OUTCOMES BEYOND PERFORMANCE

HERMES SDG ENGAGEMENT EQUITY FUND

2018 Annual Report

Hermes Investment Management
March 2019

For professional investors only

www.hermes-investment.com

HERMES
INVESTMENT MANAGEMENT

HERMES SDG ENGAGEMENT EQUITY FUND

Launched in January 2018, the Hermes SDG Engagement Equity Fund has the dual purpose of delivering attractive returns and measurable real-world impact. We seek this by targeting both traditional financial performance goals as well as aiming for positive social and environmental change by engaging with companies to help deliver the Sustainable Development Goals (SDGs).

Consequently, we have a number of core investment beliefs that underpin our strategy, including:

- Public companies have a significant role to play in, and can benefit from, backing the SDGs to help address global problems such as persistent poverty, growing inequality and climate change. Few, if any, companies are insulated from these challenges, and most have networks which stretch beyond the border of the country in which they are incorporated or listed
- The enduring success of companies is intertwined with that of the economies, communities and environments in which they operate and in which their employees and customers live
- Companies that recognise their responsibility towards society will be rewarded with greater brand loyalty, more motivated employees and more innovative product developments – and ultimately deliver investment outperformance
- Investors can influence companies to improve standards in support of the SDGs to create a virtuous circle of change across employees, communities, global supply chains and other stakeholder groups
- Engaging with companies on the SDGs also provides investors with valuable insights into investment risks and longer-term commercial opportunities, as well as answering questions central to a company's intrinsic sustainability.

Investing for SDG impact

The 17 SDGs – and the more detailed 169 underlying targets – provide a common framework for governments, investors and companies alike to understand the scale of the challenges being faced by the world and to work towards defined environmental and social objectives.

The public, rightly, increasingly expects businesses to impact society and the environment more positively. Corporate support for the SDGs therefore offers a strong signal to third parties – such as consumers or employees – that they are aligning their purposes and practices with the greater good.

Of course, not all of the SDGs are relevant to all companies all of the time. We explicitly encourage companies to be bold and imaginative in considering which goals are most relevant to them, in the context of their geographical footprint and business model, and in turn establish strategies to contribute towards achieving them.

We have spent considerable time identifying which of the 169 SDG targets are 'investable' and which are 'engagable'. In analysing each target, we debated what is within a company's sphere of influence and therefore what actions they could take to have a real-world impact in delivering it.

We concluded that less than 40% of the targets are either investable or engagable. Even though most are therefore not in our purview, a large minority are. This reaffirms our belief that companies are well positioned, due to their multitude of connections and points of influence, to play an important role in supporting the SDGs.

By focusing on areas where firms can most effectively support the fulfillment of SDGs, we can increase the likelihood of achieving tangible, positive outcomes for investors, companies and broader societies. While enduring change may involve some short-term costs, we understand that these may be required in order to embed change that will generate long-term gains.

How we measure impact

Our twin-objectives of investment returns and positive social and environmental impacts are always front-of-mind when we are appraising, monitoring and speaking with our investee companies.

However, the real-world impact of our engagements may not be immediately quantifiable, or comparable across companies in the portfolio. We do not believe that it would be appropriate, for example, to weigh the many direct and indirect benefits created by a company providing meaningful work to a small group of individuals who were below the poverty line and distant from the labour market against another company raising the pay of a large staff of low-paid employees to at least a living wage. Similarly, how might either of these be contrasted with the relative merits of, say, a utility company moving to greater provision of renewable energy or a medical firm increasing access to their surgical products in lower income countries?

Despite the challenges, we are committed to reporting both on the progress and outcomes of our engagement efforts. We are also aware that the companies we are investing in are ultimately delivering the tangible outcomes that result in positive impacts.

First, we use narratives to communicate how our corporate engagement has generated real changes within companies. And, unless impractical, we also report widely-accepted and standardised metrics, such as those from impact investment organisation IRIS, targeted to the individual company in question and around specific engagement objectives.

Importantly, the companies will corroborate the narratives after meeting any of the SDG objectives – ensuring integrity and adding credibility to our claims of effective engagement and additionality.

2018 progress and 2019 potential

During our first year, our SDG engagement efforts found a generally receptive response among the companies we approached. Many management teams and board members shared our view that 'doing well by doing good' is often a route to sustainable long-term success.

But most companies face immediate complex business challenges that can hinder their attempts to make good on those good intentions. Smaller firms, in particular, struggle to convert that willingness to change into action – due to lack of resources and the shorter-term performance demands foisted on them by the market.

Over 2019 we will be looking to leverage these initial positive conversations into more ambitious, outcome-oriented objectives, such as shifting the dial from environmental, social and governance (ESG) targets to 'impact investment' strategies.

During the year ahead we also plan to further develop an appropriate set of SDG engagement metrics while working with companies to better measure, gather and report the relevant data. As data and reporting improves over 2019 we will be able to provide more concrete evidence of how our engagement has delivered tangible impacts for the companies we partner with.

ENGAGEMENT OVERVIEW

We can only credibly impact listed companies via engagement. However, any successful engagement strategy requires buy-in from company management and boards. Our approach is to treat companies as partners rather than combatants.

