Dear Sir/Madam,

Please find below our comments on the areas under discussion in the Green Paper (www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf). We are an investment management business and hold direct equity stakes in many companies on the UK stock market, with corporate governance an important part of our offering to clients and on whose behalf we aim to vote on every resolution presented to us. As a business, Castlefield is Employee-Owned and we think that there are some areas in which public companies can benefit from some of the approaches seen within the employee-owned sector and as espoused by the Employee Ownership Association. Equally, we agree that it is right to place some focus on governance in private sector companies to ensure that best practice is upheld wherever possible in the UK. We have attempted to frame our responses directly relating to each of the questions posed as requested, albeit they may not be perfectly so.

Executive Pay

1. **Do shareholders need stronger powers? –** In a word, yes. We do have substantial powers as it is although these are not being used as widely as they could be. Nonetheless, we think stiffening the framework can make a positive difference. Executive pay is a key concern for us and many others and one of our main issues is how disproportionate it is compared to the pay of the majority of a company's employees, who after all are the bedrock on which any company's success is built. Most of the options presented have some merit in our view. It might be worth trialling having the annual vote on executive pay as always binding, as opposed to the current system of a binding vote on pay policy every 3 years but only advisory votes on the pay reports in between. An escalation process sounds attractive if one can be structured; certainly, we aim to escalate the extent of our voting against management if we do not see any evidence of meaningful change, i.e. moving from abstention to voting against, as well as potentially voting against the chairperson or even the whole of the remuneration committee. We also like the idea of stronger consequences for companies losing an advisory vote, with the view that the next vote should be binding and also require a 'supermajority' as the paper moots. We aren't sold on the idea of an upper pay threshold – the risk is that this might become simply a target to spend up to. On option (iv), whilst above we suggest that a binding vote each year on the *report* might be worth trialling, we aren't in favour of a new pay *policy* needing to be authorised every year – this would risk short-termism as in our view, a policy should be set out based on a multi-year company strategy and the possible rewards that might flow from delivering that strategy successfully. Finally for this section, strengthening the code to be more specific on engagement over pay should be of use. We are particularly mindful here of the suggestion over greater sensitivity to wider employee pay – it is standard practice for us to consider how much of a pay rise executive management is being granted compared to that of their employees and whether it seems proportionate.

2. **Shareholder engagement on pay –** it should be possible to get greater engagement from shareholders to use their votes (although voter turnout is not just an issue here!). Mandatory disclosure of voting records is an interesting option and would highlight any institutions simply voting along with management without due consideration of any of the issues. It would be controversial but could provide greater transparency – albeit with no guarantee that it would ultimately change the voting behaviour of institutions who perhaps currently rubber-stamp all resolutions without considering governance issues properly. Alternatively, perhaps all institutions should be required to publicly state that they expect investee companies to adhere to the UK Corporate Code of Conduct. We don't feel a senior

"shareholder" committee would be practical or add much value. Next, if individuals could be encouraged or facilitated to cast their votes, it would be welcome – but we know from how we cast our votes for clients that it might be logistically complex to empower every individual to vote according to their own personal views. This therefore plays back into aiming the focus on institutions to consider and vote appropriately. The two key issues seem to be those not casting that vote at all – where facilitation of voting might be an important consideration to focus on – and those that vote, but do so solely in line with management and do not meaningfully consider the issues at play. Perhaps institutions need training on utilising their shareholder powers properly and understanding why robust policies are needed in areas such as remuneration, audit independence and shareholder protections because they can make a difference to long term shareholder returns.

3. **The role of the remuneration committee –** Yes, absolutely these committees need to be more effective. We are somewhat surprised by the comment by the Executive Remuneration Working Group that executive pay can be difficult to understand even for executive remuneration committees. That suggests a structure that is not fit for purpose! We are firmly of the view that remuneration packages are overly complex and need to be simplified but quite simply, these packages should not be agreed and signed off if those responsible do not understand them. Neither of the options presented are clear-cut in our eyes, though. Consulting the wider workforce has an obvious attraction but we aren't sure if this would practically work (and have divergent views among ourselves here). This might be an area where evidence from the Employee-Owned (EO) sector could be useful, as it would be interesting to learn if employee consultation on pay was a growing feature among EO companies and if there was evidence of it being of benefit. We think the suggestion of a Chairperson of such committees having at least one year's experience on a committee before taking up a role has merit, as it potentially avoids the risk of a CEO parachuting a friend into the role who might be happy to steer the committee towards an outsized package. As for other suggestions as to how to tackle this issue, our voting policy sets out that if we are unhappy with the remuneration sanctioned, we can escalate our voting up to the point where we vote against the entire remuneration committee's re-appointment to the Board.

