Hermes Equity Ownership Services

Pensioenfonds PNO Media Engagement report

Q3 2009

HERMES

PNO

Q3

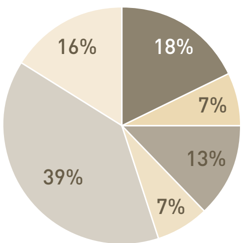
This report contains a summary of the responsible ownership activities undertaken by EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies over the past quarter. The report also provides information on our voting decisions and the steps we have taken to promote global best practice, improvements in public policy and collaborative work with other shareholders.

Contents

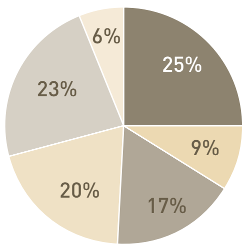
Engagement by region

Over the last quarter we engaged with 78 companies held in PNO Media's portfolios on a range of 258 social, environmental and governance issues. EOS' holistic approach to engagement means that we will typically engage with companies on more than one issue simultaneously. The engagements included in these figures are in addition to our discussions with companies around voting matters.

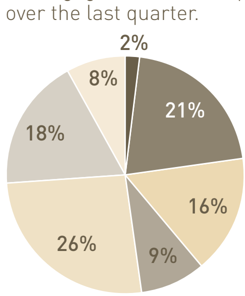
Americas
We engaged with 14 companies over the last quarter.



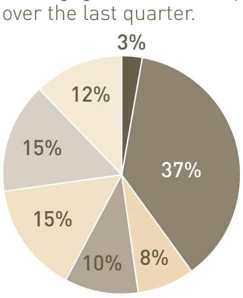
Asia
We engaged with 14 companies over the last quarter.



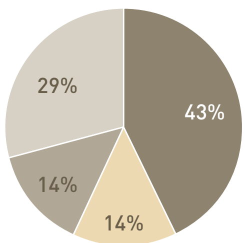
Europe
We engaged with 31 companies over the last quarter.



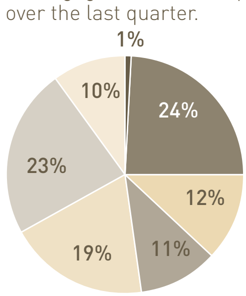
UK
We engaged with 16 companies over the last quarter.



Africa/Middle East
We engaged with three companies over the last quarter.



Global
We engaged with 78 companies over the last quarter.



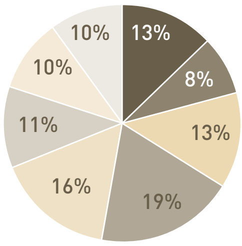
- Shareholder communications
- Social and ethical
- Environmental
- Risk management
- Business strategy
- Governance
- Remuneration

Engagement by issue

A summary of the issues on which we engaged with companies over the last quarter is shown below.

Social and ethical

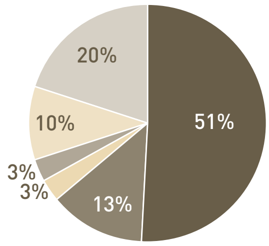
Social issues featured in 24% of our engagement over the last quarter.



- Community relations
- Health & safety
- Supply chain
- Operations in troubled regions
- Corporate culture
- Political risk management
- Bribery & corruption
- Other

Environmental

Environmental issues featured in 12% of engagement over the last quarter.



- Climate change/carbon intensity
- Water stress
- Waste
- Oil sands
- Forestry
- Other

Other Engagement

Business Strategy featured in 19% of our engagements over the last quarter.

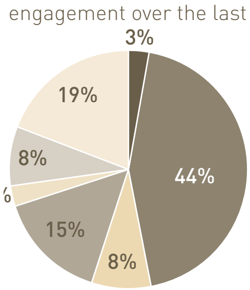
Remuneration featured in 10% of our engagements over the last quarter.

Risk management featured in 11% of our engagements over the last quarter.

Shareholder communications featured in 1% of our engagements over the last quarter.

Governance

Governance issues featured in 23% of our engagement over the last quarter.



- Accounting or auditing issues
- Board structure
- Committee structure
- Succession planning
- Poison pill
- Separation of Chair/CEO
- Other

Governance: Business strategy and board structure
Strategic engagements

Many of EOS' most successful engagements combine discussions of business strategy and structural governance issues.

Engagement statistics

Number of companies engaged with on strategic matters this quarter:	92
Africa/Middle East	2
Americas	4
Asia	22
Europe	48
UK	16

Number of significant steps forward in strategic/governance engagements this quarter:	10
Africa/Middle East	1
Americas	2
Asia	3
Europe	2
UK	2

Includes only companies which in this quarter have made substantive strategic or major governance changes.

Overview

EOS's holistic approach to engagement combines discussions on business strategy and risk management, including social and ethical risks, with structural governance issues. Our engagements fill the gap left by the investment industry's tendency to focus on the short-term. The result of this tendency is that management too often goes unchallenged in its approach to the long-term future of its business and there is minimal pressure for change. EOS assesses and engages with underperforming companies from a long-term perspective, asking questions which encourage management and boards to think afresh to overturn long-running periods of underperformance. This proven approach is often successful in adding value or ending destruction of value.

Business strategy is also a key feature of other engagements such as those highlighted elsewhere in this report. We are generally most successful in achieving change on environmental, social and other matters where we lead the conversation from a business perspective and focus on these issues as risks to the company's strategic positioning. Companies can become locked into historic patterns where they are overdue for refreshment and new perspectives on the board. Injecting new thinking at the head of the company – an independent chair or change of CEO – is frequently the key to unlocking change and driving renewed operational performance, creating long-term value for shareholders.

Engagements on governance and business strategy may require a series of meetings over months and years. It takes time for board changes to generate the business and strategic changes which improve long-term performance.


