HERMES
INVESTMENT MANAGEMENT

Overview, October 2014

Hermes EOS

Services Overview

Hermes EOS is the leading provider of integrated global voting, corporate engagement and stewardship services. We are able to provide high quality services addressing the requirements of the Principles for Responsible Investment (PRI) and Stewardship Codes around the world in a cost-effective manner by operating a shared resource platform that serves 41 like-minded institutional investors with over £120.3/US$195bn[1] in Assets under Advice and combined holdings in over 10,000 companies globally.

In joining Hermes EOS' engagement platform, investors share the costs and benefits of this world class stewardship resource, enabling them to achieve more together than they would independently. We provide a fully integrated service covering voting, engagement and public policy work. We are also able to help clients in drafting voting and engagement policies and by providing screening on a range of ESG issues and international treaties and legal frameworks.

Our 24-person team includes industry executives, senior strategists, corporate governance and climate change experts, fund managers and lawyers. Our services are described in more detail below.

Policy advisory

We have worked with many of our pension fund clients in developing their responsible ownership and investment policies. Each policy is individually tailored and can be light touch or highly bespoke, with some going into considerable detail and others taking a more high level approach. We work with our clients to identify the type of policy that is most appropriate to their needs, including key issues to be covered and the required level of detail.

We draw on our extensive experience and expertise in helping pension funds to develop comprehensive ESG policies. Our key focus is in ensuring these reflect the individual fund's outlook and objectives and that the policies are practicable and can be readily implemented.

Portfolio screening

We provide screening and high level issues-based reporting through our 'Controversial Company Reports' (CCR). This identifies where companies have committed material and ongoing violations of clients' policies. Our screening methodology is built around internationally recognised frameworks such as the UN Global Compact Principles, ILO labour standards and the Oslo and Ottowa treaties on controversial weapons and is refined according to our clients' own policies.

The output of this screen is a matrix list of the companies violating our clients' policies, ranked according to the severity of the violation and with an assessment of the likelihood of the company responding to engagement. This high level assessment is supported by individual reports on the underlying companies, focusing on the issues identified.

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[1] As at 30 September 2014

Corporate engagement

We provide corporate engagement services across public equity and corporate fixed income holdings. Our high quality engagement resource, cooperative business model and good overlap in portfolio holdings across clients forms a strong basis on which to deliver engagement services that will help institutional investors to meet their objectives. Specifically, Hermes EOS' engagement services comprise the following elements:

- Analysing clients' portfolios to identify candidates for engagement. We select companies with consideration of our clients' responsible investment policies, the size of their holdings and the likelihood of success in engagement;
- Conducting a programme of engagement with companies in which clients are invested where we consider it both desirable and feasible to influence change. Engagement typically entails a broad range of activities aimed at encouraging companies to acknowledge and address material ESG-related risks that we have identified through our portfolio analysis. It will in all cases involve direct contact with corporate officers at the appropriate level, and often requires consistent action over a number of years;
- Working with other shareholders as appropriate.

We record our engagement activity and measure engagement progress in the context of pre-defined objectives and a four-stage milestones framework. This forms the basis of our reporting to clients. The total number of companies engaged in any given year will vary based on our assessment of the desirability and feasibility of engagement.

Hermes EOS provides an intelligent voting service which integrates engagement around the vote

Voting

We provide an intelligent voting service which integrates engagement around the vote with engagement where we are intending to vote against or abstain. This can include discussions with the company where we consider voting against management and a follow-up in writing or otherwise after the vote, communicating our reasons for voting against. We may also seek to engage with the company around voting related matters.

Engagement on public policy and industry best practices

It is in the interests of investors to seek to influence a number of areas of public policy and certain types of industry best practices. Where it is desirable and feasible, we will undertake to:

- Engage on policy issues and write responses to consultations on behalf of clients;
- Provide clients with the opportunity to endorse or sign on to responses to consultations and/or thought pieces where practical;
- Provide the Scheme with written responses to consultations that they may use as a basis for their own response.

Client services

We provide the following services to clients as part of our package of voting and engagement services:

- Reporting on policy issues and any responses to consultations;
- A weekly news by email which provides updates on our engagement activity;
- Client specific quarterly reports on engagement activity;
- Client specific annual reports on engagement activity;
- Quarterly client review meetings;
- An annual review and presentation to clients' boards or relevant committees
- Monthly client calls on engagement highlights
- Responding to requests and queries; and
- Access to Hermes EOS' client website which provides real-time access to our engagement activity database
- Attendance at the bi-annual Hermes EOS Client Advisory Council.