4. **Transparency in executive pay –** Again, yes, we absolutely believe pay ratio reporting should be introduced. We are about to publish our revised voting policy, which among other topics will set out specific ratios that we have agreed as acceptable. We consider the ratio of CEO pay in the context of top-to-bottom within the company and also compared to the UK's median gross salary – this allows us to compare both within a company and in the context of the wider economy. In addition, we are also prepared to sanction a higher pay multiple if a company is a Living Wage Employer, as to us that demonstrates greater consideration of the workforce (for clarity, this relates to the true Living Wage, rather than the government's National Living Wage). On the top-to-bottom ratio, we know that the John Lewis Partnership (JLP) has a figure of 75x which is something to evidence from the EO sector. For our guidelines we are looking at a ratio here of 60-65x (with the higher figure applying to Living Wage Employers), so slightly more conservative than JLP. When compared to the UK median salary, our acceptable range is 30-35x, again with the higher figure applying to Living Wage Employers.

5. **Bonus payment disclosure** - As regards the question on bonuses, we are in favour of disclosure of targets, with retrospective disclosure acceptable as long as an acceptable rationale is provided for the delay. We are concerned that sometimes, the veil of "commercial sensitivity" is drawn over bonus targets when not wholly justified. Ideally we

would like companies to explain the rationale for their non-disclosure so that as investors, we can make a more informed judgement on whether this argument stands up to scrutiny. It should be a reporting requirement to have retrospective disclosure of all bonus targets within a specified timeframe.

6. **Long-term executive pay incentives –** we don't yet have the detail we'd like on this front – if only because the nature and scale of LTIPs is an issue we have identified as being of concern and which we intend to research and write a report on this year. In short, though, we believe such plans are not aligned with the best interests of companies or shareholders and are another means of stretching the pay gap between executives and ordinary employees. They are overly complex and overly large. We would be happy with the holding periods for e.g. share options being stretched to a minimum of 5 years rather than the current 3 year period. We believe management should be focused on the long term strategy for the business and 3 years is less than half of a typical economic cycle. Any moves that can reduce the short-termism seen on some public company boards is good in our eyes and should also mean a more stable working environment for employees, who often end up wearing the cost of failed strategies that their executives have been handsomely remunerated for. Performance criteria should be simplified, easily measurable and aligned with their investors and employees. History is littered with companies where management have been incentivised to game their financial returns in order to maximise their short-term pay-outs at the expense of a viable long-term strategy and the health of the company.

Strengthening the employee, customer and wider stakeholder voice

This section is one where it seems clear to us that the Employee Owned message can be trumpeted loud and clear! When the green paper asks for examples of good practice, I think that the EO sector as a whole can be looked to given its contribution to the economy and the different ways that this success can be achieved, all by focusing on the employees as the heart of the company. We are firmly of the view that public companies that seek to look after their employees in the long term should be better-placed to be successful.

Options for reform

7. **Stakeholder panels** – these sound interesting but might not be the most practical means to be effective. We aren't yet convinced about the wider workforce being consulted on executive pay as a plausible development and it feels more important to have a mechanism for dialogue on business strategy and implications than to focus on stakeholder involvement in pay. How best to get employee engagement working properly in public companies? Of the options, having a representative on company boards is attractive to us. We don't buy the argument that it might lead to greater conflict – debate and divergence are good things to us (within reason), as a board filled with "yes men" won't act as a suitable check on the executive management of the company. The green paper notes that employee representation on the board might be ineffective unless matched with steps to foster employee engagement throughout the company – something to be encouraged, in our view. (In 2016 we took the step of having our first Employee Benefit Trust Representative chosen, with one of her roles being to sit on the Castlefield Board – so we are new to this but we are enthused by the prospects this will bring). The Employee Ownership Association (EOA) can provide detailed evidence and guidance on how to choose such a representative and how it could work. This could perhaps involve a workers' council that then funnels a selected member into Board level discussions.