We work closely with our portfolio companies to help assess where and how to achieve the most positive impact on key beneficiary groups within their purview. For example, through engagement, we may identify new markets for much-needed products, more equitable employment models, or how the companies could exert changes through their supply chains.

Through engagement, we can give management teams the confidence to be bold and imaginative in developing more mutually beneficial relationships with stakeholders.

Our understanding of effective shareholder engagement has been developed over many years. In our view, dialogue with board members and senior executives is more effective than wielding the big stick of voting power (although that can help): what matters most is the strength of our argument, not the size of our proxy vote.

Through engagement, we can give management teams the confidence to be bold and imaginative in developing more mutually beneficial relationships with stakeholders.

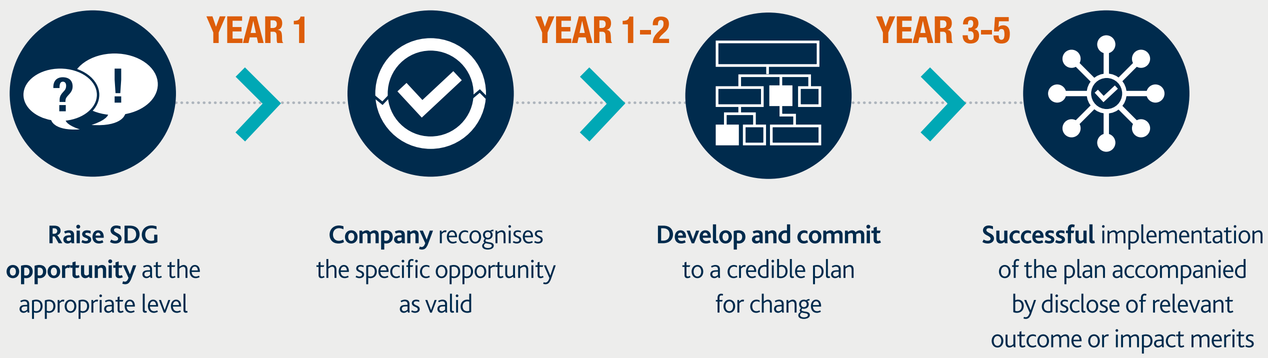
Finding an engagement target

Every company in our portfolio must have both an attractive investment proposition and a compelling impact thesis. As our impact thesis develops, we typically gain a deeper understanding of the company's business model and network of influence. Importantly, too, any impact plan must also support long-term value-creation within the business.

After developing a thesis – our theory of change – we then formulate specific objectives. These may involve introducing external parties, such as non-government organisations (NGOs), social enterprises or other private companies to help drive the initiatives. Any meaningful new initiative will likely require new budgets, processes and relationships – as well as data gathering to measure and report on any benefits.

Clearly, purposeful engagement is resource-intensive and demands pragmatism and patience from all parties. Results cannot be achieved overnight – but those worth pursuing are also worth waiting for.

Measuring progress over (typically) a multi-year process



Source: Hermes. For illustrative purposes only.

Exclusions to the rule

We prefer shareholder engagement over divestment. By engaging with companies to engender positive change, we ensure that our capital has a voice.

But there are some industries or companies where engagement will likely prove futile. For example, Hermes formally excludes investment in firms involved in the manufacturing of cluster munitions or anti-personnel mines. And, while not formally excluded, we also avoid investing in industries where engagement is very unlikely to counteract the harmful effects of the underlying products – such as the tobacco or gambling sectors.

Generally, though, we consider each company on a case-by-case basis, weighing up both the 'good' and 'bad' factors and, importantly, their capacity to improve. Indeed, our necessarily subjective and judgmental analysis of the corporate potential for change determines whether a company should be included in the portfolio. As genuine active managers, we are not compelled to hold any stock. By looking for high-quality companies that we perceive as suitable for long-term investment, we have screened out many industries and businesses, not for sustainability reasons but simply because they are not good investments in our view.

Internal governance: maintaining integrity

Most engagement happens behind closed doors, which can make it difficult to prove our claims of making positive change. To keep engagement on track, we have instituted a number of internal checks and balances to tighten the focus on our twin goals of generating both investment performance and positive impacts. These include:

- All portfolio holdings to be formally reviewed by the lead manager and lead engager, with input from relevant analysts and team members every six months. These meetings investigate whether the original engagement thesis is still valid as well as measuring progress towards any specific objectives; and,
- An internal advisory group – comprising senior figures such as heads of investments, responsibility and stewardship – meets every two months to review the portfolio and provide constructive challenges to the portfolio management team

Our engagement progress, by the numbers

In our first year, we invested in **52** companies

and orchestrated **195** total engagement actions supporting delivery of the SDGs

Overall, we engaged **94%** of our holdings[1] making progress in **88%** of these engagements

Source: Hermes as at 31 December 2018.

[1] The four stocks we did not engage in 2018 included two that we have initiated engagements with in the early weeks of 2019. Another was Dun & Bradstreet, whose CEO resigned in May 2018, and subsequently entered into an agreement to be acquired by an Investor Group. The final unengaged company is not intended to be a long-term investment but is held while we wait regulatory permissions to invest in certain markets.

