STEWARDSHIP REPORT
Q1 2020

COVID-19 & LABOUR RIGHTS

COVID-19 AND OUR ENVIRONMENT, SOCIAL AND GOVERNANCE ENGAGEMENT

We talk regularly to companies about the social and environmental impacts of their products and services. We call this ESG (environment, social and governance) engagement and it covers a wide range of issues. In February, for example, climate change, deforestation and gender diversity were just some of the ESG topics we raised with management teams.

But with the global spread of the pandemic, the firms we invest in are no longer operating under business-as-usual conditions. They are working hard to address the short-term implications of COVID-19, while also planning for its long-term impact. In these unprecedented times – as we write, around 25% of the global population is under some form of lockdown – we have taken the decision to hold off on some thematic ESG engagement for the time being. We doubt we will achieve much meaningful dialogue with companies at present and it is not right to detract management from the task in hand. That is not to say that we will not be contacting companies at all. Our ongoing dialogue with them continues (albeit over the phone rather than face-to-face), but some of the thematic engagement we had planned will be postponed until later in the year.

But let us be clear: we still expect firms to act responsibly and will contact companies if we suspect maltreatment of employees, customers or suppliers. It is in crises like this that corporate reputations are made or ruined. Even when difficult decisions need to be taken – like redundancies or site closures – there is still scope for businesses to act with integrity and to treat affected staff with respect and compassion.

COVID-19 AND CORPORATE GOVERNANCE

We are approaching the busy AGM (annual general meeting) season, where investors vote on matters such as executive pay and dividend pay outs. To an outsider it can seem a rather dry event, but the AGM is a critical mechanism for ensuring good governance.

The impact of COVID-19 is affecting AGMs in many ways, including meetings being postponed or held entirely online. More importantly, many firms are suspending dividend payments, which are ordinarily approved at the AGM. The UK regulator has set a firm tone for the financial services sector, telling banks not to pay out dividends and insurance companies to proceed with extreme caution before distributing profits. The German government has gone further, saying that the suspension of the dividend is a requirement for any company seeking government aid.

We see these as sensible, temporary measures, designed to conserve capital for the extreme economic uncertainty ahead. Equally, we are supportive of companies that have decided to suspend their share buy-back programmes in order to retain funds within the business for these unprecedented times.

Finally, the AGM is also where shareholders vote on the salary and bonus of the Chief Executive and other top-ranking staff. Here we share the view of the UK banking regulator that this is not the time for large bonuses to senior management teams, especially in industries heavily impacted by the pandemic or the recession that is predicted to follow. We take a pretty tough stance on excessive pay anyway and this year will be no exception.

COVID-19 AND CORPORATE TAX

Over the medium-term, we anticipate that corporate tax will become a "hot topic" as national governments look to re-build the economy and pay down debt. In the aftermath of the pandemic, it would be audacious of any firm, let alone one that has relied on government intervention for its survival, to pursue an aggressive tax avoidance strategy. We are already seeing calls for any firm receiving a government bailout to be subject to the Fair Tax Mark (an accreditation scheme which demonstrates that companies have adhered to responsible tax principles). We expect such calls to amplify in the months ahead. Indeed, this crisis may even provide a catalyst for greater inter-governmental co-operation on taxation. As such, companies should review their current tax arrangements to ensure that they will withstand public scrutiny in the aftermath of the pandemic.

CORPORATE EFFORTS TO TACKLE COVID-19

In many respects (and it is not our intention to be flippant), coronavirus has been more effective than PR stunts or ad campaigns at reminding us of the importance of companies to society. The UK government's list of key workers (i.e. those that are critical to supporting the country's response to COVID-19) includes a surprising number of industries, from the more obvious food processing and delivery, through to telecommunications, utilities, banks and so on.[1]

Given that our stock selection process favours companies with socially beneficial products and services, it's no surprise that many of these industries feature in our investment funds. As a conservative estimate, around a third of our B.E.S.T Sustainable Income Fund (by holding weights) is invested in companies helping the country to keep running in these unprecedented times – including Morrisons supermarkets, the water utilities firm Pennon, and Unilever, which manufactures personal hygiene products.

A third of our B.E.S.T European Fund too is invested in essential industries. This includes the supermarket chain Carrefour as well as Tecan, a lab solutions provider. Tecan has been quick to partner with others to develop a viral processing solution that helps to simplify the testing process for COVID-19.

Our B.E.S.T Sustainable Smaller Companies Fund and our B.E.S.T Sustainable UK Opportunities Fund also have significant exposure to these critical industries, both at around 30% of fund weightings. Examples here include Tristel in our Smaller Companies Fund, which supplies a chlorine dioxide disinfectant to hospitals, and BT in our UK Opportunities Fund.