Highlighted sample engagements

We spoke with a leading bank in the **Africa/Middle East** region to discuss risk management and governance matters. We are concerned about the board structure, which seems to reflect political pressures rather than the business needs of the company. We therefore suggested that the bank consider appointing directors with banking experience to help bring another perspective to the decision-making, not least in areas such as risk management. We also urged better disclosure on the work of the audit committee in respect of risk and other matters.

In the **Americas,** we met with the chair of a large financial institution to discuss board change, strategy and the company's future. We urged a good deal more clarity on the steps which the bank is taking to emerge from its current difficulties and sought clear public milestones against which management performance can be judged. We welcomed the progress towards board refreshment but argued for further steps, particularly to introduce geographical diversity to reflect the spread of the operations. We also focused in particular on the role of the government and the need to develop a clear exit strategy so that the board transparently operates in minority shareholders' interests and the strategy is driven by business not politics.

We welcomed significant steps forward by a company from **Asia** with which we have been engaging for the past two years. A conglomerate with a remarkable spread of businesses, the company has underperformed for many years and we have been urging a rationalisation of its activities. During the quarter we progressed discussions through a meeting with the CFO. This engagement saw a first significant positive step with a clearer articulation of strategic focus, and decisions to spin-off two substantial units as well as converting some associates into wholly-owned subsidiaries. We urged the company to lay out quantitative targets for major core divisions with profitability metrics so that shareholders can monitor progress and hold management to account for delivery.

We have made good progress in an engagement with a property company in **Europe.** As with many of its peers it has hit financial difficulties and we have been urging a substantial reshaping of its internal audit, control and risk management functions, which now appear to be being put in place. We managed to obtain a commitment from the CEO to make public disclosures on these significant steps forward. We have repeatedly urged a change to the external auditor and have been told that this will be opened to tender next year. We continue to urge a reshaping of the corporate structure and also of the board, which we believe needs further renewal, and hope for further developments over the coming year.

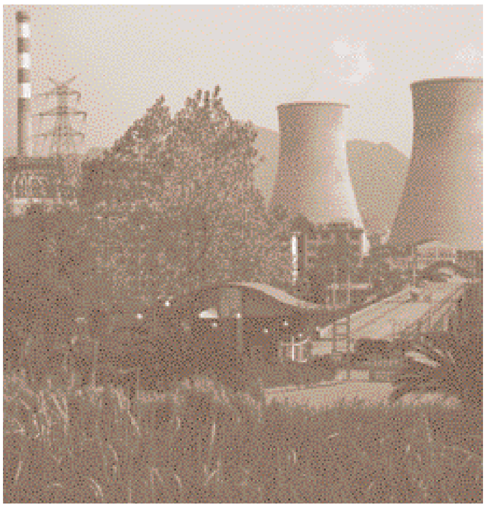
We progressed our discussions with the CEO of a **UK** company with which we have been engaging over the past few years, successfully encouraging significant board and executive change and the cessation of value destructive acquisitions. We discussed progress in delivering the new strategy and the business changes which these governance changes have helped to deliver. We pressed for clarity over the profitability of the pricing of new client wins, and particularly sought more transparent disclosure on exceptional costs, which we believe is necessary to reassure the market that the current cost savings are indeed sustainable and restructuring costs not a recurring item.

Environmental: Emissions reporting
Carbon Disclosure Project (CDP) and GHG emissions standards

A long-term supporter of the CDP, EOS recently engaged directly with 100 companies to encourage them to participate in CDP for the first time. Our focus has been Asia, which has been markedly under-represented in the survey. Additionally, we have engaged with regulators and companies to develop GHG emission reporting.

Statistics	
Number of Asian companies engaged with	99
Number of companies now responding to CDP	25
Number of companies with enhanced GHG emissions disclosure (short of CDP participation)	16

'EOS noted a significantly higher level of awareness and interest among Asian companies with regards to environmental issues.'



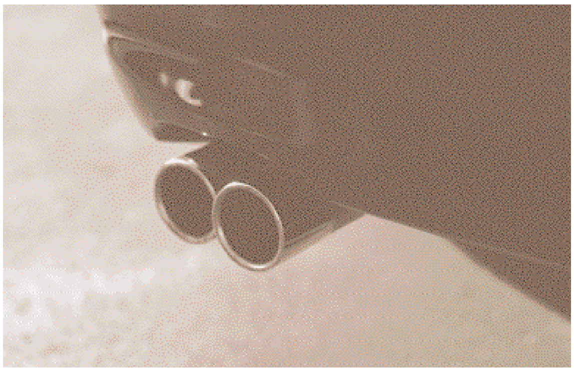
Overview

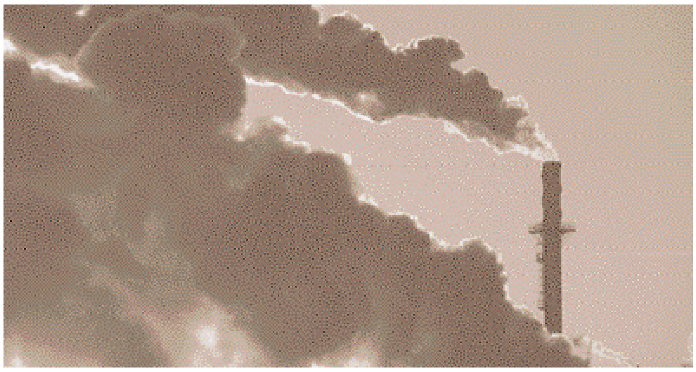
As climate change has become a more prominent issue, EOS's activities in this area have also intensified over recent years. As well as our company-specific engagement activities, using bespoke research to identify companies with emissions which are outliers in their industries and where change is necessary, we have carried forward a number of elements of promoting best practice and public policy work. A long-time supporter of the Carbon Disclosure Project, we have for a number of years worked to encourage additional companies to respond to this important questionnaire, in Europe, the US and in most recent years Asia. These efforts are described opposite in the 'Issues and companies' section.