UNIQUE INTERACTIONS

Our SDG engagement intensity in 2018

We conducted 133 unique engagement interactions, showing our pure focus on each SDG by removing any duplication caused by covering multiple goals in a single engagement interaction, in our first year. How intensely we focused on each SDG is illustrated below: the larger the SDG icon, the greater our focus on the corresponding goal.

x = UNIQUE ENGAGEMENT ACTIONS

Source: Hermes as at 31 December 2018.

Engagement intensity: regional and industrial variations

Because we can draw on the deep, global stewardship experience of Hermes EOS and engage companies across geographies and industries, corporate boards and management teams have welcomed our ability to share the best practices we have observed elsewhere – and to make connections in order to establish mutually beneficial relationships.

While awareness of the SDGs themselves varies, understanding the need to be more socially conscious is clearly on the rise. In some markets, such as in the US, politics, labour shortages and consumer sentiment seem to be giving this once-fringe practice greater prominence.

In other markets, regulation has been a greater driving force. Global themes such as demographic shifts and the current and potential future implications of climate change are focusing the minds of management teams from Brazil to Japan to Sweden.

Similarly, those sectors most exposed to ESG risks or whose products inherently have a positive impact have unsurprisingly proven the most receptive or aware – for example, oil and gas, financial services, utilities and healthcare companies.

Those in the technology sector or part of an industrial value chain are often at a more nascent stage. However, as the growing debates around technology firms' levels of diversity and use of our personal data show, society's spotlight is increasingly shining on every industry. As a result, all companies need to think about the nature of their relationships with employees, customers, suppliers and the environment. A summary of our regional engagement highlights is below.

UNITED STATES

Most of the US companies in our portfolio have been remarkably open to engaging with us on the SDGs. The positive US corporate response is in keeping with our hypothesis that while American companies often lag international peers in their public commitment to sustainability, the agenda is rapidly gaining traction.

In particular, mid-sized companies are well-positioned to leapfrog counterparts.

We saw notable progress towards SDG targets at a number of US firms, including:

5 GENDER EQUALITY

AMN Healthcare Services

We have been very encouraged by the leadership of this large US healthcare staffing business and their recognition that the company is well-positioned to address the issue of pay inequality among US doctors and nurses. The company acknowledges that it has a personal and professional responsibility to use its abundant resources to do good and help others.

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Aptar Group

Management of this US manufacturer of pumps and closures has appreciated our continued support and challenges made to the them and the supply chain and packaging ecosystem to deliver a more sustainable system. Encouragingly, the company has been responding and is strongly committed to contributing to a more circular economy.

LATIN AMERICA

Latin American companies constitute only a small proportion of our investments, but during 2018 we held productive conversations with all firms from the region in the portfolio, including:

1 NO POVERTY

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

Credicorp

We had a constructive call with the CEO of Peru's largest bank in which he agreed that the institution should be doing more to expand consumer access through technology and tailored product developments. During the year ahead we aim to explore with Credicorp how it might establish collaborative partnerships, tailored products and alternative distribution channels. Through such initiatives, we believe Credicorp has great potential to raise the levels of savings and financial protection within a country where a high proportion of the population is underbanked.

EUROPE

In keeping with the growing awareness of environmental and social matters among European companies, we engaged in productive dialogues with a number of listed companies in the region. We hope to report on more positive outcomes in the near future but progress to date includes:

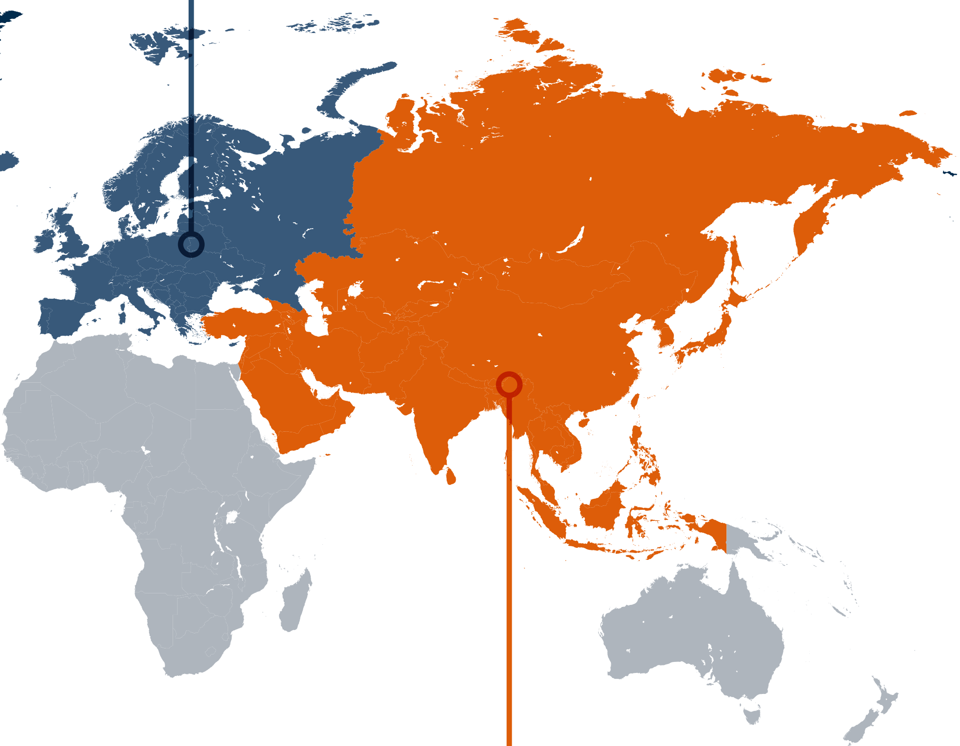
SSP Group

The London-headquartered global concessions retailer has given us assurances that it will establish group level KPIs concerning the matters we discussed.