We have seen some good examples of corporate responsibility among the companies that we hold. Unilever has committed to donating €100m of soap, sanitiser, bleach and food to various charities and partners globally.[2] In the UK, Morrisons has extended the opening hours of its production facilities so it can generate additional products for food banks. In total, it intends to provide £10m of products to food banks by July 2020.[3] Both companies are also taking measures to support smaller companies in their supply chains.

Another good example of business-to-business support is from Scout24, an online property website listed in Germany. The company has taken extensive measures to support its customer base: granting a payment deferral for its estate agent customers, enabling private individuals to list and advertise for free and providing existing professional customers with free business leads.[4]

As investors, it is important to show our appreciation for such moves and as we speak with our holdings, we are commending them for the action they have taken.

1. https://www.gov.uk/government/publications/coronavirus-covid-19-maintaining-educational-provision/guidance-for-schools-colleges-and-local-authorities-on-maintaining-educational-provision
2. https://www.unilever.com/news/press-releases/2020/helping-to-protect-lives-and-livelihoods-from-the-covid-19-pandemic.html
3. https://www.morrisons-corporate.com/media-centre/corporate-news/morrisons-to-help-restock-britains-foodbanks/
4. https://www.bloomberg.com/press-releases/2020-03-20/dgap-news-scout24-ag-supports-customers-with-a-comprehensive-immediate-action-programme-survive-prevent-accelerate

SITE VISIT

GB GROUP

In October 2019, we visited the Chester HQ of, AIM-listed, GB Group (GBG). GBG are an identity management specialist with three different product offerings: Location Intelligence, ID Verification and Fraud Management, which 'quickly validate and verify the identity and location of their customers'. GBG serves over 19,000 customers across over 70 countries, working with clients ranging from e-commerce giants to banks. Unbeknown to most, when we are making our online purchases, GBG products such as Loqate, which searches and verifies addresses within just a few keystrokes, are likely to be working in the background.

During the site visit we were able to discuss the drivers behind the Group's impressive growth and its geographic expansion in the US and Asia which has come about mainly through recent acquisitions. The Group has carried out 12 acquisitions since 2011, with its biggest being IDology, a leading US-based provider of identity verification and antifraud solutions. This has strengthened its North American presence further and the company saw its international revenue grow in 2019. One further area for growth is through partnering. As online retailers look outside China's urban areas for new growth opportunities, this can make delivery of goods within rural areas extremely difficult, adding extra costs for e-commerce players especially. This is particularly true for Western companies, where goods that cannot be delivered are returned. Therefore, partnering with local players is essential to both GBG's success and its customers.

In January this year, we became aware of an article linking GBG to a data source originating from the Department for Education. The article alleged that gambling companies had been given access to the educational database and that the information had been used to help increase the proportion of young people gambling online. The government had given access to the dataset to a third party, Trustopia, who had in turn provided access to GBG.

While GBG's identity verification services are used by some gambling companies, this service does not involve divulging the underlying data to their customers and is not something that could be used to increase users. The service is designed to verify responses provided by potential users to confirm there is a matching and genuine identity and ensuring that users who do not meet these criteria are unable to access the sites. We had a meeting with management at our offices in Manchester following the publication of the article. The company CEO, Dave Wilson, shared our view that the article misrepresented the nature of GBG's services, confirming that the data that had been accessed via a third party was not shared outside of the business. We continue to view GBG as an investment with strong positive social characteristics and a good corporate culture. Their services help businesses fight fraud and operate in compliance with increasing regulation.

Source: site visit: GBG (03.10.2019)

HEALTHY MARKETS

SHAREACTION'S HEALTHY MARKETS INITIATIVE

Castlefield is a signatory to ShareAction's recently launched Healthy Markets initiative which aims to tackle rising childhood obesity levels by mobilising the investment industry to generate positive impact. The initiative works with investors, manufacturers and retailers to support children and families to live healthier lives.

Access to Nutrition Initiative's (ATNI) UK product profile found that nearly 70% of products sold in UK supermarkets are rated as 'unhealthy'.[1] Therefore, it is not a surprise that our shopping baskets tend to be filled with products high in salt, sugar and fat, which contribute to weight gain and obesity. Childhood obesity is associated with poor physical and mental health, and children from less affluent backgrounds are disproportionately affected. Currently one in three children in the UK is overweight or obese and children who are obese are five times more likely to be obese as adults.[2] Treating overweight and obesity-related ill health costs the NHS an estimated £6.1bn a year and a total of £27bn to the economy through reduced productivity and growth.[3]

In addition to the mounting economic and societal costs, there are also significant risks for businesses. These include: the greater likelihood of regulation and taxes; potentially losing market share if they fail to adequately respond to the growing demand for affordable healthier options; and reputational damage if they are not perceived by customers and other stakeholders to be taking the right approach. Conversely, businesses that shift their strategy towards selling a wider and larger range of healthier products are more likely to realise commercial and reputational benefits.