We have urged the governments of the world to take a significant step in Copenhagen towards a carbon target which will drive carbon pricing at a sufficient level to promote changes in investment approaches both by companies and by institutions – by joining with 180 other institutional investors in a public letter organised by the Institutional Investors Group on Climate Change and the UNEP Finance Initiative among other bodies. This builds on efforts in particular countries regarding their own emissions trading or carbon constraining regimes.

Among actions specifically on reporting on greenhouse gas emissions: we are participating in a working group seeking to develop best practice on reporting for the oil and gas industry; and we have lobbied the IAASB regarding its proposed standard for assurance on greenhouse gas emissions. We have also engaged with the UK authorities on the details of their proposed voluntary framework for emissions reporting, which may prove a model for other markets.

On the oil and gas industry, we are working with other members of the IIGCC and with companies from the sector to produce a best practice framework to drive better climate change disclosure. More than many sectors heavily exposed to carbon-intensive products, the oil and gas industry faces a difficult transition from reliance on fossil fuels towards less carbon-intensive sources of energy. The intention is that this framework will enhance individual companies' reporting and also be included in the next round of the CDP.





Issues and companies

Alongside the regulatory and best practice approaches discussed opposite, EOS has also focused efforts on encouraging more companies to recognise the importance of climate change to their business, and to plan for a carbon-constrained world. One of our main approaches in this regard has been dialogue with those companies which have not previously participated in the CDP, and which appear therefore not to have focused significantly on the issue. This is as much to help the companies recognise that they need to prepare for carbon pricing and carbon constraints as to build the information held within the CDP database.

We have done this work particularly in Asia, the region where participation in CDP has been notably lower than elsewhere. However, Asian countries are increasingly introducing regulatory roadmaps on climate change, meaning that this is an issue which local companies need to attend to with increasing vigour.

In our dialogue with companies, EOS continually emphasises the importance of the significant opportunities and risks associated with climate change, and the need for management to consider proactively adapting to a low carbon economy and reducing emissions so as to ensure sustainable value creation. In most cases, the aim of EOS engagement is to urge companies to disclose carbon emission reduction targets, to implement a flexible climate change strategy and to put into place effective carbon and energy management systems. These moves together give shareholders confidence that management is appropriately managing climate change risk and preparing the business effectively to generate future returns.

We held discussions this year particularly with companies in China, where due largely to the lack of regulatory requirements or industry guidelines, the response rate to the CDP in 2008 was low. In its conversation with one Chinese company with which EOS (the first shareholder to raise environmental issues with the company) has intensively engaged with for a number of years, EOS applauded the company's continuous efforts and progress, clearly indicating the management commitment to the sustainability.

Since EOS' intervention, the company has improved its ranking to the top at an environmental survey from the bottom. In 2009, the company participated in the CDP for the first time.

As well as these conversations with Chinese companies, EOS engaged with a range of companies from Taiwan, South Korea, Japan and across South-East Asia. Whilst the increasing number of responses from Taiwanese companies was rather encouraging in 2008, EOS focused on companies which were newly invited to participate in the CDP or failed to answer the previous survey. In Japan where there has been a high participation rate in the CDP, EOS focused on dialogues with a selected number of companies which failed to report at the previous survey. At the discussion with one Japanese company, EOS's engagement led not only to the company participating in CDP, but also to a significant improvement in the quality of its reporting more generally.

Overall, while the level and quality of responses to the CDP still vary in each market, EOS noted a significantly higher level of awareness and interest among Asian companies with regards to environmental issues. During our engagements, some companies which have not responded to the CDP 2009 have provided EOS with undertakings to participate in the survey next year.

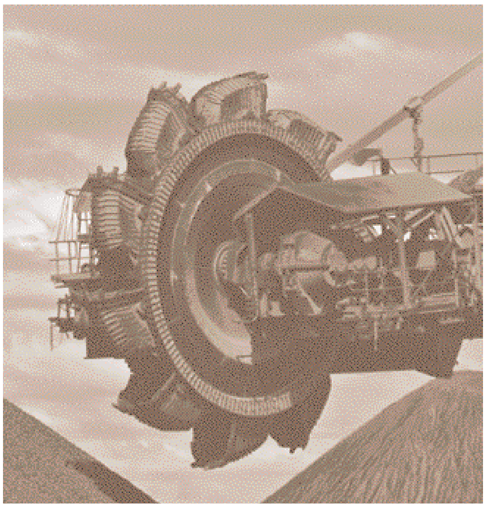
Among the Asian companies participating in the CDP in 2009 for the first time are: Advanced Semiconductor Engineering (Taiwan), Bank of Communications (China), China Merchant Bank (China), China Shenhua Energy (China), Formosa Plastics Corporation (Taiwan), Foxconn International Holdings (China), Hanwha Corporation (South Korea), Lenovo Group (China), Life-On Technology (Taiwan), Takeda Pharmaceuticals (Japan) and ZTE (China).

Environmental and social: Mining industry
Risk management for mining companies

EOS continues our engagements with mining companies to encourage them to deal effectively with the risks which their industry faces. This spans health and safety, bribery, operations in troubled regions, community relations, and a full range of environmental issues from climate change and water to air- and water-borne pollution.

Statistics	
Number of companies engaged with	23
Number of companies where substantive change sought	23
Number of these showing progress so far	12

'Mining companies stand out among all industries as being exposed to a wider and more varied combination of difficult social and environmental issues.'



The extraction of limited resources of minerals from the ground is an inherently unsustainable activity. Partly as a result, mining companies stand out among all industries as being exposed to a wider and more varied combination of difficult social and environmental issues, and therefore have long been a close focus for EOS's efforts.