The positive engagement from the SSP board was very encouraging given we previously voted against the chair's re-election due to concerns about his excessive external commitments.

Green REIT

This Irish property development company has embraced our agenda to go beyond the efficient use of natural resources to generating greater positive impacts through its sub-contractor and building management relationships.



ASIA

We have been pleasantly surprised about the willingness of our Asian holdings to engage in constructive dialogue. Notable engagements across the region included:

Techtronic

This highly innovative Hong Kong-listed power tools company has recognised the need for increased levels of due diligence through its supply chain. Techtronic has highlighted its suppliers of cobalt (used in lithium-ion battery manufacturing) for particular attention.

Samsonite

Also listed on the Hang Seng, this global luggage company had an eventful year that included allegations of accounting fraud by a short-seller in May and the CEO's resignation due to 'résumé padding'. Regardless of the controversies, we had numerous meetings with different parties in the company that set a strong base for exploring two SDG themes – more environmentally sustainable product innovation and improving labour conditions in its outsourced manufacturing – during 2019.

STRENGTH IN NUMBERS: ACHIEVING CHANGE THROUGH COLLABORATION

Encouraging positive changes within individual companies should bring long-term rewards to all parties and, ultimately, broader societies. However, our company-specific engagements have brought home the fact that in many cases industries require systemic change, including high-level policy reforms.

For example, the global environmental problems posed by packaging and the industry's contribution to climate change present challenges that lie outside the ambit of any single actor in the value chain. Our discussions with two investee packaging firms last year illustrated the tension between corporate desire for change and contrasting demands from their customers.

If global packaging waste is to be reduced – as it must be – then pressure needs to be applied across the industry's entire value chain and promoted through government policies. Policymakers in many jurisdictions are beginning to intervene with packaging reforms, such as banning single-use plastic bags and requiring greater use of recycled material. The European 'Waste Directive' and the UK 'Resource and Waste Strategy' provide strong signals that governments are beginning to take the packaging threat seriously.

Likewise, we have sought to amplify our efforts to address systematic issues by leveraging resources across Hermes. We collaborate closely with our stewardship colleagues in Hermes EOS to push the need for packaging reform and more efficient resource use across all relevant industries.

While packaging firms must invest in research and development to build more sustainable products, large consumer goods companies can also drive change via their procurement decisions.

Climate change, too, is a prime example of the tragedy of the commons, where individual players alone can't swing the game in their favour: this must be a team effort. As we have previously stated, simply divesting from companies associated with climate change – an increasingly popular strategy – is not the answer.

At the portfolio level, for instance, we engage with firms to improve energy efficiency and encourage the uptake of renewables. Similarly, we help oil and gas firms align their businesses for a transition to clean energy. Those engagements can bring rewards (and long-term investment returns) but the total carbon emissions generated by our portfolio represent a tiny fraction of global output.

Again, given the need for collective pressure to address climate change, we have partnered with other Hermes teams to join one of the biggest stewardship developments of recent years: the 'Climate Action 100+'. More than 300 institutional investors representing over $32tn have signed the initiative "to engage systematically important greenhouse gas emitters and other companies across the global economy".

The breadth of Hermes' stewardship activities has seen us take a particularly active role in the group, leading shareholder engagements with 28 of the companies identified in the Carbon 100+ list. This approach which covers three dimensions:

- How the board is managing the risks of climate change
- What action is being taken to limit emissions at a level that will keep global temperature increases below 2°C
- How well the company discloses its climate change policies and actions to investors.

VOTING ACTIVITY

An intelligent voting strategy is important in generating positive change within companies and long-term shareholder value. We do not vote in isolation: we discuss our intentions with corporate management teams and boards before and after votes, to ensure that our decisions are well-informed and that companies understand our perspectives.

For and against: our 2018 voting highlights

At 23 company votes, we opposed management on at least 1 resolution

For 45 resolutions, we diverged from recommendations by proxy advisor Institutional Shareholder Services

6 portfolio companies received shareholder proposals, and we opposed 2 and supported 4

Responding to shareholder proposals

1. That **Cooper Companies** report on the feasibility of achieving **net-zero greenhouse gas emissions**. We **opposed** that the company report on the feasibility of achieving net-zero emissions by 2030 because its scope one and two emissions are relatively modest, and its scope three emissions negligible. In addition, reporting on the feasibility of achieving net-zero emissions is, in our view, too burdensome a task. We believe there are more material matters for Cooper to focus its limited resources on. The resolution received **30% support**.

