three companies and supporting with a further eight companies.

In Focus: Nature

With COP 15 finally going ahead in Montreal in December 2022 after multiple postponements, the threat to wildlife and natural habitats remained in focus for investors last year. The World Economic Forum has identified biodiversity loss as one of the three most severe global risks over the next 10 years.

Through the year we continued to advocate for best practice and industry standards, including calling for an ambitious Global Biodiversity Framework at COP 15.

Engagement

After joining the Natural Capital Investment Alliance (NCIA) in 2021, we contributed towards its goal of mobilising more than $10bn in aggregate for natural capital investment opportunities by the end of 2022 through the launch of our Biodiversity Equity Fund.

[33] Abbvie, 'AbbVie Will Donate Profits from Russia to Humanitarian Relief Efforts' (April 2022)

CASE STUDY

Biodiversity Equity Strategy

We launched our Biodiversity Equity Strategy in Q1 2022. The team at FHL has extensively researched the major regional and global threats to biodiversity and have defined six themes for the Fund: land pollution, marine pollution and exploitation, unsustainable living, climate change, unsustainable farming, and deforestation. These discrete themes contain businesses which help mitigate the loss of, or provide solutions to, the specific biodiversity risks they bear. Each of these themes has multiple sub-verticals that are aligned to specific UN SDGs.

We look for best in claxss companies, which help preserve or replenish biodiversity. For each company, we analyse financials, ESG factors, and complete a biodiversity assessment to determine company impacts and dependencies. We seek to quantify this, where possible, through our impact database. Engagement with portfolio companies is a core aspect of the fund, with a dedicated Lead Engager in place. The specific engagement objectives vary by company and sector but include asking companies to assess and disclose their impacts and dependencies on biodiversity and scale up parts of the business that are addressing biodiversity loss.

The two themes which, as of Q4 2022, make up the greatest proportion of our investments are those tackling deforestation and unsustainable farming. For example:

Deforestation

There is a clear and accepted body of evidence that the most biodiverse regions on land map onto forest lands. We cite the UN FAO 2020 study for this assertion, and note that this is supported by our work with the Natural History Museum, whose Biodiversity-Intactness Indicator establishes similar results. Within our deforestation investment theme, we focus specifically on the deforestation from non-farming uses. We identify businesses which: (i) directly prevent deforestation, (ii) reduce the intensity of timber use in existing product markets, or (iii) sustainably manage forest assets. Outlined below are three investment names which assimilate into these three classes:

- **Natura:** The world's largest B-Corp, and a beauty and personal care brand, serving 200m customers globally. Natura sources 38 feedstocks which are exclusive to the Amazon, through 33 local indigenous communities. This creates a viable economic case for c. 2m hectares of forest land being left in situ. Furthermore, the business runs two not for-profit forestry tracker services which allow third party names to monitor their own impact on deforestation.
- **Trex:** A market leader in the manufacture of wood-alternative composite decking, made from a c. 50:50 blend of recycled polyethylene and waste wood. This product competes with and displaces the incumbent virgin timber decking. We estimate that in 2020 the business helped to prevent the felling of 57,000 trees through its displacement of virgin timber decking.
- **Stora Enso:** A true champion of sustainable forestry management in the paper and pulp market. We credit Stora Enso for their best-in-class risk mitigation (with a principally European footprint, with 99% Forest Stewardship Council certification), and commitments to restoration projects, particularly in the Brazilian Atlantic Rainforest (a Veracel joint venture). Stora Enso has committed to achieve a net-positive impact on biodiversity by 2050. We have engaged with the company to ask how this goal will be measured and applied across different countries, and encouraged the company to commit to an earlier timeline.

Unsustainable farming

Our fast-growing global population poses a significant challenge for farmers: how can we produce more food in a way that is sustainable for the long term? Industrialised farming practices, while designed to boost yields, are having a devastating effect on the environment, with soil degradation, use of polluting chemicals and pesticides, and land conversion driving deforestation and habitat loss. The decline in biodiversity affects the whole ecosystem, which can have indirect consequences for other sectors. All these factors also make it harder, and more costly, for farmers to achieve a reliable yield. Regenerative agriculture is defined as a system of farming principles and practices that increases biodiversity, enriches soils, improves watersheds and enhances ecosystem services. It seeks to restore the soil's natural ability to absorb and retain carbon, minimises chemical inputs and integrates crops with animals and forestry:

- **Trimble:** A leading provider of technology solutions that enable professionals and field mobile workers to improve their work processes. Trimble's agricultural business includes precision solutions which enable farms to collect and analyse large volumes of data to drive performance, quality and profitability. Trimble claims this precision-planning approach can increase yield by up to 30%, and reduce the use of fertilisers by 32% and herbicides by 77%. The technology can also reduce nutrient loss by 50% at the minimum, while ensuring no deterioration in soil fertility[34].
- **John Deere:** A leading manufacturer and distributor of agricultural, construction, forestry, and commercial and consumer equipment. Through its production and precision agriculture division, John Deere provides equipment and solutions to production-scale growers of corn and soy, small grains, sugar cane and cotton to help farmers improve efficiency and product more at a lower cost. For example. the ExactEmerge tool has sensors to enhance planting accuracy, doubling the speed of planting with c.15% fewer seeds used[35]. Our engagement with the company has focused on asking the company to develop relevant biodiversity metrics and science-based goals, and articulate a strategy to help customers minimise their negative impacts on biodiversity through precision agriculture.

[34] Trimble, (2022)
[35] John Deere, (2022)

We have responded to this challenge by engaging with companies on their impacts and dependencies on biodiversity, and encouraging them to develop strategies to avoid and mitigate their impacts on nature, whilst aiming for an overall net-positive impact. EOS have also developed a dedicated biodiversity engagement programme for companies in the food and beverage sector to encourage better stewardship of nature. The selection process for the target companies was based on multiple factors, including laggard companies on the Forest 500 or Farm Animal Investment Risk and Return (FAIRR) benchmarks, companies with low ratings on the World Benchmark Alliance Seafood Index, or those selected as having poor water-related performance as part of the Ceres Valuing Water Finance Initiative. We also looked at companies with controversies related to biodiversity, such as inappropriate antibiotic use and animal welfare concerns. More information on our biodiversity engagements is available in the EOS Annual Review 2022.

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. We are also part of the recently launched Nature Action 100 initiative, which will facilitate collaborative engagement with companies that have the greatest impact on biodiversity.

Thought leadership and advocacy

As co-chair of the Finance for Biodiversity Foundation's public policy and advocacy working group, we advocated for an ambitious Global Biodiversity Framework (GBF) to be agreed at COP 15. We focused on the need for the GBF to require public and private financial flows to be aligned with global biodiversity goals and targets. We also contributed to three position papers outlining text suggestions for the GBF[36]. We attended international biodiversity negotiations virtually in August 2021, in Geneva in March 2022, and in Montreal in December 2022. At COP 15 the Kunming-Montreal Global Biodiversity Framework was adopted by almost 200 countries. This features a target to protect at least 30% of land and seas by 2030, and addresses key issues related to biodiversity loss, such as subsidies and the financing gap. There is a requirement for financial flows to be aligned with both the 2030 targets and the 2050 vision, which should stimulate action over the short, medium and long term. In addition, governments will be required to ensure that large companies and financial institutions assess and disclose their risks, impacts and dependencies on biodiversity throughout operations, value chains and portfolios.

In focus: Cost of living crisis

Soaring food and fuel price inflation squeezed household budgets in 2022, driven by supply chain disruption, Russia's invasion of Ukraine, and labour shortages in key sectors such as logistics. The crisis is having a disproportionate impact on low-waged households as they spend a larger proportion of their income on basic necessities, such as fuel and food. According to the Living Wage Foundation[37], there are an estimated 4.8 million workers in the UK earning a wage that is below the cost of living. Governments have a responsibility to ensure that their citizens' basic needs are met, and that their human rights are protected. While some governments have responded to the energy crisis with price caps and energy reduction measures, energy bills are more than double what they were a year ago. Combined with the rising cost of food, motor fuel, housing costs, and other basic expenses, this has meant extreme hardship for certain segments of the population in many countries.

In recognition of these pressures, we integrated cost of living engagements into our wider stewardship programme in 2022. We challenged companies on their role during this difficult time, encouraging them to assess the impacts of their business models on their stakeholders, and to articulate the actions they could take to help support the most affected, without damaging their long-term sustainability. Companies need to balance the various pressures in their value chain and steer a responsible course through crises. We encourage companies to consider paying the real living wage, as demonstrated by our voting decisions, to be creative in meeting the challenges at different levels in their organisation, and to think carefully about how they can support their employees with other benefits. This includes exercising restraint over executive remuneration, similar to the approach taken during the height of the pandemic. For example, we challenged Marks & Spencer on its decision not to subscribe to the Living Wage Foundation, but were reassured that it was working on different cost of living proposals that could achieve an equivalent wage package, such as increased shopping discounts for employees and families.

Some sectors have a greater opportunity to cushion the blow for struggling households and small businesses, perhaps by providing some breathing room in a payment schedule. For example, banks can consider the impact of higher interest rates for borrowers, and a potential rise in defaults, while energy utilities can provide more affordable social tariffs for the most vulnerable. The Commonwealth Bank of Australia has introduced a tiered level of support for customers, with the flexing of contract conditions, and a review of options to help minimise or manage the impact of rate rises. On the utilities side, Duke Energy is increasing the availability of funds to support struggling customers, as well as highlighting flexible payment options.

As well as engaging with individual companies, in recognition of the systemic nature of this issue, we also supported several letters to the UK Government underlining the need to address the intersecting energy security, cost of living and climate crises urgently.

[36] Finance for Biodiversity, 'Aligning financial flows with biodiversity goals and targets', (February 2022); Finance for Biodiversity, 'Aligning flows with biodiversity goals and targets, part II', (June 2022); Finance for Biodiversity, 'Aligning financial flows with biodiversity goals and targets, part 3', (December 2022)

[37] Living Wage Foundation, 'Life on Low Pay' (February 2022)

DEEP DIVE: deforestation

Halting and reversing tropical deforestation will be essential if we are to avoid the consequences of severe climate change and biodiversity loss. Deforestation and forest degradation, mostly driven by beef, palm oil, soy and other agricultural commodity production, has continued despite the immense value of tropical rainforests.

Our commitment

The critical role of nature in climate change adaptation and mitigation was recognised at COP26 in 2021, 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[38].

Our CEO Saker Nusseibeh, CBE, addressed the World Leaders Summit at COP26 on behalf of a group of investors committing to strengthen their efforts to tackle deforestation in their portfolios, as well as those joining the Natural Capital Investment Alliance to accelerate the development of natural capital as a mainstream investment theme.

We signed the commitment to strive to eliminate commodity-driven deforestation from our portfolios by 2025, alongside over 35 financial institutions representing a total of more than US$8.9tn. This was in recognition of the need for investors to conduct sustained and outcomes-focused engagement with companies in forest-risk sectors and with regulators in order to seek more sustainable production and consumption practices in support of climate goals.

2022 progress

In line with our commitment, in 2022 we published our Policy Statement on Deforestation. This sets out our approach to deforestation across public markets, real estate, infrastructure and direct lending. In public markets, we use a range of data sources to assess our exposure to deforestation risk through palm oil, soy, cattle (including beef and leather) and timber (including pulp and paper). This informs our engagement prioritisation.

During 2022 we worked as part of the PRI Sustainable Commodities Practitioners Group to explore how the finance sector can effectively address deforestation. We were also part of the Global Canopy ForestIQ project to improve data availability on deforestation.

Through the Finance Sector Deforestation Action (FSDA) collaborative initiative that followed this commitment, we sent letters to multiple companies outlining deforestation risks and asking for meetings. We will continue engaging with relevant companies including palm oil producers, processors, traders, consumer goods and retail companies, and banks providing financing. This group has also been engaging with data providers, as described under Principle 8.

We hold the chair or other responsible directors accountable through voting recommendations where we believe companies' actions are materially misaligned with the goals of the Paris Agreement or where companies are not responding sufficiently to the risks and opportunities posed by climate change. We include a focus on companies that are involved in activities that are clearly incompatible with limiting global warming to safe levels, such as causing deforestation. For example we voted against a director at TJX in line with this policy.

In 2023, we will continue to enhance our deforestation exposure analysis in public markets as data availability improves. We will report on our exposure analysis and risk mitigation activities. We will also be increasing our focus on deforestation in our advocacy work, in recognition of the need for systemic change to tackle this issue.

[38] UN Climate Change Conference UK 2021, 'Glasgow Leaders' Declaration on Forests and Land Use', (November 2021)

Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Ensuring our policies support effective stewardship

The latest versions of our policies are available on our Policies and Disclosures webpage. We regularly review our policies to ensure they remain effective. The process for doing so depends on the specific policy:

- Our Conflicts of Interest Policy is reviewed annually. No material changes were made to this policy in 2022.
- Our Stewardship Conflicts of Interest Policy is reviewed annually by the Governance Committee to ensure it adequately reflects the types of conflicts that may arise. This means we can ensure that they are appropriately managed and, as far as possible, mitigated. No material changes were made to this policy in 2022[39].
- Our Engagement Policy and Sustainability Risks Policy for FHL are reviewed annually by our Governance Committee. The Engagement Policy fulfils our requirements under the Shareholder Rights Directive II (SRDII) to have an engagement policy covering our public equity engagement approach and the Sustainability Risks Policy fulfils our requirements under the EU Sustainable Finance Disclosure Regulations[40]. No material changes were made to this policy in 2022.
- EOS' Engagement Plan is a key policy for public-markets engagement and covers the next three years. It is updated on an annual basis using a structured horizon scanning exercise which considers extensive feedback from our investment teams and EOS third-party clients, as well as an external scan of industry issues. This ensures that we consider fresh perspectives and continue to identify the key themes which cover our clients' priority areas, ensuring we carry out effective stewardship.

We regularly review our policies to ensure they remain effective.

- EOS' Global Voting Guidelines act as a policy which inform EOS' voting recommendations to our investment teams as well to EOS clients who request to receive voting recommendations. The FHL Global Voting Policy and Guidelines, which are aligned with EOS' Global Voting Guidelines, inform the voting decisions made by our investment teams. Our Guidelines are informed by a hierarchy of external and internally developed global and regional best-practice guidelines. This is further supported by public regional voting guidelines and EOS-developed regional corporate governance principles, available on our website, which set out our fundamental expectations of the companies our clients invest in. We also have nearly 50 country-level policies. The primary policy-development cycle for EOS voting guidelines is an annual process and runs in conjunction with the policy-review process at ISS[41], which informs its benchmark research. EOS looks at feedback from clients, evolving best practice in each market, as well as the changes made at ISS in view of resolution-level data for past voting seasons, to consider what additional changes are warranted. Further input is provided by our Engagement Plan, which identifies thematic priorities for engagement. These can often be boosted by enhanced vigilance and potentially escalation through our voting recommendations. EOS completes its major policy changes before the main voting season in each market. Once changes are applied, the policy is monitored to ensure it is having the desired effect and is adjusted further where appropriate. Our Global Voting Policy and Guidelines are approved annually by the Governance Committee. The regional corporate governance principles are approved by the Head of Stewardship and regional team leads, and noted by the Governance Committee.
- Our approach to controversial activities is reviewed at least annually by the Governance Committee. This policy applies across asset classes.
- Our Design Innovation Standards, which were issued in 2021, and our Responsible Property Management Refurbishment guide also help us embed sustainability principles into development, refurbishment and maintenance. This internal guidance is reviewed at least annually or if there is a relevant major legislation change. It is reviewed by our third-party delivery partners where appropriate.

[39] As HGPE does not hold listed equity of any length of time it is not in scope of the Stewardship Conflicts of Interest Policy.

[40] HGPE are not currently in scope of the FHL Engagement Policy and have a separate Sustainability and ESG Risks Policy which is reviewed by the governing body of HGPE and updated when required.

[41] ISS is a provider of corporate data, analytics and insight. Its services include proxy-voting services. The way we use ISS research is explained further under Principle 12.

Our approach to assurance

We have several internal and external processes in place to maintain high standards of stewardship.

Internal processes

The Risk and Compliance departments, together with senior management, continue to augment and embed our firm's compliance framework, which includes:

- Managing any potential conflicts of interest.
- Monitoring of regulatory and client-specific guidelines by using the appropriate systems.
- Ensuring that the risks associated with new products, instruments and markets/locations are adequately considered.
- Staff inductions and regulatory training, including Know Your Customer, Anti-money Laundering, and Anti-bribery and Corruption training.

Our internal audit function's primary role is to help the relevant Boards, including the Funds Boards and the FHI Audit Committee, and executive management to protect the assets, reputation and sustainability of the organisation. The Internal Audit team is independent of the day-to-day operations and management of the company and is responsible for providing independent, objective assurance to management through a systematic and disciplined risk-based audit approach and assessment of the internal control framework across our firm. Internal audit reports are published at the conclusion of each audit. The individual reports highlight any control weaknesses noted, along with agreed remediation actions, owners and expected resolution dates. Updates on all reports and the status of open internal audit issues are provided to the SMT and the relevant Boards, including the Fund Boards and the FHI Audit Committee.

Responsibility matters including ESG integration remain key areas of continued audit focus. Specifically these were considered in the 2022 Audit Plan through reviews of: Fixed Income and Global Emerging Markets investment processes; Mandate Compliance; and Client Reporting.

Bespoke 'responsibility accountabilities' have been defined for each business area within the organisation and, as appropriate, relevant goals will be part of each colleague's technical performance objectives. These 'accountabilities' set out what responsibility each business area has for supporting the delivery of our purpose. These responsibility accountabilities are reviewed every two years by the Responsibility Office with each business area and actions are identified where improvements can be made. The outcome of this review and key actions are reported to the SMT. Our next review is planned to take place in 2023.

To maintain the quality of our public-markets engagements, we have established a quality-assurance programme. Day-to-day operations and quality assurance are managed by the EOS leadership team, consisting of the Head of Responsibility, the Head of Stewardship, the Head of Client Service and Business Development, the Director of Business Management and the Regional Team Leads (North America, Europe and Asia and Emerging Markets).

Our internal audit function's primary role is to help the Board, its committees and executive management to protect the assets, reputation and sustainability of the organisation.

In relation to engagement quality, each year we plan a series of director-led engagement clinics to confirm that engagement is focused on the right objectives and issues and review the proposed approach to engagement. In 2022, we dedicated this time to a major review of the quality of engagement objectives and plan to restart regular clinics later in 2023.

Our independent Responsibility Office meets quarterly with each of the investment teams to discuss their approach to ESG and engagement integration and to talk about how this has been applied to specific investments.

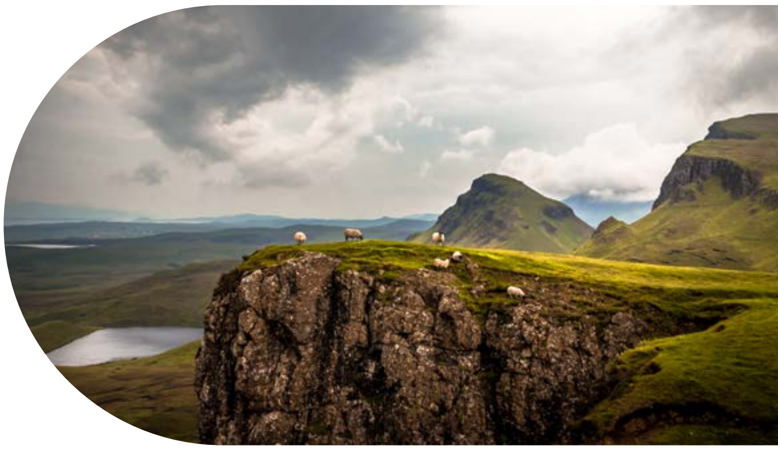
Our Real Estate ESG team has a comprehensive monitoring programme to measure, monitor and report on our ESG performance. The results are published annually in our Real Estate ESG report, available to the public. All data used in Real Estate ESG reporting are verified and assured by a third party in accordance with relevant industry standards.

External assurance

Prime Advocates Limited, an independent external assurer, undertook a second[42] limited assurance engagement on the information disclosed as part of the sustainability reporting of FHL in the period from July 2021 to June 2022 (inclusive). The limited assurance engagement related to our stewardship and ESG integration within our public equities, credit, real estate and infrastructure investment portfolios[43].

The selected subject matter for stewardship & ESG assurance was as follows:

- FHL engagement and ESG integration policies and procedures.
- FHL (including EOS) engagement policies and procedures regarding FHL stewardship and ESG integration.
- Representations and assertions in FHL reports and financial statements about ESG matters.



[42] The initial assurance covered the period from July 2020 to June 2021. The summary report can be found here.

[43] Private equity were not in scope of the external assurance engagement.

- Compliance with regulatory requirements and best practice standards.
- FHL internal guidance documents and general control policies and procedures in connection with stewardship and ESG integration.
- Internal systems, controls and processes for ESG integration.
- ESG and engagement outputs.

Figure 23. Assurance Summary – stewardship and ESG integration

Overall: Meets/Exceeds ✔ ◆	Scope of conceptual stewardship & ESG application	Processes, procedures and implementation
Equity (listed)	◆	✔/◆
Credit (listed)	◆	✔/◆
Real Estate	◆	◆
Infrastructure	✔/◆	✔

✖ Fail ✔ Meet ◆ Exceed

Source: Prime Advocates Limited, 2023.

Conclusion: The assurer's report contained the following conclusion: 'Based on the procedures we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that FHL's [stewardship and ESG integration] within its portfolio investment for public equity, public credit, real estate and infrastructure has not been prepared, in all material respects, in accordance with the identified applicable appropriate criteria. We are satisfied, subject to our limited reasonable assurance, that FHL **exceeds** regulatory requirements and current best practice for [stewardship and ESG integration].'

The assurer also identified the following areas of attainment and areas for improvement:

Areas of attainment/ excellence:

- FHL's holistic, adaptive and material ESG data-driven focused approach to S-ESG Integration, pervasively applied across all investments and strategy types. [All]
- Expert internal senior ESG expertise of the Responsibility Office applied across all asset classes to varying degrees. As such reinforced by cross-departmental collaboration to excellence via FHL's Responsibility Working Group. [All]
- Leverage of the market-leading EOS stewardship engagement service, adding information, active management, oversight controls and ESG issue engagement power. [All]
- Use of EOS engagement methodology for better engagement in FHL Infrastructure. [Infrastructure]
- FHL legacy and leading industry position. Utilisation of FHL's market-leading Public Policy/ Advocacy teams allows FHL to influence and innovate on ESG themes, progressing the market and assisting their portfolio's S-ESG Integration. [All]
- FHL attains best practice on the collection, management and disclosure of quantitative ESG data across its investments, leveraging experts and robust systems. [Real Estate]
- FHL outperformed best practice on the conceptual scoping of ESG integration with progressive and best practice Net Zero, biodiversity and deforestation, project embodied carbon and "placemaking" community engagement commitments. [Real Estate]

Areas for improvement:

- Further added quantitative ESG metric measures matching FHL's progressive ESG goals and actions relevant to portfolios (for increased accountability and optimisation) (e.g., SDG tool, biodiversity/ social/ social value impact tool, more building meters, water and waste and carbon scope 1, 2 and 3 verified data, property biodiversity commitment, deforestation attainment and other social values). [Equity/ Credit/ Real Estate/ Infrastructure]
- Application of a Transparency and Accountability Framework further to the Controversial Activities Policy implementation. [Equity / Credit]
- Bespoke data capture questionnaires and more frequent direct material ESG data points allowing for strategic S-ESG Integration management and reporting. [Real Estate/ Infrastructure]

Our Real Estate team have a checklist to ensure the appropriate sustainability due diligence is carried out on all ESG factors when acquiring new assets.

The Real Estate ESG team completes Global Real Estate Sustainability Benchmark (GRESB) reporting to benchmark our real-estate assets against their peers. All data is managed and verified by a qualified third party and is submitted to the relevant certification scheme. This data output and analysis is fed back to the internal teams on a quarterly basis through update reports by property managers. We also have a checklist to ensure the appropriate sustainability due diligence is carried out on all ESG factors when acquiring new assets.

In 2021 we developed internal Design Innovation Standards with guidance for new developments. This sets out requirements for site teams to follow to ensure the relevant ESG principles are embedded into the design, construction and operations of the asset. We continuously explore additional industry benchmarking and certification to ensure a third-party verified certification is carried out for specific assets to implement sustainability initiatives and to engage occupiers. Our infrastructure team also participate in the GRESB assessment on behalf of a selection of their portfolio companies, primarily those which do not have a strategic sustainability framework in place and therefore benefit from participating, We provide more detail on the outcomes of such certification processes under Principle 9.

Our Race Steering Committee oversaw work to implement the Report's recommendations and will continue to do so in 2023.

Fair, balanced and understandable stewardship reporting

As described above, we have internal and external assurance processes in place to ensure the quality of our stewardship. EOS also undertakes a competitor analysis review on a regular basis. In the introduction to this report, we set out the steps we have taken to ensure that our reporting is fair, balanced and understandable, including representing a range of outcomes in our reporting and describing lessons learned. We have sought to proportionately represent the breakdown of asset classes and geographies in the examples and case studies that we use, and been clear about any differences in approach.

Relevant business areas have reviewed the content of this report relating to their business area, and the report has been approved by our Board.

Continuous improvements

We use these assurance processes, reviews and learnings from our investment and stewardship practices to continue to make improvements to our stewardship approach. This ensures we continue to provide best-practice services for our clients.

We will consider any recommendations of our external assurance provider's second engagement in relation to stewardship and ESG integration during 2023 once their outcomes are made available.

We enlisted an external consultant to undertake a series of listening and coaching circles with leadership colleagues on ethnic diversity and inclusion. The resulting Insight Report was presented to all staff. In 2022, our Race Steering Committee oversaw work to implement the Report's recommendations and will continue to do so in 2023.

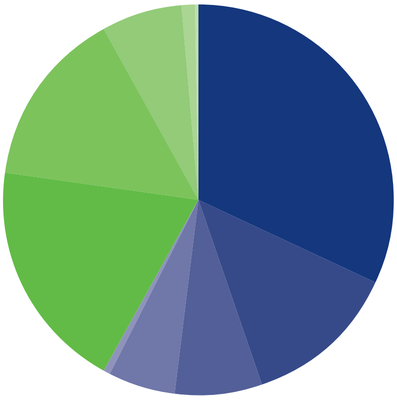
As described under Principle 2, we have made further changes in response to internal and external assurance, including upgrading the ESG integration processes of our private equity team following the UN PRI assessment.

Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Our client base

Figure 24. The breakdown of our client base:



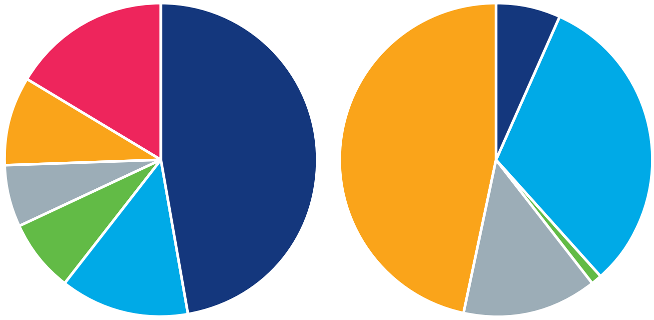
	Sum of AUM %		Sum of AUM %
Institutional	**58.32**	**Wholesale**	**41.68**
United Kingdom & Ireland	31.95	Europe	18.99
Europe	12.95	United Kingdom & Ireland	14.65
North America	7.25	North America	6.69
Asia Pacific	5.44	Asia Pacific	1.32
MENA	0.73	MENA	0.02

Grand Total 100.00%

Source: FHL, as at 31 December 2022.

Our assets under management

Figure 25. The breakdown of AUM by asset class and geographies



	% of AUM
Equity	47.48%
Fixed Income	13.10%
Infrastructure	7.56%
Liquidity	6.34%
Multi Asset	0.00%
Private Equity	9.37%
Real Estate	16.14%
Grand Total	**100.00%**

	% of AUM
Asia ex-Japan	6.74%
Europe ex-UK	31.84%
Global	1.07%
North America	13.90%
UK	46.45%
Grand Total	**100.00%**

Please note, due to rounding the Grand Total does not correspond with the sum of the separate figures. 'Liquidity' in the pie chart above includes our money market funds.

Source: FHL, as at 31 December 2022.

Our investment time horizons

Our approach is to seek opportunities to deliver long term sustainable wealth creation for investors. It is this understanding that informs our belief that we have a duty to consider the longer-term risks and opportunities when investing. This means carrying out extra work when analysing companies to understand externalities, governance practices, environmental impacts, treatment of workforces and the influence of operations on local communities. It also means using our influence to improve the behaviour of those companies in which we have invested, the operations of the assets that we directly manage and advocating for systematic improvements to the financial system in which we participate. Some engagement initiatives will take a number of years to come to fruition.

All of our strategies adopt a long-term investment horizon. While this will vary depending on the investment strategy and the markets within which they invest, a typical time horizon adopted by our investment teams is three to five years. This aligns us with our pension-fund clients who typically invest over the long term.

How we have sought and incorporated our clients' views

We seek client views through a number of fora to ensure we understand how we can continue to best meet their needs. We meet regularly with our clients, in-person and/or virtually, to seek their views and feedback. We held regular webinars for our clients across our strategies to apprise them of market trends, portfolio performance and attribution, as well as our outlook and resulting positioning. Furthermore, we held regular client conferences and seminars, including our ESG Academy.

The majority of our clients have an appointed client team to meet their needs, which consists of relationship managers, sales managers and client-services managers. Several of the teams also involve members of senior management or other parts of the business. These client teams are responsible for developing a deep understanding of their client, their needs, views and approach. The client teams are trained to listen to clients, support them and develop new ideas in tandem with them.

Through this approach, we have developed a number of commingled funds with existing clients. These funds are a testament to our ability to work closely with our clients, take their views and needs into account and launch strategies that are appealing to like-minded clients. During 2022, we launched the Federated Hermes Global Emerging Markets ex-China Fund. The UCITS Fund, seeded by and designed in partnership with an existing client from our Global Emerging Markets Equity Fund, aims to generate long-term, risk-adjusted outperformance by investing in emerging market equities with the exception of China, which has over time become a large percentage of emerging market strategies. By co-designing the strategy with an existing client we were able to add flexibility to our range of emerging market solutions and provide our clients with the opportunity to reduce their exposure to China either for asset allocation purposes or for values based purposes.

We also consulted with clients on the design of the Federated Hermes Biodiversity Equity Fund, and how to bring it to market. We launched the fund in 2022 with the support of some of those clients who provided seed funding.