For a start, extractive companies cannot dictate where the resources they wish to exploit lie. While naturally they will favour operations in countries with stable politics and reliable legal systems, not all the world's resources – particularly after some years of extraction – are within such borders. It is often therefore that mining companies are among those with which EOS engages on the risks of operations in troubled regions. As ever in these cases, we consider the presence in the troubled region from a risk/reward perspective, and while on occasions we encourage companies to consider departing from the relevant country, more often the discussion is around ways to mitigate the negative impacts of the company's presence through an active programme of community relations. In countries where the security forces are known to mistreat their own population, companies need to take care to minimise the risk of being complicit in human rights abuses. The extractives sector has developed its own Voluntary Principles on Security and Human Rights, which EOS endorses and encourages companies to adhere to.

Such a programme is often also vital given that there are often differences between the traditional land ownership system and the legal regime, meaning that communities may believe they are owed royalties in some form or other even when the law does not dictate this. Such concerns need to be handled with great delicacy and diplomacy, as do situations where local people are moved or their amenities affected by a new or expanding operation. The cost of failing to manage such situations with the necessary care can be very significant.

Thus mining companies face challenges around the risks endemic in countries with weak legal regimes, not least bribery and corruption. It is for this reason that the Extractive Industry Transparency Initiative, of which EOS has long been a supporter, is so important: it makes more clear the flow of money from the mining companies to the authorities and so discourages graft and encourages

the local communities to see the benefits that flow to them from the corporate activity. Thus, it acts to defuse the so-called 'resources curse'.

It is a sad fact that the mining industry is one of the most significant killers of its employees and contractors globally. A good deal of the work done, often deep underground, using explosives and with heavy machinery which is inherently not very manoeuvrable, means that injuries and deaths are difficult to avoid. Yet unless companies do so, quite apart from the personal tragedies that occur, their businesses will face regular disruption and sometimes closure by the authorities. Often the greatest challenge with health and safety is ensuring that staff live up to the structures and procedures which the company puts in place, and this means that companies need to continue to find new ways to engage staff to cajole them to maintain disciplines. EOS talks with companies about the need for cultural change, and for ongoing efforts rather than just one-off programmes.

Mining is also a dirty business: depending on the mineral sought, there can be many tonnes of rock mined for every ounce of useful ore. Even when ore is a larger portion of the rock mined, there is much that after processing must be disposed of. Often this is in the form of ground up rock which has been crushed so that the useful ore can be extracted. These so-called 'tailings' are troublesome because their dusty nature means that they are prone to be highly polluting. If the waste rock is stored above ground, often it needs to be kept wet to prevent it becoming dangerous air pollution. Often much is stored in so-called tailings dams which function well provided they do not fail and release the pollution into surface water or water tables. EOS actively engages across the range of these pollution issues.

Mining operations, whether in terms of processing the minerals or cooling furnaces, use a great deal of water. Often though, the operations are in places which face stressed water supplies: whether it is in Australia, the Southern USA, South Africa or South America many mines are in places where water supply is limited. This gives rise to challenges around finding supplies which do not remove resources from the local population, cleaning and recycling the water, as well as cleaning the water after use. The costs and challenges of this are significant, as a number of operators have found. We continue to test these efforts in an ongoing engagement programme.

There is also the burden of remediating old mine workings. There is an issue with the above-ground environment and returning the industrial operations to a natural state which invites biodiversity. But more complex still than this is what happens underground. There are significant issues around the potentially polluting effects of old workings, not least through something known as acid mine drainage which sees water table polluted as water flows through the shafts. In some cases pumping must be maintained for years after mining finishes to prevent damage to the wider environment and community. Unless a mine operator builds up a fund to pay for remediation costs after closure, it is not internalising all of the costs of its operations and its profits are misleading.

Given the range of issues faced by the mining sector, EOS takes its usual company-specific approach and as part of each engagement discusses those issues which are most material to that company. Having had multiple dialogues with most of the companies, engagements in many cases have covered all of these issues – and more. In a number of our engagements, EOS has successfully encouraged companies to make significant improvements to their approaches to community relations, to security at particular operations, to water usage and wider environmental impacts, and to health and safety. Our efforts in these different regards continue.

The world's leading mining companies include: BHP Billiton (Australia/UK), Vale (Brazil), Rio Tinto (Australia/UK), Anglo American (South Africa/UK), Xstrata (UK), Barrick Gold (Canada), Goldcorp (Canada), Freeport McMoran (US), Southern Copper (US), Anglo Platinum (South Africa), Newmont Mining (US), ENRC (UK), Zijin Mining (China), Teck Resources (Canada), Kinross Gold (Canada), Impala (South Africa), Grupo Mexico (Mexico), AngloGold Ashanti (South Africa), Jiangxi Copper (China), Newcrest Mining (Australia), Antofagasta (UK), Cameco (Canada), Vedanta Resources (UK) and Kazakhmys (UK).

Social and ethical: Operations in troubled regions

Focus on Nigerian oil industry

The oil-rich Niger delta in Nigeria recently saw one of its periodic upsurges in violence, followed by a tentative ceasefire, drawing attention once again to a region where oil operations have given rise to a number of significant challenges.

Statistics	
Number of companies engaged with	5
Number of companies where substantive change sought	5
Number of these showing progress so far	2

'We took the opportunity to intensify this engagement earlier this year through a visit to Nigeria and meetings in the country with various members of the different international companies' management teams.'

Overview

Oil and gas production are cornerstones of the Nigerian economy, accounting for more than 90% of tax revenues and foreign exchange earnings. Nigeria is one of the top 10 countries globally for both oil and gas production. The bulk of the oil in the country is in the extremely poor Niger delta region – though increasingly production is moving offshore.