2. For **AMN Healthcare** to **reduce the ownership threshold** required for shareholders to call a special meeting. Our reasons for **not supporting** this proposal were: the company's management and board are consistently receptive to shareholder dialogue, and its share register includes two large holders with more than 10% of the outstanding shares. The resolution received **44% support**.

3. For **Dun & Bradstreet** to **reduce the ownership threshold** for shareholders to call a special meeting. We **supported** the shareholder proposal, which received **41% support**.

4. Seeking **Middleby Corporation** to **report on sustainability**, including greenhouse-gas emission targets. We **supported** the proposal, which gained **57% support**, because the company's **last sustainability report was published in 2011**.

5. For **Alliant Energy Corporation** to report on its **contributions to political parties**. We **supported** this call for **increased transparency**, but it fell short of a majority consensus at **39% support**.

6. That **Genesee & Wyoming** commit to **greenhouse gas-reduction goals**. We **supported** the proposal, spoke with the company months in advance and have continued to engage subsequently on the topic. The resolution received **54% support**.

Other major voting decisions included:

At **SSP**, we **voted against** the **company's remuneration policy and report** and also **opposed the re-election of the company's chair**, Vagn Sørensen, due to concerns about **over-boarding.** In a subsequent meeting, he committed reducing his external commitments during the year by one or two roles.

At odds with our proxy-voting policy, we **supported the re-election of Adonis Pouroulis as chair of Petra Diamonds**. His re-election was subsequently opposed by 22% of shareholders, but we have confidence in Adonis as chair and his commitment to the company that he founded just over 20 years ago. We have consistently found him to be open and frank in discussions with us about both the company's operations and recent failings and also about succession plans for the board. This shows how **engagement insights inform our voting decisions.**

We **voted against** the **compensation resolutions** at a number of our **US holdings** this year – including AMN, Silicon Laboratories, ROIC, Snap-On, Aptar Group, Brunswick Corp, Middleby, Fortune Brands, Wex, Genesee & Wyoming, Clean Harbors and Eagle Materials – because of various **concerns about pay structure**.

Our voting policy also **suggested a vote against** the compensation of **Kirby Corp**, however **we supported management** in this instance because actual pay outcomes have been **consistently prudent** and **aligned to performance**, and our **engagement** with the company has proven **positive and reassuring**. Indeed a further dialogue with the Chair of the Compensation Committee later in 2018 gave us further reassurance, and again illustrated how **engagement insights inform our voting decisions**.

Source: Hermes as at 31 December 2018.

ESG OVERVIEW

Our ESG strategy aims to identify good-quality companies and, through engagement, bring about positive change to create better businesses that are well-positioned for sustainable and commercial success in the years ahead.

As our approach targets companies with scope for improvement, the portfolio is not expected to score exceptionally high in the industry league tables based on standard ESG ratings by research houses. Furthermore, we believe that ESG ratings, especially for smaller companies, are imperfect, incomplete and historic – but they are also not designed to answer the questions that our investment strategy addresses.

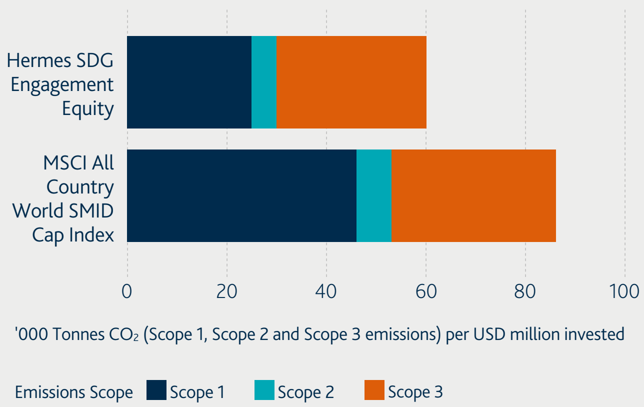
Nonetheless, we do expect to see the ratings of many of our portfolio companies lift over time, as they make improvements where necessary and better disclose performance on relevant ESG matters. We will monitor portfolio ESG rankings over periods longer than one year.

Carbon footprint

Given our investment strategy, our portfolio has exposure to so-called 'dirty' sectors, aiming to find companies in industries that are open to meaningful engagement – and change.

Undoubtedly, chemical, industrial, materials, oil and gas, and utilities companies – all of which are represented in our portfolio – generate substantial environmental impacts. And this is precisely why investors need to work with these companies to press for more efficient manufacturing operations, an increased use of cleaner energy and reduced levels of pollution.

Carbon emissions: portfolio v benchmark



Source: TruCost as at 30 June 2018.

Three grades of carbon emissions

Scope 1 emissions:	direct emissions from company-owned or controlled sources
Scope 2 emissions:	indirect emissions caused by the generation of purchased energy
Scope 3 emissions:	all other indirect emissions that occur throughout the value chain of the reporting company, including from both upstream and downstream entities

CLEANING UP: ALLIANT ENERGY

US-based Alliant, the only utility company we invest in, generates about 27% of the portfolio's carbon emissions. Overall, the top-five emitters represent about 50% of the entire portfolio's modeled emissions, and the top-five holdings account for about 5%[2].