Excellence. Responsibility. Innovation.

Hermes Investment Management

Hermes Investment Management is focused on delivering superior, sustainable, risk-adjusted returns – responsibly.

Hermes aims to deliver long-term outperformance through active management. Our investment professionals manage equity, fixed income, real estate and alternative portfolios on behalf of a global clientele of institutions and wholesale investors. We are also one of the market leaders in responsible investment advisory services.

Our investment solutions include:

Alternatives

Commodities, Hedge Fund Solutions, Infrastructure and Private Equity.

Equities

Asia, Emerging Markets, Europe, Global and Small & Mid Cap.

Fixed Income

Global High Yield Bonds, Multi Strategy Credit, UK Government Bonds and UK & Global Inflation-Linked Bonds.

Real Estate

International Real Estate, Pooled Funds, Segregated Mandates, UK Real Estate and UK Real Estate Debt.

Responsible Investment Services

Corporate Engagement, Intelligent Voting, Public Policy Engagement and PRI.

Offices

London | New York | Singapore | Sydney

Why Hermes EOS?

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

Contact information

Business Development

United Kingdom	+44 (0)20 7680 2121	**Africa**	+44(0)20 7680 3726	**Asia Pacific**	+65 6808 5858
Australia	+61 (0)2 8079 2091	**Canada**	+1 212 542 3469	**Europe**	+44 (0)20 7680 2121
Middle East	+44 (0)20 7680 3726	**United States**	+1 212 542 3469		

Enquiries marketing@hermes-investment.com

Commentary, December 2014

Hermes EOS

Hermes EOS' Climate Change Activities 2013-2014

Overview

Climate change has been described by Nicholas Stern as "the greatest market failure the world has seen"[1]. At present, the world's emissions trajectory remains poised to increase global temperatures by 3.2°C to 5.4°C in 2100, according to a recent Intergovernmental Panel on Climate Change (IPCC) report. We are predicted to reach a temperature rise of more than 2°C in the next 30 years, which increases the likelihood of extreme and irreversible weather events. At 4°C, the World Bank has predicted the inundation of coastal cities, increasing risks for food production, unprecedented heat waves, substantially exacerbated water scarcity, increased frequency of high-intensity tropical cyclones and the irreversible loss of biodiversity. To keep global warming to below 2°C, the global economy needs to cut carbon intensity by 6% every year between now and 2100. It is therefore widely acknowledged that climate change will have a broad-ranging impact on economies and financial markets over the coming decades. Due to the potentially significant long term financial implications for asset owners and their beneficiaries , Hermes EOS has been undertaking a range of public policy, corporate engagement and best practice activities to help influence actions towards keeping global warming, if not to 2°C, to a minimum.

Corporate Engagement

We have focussed our corporate engagement efforts on the energy and extractive industries. According to the IPCC, the power and industry sectors combined have the biggest carbon footprint, accounting for about 60% of total, global CO2 emissions. Since the beginning of 2014, EOS has engaged with 33 companies on the topic of climate change. This has been done through a variety of media, but most notably as a result of an Institutional Investors Group on Climate Change (IIGCC) and sustainability leadership organisation, Ceres initiative. The Carbon Asset Risk Initiative, a collaborative engagement project that sent 45 letters to the world's biggest oil, gas, coal and electric power companies, requested assessments of the financial risks that climate change poses to the companies' business plans in 2013. Following up these letters, Hermes EOS has engaged with some of the world's biggest emitters and extractive companies. Companies have included BP, Royal Dutch Shell, BG Group, Rio Tinto, BHP Billiton, Glencore, Anglo American, Chevron, Exxon, Statoil, Total and many others, with an acute focus on discussing and gaining a greater understanding of their exposure to "stranded assets".

What are "stranded assets"?

According to the Smith School of Enterprise and the Environment, "stranded assets are assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities and they can be caused by a variety of risks". Risks could include climate change or natural capital degradation, a change in resource landscapes such as the abundance of shale gas, new government regulations, such as changes to air pollution regulation, a fall in clean technology costs, evolving social norms and even changes to litigation or to fiduciary duties[2]. Furthermore, the world used over a third of its 50 year carbon budget of 886GtCO2, leaving only 565GtCO2 to be burnt. Fossil fuel reserves owned by the top 100 listed coal and top 100 listed oil and gas companies amount to 745GtCO2, leaving only 20% of total reserves to be burned unabated. The remaining 80% of assets are thus technically unburnable and therefore "stranded"[3]. Company valuation and credit ratings methodologies however do not typically inform investors about their exposure to these stranded assets. With many institutional investors being heavily exposed to fossil fuel companies either through passive holdings or traditionally constructed portfolios, it is imperative to understand where the biggest risks lie. Therefore encouraging energy and extractive companies to disclose their energy scenarios, and learning how they see themselves exposed to this issue, is the first step to understanding how their assets are exposed to stranding.