Poor relations between the oil industry and the local population have been fuelled by a concern that the benefits of oil production do not flow to the people most directly affected by the operations. This dissatisfaction has led to violence against industry operations and staff, and regular attempts both to sabotage oil pipelines and to steal fuel. These activities have become increasingly well-organised and well-armed. Nigeria's poor reputation for tribal rivalries and for bribery and corruption has tended to intensify the impression that the value created by the industry has not been shared appropriately.

In this context, international oil and gas operators face a range of challenges. Their ability to deal with them is also hampered by the fact that they operate through joint ventures with the national oil company in Nigeria, the NNPC – an arm of government – and these joint ventures are unincorporated. This means that rather than being free to operate and reinvest on the basis of their own profitability, the joint ventures have been limited by the politics surrounding budget-setting. Among other things this convoluted process has markedly slowed the investment needed to address one of the industry's most painfully running sores: the flaring (burning) of gas at oil operations, causing significant pollution rather than putting this potentially valuable fuel to good use.

Issues and companies

EOS has been engaging with oil and gas companies in relation to their operations in Nigeria for some years. We took the opportunity to intensify this engagement earlier this year through a visit to Nigeria, holding meetings in the country with various members of the different international companies' management teams.

We asked what effect the Petroleum Industry Bill would have on the industry. The Bill is an attempt to modernise the oil industry and includes measures to incorporate the NNPC, increase the tax revenue from the industry, improve opportunities for the indigenous oil industry and provide a regulatory platform for the future. The industry is concerned that the Bill risks making operations uneconomic for the oil companies. We talked about establishing a more sustainable footing for the industry, agreeing that this is likely to require a royalty to the owners of the oil producing land, or some transparency over oil revenue payments from central to local governments, in order to provide an alignment of interests between the local people and the oil companies – currently the central government controls all extraction rights. Such a reform is not in the Bill at present. We encouraged the companies to play an active part in assisting the government to establish the rules which will enable a sustainable future for the oil industry.

On the associated issue of flaring, we urged the companies to address this proactively and to accelerate as far as realistic their timetables for bringing the practice to an end – discussing any ways in which their financial arrangements with NNPC could be adjusted to ensure that the national company paid its portion of the costs. We discussed the specifics of existing reduction targets and urged that these should be made public, as should progress towards achieving them so that investors can hold the companies to account.

We discussed security and human rights issues, encouraging the application of the Voluntary Principles on Security and Human Rights. We discussed efforts to give human rights training to the local security forces. And we also talked through community relations programmes more generally; not least the delicate balance which must be struck of the companies empowering local people and not seeking to act as the state in a region where government is almost entirely absent. We discussed the allied issue of sabotage of and thefts from pipelines and how companies are actively seeking to reduce these and also to remediate the environmental impacts of pipeline break-ins.

On corruption, we asked how the companies ensure that payments were made to the correct recipients in a country with a poor reputation in this regard. We talked through the levels of due diligence in place to ensure that the money goes to the right recipients, and the involvement of senior management to oversee payments processes. Among other things, we recommended the Woolf Report, commissioned by BAe Systems, as a global standard on fighting corruption.

In all cases, we urged much clearer disclosure and reporting on the companies' activities in these areas. A good deal of the negative publicity surrounding Nigerian operations is based on historic issues and this will only be supplanted if companies are more proactive in telling their story as it now is. We also expect, as usual, that greater disclosure will help drive better behaviour by the companies over time.

Having met the leading onshore oil and gas producers in Nigeria, it is impossible to over-emphasise the complexity and difficulty of managing an oil company in that country. There can be no long-term solution to these problems unless there is some development of the oil region to ensure there is a greater alignment of interests between the local people and the international companies – but that development can never be the sole responsibility of the companies themselves. At least one part of this alignment does lie clearly in the hands of the companies: they must operate to the highest global environmental and human rights standards, and we will continue to encourage best practice and disclosure in these regards. Other problems can only be solved by the fiscal, legal and regulatory reform of the industry and we will continue to engage with the companies and if appropriate with the government and other relevant bodies to help find sustainable improvements.

The international oil and gas companies operating in Nigeria include: BG (UK) Chevron (US), ENI (Italy), ExxonMobil (US), Royal Dutch Shell (UK/Netherlands)

Governance: Global best practice
The Renewed ICGN Principles

EOS staff have played a key role in the development of the new Principles which will shortly be launched by the International Corporate Governance Network. Historically highly influential guidance, the fact that these Principles integrate a range of new issues potentially raises these matters up the corporate agenda.

'An appropriate culture is something which the best managers spend a great deal of time thinking about and seeking to instil in their workforce. Yet it has been neglected consistently by the investment community.'

Founded in 1995, the International Corporate Governance Network is one of the longest-standing and leading global organisation for long-term responsible investors. Its Principles, first produced in 1999, have been highly influential. Building from the foundations of the OECD Principles of Corporate Governance, the ICGN Principles provided more detail on the views of the international investor community. These Principles were revised and expanded in 2005 following the OECD's review of their own guidelines. They act as the cornerstone for the ICGN's work across responsible investment, and have been highly influential.

Because of the ICGN's status as a leading organisation for investment institutions, the Principles have been read as setting out the perspective and expectations of international investors of the companies in which they invest. Some ICGN members have made this more explicit: for example, leading institutions such as CalPERS have adopted the ICGN Principles wholesale as their international standards.

In 2008 the ICGN board recognised the need to consider a further revision of the Principles, not least in the light of what had been learnt through the credit crisis and its aftermath. In November, the board had produced one of the best responses to the financial crisis from an investor organisation; openly acknowledging the failings of the investment community which played a part in the crisis, it talked directly about ways forward and of a desire to rise to the new challenges which the crisis had revealed. But the board recognised that reconsidering the Principles would also make sense.