By the end of 2018, Alliant had permanently retired about 30% of its fossil-fuelled generation capacity compared to 2005. In August 2018, the company published new targets for 2030, in which it committed to:

- Renewables being greater than 30% of its energy mix
- Cutting CO_2 emissions from fossil-fuel power generation by 40%
- Going further, by 2050 the company aims to:
- Eliminate all existing coal from the energy mix
- Reduce CO_2 emissions from fossil-fuelled generation by 80%[3].

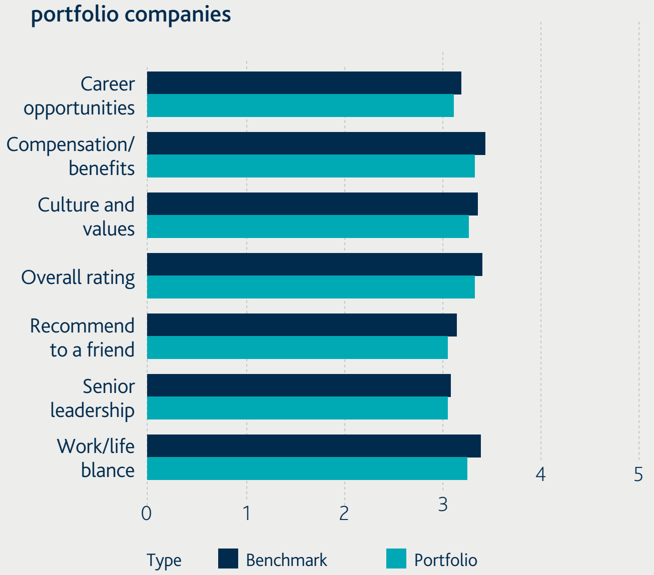
In September 2018, we discussed these updated emission reduction targets with Alliant's management team, pressing them to reveal when the company's coal operations would likely become uneconomical.

The company considers the new commitments to be very conservative, agreeing that it may be able to move more quickly than expected. When we questioned the need for building more new-generation capacity, management explained that the existing $5bn earmarked for the five-years after 2021 was also very conservative. The company is on the lookout for additional opportunities to increase clean-energy production.

Employee wellbeing

To gain an insight into employees' perceptions of the quality of a company and what it offers, we assess ratings compiled by Glassdoor, which are based on workers' direct feedback to the data provider.

Glassdoor ratings: aggregate scores for portfolio companies



Source: Glassdoor as at 31 December 2018.

[2] Source: Trucost, Hermes as at January 2019.
[3] Source: "Energy and Climate," published by Alliant Energy. Access: https://sustainability.alliantenergy.com/energy-climate/.

INVESTMENT REVIEW

Focus on stock-specific risk

Aiming to outperform the global small- and mid-cap market while also generating SDG-aligned impacts, we take a bottom-up, fundamental approach to investing. We believe that outperformance is best and most consistently generated by aiming to produce the greatest return possible from stock selection, not from market timing and taking significant regional and sector positions.

By concentrating on stock selection, we aim to maximise investors' exposure to the achievements of individual companies and their SDG impacts. This approach is differentiated from other stock-picking funds that are benchmark agnostic but can, as a result, incur significant risk deriving from factors other than stock selection.

Our portfolio outperformed the benchmark by a net 1.4% to return -12.4% in 2018. As intended, stock selection accounted for the majority of outperformance, contributing 83.3% to our relative return.[4]

In 2018, our portfolio outperformed the benchmark by net:

1.4%

Contributed to our relative return:

83.3%

Diversification and conviction: seeking the right balance

By investing in a diverse range of stocks, we can target many SDGs rather than focus on specific themes – which would likely take us into stocks already held by other sustainability-orientated funds. It is possible to be well-diversified in SMID stocks and still achieve an active share of more than 98%, given high levels of idiosyncratic risk in SMID stocks. There is categorically no benchmark-hugging in this strategy.

Notwithstanding the aim of having a balanced portfolio, however, the change-seeking nature of the SDGs results in the portfolio inevitably leaning towards industrial and old-economy stocks – a situation we closely monitor. However the diversity of stocks classified as industrials helps mitigate this concentration risk. We aim to hold about 50 stocks in the portfolio, judging this to be enough to achieve the desired diversification without diluting investment conviction and engagement effort.

Investment appeal, engagement potential

To implement our strategy, we perform the fundamental stock research that is essential in small-cap investing and assess which of the SDGs apply to each potential investment. Further, we consider what more a company could potentially do in order to contribute to those goals, and whether its leadership team would be willing to work with us in building a better business that helps improve the world. Upon finding a company with strong investment and engagement theses, we invest and then engage.

In our engagements, we encourage corporate boards and management teams to improve the sustainability of their businesses and contribute to fulfilling one or more SDGs. In the process, we can assist by sharing our knowledge of industry best practices, which has been accrued through other engagements, and advising on reporting and disclosure. Where relevant, we can introduce companies to third parties in order to assist their efforts.

Hermes SDG Engagement Equity Fund: net returns (%)

	31/12/17 to 31/12/18	31/12/16 to 31/12/17	31/12/15 to 31/12/16	31/12/14 to 31/12/15	31/12/13 to 31/12/14
Fund	-12.4	N/A	N/A	N/A	N/A

Source: Hermes as at January 2019. Fund inception date: 29 December 2017. Returns shown are in US dollars and net of fees and costs.

