STEWARDSHIP REPORT

Q1 2019

CASTLEFIELD

THE THOUGHTFUL INVESTOR

VOTING Q1 2019

VOTING

At Castlefield, we understand that an important part of managing our clients' assets is being active stewards. We have developed a set of voting guidelines which outline our stance on issues such as executive pay (which should be linked to performance), director independence (which is crucial for objective board oversight) and auditor appointment (regular auditor rotation reduces the risk of fraudulent activity). A key part of this commitment is our voting activity and we aim to utilise every voting opportunity. The application of our voting policy ensures we take a uniform approach to decision-making. In addition, we opt to update our voting guidelines regularly to ensure that they still serve their purpose of representing client views. During February of this year we spent time performing our annual revisions and we will be using these updated guidelines over the coming year. Details of the changes can be found later in this report.

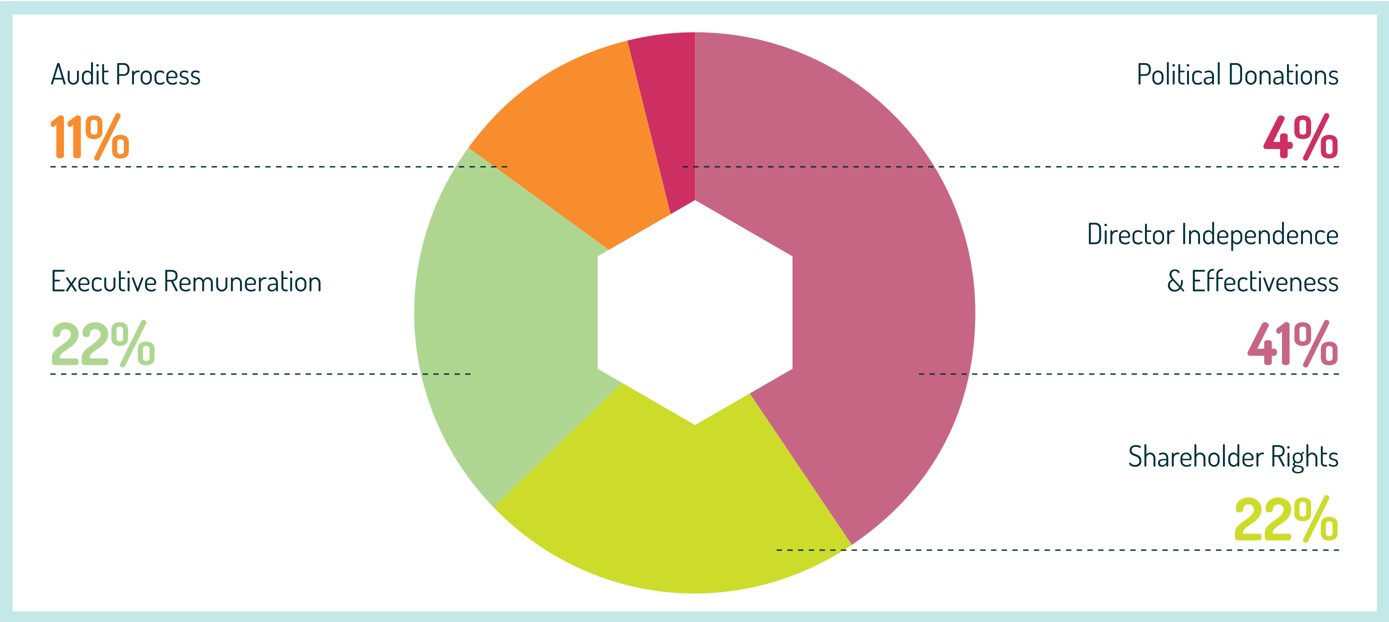
RESOLUTIONS

Number of resolutions where votes were cast **For**	156	85.2%
Number of resolutions where votes were cast **Against**	23	12.6%
Number of resolutions where votes were **Abstained**	4	2.2%

Over the quarter, our investee companies hosted **21** meetings with **183** resolutions to be voted. Of the proposals we voted on, **156** of our votes were cast in support, **23** were against and **4** were abstentions.