Working in collaboration with ShareAction, ATNI have recently published the first UK retailers' benchmark to determine the contribution the UK's major retailers are making to tackling childhood obesity. The scope of the report is limited to assessing the extent of their public commitments, rather than whether they are actually implementing these actions. It is important to assess retailers, as they play a crucial role in influencing consumers' food and drink consumption through the formulation, packaging, labelling, pricing, promotion, positioning and advertising of both their own-brand and branded products. As part of ShareAction's investor coalition we will be engaging with companies to encourage them to significantly increase disclosure and to deliver improvements in their policies and practices to support healthy eating.

Access to Nutrition Initiative's UK product profile found that nearly **70%** of products sold in UK supermarkets are rated as 'unhealthy'.[1]

1. ATNI (2019), UK Product Profile
2. ATNI (2020), UK Supermarket Spotlight
3. ShareAction (2019), Hitting the Sweet Spot: The Investment Case for Solutions to Childhood Obesity

EXTERNAL ADVISORY COMMITTEE & VOTING POLICY CHANGES

Castlefield's External Advisory Committee met during February to provide their views on a number of discussion points and policy updates provided by both the Committee members and the investment team at Castlefield. We think it is important to get an external viewpoint on sustainability topics and how we address them as a part of our investment process for the B.E.S.T Sustainable fund range.

Topics covered during the meeting included divestments made from the funds, the impact of single use plastics, and the aquaculture industry. We also followed up on last meeting's discussion on the Sustainable Development Goals (SDGs) with some examples of how it is being used for reporting purposes and looked at an analysis of one of our own funds. A summary of the minutes is now available on our website.

CASTLEFIELD CORPORATE GOVERNANCE & VOTING GUIDELINES

This meeting also saw the Committee review the annual update to the Castlefield Corporate Governance & Voting Guidelines. As investors, we vote at company AGMs. It's a responsibility we take seriously. Voting is a chance to tell directors what we think about their oversight of the business. To make sure we vote consistently across all the companies that we hold shares in, we have a voting policy. We update it annually to ensure we're taking account of emerging issues. This year, we've added in a number of new clauses to reflect the new Stewardship Code that has been issued by the Financial Reporting Authority. Here's a summary of our changes:

Gender Diversity: We've had many conversations with companies over the past few years about gender diversity and we've now formally set out our expectations in our voting policy: we expect 30% of board level directors to be female and that senior leadership teams (i.e. one rung below board level) have a good gender balance.

Ethnic Diversity: In our voting policy, we've adopted the recommendations of the Government's Parker review on ethnic diversity. Companies should demonstrate commitment to addressing the findings of the Parker review, which includes a target of having one BAME (black, Asian or minority ethnic) director on FTSE100 boards by 2021 and on FTSE250 boards by 2024.

Post-cessation Shareholding Requirements: most CEOs receive part of their pay in shares. It's a way of encouraging executive directors to think about the long-term performance of the company, just as we do as investors. The problem is that executive directors don't tend to stay long (5.5 years on average for a FTSE 100 CEO[1]) and have been able to sell their shares upon leaving the business. This could incentivise decision-making that boosts the share price in the short term, without considering the longer-term impact on the business. To counter this, we're now including a clause in our voting policy which says that we want to see directors being required to hold onto a significant number of shares for two years after leaving the company.

Tenure of non-executive directors: The role of non-executive directors (NEDs) is, in part, to question and challenge senior managers such as the CEO. If NEDs stay on the board for too long, there's a risk they might stop asking those difficult, but necessary, questions. They might become complacent or start accepting the "quirks" of a company rather than continuing to challenge them. That's why, in the UK, after nine years a NED is no longer considered independent. In other European markets, a director can be viewed as independent for twelve years. We wanted to have one consistent policy on tenure to cover all our UK and European holdings and whilst we have always stated that any director in post for over nine years will no longer be considered independent, we have recently clarified that this will apply irrespective of geography in our latest voting policy.