8. **Type and size of company for the stakeholder voice** - The issue of size of company to introduce a focus on strengthening the stakeholder voice is a tricky one – ideally, all companies would do so but in practical terms, we feel there should be some form of minimum size to make it workable. For companies with very few employees, trying to force a structure into place that is more suited to far larger companies would be counterproductive. We haven't considered where such a size threshold would fall, however.

9. **How to take reform forward -** We believe that a code-based approach is the best for driving reform. Voluntary approaches are unlikely to get widespread uptake, or at least the level of uptake desired, whilst the government already seems to have ruled out legislation in some areas (such as worker representation on boards), so code-based remains by default. Given the success achieved to date with the code applying to public companies, this can be continued and widened as necessary. We like the "comply or explain" part of the UK Corporate Governance Code and think that could be applied more widely.

<u>Corporate governance in large, privately-held businesses</u>

10. **The case for strengthening the corporate governance framework for the UK's largest, privately-held businesses** - the key seems to be the ability of both public and private companies to learn from each other and share best practice. The Employee Owned sector has a huge amount to offer given its success and its focus on ensuring sustainability and profitability. For example, great attention to detail is paid when recruiting and retaining staff (with the aim of reducing staff turnover), while the motivation that derives from being employed in companies that place greater focus on individual well-being and prospects is highly transferable. Public companies have the potential to do much better – and arguably achieve greater public respect – if they take the time to invest in their employees. After all, executives running public companies that can be profitable and sustainably so will reap the financial rewards in due course, without needing to resort to excessive remuneration and a short term focus. We already look favourably on public companies where employees have a meaningful stake in the business (e.g. via EBT or ESOP) and believe that they have a competitive advantage. In addition, we can and do invest in private companies via non-voting instruments where e.g. the remuneration policies outlined above can't be applied. Examples would be private equity funds or individual bonds issued by private companies. Even though the same voting opportunities do not exist, if better standards are adopted by all companies it could improve financial performance and stability. So if the FRC can stiffen the code to ensure greater thought on executive remuneration and to encourage investor engagement, that is one side of the equation; then on the other, the EO sector can, via the EOA, highlight the kind of practices that enable EO companies to be admired for their stakeholder focus and engagement and for the success that flows as a result. At the same time, it is important that privately-held businesses can also be seen to enjoy the same kind of corporate governance standards and scrutiny – particularly in the largest examples of the type – that their publicly-listed counterparts do. Good corporate governance should be expected regardless of the legal form of a business.

11. **Which privately-held businesses should be in scope? –** We have not considered this in great detail, but in principle, if any size threshold is applied to public companies then the same threshold might be a sensible starting point for the private sector. Any burdens for complying with the framework should be taken into account and the level of compliance could be varied – such as in public companies, where companies listed on AIM are not subject to the same degree to the UK Code.

12. **How should strengthening the corporate governance framework be achieved?** - as with response 9 above, we feel that a code-based approach is preferable. It seems to work and the emphasis should be on improving and/or refining the code, rather than introducing legislation.

13. No commentary here. However, there is some merit in considering a threshold other than one simply focused on the legal form of a business.

Other Issues

14. **Is the current corporate governance framework in the UK providing the right combination?** – By and large, we think it is. As noted earlier, we think that the "comply or explain" method is particularly effective and is something that we adhere to but also adopt as an internal guidance point, so we keep records of where we might have diverged from our own guidance and policies. Trying to keep burdens manageable is a worthwhile aim and in general, we think that the high standards in tandem with low burdens is a sensible approach. There is scope to do more albeit arguably the majority of this needs to come from investors themselves in using the tools afforded them by the Code. Some stiffening or tightening in some areas of the Code will undoubtedly prove useful though.

Please do not hesitate to get in touch if you require clarification on any of the points expressed above.

Regards,

Simon