We set up the Federated Hermes Academy in 2021, an education hub developed by our experts for our clients and prospects seeking to understand responsible investing and how the integration of ESG and stewardship can help create long-term wealth sustainably. We ran five Continuing Professional Development (CPD) accredited seminars throughout 2021 as part of our Academy and three in 2022, which are also available on our website. For 2022, there were a total of 594 registrations across all three modules, covering topics such as net zero, social inclusion and sustainable real estate. We also employ the services of third-party market-research agencies to help identify client demands and needs. This is conducted both for existing strategies and any new products.

As we set out under Principle 1, we use our Customer Outcomes Group (COG) to conduct post-implementation annual reviews on an ongoing basis[44]. This is to confirm that all products continue to meet a customer need, perform in line with their stated objectives and have continued commercial viability. Client feedback may be obtained by a third-party market-research agency or directly through the sales and client teams, and this feedback will be considered as part of the review. For example, during 2022 we modified a number of our funds to exclude a broader range of controversial activities. These changes were initiated in response to changing client appetite as a result of sustainability related regulation and also after a review was conducted by the COG identifying the opportunity to make changes to the funds to better meet our client's needs. The changes were formulated based on insight from existing clients and a review of the external competitor marketplace.

We continue to receive positive feedback from our clients on the service we provide, our thought leadership and the way in which we manage their assets. This is a strong indication that our clients feel that their views are being heard and that we are providing a service that meets their needs.

Finding the right fit

We offer a range of strategies across asset classes, each with their own investment style and stewardship approach, so that clients are able to invest in products that meet their needs. All of our products are high active share, integrate ESG considerations and engagement insights in investment decision making and deploy best practice stewardship. The stewardship approach will be informed and aligned to our firm-wide policy, as articulated in various policy documents (see Principle 5).

While each investment team is responsible for the investment and stewardship decisions within the strategies that they manage, we are in regular dialogue with our clients for their views and inputs on certain topics or issues. This ensures that the client is front and centre of every decision that we make.

Our investment offering is structured on three strategic pillars of Active ESG, Sustainable and Impact. Each product managed is mapped to the EU SFDR classifications where applicable and aligned with one of these investment categories to outline the level of ESG integration adopted by that particular strategy and ensures complete transparency with our clients.

Our Active ESG products offer best-practice integration of ESG analysis and engagement insights, with the objective of delivering long-term outperformance.

Our Sustainable products offer thematic exposure to companies we consider to be leaders in offering environmental or social products and services or mitigating their environmental impact. These portfolios also have a clear set of exclusions to ensure that potentially harmful activities cannot be invested in and an additional objective to deliver a reduced environmental footprint vs. their benchmarks.

[44] HGPE is not within the remit of the COG. For our infrastructure and private equity products, these processes are therefore managed separately within HGPE.

Our Impact products seek to deliver real-world measurable positive change either through investment in companies that provide products and services which help to solve the worlds environmental or social challenges or through companies that, with effective investor engagement, can make a greater material positive contribution to the world.

While these approaches differ and may appeal to different client types, each is underpinned by our best-practice integration of ESG analysis and engagement insights and the delivery of sustainable outcomes through effective stewardship.

The EOS Engagement Plan was developed to provide clients with a clear articulation of the approach to engagement being carried out, acting as a statement of our stewardship priorities and objectives on our clients' behalf. Under Principle 9, we identify our 12 key themes and 32 related sub-themes for the next three years. We find this breadth of coverage is necessary to reflect the diversity of the issues affecting companies in our global engagement programme. The Engagement Plan is developed utilising the engagement team's specialist expertise and is informed by input from EOS' third-party clients and our investment teams. This ensures that the themes represent client priorities and those of their underlying beneficiaries. Through the EOS annual survey, we have seen that a consistent majority of clients say that engaging for impact and outcomes is a priority.

To ensure that we continue to manage our assets in line with the approach we market to prospects and agree with clients, our Compliance department monitors fund guidelines – including objectives and constraints – through thinkFolio, an order management and trading system. All active portfolios undergo pre- and post-trade compliance. Where possible, pre-trade portfolio parameters, counterparty limits and other guidelines are coded into thinkFolio before investment. A member of the Compliance department undertakes the guideline coding, while another member conducts a second review. The thinkFolio programme is coded to prevent any trade in a prohibited counterparty or jurisdiction taking place before execution.

The EOS Engagement Plan was developed to provide clients with a clear articulation of the approach to engagement being carried out, acting as a statement of our stewardship priorities and objectives on our clients' behalf.

The Compliance team also runs a daily post-trade breach report in thinkFolio, which shows when investment guideline limits have been exceeded. This is irrespective of whether the breach has occurred as a result of market movements or a corporate action.

The Investment Office monitors adherence to internal risk guidelines and provides an early warning of potential breaches. If any internal risk guidelines are breached, the situation will immediately be flagged to the appropriate investment team and the portfolio manager will usually adjust their position. However, in cases where investment teams believe it is more appropriate to continue with an outlying position or challenge the internal risk guideline, the situation will be escalated for discussion at the Portfolio Review Committee (PRC) to agree a resolution.

Communicating with our clients

We are committed to being open and transparent. As noted earlier, the Federated Hermes Pledge underpins our firm-wide commitment to always put clients first and to act responsibly.

Reporting is critical to demonstrate our activity on our clients' behalf. We have therefore developed a suite of high-quality, activity-based, qualitative and quantitative communications to support internal and external stakeholder communications.

We publish our annual Climate Related Financial Disclosures report, where we lay out our approach to identifying and managing climate-related risks and seizing opportunities as a business. These include how we are involved at the policy level in developing climate-related initiatives and how we ensure that everyone in the business factors the weight of the climate emergency into the work that they do.

We regularly publish detailed case studies and periodic reports that cover a range of asset classes, alongside thought pieces, blogs and podcasts on topical and emerging ESG issues. We also make publicly available a quarterly EOS engagement and voting recommendations report covering thematic ESG topics and EOS' annual report, which includes statistics, case studies and public-policy information.

During 2022, the upgraded company website was launched, which migrated and merged the legacy Hermes websites and the sustainability hub to an improved web platform. We established the Federated Hermes Academy, an education hub developed by our experts for our clients and prospective clients seeking to understand responsible investing and how the integration of environmental, social and governance and stewardship can help create long-term wealth sustainably. We ran five CPD accredited seminars throughout 2021 and three CPD accredited seminars in 2022 as part of our Academy.

ESG analysis and engagement insights where material are integrated into all of our investment decisions across each of our strategies. We continue to improve our reporting on ESG so that our clients can fully understand our approach to responsible investment and plan to roll out further enhancements on ESG reporting as tools and technologies evolve. For our equity funds, we aim to provide clients with carbon performance and high-level engagement and voting information relevant to the portfolio on at least a quarterly basis. Our ambition to roll out equivalent reporting on carbon performance and engagement to our public fixed income reporting remains a priority. We also continue to report on our water and waste performance for three of our equity strategies with an objective to outperform the benchmark on these factors. We provide detailed quarterly and half-year reporting on both ESG and engagement information to the clients of our SDG Engagement and Impact funds.

Our real estate team publishes an annual ESG report, which publicly discloses environmental and social outcomes for our real estate funds. We have also published several reports to measure the social and economic outcomes of our real estate placemaking initiatives.

Our real estate team publishes an annual ESG report, which publicly discloses environmental and social outcomes for our real estate funds. We have also published several reports to measure the social and economic outcomes of our real estate placemaking initiatives.

Our infrastructure team issued their first annual Sustainability and Stewardship Report in 2019 and their first public report in 2022. Annual reports provided an overview of their sustainability and stewardship approach and activities over the year. We also issued to our Infrastructure investors a Sustainability KPI Supplement to detail quantitative ESG information alongside the Report. Summaries of material ESG matters at individual companies are also included in the narrative section of our investor quarterly reports.

Our private equity team also issued its first ESG reports for some of our latest funds with the aid of a third-party provider in 2022.

Typically, we offer clients annual meetings where the client director and portfolio manager review the portfolio and provide insight into ESG activities undertaken. However, we aim to meet the needs of each client and can be available to meet at more frequent intervals or via conference calls as required. We hold regular webinars for our clients across our strategies to apprise them of market trends, portfolio performance and attribution, as well as our outlook and resulting positioning. Furthermore, we held regular client conferences and seminars including our Academy.

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

At FHL, we believe responsible investment requires integration of material ESG factors in the investment process alongside material traditional performance factors and active ownership of assets through stewardship.

Holding this focus across all of our strategies, while also behaving responsibly as a firm, is integral to delivering sustainable wealth creation.

Figure 26. Creating wealth sustainably

Source: FHL, as at 30 April 2023.

We do not see the integration of ESG and engagement insights within investment decisions as a separate category of investing. Instead, we believe material ESG risks and opportunities should inform all investment decisions. That is why we integrate ESG considerations and engagement insights into our investment processes in all of our products, across all asset classes. As our research has demonstrated, investors do not need to sacrifice returns to invest responsibly. On the contrary, our research shows that companies with good environmental, social and governance performance indicators tend to outperform others over the medium and long term[45]. In the credit space, our research on ESG risk in CDS spreads and sovereign credit further evidence the importance of ESG in investment decisions[46]. For this reason, we aim to ensure that investors' capital is deployed to create wealth sustainably, delivering sustainable growth and helping to build a better society and planet for all – dual perspectives that we believe should not be separated, but considered as one.

We believe there are four mutually reinforcing strands of being a responsible investment manager: ESG-integrated investments; active ownership and management; advocating in beneficiaries' interest; and behaving as a responsible business. Together, these aim to generate sustainable wealth creation for the end beneficiary investors, encompassing investment returns and their social and environmental impact.

Figure 27. Our strategy

Source: FHL, as at 30 April 2023.

Prioritising issues for assessment of investments

Taking an active approach is a central part of our investment proposition. As a result, our portfolio managers are able to take a selective approach by only investing in companies with the necessary characteristics, in the team's opinion, to be sustainably successful over the long term. This approach stems from our values and investment beliefs, which we described earlier under Principle 1. We consider all material investment factors, including those relating to material ESG issues and insights from engagement.

While the most pressing material risks are those that will crystallise in the short term, we are long-term investors that strive to deliver sustainable wealth creation for our end investors. This means that our definition of materiality is necessarily wider. We believe that a wider range of risks will ultimately become material over a longer timeframe and that we need to engage proactively to mitigate them.

The key medium- to long-term risks – many of which may also present threats over shorter timescales – that we factor into our investment analysis and engagements include climate change, natural resource scarcity, pollution, human rights, human capital and labour rights, conduct, culture and ethics, corporate governance and strategy, risk and communications. More detail about how we engage on these issues and the outcomes we seek is available under Principle 9.

An ESG issue will rarely be the sole or standalone driver behind any investment decision. Instead, material ESG factors are integrated into fundamental analysis and inform the teams' investment decision making. The impact on the investment

[45] FHL, 'Despite headwinds, ESG continues to perform', (July 2022)
[46] FHL, 'Pricing ESG risk in credit markets: reinforcing our conviction', (December 2019); FHL,' Pricing ESG risk in sovereign credit', (March 2020)

decision will vary depending on the mandate of the fund. For a fund that integrates ESG but is not a thematic fund, the presence of ESG risk does not necessarily preclude investment, but rather helps investment teams reach a more holistic view of the risk profile of a company and the actions needed post-acquisition to mitigate risk.

Investment teams may also identify opportunities in companies that are improving their ESG practices, particularly given our strong engagement capabilities. For our funds with a thematic focus and/or our impact funds, the existence of ESG risks and opportunities and the prospect of creating or increasing positive outcomes will be significant where it is one of the main drivers of investment decisions.

Research and analysis by all of our investment teams includes an evaluation of performance on strategy, financials, material risk and ESG factors, and the interplay between these elements. Insights from engagement with company management, boards, subject specialists and other shareholders and stakeholders – including the extent of engagement progress – is also a key input into this process and investment decisions at a portfolio and individual asset level. Such engagement is carried out in a co-ordinated manner both by our investment teams and by EOS to maximise the impact of our engagement. These factors influence decisions to invest and are also actively monitored after investment, with the potential to influence decisions to sell an asset or increase the size of our investment. Where concerns arise in relation to one of our existing investments, engagement is often a means to both raise concerns with the company and, where effective, reduce the investment risk and enhance the opportunity from the investment.

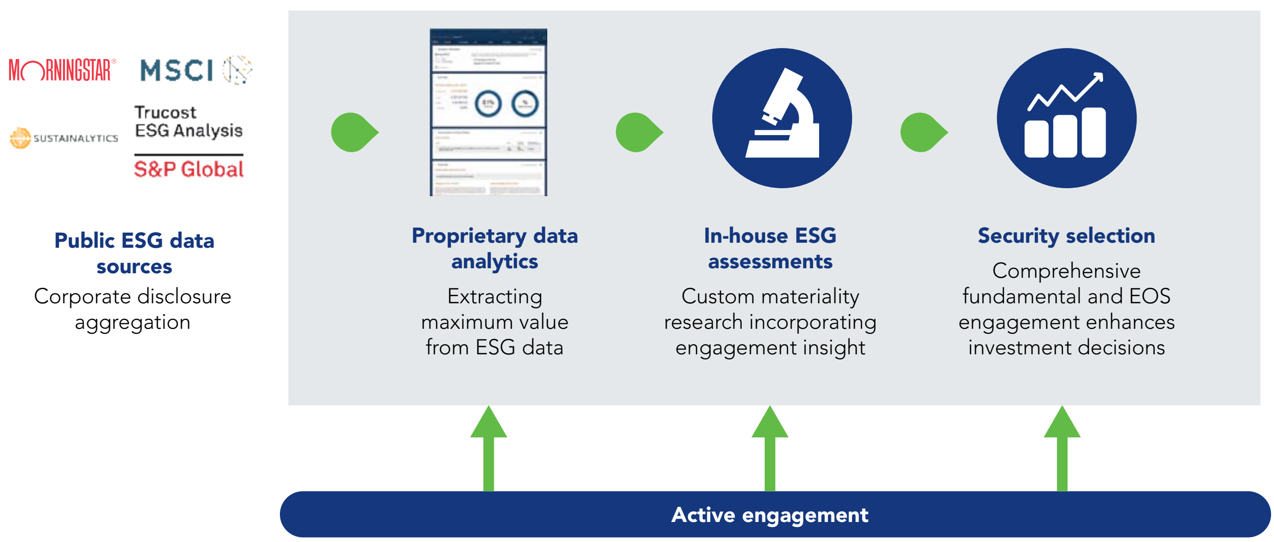
The ESG Integration team within the Responsibility Office also works very closely with the investment teams to help identify material ESG issues that are specific to the investment manager's strategy. The ESG Integration team organises sector-level knowledge-share sessions between EOS and the investment teams and also works with the investment teams to develop frameworks which assess the materiality of ESG risks at the company level. Finally, the ESG Integration team obtains data from third-party providers, which is overlaid in our proprietary tools by insights gleaned from our engagement with the company, and is also used by analysts and engagers in their company research and portfolio analysis.

We encourage our fund managers to use their own expert judgement when considering ESG issues, just as they would with other fundamental investment factors – for example, the strength of a company's structural competitive position or the quality and depth of management.

Climate change continued to be a key priority across our investment teams in 2022, demonstrated by the work of our CNWG. In particular, we published an enhanced business-wide climate change approach, the Climate Action Plan, which set out why and how we will seek to work with clients and investee companies on decarbonisation goals in addition to interim targets . Deforestation also remained a firm focus and during 2022 we began to assess our exposure to deforestation risk across a range of asset classes in line with our commitment. More detailed explanations of our work on climate-change risk and opportunities, deforestation and social issues are available under Principle 4.

How we integrate stewardship and investment across our products

Figure 28. ESG and engagement integration: leveraging market leading engagement capability to enhance investment performance



Source: FHL, as at 30 April 2022.

A tailored approach with centralised support: All our investment activity is supported by our dedicated Investment Office and Responsibility Office, both of which report directly to our CEO. Regular meetings are held between the two offices and with the investment teams to ensure proper coordination and integration of ESG factors and engagement insights. However, it is the responsibility of our investment teams to effectively integrate ESG and engagement information into their investment processes and ultimately our fund managers have discretion on investment decisions. This ensures that ESG factors are fully integrated into investment analysis and decision making.

Developing a holistic view: Research and analysis by all of our investment teams includes an evaluation of performance on strategy, financials, risk and material ESG factors (including from a range of proprietary ESG and engagement tools), and the overlaps between these elements. Insights from engagement with company management, boards, subject specialists and other shareholders and stakeholders – including the extent of engagement progress – is a key input into this process and investment strategy. Such engagement is carried out both by our investment teams and by EOS on their behalf. These factors influence decisions to invest and are also actively monitored after investment, with the potential to influence decisions to increase/decrease our exposure to the asset as well as sell an asset. Where concerns arise in relation to one of our existing investments, engagement is often a means to both raise concerns with the company and seek to reduce the risk.

Stewardship integration: Our experience suggests that a systematic engagement approach, combined with tried and tested methods of escalation such as collaboration or shareholder meeting interventions, is needed to accelerate change at companies, such as those failing to prepare for the low-carbon transition. Driving change through engagement is one side of the coin – effective integration of stewardship insights is the other.

The principal objective of stewardship is to maintain or enhance the value of an asset. The beneficial outcomes sought through engagement include those of a governance, strategic, environmental or social nature.

In addition, we believe that ESG-aware investors should not rely on data alone, as it is often backward looking and updated infrequently with at a time lag. As such, active ownership is an important pillar of our investment approach. Engagements can deliver useful investment insights (although engagers and analysts must always seek to avoid acquiring any inside information). The voting recommendations and engagement activities of our stewardship team can promote positive change within companies, unlocking hidden value and also providing a forward-looking view of ESG and broader performance that can lead to opportunities.

The investment teams assess and continue to monitor strategy, financials, risk, material ESG factors and the overlaps between these elements throughout the life of the holding. The monitoring of strategy, financial and non-financial performance and risk and capital structure is done through carrying out a financial analysis of company reports, attending analyst meetings and investor presentations, using media sources and third-party research and attending engagement meetings. Each investment team is responsible for looking at the financial performance, risk and capital structure of investee companies. All teams also have access to ESG data and proprietary tools, including engagement information. When a concern is identified, this will inform engagement and investment decisions.

The information we gather through stewardship enables us to develop a more comprehensive view of both the risk and opportunities a company is exposed to and to factor this into valuations and investment decisions. Such assessments are not a one-off but rather form an ongoing feedback loop. Monitoring this information informs our engagements, while engagement insights inform our investment decisions. Our fundamental research benefits from our ongoing dialogue with investees, as well as that between our public-markets investment teams and stewardship arm. We invest time and resources to encourage companies to strengthen their governance, give our views on strategy and encourage companies to take a long-term view, particularly on sustainability issues. The insights we glean from these interactions help us to better understand a company's complex strategic challenges – something that ultimately helps us serve our clients. Our latest research has confirmed the importance of environmental metrics as a performance indicator, as poorly ranked companies tend to significantly underperform over the long term[47]. This reinforces our aim to generate sustainable wealth creation for the end beneficiary investor, encompassing both investment returns and their social and environmental impact.

We also consider the environment that an asset is operating in when assessing risks, including ESG risks. For example, because emerging markets are not as transparent as developed markets, the risks are higher. As a result, our Global Emerging Markets team recognises that investors need to be more prudent and seek a margin of safety – something that can be secured by integrating ESG factors. Similarly, for our Asia ex-Japan fund, assessments of corporate governance factors are particularly important when considering potential investments in countries such as China and South Korea. The team has a varied and lengthy list of warning signs that they consider and seek to visit and/or speak directly to management prior to investing in a stock.

Given the integrated approach of all of our investment teams, information gathered through stewardship directly informs our investment decisions (alongside other factors such as more traditional financial analysis).

The nature of engagement, as described here and in Principle 9, varies between asset classes. Engagement is also influenced by sector and geography and each investment team tailors its own ESG and engagement integration approach to suit their investment philosophy (see Principle 6 for a breakdown of our asset classes). ESG factors and engagement insights can be a component of a screen, a source of ideas, an input into fundamental analysis or an adjustment to valuation drivers and/or a portfolio construction factor. But common across all of our funds is a set of shared investment beliefs, as set out in Principle 1, which influences every aspect of the investment process. ESG

[47] FHL, 'Despite headwinds, ESG continues to perform', (July 2022); Hoepner, A.G.F., Oikonomou, I., Sautner, Z., Starks, L.T., and X.Y. Zhou. (2020). ESG Shareholder Engagement and Downside Risk. ECGI Finance Working Paper 671/2020.

factors and engagement insights are integrated into investment decision making, whether it is deciding to avoid, buy, hold or exit a position.

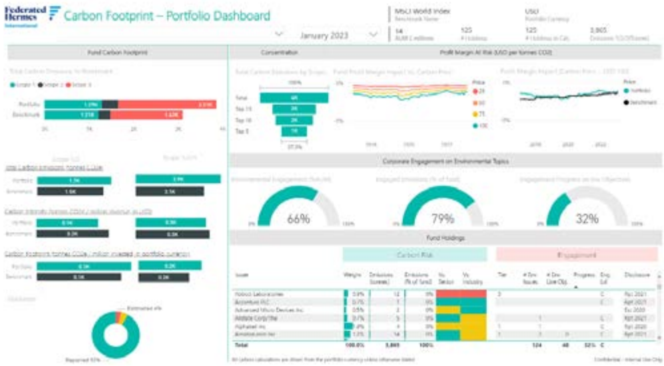
The Responsibility Office oversees and supports all of the below ESG and stewardship integration activities. This is achieved through a number of different activities, such as coordinating knowledge-share sessions between teams (including EOS), working with the investment teams to develop frameworks to assess different ESG risks and coordinating conversations with EOS to ensure there is good engagement across the strategies. The investment teams also meet formally with the Responsibility Office at least every quarter to discuss their ESG and engagement integration activities.

Public markets

For public markets, our firm's proprietary ESG tools are of particular note:

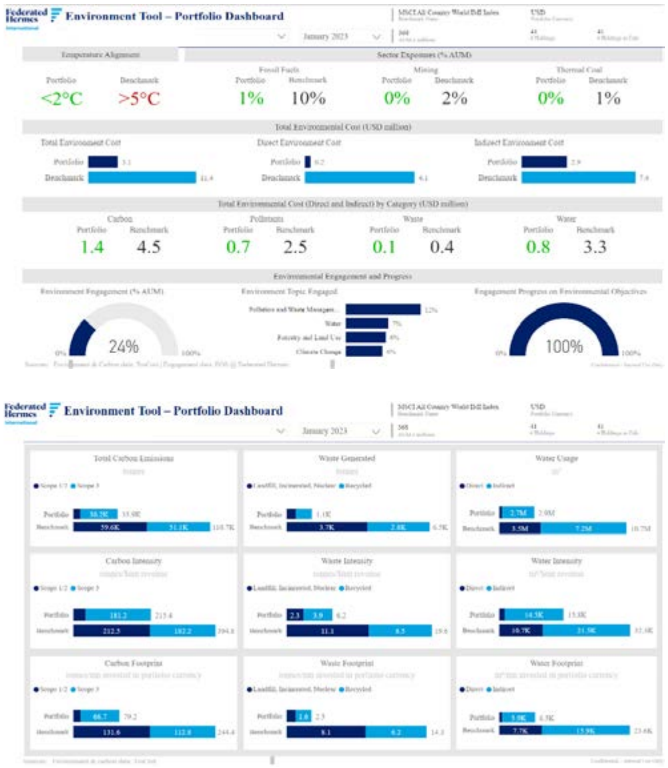
- Our **Carbon Tool** enables fund managers and engagers to identify carbon risks in portfolios and companies that currently exist or may develop in the future. Importantly, the tool incorporates our stewardship activity and intelligence and is able to identify companies that are priorities for engagement and their progress against environmental objectives.
- Our **Environmental Tool** assesses both portfolios and companies on their carbon, water and waste performance. It also looks to quantify the environmental cost of the impact via the following six lenses; carbon, water, waste, air pollutants, land/water pollutants and natural resource use. In addition, we assess our portfolios and companies alongside exposures to carbon intensive sectors, namely: fossil fuels, mining and thermal coal. This tool also incorporates our stewardship activities with a focus on environmental engagement at both portfolio level and company level.
- Our **Corporate Governance Tool** provides a breakdown of corporate governance characteristics, such as information on board independence, diversity and audit tenure. This tool compares the governance of companies to the expectations we have set and flags any companies that do not meet the expected standard.
- Our **ESG Dashboard** includes our proprietary Quantitative ESG (QESG) Score and identifies stocks with positive ESG characteristics and/or stocks demonstrating positive ESG change. The QESG score captures how a company manages its ESG risks. The dashboard includes a snapshot of what themes that company has been engaged on along with progress made.
- The **Portfolio Snapshot** allows us to examine ESG ratings and controversies and identifies contingent risks. Our portfolio managers use this tool to evaluate a strategy's ESG performance over time. It also provides insights into engagement and the progress made, and our voting choices relative to the benchmark.

Figure 29. Carbon Footprint – Portfolio Dashboard



Source: FHL, as at 31 January 2023. For illustrative purposes only.

Figure 30. Environmental Tool – Portfolio Dashboards

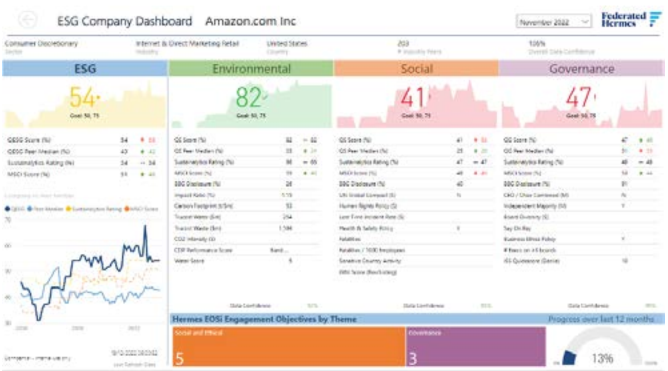


Source: FHL, as at 31 January 2023. For illustrative purposes only.

Figure 31. Corporate Governance – Company Dashboard

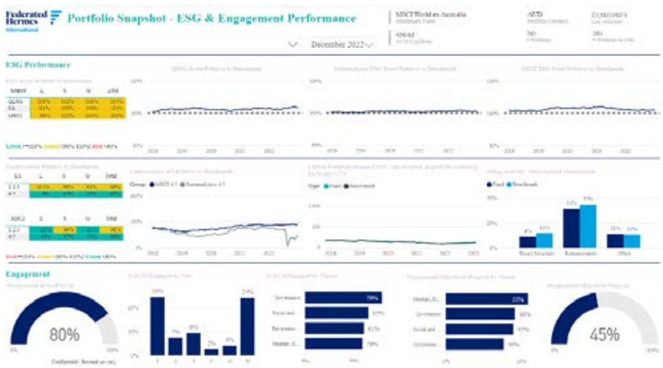
Source: FHL, as at 31 December 2022. For illustrative purposes only.

Figure 32. ESG Dashboard



Source: FHL, as at 31 December 2022. For illustrative purposes only.

Figure 33. Portfolio Snapshot – ESG and Engagement Performance



Source: FHL, as at 31 December 2022. For illustrative purposes only.

Through these tools, along with additional EOS engagement information, the public equities and fixed income teams have access to third-party ESG data, as well as insights on engagement carried out by EOS with investee companies and the broader investable universe. These sources are a valuable input to the investment process, as well as to the ongoing monitoring of and engagement with companies.

We believe that ESG-aware investors should not rely on ESG data alone. The information provided by companies may not be comparable with peers. In addition, it is often backward looking, updated infrequently and with a time lag. As such, engagement activities and voting information can be used by our teams to provide a forward-looking view of ESG characteristics and the broader performance of a company. As well as accessing EOS' engagement portal – which includes the engagement history and progress against live objectives – portfolio managers can, and are encouraged to, attend engagement meetings with the engagers. The benefit of these joint meetings is substantial and results in more robust engagement that focuses on the relevant and material ESG risks and opportunities. Our investment teams also regularly discuss salient ESG issues with company management directly.

Our investment teams regularly interact with the relevant sector or regional lead within EOS to better understand the ESG issues within their investment universe, and also discuss specific companies with the relevant engager. Such interactions can help the portfolio manager discern whether a particular ESG issue is material or not, something which cannot always be gleaned from raw ESG research data. Therefore, we believe that to implement a credible and successful ESG integration approach it is of utmost importance that engagement information is part of the ESG information universe.

Because our EOS engagement team engages globally in respect of both our internal holdings[48] and the holdings of EOS' third-party clients, its coverage extends beyond our own holdings. This coverage allows our analysts to benefit from these engagement insights when looking at prospects, as well as in relation to ex-post monitoring.

While there are principles that govern our ESG and stewardship integration across our investment teams, we believe in developing processes that are relevant to the investment strategy. Therefore, the method of this integration can vary by investment team. Below is an outline of our public credit team's approach.

Public Credit

The public credit team believes there is a direct link between ESG risk and credit risk, and sees no separation between ESG-integrated investing and more traditional investing based purely on financial metrics. Their approach not only relies on inputs from various external data providers, but also builds on the extensive experience of our EOS engagement platform and the bottom-up work of individual analysts. The methodology aims to capture the positive movement in a company's ESG characteristics and not rest on annual data inputs. The insight gained from engaging with companies is an important ongoing additional input into the fund managers' investment considerations as a strong focus is placed on driving positive change within investee companies. The team believes that there is an opportunity to add alpha by investing in companies that may score poorly in ESG characteristics as measured by the traditional data providers, but show an earnest desire to improve those ESG behaviours. This can be achieved by investing and engaging with the company prior to its ESG risk reduction being priced into market consensus.