Past performance is not a reliable indicator of future results and targets are not guaranteed. 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. Investing in smaller/medium sized companies may carry higher risks than investing in larger companies. Investments in emerging markets tend to be more volatile than those in mature markets and the value of an investment can move sharply down or up.

We consider what more a company could potentially do in order to contribute to those goals, and whether its leadership team would be willing to work with us in building a better business that helps improve the world.

[4] Source: Hermes as at January 2019.
[5] "Obesity and overweight", published by the World Health Organisation on 16 February 2018.
[6] World Health Organisation, cited in "Rage against the busted medical machines," by Nahid Bhadelia. Published by NPR on 8 September 2016.

CASE STUDY

ENGAGEMENT PROGRESS: BRUNSWICK CORP

Brunswick Corp, a holding in our portfolio, is a global leader in recreational marine products, producing marine engines, parts and accessories, and a range of recreational boats across 14 brands. Brunswick has almost 14,500 employees.

Engagement context

- Brunswick's manufacturing processes, while fully vertically integrated, are nonetheless energy intensive. Its products are more energy-efficient than those of its peers, but still generate pollution when used and the fibreglass vessels it creates are difficult to recycle, re-use, or dispose of without causing pollution or navigational hazards. Brunswick's engine business has embraced resource-efficiency principles, showing the potential for the group to extend this approach to boat structures and assume greater responsibility for their end-of-life disposal or repurposing.
- With a significant workforce and network of external suppliers, Brunswick directly influences the quality of work and living standards of its employees and, through external contracts, people working in its supply chain.

Engagement themes

- **Group-level sustainability plan**
- **Decent pay and working conditions**
- **Green products**
- **End-of-life recycling**

SDG alignment

Engagement timeline: 2018

Milestones	1	2	3	4
	Raise SDG issue at the appropriate level	Company recognises that the issue is valid	Develop and commit to a credible plan for change	The plan succeeds and relevant impact metrics are disclosed

Group-level sustainability plan — 2

12 March 2018: Brunswick's engines division, Mercury Marine, has an impressive sustainability plan. In a meeting with the group's Chief Financial Officer (CFO), we encouraged the replication of this report across the entire business. The CFO agreed, and said the group aimed to provide similarly robust disclosures.

Decent pay and working conditions — 1

25 May 2018: Visiting Mercury Marine's manufacturing site, we were impressed by its low employee turnover, high level of gender diversity and consistent firm-wide healthcare policy. We asked Brunswick whether this approach was applied consistently across the group.

Green products — 1

30 October 2018: We discussed the potential for manufacturing electric boats, and learned that Brunswick developed a hybrid model five years ago and that many of the barriers slowing electric-car adoption, such as charging infrastructure and the need for lower weight, were less obstructive for boats. But the economics and level of perceived demand are not currently compelling. However, given the increasing consumer preference for electric transport, the company is open to considering entry-level electric boats as a way to expand their customer base.

End-of-life recycling — 1

25 Jan 2018: We wrote to the company Chairman to explain the objectives of SDG Engagement Equity and the potential to apply circular-economy principles to boat production in order to increase the recycling or repurposing of fibreglass.

Engagement commentary

Our engagement in 2018 was comprehensive. We met with the company's management team, visited its principal manufacturing facility and exercised our voting rights. We were impressed by the human-capital management and sustainability practices of specific divisions, notably engine business Mercury Marine, and are encouraging Brunswick to extend them across the group.

CASE STUDY

ENGAGEMENT PROGRESS: CREDICORP

Credicorp, a business we invest in and engage with, is a leading financial holding company in Peru. Its subsidiaries include Banco de Credito del Peru (BCP), the country's largest bank by loans and deposits, and MiBanco, which specialises in microfinance.

Engagement context

- With limited access to banks to build savings, breaking the cycle of poverty is difficult for many Peruvians: about 8.2% of adults have saved at a financial institution during the past year, compared to the regional average of 12.2%[1].
- Financial inclusion can help reduce poverty and inequality by enabling people to save and invest for the future, and manage income shocks like unemployment, a poor harvest or the loss of a breadwinner – thereby preventing people from falling into poverty in the first place.
- Peru's government aims for at least 75% of adults to have access to a bank account by 2021, and to increase the number of micro and small- and medium-sized enterprises (SMEs) with access to loans from the current level of 35% to 60%[2]. SMEs provide 61% of employment in Peru but 45% of them are financially constrained[3].

Engagement themes

- **Establish an ESG due-diligence framework for commercial lending**
- **Use digital technology to expand access to financial services**
- **Create micro-insurance products for health and income protection**

SDG alignment

1 NO POVERTY

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

Engagement timeline: 2018

Milestones	1	2	3	4
	Raise SDG issue at the appropriate level	Company recognises that the issue is valid	Develop and commit to a credible plan for change	The plan succeeds and relevant impact metrics are disclosed

Establish an ESG due-diligence framework for core lending businesses

1

17 May 2018: Asked the company for a conversation with subsidiary BCP about the social and environmental due diligence in its lending business.

Develop technology to expand access to financial services

1

17 May 2018: We discussed the growth strategy of Credicorp's microfinance business, Mibanco, which spans people without IT access to small businesses.