Engagement on stranded assets

"Stranded assets" has garnered much international attention in the past two years. But despite climbing up companies' agendas, disclosure has ranged considerably. Our engagement efforts have focussed on the biggest western oil and gas companies, as there is less scope for fruitful engagement with emerging market companies. Please see appendix for further information. Positively, there have been notable changes from the big players in the sector.

- Exxon Mobil a few years ago was a staunch climate change denier, but recently participated in a several hour long investor dialogue on the issue with a number of members of senior management and a greenhouse gas specialist from its strategic planning unit. We had a detailed conversation on its scenario planning for both climate change and energy demand and the company noted that it used more demanding carbon pricing than some of its peers.

[1] http://www.theguardian.com/environment/2007/nov/29/climatechange.carbonemissions
[2] http://www.smithschool.ox.ac.uk/research/stranded-assets/
[3] http://www.carbontracker.org/report/carbon-supply-cost-curves-evaluating-financial-risk-to-oil-capital-expenditures/

- Shell has spoken meaningfully about climate change, publicly agreeing that climate change is a human provoked issue, and has stated its proven reserves won't strand. It is however yet to disclose how its unproven reserves will be affected by the 'climate bubble'.
- On a recent site visit to Suncor, one of Alberta's largest oil sands operators, we learnt that over the longer term the company believes that carbon capture and storage will become viable, particularly once a material carbon price is in place. By wanting a more meaningful carbon price, $40 or higher, the company and industry is ahead of local policy.

Additionally, the miners in particular have been much more receptive to conversations and the disclosure of their scenarios – a result of their diverse portfolios leaving them open to positive business results, no matter which way the energy markets swing. We have had very useful conversations on scenario planning with Anglo American and BHP Billiton, where both companies have been keen to disclose their expanding scenario work and how the changing energy market could affect their strategies. The oil and gas companies, and unsurprisingly those with exposure to high capex operations, have however been less forthcoming especially on the detail of their scenario planning and how quickly the business will be able to respond to challenges arising out of climate change.

Unpicking this complex issue is part of an educational journey for investors. So far, the point where we and many other investors have reached is: useful conversations with companies, a greater understanding their thinking on the risks posed to their business models, the shadow carbon prices they are using and the scenarios which they use to test current and future assets. But global energy sources, generation, transport, technology and climate change legislation are changing and the next step will be for the companies to explain where they see their businesses in 10-20 years, and how their future capex investment plans are aligned with these future business models. We will continue to work with companies to understand their exposure, but also with other investors and relevant organisations to develop our thinking on the topic further.

Public Policy Engagement

Hermes EOS has also been undertaking public policy work through active participation in IIGCC's Public Policy Group and through United Nations Environment Programme Finance Initiative (UNEP FI)'s Investment Commission which we have chaired in 2013 and 2014. In 2013, as a result of the country's influence in the area, we met with German ministry officials to encourage their continued support for the European Union Emissions Trading Scheme (EU ETS). To gain a better understanding of European Union EU ETS policy movements, we hosted an IIGCC meeting with Eurelectric, the association of the electricity industry in Europe, and utility companies. In 2014 and in collaboration with the IIGCC, we invited the International Environment Agency to make a special presentation on energy sector investments to a large group of UK based investors. Through UNEP FI, we have been involved in a number of initiatives to improve company carbon disclosure including the Sustainable Stock Exchange (SSE) initiative and Friends of 47. We have also participated in forums which have encouraged investor assessment of their investment portfolios' carbon footprint. We attended a gathering of climate finance specialists, which included the chair of the UN Framework Convention on Climate Change (UNFCCC), to discuss investment solutions that will bridge the gap between the finance community and climate change solutions and later in the year, we joined some 340 global investors representing $24 trillion in assets to sign the biggest ever global investor statement on climate change, calling on governments to take action that supports investment in clean energy and climate solutions. We have also asked governments to support a new global agreement at the 2015 UN Climate Change Conference talks in Paris, in addition to national and regional policy measures to reduce carbon emissions.