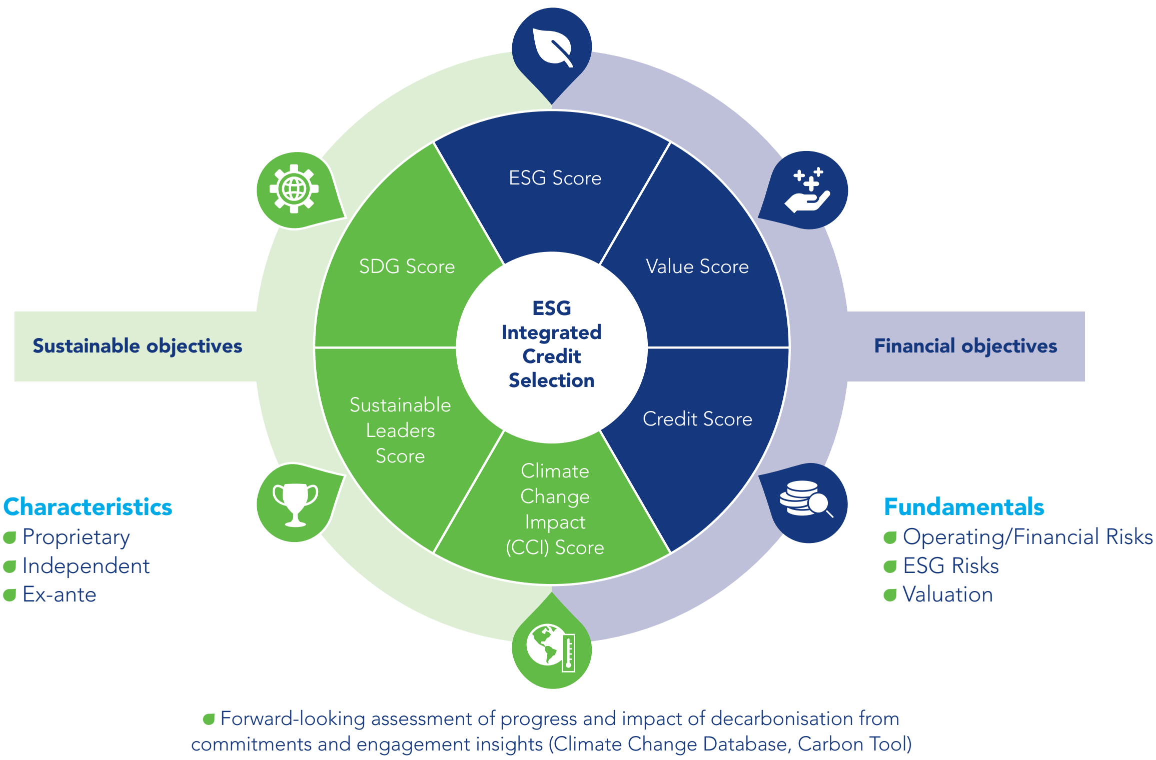
The team's holistic approach to ESG integration considers ESG factors within all stages of the investment process, from initial universe screening through to stewardship and advocacy. The process begins when screening global credit markets to create the core investible universe (the universe from which portfolio managers can select securities). They are able to 'screen in' securities on which we have high conviction from a sustainability perspective (as indicated by their proprietary sustainability scores) but which are not already captured by other criteria. This means they are able to include securities that would not necessarily screen highly if considered from the purely financial angle of the investment process. In addition to this, the team operates a minimum ESG threshold for investment. Using the proprietary and forward-looking ESG scoring system (detailed below), the lowest scoring issuers from an ESG perspective are excluded from portfolios.

For investment solutions governed by a sustainable investment objective alongside a financial investment objective, the sustainability analysts take the lead in the development and maintenance of sustainable investment processes and proprietary sustainability scores. For the purposes of these solutions, the sustainability scores allows us to screen the investible universe to ensure the portfolio is constructed in a way that feeds into the sustainable objective of the strategy.

We believe that to implement a credible and successful ESG integration approach it is of utmost importance that engagement information is part of the ESG information universe.

[48] Throughout this report, references to FHL holdings relate to the holdings that we manage on behalf of clients.

Figure 34. The team's suite of proprietary ESG and sustainability scores



Source: FHL, as at 31 December 2022.

- **ESG Score** (from one to five) – assesses the potential forward-looking impact of non-fundamental factors on a company's enterprise value. The scores are assigned by credit analysts as part of their bottom-up assessment of each issuer, alongside more traditional financial scores of credit and value. Within their assessment, the analysts will consider the FHL QESG score, as well as the sustainability scores assigned by the engagers, which are considered in the ESG score for each issuer.
- **Sustainable Development Goals (SDG) Score** (from one to five) – determines the ex-ante potential for a company to effect positive change on society and environment. SDG scores assess a company's willingness and ability to manage its operating process and/or the products it produces in a purposeful way for the benefit of society and/or the environment.
- **Climate Change Impact (CCI) Score** (from one to five) – assesses the climate change credentials of a company along two dimensions: 1) how credible is the company's process and progress in decarbonisation compared to its own goals — if any — and compared to its sector peers (i.e. scope and ambition of decarbonisation plans; near-term and mid-term goals innovation; capital expenditure; reporting) and 2) the impact of decarbonisation on the company and on the wider economy (i.e. materiality; time frame; avoided emissions; value change contribution).
- **Sustainable Leaders (SL) Scores** (from one to five) – a sector-weighted, ordinal assessment of the sustainability leadership of companies, derived from the sector-weighted average combination of our proprietary scores overlaid by views from credit analysts and engagers.

Once in the universe, the credit research analysts will assess various factors to understand how much the company's behaviours jeopardise or enhance its enterprise value.

The credit research analysts and engagers discuss the ESG and sustainability scores in detail at the credit committee when evaluating credit selection. Engagers work closely with the credit research analysts throughout the process and take ownership of evaluating each issuer for the sustainability scores.

If a company advances through the initial screening, then it is included in the investment universe. These scores are reviewed on a regular basis to ensure any updates are taken into consideration.

Once in the universe, the credit research analysts will assess various factors to understand how much the company's behaviours jeopardise or enhance its enterprise value. The criteria do not differ across jurisdictions or sectors; however, the team recognises that certain sectors are more vulnerable to ESG behaviours which can lead to sudden degradation in firm value. To that end – while the team looks at the relative standing of a company within its sector for each of the three components of ESG – for each sector they might emphasise one ESG factor more than others. The main criterion for the governance category is the earnestness with which a company seeks to improve all of its behaviours and their responsiveness to the team's engagement. The analyst assesses management's desire and ability to build a sustainable business that will support and perpetuate firm value.

Once issuers have gone through our screening and bottom-up research process, they are available for selection by portfolio managers across our range of credit funds. Our suite of ESG and sustainability scores have a direct effect on the sizing and selection of securities, depending on the fund's objective.

The team's approach to stewardship

The team identify engagement opportunities in investee companies through the assessment of their ESG practises. This tends towards companies with weak ESG practices but which present room for improvement and demonstrate a willingness to engage. Generally, engagements are carried out in collaboration with our in-house engagement team, EOS, and the EOS analyst will lead the engagement relationship. The Credit team, however, also benefits from having a dedicated engagement team, who are responsible for developing engagement strategies and work with their investee companies. Wherever possible, the relevant credit analyst will attend joint engagement meetings. In both instances, credit analysts will sit with EOS analysts before and after meetings to share knowledge, perspectives and ideas.

For sustainable and impact portfolios, which include a sustainable investment objective alongside a financial investment objective, the dedicated engagement team will play a greater role in setting the engagement strategy and objectives, along with the requirements of the mandate. For example, within our SDG Engagement High Yield strategy, the team owns the engagement programme, which seeks to generate social and environment impact in line with the UN SDG framework.

SDG ENGAGEMENT HIGH YIELD CREDIT STRATEGY CASE STUDY

Catalent

New Jersey-headquartered Catalent is a leading partner to more than 1,000 pharmaceutical companies worldwide, providing them with solutions for product development, manufacturing and supply to end-users. Its 18,000 employees are located across five continents, developing 74 billion doses of treatment annually, ranging from soft capsules to specialised delivery products, such as prefilled syringes and dry powder inhalers. The company mainly specialises in biologics (drugs produced from biological sources) and branded small molecule drugs (drugs produced using chemical synthesis), but also offers over-the-counter (OTC) solutions and generics.

Catalent is a leading contract development and manufacturing (CDMO) company[49] and a global provider of advanced delivery technologies and manufacturing solutions for drugs. As of 31 December 2021, the company reported $4.5bn in annual revenues and $1.2bn in adjusted EBITDA[50]. Its business model benefits from a wider trend within healthcare towards outsourcing, which favours CDMOs. As a leader in this space, Catalent is well positioned to gain market share and continue to drive industry consolidation.

We have been engaging with the company on the following:

- Universal access to healthcare - One of Catalent's strategic priorities is to assist the pharmaceutical sector in bringing new, innovative treatments to the market. Between 2016 and 2020, the company spent more than $4bn investing in next-generation therapies[51], and has been involved in developing over 100 treatments for rare diseases in recent years[52]. It has specialised in providing advanced delivery mechanisms for innovative solutions such as gene therapy (which, it says, could help to meet the needs of patients suffering from over 4,000 genetic conditions with no adequate existing treatments) and cell therapy, which studies have shown might be a viable solution for treating degenerative diseases, such as Parkinson's disease. We have engaged the company on how it can contribute to the global push to address unmet medical needs. We believe it is in a strong position to do so through partnerships and innovation along the pharmaceutical value chain. We will also seek to understand how perceptions of unaddressed needs, as well as considerations of public and commercial incentives, feed into the company's decision-making process when identifying new ventures.
- Greener pharma supply chain - In July 2021, Catalent exceeded its target to reduce its operational emissions by 15%, two years early. This was largely driven by increasing the renewable component in its total energy mix, from 6% in 2020 to 97% in 2021. The company has announced that it will set SBTi-aligned targets by 2024. However, its targets and initiatives have so far focused on operational emissions, and it has not yet disclosed the emissions associated with its value chain. Recognising the significance of Scope 3[53] within the sector, we set an objective for Catalent to enhance its oversight of suppliers, ultimately enabling it to measure the environmental performance of its supply chain and set targets for improvement. The company has responded to our suggestions positively and is looking at platforms to monitor and engage with suppliers on their emissions. We will continue to engage with the company on this issue to tackle its full scope of emissions.
- Tackling inequitable health outcomes with female leadership - We engaged the company about current and future diversity and inclusion initiatives. The company emphasised that diversity and inclusion is a key priority of its environmental, social, and corporate governance (ESG) strategy, and that it is working on implementing policies for recruitment and career advancement within the organisation. We are encouraged by its development of regional recruitment strategies for operational and management roles. We have specifically flagged the low gender diversity of the company's Board of Directors in a letter to the company, outlining the importance of diversity of thought at the leadership level and our expectation that the company outlines a strategy to improve board diversity. We will continue to encourage the company to address the issue of gender and wider definitions of diversity.

[49] CDMO businesses serve other companies in the pharmaceutical industry on a contract basis to provide services such as drug development or drug manufacturing. This allows major pharmaceutical companies to focus their efforts on specific parts of the drug discovery, development and marketing process perceived to be most beneficial.

[50] A measure of corporate profitability worked out by taking a company's enterprise value or EV, calculated as equity plus debt, and dividing this by its earnings before interest, tax, losses and write-offs. EBITDA stands for Earnings Before Interest, Taxes, Depreciation and Amortization.

[51] Catalent Sustainability Report 2020

[52] Catalent, 'Orphan Drugs', (2020)

[53] Companies' greenhouse gas emissions are categorised into three groups or 'Scopes' by the most widely-used international accounting tool, the Greenhouse Gas (GHG) Protocol. Scope 1 covers direct emissions from owned or controlled sources. Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in a company's value chain.

Further examples of how some of our investment teams integrate ESG and stewardship in their investment decision-making processes are below:

Impact Opportunities Strategy

The team behind our Impact Opportunities Strategy, Biodiversity Equity strategy and Global Sustainable Equity strategy[54] seeks to identify megatrends in alignment with 17 UN SDG goals and 169 targets. As such, the team looks to invest in companies that are providing goods or services which are helping to resolve the world's most pressing needs be it of the environment or the society. Whilst ESG and engagement integration are integral to all three strategies, Impact Opportunities goes a step further and quantifies the impact of each of its portfolio companies. The team believe that an impact label without quantifiable outcomes has no value.

The Impact Opportunities strategy looks to generate value by investing in companies that create positive impact which is sustainable and quantifiable. The team have found that companies that provide products or services that help solve unmet needs of society or the environment are exposed to scalable and secular growth opportunities. The team seeks to identify companies which are providing impactful solutions across nine main themes; energy transition, circular economy, water, health and wellbeing, education, financial inclusions, future mobility, food security and impact enablers.

The impact assessment of each company covers four categories:

- Nature – how is the company meaningfully contributing to the SDGs?
- Intentionality – Is the delivery of positive impact core to the business model now and/or in the future?
- Additionality – How is the company generating an impact that would not happen otherwise?
- Balance – Is there a favourable balance between the company's positive and negative impacts?

In order to have accountability and transparency for their investments, the team have created a proprietary impact database[55] that monitors quantifiable impact achieved by investee companies across all three strategies on an annual basis. The impact can be quantified on company, portfolio and individual client holding level.

Global Equities

Assessment of the ESG characteristics of a company is a vital part of the team's investment approach and the team uses ESG research in both proprietary models and in discussion with EOS.

The team have built a bespoke quantitative assessment of the most important ESG issues, the QESG Score, which evaluates a company's ESG characteristics and identifies positive ESG change. The team believes that companies less exposed to ESG risks than peers will outperform over the long term. Further, it believes that companies that are improving their ESG profile through positive change can unlock shareholder value.

The QESG Score is designed to capture a company's behaviour on various ESG issues, as well as observed change in its ESG behaviour. The score combines data from EOS, Sustainalytics, MSCI, CDP, ISS, Trucost, FactSet and Bloomberg and is weighted 50% governance factors, 25% environmental factors and 25% social factors. The score is shown in the ESG Dashboard. The weightings used are based on the expertise of the EOS team. Following research into the growing impact of ESG factors, the team found a meaningful correlation between governance and stock performance.

The QESG Score is a valuable component of the ESG Dashboard, which is used in the subjective part of the process and provides a concise digest of the ever-increasing amount of data on ESG risks. As such, all of the team's investments are analysed from an ESG perspective.

The team have also created a sustainability framework that is a multi-factor assessment that evaluates a company's capacity to facilitate Sustainable Wealth Creation while minimising Sustainable Wealth Destruction. Sustainable Wealth Creation and Sustainable Wealth Destruction are comprised of various subcomponents. Broadly speaking, they can each be categorised in two separate themes: social (for example, the treatment of major diseases, nutrition, education, etc.) and environmental (for example, sustainable water, pollution prevention, alternative energy, etc.). In turn, each of these themes can be further disaggregated into direct and indirect factors. This Sustainability Assessment lays the foundations of the team's Sustainable Opportunities score, which measures how a company contributes to sustainability. The team are currently using the score to inform their analysis while they learn more about the companies that the score positively identifies and in time they will determine how they will use the score in their investment process based on these observed outcomes.

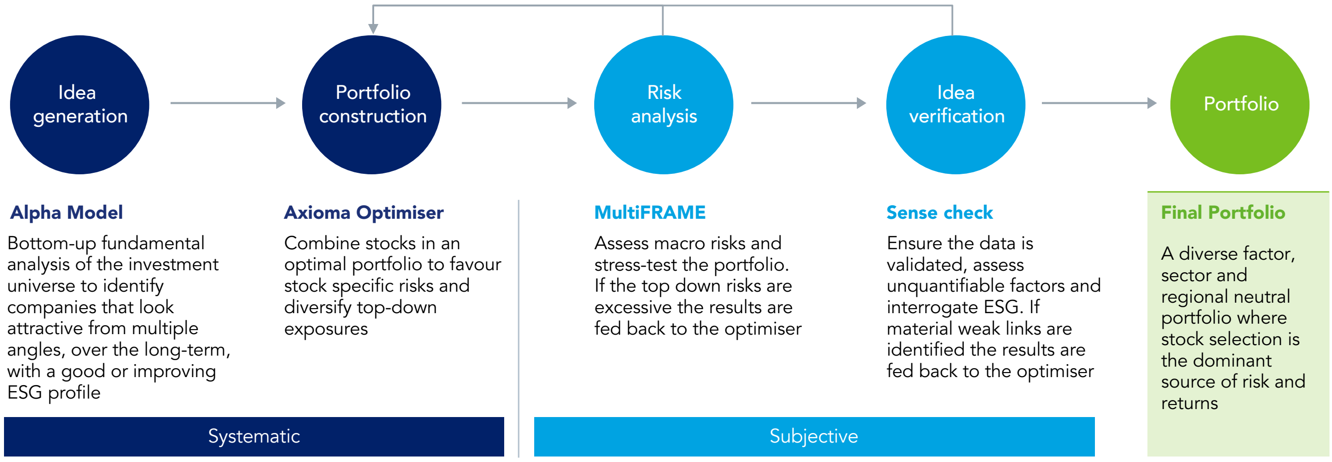
The expertise of EOS has also helped define the key performance indicators or risk factors on which each company is measured. These are either generic, such as board structure, or sector specific, focusing on the major risks by industry – such as CO_2 emissions and fleet consumption for the automobiles industry, paper sourcing for media and energy efficiency for airlines. The team uses it to identify ESG risks within companies and determine the materiality of these risks. Any change in the level of ESG risk and progress on current engagements are key factors that could influence an investment decision.

The ESG integration approach adopted by the team is complemented by direct dialogue with businesses that is made possible through EOS, which ensures the team remains active owners of the companies held in the portfolio.

Our Responsibility Office is tasked with monitoring and overseeing every investment team's integration approach. To that end, the Responsibility Office meets with every investment team on a quarterly basis to review the portfolio holdings from an ESG point of view and flag, if necessary, particular holdings which our third-party ESG data vendors might have highlighted as controversial. As such, the Responsibility Office and the investment teams regularly use our proprietary ESG tools to review the ESG performance and engagement coverage of our holdings.

[54] Our Impact Opportunities and Biodiversity Equity strategies are in our Impact pathway, and our Global Sustainable Equity strategy is in our Sustainable pathway.
[55] The database comprises FHL and Net Purpose data.

Figure 35. Global Equities Investment Process



Source: FHL, as at 31 December 2022.

Figure 36. Identifying opportunities and avoiding harmful or controversial behaviour

	Uninvestable	Potentially attractive	Attractive
Behaviour	• Reliance on harmful products (eg: Tobacco, coal, weapons) • Significant ESG Controversies • Breach of UN Global Compact	• Good company but products have little societal benefit • OK company, but limited ESG improvements • Challenged company, but reducing exposure to harmful products	• Sustainable products that benefit society • Robust processes & effective management of ESG risks • Leading and improving governance standards
Outcome	• Alpha Score severely reduced • Major financial & reputational risks	• Alpha score driven mainly by financial characteristics • Engagement vital in understanding & controlling risk	• Alpha score enhanced to reflect the lower risk and higher quality company

Source: FHL, as at 31 December 2022.

The Responsibility Office also conducts an assessment using our proprietary ESG Assessment Matrix on an annual basis to determine where each of the investment teams are in their ESG and stewardship integration journey. The matrix contains 86 Key Performance Indicators across 28 sub-indicators and aims to assess the teams on the following:

- **Investment process and philosophy** – how well the team understands material ESG factors for its universe and how they stay abreast of developments, where in the process the team integrates ESG and stewardship insights and how this impacts investment decisions to the benefit of clients and their investors. Within the stewardship sub-category – the teams are assessed on their proactiveness in identifying areas of engagement, their interactions with EOS and how involved they are in the engagements, how regularly the teams assess the progress made on engagements and how this influences their investment decisions.
- **Communication** – how clearly the team articulates, for clients and their investors, the ESG and stewardship approach of an investment strategy, and how it reports on its ESG performance.
- **Advocacy** – how actively the team is involved in initiatives in clients and their investors' interests, both internally and externally, on ESG themes as well as ESG and stewardship integration in asset management.

SDG Engagement Strategies

While all of our strategies integrate engagement into their investment processes, we have a selection of strategies with a specific focus on selecting companies with engagement potential. Our SDG Engagement Equity strategy and SDG Engagement High Yield Credit strategy seek to achieve a meaningful social and/or environmental impact as well as a compelling return through investing in and engaging with companies to drive positive change in line with relevant SDGs. The SDGs provide an ideal framework to identify ex-ante potential for creating positive societal and environmental change through engagement to create more impactful and sustainably profitable companies.

Given the added focus on engagement for these strategies, we have dedicated engagers based in the relevant investment teams who focus solely on these strategies and work closely with EOS to ensure a consistent approach (see Credit section above for additional detail). All investments are formally reviewed by the lead manager and lead engager, while the relevant analysts and team members also provide input every six months. These meetings investigate whether the original engagement thesis is still valid and also measure progress towards any specific objectives. In addition to the case study below, case studies for our SDG Engagement strategies are available under Principles 4 and 9.

SDG ENGAGEMENT EQUITY STRATEGY CASE STUDY

SSP

London-headquartered SSP is the world's second-largest travel concession caterer. The company operates about 2,700 units across 36 countries and approximately one third of its revenue comes from outside Europe and the UK. SSP's units are a mix of franchise partner brands such as Starbucks or their own proprietary brands such as Upper Crust. The company's units are predominantly found in airports (60%) and railway stations.

The company has improved markedly on both governance and sustainability issues in the last few years. From near zero sustainability reporting and limited internal initiatives in 2017, the company has established a comprehensive sustainability strategy which includes meaningful measurable targets across relevant topics.

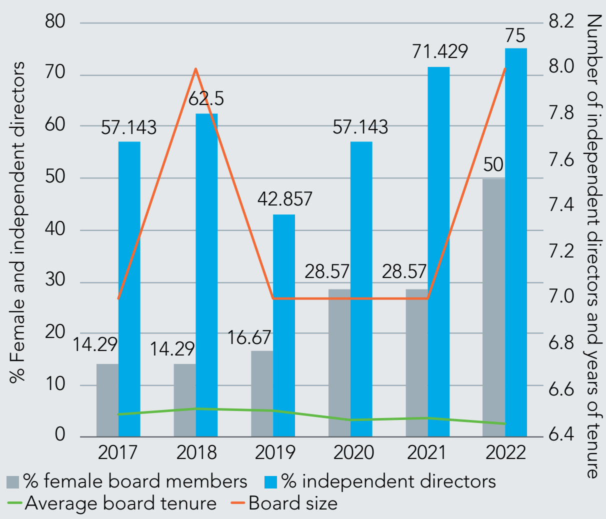
During our engagement there have been two changes in CEO and a change in chair which in part accelerated and in part slowed progress. Kate Swann, who had been CEO from 2013 and through to its listing, departed in 2019 to be succeeded by Simon Smith. As the headwinds from Covid-19 hit, Smith navigated the business through the pandemic and supported the enhanced focus on sustainability and people (beyond the expense line) but departed in 2021. Patrick Coveney arrived as CEO in March 2022 having previously led Greencore, where he oversaw an ambitious sustainability strategy.

Our dialogues since the beginning of 2018 have extended from the chair through to executive management and below. Our engagement has included conversations on corporate governance, as well as environmental and social issues, with a consistent focus on SSP's people strategy.

In the early period of our engagement with SSP, conversations around governance matters were a priority as the company sought to evolve its governance structures and processes to reflect the maturity of the business. The process around succession planning and retention of key personnel has also been an obvious focus. Positively, in recent years there has been significant refreshment of the board which now features high levels of independence, industry expertise and diversity.

We were pleased to actively input into the company's revised remuneration policy for its executive directors, the end result of which was a shift away from a traditional long-term incentive plan to a restricted shares plan. The new pay structure we believe better aligns executive interests with those of long-term shareholders and closely mirrors the Federated Hermes Remuneration Principles as set out in 2016.

Figure 37. Improving board independence and diversity at SSP



Source: SSP company filings, as at 31 December 2022.

We commend SSP on the progress it has made to date. Nonetheless, we continue to engage with the company on multiple themes – spanning their human capital management practices, supply chain oversight and due diligence and the nutritional profile of their food offerings. While goals have been set, there remains a long way to go to deliver upon these aspirations. We are hopeful of seeing the positive momentum maintained during 2023 and beyond.

Private markets

In private markets, ESG data is often less readily available. As such, the teams are heavily reliant on their due-diligence process and have developed their own frameworks for assessing ESG risks within their investments.

Private debt

The private debt teams consider ESG behaviours when carrying out credit analysis for each potential investment. ESG considerations are a fundamental part of the research presented, and discussed, for all new transactions tabled at the Investment Committee. Material ESG issues will often form part of engagement with the company prior to investment and once invested.

For our direct lending team, the key is to identify meaningful ESG risks (both current and potential) before investing. Due to the difficulty of divesting and the capped upside, it is important to manage the downside and engage where possible ex-ante.

CASE STUDY

Direct Lending

Our direct lending team reviewed the opportunity to lend to a Nordic-based provider of biodegradable consumer and industrial packaging, and insulation materials. The company's broad product portfolio as well as the underlying market drivers to move away from plastic-based products and towards more sustainable packaging and building solutions presented a compelling prospect. The proposed debt financing was to support the continued expansion of the company's product offering, manufacturing facilities and geographic footprint. To ensure the borrower continued on its journey to improve sustainability practices, several conditions were included in the loan documentation. These included a requirement for sustainability reporting, annual disclosure of the CSR report and the reporting of 3 KPIs relative to targets: (i) usage of bio-based and recycled raw materials as a % of total raw material; (ii) the % of CO_2 neutral energy and (iii) the use of Certified Paper. By building this into the documentation, we have agreed measurable and time bound targets to continue to drive progress.

The direct lending team undertakes enhanced due diligence on industries that are deemed controversial, such as energy, chemicals, forestry and agricultural commodities, manufacturing and mining and metals. They also undertake transaction-specific ESG analysis by carrying out an assessment on ESG risks for every investment opportunity. In addition, the team focuses acutely on the sensitivity of the company's cashflows to the identified potential ESG risks. With that in mind, the direct lending team will evaluate if investors are adequately remunerated for the ESG risk(s) of the transaction. We have recently developed a modelling tool to help us estimate Scope 1 and 2 carbon emissions for companies that do not disclose their carbon emissions. The team have been using this to estimate carbon emissions for their holdings to form part of their investment analysis as well as use it as a tool for engagement to improve disclosures by the company.

As with our direct-lending investments, it is important for our asset based lending team to identify risks that may impact on a borrower's ability to repay their loan. We have integrated our responsible property investment (RPI) principles and programme into the debt-investment procedures. This is done as follows:

- **Underwriting and due diligence:** The focus of our responsibility programme is on ensuring a strong due-diligence process, including assessments of ESG and climate risks and opportunities before agreeing new loans.
- **Loan origination and documentation:** The business plan agreed is included in the loan documentation at the loan-origination stage. This includes all mitigation activities identified and detailed in the asset business plan, asset refurbishment plans and/or planned and preventive maintenance programmes.
- **Management and monitoring post closure, asset upgrade finance:** We collect and manage the sustainability information we hold on the borrowers and the underlying assets.

Where we provide capital for refurbishment in accordance with the business plan, refurbishment agreements include a review of our responsible refurbishment guide and minimum requirements.

Real estate

ESG is integrated into the investment strategy and working practices of all of our real-estate portfolios. A consideration of ESG principles is embedded into the property selection and investment process, including through initial screening and due diligence and as part of the investment decision.

At the transaction stage, we use a number of procedures and tools that have been developed internally and through our sector engagement programme. This includes an initial screening, where the team assesses the risks and opportunities for value-add from ESG characteristics. This is then followed by a responsible investment due diligence for any new acquisitions, where surveyors and environmental consultants collect relevant data on the buildings to identify risks and opportunities. As part of our due diligence process, we inquire to understand the level of community and occupier engagement in the assets being considered. The findings from this then inform the asset-management plans and processes.

Sustainability regulatory risk assessments are then used to identify typical risks that should be incorporated when devising the parameters entered into the investment models (using discounted cash flow analysis). Typically, the team integrates ESG information that can affect investment fundamentals such as refurbishment budgets, risks of voids, lease lengths and obsolescence. ESG criteria and assessments are integrated into the investment decision papers submitted for approval to the Investment Executive Committee. The Head of Real Estate ESG sits on the Investment Executive Committee to review and ensure that ESG integration is appropriately covered.

ESG and engagement information continue to be integrated into the development and monitoring of our real-estate assets after purchase:

- Setting ESG requirements: through our internal responsible property development requirements we have set minimum requirements that assets must meet when undergoing refurbishment or new construction. This is monitored through an online platform.
- Monitoring and data collection: we work with our property managers, facilities managers and consultants to monitor ongoing implementation and improvements. This is reported back to the business on a quarterly basis. Annual key performance indicators (KPIs) are set and progress against them is measured.
- Engagement: we work with our property and asset managers on site to engage with the delivery teams, occupiers and visitors. Site-specific annual surveys and other engagement activities are carried out successfully.

For our real estate team's indirect and international investments, we carry out active engagement on governance matters and on ESG policies and strategies with property developers, property management teams, tenants, lawyers and agents. We include commitments to develop a joint ESG strategy on acquisitions for jointly managed assets.

Infrastructure

ESG and sustainability considerations are fully integrated into all of our infrastructure products and activities. As investors, we integrate an assessment of ESG risks and opportunities related to a prospective investment into our investment analysis and consider the long-term sustainability of each investment with reference to regional and global sustainability objectives. As owners, we see ourselves as stewards of infrastructure assets, not only for this generation but also for future generations. We engage actively with our investments on all areas of potential ESG risk and opportunity supported by robust data monitoring.

We select investments based on strict investment criteria and restrictions in accordance with our clients' needs. ESG matters are considered together with all other risks and opportunities identified in the course of due diligence. They are factored into Investment Committee papers at each of the three stages of our investment process. Conclusions are factored into the investment decision, investment valuation, transaction documentation and/or transitioned to our asset management team for further engagement post-completion.

Figure 38. ESG Integration in investment process

Initial review
- Mandate compliance and ethical exclusions check
- Potential key sector or thematic issues identified via an ESG materiality matrix
- Assess need for targeted ESG due diligence

Due diligence
- Focus on any potentially financially material ESG issues on which deep dive due diligence is conducted
- Include due diligence output in the investment valuation process and in the negotiation of acquisition documentation and / or transition plan for future engagement

Investment approvals
- Outputs from the above are included in the investment approval papers presented to the Infrastructure Investment Committee

Develop 100-day plan
- Development of the 100-day plan for the relevant asset identifying areas of strategic focus, engagement themes and development of KPI's to monitor

Source: FHL, as at 31 December 2022.

We identify potentially material ESG matters which may pose a risk (to value or reputation), represent significant opportunities or have significant environmental or social impacts using a proprietary GRESB-derived materiality matrix. We then undertake internal due diligence or appoint third party advisers to deep dive into areas of focus where appropriate. We further undertake a high-level assessment of alignment of key business activities with the SDGs. Our most recent investment assessments take into account whether an investment has the capacity to reduce its emissions on a trajectory aligned with a 1.5°C warming scenario pursuant to the Paris Agreement, and/or whether the investment represents a solution with reference to the climate mitigation and adaptation criteria within the EU Sustainable Finance Taxonomy. We will decline investments which are unlikely to achieve stable, sustainable returns over our long term investment horizon (e.g. which bear stranded asset risk) and where an opportunity lacks the governance, information or alignment with co-shareholders to enable us to influence material ESG matters over time.

Where we invest, we will transition any identified ESG risks or opportunities identified in due diligence to the ongoing asset management team. The asset management team is fully integrated into the investment process, with informal and, if required, formal input being provided at each Infrastructure Investment Committee approval stage and a 100 day transition plan for the investment being developed during the final stages of investment due diligence and execution to ensure a smooth transition, including of key relationships. In addition, where practicable, the ongoing asset management team will include team members who have undertaken the original acquisition.