2

9 November 2018: In a call with Mibanco's CEO about the lender's three-year business plan, we pointed out that its use of technology in distribution lags peers in Asia and Africa. We learned that Mibanco is assessing digital channels, including mobile.

Engagement commentary

During 2018, our engagement involved constructive conversations with Credicorp's Investor Relations team and its Chief Executive Officer, who was enthusiastic about broadening financial inclusion through digital technology and developing micro-insurance products. Our original case for engagement – that the company is uniquely well placed to significantly increase financial inclusion and the growth of SMEs – have been substantiated. In 2019, we aim to agree specific steps with the company that will result in progress towards achieving the objectives of this engagement. We believe that Credicorp is a willing partner and are excited by the possibilities.

[1] "Peru – Global Findex," published by the World Bank in 2018.
[2] "Peru launches National Financial Inclusion Strategy to expand financial inclusion," published by The World Bank in August 2018.
[3] "MSME Finance Gap," published by the SME Finance Forum in 2017

ENGAGEMENT THEME

Fitter, happier, more productive: companies can help increase global health and wellbeing.

Enduring challenges

The healthcare sector is crucial in achieving the aims of the SDGs. The world is facing increasingly complex health problems that are proving difficult to overcome. They include:

- **The diminishing power of medicine**
  New antibiotics and antivirals are needed to combat antimicrobial resistance, but the pipeline of new drugs is drying up
- **Geographical shifts in disease patterns due to increasing travel and tourism**
  For example, malaria cases in the UK doubled between 2000 and 2009[1]
- **Rising incidence of non-communicable diseases**
  Obesity has become a global health threat in most of the world, causing greater rates of diabetes and heart disease. According to the World Health Organisation, the global prevalence of obesity nearly tripled between 1975 and 2016, when about 13% of the world's adult population – 11% of men and 15% of women – were obese[2]
- **The absence of basic medical services in developing countries**
  More than 80% of medical equipment in the developing world is donated, but only 10-30% of it is used – most is often broken or incompatible with local electricity infrastructures[3]
- **Skills gaps in the aged-care system**
  If we don't have appropriately skilled staff to meet increasing demand – now and in the future – a substantial group of the most vulnerable people in our society will be uncared for
- **Accommodating ageing workers**
  People are generally living and working longer: for example, in the UK, almost one-third of workers will be over 50 years of age by 2020[4]. Companies may shy from hiring older workers given the increasing costs associated with healthcare, but they should instead invest to cater for a multi-generational workforce, thereby benefiting from a diversity of experience, extending employees' careers and reducing the risk of compensation claims.

Positive impacts

There are clear opportunities to create value by supporting SDG three – which forward-thinking companies will see and respond to accordingly.

For investors, these can be viewed through two dimensions: identifying growth sectors and including employee health data in investment analysis.

Growth sectors

For healthcare companies, there are some significant commercial opportunities aligned with contributing to SDG three: good health and well-being. They include:

- **Remote-patient monitoring:** technology enables healthcare workers to monitor patients outside conventional clinical settings, increasing access to care and reducing healthcare delivery costs
- **Telehealth:** remote data exchanges between patients at home and their clinicians to treat long-term conditions
- **Identifying counterfeit drugs:** fake medicines are becoming a serious concern worldwide, and are becoming more common in the legitimate pharmaceutical supply chain
- **Tobacco control:** smoking, a chronic yet preventable epidemic, is one of the most significant determinants of the increased global rates of mortality and ill-health
- **Weight management:** due to the rapidly growing obesity crisis, the need for weight-management products and services has grown.

Healthy employees, stronger performance

For all companies, investing in their employee's wellbeing makes business sense. Today, employers are called upon to support a diverse workforce, including people who are working later in life and face the health risks associated with older age.

The quality and reach of public healthcare in the future is uncertain and the cost of private healthcare is rising, making it increasingly expensive for people to obtain treatment. Companies are therefore well-placed to take greater responsibility for their employees' health and wellbeing – and benefit from this, too. While the data are relatively new, research has found a distinct correlation between best-practice wellness programs and corporate performance, due to reduced absenteeism and medical conditions, and improved productivity[5]. This is an agenda we will be raising more systematically with companies during 2019.

Will Pomroy
Lead Engagement Manager, Hermes SDG Engagement Equity Fund

Hamish Galpin
Lead Portfolio Manager, Hermes SDG Engagement Equity Fund

1 "Health issues in geography," published by the Geographical Association in 2010.
2 "Obesity and overweight," published by the World Health Organisation on 16 February 2018.
3 World Health Organisation, cited in "Rage against the busted ,medical machines," by Nahid Bhadelia. Published by NPR on 8 September 2016.
4 Office for National Statistics, cited in "An ageing workforce," a Postnote (number 391) published by the Houses of Parliament in October 2011.
5 See, for example, "Are happy workers more productive?" by Eugenio Proto. Published by IZA World of Labor in December 2016.

OUTCOMES
BEYOND
PERFORMANCE

Hermes Investment Management

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

High active share equities, private markets, credit and responsible investment advisory services.

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

Federated | HERMES IS A FEDERATED INVESTORS COMPANY.

BD03223 03/19 0005682