A member of the EOS team was invited by the ICGN board to lead the work on the new Principles. He accepted and gathered a small group of individuals from around the world – a genuinely global group which included senior individuals from the corporate community as well as leading investor representatives – as the committee to lead the drafting process.

Changes of substance, including risk and culture

There were some elements of change which seemed self-evidently necessary to all members of the drafting committee: the inclusion of a section on risk management was the most significant of these, but other elements such as a need for some discussion of employee remuneration also seemed an important lesson of the crisis which ought to be reflected in the Principles going forwards. The 2005 Principles' version of the "overriding objective of the corporation" also sounded uncomfortable in the light of the crisis, as it appeared to focus on short-term share price performance against a peer group. Given the value which the committee had so recently seen being lost as a result among other things of management focusing their attention on near-term share prices, it was felt that this area needed some close attention.

But beyond these more obvious changes there were two elements which the EOS team were particularly keen to see developed in the new Principles. These were the softer issues of corporate culture and boardroom behaviours. Corporate culture is a vital issue which is the determinant of whether the intent of management will actually be carried into practice. An appropriate culture is something which the best managers spend a great deal of time thinking about and seeking to instil in their workforce. Yet it has been neglected consistently by the investment community, often even by those investors which actively consider social and ethical matters. Ensuring that this topic was given appropriate status in the ICGN Principles seemed an important step towards giving it the status it deserves in dialogue between companies and their owners.

On boards, it always seems that corporate governance guidelines rush to discuss board structures and the independence of individual members rather than taking a step backwards to consider what the underlying aim of those structures and that independence is. This must be a board which behaves openly and honestly, challenging management as well as supporting them and which has the necessary mix of skills and experience to ask the left-field questions as well as the difficult ones. It thus made sense to the EOS team to seek to change the opening of the ICGN Principles section on the board to start with an outline of the board behaviours which we believe ensure effective decision-making on behalf of investors before the discussion of structures, independence and so on.

In addition, the new Principles integrate environmental and social matters in a way which the ICGN has not done previously. This theme runs throughout the Principles, from the inclusion of such matters explicitly within the overarching corporate objective, through ethics being the core of the section on corporate culture, to inclusion as part of the risk management and disclosure expectations.

There were some very active discussions in the committee meetings, with careful debate on some of the smallest of issues, but pleasingly these proposed innovations were almost universally readily welcomed. They also survived the delicate process of ICGN member consultation, which occurred both by email and face-to-face at the July conference in Sydney. The consultation process undoubtedly strengthened the Principles and provided some clarity in areas which the committee had glossed over or missed entirely, but the form of the Principles and the new introductions have received overwhelming support, both at the vote at the AGM and in the subsequent member ratification.

The challenge to come

Our challenge is now to help the new Principles be as influential as their predecessors. It is a more crowded stage now than before, with most countries having their own established governance codes. However, many of these are being or will be reviewed over the next few years as each market reconsiders its guidelines in the face of the financial crisis. We are already beginning to promote the developments to the ICGN Principles as a possible model for some of these markets to follow – and we seem to be gaining a positive reception thus far. At least one member of the drafting committee will be closely involved in developing her market's governance guidelines and expects to use elements of the revised Principles in that effort.

And all this is before the Principles are officially launched. That will occur in November at the ICGN's conference in Washington DC and they will then be available at www.icgn.org. We are hoping that following their formal launch and the publicity which will hopefully accompany it the Principles will gain even greater currency. It is after that point that investors such as CalPERS will have the opportunity to adopt them as their own standards.

Public policy and best practice

Protecting and enhancing value by promoting better regulation

EOS contributes to the development of policy and best practice on corporate governance, corporate responsibility and shareholder rights to protect and enhance the value of its clients' shareholdings over the longer term.

'Investment institutions are typically absent from public policy debates even though they can have a profound impact on shareholder value. EOS seeks to fill this gap.'

Overview

EOS actively participates in debates on public policy matters to protect and enhance value for clients by increasing shareholder rights and boosting protection for minority shareholders. This work extends across: company law, which in many markets sets a basic foundation for shareholder rights; securities laws, which frame the operation of the markets and ensure that value creation is reflected in value for shareholders; and in developing codes of best practice for governance, management of key risks and disclosure. In addition to this work on a country-specific basis, we address regulations with a global remit, which are currently in the areas of accounting and auditing standards.

Investment institutions are typically absent from public policy debates even though they can have profound impact on shareholder value. EOS seeks to fill this gap.

By playing a full role in shaping these standards we can ensure that they work in the interests of shareholders rather than being moulded to the narrow interests of other market participants (particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates) whose interests may be markedly different.

Highlighted sample activities

Acting in concert regimes

Acting in concert rules in various jurisdictions are a key impediment to effective collective engagement by investors. We are keen to limit the effect of these barriers so that they do not prevent shareholders from calling management to account for their actions. In Europe therefore we are leading a UNPRI clearinghouse collaboration to engage with the European Commission and the regulators in individual countries to ensure that the spirit of EU legislation is reflected in practice. Among actions in other markets, in this quarter we have started to work on the acting in concert regime in South Africa.

Call to action at Copenhagen

We co-signed a letter alongside nearly 200 institutional investors from around the world, calling for concrete steps at the Copenhagen climate change negotiations in December. The statement calls on the policy-makers preparing for these crucial negotiations to develop a strong and binding treaty on reducing greenhouse gas emissions. We argued that only through such a clear and binding treaty will investment in carbon mitigation become attractive for institutional investors.