Sustainability is fully integrated into our ongoing strategic asset management framework. Given the long-term nature of our investment, engagement is the primary means to tackle ESG risks post-completion.

Private equity

Our private equity team co-invest both directly in a selection of companies alongside other General Partners (GPs) and indirectly through fund investments. Typically we are a minority investor for direct co-investments. Our private equity team have identified four key megatrends that they believe will reshape global economic activity over the next 10-20 years and drive the growth of certain companies in niche sectors regardless of economic cycles. It is these fast growing, noncyclical businesses in the EMEA, North America and APAC, which are our investment targets. Within the megatrends we look for investable growth themes, and then drill down to the sectors most likely to benefit in order to find companies capable of generating sustainable long-term alpha. All investment opportunities are subjected to our rigorous, systematic investment process which we have developed over many years. As well as driving our co-investments, our fund selection also closely follows the key themes we have identified. When investing in funds, we form close relationships with the GPs we back, often initially via a co-investment relationship. This gives us valuable insight into the experience of the team and how value is created.

The team firmly believe that acting responsibly does not impede results. Creating a positive effect on society and the environment – sustainable investing – is closely aligned to our objective of delivering above market returns for our investors.

The team considers both ESG risks and opportunities ahead of each investment. Due the nature of the asset class and our position as a co-investor, our private equity team aim to identify ESG risks at the point of investment due to the difficulties faced in escalating activities during the investment hold. The team assess all investments using a proprietary responsible investment framework to guide decisions. The team has one framework for funds and one for direct co-investment. The aim is to protect investors from the impact of 'bad' investment decisions, avoiding businesses that are later penalised for failing to meet legal, regulatory or public standards of conduct.

ESG risk assessments are conducted on lead GPs for all new co-investments and fund investments. The private equity team considers the ESG practices of managers ahead of making fund investments. The team assesses managers capabilities across 5 key areas: (i) policies and commitments to standards, (ii) governance and mindset, (iii) investment process, (iv) climate risk and (v) communication and reporting. Each manager is scored on each dimension using a standardised and proprietary matrix that leverages Institutional Limited Partner Association and UN PRI recommendations. The assessment of managers capabilities is included in the Investment Committee papers and contributes to the investment decision.

For direct co-investments, material ESG risks and opportunities are presented (at a minimum) in the Investment Recommendation Paper (IRP), (for example, exposure to fossil fuel revenues, high climate impact sectors and external standards violations). ESG considerations are tabled across the investment process in local team discussions and formally considered and discussed at the Investment Committee where each investment is scored on a proprietary ESG framework. Based on a risk-based approach, only investments which have risks within tolerable limits are progressed to investment. For these investments, material ESG issues and KPIs are identified to be monitored post-investment. Deals are routinely rejected when they do not clear the ESG risk threshold and good ESG practices are considered positively into the investment thesis. Our private equity team collaborate with various industry initiatives and subscribed to the ESG Data Convergence Initiative in 2021. The initiative aims to improve disclosures of ESG KPIs in private equity by selecting a limited series of KPIs that subscribers of the initiative shall aim to collect and share with their own investors. As part of this initiative we now engage with each new company or lead investor as part of the investment process to receive the KPIs from the ESG Data Convergence Initiative on a yearly basis.

We seek to improve and protect the financial value of investments through assessing, monitoring and seeking improvements to material ESG risk areas. Our private equity team takes a risk-based approach to effectively identify, monitor and manage ESG risks, opportunities and impacts identified across its portfolio. For direct co-investments, we receive quarterly reports from the GP that include both financial information and qualitative data. These reports often contain ESG information. In addition to this, we often have a quarterly call with the GP where we discuss the reports and any other topics we wish to raise. For fund investments we also receive quarterly reports and are invited to participate in AGMs. In a minority of cases we are part of the limited partner advisory committee (LPAC) and hence part of the fund's governance structure. We can raise issues with managers in those forums or bilaterally.

How we have aligned our approach with client investment time horizons

Under Principles 1 and 6 addressed earlier in this report, we set out our belief that the purpose of investment is to create wealth sustainably over the long term. This informs our view that we have a duty to consider the longer-term risks and opportunities when investing, which aligns with the goals of our pension-fund clients who typically look out over the long term. All of our strategies adopt a long-term investment horizon. While this will vary depending on the investment strategy and the markets in which they invest, a typical time horizon for investment decisions adopted by our investment teams is three to five years. As such, depending on the investment being considered, its fundamental or ESG performance drivers are likely to be relevant in any evaluation for significantly longer than three to five years.

> **We believe we cannot deliver long-term returns without identifying and working towards mitigating material ESG risks and, where possible, seizing positive opportunities.**

All of our strategies look to deliver sustainable wealth creation over the long term and our combined approach to responsible investment and responsible ownership is the key to catalysing positive change within companies and generating financial gain over the long term. We believe we cannot deliver long-term returns without identifying and working towards mitigating material ESG risks and, where possible, seizing positive opportunities.

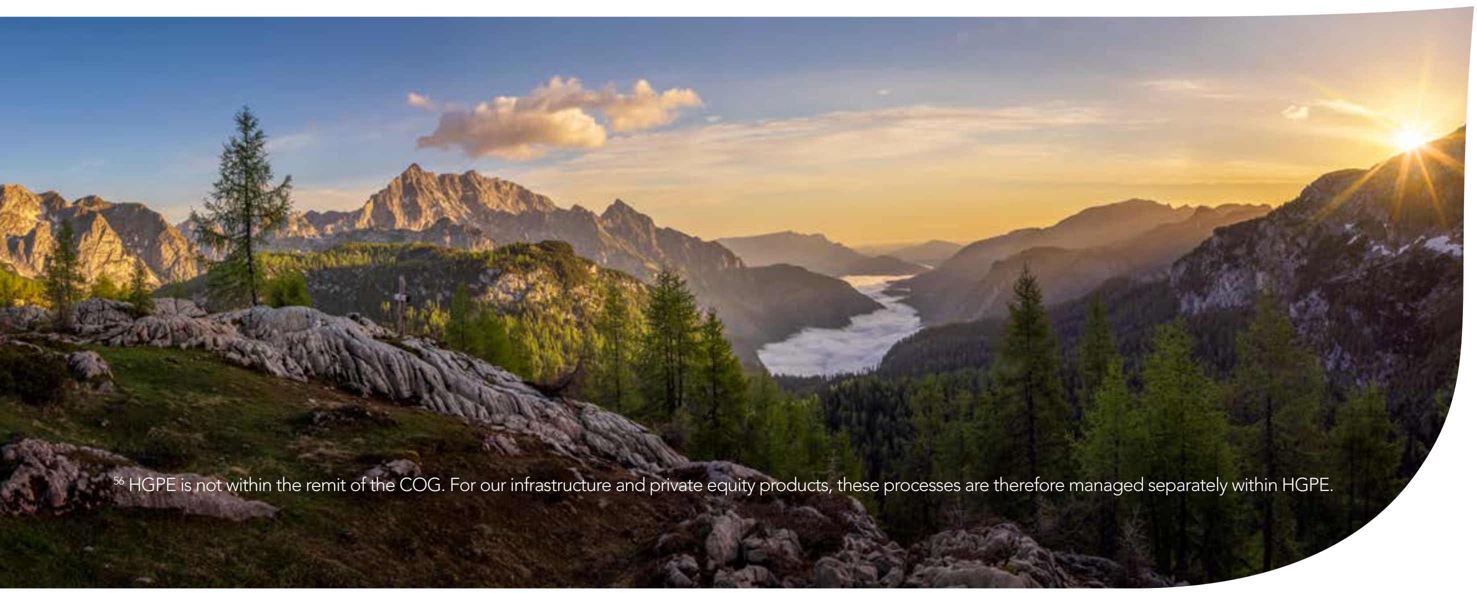
We consider our clients' and potential clients' needs throughout the entire product-development process. As such, stewardship and ESG integration is built into the investment process at the outset and clearly articulated in any legal and marketing documentation for the strategy. The Customer Outcomes Group (COG) then uses this documentation to monitor the investment teams at least annually to ensure they are acting in line with the parameters they have set for themselves. More information about the COG and other processes that ensure we continue to meet client needs is available in our reporting under Principle 1[56].

Service providers

Our stewardship is undertaken in-house by our investment teams and EOS, as described under Principles 7, 8 and 9. In the case of private equity, the team work with lead GPs in instances where they do not have the ability to engage directly. Likewise, the investment teams are responsible for integrating ESG and engagement information into their investment processes (with the support of the Responsibility Office, which promotes best practice).

We also use third-party data providers, as described under Principles 7 and 8. In some cases, we integrate this third-party data into our proprietary tools to enable our investment teams and engagers to access and compare a wide range of data quickly. The parameters for such services are clearly set out in the relevant contracts and the ESG Integration team within our Responsibility Office monitors the provision of such services on an ongoing basis. Key parameters that we consider when assessing a data provider are data quality, methodology used for any calculated data points, frequency of update, data delivery mechanisms and coverage.

As described in more detail under Principle 8, our real estate team use external property managers for all day-to-day property management. To ensure our expectations are clearly understood, ESG requirements and commitments are included in their contractual service agreements. The managers are responsible for the implementation of our ESG programme and health-and-safety measures, as stated in their service agreement. As described under Principle 8, our private equity team make direct and indirect co-investments and monitor the GPs.



[56] HGPE is not within the remit of the COG. For our infrastructure and private equity products, these processes are therefore managed separately within HGPE.

Principle 8

Signatories monitor and hold to account managers and/or service providers.

All voting recommendations to our investment teams are made internally by EOS and engagement activity across asset classes is carried out by EOS personnel or the investment teams themselves, with the exception of some engagements for our private equity funds as described below. More detail on how we use ISS research to inform our voting decisions – and how EOS use ISS research to inform voting recommendations to voting services clients – is available under Principle 12.

As noted earlier we use a number of external ESG data providers, as each data provider has developed their own methodology which can result in differing views. Taking this range of views into account, along with our qualitative fundamental analysis and insights from engagement by EOS or the investment teams, helps us to form a more comprehensive view of the company.

> **Having worked with the data providers over many years we are able to critically assess the strengths and weaknesses of the approaches and feed this insight back to the service providers.**

As part of our ongoing research into assessing sustainability within companies we have spoken with a number of data providers on their frameworks and how these are applied to companies and sectors. Having worked with the data providers over many years we are able to critically assess the strengths and weaknesses of the approaches and feed this insight back to the service providers.

We may also engage with data providers when we identify incorrect information. Over the course of 2022, we identified instances where environmental data received from the data provider did not match our expectation of the company's performance on those factors.

For example, we engaged with a data provider in relation to their assessment of a company as being involved in a biodiversity-related controversy, which we believe to be incorrect. Following discussion with one of our investment teams and seeing their qualitative analysis of this company, we fed this back to the data provider which updated their assessment of the company, removing the controversy.

CASE STUDY

Engagement with data providers on deforestation data

Any collaboration is done in line with applicable rules on antitrust, conflicts of interest and acting in concert. Indeed, each party will exercise unilateral decision-making principles in deciding how to act while engaging in any collaboration.

As part of the Finance Sector Deforestation Action initiative, we took part in a collaborative engagement with data providers on the need for improved deforestation data on companies. Access to more detailed data for a wider range of companies is important to allow investors – particularly those who have made commitments on deforestation – to enhance their analysis of investees.

As an initial step, a letter was sent to a range of key data providers setting out the kind of data investors are looking for to assess their exposure to deforestation risks and impacts, including which commodities a company is exposed to and whether they have made any conversion- or deforestation-free commitments.

Following these letters, the group met with several data providers who responded to the letter. During these sessions, we outlined the information we need as investors to assess our investments in relation to deforestation. The data providers also shared the biodiversity- and deforestation-related products they had on offer or were planning to release, and we were able to provide feedback on these. These meetings put forward a coherent request from the industry to data providers, and also enabled us to understand what data we may have access to in future. We look forward to seeing the data providers move forward with some of these products in 2023.

For our real estate team, all day-to-day property management – including rent and debt collection and active responsible property management – is dealt with by external property management agents. They are selected following a rigorous process that includes ESG considerations, while ESG requirements and commitments are included in their contractual service agreements. The performance of property manager agents – and any other agents appointed for work on activities such as rent reviews, lease renewals, transactions property maintenance, health-and-safety issues and environmental issues – is closely monitored by our internal asset managers. The property managers are contractually responsible for implementing the ESG programme and health-and-safety measures, as stated in their service agreements. Their requirements include risk management, refurbishment and development, utilities measurement and reporting, ESG business plans, energy management, water management, waste management, transport, procurement and supply chain, environmental risk and management, stakeholders (tenants and community) and quarterly monitoring of progress against targets. In 2022, our property and asset managers focused on aligning their ESG plans to our net zero target identifying priority projects in order to increase energy efficiency and reduce the emissions of our assets.

Our infrastructure team is primarily a minority shareholder in operational businesses, at which we engage via the governance structure at multiple direct levels – during day to day asset management with operational teams, as board and or committee member and as shareholder. However, we also have some majority shareholder investments in energy and transport assets at which we engage directly with Operations and Maintenance (O&M) providers in the day-today running of the assets. Collaboration on sustainability matters with the O&M providers is a key priority at these assets and we value positive relationships with aligned counterparties. As an example, at our investment in Fallago Rig, an onshore windfarm in Scotland, we engaged the Asset Environmental Officer of our O&M provider, EDF Renewables and, after agreement with the board, undertook a bottom-up physical climate risk assessment of the windfarm. Flood emerged as the main physical risk to which access tracks are particularly vulnerable. As part of the assessment, current adaptations were reviewed and further adaptations recommended. Following the assessment, "Physical Climate Risk" was included in the company's risk register, and presented to the Board of Directors every quarter.

We also have two legacy indirect investments which remain part of our cornerstone infrastructure fund, HIF I. Engagement with managers for our indirect investments ESG and sustainability considerations are integrated in our asset management approach. However, our approach necessarily changes where holdings are indirect. Where ESG reporting and engagement by underlying managers is limited, we remain focussed on foundational, open questions and climate change, as a pervasive material risk to infrastructure across sectors.

When investing in funds, our private equity team form close relationships with the GPs we back, often initially via a co-investment relationship. This gives us valuable insight into the experience of the team and how value is created. ESG risk assessments are conducted on lead GPs for all new co-investments and fund investments. The private equity team considers the ESG practices of managers ahead of making fund investments. The team assesses managers capabilities across 5 key areas: (i) policies and commitments to standards, (ii) Governance and mindset, (iii) Investment process, (iv) climate risk and (v) communication and reporting. Each manager is scored on each dimension using a standardised and proprietary matrix that leverages Institutional Limited Partner Association and UN PRI recommendations. The assessment of managers capabilities is included in the Investment Committee papers and contributes to the investment decision. We seek to improve and protect the financial value of investments through assessing, monitoring and seeking improvements to material ESG risk areas. Our private equity team takes a risk-based approach to effectively identify, monitor and manage ESG risks, opportunities and impacts identified across its portfolio. For direct co-investments, we receive quarterly reports from the GP that include both financial information and qualitative data. These reports often contain ESG information. In addition to this, we often have a quarterly call with the GP where we discuss the reports and any other topics we wish to raise. For fund investments we also receive quarterly reports and are invited to participate in AGMs. In a minority of cases we are part of the limited partner advisory committee (LPAC) and hence part of the fund's governance structure. We can raise issues with managers in those forums or bilaterally. We describe in more detail under Principle 9 how we work with GPs when it comes to engagement with investee companies.

In terms of our investment operations, our middle office is responsible for monitoring outsourced functions on a day-to-day basis. We also have a Supplier Review Group, which chaired by FHL's Chief Operating Officer, that is responsible for the oversight of material outsource arrangements and critical supplier arrangements, where regular reviews of the risks and performance of these arrangements are overseen, in particular key risk indicators are used to monitor any deterioration in the service and/or risk profile. Furthermore, our contracts with material third parties include a service level agreement (SLA) where applicable. The SLA details service standards we expect from our third parties – which include a number of agreed key performance indicators (KPIs), and where applicable, dependencies and escalation requirements in respect to risk incidents. The contract and/or SLAs include details of the required governance structure and frequency of service reviews between the third party and our business.

As part of the governance structure, significant or persistent issues can be escalated to the Risk, Compliance and Financial Crime Executive. In addition to the service reviews, periodic on-site visits and due diligence reviews take place and the latest SAS70 reports (or equivalent controls report) and credit worthiness are reviewed to identify any adverse conditions that may have an impact on the service provider and the services provided.

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

How we identify issues for engagement and develop objectives

Our approach to engagement is driven by our purpose and investment beliefs. We believe that the purpose of investment is to create wealth sustainably over the long term and that investing responsibly is the best way to sustain long-term outperformance and contribute to beneficial outcomes for investors, companies, society and the environment. We aim to generate sustainable wealth creation for the end beneficiary investor, encompassing both investment returns and their social and environmental impact. As a result, our engagement is outcomes-driven and focused on ensuring that the companies we invest in are creating wealth sustainably. Given the time horizons of our strategies to meet our clients' needs (as described under Principle 6) we are able to engage on particular issues over multiple years to encourage fundamental change within our investee companies. We believe that this approach delivers the best results for our clients and end beneficiaries.

We adopt a systematic approach to identifying companies for engagement. We select companies and tailor the intensity of engagement based on the size of our investment, materiality of the risks and issues and feasibility of achieving change through engagement. We believe that this enables us to most effectively serve our clients' needs by focusing our efforts on where they are needed the most and can have the most impact.

Our EOS Engagement Plan and related corporate governance principles and voting guidelines, as well as our FHL Voting Policy and Guidelines which are updated each year drawing on our extensive experience as an active and engaged shareholder, set out a number of expectations which we believe should exist between owners, boards and managers to create a framework for communication and dialogue.

While we can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines through campaigns that could undermine the trust that would otherwise exist between a company and its owners. We are honest and open with companies about the nature of our discussions and aim to keep these private. Not only has this proven to be the most effective way to bring about change, but it also offers a level of protection for our clients by ensuring their positions will not be misrepresented in the media. In 2022, we published our Climate Action Plan which takes an engagement-driven approach. As climate change continues to be the biggest single issue of concern for long-term investors, the emphasis of our engagement is 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. Our Climate Change Expectations for investee companies set out very clearly our rationale for believing climate change is a material issue – and six key expectations of companies that range from setting science-based targets to having a positive public policy position on the issue and committing to disclosing in line with the TCFD. Our Policy Statement on Deforestation, also published in 2022, sets out our engagement-driven approach across asset classes to deforestation.

Public markets

EOS has established a detailed public markets engagement plan on a rolling three-year basis, with themes ranging from human and labour rights to circular economy and zero pollution. EOS focuses its stewardship on the issues that have the greatest potential for long-term positive outcomes for investors and their beneficiaries. The full taxonomy below identifies 12 key themes and 32 related sub-themes for engagement. This breadth of coverage across the whole programme is necessary to reflect the diversity of issues in our global Engagement Plan, which covers all regions and sectors, including those which are most material to the individual companies. The selection of these themes is developed in line with input from the investment teams at FHL, as well as EOS' third-party clients.

Figure 39. Engagement themes: Our stewardship process to achieve long-term sustainable returns on investment

Source: FHL, as at 31 December 2022.

We review our engagement plan every year to ensure it is up to date and reflects client priorities. The turbulent geopolitical and economic landscape in 2022 served to solidify our existing engagement priorities, while placing them in a new context. In addition to our priority themes, we maintained a comprehensive engagement plan including seeking to avoid the emergence of 'superbugs' through anti-microbial resistance, increasing resource efficiency through the circular economy, reducing all forms of harmful pollution and seeking positive wider societal outcomes through increased corporate responsibility. The feedback we received from clients confirmed we were broadly striking the right balance on priorities for the different themes, however, we will further intensify in certain areas which we have reflected in our engagement plan for 2023.

Based on the review, our work in 2022 continued to focus the four priority areas – **climate change action, human and labour rights, human capital management** and **board effectiveness and ethical culture** – as these remained the most material themes. However, we continuously updated our work in each area as follows:

Four priority themes

Climate change action:

- In 2022, we intensified engagement on aligning corporate targets to the goals of the Paris Agreement as close as possible to 1.5°C.

Human and labour rights:

- We continued engagement on human rights in the supply chain, in particular the integration of human rights issues into business models and purchasing practices, and how this impact is evaluated and assessed. We elevated our focus on digital rights, which are human rights specific to digital products and services and began engagement on online privacy rights, online freedom of expression, and negative societal impacts of digital products and services based on our investor expectations.

Human capital management:

- We increased our focus on diversity and inclusion, freedom of association, and health and safety, with a particular reference to the employee value proposition in the context of a tightening labour market.

EOS proactively engage with around

1,120 companies annually, of which approximately

575 are held by Federated Hermes Limited.

Board effectiveness and ethical culture:

- Board effectiveness and ethical culture: We launched a report in 2020 setting out our expectations on how best to improve the dynamics of a board, which was used as a platform for engagement in 2021 and 2022.

We annually review, develop and publish a rolling three-year engagement plan. The EOS engagement selection process is a key structure which enables us to support client stewardship. We select around 325 companies for the core EOS Engagement Programme, of which approximately 130 are held by FHL's equity and credit teams (as at 31 December 2022). These companies are formally identified on an annual basis, and intermittently throughout the year. The three key considerations are:

1. Size of holdings. EOS take into consideration the aggregate holding size of FHL and EOS clients.
2. Materiality of identified ESG and financial risks. This is assessed using quantitative and qualitative data sources, including inputs from external providers like Sustainalytics, MSCI, Trucost, CDP, BoardEx, ISS, FactSet and Bloomberg. EOS also considers the output from our quarterly screening tool, the Controversial Companies Report, which looks at a number ofinternal norms and standards including the UN Global Compact Principles and the OECD Guidelines for Multinational Enterprises. It also uses the proprietary ESG Dashboard and QESG score, which captures how a company manages its ESG risks and whether it is improving. All this data is scrutinised by the EOS team, alongside insights from engagement and voting recommendations history, media flow, investment management intelligence, public policy and market best-practice trends.
3. Feasibility of engagement. We endeavour to allocate our engagement resources efficiently and towards companies where we can affect change.

This combination of analysis supports our pursuit of stewardship through our shared service model.

Each company in our core engagement programme is given an appropriate intensity tier, based on the likely impact of engagement and ultimate benefit to the value of the underlying investment. We then assess the required intensity or depth of the engagement needed to resolve the issues:

- **Tier 1+** - a small number of companies sometimes termed 'super tier 1' companies with material client holdings that have more significant or numerous long-term sustainability or corporate governance issues with the opportunity of feasible engagement and where intense engagement and possibly time spent collaborating with other investors, supported by detailed research, is anticipated to be required in order to achieve material change, with the expectation of approximately eight to ten interactions per year.
- **Tier 1** – Companies with material client holdings that have more significant or numerous long-term sustainability or corporate governance issues with the opportunity of feasible engagement and which we consider require more time and effort to progress, including more detailed research, leading to typically more intense engagement, with the expectation of approximately five interactions per year.
- **Tier 2** – Companies with material client holdings and identifiable long-term sustainability or corporate governance issues with the opportunity of feasible engagement, which we consider can be meaningfully pursued with average levels of time and effort, with the expectation of approximately three interactions per year.
- **Tier 3** – Companies representing significant client holdings which either a) face a particular identified ESG-related risk which can be addressed with limited, targeted engagement; b) companies with generally lower levels of risk to long-term sustainability or which are in the process of being monitored for implementation of the outcomes of previous engagement work. We typically only set one engagement objective, or follow a limited number of engagement issues, rather than specific engagement objectives and plan one or two interactions per year.

There are many companies with whom we engage that sit outside of our core engagement plan. EOS proactively engage with around 1,120 companies annually, of which approximately 575 are held by FHL. Around 80 of the companies which are not in the core engagement programme are selected as EOS engagement targets by our investment teams based again on the size of our holding, the materiality of the issues and the feasibility of engagement. Although these engagement targets are selected by our investment teams, the output of these engagements are also provided to EOS third-party clients. In 2022, the dedicated engagers in our SDG Engagement strategies engaged with 111 companies in addition to those companies engaged with by EOS. The remainder of these engagements relate to issues around voting at general meetings or are in reaction to events that cannot be predicted in advance. Our investment teams also conduct engagements with companies directly. These engagements are not reflected in our overall engagement statistics.

EOS provides voting recommendations for around 13,900 meetings to both FHL and third-party clients, using engagement insights to inform its rationale where possible.

In addition, EOS provides voting recommendations for around 13,900 meetings to both FHL and third-party clients, using engagement insights to inform its rationale where possible. Finally, EOS monitors around 17,000 companies held by FHL and third-party clients. Overall, these processes enable us to provide comprehensive stewardship coverage.

The EOS senior leadership team, comprised of the Head of Responsibility, the Head of Stewardship, the regional team leads, the Head of Client Service and Business Development, and the Head of Business Management, review and advise on the design and implementation of our Engagement Plan and engagement programme, in addition to our voting recommendations and screening services. It considers engagement quality, continuity and coverage in the interests of clients.

Setting engagement 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.

Issues: An issue is a topic we have raised with a company in engagement but, unlike objectives, 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.

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 against these objectives is assessed regularly and evaluated against the original engagement.

Figure 40. EOS' proprietary milestone system

Source: FHL, as at 31 December 2022.

In this example, we have applied human rights, which is one of our Engagement Plan social and ethical themes, and focused on the specific disclosure sub-theme to set a tailored objective for a US software company. We asked the firm to establish a clear board or executive level oversight for human rights risks in its products and services and detail below how we would recognise progress along our milestone stages:

- **Milestone 1:** Concerns raised at company on how directors oversee and manage risks related to data privacy, freedom of expression, and artificial intelligence.
- **Milestone 2:** Company acknowledges our concern by accepting our shareholder proposal for its 2020 AGM where we seek improved disclosure of relevant metrics that show the supplier code of conduct is adhered to as intended.
- **Milestone 3:** Milestone progress made: company develops in content quality policies and facial recognition applications and commissions a formal human rights impact assessment (HRIA).
- **Milestone 4:** Completion – company clarifies Audit Committee broader responsibilities to include sustainability and human rights and commits to establishing a human rights executive council to oversee and provide guidance on a groupwide human rights programme and added information on due diligence and transparency.

In this particular example, Milestone 4 was achieved after a year of engagement.

Our milestones are specific and measurable, which helps us identify progress towards achieving the objective. An engagement objective can take up to three years to complete, depending on factors that include the nature of the issue and how receptive the company is to engagement. Engagement clinics are held with directors to review and challenge engagement strategy and tactics, to ensure that objectives are appropriate and also that milestone progress correctly reflects reality. In some rare instances, we will discontinue engagements on the basis that our engagement efforts have been met with strong resistance or the matter has dissolved.

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. Our approach to climate change engagement in line with our Climate Action Plan is described under Principle 4.

Private markets

For our private market strategies, engagements are prioritised according to the exposure of the portfolios. For example, in our Direct Lending strategy, the team engages with the sponsor and management team to remedy any ESG issue that arises during the life of a loan. This engagement is conducted in collaboration with EOS to ensure that the engagement is outcomes-focused and impactful.

Real Estate

Our real estate business is an industry leader in responsible asset management. The team has developed their ESG framework with principles, commitments and targets. Following growing awareness in the investment industry, we believe that responsible investors need to go beyond standard KPIs and develop qualitative processes to assess the wider socioeconomic impacts of their investment programmes and occupier and tenant engagements.

Over the years, the increasing focus on ESG has demanded fresh thinking and new ways of working. The real estate team has been monitoring the sustainability performance of its directly managed assets since 2006 and has annual targets which are monitored and reported against in our public Real Estate ESG report. The team has also created a range of dedicated tools and procedures that cover all aspects of our real-estate operations. Our responsible asset and property management programme integrates the following ESG procedures and tools:

- Minimum sustainability requirements for refurbishments and developments set out in our internal Design Innovation Standards and Responsible Property Management Refurbishment Guide. These include requirements that construction contractors comply with sustainability guidelines, environmental site-selection requirements, environmental site-development requirements, resilient building design and orientation and minimum requirements on pollution, sustainable materials, waste, energy, water and biodiversity.
- Dedicated Responsible Property Management (RPM) guidelines for our directly managed assets, covering the following ESG matters: water efficiency requirements, energy efficiency requirements, energy generation from on-site renewable sources, waste management plans at sites and occupier health and wellbeing requirements.
- Strategic and operational sustainability benchmarking of our real-estate funds.
- Active data management systems for utilities and waste.
- Ongoing monitoring of performance with continuous feedback between property managers, investment managers and sustainability experts.
- Stringent risk and safety requirements and supporting tools.
- Community and occupier engagement tools and programmes.

These tools enable us to assess, monitor and manage social and environmental risks and opportunities in the real-estate portfolio, and therefore informs the objectives of our engagement.

As part of our Real Estate ESG programme, we have been assessing what positive impact investment would mean for each step of our investment process. Our 'impactful intent' approach aims to deepen our ESG practice by intentionally seeking a defined positive environmental or social outcome in a particular place or market as a core focus of our responsible investment strategy, in addition to strong risk-adjusted financial returns. This involves using a purposeful framework to focus our real-estate operations on three specific impactful investment themes. For each of these investment themes, we are committing to activities with measurable environmental, economic and societal outcomes, which ultimately support specific SDG targets. Our impactful investment themes are:

- Meaningful placemaking that creates civic pride;
- Healthy, engaged and productive communities that drive desirable social and environmental outcomes; and
- Climate and resource efficiency and achieving a just transition to a low-carbon, circular economy in order to help prevent further adverse climate change and resource scarcity.

At the heart of our approach is our commitment to creating a 'meaningful city' – or a place that people want to live and work in, and which foster a sense of belonging among inhabitants. Because most of our investment is concentrated in densely populated urban areas, it is inevitable that the way we manage these developments will have a deep, long-lasting effect on the cities and the people that live in them.

Under Principle 4, we describe our real estate team's commitment to net zero and pathway to achieving these goals.

Infrastructure

Every investment professional in the infrastructure team has responsibility for asset management, albeit with certain professionals being primarily focussed on this area. The asset management team for each investment is responsible for the ongoing monitoring of the investment including annual strategic reviews, the semi-annual valuation process and

investor reporting, and engagement at the portfolio company-level, through Board representation on operating or holding companies, as applicable.

Our principal asset management purpose is to generate long-term, sustainable and mandate compliant returns for our investors. We have a mature framework in place which creates the environment to achieve this purpose. Below is an infographic version of this approach.

Figure 41. Infrastructure asset management approach

Source: FHL, as at 31 December 2022.