1. https://www.roberthalf.co.uk/press/ceo-turnover-decline-internal-candidates-rise-top

ENGAGEMENT CASE STUDIES

	GREENCORE	KONE
Where is this held?	Greencore is not currently held in our fund range.	Castlefield B.E.S.T Sustainable European Fund.
What does the company do?	The company supplies sandwiches, chilled and frozen food to supermarkets and other food retailers.	Finland-based Kone is a global leader in elevators and escalators. To learn more, please see our October stock story on our website: castlefield.com/news-media/blog/european-stock-story-of-the-month-kone.
What was the engagement concerning?	We regularly meet with a wide range of companies to see if they are suitable for investment. When we first met with Greencore, we asked about how they manage their social and environmental impacts. We do this with all companies that we meet; it's a key part of our research process. Greencore told us about some of their environmental initiatives and asked for a separate conference call to get our views on their work in this area. In that call, we highlighted the areas where Greencore is already performing at a high standard, namely on minimising food waste and on its gender pay gap reporting. In terms of areas for improvement, we explained that we would like to see more detail on their plans to reduce plastic packaging and the nutritional profile of its food range. It was a constructive call and Greencore seemed receptive to our suggestions. Although we do not hold Greencore in our funds, we were happy to speak to them and offer our suggestions on better ESG management and reporting.	In anticipation of their upcoming Annual General Meeting (AGM), we got in touch with the company as we had a number of governance issues we wanted to raise. For example, the Group's auditor had been in place for a considerably long period of time, a lack of independence on the Board (founder as Chairman and his son as Vice-Chairman and also the Chair of the Audit Committee) and the issue of bundled director resolutions which is a common theme in Finnish companies (i.e. the resolution for re-electing the Board was bundled into one resolution rather than breaking out each individual director, which is best practice). Later in February, fund manager Rory Hammerson attended a lunch with the CEO in Edinburgh. When Rory raised the question around independence to the CEO, he turned to Rory and said "we listened" – and noted that at their recent AGM they have appointed an independent member to be the Chair of the Audit Committee in place of the Vice Chairman (son of the founder) following our conversation with the Group in early February. This is a great outcome and shows that we are having a positive impact and that our messages are being relayed, there's still some changes we would like to see but baby steps!

WORKFORCE DISCLOSURE INITIATIVE WEBINAR

WORKFORCE DISCLOSURE INITIATIVE WEBINAR:
'INVESTOR PICK: HOT ESG TOPICS FOR 2020.'

In last quarter's commentary, we discussed our involvement with the collaborative engagement stream, the Workforce Disclosure Initiative (WDI), which Castlefield is a signatory to. By way of recap this is a project that aims to make the process of disclosing workforce data simple and efficient. It allows companies to demonstrate to investors, clients and other stakeholders, how they manage their staff and supply chain workers compared to peer organisations. It also gives companies the opportunity to explain how their approach to workforce management is aligned to the overall business strategy, and to signal their understanding of major workforce-related risks and opportunities.[1] Now in its fourth year, the WDI offers an excellent opportunity to generate meaningful and comparable data on workforce issues that will improve our understanding of investee companies.

Since we last reported, we have established an even closer relationship with the WDI team. As a long-standing ally, Castlefield, along with EdenTree Investment Management, was asked by the WDI to participate in its recent webinar, "Investor Pick: Hot ESG Topics for 2020". The webinar outlined how Castlefield integrates WDI's workforce and supply chain data into our investment process and engagement with companies. The WDI dataset is incredibly useful to our work because it provides us with greater insight into the social operations of our investee companies and allows us to have meaningful engagement on the findings. Comparing a company's disclosure against its peers through public scorecards encourages a "race to the top", spurring companies to want to be seen as doing better than its competitors. All businesses, no matter their size or technological capability, rely on their people and their supply chain, and, as investors, we do not view social considerations and financial returns as mutually exclusive.

An unprecedented number of companies (both disclosing and non-disclosing) joined the webinar, and we hope that by sharing our experience we can encourage more companies to participate in the WDI survey, providing investors with more invaluable data. We were pleased to have been asked to participate, which we feel is a true testament to the commitment Castlefield delivers to its collaborative engagement streams. A replay of the webinar can be found at the URL below.