Further steps forward in US regulation

There continues to be strong progress on regulation in the US, and we have played a full part in ensuring that investors have effective input to how this develops. We made detailed comments to the SEC in response to consultations on proxy access and proxy disclosure and solicitation, urging positive steps forward and using our international experience to reject the arguments of those who suggest that proxy access will undermine the effectiveness of companies and their boards. We have also been able to make more informal representations to the Commission through its new investor advisory committee, which includes one of EOS's board members. Further to these actions, we made representations to the regulator regarding shareholder proposals and activism. Finally, we are also seeking to ensure that investors respond positively and appropriately to the new powers which the proposed changes will put into their hands, and have again shared our international experience through a series of speeches, conference calls and articles on the developments.

Forest Footprint Disclosure Project

The FFDP has made significant steps forward this quarter, with letters being sent out to hundreds of affected companies seeking their responses to a series of questions regarding their perceptions of the impact their activities have on forest resources. We have played a key role as one of the leading investor supporters of FFDP, by providing detailed advice and input both on the questions to be asked and on the companies which should be approached. We continue to cooperate with the team and will work closely with them in identifying problem companies both through the responses to the disclosure requests and lack of responses and will look to lead group engagements on the issue.

Japanese regulatory reform

We continue our dialogue with Japanese officials, companies and advisers regarding the need for change to the Japanese regulatory regime. We are delighted by the first steps towards introducing a form of pre-emption rights in the country, something we have been seeking in our dialogue with regulators over recent years. While this is a positive step, we have argued for some adjustments to tighten the protections for existing shareholders. Beyond this, we believe that more needs to be done in a range of areas, not least in relation to board structures and the role of the statutory auditors. We are also continuing to urge a reassessment of the takeover regime so that companies see less need to introduce poison pills, and to this end are recommending the adoption of a system akin to that seen under the EU Takeover Directive.

Regulatory responses to the crisis

We continued in our efforts to drive an effective response from regulators around the world to the financial crisis. We made contact with government representatives from a number of countries to highlight our views as to the areas where regulation of financial institutions and of the financial system needs to change. We believed that this was crucial in the run-up to the September G20 summit in Pittsburgh. Again we highlighted the need for the issues of risk management, board structure and behaviours, and remuneration to be dealt with effectively.

Public policy and best practice continued

Among other points on remuneration we recommended that the proportion of current profits which is a result of effective government subsidy (through asset purchases and rock-bottom interest rates, for example) should be excluded from the calculation of bonus pools for banking staff. We argued that this would more closely reflect the performance of the individuals and see the government subsidies end up in the place they were intended for: rebuilding capital ratios rather than going into individuals' back pockets.

ICGN Principles revision

The revised Principles were approved by ICGN members, as discussed elsewhere in this report.

Other public policy work this quarter included:

Companies Acts and equivalents

- EU adoption of ISAs – response to consultation on requiring all EU audits to be carried out according to International Standards for Auditing
- German governance law – letter to all large German companies highlighting our views on remuneration report votes and supervisory board composition

Securities Laws and Regulations

- Brazilian listing regime – discussion with former chair of CVM on how to make regulatory enforcement more effective
- Hong Kong pre-emption rights – dialogue with individual companies to enhance practices
- Hong Kong short positions – consultation response to encourage greater transparency
- South Korean pre-emption rights – dialogue with individual companies to enhance practices

Codes of best practice

- EU on governance in financial institutions – responded to survey regarding corporate governance within banks and other institutions
- German board diversity – creation of working group to promote diversity
- Indian governance – developing our work on ACGA governance white paper for India
- Spanish chartered director qualification – support of first cadre of graduates from Spanish Institute of Directors course
- Norwegian corporate governance – input to review of the governance Code
- UK corporate governance – input to review of the Combined Code

Global standards

- IOSCO periodic disclosure – response to consultation on more effective corporate reporting
- IAASB greenhouse gas emissions reporting – comments to IAASB member ahead of board considering proposals for assurance standard on emissions reporting
- IASB financial statements presentation – discussion with IASB board member, highlighted concerns and possible ways forward
- IASB financial instruments – meeting with IASB board member, response to consultation

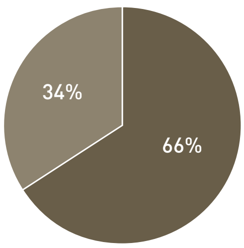
Hermes votes at general meetings wherever practicable. We take a graduated approach and base our decisions on annual report disclosures, discussions with the company and independent analysis. We inform companies before we vote against or abstain on any resolution, usually following up such votes with a letter. We maintain a database of voting and contact with companies and if we believe further intervention is merited, we include the company in our main engagement programme.

Hermes votes at company meetings all over the world, wherever its clients own shares.

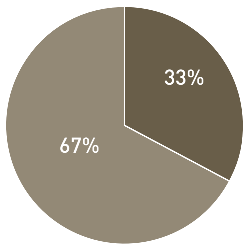
Voting overview
How we voted for PNO Media

Over the last quarter, we voted at a total of 97 meetings around the world, analysing 990 resolutions. At 21 of those meetings we opposed one or more resolutions. We voted with management by exception at one meetings, while we supported management on all resolutions at 75 meetings.

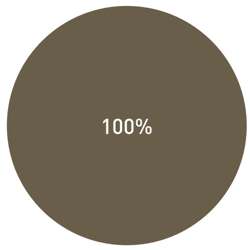
North America
We voted at 29 meetings (263 resolutions) over the quarter.



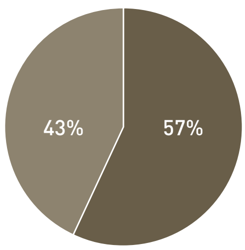
Japan
We voted at three meetings (26 resolutions) over the quarter.



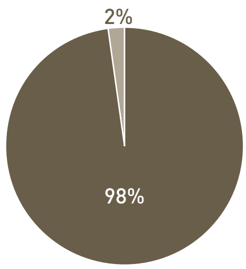
Australia/New Zealand
We voted at two meetings (16 resolutions) over the quarter.