Post initial acquisition, annual strategic reviews, undertaken in Q1 each year, provide a status update of each investment, investment performance to date, key valuation metrics and outlook, and key risks and opportunities, informing our strategy at asset and at portfolio-level. Strategic reviews incorporate an assessment of sustainability risks, opportunities and impacts.

Asset and portfolio level objectives are developed in an integrated nature with sustainability, through our detailed Asset Management sustainability guidance document, which is aligned with the EOS stewardship model building blocks. Objectives will either relate to specific financial/commercial areas (where success is often based on having completed the objective), or sustainability, where we apply an EOS-informed milestone approach with the aim of seeking continuous improvement.

Progress against objectives is subject to detailed semi-annual reviews. Day-to-day financial and operational performance is monitored, analysed and then reported through an internal monthly flash report, which is reviewed by the Infrastructure Investment Committee. We produce quarterly reporting, in line with IILPA guidelines, to LPs in line with our valuations process. In addition, we hold an AGM to provide a detailed overview of the full-year performance and outlook across the portfolio. We produce annual external sustainability reporting that includes performance against sustainability KPIs.

From a thematic perspective, climate change and emission reductions are currently our number one sustainability engagement priority with infrastructure portfolio companies. The climate crisis, manifested through the increasing frequency of extreme climate events, necessitates a strong and continued focus to reduce business carbon footprint and manage climate risk and opportunity at Board level, which given our strong governance rights and active engagement approach, we are able to influence. Our infrastructure team are seeking to achieve 100% Paris-alignment of assets by 2025, in line with the Paris-alignment approach described under Principle 4.

Pollution and waste from operations, supply chains or products are inconsistent with a sustainable business model in infrastructure. Shifting to circular business models and a pro-active approach to natural resource conservation and management are central to futureproofing businesses and protecting the environment. This is an important engagement priority for our infrastructure team.

Infrastructure often involves heavy industry and potentially dangerous activity meaning occupational health, safety and wellbeing is always of primary importance. We also encourage active promotion of all facets of physical and mental wellbeing, as drivers of overall health, happiness and productivity.

We promote diversity, equity and inclusion (DEI) strategies, actions and advocacy covering closing pay gaps, representation of all elements of diversity at all levels of an organisation and the creation of an inclusive workplace. DEI strategies should include relevant targets, dedicated resources, implementation, monitoring, metric reporting and continuous effectiveness assessment and improvement.

We are also continually conscious of: the public service nature of infrastructure investments; the need to maintain our social licence to operate in a variety of ways; and the importance of maintaining a reputation as a force for good to both the businesses we invest in and our investors.

Private equity

We seek to improve and protect the financial value of investments through assessing, monitoring and seeking improvements to material ESG risk areas. Our private equity team takes a risk-based approach to effectively identify, monitor and manage ESG risks, opportunities and impacts identified across its portfolio. For direct co-investments, we receive quarterly reports from the GP that include both financial information and qualitative data. These reports often contain ESG information. In addition to this, we often have a quarterly call with the GP where we discuss the reports and any other topics we wish to raise. For fund investments we also receive quarterly reports and are invited to participate in AGMs. In a minority of cases we are part of the limited partner advisory committee (LPAC) and hence part of the fund's governance structure. Engagement objectives are focused on the assets with higher identified ESG risks.

How we engage

Our public markets dialogue with investee companies is primarily conducted through in-person meetings, calls, letters or emails, either directly or as part of a collaborative group. The nature and frequency of the dialogue depends on the location of the company, stage of engagement, severity of the issue and willingness of the company to engage. As evidenced by research, effective engagement that delivers value, demands a specific skill set that goes far beyond written activity or interaction with lower-level company representatives. Change is brought about by access at the board level gained by engagement professionals who have industry or professional experience, gravitas and specialist skills at challenging senior decision makers[57]. The majority of our dialogues are conducted with the board of directors (primarily the chair, lead independent director and chairs of board committees), corporate secretary, subject specialists or investor relations. Occasionally the dialogue is with executive teams, although only where we believe the concern justifies their time and attention.

Figure 42. Number of companies engaged at board/senior level in public markets

We have engaged 447 companies at board/senior management level,[35] including:

Senior management	
CEO	68
Chair	53
Company secretary	191
Executive management team	137
Other board director	47

Source: FHL, as at 31 December 2022.

We use our own relationships to initiate and progress engagements in the majority of cases, whether this is through the investment teams or EOS, in addition to attending meetings facilitated by intermediaries. Most public-markets engagements are carried out by EOS, who may be joined by relevant portfolio managers or analysts from our investment teams. The investment teams also carry out engagements themselves. The Responsibility Office ensures that our investment teams and EOS work closely together with a joined-up approach.

Making realistic and realisable demands of companies, informed by hands-on experience of business management and strategy setting, is critical to the success of our engagements. With all engagements, we seek to build a strong relationship with the company and are willing to be patient, remaining focused on achieving goals which are directed towards long-term success. Our proprietary systems enable us to track progress against specific objectives and remain outcomes-focused throughout the duration of our engagement with a company. We have invested in the underlying systems in which we capture, measure, manage and then express our stewardship activity and outcomes. Not only can our engagement professionals better capture their progress, momentum, challenges and next steps and general workflow, but our clients are able to absorb the information in ways and through lenses that suit them.

Geographies: There are some nuances in how we engage with each market. EOS has developed regional voting guidelines and corporate governance principles which set out our fundamental expectations of the companies we invest in across a number of important ESG topics. This regional approach reflects the variations in the markets in which the companies we invest in operate. They also inform EOS' Global Voting Guidelines, FHL's Global Voting Policy and Guidelines, which, in turn, guide EOS' voting recommendations and our investment teams' voting decisions for listed equities. EOS has intentionally built a diverse team of experienced and international voting and engagement professionals who have the expertise, language skills and cultural knowledge to work to deliver real beneficial change at companies. Our ability to engage in the local language and understanding of local culture and business practice are critical to the success of our engagement work. Within our team, we have nationals from 19 countries who are fluent in 19 languages.

[57] FHL, 'New research shows the importance of board', (September 2017)

Figure 43. 2022 Engagement activity[58]

Theme	Companies engaged	Issues and objectives engaged
Environmental	303	666
Social and Ethical	274	556
Governance	486	894
Strategy, Risk and Communication	192	349
Total	**-**	**2,465**

Source: FHL, as at 31 December 2022.

Figure 44. Engagement by region in 2022

Region	Companies engaged	Issues and objectives engaged
Australia & New Zealand	18	61
Developed Asia	60	267
Emerging & Developing Markets	78	315
Europe	120	516
North America	265	1,172
United Kingdom	37	134
Total	**578**	**2,465**

Source: FHL, as at 31 December 2022.

Equity vs. Credit: Both equity and bond holders have a shared interest in sustainable growth, increasing enterprise value and the long-term health of companies. EOS' breadth of engagement allows us to engage with companies on behalf of equity and bondholders. We believe that engaging simultaneously on equity and credit creates a common long-term voice, increases access and influence and shared resourcing to pool the priorities of like-minded investors. In a two-part paper over 2018-19, we explained why we believe the shared interests of bondholders and shareholders provide incentives to jointly engage companies – and generate positive outcomes by doing so[58]. We summarise the top three benefits of this approach below:

- A common long-term voice: Speaking with a common voice across asset classes gives companies a clearer signal of the key concerns of long-term investors and the agenda which the board should prioritise. Building a long-term sustainable business model which manages ESG risks and opportunities, overseen by good corporate governance in pursuit of business purpose, helps build enterprise value in the interests of all asset classes.
- Access and influence: Aggregating equity and bond assets gains a company's attention. Representing an increased asset base across multiple asset classes gives greater leverage. We can also use shareholder rights such as voting at shareholder meetings or speaking at annual shareholder meetings, as well as speaking on behalf of credit in response to new issues raised in credit prospectuses.
- Shared resourcing: Engagement on long-term value drivers across many sectors, themes and countries is complex. Our engagement is informed by our client-led approach which allows us to pool the priorities of like-minded investors to determine the companies and the themes of our engagement on ESG and strategic issues.

Where there are rare conflicts such as when a company is failing, and its very survival is in doubt, the interests of bond and shareholders can diverge as they compete over what remains for investors.

We have established a Stewardship Conflicts of Interest Policy to follow in such rare situations, as described under Principle 3. If a potential conflict of interest is identified, the issue is escalated first to a line manager and then an escalation group reporting to an independent sub-committee of the board of directors. If a potential conflict materialises, the joint equity-credit engagement is restricted to those objectives that are not affected.

As shareholders and creditors are both financial stakeholders, they share a common basis to engage in constructive dialogue with companies. However, as creditors serve as a recurring source of cash to a company, they have a different kind of influence. This influence varies even within fixed income. For example, for smaller companies in leveraged finance or direct lending, the disintermediation of capital is spread over a smaller investor base. This means these investors may have greater influence versus any individual investor in a large-cap name. When engaging as bondholders, we may be able to use other routes to the company such as the Chief Financial Officer or treasury department, or as part of bond roadshows, which are typically more frequent than equity issuance. Also, we may encourage companies to issue green and sustainability-labelled bonds to encourage clearer sustainability frameworks and reporting, and, in cases where companies issue such bonds, we may engage on the validity of any sustainability claims made. Moreover, we are seeing an increasing number of leveraged buyout deals being funded with green and sustainable bonds, and, in such cases, we may engage with private equity sponsors.

Engaging on derivatives in credit portfolios is done in the same way as we engage with equities and bonds; we engage with the underlying issuer. Engaging on sovereign bonds poses a particular challenge, as there is often a shortage of relevant data and little accessibility. However, we use what data we do have to assess ESG risks and their potential impact on the sovereign's ability and willingness to meet financial obligations. Momentum is building across the investment industry to improve the availability of data and engagement within this asset class.

Within private markets, our real estate team has an extensive community and occupier engagement programme across our retail and office assets that focuses on governance, skills, safety, health and wellbeing. Retail and office assets represent, on average, about 50-60% of our direct investment, depending on the fund. We aim to positively impact the health and wellbeing of our occupiers and local communities by establishing a constructive dialogue through a range of activities carried out during the life cycle of real estate assets, including:

- Development and refurbishment: land decontamination, the use of safe and healthy materials and enforcing risk management and safety standards in development, refurbishment and property management.

[58] FHL, 'We can all get along', (September 2018); FHL, We can all get along: Part II', (June 2019)

GLOBAL EMERGING MARKETS CASE STUDY

LandMark Optoelectronics

LandMark Optoelectronics engages in the research, design, manufacture, and sale of laser epitaxial wafers and optoelectronics wafers. It specialises in the manufacture of wired communications machinery and equipment, and electronic components.

EOS started their engagement with LandMark Optoelectronics on climate data disclosure and target-setting in 2018 by regularly meeting with the CFO. They requested the company starts collecting and reporting ESG progress annually and suggested it refer to the CDP climate change survey framework for disclosure.

In 2019, EOS urged that the process of determining a long-term target should start as soon as possible and be given sufficient resources, instead of its current approach of only setting yearly incremental emissions reduction targets. They also suggested it further examine peer companies' disclosure and explore purchasing green energy to reduce its Scope 2 emissions. In 2021, they encouraged more detailed disclosure about risk and financial impact and how this links to strategy. They shared information about science-based targets, as well as several TCFD examples.

In terms of outcomes, in 2018 the CFO shared with EOS that the board had approved allocating dedicated resources for corporate sustainability purposes and that the company will disclose greenhouse gas emissions information in its next annual report.

Over the course of 2019 to 2022, the company enacted various improvements. These included issuing its first CSR report, establishing a corporate sustainability committee at the board, and taking steps to install solar panels on its newly built factory's rooftop. In addition, the company disclosed its first short-term climate target in June 2021 by committing to reduce greenhouse gas emissions intensity by 6% by 2025.

At a meeting in June 2022, the chair and CFO shared that the board had decided to commit to carbon neutrality by 2050. In its latest sustainability report published in the same month, it further disclosed its medium- and long-term climate targets. The company confirmed that its carbon footprint verification and a carbon management plan will be finalised by the end of 2022, and it will further improve its TCFD reporting in the 2023 sustainability report. The CFO also confirmed that a submission to Science Based Targets initiative (SBTi) is also part of the company's next three-to-five-year plan.

EOS welcomed the company's new climate commitment and will continue to engage with the company on board gender diversity, its alignment to the Paris Agreement goals (or further 1.5°C alignment), improvement of TCFD reporting and its supply chain climate readiness. A full case study is available on our website.

In June 2022, the chair and CFO shared that the board had decided to commit to carbon neutrality by 2050.

- Asset management: actively managing wellbeing initiatives through our Collaborative Asset Performance Programme +, targeting greater occupier engagement, wellbeing and comfort.
- Attaining wellbeing certification: in 2022, we added a further three assets to our BREEAM In Use certified portfolio and recertified buildings certified in 2019 to the new iteration of the certificate. This consequently meant that the majority of assets saw an uplift in their scores. We have 46 BREEAM In Use certificates as 7 Fitwell certificates. In 2022, we took part in the NABERS pioneer project targeting two development assets (the first outside London) with this new energy use intensity standard, these two assets are in line with the most efficient in the country under this new scheme.
- Participating or supporting initiatives that promote wellbeing among occupiers and communities: we have addressed sustainable transport, healthy living among occupiers and community health, and have implemented the UK Modern Slavery act through our activities and supply chain.
- The team have also engaged with all occupiers during lease negotiations, with the intention of including sustainability clauses in all lease agreements.

We have continued to focus on reducing the carbon footprint of our real estate portfolios in 2022 and increase the energy efficiency of our assets.

We have progressed our work on social value by analysing local needs at a range of different assets and identify where targeted improvements could be made. Furthermore, we manage our community engagement programme through our property managers and have established a stakeholder engagement plan, which provides support to our property managers, sets minimum requirements, and facilitates additional community engagement activities. Moving forward, the Real Estate ESG team will place an increased emphasis on occupier engagement.

It is naturally more challenging to engage with occupiers within the industrial and retail sectors, given the type of leases and structure of their activities. The full repairing and insuring (FRI) lease structure common in these types of assets offers the occupiers complete autonomy in how they manage and maintain the building and carry out procurement activities. This means that obtaining data and encouraging sustainable procurement choices can be challenging. In our indirect funds, the managing partners engage with the occupiers.

Meaningful cities provide a well-functioning backdrop that allows citizens to participate freely in social, economic, leisure and community-based activities. Cities designed around such holistic principles create a virtuous cycle, benefiting individuals, communities, businesses, and local and regional government authorities, while helping to preserve natural capital and ensuring the historic continuity of built environments. In turn, meaningful cities can likely sustain higher economic growth by attracting and retaining talent and capital, which provides a better return on capital for investors: a true win-win.

For our Direct Lending and Real Estate Debt teams, the key is to identify both current and potential meaningful ESG risks before investing. Due to the difficulty of divesting and the capped upside, it is important to manage the downside ex ante. Because of a lack of market benchmarks, the teams often use more qualitative information – often gained through dialogue with the borrower – as well as information contained in the due diligence packs. The teams collaborate with EOS to ensure that their engagement is outcomes focused and impactful.

Following the completion of an investment in the Direct Lending funds, ESG risks – like all credit risks – are monitored. Should an ESG issue arise during the life of the investment, the Direct Lending team will seek to engage with the sponsor and management of the borrower to rectify or improve the ESG issue.

We include information requirements in all of our real estate debt loan documentation to ensure that the borrower passes on the relevant ESG information to us, which we use to monitor ESG in our investments. Many of our real estate debt loans support assets where a wider impact is delivered, such as refurbishments and regeneration. These factors are a strong consideration before investments are made, as are risks posed by ESG factors. As with our direct lending investments, the key is to identify risks that may impact on a borrower's ability to repay their loan. We also intend to engage with the borrower where additional ESG issues arise during the life of the loan.

For our infrastructure team, superior investment performance, for the benefit of all stakeholders, begins with best-in-class governance, where transparency of information, clear lines of responsibility, accountability and appropriate management of conflicts are paramount.

The team promote best practice systems, processes and procedures that encourage proactive engagement with sustainability factors, avoiding tick box exercises, effectively monitoring compliance and facilitating innovation.

We encourage the integration by management teams of sustainability considerations into companies' governance structures, strategies and risk registers in the belief this will have a catalysing and disproportionate positive impact on a company's long-term sustainability.

As an active investor, we engage directly with companies, at all levels, on a range of issues whilst maintaining an appropriate level of executive accountability. We set engagement priorities annually in an integrated approach with wider non-sustainability objectives. Priorities are guided by the use of the EOS stewardship model. This provides the framework on which asset teams will develop priority areas, focusing on the parts of the model deemed most material to the particular asset. Progress against engagement priorities is reviewed twice annually.

In private equity, for a small proportion of our assets where our the team have some control and/or the ability to influence company decisions directly, we seek to work closely with investee companies to monitor, challenge and improve ESG performance. We engage with the lead GP and management team on a regular cadence (quarterly or yearly, depending on the severity of the risk) to monitor the risk and engage on potential outcomes. Engagement objectives are focused on the assets with higher identified ESG risks.

We engage with the lead GP and management team on a regular cadence (quarterly or yearly, depending on the severity of the risk) to monitor the risk and engage on potential outcomes.

However, in almost all cases our team has limited control and/or ability to influence decisions directly (whether for direct or indirect co-investments). In these instances the team will work closely with the lead GPs to assess, monitor, and seek to improve ESG performance of the underlying investee companies. Where we believe there are significant ESG risks we will ask the lead GP to address these. Whilst we have no formal rights in this situation and the assets are illiquid, we seek to leverage on our relationship with the GP to have a constructive discussion. The GP would then typically engage with the company management. We only invest with active GPs who are very closely involved with the investee companies and in regular contact, and as set out under Principle 7 ESG considerations are factored into the GP selection process.

Outcomes of engagement in 2022

Public markets

Through stewardship activities, led by EOS, we engaged with **578** of our public markets holdings in 2022, covering **2,465** identified objectives or issues. We made progress on **55%** of all objectives related to our holdings, which equated to **81%** of our equity and credit AUM (compared to 77% in 2021)[59].

Figure 45. Fund level engagement coverage for pooled equity funds during 2022[60]

Fund name	% AUM Engaged in 2022
Federated Hermes Asia Ex-Japan Equity Fund	72%
Federated Hermes Emerging Asia Equity Fund	60%
Federated Hermes Global Emerging Markets Equity Fund	77%
Federated Hermes Global Emerging Markets SMID Equity Fund	30%
Federated Hermes Global Equity Fund	83%
Federated Hermes Global Equity ESG Fund	87%
Federated Hermes Sustainable European Equity Fund	76%
Federated Hermes Sustainable Europe ex-UK Equity Fund	75%
Federated Hermes Impact Opportunities Equity Fund	69%
Federated Hermes Sustainable Global Equity Fund	86%
Federated Hermes US SMID Equity Fund	86%
Federated Hermes Global Small Cap Equity Fund	85%
Federated Hermes SDG Engagement Equity Fund	98%
Federated Hermes Global High Yield Credit Fund	84%
Federated Hermes Multi-Strategy Credit Fund	85%
Federated Hermes Absolute Return Credit Fund	81%
Federated Hermes Unconstrained Credit Fund	83%
Federated Hermes SDG Engagement High Yield Credit Fund	94%
Federated Hermes Climate Change High Yield Credit Fund	81%
Federated Hermes US High Yield Credit Fund	37%

Source: FHL, as at 31 December 2022. To note, the Federated Hermes Biodiversity Equity Fund and the Federated Hermes Emerging Markets Debt Fund are excluded from this chart as they were launched during 2022 and therefore had insufficient engagement data.

CASE STUDY

Bank Rakyat Indonesia

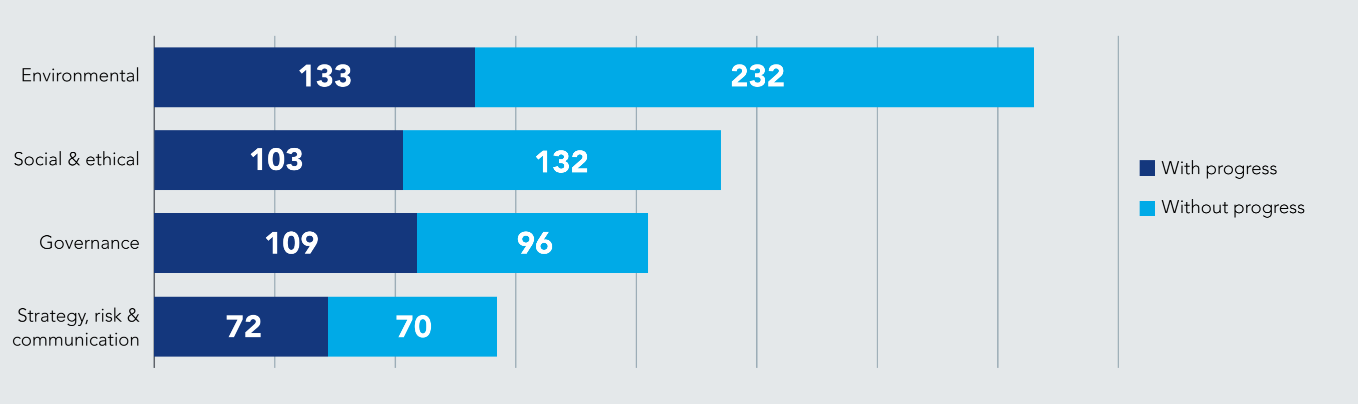
Bank Rakyat Indonesia is a financial services company headquartered in Indonesia. EOS have been engaging with Bank Rakyat Indonesia for over a decade and were pleased to see a sustainable finance plan launched in 2018. Since then, EOS have engaged with senior management at its headquarters, sent letters to the board and liaised with the investor relations and compliance teams, seeking a more ambitious and strategic sustainable finance plan.

The company has gradually improved its sustainable finance plan and plans to make a public commitment to reach net zero emissions across Scopes 1, 2 and 3 aligned to the Paris Agreement once it has started the process of obtaining science-based targets accreditation in 2023. The company plans to report against the Task Force on Climate-related Financial Disclosures (TCFD) and to sign up to the UN Global Compact, the Partnership for Carbon Accounting Financials (PCAF) framework and the UN Environment Programme Finance Initiative (UNEP FI). The company has set up a dedicated ESG 'desk' under the director of compliance and an ESG board committee chaired by the CEO. EOS plans to issue a more detailed strategy in 2023 encompassing the above elements.

[59] Our AUM here includes equities, warrants and bonds, as well as single name credit default swaps that give the firm long exposure to the underlying instrument and its associated company. Other derivatives, cash, index and government instruments are excluded.

[60] This table covers those funds which were launched prior to 2022 and for which data for the whole year is therefore available.

Figure 46. Progress made on our engagement objectives by theme in 2022



Source: FHL, as at 31 December 2022.

CASE STUDY

SDG Engagement Equity Strategy – Retail Opportunities Investment Corporation

Retail Opportunities Investment Corporation (ROIC) is the largest publicly-traded, grocery-anchored shopping centre real estate investment trust (REIT)[61] focused exclusively on the west coast of the US. The construction and operation of buildings contribute around 40% of worldwide greenhouse gas emission[62]. In the United States, the Department of Energy estimates that commercial buildings account for c18%[63] of energy usage and account for 40% of carbon dioxide (CO_2) emissions, and 88% of potable water consumption[64].

Commercial building operators can contribute to reducing carbon emissions by switching to cleaner energy sources and reducing energy consumption via energy efficiency measures. Furthermore, operators such as ROIC can contribute to water use savings by adopting a series of water upgrade measures.

We have been invested in ROIC for many years, including since inception of our SDG Engagement Equity strategy at the end of 2017. During that time, we have had approximately 20 interactions which have included meetings and calls with the senior management team, most commonly the CEO, as well as with the chairman and others.

Many real estate companies are now including ESG information as part of their investor and public reporting and include numerous key performance indicators, including energy usage, greenhouse gas emissions, waste management, number of sustainability certified assets among other metrics. This level of disclosure remains patchier in some markets such as North America than for Europe, however, there is progress.

When we first began engaging with ROIC on sustainability matters the company was notably lagging, although in a market as per above with lower levels of ESG disclosure than elsewhere. After multiple, predominantly positive and constructive conversations with the ROIC management team over a sustained period, we have been pleased at the progress the company has made to date with the establishment of reporting and time-bound sustainability improvement targets. Indeed, management noted privately that our dialogues were the catalyst for them to accelerate their practices and investment around this agenda. Beyond the 'E', the company has made large strides on governance with much improving levels of diversity – spanning age, gender and ethnicity. As of July 2022, the company operates a refreshed and diverse board and has for a couple of years afforded a material weighting (25%) towards ESG metrics within the performance-share element of the long-term incentive plan granted to management.

While the rate of progress has been laudable, there remains scope for more to be achieved. We continue to speak with ROIC around its installation of energy efficient lighting and solar arrays, as well as its installation of EV charging units and its support for more efficient waste management.

[61] A real estate investment trust (REIT) is a company that owns, operates, or finances income-generating real estate. REITs pool the capital of numerous investors. This makes it possible for individual investors to earn dividends from real estate investments – without having to buy, manage, or finance any properties themselves.

[62] GRESB, 'Comprehensive Carbon Footprinting in Real Estate', (November 2018)

[63] U.S. Energy Information Administration, 'FAQs', (December 2022)

[64] U.S. Energy Information Administration, ' Use of energy in commercial buildings in depth', (September 2018)

CASE STUDY:

SDG Engagement Equity Strategy - Eagle Materials 2022 Update

Eagle Materials is the largest domestic-only producer of cement, aggregates and wallboard in North America. As of Q4 2022, Eagle Materials represented 19% of the Federated Hermes SDG Engagement Equity Fund's total carbon footprint. This figure, while high, is perhaps unsurprising given cement manufacturing is estimated to represent c.8% of total global emissions[65].

Over the period of our investment, we have met with Eagle's management on numerous occasions to discuss issues of interest and have been encouraged by the progress made. We had long contended that their position as the most cost-efficient producer in North America was testament to their commitment to do more with less. While there remains scope for further progress, Eagle has already delivered meaningful improvements. Despite their relatively efficient process we have for some time been engaging with the company with respect to the three primary levers for realising further necessary emissions reductions in the production process: i) greater usage of alternative fuels (in particular displacing use of coal); ii) increased clinker substitution; iii) and adoption of carbon capture, utilisation and storage technology.

We intend to continue to engage with Eagle Materials on these identified central issues.

On the development and adoption of their alternative fuels roadmap, as of November 2022, four of their facilities are now using alternative fuels (e.g. tyres or biomass). Their other facilities have identified sources for utilisation but are still working through permitting issues and some kiln modifications.

On clinker substitution, having begun production of a lower clinker, Portland Limestone Cement in 2021, this had grown to represent 30% of their production by the end of Q3 FY23 and they are on course for this lower clinker cement to constitute 100% of production by 2025.

Finally, on carbon capture – the most important lever in the cement industry's decarbonisation pathway – Eagle are continuing to collaborate with Chart Industries to test their Cryogenic Carbon Capture technology at their Central Plains facility in Sugar Creek.

We intend to continue to engage with Eagle Materials on these identified central issues. We hope to see further progress made in the coming year with respect to explicit target setting around, for example, alternative fuel utilisation, as well the establishment of publicly disclosed emissions reduction goals to underpin their Net Zero 2050 ambition. Fundamentally, we are hopeful that the company will continue to take a leadership position within the industry, raising collective ambitions and in turn accelerating the progress towards net zero.

[65] Fast Company, 'Cement is responsible for 8% of global emissions—but it doesn't have to be,' (November 2021).

CASE STUDY:

SDG Engagement High Yield Credit Strategy - EQT Corporation

EQT Corporation (EQT) engages in natural gas production and commercial sales from the Appalachian Basin, predominantly within Pennsylvania, West Virginia and Ohio, and is the largest independent natural gas producer in the United States[66]. EQT's shale basins benefit from an environmentally advantaged geology for natural gas extraction, providing an operational carbon and methane emissions intensity for its produced gases and liquids which is amongst the lowest of comparable natural gas peers in the US and globally, per unit of energy[67].

As EQT's emissions per unit of production is among the lowest in the US, it can continue to decrease Scope 1 and 2 emissions, before offsetting or sequestering remaining emissions. Of particular importance is methane, given that this potent global-warming potential gas drives substantial CO_2-equivalent emissions. On setting the objective, we felt the company should set a net-zero target to be achieved within a matter of years, given its advantaged profile and history of intensity reductions. We wanted EQT to articulate, in particular, how methane management contributes to the effort.

In 2021, we were therefore pleased that EQT announced its intent to achieve operational net zero prior to 2025, with specific detail on emissions reductions efforts. This includes Scope 1 carbon intensity of below 160 MT CO_2e/Bcfe (~70% reduction vs. 2018) and Scope 1 methane intensity below 0.02% (~65% reduction vs. 2018).

EQT's 2021 remuneration policy integrated emissions intensity, safety performance and employee incident rates as ESG incentives in short-term remuneration. However, in line with net-zero aspirations and nearer-term commitments to carbon and methane emissions reductions targets, we felt it should consider expanding these to long-term incentive plans (LTIPs) alongside financial performance drivers. This allows EQT to align decarbonisation incentives with medium term emissions reductions pathways.

This objective was completed in 2022 when the company introduced an innovative emissions reduction and net zero incentive. This incentive limits the amount of carbon credits the management team can use in reaching net zero by 2025. A penalty is applied to the LTIP award result if the company purchases credits for more than 350,000 tonnes of CO_2 per annum, and a positive modifier if it is able to purchase credits to offset less than 100,000 tonnes, in arriving at net zero by 2025. This should help focus management on investing in genuine, additionality-based offsetting solutions while decreasing the actual emissions intensity of operations simultaneously.

When we commenced engagement, only Scope 1 emissions had been disclosed and, as of 2019, environmental metrics were disclosed inconsistently. The new management team, in place since July 2019, set out to create an efficient, lowest-cost operational model driven by technological innovation and workforce capabilities and collaboration. It sought to reach leadership among peers on ESG disclosure and strategy. We felt EQT should use its sustainability strategy to set targets that decrease environmental impacts of operations. We wanted to see short and medium-term targets which drive meaningful improvements in environmental performance, including on water management. Moreover, the company needed to disclose material environmental impact drivers in a year-over-year fashion, including water use and emissions and energy footprints in Scope 1 and 2.

We reviewed the latest disclosures in line with a 2022 engagement. EQT delivered reporting which includes Scope 1 and 2 historic emissions, emissions reduction targets at or ahead of 2025, a net zero target to be achieved before 2025, and consistent, comparable social and environmental indicator reporting. We will engage it on climate risk scenario analyses and key assumptions within TCFD-based components, which have already evolved to a degree in recent ESG disclosures.