1	**EXECUTIVE REMUNERATION**	... is covered by the remuneration report and the remuneration policy. If either of these proposals do not adhere to the guidelines in our voting policy, we vote Against these resolutions.
2	**SHAREHOLDER RIGHTS**	... refers to requests made by a company to engage in practices that we believe may be detrimental to shareholders. For example, we do not believe 14 days' notice is sufficient time for shareholders to prepare to exercise their voting rights and so will vote Against this request.
3	**DIRECTOR INDEPENDENCE & EFFECTIVENESS**	... is an issue often involving Non-Executive Directors (NEDs). NEDs should be independent in order to be effective and if a NED has been in place for longer than the nine-year tenure recommended by the UK Corporate Governance Code we will often vote Against or opt to Abstain. We will also vote Against the reappointment of a director if we feel they have not been particularly effective or if we feel that, due to a large number of external commitments, they may not be able to dedicate sufficient time to their directorship.
4	**POLITICAL DONATIONS**	We do not think it is appropriate for companies to make political donations and consequently will always vote Against a resolution seeking permission to do so.
5	**THE AUDIT PROCESS**	... refers to auditor independence which may be compromised if the auditor has been in place for a long time and no tendering process has been undertaken, or if a large proportion of fees paid are for services other than their primary audit function.

% OF VOTES TO ABSTAIN OR GO AGAINST MANAGEMENT IN Q1



During the first three months of 2019, we were most likely to abstain or vote against management on the basis of director appointments. This accounted for **41%** of votes against and abstentions. This is usually due to issues surrounding independence and the time commitments of the non-executive directors facing re-election.

Remuneration was another key reason for not voting with management and accounted for **22%** of dissenting votes cast over the period. The reasoning behind this was often excessive base salary or incentive payments. We vote against pay packages where there is a large disparity between the pay of directors and the average pay received by company workers. We will also vote against pay packages that lack stretching performance targets as this makes it too easy for executives to be awarded generously for mediocre performance.

An additional **22%** of abstentions and votes against fell into the category of 'shareholder rights'. We vote against resolutions proposing to hold general meetings at 14 days' notice as we firmly believe that this does not allow for investors to prepare adequately for the meeting and therefore is an infringement of shareholder rights.

The number of protest votes relating to the audit process accounted for 11% of the total for this quarter. This is slightly lower than last quarter despite the introduction of a new voting guideline relating to auditors. This new addition to our voting policy prohibits the payment of non-audit fees to professional services firms that also act as the external auditor for the company. We feel that this measure will improve our monitoring of auditor independence as it will prevent the auditor becoming compromised by a cosy relationship between them and their client company.

Finally, we do not view political donations as an appropriate use of capital and, as such, we always vote against resolutions requesting shareholder permission for this activity, between January and March this was **4%** of total dissenting votes.

CORPORATE GOVERNANCE & VOTING

ANNUAL UPDATE TO THE CORPORATE GOVERNANCE AND VOTING GUIDELINES

When a share in a company is purchased, shareholders gain certain rights. This includes having a say in how that company is managed. At Castlefield, we use these rights to vote on strategic issues that we feel affect all stakeholders, this not only includes investors but also employees, customers and wider society. These issues are presented for shareholder vote at least annually. We take the time to consider each resolution carefully and aim to vote on all the stocks we hold in our Castlefield Fund Range. This voting process is an essential part of being a Thoughtful Investor. As a consequence, we revise our voting guidelines on an annual basis to take account of emerging governance issues and to hone how we represent our clients when exercising our duties as stewards.