We believe positive momentum is building and will further intensify our public policy engagement efforts on all climate change related issues and there will be particular focus on countries that are influential in ensuring greater movement is made on global and national emission reductions.

Best Practice

Advances in a range of new technologies make the wider scale adoption of decentralised and alternative energy solutions a real possibility. The knock-on effects of this transition have the potential to deflect global demand for electricity and fossil fuels away from current estimates. Technological advances and cost reductions of decentralised energy system made up of, say, photovoltaic, electric vehicles and battery storage, cannot be ignored as a viable option which can compete with incumbent supplies in the next 15 years, and we have noticed more recently that many sell-side research papers highlight the positive outlook for renewables.

Accordingly, as part of the IIGCC Climate Risk group, we have been working with Legal & General Investment Management, F&C Investment Management and the IIGCC to raise awareness around the need for more research. Before the end of 2014, the IIGCC will release a request for tools, asking the sell-side/broker market to provide further research on the impact that these technologies could have on the oil and gas, mining and utility sectors, should they become more widespread and attractive to investors. The output of this work will not only highlight to investors how the energy and extractive sector future business models may be affected, but it may also showcase where potential renewable investment opportunities may lie for investors.

Conclusion

As next year's climate conference in Paris approaches, where the world will come together to discuss either reaching a global agreement or combining national commitments to reduce greenhouse gas emissions, climate change and carbon reduction will increase greatly in prominence. We continue to explore other avenues for our work in this area, and intend to work with other investors, associations and public policy makers to help keep global warming to a minimum.

Appendix

Companies engaged with regarding climate change in 2014 (in bold specifically on stranded assets and climate change scenario modelling):

Company name	Region	Sector
BG Group PLC	United Kingdom	Energy
BP PLC	United Kingdom	Energy
Chevron Corp	North America	Energy
Exxon Mobil Corp	North America	Energy
Lukoil OAO	Emerging Markets	Energy
Marathon Petroleum Corp	North America	Energy
Occidental Petroleum Corp	North America	Energy
PetroChina Co Ltd	Emerging Markets	Energy
Phillips 66	North America	Energy
Royal Dutch Shell PLC	United Kingdom	Energy
Spectra Energy Corp	North America	Energy
Statoil ASA	Europe	Energy
Suncor	North America	Energy
Total SA	Europe	Energy
Tullow Oil PLC	United Kingdom	Energy
Valero Energy Corp	North America	Energy
Anglo American PLC	United Kingdom	Materials
BHP Billiton PLC	United Kingdom	Materials
Glencore PLC	United Kingdom	Materials
MMC Norilsk Nickel OJSC	Emerging Markets	Materials
OceanaGold Corp	North America	Materials
Rio Tinto PLC	United Kingdom	Materials
Centrica PLC	United Kingdom	Utilities
CLP Holdings Ltd	Emerging Markets	Utilities
Duke Energy Corp	North America	Utilities
Korea Electric Power Corp	Developed Asia	Utilities
National Grid PLC	United Kingdom	Utilities
SABMiller PLC	United Kingdom	Food Beverage & Tobacco
East Japan Railway Co	Developed Asia	Transportation
Easyjet PLC	United Kingdom	Transportation
Guangzhou Automobile Group Co Ltd	Emerging Markets	Automobiles & Components
National Australia Bank Ltd	Australia & New Zealand	Banks
Berkshire Hathaway Inc	North America	Diversified Financials

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Our investment solutions include:

Private markets

International Real Estate, Pooled funds, Segregated mandates, UK Real Estate, UK Real Estate Debt, Infrastructure, Private Equity.

High active share equities

Asia, Global Emerging Markets, Greater China, Europe, Global and Small & Mid Cap.

Specialist fixed income

Global High Yield Bonds, Illiquid Credit, Multi Strategy Credit, UK Government Bonds and UK & Global Inflation-Linked Bonds.

Multi asset

Multi Asset Inflation.

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Contact information

Hermes EOS

Freddie Woolfe +44 (0)20 7680 2121 freddie.woolfe@hermes-investment.com

Business Development

United Kingdom	+44 (0)20 7680 2121	**Africa**	+44 (0)20 7680 2205	**Asia Pacific**	+65 6808 5858
Canada	+44 (0)20 7680 2136	**Europe**	+44 (0)20 7680 2121	**Middle East**	+44 (0)20 7680 2205
United States	+44 (0)20 7680 2136				

Enquiries marketing@hermes-investment.com