Future objectives will focus on execution of net zero to ensure this is delivered by 2025, and how the company may be able to commercialise future energy innovations which address the challenges of climate change, including biomethane and potential for regional hydrogen and carbon capture hubs. EQT's ambitious orientation towards responsible fuels and best-in-class operations can be influential in the US.

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[66] EQT, 'Corporate Profile'
[67] EQT, 'Unleashing U.S. LNG', (March 2022)

We publish case studies throughout the year on our website to demonstrate the approach we take and the outcomes of our engagement. EOS case studies are fact checked by the engagement companies and published on the EOS Insights website page.

In some instances, we will discontinue engagements on the basis that our efforts have been met with strong resistance, or the matter is no longer relevant. The following are reasons an objective may be discontinued:

- Company unresponsive: the company has not been responsive to our engagement, and we do not believe it worthwhile to dedicate further stewardship resource, having considered the effort required to achieve change, the probability of achieving change and the materiality of the issue.
- Company disagreed: the company has expressed its disagreement with our engagement proposals, and we do not believe it worthwhile to dedicate further stewardship resource, having considered the effort required to achieve change, the probability of achieving change and the materiality of the issue.
- No longer relevant/ material: the original objective is no longer considered sufficiently material or relevant. This could be due to a change in the company's business profile (such as divestment of a business unit of concern) or if engagement reveals that the original concern is of lower materiality than originally anticipated.
- Restarted as new objective/issue: engagement reveals that the original objective should be materially changed – for example, split into two separate and related objectives or combined with another objective.

Providing explanations for scenarios where engagement has stalled – that is, in instances where engagement is moving slowly, or a company refuses to make changes – is more challenging because we conduct the majority of our engagements behind closed doors. We are mindful of the relationships we have built with companies, as well as our future engagements with them. For these reasons, we provide anonymised case study examples.

CASE STUDY

Discontinued objective – shareholding requirements of CEO

We initiated engagement with a multinational health care company about the quantum of CEO pay when we sent our vote recommendations ahead of the company's 2019 annual shareholders' meeting. We did not receive a response at that time but were pleased to speak with the general counsel ahead of the company's 2020 annual shareholders' meeting. We reiterated our concern about CEO quantum and the practice of benchmarking the long-term incentive plan (LTIP) at the 75th percentile of peers. We also had concerns about the short-term nature of the options, which begin vesting in one year, a practice which is misaligned with our remuneration principles.

The company was receptive to our initial feedback in 2020 and shifted to benchmarking the LTIP at the 60th percentile for 2021. Initially, we were not inclined to recommend support for the 2021 say-on-pay item due to the use of options in the LTIP and the excessive pay for the outgoing CEO, but ahead of the 2021 annual shareholder meeting, the company cited the role the executive chair had played in ensuring strong performance and protecting stakeholders throughout the pandemic. We also acknowledged that the quantum of the new CEO's pay was 30% lower than the prior CEO's 2019 pay out. We did, however, reiterate our concerns about the use of options in the LTIP and the excessive pay for the outgoing CEO for his role as executive chair.

Ultimately, we recommended support for the say-on-pay item but indicated that we would monitor quantum and the compensation structure going forward. For the 2022 annual shareholders' meeting, we were disappointed to see the committee shift back to benchmarking the LTIP at the 75th percentile of peers, alongside the nearly 100% increase in options awarded and top quartile quantum. We recommended opposing the say-on-pay item and the longest-standing member of the compensation committee. As there has been no indication of positive momentum on this issue, we have discontinued our engagement. However, we appreciate the company's engagement on other governance issues and concerns around product quality and safety.

Private markets

Our real estate team publishes an annual ESG report, which publicly discloses environmental and social outcomes for our real estate funds. Through our placemaking activities, we have created significant social and economic growth in a number of our real estate construction projects. This has been achieved through generating construction jobs, apprenticeships and local supply chain spending.

As we expand our reporting to cover the eight social hubs identified for real estate placemaking initiatives, we have developed a comparative framework which enables us to clearly measure and analyse the positive impact that investment has on social infrastructure. This work will focus on different types of operational assets within our portfolio in a range of locations.

We have continued to work with Social Value Portal to develop our understanding of the social capital generated by our placemaking schemes in Leeds and Manchester.

GRESB: GRESB – the global real-estate sustainability benchmark for real assets – is an investor-driven global sustainability benchmark and reporting framework for listed property companies, private property funds, developers and investors that invest directly in real estate.

The assessment is shaped by what investors and the industry consider to be material issues in the sustainability performance of real estate investments. Scoring covers seven areas: management, policy and disclosure, risks and opportunities, monitoring and environmental management systems, performance indicators, building certifications and stakeholder engagement.

The table below summarises the 2022 scores and movements from 2021 for our real estate funds. The scores were impacted by the comparison with energy and water use during Covid-19 lockdowns, but continue to show improvement in ESG areas across the portfolio. In 2022 we added two new funds to the benchmark allowing us to assess the performance of these two place-making schemes in more detail.

Figure 47. Real Estate 2022 GRESB scores

Fund	Star Rating		Green Star	GRESB Score		Change in Score	Peer Ranking	
	2021	**2022**		2021	**2022**		2021	**2022**
BTPS	5	**4**	Yes	87	**85**	-2	1	**1**
BTPS Developments	4	**4**	Yes	88	**89**	1	4	**5**
Federated Hermes Property Unit Trust (FHPUT)	3	**3**	Yes	75	**77**	2	13	**15**
HCLLP	4	**5**	Yes	86	**88**	2	6	**3**
Metro Property Unit Trust (MetroPUT)	2	**2**	Yes	72	**72**	0	7	**5**
Centre:MK	5	**5**	Yes	95	**90**	0	1	**1**
Hestia	5	**4**	Yes	87	**85**	-2	2	**3**
Paradise	-	**3**	Yes	-	**75**	-	-	**7**
Paradise Developments	-	**3**	Yes	-	**82**	-	-	**7**
NOMA	-	**2**	Yes	-	**71**	-	-	**9**
NOMA Developments	-	**5**	Yes	-	**99**	-	-	**2**
Wellington place	5	**5**	Yes	91	**90**	0	3	**1**
Wellington place Developments	5	**5**	Yes	91	**99**	8	2	**1**
Silverstone	2	**2**	Yes	69	**67**	-2	5	**5**
Silverstone Developments	5	**2**	Yes	92	**67**	-25	3	**5**
Milton Park	2	**2**	Yes	66	**68**	2	3	**4**
Milton Park Developments	3	**2**	Yes	83	**81**	-2	9	**8**

Source: FHL, as at 31 December 2022.

In the overall ratings, our operational assets Centre:MK, Wellington Place, and HCLLP all achieved a 5-star rating, whilst for developments, Wellington Place and NOMA also achieved a 5-star rating. BTPS, Wellington place and Centre:MK were at the top of their peer group. The real estate team, through effective stewardship of its portfolio, managed to retain the score in the majority of its submissions and achieved an improvement in the Peer Ranking and/or GRESB Score for most of the funds.

The success of our Real Estate ESG approach can also be seen in the certifications that our properties receive. In 2022, we achieved an additional 3 BREEAM In Use certifications for our assets. This included a newly operational property in Paradise, Birmingham (Two Chamberlain Square), showing that it has maintained its sustainability credentials from construction into operations, achieving an 'excellent' rating.

REAL ESTATE CASE STUDY:

Fleets' Corner Business Park

Located in Poole, FHL's Fleets Corner Business Park is one of the most significant assets of its type in Southern England, and is home to many recognised names such as Lush, Starbucks, Travelodge and CityFibre, alongside local businesses.

Spanning 560,000 sq.ft., Fleets Corner offers a range of new and comprehensively refurbished industrial accommodation, accounting for 320,000 sq ft of the site, the largest amount in Dorset. Alongside industrial units, the business park offers 40,000 sq ft of refurbished office space, and has a range of amenities onsite, including the newly built Starbucks drive-thru and the brand new 81-bed Travelodge hotel.

Fleets Corner Business Park is managed in accordance with the Responsible Property Investment programme, which seeks to deliver holistic outcomes by generating positive societal and environmental impacts in addition to meeting financial return targets. FHL is committed to reducing its environmental impact, creating carbon savings and supporting the climate transition by seeking to meet high-performance criteria for both new-build and existing projects.

FHL has sought to meet the highest sustainability performance at Fleets Corner, and all new builds include the following accreditation and specification: BREEAM Excellent, EPC A, solar PV panels, PIR lighting sensors, external cycle racks, shower facilities, external biodiversity and tree-planting programmes, and an attractive built environment to promote the end-user experience. Refurbishment projects at Fleets Corner have sought to improve energy performance as well as promote the end users' overall experience, and includes the following features:

- HVLS destratification fans saving up to 20% energy used in heating refurbished industrial units
- New thermal rated fenestration (where appropriate)
- Toilet refurbishments
- Enhanced building management systems and boiler sequencing
- External cycle racks
- New shower facilities
- Automatic electric water heaters
- Rainwater harvesting to supply WCs
- Flow restrictors on water outlets to reduce water usage
- Leak detection
- Health and safety are front of mind, ensuring building standards are kept up to date.

Working collaboratively with CBRE, its property management partner, FHL has sought to reduce energy consumption and carbon emissions and promote a more sustainable basis to service provision on site:

- The landlord's electricity is 100% renewable A BREEAM In Use rating for existing office accommodation
- No communal waste is sent to landfill
- LED estate lighting – energy consumption reduction of 90%
- PIR sensor lighting in building communal places A Green travel plan for occupiers A Access to bike share scheme

Infrastructure

At a number of our portfolio companies, our roles at board and committee level have enabled us to successfully collaborate and influence sustainability strategy and go on to approve matters related to the strategy's implementation

Owing to our engagement approach and nature of the asset class, we have a significant number of day-to-day engagements. We choose to monitor number and quality of engagements on a sample basis, using a single quarter of the year. For 2022 we recorded engagements for Q4. In Q4 2022, we recorded 50 sustainability-related engagements. Of these, 44% were direct engagements with investee company management teams. The other engagements were mainly with co-shareholders, Board Committees and industry associations. In terms of theme, 42% of engagements were related to climate change, 21% focused on health, safety and wellbeing and 13% on diversity and inclusion.

INFRASTRUCTURE CASE STUDY:

Scandlines

Overview:

In 2018 we acquired a shareholding in Scandlines, a ferry operator between Denmark and Germany, in consortium with an aligned co-shareholder. We have participated in extensive discussions on sustainability (and climate change in particular) at board and committee level since acquisition, building on Scandlines' track record of investing in green technology to reduce its environmental footprint and CO_2 emissions.

These have most recently resulted in the approval in September 2021 of the acquisition of a new €80m investment (inclusive of works in the harbour) in a new zero-emission freight ferry and in Scandlines setting in 2022 ambitious net zero direct emissions targets by 2040 (and 2030 for its main Denmark to Germany route), which it aims to meet through further electrification of its fleet, providing one of the greenest links between Sweden/ Denmark and Germany.

Our rationale:

The new zero-emission freight ferry will allow Scandlines to expand its cargo capacity whilst retiring older vessels from the fleet. Its impact (described further below) is consistent with our engagement thesis that Scandlines can continue to improve its commercial offering and grow revenues (with low carbon transportation being seen as increasingly desirable by freight customers) while also decarbonising its operations and thereby minimising impact of operations on the planet and potentially reducing cost.

Our engagements:

The approval of the investment required board votes to be exercised at Scandlines in September 2021, the exercise of which was escalated to the Infrastructure Investment Committee due to the materiality of the proposal.

> **The new zero-emission freight ferry will allow Scandlines to expand its cargo capacity whilst retiring older vessels from the fleet.**

The outcomes:

The vessel is currently being built and expected to be deployed in 2024. Deployment of the new vessel from 2024 is expected to reduce Scandlines' emissions by c.170k tons of CO_2 to 2035, or the equivalent of one full year of operations pre-Covid 2019. Given this and the replacement of older vessels, it is also expected to result in much lower Opex (including likelihood of carbon taxes). Monitoring of progress of the project's progress is taking place via a dedicated Green Agenda SteerCo.

> **Deployment of the new vessel from 2024 is expected to reduce Scandlines' emissions by c.170k tons of CO_2 to 2035.**

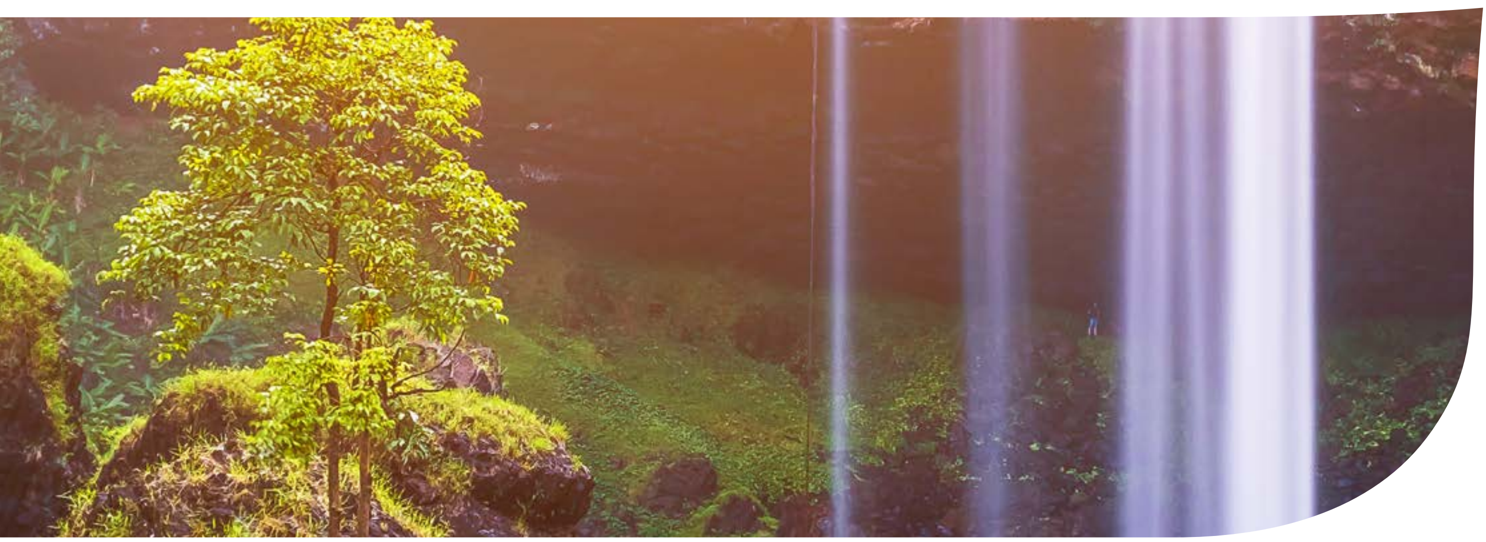
Our infrastructure team also participated in the GRESB assessment on behalf of a selection of their portfolio companies. Every company in which we hold a controlling stake, together with the utility businesses and Eurostar, in which we are a significant minority (and whose co-shareholders also support GRESB), participated in the 2022 assessment. The majority of companies improved their scores against 2021. The table below summarises the results across the portfolio. These results are published in the infrastructure KPI Supplement for investors, in addition to the UN PRI scores.

Our private equity team is currently developing an outcome-seeking engagement strategy and engagement presently occurs on an ad-hoc basis.

Figure 48. Infrastructure 2022 GRESB scores

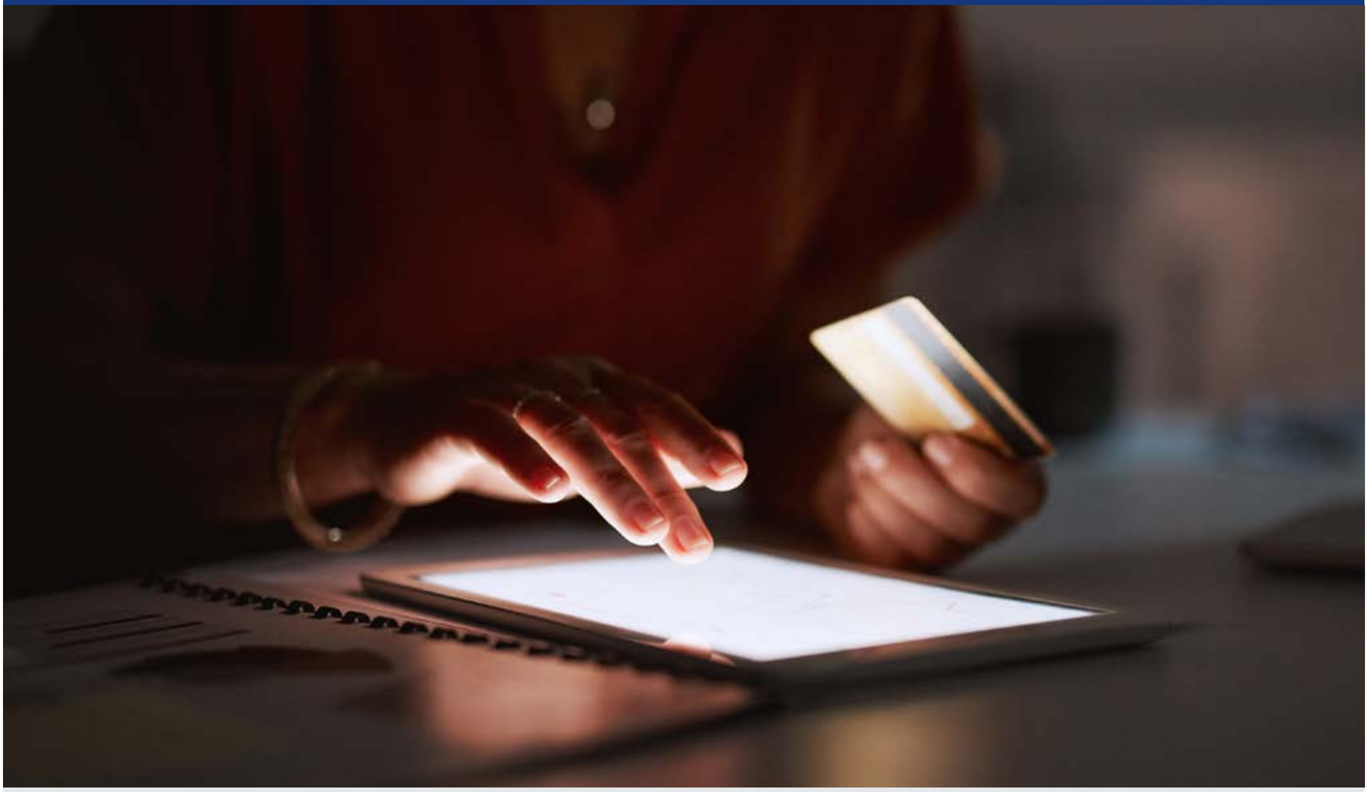
Asset	2021 Score (issued 2022)	2020 Score (issued 2021)	YoY Score Change RAG	Key factors
Southern	100/100	91/100		• Southern obtained the maximum score in all categories except for one, where the company obtained 98.1% of the maximum score
Cadent	90/100	83/100		• Demonstrated exceptional performance in 2022 with benchmark sector leading scores across a number of categories, including Health and Safety, Customers, Certification and Awards as well as Emissions • Continued to reduce YoY emissions owing to further controls on gas leakages throughout their distribution network • Ranked 6th out of 9 Europe Gas Distribution Network
ASG	68/100	61/100		• ASG has seen its score increase YoY since starting GRESB submissions • Performs robustly across Governance criteria, including Leadership structures and Policies. Scope for improvement in developing an approach to biodiversity and improving operational risk management • Ranked 21st out of 40 in Photovoltaic Power Generation
Eurostar	55/100	55/100		• Ranked 5th out of 7 in UK Passenger Rail Rolling Stock. Eurostar performs fairly consistently across E, S and G criteria • Eurostar's score remained flat partially owing to the challenging, Covid-related environment reducing the ability and funding available to drive improvements • In October 2022, Eurostar welcomed a new CEO Gwendoline Cazenave and noted her commitment to driving sustainability at the organisation
IHR	52/100	N/A		• 2021 was IHR's first GRESB submission • Whilst performing well on the majority of Governance criteria as well as the approach to waste, there is scope to focus on improving stakeholder engagement indicators. We will use the insight provided to help inform engagement priorities in 2023 • Ranked 6th out of 6 in Southern Europe Motorways
Fallago	70/100	83/100		• Fallago scored highly on a number of social and governance areas including Risk Management • Ranked 6th out of 6 in Northern Europe Onshore Wind Power Generation. Stakeholder Engagement, Policies and Reporting • Fallago has historically been one of the top performers in its peer group and remains one of the stronger ESG performers in our portfolio. The reduced score YoY was solely due to an administrative / input error and we will rectify this in future assessments

Source: FHL, as at 31 December 2022.



CASE STUDY:

Private equity



Paysend, a HGPE portfolio company, is a payments company digitising and lowering the cost of remittances. The company has a global footprint with relevant exposure to the CEE and CIS regions, including Russia at the time of investment. The company is addressing SDG 10 directly by reducing the transaction of migrant remittances to less than 3%, however its business model has inherent money laundering and conflict financing risks mitigated by company best practices (as per investment due diligence).

The Russian invasion of the Ukraine exacerbated the latent money laundering and conflict financing risk. The investment team engaged with the company and the GP immediately in Q1 2022 to address the company's response to the situation. The company was then flagged further in our internal committees for ESG and quarterly performance.

Management of Paysend reacted swiftly to the crisis and was able to leverage on its best practice experience and rapidly enhanced anti-money laundering and Know Your Customer policies to address the rapidly changing landscape and expanded its sanctions list reviews.

It was also decided to forego the fees of any money transfers into and out of Ukraine in order to support the local population

Their already strongly tech-enabled model switched to a 24/7 updated compliance product scanning each transaction in line with daily updating sanctions. In addition, it was also decided to forego the fees of any money transfers into and out of Ukraine in order to support the local population, which has led to increased volumes in the region. Lastly, all transfers from and to Russia were turned off and the company has divested their Russian subsidiaries.

The team had daily engagement and monitoring meetings at the outset of the conflict, which turned into weekly and monthly meetings as it came through that all risks were being effectively managed by the company and no breaches were reported. Since then, the company has moved onwards to more strategic growth initiatives focusing on Latin America and the United States and expanding their strong technical partnership with Visa and Mastercard.

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

We see value in both direct and collaborative engagement, and it is the combination of both which helps us to influence issuers and borrowers and to carry out effective stewardship. Where there are shared objectives – in particular the promotion of long-term sustainable value – we use both formal fora and other more informal links to work collaboratively with other investors on a global basis. Such interactions can be ad hoc or ongoing. Crucially, the primary concept of EOS' stewardship service is to provide a mechanism for like-minded asset owners to pool their resources and, in so doing, create a stronger and more effective stewardship voice. We consider initiatives on the basis of factors including effectiveness, feasibility, alignment, benefits to the end user and reputation. Any collaboration is done in line with applicable rules on antitrust, conflicts of interest and acting in concert. Indeed, each party will exercise unilateral decision-making principles in deciding how to act while engaging in any collaboration. As described under Principle 4, we contribute to policy discussions both directly and in collaborative fora and initiatives. We are a member of a number of industry bodies and initiatives around the world, through which we conduct collaborative engagement both on thematic issues and with specific issuers.

Our collaborative engagements

Public markets

We collaborate with other investors in our engagement with companies when this may be beneficial for the engagement and could influence the actions and governance of investee companies. We seek collaboration where interests are aligned, and the objectives are based on material issues. Any collaboration is done in line with applicable rules on antitrust, conflicts of interest and acting in concert.

In order to succeed in the long run, we believe that companies will need to effectively manage relationships with key stakeholders. They also need to be mindful of their impact on the environment and their role in both the communities in which they operate and society as a whole – something that grants them their licence to operate. As a result, we are interested in and seek (if necessary) to influence a company's management of these wider risks, where they have been raised. While we do not generally communicate directly with stakeholders, we will feed back their concerns – once verified – to company management through our position as shareholders. We believe we have a duty to use our influence to improve the behaviour of the companies in which we invest; in turn, this should benefit society as a whole. Our stewardship activities may also include discussions with relevant stakeholders of investee companies, such as industry bodies, policymakers, regulators, customer groups, employee groups and civil society organisations. All of our activities are supplemented by our belief in transparency, and our public reporting may be of value to relevant stakeholders.

We list here examples of how we have collaborated with other investors to engage with issuers in 2022:

- **Biopharma Sustainability Roundtable:** During the Biopharma Sustainability Roundtable's 2022 in-person investor day in Copenhagen, we gave a presentation on the topic of antimicrobial resistance (AMR) to other investors and companies including Merck, Sanofi, Bristol Myers Squibb and Novo Nordisk. We set out what we saw as the potential risks associated with a high-AMR scenario for companies in the pharmaceutical sector and those involved in the manufacturing of medical products and devices for human or animal health. We encouraged companies to think about how our model would apply to their organisation and to report on the material business risks posed by AMR. We were pleased by the companies' receptiveness and to hear them acknowledge the severity of this issue. However, we found low levels of awareness amongst companies and investors about the issue of potential AMR risks, including those to business continuity. As one company pointed out, all its research and development models depend on the effective use of antibiotics, meaning that a high-AMR scenario would be detrimental to the production of new drugs. Another company explained that it was the first time it was asked to report on the risks that AMR would represent to its business. We encouraged companies to discuss this issue internally and to escalate AMR to board-level strategy discussions. We will continue engaging on this important topic.
- **Climate change and human rights at Canadian banks:** EOS made coordinated statements during 2022 at several Canadian banks, including Toronto-Dominion, addressing the banks' climate strategies as they relate to a just transition. This broadened the conversation from a pure focus on environmental net zero 2050 targets to encompass larger human rights impacts. It also highlighted the guidance from our work with the Institutional Investors Group on Climate Change (IIGCC) in developing investor expectations for the banking sector. EOS asked the banks to make an explicit commitment to achieving a just transition, paying attention to the impacts and opportunities for key stakeholders, including workers, their families and the communities most impacted by the low carbon transition. EOS also asked for reporting on the specific actions the banks would take to achieve the just transition, being clear on how borrowers' own commitments, capacity and strategy to achieve the just transition were factored into financial decision-making.

  This was consistent with our participation in the Investor Statement on Line 3, Oil Sands Projects, and FPIC , backed by investors and their representatives. EOS lent support and expressed concerns about the risks and costs associated with the financing of oil sands projects. The letter asked financiers to develop policies that eliminate financing for oil sands projects or companies that do not

[68] 'Investor Statement on Line 3, Oil Sands Projects, and FPIC', (March 2022)

protect indigenous rights, such as the right to give free, prior, and informed consent (FPIC). Additionally, signatories asked financiers involved in oil sands development to support FPIC in their lending and investment practices. This was in light of the risks and the threats that this type of financing poses to the rights of indigenous peoples, the cultural survival of indigenous practices, the long-term health of local water systems, and the climate. EOS led this engagement with Toronto-Dominion, as well as two other banks. EOS received responses from all three banks and are now formulating our next steps in partnership with the Investors & Indigenous Peoples Working Group, which coordinated this letter-writing campaign.

In 2023, EOS will continue to engage banks on their just transition plans with a focus on FPIC and the specific actions banks can take to achieve the just transition, including how these are factored into financial decision-making. We will also pursue other sector-specific engagement as it relates to the just transition including employee training and upskilling in those industries most at risk for disruption, such as car manufacturing, as plants switch to electric vehicles. Other considerations include community support as coal mines close, and green energy affordability to tackle global energy poverty.

Private Markets

As well as to collectively finance a loan, our private debt teams may collaborate with other lenders to influence borrowers as part of the engagement process. As described under Principle 9, we would typically do this at a point at which we are in the strongest position, i.e. when we have been mandated to provide the financing and we are negotiating the loan documentation. In particular, as our direct lending team has a co-lending programme with four major European banks, we often work with the relevant co-lending bank to influence the borrower. For example, during 2022, we worked with one of our co-lending banks to negotiate the terms of a loan with an engineering consultancy business whereby the interest rate of the loan will decrease as the company reaches targets for employee turnover and also gender diversity in leadership, while the interest rate will increase if the borrower fails to meet the targets. In another example, we negotiated with a borrower operating in the packaging industry that they would benefit from a reduced interest rate in the event they meet certain hurdles related to the usage of bio-based and recycled raw materials as a % of total raw materials, the % of CO_2 neutral energy and the use of Certified Paper increasing to meet a prescribed amount.

We work with the other investors within our real estate joint ventures at both the ownership and asset-management levels. The boards of our joint ventures have representatives from both investors. We work together with investors within the decision-making framework of the Partnership Agreement. Each vehicle has an appointment with a FHL company (including MEPC, a fully owned subsidiary) for the investment management and/or development management of the asset. The appointed team reports to the board and is responsible for the day-to-day running of the asset, engaging with both owners within the joint venture to suggest and progress initiatives. It is at this level that our ESG approach strongly influences the delivery of the asset and property management services.

Our infrastructure team invests directly in assets as a minority (and sometimes majority) shareholder with proportionate governance rights, typically a board seat. Collaborative engagement with portfolio company management teams and co-shareholders is part of our day-to-day interactions, as described under Principle 9. A case study is included in the following section.

As described under Principles 2, 7 and 9, as a minority investor we interact with the lead GPs of our direct co-investments and fund investments. Due to the nature of the asset class, other collaborative activities with other investors are limited and usually relate to informal discussions around governance or fees.

Any collaboration is done in line with applicable rules on antitrust, conflicts of interest and acting in concert. Indeed, each party will exercise unilateral decision-making principles in deciding how to act while engaging in any collaboration. More information on our advocacy and collaborative engagement on thematic issues and public policy through industry initiatives is available under Principle 4.

The outcomes of our collaborative engagement

We monitor the progress of our collaborative engagements with specific issuers in the same way we monitor our direct engagements. We do not categorise our engagements with specific issuers into either collaborative or individual/staff engagements. The outcomes of our collaborative engagements are therefore included in our reporting under Principle 9 of our broader engagement outcomes. However, here we provide some case studies as an example of how we collaborate with others in our engagement with issuers. As noted above, more information on our collaboration on thematic issues and public policy is available under Principle 4.

Each quarter, EOS publishes a Public Engagement Report which details its collaborative work on public policy and best practice over that period. These are publicly available on the EOS library page of the website.

CASE STUDY:

Investor expectations for banks – 2022 update

In 2021, we co-authored a paper setting out investor expectations on the alignment of the banking sector with the goals of the Paris Agreement. Officially launched by the Institutional Investors Group on Climate Change (IIGCC), the paper focused on three areas: the actions banks should take to align their financing activities with the Paris Agreement goals and the achievement of net-zero emissions; steps to strengthen the governance of their climate strategy; and disclosure to demonstrate implementation. 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 seven banks and takes an active participating role with four other banks.