Our updated policy includes the following changes:

- We have included a new provision to vote AGAINST executive directors who fail to adhere to the shareholding requirements outlined in their remuneration policies. Shareholding requirements are designed to align directors with shareholders and ensure they have "skin in the game". Where executives fail to reach the minimum prescribed shareholding within a reasonable timeframe, we feel they demonstrate a lack of commitment to the company and so do not intend to support them going forward.
- In line with changes to the UK Corporate Governance Code, we have also opted to edit our guidelines to vote AGAINST remuneration schemes that do not require executives to hold shares in the company for a minimum of 5 years. This is to align executives with the interests of long term shareholders such as Castlefield.
- After reviewing the discrepancies between the pension provisions made for executives and the wider workforce last year, we have opted to include a separate guideline concerning pensions. Where pension provision for executives are based on more than just basic pay or are deemed far in excess of those available to the wider workforce we will vote AGAINST resolutions concerning remuneration. We may also vote AGAINST pension contributions which are paid out entirely in cash rather than into a pension scheme. This is because cash payments allow the decoupling of CEOs from company pension schemes that once anchored them to reasonable levels.
- We have further strengthened our position that our investee companies should have a culture of inclusivity. We have included the point that companies should evidence that they are taking meaningful action to address a lack of diversity. This provision is designed to address the need for companies to go beyond a mere policy and demonstrate responsible practices when it comes to cultivating a diverse workforce.

The latest changes were made following discussions during the internal Stewardship Committee meeting and are based on reflections on how the previous iteration has been implemented over the preceding 12 months. In addition, the External Advisory Committee were approached to share their opinions on the Castlefield stewardship process and offer their recommendations for improvement. The Committee is composed of independent members with expertise in sustainability and investment. The External Advisers are able to provide invaluable insights and new perspectives to help ensure that the guidelines offer voting consistency across all holdings.

ENGAGEMENT

ENGAGEMENT ON WATER USE - MANUFACTURE OF SEMICONDUCTORS

Sustainable Development Goal 6 aims to ensure availability and sustainable management of water and sanitation for all. One of the targets that underpins this goal seeks to substantially increase water-use efficiency across all sectors, ensure sustainable withdrawals and supply of freshwater to address water scarcity and reduce the number of people suffering from a lack of water[1]. Manufacturing is a key area where intensity of water use can be reduced in order to help meet this target.

Every manufactured product requires water. It is estimated that industry accounts for 20% of global water use, whereas drinking water accounts for just 1%[2]. On top of this, global water demand for manufacturing is expected to increase by 400% from 2000 to 2050[3]. Castlefield hope that by engaging with investee companies that we have identified as having exposure to water use as a significant risk, we can encourage these businesses to increase efficiencies in this area.

An industry that we have identified as being particularly water-intense is the production of semi-conductors. Semiconductors are essential components in technology products which have facilitated many advancements, including computers and smartphones. However, the manufacturing process is reliant on large volumes of ultrapure water to avoid contamination of the chips and maintain the integrity of the product[4]. The silicon wafers used in these products must be washed repeatedly to remove contaminants. As a consequence, we wanted to contact investee companies that manufacture in this way to find out more about how they consider water use and what can be done to improve efficiency.

Melexis designs, develops, tests, and markets advanced integrated semiconductor devices primarily for the automotive industry. It is a Belgian company held within our Castlefield B.E.S.T Sustainable European Fund. We have written to the company to find out more about how they assess suppliers based on their water efficiency and whether they have targets in place to reduce water use as part of their direct operations and as part of their supply chain. We are in regular contact with company representative and look forward to hearing their response during our next conference call.

One other company that was contacted was CML Microsystems which, through its subsidiaries, designs, manufactures, and markets a range of semiconductor products for use in communications and data storage industries worldwide. CML is a UK company held within the Castlefield B.E.S.T Sustainable UK Smaller Companies Fund. We wanted to engage with the company to find out more about how they consider water scarcity as an environmental risk. A representative replied to say that although they do not have specific measures in place to assess the water efficiency of third parties, their biggest wafer suppliers take the issue very seriously and have it as a key focus in their own CSR programmes. They also mentioned that CML places an on-going focus on reducing resource usage as a cost reduction mechanism. We were pleased to hear back from CML and hope that this will be the start of an ongoing engagement surrounding best practice water use.