Western Europe
We voted at 21 meetings (148 resolutions) over the quarter.



UK
We voted at 42 meetings (537 resolutions) over the quarter.



- Total meetings voted in favour
- Meetings where voted against (or voted against AND abstained)
- Meetings where abstained
- Meetings where voted with management by exception

What is EOS?

Hermes Equity Ownership Services (EOS) helps institutional shareowners around the world to meet their fiduciary responsibilities and become active owners of public companies. EOS' team of engagement and voting specialists monitor its clients' investments in companies and intervene where necessary with the aim of improving performance. EOS' activities are based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

As the largest pension fund in the UK, Hermes' parent the BT Pension Scheme (BTPS), has substantial interests across international markets. Through pooling resource with other like-minded funds to create a stronger and more representative shareholder voice, our joint company engagements are more effective.

Hermes has the largest stewardship resource of any fund manager in the world. Our team includes former CEOs and other board members of public companies, as well as senior strategists, corporate governance experts, investment bankers, fund managers, lawyers and accountants.

The depth and breadth of this resource reflects our philosophy that ownership 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 and with credibility. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy setting is critical to the success of our engagements.

Hermes and the BTPS have extensive experience of implementing the United Nations' Principles for Responsible Investment (UN PRI). EOS' Chief Executive Colin Melvin chaired the committee that drew up the original principles, and the current chair is a trustee of the BTPS. This insight enables EOS to help clients who wish to become signatories or have already achieved signatory status to meet the challenges of the PRI.

How does EOS work?

EOS uses a proprietary screening process to determine which companies will benefit from intensive engagement. The first element of this screen looks at the companies' ability to create shareholder value by comparing the weighted average cost of capital with cash returns to investors. The second element assesses the prospects for engagement success. We apply further screens across a range of other metrics including environmental and social issues.

The Hermes Principles set out our basic expectations of companies in which our clients invest. These cover business strategy, communications, financial structure, governance and management of social, ethical and environmental risks. The Principles and their regional iterations guide our intervention with companies throughout the world. Our approach is pragmatic and company and market specific, taking into account individual company circumstances.

We escalate the intensity of our involvement with companies over time depending on the nature of the challenges they face and the attitude of the board towards our intervention. Some engagements involve one or two meetings over a period of months, others are more complex and entail multiple meetings with different board members over several years.

At any one time there are many companies included within our engagement programmes, meaning that significant additional resources are dedicated to these situations. All of our engagements are undertaken subject to a rigorous initial assessment and ongoing review process to ensure that we are focusing our efforts where they can add most value for our clients.

While we are robust in our dealings with companies, the aim is to deliver value to clients, not to seek headlines through campaigns. These can often undermine the trust which would otherwise exist between a company and its owners. We aim to be honest and open with companies about the nature of our discussions and will seek to keep such discussions private. Not only has this proved the most effective way to bring about change, it also acts as a protection to our clients, so that their position will not be misrepresented in the press.

For these reasons, this public report does not contain specific details of our interactions with companies but aims to bring clarity on some of the most important issues relevant to responsible owners today and EOS' related activities in these areas.

We would be delighted to discuss EOS with you in greater detail.

For further information please contact Colin Melvin on 020 7680 2251.

Important information

This communication is directed only at recipients who are eligible counterparties or professional clients, as defined in the Glossary to the Financial Services Authority's Handbook of Rules and Guidance. Any investment or service to which this communication relates is only available to and will only be engaged in with such persons and any other persons who receive this communication should not rely on or act upon this communication.

This communication is issued and approved only for the purposes of section 21 of the Financial Services and Markets Act 2000 by Hermes Investment Management Limited ("HIML").

Hermes is a multi-specialist asset manager, independent of any broader financial services organisation. Each Hermes operating company (and limited liability partnership) is either a subsidiary of, or is otherwise affiliated to, Hermes Fund Managers Limited. They carry on business under the name "Hermes". The main operating companies within the Hermes Group are Hermes Investment Management Limited ("HIML"), Hermes Administration Services Limited ("HASL"), Hermes Focus Asset Management Limited ("HFAM"), Hermes Focus Asset Management Europe Limited ("HFAME"), Hermes UOB Capital Asset Management Limited ("HUCM"), Hermes Private Equity Limited ("HPEL"), Hermes Real Estate Investment Management Limited ("HREIML"), Hermes BPK Partners LLP ("HBPK") and Hermes Equity Ownership Services Limited ("EOS"). All of the above named operating companies are separately authorised and regulated by the Financial Services Authority except for Hermes Real Estate Investment Management Limited ("HREIML") and Hermes Equity Ownership Services Limited ("EOS") which are not regulated.

Hermes Equity Ownership Services Limited ("EOS") has its registered office at Lloyds Chambers, 1 Portsoken Street, London, E1 8HZ.

Please note that the Financial Services Authority does not generally regulate any activities referred to in this document which are not regulated activities under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

This document has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. This document is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Prospective investors must rely on their own examination of the legal, taxation, financial and other consequences of an investment in the funds, including the merits of investing and the risks involved. Prospective investors should not treat the contents of this document as advice relating to legal, taxation or investment matters. Before entering into an agreement in respect of an investment referred to in this document, you should consult your own professional and/or investment advisers as to its suitability for you and should understand that statements regarding future prospects may not be realised. No action should be taken or omitted to be taken in reliance upon information in this document.

Figures, unless otherwise indicated, are sourced from Hermes.

This document may include a list of Hermes Equity Ownership Services Limited ("HEOS") clients. Please note that inclusion on this list should not be construed as an endorsement of Hermes Equity Ownership Services Limited ("HEOS") services. Should you wish to contact a client for reference purposes, please let Hermes know in advance.

Hermes Equity Ownership Services

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