Following this work, the Net Zero Assessment Framework was produced in July 2022 by the IIGCC and the Transition Pathway Initiative (TPI) To help investors assess banks on their transition strategies and align their own portfolios with net zero.[69] We continued in our role as a co-chair for the IIGCC Banks Working Group, contributed directly to the finalisation of this framework. This included giving direct and specific feedback on the scoring methodology, co-authoring the report foreword, and contributing to the socialisation of the framework. It includes pilot indicators under six key areas underpinning a bank's approach to the transition. These are long-term commitments, short- and medium-term targets, decarbonisation strategies, climate governance, policy engagement, and audit and accounts.

The framework was designed to enable investors and their representatives to robustly engage on bank transition strategies, as part of their own net-zero alignment efforts and stewardship of portfolio companies. Through the development of this framework, we support the shift in investor engagement to go beyond a focus on a high-level commitment, towards practical tactics and implementation.

The results of the initial benchmarking exercise against the six pilot indicators showed a significant gap between global financial sector best practice and what is needed to align with 1.5°C. We found these results helpful in highlighting opportunities for improvement, which we could then cite when engaging with the evaluated banks. The framework has also been useful when engaging with banks that are lagging behind and still considering how to build a comprehensive climate strategy. We have referenced the Net Zero Assessment Framework in direct and collaborative engagements, particularly in discussions around a bank's transition strategy. For example, we engaged with First Citizens Bank to discuss updates to its ESG strategy following its merger with CIT Group. Following the merger, the bank has significant commercial relationships in addition to an extensive retail banking portfolio, and is determining how its ESG strategy should look. We pointed to the Net Zero Assessment Framework when articulating the expectations we have for portfolio-related climate strategy and encouraged the bank to build its decarbonisation strategy and climate governance, in addition to considering emissions reduction targets.

As part of our work to support the framework, we helped to ensure that all the collaborating investors and evaluated banks were made aware of the analysis and methodology, facilitating a bank-wide webinar series to communicate the results and a way forward for the assessment. We also directly contributed to the feedback process informing the next iteration of the framework, to be released in Q2 2023. We have also referenced the Framework when taking part in public events.

In 2023, we aim to drive the second iteration of the framework and contribute to elements reflecting the just transition. We will continue our co-chair role with the IIGCC to contribute to how the collaborative drives engagement on implementation and tactics that enable progress against net-zero commitments. As the framework evolves and banks begin to respond to the areas outlined across the pillars, there is the potential for us to leverage this resource to inform our vote policy.

[69] Transition Pathway Initiative, 'An investor-led framework of pilot indicators to assess banks on the transition to net zero', (July 2022)

CASE STUDY:

Methane collaborative engagement and advocacy

Methane accounts for about 20% of global greenhouse gas emissions, but is more effective than carbon dioxide at trapping heat in the atmosphere over the short term[70]. So curbing methane emissions this decade would buy valuable time for big carbon-emitting sectors to find viable solutions. Scientists say this is required to keep the Paris Agreement goal of 1.5°C within reach and ultimately help to avert catastrophic heating. The importance of methane as an effective short-term lever is recognised in key industry scenarios. The International Energy Agency's Net Zero scenario assumes a 75% fossil fuel methane emissions reduction by 2030 and the Oil & Gas Methane Partnership (OGMP) calls for a 45% emissions reduction by 2025 relative to 2015 levels, with a 60-75% reduction by 2030.

Tackling methane emissions through engagement is not a new focus for us, but we have been able to leverage the greater awareness post-COP26 to help galvanise industry efforts. Under our Engagement Plan, we are seeking a 60-75% reduction in oil and gas operational methane emissions by 2030, from a 2015 baseline. Specifically, we ask for methane reduction commitments and implementation plans aligned with the UNEP-managed OGMP 2.0 to achieve a critical near-term outcome that progresses longer-term decarbonisation objectives.

EOS helped to set up a collaborative Climate Action 100+ midstream roundtable on methane attended by midstream companies and investors, alongside the Energy Infrastructure Council and the GPA Midstream Association. Investors reiterated the importance of energy transition plans with timelines and targets, aligning with the OGMP 2.0 reporting framework, and supporting methane regulations. Companies described their key initiatives to cut methane emissions. For example, Kinder Morgan said that it focused on reducing venting from pipeline repair or testing activities and leaks at compressor stations.

Encouragingly, the OGMP 2.0 is gaining traction, with Occidental Petroleum and EQT among the signatories, and we are urging other companies such as Kinder Morgan and Enbridge to sign up. We also discussed the importance of aligning with OGMP 2.0 with energy industry certifiers Equitable Origin and Rocky Mountain Institute-affiliated MiQ.

On the public policy advocacy front, we submitted a comment letter on the US Environmental Protection Agency's proposed rule on US oil and gas sector methane emissions for new and existing sources. We expressed support for strong methane emissions performance standards and endorsed the OGMP 2.0 disclosure framework.

In the letter, we stated our principles-based position, including that the rule should enhance reporting transparency, credibility and comparability. We said that regulation should promote best operating practices such as advanced leak detection and the use of zero-emitting pneumatic controllers, while reducing the wasteful practice of routine flaring. It should also improve public health and safety, and environmental justice, addressing orphaned and abandoned wells, and requiring states to engage with the public and industry. We have also spoken at several events on this topic.

[70] United States Environmental Protection Agency, 'Importance of Methane', (June 2022)

CASE STUDY:

LyondellBasell

We have engaged with the multinational chemical major, LyondellBasell Industries NV (LyondellBasell), on climate change since 2017. As part of CA100+, a collaborative engagement of more than 370 investors and their representatives seeking greenhouse gas emissions reductions from the world's largest emitters, we co-lead the engagement with the company.

After LyondellBasell published its first sustainability disclosures and CDP reports in 2017, we engaged with the company to set more ambitious climate targets. With the support of other CA100+ investors and their representatives, we met the CEO and senior management in Q2 2021 to discuss the company's progress towards disclosing sustainability targets, including its planned science-based targets and a net-zero ambition.

In order to accelerate progress, as the CA100+ lead for the company, we used a legal mechanism to propose a discussion on climate change at the company's 2021 annual meeting. EOS led contributions by a group of eight institutional investors who questioned climate progress leading to over 45 minutes of shareholder-board discussion on the company's climate change strategy. During the meeting the company indicated its willingness to make further commitments.

In Q3 2021, we welcomed the company's release of its climate strategy, setting a Scopes 1 and 2 net-zero ambition for its global operations by 2050; a 30% absolute reduction of Scopes 1 and 2 emissions by 2030; and a goal to source a minimum of 50% of its electricity from renewable energy by 2030. In addition to its climate goals, LyondellBasell prioritised actions in its 2020 sustainability report to help eliminate plastic waste from the environment including waterways and oceans and to advance a circular economy.

It has also set out a pathway towards achieving its 2030 target and we encouraged LyondellBasell to collaborate with industry peers with the aim of developing a science-based sector-wide Scope 3 approach. In late 2022, LyondellBasell announced that it would increase its 2030 greenhouse gas emissions reduction target for Scopes 1 and 2 emissions to 42%, relative to a 2020 baseline. It also said it would establish a 2030 Scope 3 greenhouse gas emissions reduction target of 30%, relative to a 2020 baseline, and in accordance with guidelines from the Science Based Targets initiative (SBTi). It will submit its climate goals to the SBTi to be validated against SBTi guidance.

We continue to engage with LyondellBasell on its pathway to net zero including capital allocation and climate policy. We note the company's pathway to net zero will require shorter-term adjustments, such as energy/material efficiency improvements or switching to renewable energy, as well as longer-term solutions including hydrogen. We expect to see greater clarification and detail from the company on how climate transition pathways contribute to its net zero ambitions and align with capital expenditure plans, financial accounting and audit, and just transition.

For further examples of CA100+ collaboration and escalation, see Principle 11.

In late 2022, LyondellBasell announced that it would increase its 2030 greenhouse gas emissions reduction target for Scopes 1 and 2 emissions to

42% relative to a 2020 baseline.

CASE STUDY:

Scandlines

At Scandlines, a Danish ferry operator, our infrastructure team collaboratively developed with two co-shareholders an ESG proposal to 'green' company operations which was presented to company management. This led to the formation of an ESG working group with management, for which we were nominated by co-shareholders to attend on their behalf. This group supported the formation of a formal Safety and Sustainability Committee for which we were nominated to chair, and now includes co-shareholders. The committee has worked collaboratively in 2022 to set ambitious net zero direct emissions targets by 2040 (and 2030 for Scandlines' main Denmark to Germany route), which it aims to meet through further electrification of its fleet. In 2022, Scandlines ordered a new modular, zero emission freight vessel, expected to be delivered in 2024. It will represent the world's largest battery installation on a ferry.

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

Any voting recommendation or escalation technique is done in line with applicable rules on antitrust, conflicts of interest and acting in concert. Indeed, each party will exercise unilateral decision-making principles in deciding how to vote. Our engagements across all asset classes are outcomes focused, although the nature of escalation varies depending on both the rights we have available and the specific context.

Public markets

The companies identified for the core engagement programme at the beginning of each year are assigned an engagement intensity tier, although this is subject to change throughout the year, as individual company circumstances change.

We escalate the intensity of an engagement activity over time, depending on the nature of the challenges each company faces and the attitude of the board towards our dialogue. Generally, our engagement activity becomes more active where we believe that engagement will lead to an increase in or prevent/limit a decrease in the value of a company over the long-term.

Engagements on some objectives may involve only a small number of meetings, although others are more complex and will entail multiple meetings with management and board members over several years. Such activity often requires persistence. Our long-term and diverse perspective enables us to persist with the more difficult and time-consuming engagements to bring about changes in either strategy, financial structure, operational or risk management or governance, including in relation to ESG risks. Any change we encourage a board or management team to make will be with the intent of improving a company's long-term performance.

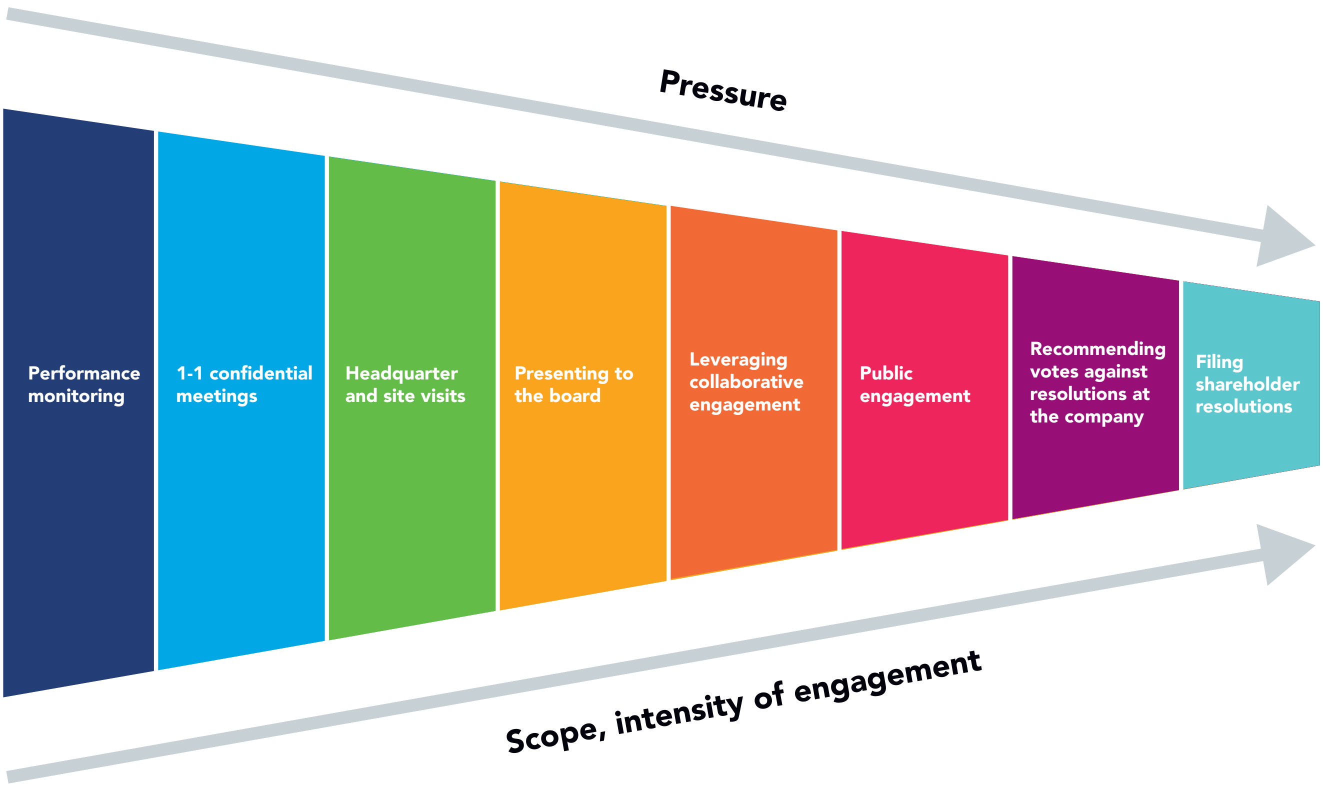
While we can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines which could undermine the trust that we believe should otherwise exist between a company and its owners. As a result, we generally prefer to conduct engagement privately, rather than taking a public route when seeking change at companies, although (as described earlier under Principle 7) details of all engagement meetings conducted by our stewardship team are shared across investment teams and with EOS' third-party clients. In our experience, working constructively with boards and management in private is the most effective way to achieve positive change, as it allows us to build trusted relationships with companies, which results in more open and frank discussions.

However, on the occasions that we are not able to achieve success by our usual methods of conversations behind closed doors, we may escalate our engagement by choosing to speak publicly at the company's annual general meeting (AGM) to garner additional investor support and add further pressure. When doing so, we would normally notify a company in advance. We may also vote against (or EOS may recommend voting services clients vote against) a resolution or management/the board at a company's AGM – we consider this choice carefully as we only want to use this technique if our usual engagement has consistently stalled, and we are not confident that the company is taking any action to address our concerns. We disclose a number of these instances under Principle 12. Given the assets we represent, such action sends a strong signal to the company and can help progress our dialogue.

Similarly, we have demonstrated a willingness to use the full range of rights that we have at our disposal, including the tabling of resolutions at shareholder meetings when necessary or collaborating with others to co-file shareholder resolutions (as described under Principle 12). We prioritise issues for escalation for the most material issues and companies, typically with our Tier 1 engagement companies, our most intense dialogues. Using the escalation techniques described can be a time consuming, and sometimes costly, process. As mentioned above, through the EOS annual survey, we have seen that a consistent majority of clients say engaging for impact and outcomes is a priority.

EOS uses the following engagement tools to escalate engagement over time. The graphic demonstrates how different tools are selected as the scope or intensity of the engagement increases in tandem with pressure for change at the company.

Figure 49. Engagement tools employed by EOS

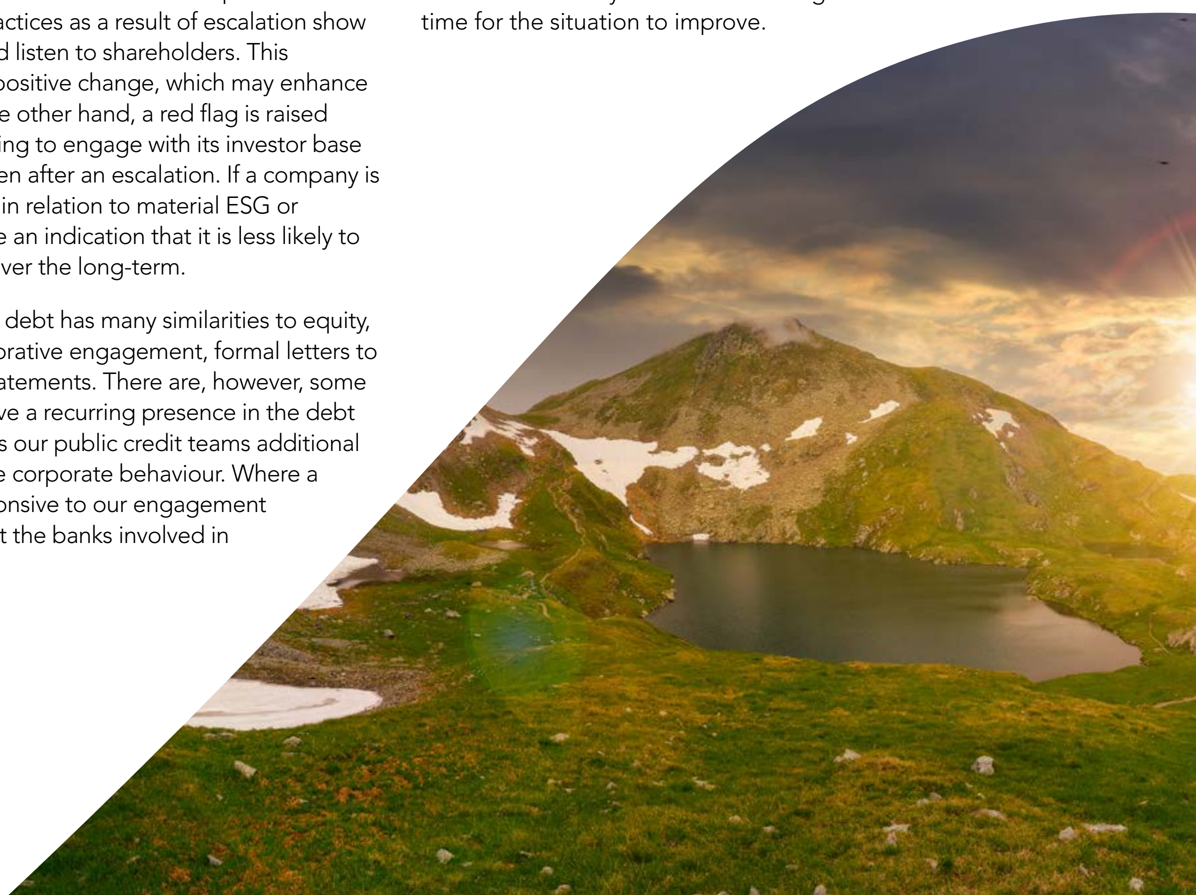


Source: FHL, as at 31 December 2022.

If our usual private engagement approach has not been successful, EOS will sometimes escalate an engagement. When this happens, the relevant portfolio managers are notified about it immediately – something that allows them to factor this information into their investment decisions. Companies that consider changing their practices as a result of escalation show a willingness to engage and listen to shareholders. This indicates the potential for positive change, which may enhance the investment case. On the other hand, a red flag is raised when a company is not willing to engage with its investor base or is resistant to change even after an escalation. If a company is unwilling to make changes in relation to material ESG or strategic issues, this may be an indication that it is less likely to create sustainable wealth over the long-term.

Escalating engagement on debt has many similarities to equity, including the use of collaborative engagement, formal letters to the company and public statements. There are, however, some differences. Companies have a recurring presence in the debt capital markets, which gives our public credit teams additional pressure points to influence corporate behaviour. Where a company has been unresponsive to our engagement efforts, we may also contact the banks involved in a new issuance.

For our engagement-focused funds, we may also withdraw our capital where we deem the engagement has failed, for example, where the company's actions contradict the outcome our engagement has been seeking. However, this is a last resort and only used after allowing sufficient time for the situation to improve.



CASE STUDY

EOS escalation tactics

Since the initiative's inception, EOS has advised on high-level governance and engagement strategy, as well as leading or supporting a significant portion of company engagement dialogues. We believe that escalation of engagement will be increasingly important to ensure that companies make the necessary changes at the pace required.

Collaborating with other investors is also critical to driving change. EOS is a significant supporter of the collaborative initiative CA100+, leading or co-leading engagement at over 24 companies across all regions. Several examples of our engagements linked to Climate Action 100+ are included in this report.

EOS have been at the forefront in using escalated engagement techniques, including:

- Supporting the filing of a shareholder resolution asking for an explanation of how its lobbying activities help to address climate risk, when automobile company Volkswagen[71] remained reluctant to provide lobbying reports after we had specifically requested transparency on climate-related lobbying activities. More information on shareholder resolutions is available under Principle 12.
- Supporting climate-related shareholder proposals at US and Canadian banks asking for banks to align financing with the International Energy Agency's Net Zero by 2050 scenario where they were not overly prescriptive and aligned with an energy transition in line with 1.5°C, for example at Toronto-Dominion Bank and JPMorgan Chase.
- Pressuring technology company Hon Hai Precision Industry (better known internationally as Foxconn), as CA100+ co-lead for the company, to improve its climate risk disclosure and align these with the TCFD recommendations to give investors better visibility of its exposure to climate-related risk.

These examples relate to EOS' entire AUA, which includes third-party assets, as well as FHL's assets. EOS will continue to play an active role in CA100+ and other collaborative climate engagements, leveraging the power of collaborative engagement as an escalation tool, and a way to signal investor consensus on the need for rapid climate action from the world's largest emitters. We will continue to shape efforts to expand collaborative engagement on climate change to additional sectors and companies not covered by CA100+. More information on EOS' 2022 CA100+ engagement activities is available in the EOS 2022 Annual Review.

[71] FHL did not have voting rights for Volkswagen at the time of the meeting.

Our case studies provide detailed insights into how our engagement escalates over time and can lead to change and completion of our objectives. In addition to the case studies below, there are further examples of how we have used voting and shareholder resolutions as an escalation technique, and the breakdown of why we have voted against proposals during 2022, under Principle 12.

CASE STUDY

AIA Group

AIA Group is an insurance company based in Asia.

Aim: Our engagement efforts focused on governance, human capital management and sustainability strategy.

Engagement overview:

- We have been engaging with AIA on a range of topics since 2013, including on governance, human capital management and its sustainability strategy. Since 2018, we have been communicating our expectation for the board to feature at least 20% female directors by 2020 due to the evidence that greater diversity results in improved debate and decision-making.
- Given limited progress, in 2020 we recommended voting against the election of the nomination committee chair, who is also the independent board chair. The company secretary acknowledged our concerns and followed through on some of our suggestions, such as refreshing the board diversity policy.
- We continued to reiterate our perspective and signalled our ongoing concerns at the 2021 AGM, with a further recommended vote against the longest-serving member of the nomination committee who was up for election.

Outcomes and next steps:

- We are pleased to see that the company has now appointed an additional female director to the board, which has resulted in board gender diversity rising to 18%, just below our current expectations.
- In a call with the head of investor relations and the sustainability team in early 2022, we welcomed this development and thanked the company for taking our feedback into account, whilst encouraging it to stay focused on further increasing board gender diversity.
- We learned that the new female director has brought valuable technology and accounting skills to the board.
- We will continue our productive discussions with AIA about its board composition and effectiveness, as well as climate change and other sustainability matters.

CASE STUDY

Activision Blizzard

The video game industry already had a poor reputation for its lack of inclusivity[72] but this was reinforced by lawsuits brought against US gaming company Activision Blizzard, which resulted in multi-million dollar settlements[73]. We conveyed our concerns to the company after allegations of sexual harassment and discrimination, and expressed our disappointment in the response from its CEO and the board. In our view, the public communication and commitments made did not reflect the seriousness of the matter, nor did they address the various material short and long-term risks for the company and its shareholders.

We first raised these concerns in Q4 2021 with the head of investor relations who pointed to changes enacted by the company in the wake of media reports. These measures included increasing diversity, conducting an equity pay gap analysis, increasing hourly wages for part-time employees and instituting a workplace responsibility committee. We pointed out that most of these changes were target-related and while laudable, did not address the root cause of the problem, which appeared to be one of culture.

We followed up this meeting with a formal letter to the board setting out our expectations around board governance of sexual harassment and discrimination issues. We also posed some detailed questions for the company to address in a subsequent meeting with the lead independent director or co-chairs of the workplace responsibility committee. Four months later, the vice president of ESG and shareholder outreach sent a reply, outlining the board's approach to some of the issues we had raised. We found this response to be insufficient, and our request for a meeting went unanswered.

At the company's 2022 annual meeting, we recommended support for two shareholder proposals that could help Activision Blizzard improve its management of human capital, human rights and the associated risks following the sexual harassment and discrimination allegations. The first proposal asked for a report on the company's efforts to prevent abuse, harassment and discrimination. The second urged the board to adopt a policy of nominating a director candidate selected by the company's nonmanagement employees. We agreed with the latter's proponents that an employee representative on Activision's board would be particularly beneficial given the allegations and the lack of an appropriate response from the company. More information on these resolutions is available under Principle 12.

> **At the company's 2022 annual meeting, we recommended support for two shareholder proposals that could help Activision Blizzard improve its management of human capital, human rights and the associated risks following the sexual harassment and discrimination allegations.**

[72] The Guardian, 'Activision Blizzard scandal a 'watershed moment' for women in the gaming industry', (August 2021)
[73] The Guardian, 'Judge approves Activision Blizzard's $18m settlement over sexual harassment suit', (March 2022)

CASE STUDY

Microsoft

Tech giant Microsoft found its own culture under scrutiny when it announced plans to buy Activision Blizzard in January 2022. In Q1 2022 we engaged with Microsoft on a 2021 shareholder proposal that had gained 78% support, asking the board to report on the effectiveness of its workplace sexual harassment policies.

The company said that its communications on these issues had improved. It also committed to annual public reporting on the implementation of its sexual harassment and gender discrimination policies, including the total number of reported concerns, the percentage substantiated and the types of corrective actions taken. We appreciated this transparency and encouraged it to integrate its policies and practices at Activision Blizzard when the acquisition closed.

We forwarded to Microsoft our expectations for board oversight of sexual harassment and discrimination issues that we had sent to the Activision board. We were pleased to receive Microsoft's first report on its workplace culture with an independent review via email in late 2022.

Private markets

For most of our private markets teams, a lack of liquidity means that it is not easy to divest or decrease exposure to investments. As a result, investments in this space are considered to be long-term relationships, and it is for the investment team to conduct appropriate due diligence prior to investing to ensure that the firm and its shareholders are willing to work with us to drive positive change. At this point, positive behavioural changes in relation to ESG risks can be included as a requirement in the documentation to ensure progress. However, it is not always possible to envisage all ESG risks that could arise during the life of the investment. In these situations, our private debt and real estate teams would engage with the appropriate stakeholders such as the borrower or the tenant, potentially with the help of EOS, to escalate and resolve any issues through dialogue. Our Direct Lending team may also involve the private equity shareholder. There can be additional instances during the life of a loan when we have an ability to influence the company's behaviours. This is primarily when the borrower needs to amend the terms of the loan. As described under Principle 12, while we have enforcement rights when a borrower breaches the agreed terms or defaults on a loan, we use these rights only as a last resort. In the first instance, we seek to negotiate a positive outcome for all parties involved, although we will always act in our investors' best interests in line with our fiduciary duty.

As a direct investor in portfolio companies, our infrastructure team escalates from asset management (operational) level, to committee, then board, then shareholder level discussions to the extent needed. As an example, over the last 18 months we have escalated engagement on sustainability with Eurostar. Although we view Eurostar as a climate solution, supporting green travel across Europe, we prioritised engagement to ensure the appropriate governance and resource is in place in order to further the green agenda, particularly around emissions reduction target setting. Having started with asset management discussions, we escalated this to executive and board level including in a 1-2-1 session with the CEO and collaborative discussions with co-shareholders. In late 2022 Eurostar hired a dedicated sustainability resource. A Head of Sustainability is to be appointed in 2023 and a sustainability strategy is in development.

Due the nature of the asset class and our position as a co-investor, our private equity team aims to identify ESG risks at the point of investment due to the difficulties faced in escalating activities during the investment hold.

Principle 12

Signatories actively exercise their rights and responsibilities.

Our rights and responsibilities as an investor

As we set out under Principle 1, we believe that the purpose of investment is to create wealth sustainably over the long-term, and that investors must behave in a way that is consistent with solving the world's problems rather than compounding them. Intertwined with this is the belief that, consistent with client objectives and applicable requirements, investors must be responsible stewards of capital in order to contribute to positive outcomes for our clients and beneficiaries, as well as society and the environment. Throughout this report, we have sought to demonstrate how we have responded through active stewardship across all of our products and asset classes. Investor rights are themselves an asset, and we view the exercise of these rights as part of our fiduciary duty and a responsibility of effective stewardship.

For listed equities, our voting and engagement are co-integrated as part of our overarching approach to stewardship. As such, our voting decisions – as well as EOS' recommendations to third-party clients on voting decisions – are informed by the insights and experience of engagement with the investee company. We may attend the AGMs of investee companies or arrange for representation at the AGMs by the EOS team. This can include asking questions or making statements to the board. We may also file or co-file shareholder resolutions. The exercise of all such rights is based on an evaluation of materiality and an analysis of costs and value. EOS engagement professionals go through a training and onboarding process which involves shadowing more experienced colleagues to ensure they sufficiently understand the voting policies and how shareholder rights differ according to the markets involved. Senior engagement professionals dedicate time to handling escalated votes and discuss market developments. We set out in more detail how we have exercised our shareholder rights for listed equities, including voting rights, in the following section.

For our fixed income products, the rights we hold vary between the type of assets we invest in and even between individual investments. We seek to achieve mutually beneficial outcomes while protecting our clients' interests, in line with our fiduciary duty. For our Credit team, documentation is a governance factor, and the quality of the documentation can be used to determine how a company's management thinks about its stakeholders. As part of the investment process, we therefore see both the covenants and the quality of bond and loan documentation as indicators of governance strength or weakness.

As investment managers, we use the rights granted to us by our real estate client mandates to improve the value of the assets in our portfolios in line with our fiduciary duty. The rights and responsibilities we hold vary between mandates and depend on the level of client involvement in the decision-making process. Our investment strategies reflect market conditions and consider material ESG factors. Our asset management activities seek to improve the assets – by improving their ESG profiles and through tenant engagement – and thereby deliver positive social and environmental outcomes, which benefit our clients and their end beneficiaries.

Due to the nature of the asset class and holding the position of co-investors, direct investments are very limited for our private equity team and our investor rights tend to be reduced to information rights and some financial rights. Lead GPs have significantly more rights than we typically do as a minority co-investor. They are able to make decisions that impact the company, such as deciding on company strategy. Whilst we do not have contracted expectations around how they use such rights, we select managers based on their previous experience and demonstrated capabilities in managing such rights appropriately.

Our infrastructure team invests directly in assets as a minority (and sometimes majority) shareholder with proportionate governance rights. Shareholder rights, including reserved matters and the right to board representation, enable downside protection and strategic influence over value. Our expectation is to have at least one board member at each portfolio company. We also have representation at various committees, including chairing two sustainability committees at Cadent Gas and Scandlines. Information rights are essential to ongoing monitoring and management and should cover all information needed by us for our day to day asset management, valuation and investor reporting.