The engagement was particularly pertinent for this quarter as the 22nd of March 2019 was UN World Water Day, an event designed to promote awareness of water scarcity. Water is a human right and efforts to ensure access to safe water for all should be on everyone's agenda. As part of our commitment to monitoring water use, Castlefield will continue to analyse water risks as part of our sustainable investment process and engage with companies where we feel the management of this most important resource could be improved.

REFERENCES

1. https://sustainabledevelopment.un.org/sdg6
2. http://wwd.unwater.org/2018/app/uploads/2018/02/fact_sheet_WWD2017_EN_2.pdf
3. http://wwd.unwater.org/2015/home/en/index.html
4. https://www.sustainalytics.com/sustainblog/world-water-day-water-use-semiconductor-industry/

STEWARDSHIP CONSULTATION RESPONSE

On top of our day-to-day engagement with companies on matters such as executive pay, carbon emissions and boardroom diversity. We have spent quite a bit of time recently looking at the Financial Reporting Council's Stewardship Code (the Code), which supports the FRC's wider UK Corporate Governance Code and sets standards for investors for monitoring and engaging with companies. The FRC aims to improve the quality of dialogue between investors and companies through updating the former provisions and principles. The previous code had not been updated since 2012 and, in order to keep pace with the evolving backdrop of stewardship within the UK, the FRC wish to make improvements.

Since 2012, the UK's overall high standards of corporate governance have continued to attract investment from across the world. However, we have seen examples of poor governance practice, poor decision-making and underperformance that have contributed to corporate failure. By re-examining important issues, institutional investors like Castlefield can influence decision-making to improve the effectiveness of capital allocation in the economy. This will benefit investors and society and support sustainable economic growth. We definitely welcome the higher standards outlined in the 2019 draft Code and feel that they are conducive to creating an environment where asset owners and managers integrate stewardship responsibilities into their investment processes in a meaningful way, to the benefit of clients.

THE FRC DEFINES STEWARDSHIP AS FOLLOWS;

Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society. Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities.

www.frc.org.uk

The new Stewardship Code is expected to differ from the last one, published seven years ago, in several ways, the key ones being:

- **CORPORATE PURPOSE**

  We believe that an investment management firm's approach to Stewardship should be central to its corporate purpose and should be discussed at board level, so it is pleasing to see that the new Code promotes this idea.

- **ESG**

  The previous Code, being a product of its time, barely addressed environmental, social and governance factors. These are central to our investment approach so we are pleased to see them given due consideration this time round.

- **MORE RIGOROUS REPORTING REQUIREMENTS**

  All signatories will be required to make public disclosures about their stewardship activities and their assessment of how effectively they have achieved their stated objectives. Reporting will now be in two parts: a Policy and Practice Statement upon signing the new Code and an annual Activities and Outcomes Report.

- **TIERING**

  We are Tier 1 signatories to the present Code, the highest level – however, so are most other asset managers. The tiering system is being redesigned and the bar raised so that investors can more easily differentiate between asset managers who are really serious about good stewardship and those who are less so. The new Tier 1 should better represent companies that explain their approach to stewardship transparently and to a high standard, we are hopeful that we will maintain our high ranking status as a result of our commitments to disclosure and engagement.

- **ASSET CLASSES**
  The 2012 Code only covered listed equity investments whereas the new Code is expected to include stewardship of corporate bonds and other asset classes.

The draft 2019 Code significantly raises the standard expected from institutional investors and aims to create a "market for stewardship" driven by a demand for better quality information about how asset managers and service providers fulfil their responsibilities. When we sign up to the new Code, Castlefield will make a serious commitment to maintaining and improving the quality and integrity of our financial markets. The FRC will be devoting more resource to evaluating the quality of disclosure of both policies and activities.

We are always pleased to participate in consultations because, as a smaller investment management firm based outside of London, we hope that our contributions offer a different perspective from those of our industry peers. We hope that the Castlefield responses to the FRC provide helpful insights and help in the process of enhancing stewardship activities within the wider investment industry. We look forward to seeing the finalised version of the Code and hope that our suggestions are included in the 2019 edition.

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