Listed equities: voting approach

We, as shareholders, are granted a wide range of rights which both offer us a level of protection and enable us to fulfil our stewardship responsibilities effectively. In particular, we consider the vote as part of the asset and accept that we have a responsibility to exercise this right in a considered fashion.

Our voting policies

EOS' Global Voting Guidelines act as a policy to inform EOS' voting recommendations to our investment teams, as well as to EOS clients who request to receive EOS' voting recommendation service. FHL's Global Voting Policy and Guidelines, which are aligned with EOS' Global Voting Guidelines, inform the voting decisions made by our investment teams. Our Guidelines are informed by a hierarchy of external and internally developed global and regional best practice guidelines. The most important of these are our EOS-developed regional voting guidelines and Corporate Governance Principles, which are available on our website. In 2022, we had 22 of these guidelines, which set out our fundamental expectations of the companies our clients invest in with the aim of creating a common understanding between boards, managers and owners, of the proper goals of a public company. In an effort to streamline our disclosure in a way that makes it more transparent and useful for companies and clients, EOS have now moved from publishing market-level Corporate Governance Principles to publishing regional Public Vote Guidelines in some markets in

2023. While our Corporate Governance Principles focused on the high-level principles that guided our vote policies across 22 global markets, our Public Vote Guidelines place a stronger emphasis on the policies themselves, which more directly inform the voting recommendations we issue to our clients. EOS also published a set of Global Corporate Governance Principles to provide more information on what EOS considers to be governance best practices, not limited to issues with direct vote policy implications.

Additionally in 2022, following an intensive review of diversity expectations, corporate governance codes, and progress across the 22 markets where we publish Corporate Governance Principles, EOS increased its diversity expectations in most markets in the UK, Europe, North America, Asia and emerging markets.

The policy development cycle for our voting guidelines runs annually, in conjunction with the policy review process at ISS, which informs its benchmark research. EOS considers changes made at ISS in view of resolution-level data for past voting seasons in order to consider what additional changes are warranted. This includes integrating feedback from clients and evolving best practice in each market. EOS' Engagement Plan provides further input and identifies thematic priorities for engagement. This can often be boosted by enhanced vigilance and, potentially, escalation through our voting recommendations. EOS completes its major policy changes before the main voting season in each market. Once changes are applied, the policy is monitored to ensure it is having the desired effect and is adjusted further, where appropriate.

In addition, EOS has developed very detailed country-specific customised voting recommendation policies for over 50 key markets. Voting guidelines differ by country to reflect the differing regulatory, legal and corporate governance codes, as well as best practice.

Voting decisions

Voting rights are exercised with a view to achieving best practice standards of corporate governance and equity stewardship and with the aim to support the delivery of long-term value in our funds. Ultimately our investment teams make all voting decisions, based on EOS recommendations. EOS engagers, who are well versed in the voting policies, make recommendations to our investment teams based on our voting guidelines, as well as any further information that they receive through their research, engagement and specialist knowledge of the company.

While it is difficult to provide a general description, EOS will typically recommend a vote against management when it considers that a vote with management would not serve the best long-term interests of shareholders. For example, this may be either with respect to a proposed remuneration policy or when EOS believes the board does not have the skills to govern the company effectively. There may also be specific instances when a vote in favour of management would be actively detrimental to the company – for example, in the case of a proposed merger or acquisition that does not look to be in the long-term interests of the firm.

EOS uses ISS to provide research on all the companies for which it provides voting recommendations, which comes to over 13,000 meetings a year. The recommendations that our investment teams and EOS third-party clients receive are, in the first instance, based on ISS's research using our voting guidelines. This is then overlaid with our intelligent voting approach.

EOS has a value-add and cost-effective mix of automated and manual voting recommendations, which focuses resources on key topics and companies with significant holdings and/or contentious issues or ongoing engagement objectives. Engagers add insight and value to a specific subset of these meetings – those on EOS' watchlist – by considering the voting recommendation approach in light of the specific company context and the engagement. Our equity holdings are added to the EOS watchlist at the beginning of the year, which means that the majority of voting recommendations made to our investment teams are manual. EOS endeavours to engage around the vote with all companies on the watchlist for which it is considering recommending a vote against – this comprises 1089 companies, including around 325 in the core engagement programme. EOS will also discuss such cases with the relevant portfolio manager. We receive research from ISS, but also have access to our own information on our electronic platform, which captures meeting notes and documentation relevant to the company's engagement history and objectives.

EOS will also engage to identify any further relevant information that might inform the voting recommendation and has regular conversations with our investment teams about the reasons for their views on particular votes. We will vote 'for, by exception' to our voting policy when we judge that we will further the engagement and likely achieve beneficial change by doing so.

Votes are escalated when especially important for the company/complex, or when a disagreement or potential conflict of interest arises with the recommendation received from EOS. For our investment teams, the voting recommendation provided by EOS will inform their assessment, but they will make their final judgement independently. On the rare occasion that there are disagreements between investment teams and/or EOS on the appropriate voting recommendation or decision, the matter is logged and escalated for consensus to be reached at the director level. We expect votes cast by our investment teams to be consistent with the voting recommendations we provide to our stewardship clients, who request to receive voting recommendations. In such cases, the rationale for divergence will be documented. As described under Principle 3, we have escalation processes in place when there are different views between EOS and our investment teams, or when conflicts of interest arise in the course of fulfilling our commitment to acting as good stewards of those companies in which we invest.

Clients with segregated mandates have the option to carry out the voting themselves, or to benefit from the voting recommendations and decisions of the relevant investment team, based on EOS' recommendations. Underlying clients of our pooled funds are not able to override the investment team's vote or to vote their share separately.

Securities lending

We do not, as a matter of course, participate in securities lending transactions. We endorse best practice principles, such as the Securities Lending Code of Best Practice issued by the ICGN.

Listed equities: 2022 Voting

Our 2022 voting records and rationale

Our voting records are published online in arrears. This ensures that we are transparently accountable, but that our dialogue with companies around voting issues is not compromised. The records include all voting decisions of FHL. These records relate to the voting decisions of the FHL teams on behalf of FHL funds and clients. Information on the voting recommendations made by EOS to EOS voting service clients can be found in the EOS Stewardship Report. Company meetings where we have recommended voting in line with management on all resolutions are condensed. In 2022, we cast votes at 765 meetings involving 8,431 resolutions.

Figure 50. Global 2022 voting statistics

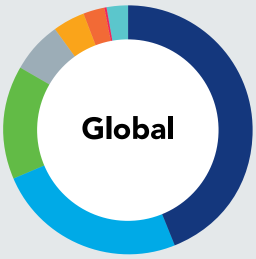
- Total meetings voted in favour **35.8%**
- Meetings where voted against (or voted against AND abstained) **56.5%**
- Meetings where abstained **0.4%**
- Meetings where voted with management by exception **7.3%**

Source: FHL, as at 31 December 2022.

Votes against the board: We provide the rationale behind our decision when we have voted against management on one or more resolutions. We seek to be supportive of boards and to recommend votes in favour of proposals unless there is a good reason not to do so. This is in accordance with our voting policies and global or regional governance standards. We will vote against management if, by doing so, we are striving to protect long-term shareholder interests.

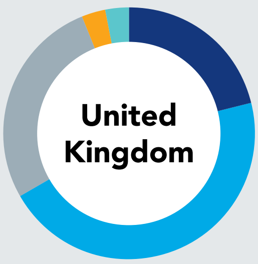
For example, we again tightened our diversity and inclusion voting policies, encouraging greater representation of women and ethnic minorities on boards and in leadership teams. We voted against proposals at companies including Amgen, Beijing Enterprises and China Mengniu Dairy for insufficient gender and ethnic diversity.

Figure 51. Breakdown of votes against by region

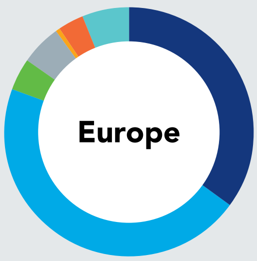


- Board structure **44.1%**
- Remuneration **24.5%**
- Shareholder resolution **14.7%**
- Capital structure and dividends **6.8%**
- Amend Articles **4.2%**
- Audit and Accounts **2.8%**
- Investment/MandA **0.2%**
- Other **2.6%**

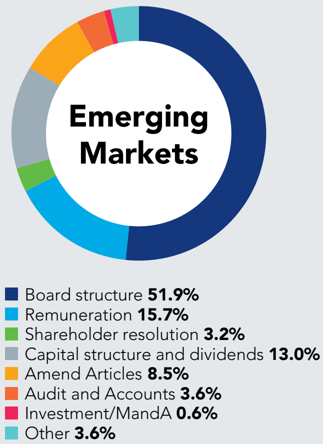
- Board structure **70.0%**
- Remuneration **8.5%**
- Shareholder resolution **4.6%**
- Capital structure and dividends **3.1%**
- Amend Articles **6.2%**
- Audit and Accounts **6.9%**
- Other **0.8%**

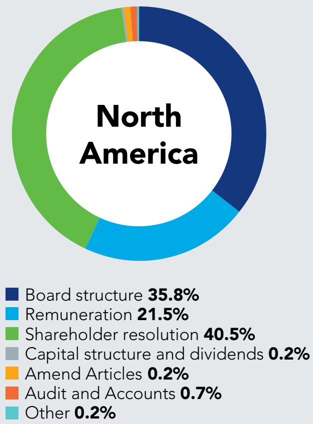


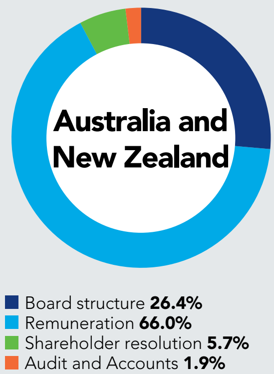
- Board structure **21.2%**
- Remuneration **45.5%**
- Capital structure and dividends **27.3%**
- Amend Articles **3.0%**
- Other **3.0%**



- Board structure **35.1%**
- Remuneration **45.7%**
- Shareholder resolution **4.1%**
- Capital structure and dividends **5.3%**
- Amend Articles **0.4%**
- Audit and Accounts **3.3%**
- Other **6.1%**







Source: FHL, as at 31 December 2022.

Votes not in line with our policy: We retain the ability to go against our high-level policy when warranted. This is on the basis of particular company circumstances or engagement insights, to best serve the interests of long-term shareholders, like us. If EOS engagers are considering whether to recommend a vote that is not in line with our policy – and there is not a clear and understood reason for this (see below on voting by exception) – then they will escalate this to a more senior team member. In these cases, engagers record in our Engagement Management System that they have consulted a senior engager. When a potential conflict is identified, the matter is escalated in line with our Conflicts of Interest policy, following the process outlined earlier under Principle 3.

On occasion, our policy may suggest a vote against management, but engagement insight suggests otherwise – for example, a company may have committed to making a change, with a view to implementing said change the following year. We may, here, vote by exception to our policy. These instances are highlighted in our voting disclosures and are within the scope of our overall voting policy.

- We continued to push for improved board independence this year. In some markets, we now seek higher proportions of independent directors, such as 40% in Mexico and 50% in Brazil for the Novo Mercado listing segment, where corporate governance requirements are more stringent. Through our engagements, we are able to consider not just the proportion of independent members but also how they function in practice. Some boards fulfil the independence criteria at a technical level, but this does not always result in sufficient genuinely independent thought on the board. However, there are times when engagement remains the best way forward, even if there are some concerns about independence. For example, at Samsung Electronics, nearly half the board are executives, reducing the proportion of independence directors. However, we ultimately supported the election of proposed executive board members, given a range of recent positive governance developments, including the implementation of a new compliance framework. All proposals passed. We will continue to engage for an increase in the proportion of independent directors.
- At retailer Ocado, we voted for the chair, by exception to our policy, on the basis that gender diversity on the board continues to fall below our minimum expectations. We gave conditional support on the basis that the company has made progress over the last year and commits to go further, but we advised that this was likely to be the last year that we would be supportive of the chair if the board remains below 33% women.
- Legal requirements on board and senior management diversity are tightening in South Korea, Malaysia and Hong Kong. We voted against companies where our expectations were not met. At AIA Group and Ping An Insurance, however, we recommended support for directors by exception to our policy to recognise their progress in reaching a level of diversity that is just below our minimum expectations. Both proposals were accepted.
- At retailer Walmart, we voted for the chair of the nominating and governance committee by exception to our policy as, although the company appeared not to meet some of our expectations regarding human rights, the company agreed to our request to speak with a board member about human rights and employee oversight, indicating we may see progress through engagement. We will review again whether vote action is appropriate at next year's AGM.

Shareholder resolutions: We support the selective use of shareholder resolutions, as they can be a useful tool for communicating investor concerns and priorities, asserting shareholder rights or supplementing or escalating direct engagement with companies. We consider such resolutions on a case-by-case basis and encourage boards to engage with serious, committed long-term shareholders like ourselves. When considering whether or not to support resolutions, we consider factors which help to ensure that the proposal promotes the interests of long-term shareholders. These include what the company is already doing or has committed to do, the nature and motivations of the filers (if known) and what potential impacts – positive and negative – the proposal could have on the company if implemented. When boards interact in an active and engaged way with shareholders on issues that affect the long-term value of companies, we see less need to file or support shareholder resolutions.

In our experience, shareholder proposals can facilitate a dialogue with issuers, and we welcome these opportunities, where appropriate, whether we vote in favour of the resolution itself or not. We expect boards to address the issues raised by shareholder proposals, which receive significant support, or where they are material to the company. In addition, we view any failure to implement a shareholder proposal that has received majority support as a clear indication that the board of directors is not fulfilling its obligations to the owners of the company.

When we vote in favour of a shareholder resolution and there is no management recommendation, this is classed as a vote against management in our disclosures. This is to ensure that we do not under-report conflicts, although in some instances it may not be voting against what management would have wanted.

We support the selective use of shareholder resolutions, as they can be a useful tool for communicating investor concerns and priorities, asserting shareholder rights or supplementing or escalating direct engagement with companies.

We also initiate shareholder proposals in markets where it is relevant to do so, typically in Germany and the US, either as lead filer or as co-filer alongside other investors. Consistent with our intelligent voting approach, this typically forms part of a wider engagement with the company and is used as a tool for leverage in EOS' dialogue with management.

Examples from 2022 include:

- This year we saw record numbers of shareholder proposals at major US companies, including many on social issues, against a backdrop of soaring inflation and a tumultuous political environment. These covered topics such as paid sick leave, employee representation on boards, reproductive rights risks, unionisation, and animal welfare, some of which were supported by high-profile campaigns.
- For example, at retailer TJX, we supported a shareholder proposal to adopt and publicly disclose a policy that all employees, part- and full-time, accrue some paid sick leave that can be used after working at TJX for a reasonable probationary period. This policy should not expire after a set time or depend on the existence of a pandemic. Whilst it was rejected, the proposal garnered over 33% support showing that shareholders increasingly view paid sick leave as a basic human right.

- At video game developer Activision Blizzard we supported two shareholder proposals that could help the company to improve its management of human capital, human rights and associated risks following recent sexual harassment and discrimination allegations. The first urged the board to adopt a policy of nominating a director candidate selected by the company's non-management employees. We agreed with that an employee representative on Activision's board would be particularly beneficial given the recent allegations, however the proposal was rejected with 92% voting against. The second proposal asked for a report on efforts to prevent abuse, harassment and discrimination. This proposal was accepted, with 63% support.
- At retailer Walmart, we supported a shareholder proposal asking for a report on the alignment of racial justice goals and starting wages. We strongly recommended that Walmart consider increasing the transparency of its employee pay disclosures, including gender and ethnic pay gap data, by reporting in line with the Workforce Disclosure Initiative framework. A similar proposal last year received 12.5% support, and this – whilst rejected – attracted 13.2% support.
- Also at Walmart, we evaluated a controversial proposal asking for a report on the potential impacts of restrictive reproductive healthcare legislation. After much debate and engagement, we recommended a vote against, as we believed the company's resources would be better spent on enhancing associated healthcare benefits. The proposal was rejected with 86% against. When engaging with Walmart on this, we were reassured that it had a process for assessing upcoming legislation.
- More Civil Rights Audit (CRA), Racial Equity Audit (REA) and Racial Justice Audit shareholder proposals were filed this proxy season. In 2022, we supported the Apple CRA shareholder proposal, which was accepted with 54% shareholder support. Where we assessed that the intention of a proposal was to undermine racial equity, such as those at Bank of America and Citigroup, we opposed. Both proposals were rejected with 98% and 96% against respectively. In 2022, ahead of the company's annual meeting, we engaged with Amazon on a shareholder proposal that publicly highlighted the company's tax avoidance strategies. An exempt solicitation filed with the Securities and Exchange Commission by co-filers Pensions & Investment Research Consultants (PIRC), OIP Trust and Greater Manchester Pension Fund, stated that Amazon does not disclose revenues, profits, or tax payments in non-US markets in its standard reporting and has faced increased attention from tax authorities[74]. With management opposing the proposal it was defeated, although according to our calculations it gained 17.5% of the dissident vote[75]. It is worth noting that the last tax transparency shareholder proposal at a major multinational (Google in 2014) received support of only 1%[76,77].

Other notable votes: There are other instances when votes are notable due to the outcome of the resolution, the level of dissent or the subject matter of the vote. The shareholder resolutions described above are examples of this, as are the following examples:

- With economies recovering in several major markets in 2021, we saw a resurgence in some executive pay packages. In North America, EOS continued to recommend opposing the majority (78%) of say-on-pay proposals on the basis that practices across the region remained materially misaligned with our principles. For example, we voted against executive pay at Netflix. Some 73% of shareholders rejected the pay proposal, so we will expect a robust response from the compensation committee in the coming year.
- We voted against Fresenius Medical Care AG & Co KGaA discharging the supervisory board members and the personally liable partner from their liability. We opposed the discharge from liability in 2019, when we had concerns about charges of bribery and the company's apparent failure to maintain proper internal controls. The current lawsuit brought by the company's former global chief legal operations officer, who claims that the company demoted and dismissed him after he blew the whistle on the company's alleged embezzlement and waste of company funds, renews our concerns. While we recognise that the lawsuit has yet to reach its conclusion, we did not believe discharging all relevant parties from liability was in shareholders' best interests at this time. This was a significant vote as it is a relatively unusual step to oppose the discharge of the supervisory board.

[74] Microsoft Word - Exempt Solicitation Amazon 2022-04-14 (unpri.org)
[75] United States Securities and Exchange Commission, 'Amazon.com, Inc.', (May 2022)
[76] Forbes, 'Microsoft And Cisco Face Shareholder Pressure Over Public Disclosures', (June 2022)
[77] United States Securities and Exchange Commission, ' Google Inc.', (May 2022)

The proportion of shares voted and votes withheld

We aim to vote either in favour or against a resolution and only to abstain in exceptional circumstances, such as when our vote is conflicted, a resolution is to be withdrawn or there is insufficient information upon which to base a decision. We voted 99.2% of all votable shares[78]. There are a very small minority of meetings where we may not successfully execute votes. In 2022, this included meetings where Powers of Attorney were missing or late, as well as instances of share-blocking, where we chose not to vote in order to avoid the risk to trading. There was also an operational oversight leading to a no vote instruction being placed on ballots.

Monitoring our shares and voting rights

As highlighted previously, EOS' approach is to focus engagement resource on the meetings of greatest interest and materiality to our investment teams and third-party stewardship clients. Each year we compile a list of the highest-priority companies where we want to ensure that our engagers are manually reviewing each agenda item for any vote that comes up. These are known as watchlist companies and are comprised of our engagement programme firms, companies of particular interest/sensitivity or those where our investment teams or EOS third-party clients represent significant holdings (in absolute terms or as a percentage of the company's voting rights). The voting watchlist represents a majority of EOS' AUA by value. EOS uses ISS to identify the meetings for which we have voting rights. EOS ensures that these accounts are suitably set up for voting.

> **EOS leverages and builds on ISS research and infrastructure (including the ISS ProxyExchange platform) and seeks to add value primarily by selectively escalating the most important or difficult voting recommendations.**

Monitoring service providers

We use the services of ISS to provide research on all companies for which EOS makes voting recommendations. EOS leverages and builds on ISS research and infrastructure (including the ISS ProxyExchange platform) and seeks to add value primarily by selectively escalating the most important or difficult voting recommendations (based on the materiality of holdings and the nature of the issues under consideration), engaging with companies and operating voting policies and approaches that more closely align to our views than ISS's benchmark policy.

The recommendations that our investment teams and EOS third-party clients receive are, in the first instance, based on ISS' research using our voting guidelines. This is then overlaid with our intelligent voting approach. Engagers are deployed to add insight and value to a specific subset of these meetings – those on EOS' watchlist – by considering the voting recommendations approach in light of the specific company context and the engagement. As described earlier, our equity holdings are added to the EOS watchlist at the beginning of each year. As a result, the majority of the voting recommendations made to our investment teams are manual. ISS services are monitored by EOS through daily communication, ISS scheduled reports providing oversight of voting performance, regular service meetings, client voting account reconciliation and audit reviews conducted periodically by EOS on automatic voting instructions submitted by ISS across EOS client accounts.

[78] Individual shares may be double counted where there were multiple meetings during 2022

Fixed income: how we use our investor rights

Fixed Income

Our Real Estate Debt team does not habitually buy into deals that have already been structured. As a result, we have the opportunity to negotiate transaction documents ourselves. We seek to find mutually beneficial outcomes, while protecting the interests of our clients. Our approach to seeking amendments differs case-by-case, depending on the nature of the amendment. We aim to embody the values captured in the Federated Hermes Pledge in all of our dealings.

Meanwhile, our direct lending loan agreements are bespoke, and negotiated between ourselves and the borrower after we have conducted our due diligence. We construct the loan documentation to align it to the specific borrower and their behaviours, including issues identified in our ESG due diligence. Each loan contract is different, and we may require the borrower to change certain behaviours (including in relation to ESG risks) as part of the conditions of the loan. While we are not able to initiate an amendment of the loan terms once the financing has been provided, key opportunities where we can seek to influence the company's behaviour after the contract has been agreed can arise when the borrower seeks our permission to alter the loan terms – for example, because the company wishes to make an acquisition. Outside of these amendment events, we will engage with management or the private equity shareholder to influence behaviours via the resources we have internally.

For credit and structured credit markets, the chance to influence such documentation comes at the time of primary issuance. If the documentation is unfavourable to the interests of creditors, this is a risk factor and we will engage with the company, as well as the originator of the assets and arranging bank for structured credit, to improve it. If we are unable to achieve these changes, they will become a factor in our investment decision and will influence how we choose to allocate our risk. For example, in December 2022 an investment bank bought a transaction through an arranging bank; the transaction came through as private which the team raised as a potential governance issue. Since this instance, we have lowered our exposure to the bank and we continue to discuss with them on a regular basis to ensure the platform is adequately managed.

Within structured credit, an essential part of the due diligence process is to review the prospectus and transaction documents. These govern the noteholders' relationship to the special purpose vehicle (SPV), the assets within and the related counterparties. We pay particular attention to the ability of the SPV to pay interest and the principal on notes under multiple stress scenarios, which includes an assessment of the triggers and covenants in the deal and our enforcement rights over the assets in the collateral pool. We also ensure the transaction complies with all relevant regulation and any appropriate safeguards for future changes to regulations. Once the prospectus and transaction documents have been thoroughly reviewed, we work alongside the issuers, originators, sponsors and/or arranging banks to secure any amendments in the documentation that we feel are necessary to protect our position as a noteholder in the capital structure.

We seek access to information provided in all documentation through engagement with the company, as well as the originator of the assets and arranging bank for structured credit. The more information we have, the less uncertainty there is. This, in turn, may increase our willingness to take on more risk.

Impairment and enforcement rights

The relevant rights for real estate debt are the control over cash flows within the Borrower structure and enforcement rights, which are available when there is a breach of covenants. We only use enforcement as a last resort – in the first instance, we seek to engage and agree an alternate approach with the party in breach. As we are often the sole lender, we are able to hold these bilateral conversations directly with the recipient of the loan. After the good experiences with our borrowers in 2021, we have continued to work with them during the course of 2022. Covenant breaches triggered by the effects of Covid-19 did not lead to missed interest payments in our portfolio. No enforcement was required as a result of the pandemic disruption. We continue to manage our loan portfolio with the long-term interests of our clients in mind.

As each of our direct lending loan agreements is bespoke, our specific rights can vary. If a borrower defaults on a loan – for example, if an interest payment is missed or the borrower fails a covenant test – our Direct Lending team will enter into a negotiation with both the shareholder and the management team of the borrower. We will seek a positive outcome for all parties involved in the negotiation, although we will always act in our investors' interests in line with our fiduciary duty and applicable requirements. We have a right to take security over the shares of the borrower in such circumstances but will always seek to find other solutions before taking this action.

In a distressed situation, value is impaired and will be redistributed among financial stakeholders. When we invest, we seek to understand the recovery risks associated with the impairment of assets. If a company is in distress, an organised group of bondholders can decide whether to enforce their rights or not, although this is very rare. We want the appropriate right to recovery of a failed business. In some cases, bond documentation is written so that there is a carveout or 'trap door', meaning that the assets that support the bond we are buying can be transferred outside of the restricted group. This would be a disincentive to invest, and we would communicate this to the bank or company. Under certain situations we would not invest, as we would not have what we deem to be appropriate rights under a distressed scenario.

Sustainability and investment glossary

Active Management
Actively selecting investments based on an investment team's own judgment, research and experience rather than an asset's index weighting. An actively managed fund is not a tracker fund.

Active Ownership
Actively exercising shareholder rights by voting at meetings and engaging with companies to encourage responsible corporate behaviour.

Active Share
A measure of the percentage of a fund that is invested differently than it benchmark. It expresses how active the fund manager is.

Advocacy
Actively seeking to influence change in public policy in the interests of investors and the wider society by engaging with policymakers, regulators and industry bodies on a range of issues. These include: the financial system and investment industry, corporate governance, business purpose, climate change, inequality and inclusion.

Carbon footprint
A measure of a group, individual or a company's total greenhouse gas emissions.

Carbon pricing
The economic cost of emitting CO_2 into the atmosphere, either in the form of a fee per unit of emissions or an incentive for reducing emissions.

COP
An annually held UN conference. The Paris Agreement was negotiated at the 21st conference in 2015.

Corporate governance
The system of rules, practices and processes by which a company is managed, directed and controlled.

Corporate responsibility
A company's duty to operate in a manner that does not harm the environment or society, and to take responsibility for its actions and their impact on employees, stakeholders and communities.

Divestment
A form of negative screening through the process of selling investments that are not aligned with ESG or other objectives.

Engagement
A purposeful, long-term dialogue between a company and its shareholders that aims to change or influence the way in which a company is run, in order to enhance the value of the company and generate positive environmental and social outcomes.

ESG
Environmental, social and governance issues, which constitute the three pillars of responsible investing.

ESG integration
A responsible investing approach which systematically and consequentially integrates financially material ESG factors and engagement insights alongside traditional performance factors in investment analysis and investment decisions.

ESG leaders
A responsible investing approach which invests in assets with an above-average ESG performance, thereby creating a portfolio with a better ESG performance than the benchmark.

Exclusions Policy
An investment firm or team's policy to exclude investments from specific sectors, business activities and/or behaviours from their investment universe.

Exclusions investing
A responsible investing approach which excludes investments from specific sectors, business activities and/or behaviours from the investment universe.

Fiduciary duty
Fiduciary duties ensure that those who manage other people's money act in the interests of beneficiaries, rather than serve their own interests.

Green bond
Debt securities which are used to fund projects with environmental benefits.

Greenwashing
The act of making a product, service or organisation seem more environmentally friendly than it actually is.

Impact investing
Investing in order to achieve a measurable, positive impact on the environment or society, in addition to generating financial returns.

Integrated reporting

Company reporting that integrates both sustainability and financial information in one source.

Negative screening

An investment approach that excludes some companies or sectors from the investment universe due to their policies, actions, products or services.

Paris Agreement

An international accord, agreed at COP 21 in Paris in 2015, that aims to keep the rise in global average temperatures below 2°C compared to pre-industrial levels, while pursuing efforts to limit the increase to 1.5°C.

Principles for Responsible Investment

Developed by investors, the six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a set of possible actions for incorporating ESG issues into investment practices.

Positive screening

An investment approach that seeks to include companies from the investment universe due to their policies, actions, products or services.

Proxy voting

A ballot cast by one person on behalf of the others. As many shareholders cannot attend annual and special meetings, companies allow shareholders to cast proxy votes.

Responsible investing

An investment approach that considers ESG related factors and incorporates engagement and stewardship activities to better manage risk, create positive societal impacts and generate sustainable, long-term financial returns.

Shareholder activism

A form of public engagement by which investors use their shareholdings to promote change at a company and achieve certain goals.

Shareholder Rights Directive II

A directive from the European Union that aims to strengthen the position of shareholders and to ensure that decisions are made for the long-term stability of a company.

Stewardship

A dialogue between shareholders and boards that aims to ensure that the company's management and strategy are effective and aligned with shareholders' interests. A focus on ESG issues helps to mitigate risk and produces positive outcomes for society and the environment.

Sustainable investing

A long-term, active approach to investing that is efficient and intergenerationally fair to all beneficiaries and stakeholders, combining an analysis of ESG factors and active ownership.

Stewardship codes

Codes that offer guidance on investor engagement and transparency about how investors should exercise their ownership and governance responsibilities. The first stewardship code was introduced in the UK in 2010 and almost all OECD jurisdictions now have national codes or principles.

Sustainable Development Goals (SDGs)

Convened by the UN, the Sustainable Development Goals (SDGs) are the blueprint to achieve a better and more sustainable future for all. They address the global challenges we face, including those related to poverty, inequality, climate change, environmental degradation, peace and justice. There are 17 goals, 169 targets, and progress towards these targets are tracked by 232 indicators inherent in the goals.

Thematic investing

There are two broad types of thematic investing:
Thematic investing (social or environmental):An investment approach that promotes specific social or environmental themes, and often allows investors to express their values. It can exclude or target the best ESG performers or invest in the most impactful companies.

Thematic investing (megatrends):
An investment approach that focuses on powerful, long-term global themes or megatrends that are both structural and transformative in nature.

UN Global Compact

A global corporate sustainability initiative that calls on companies, investors and other participants to align their strategies and operations with universal principles on human rights, labour, the environment and anti-corruption.

Voting

Exercising the rights given to equity holders in companies to vote on business matters and director elections during annual and extraordinary general meetings.

The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Any investments overseas may be affected by currency exchange rates. Past performance is not a reliable indicator of future results and targets are not guaranteed.

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Federated Hermes
Limited

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, where possible, to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important 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

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