https://shareaction.org/wdi/company-resources/webinars/

1. shareaction.org/wdi

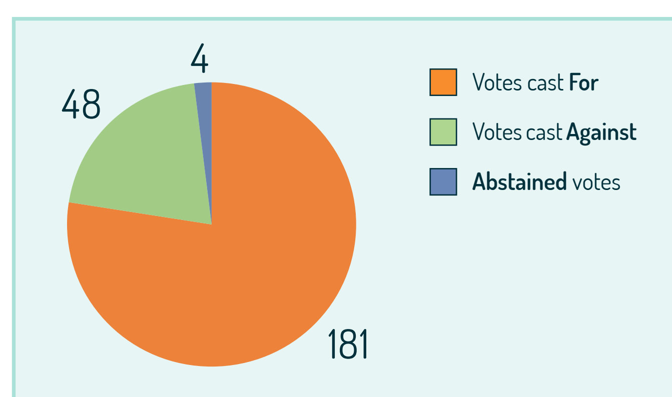
Q1 2020 STEWARDSHIP

VOTING

As investors, it is our responsibility to the companies that we hold to vote on issues such as executive pay, director nominations and political donations. We aim to vote on all the stocks held in the collective funds we manage. We consider each resolution carefully and often engage with companies where we disagree with their approach. As we mention above, we have a set of voting guidelines that we update annually. The guidelines ensure that we vote consistently across all our fund holdings.

In general, we have a modest number of AGMs during the first quarter of the year. The majority of meetings are usually scheduled for Q2, although COVID-19 is, understandably, causing disruption.

RESOLUTIONS



During the period, our holdings hosted **26** meetings with a total of **233** resolutions. Of this, we voted for **181** and against **48** resolutions. In addition, we abstained on four occasions.

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.

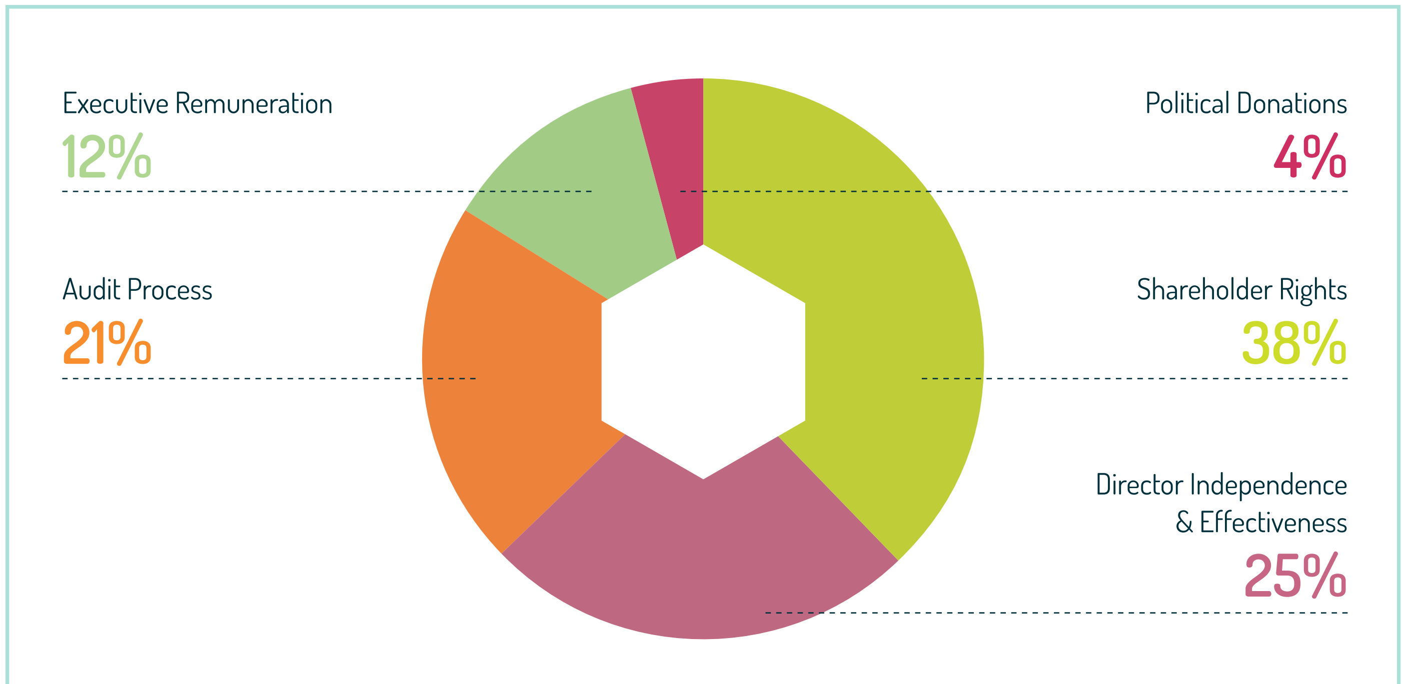
2. **SHAREHOLDER RIGHTS** ... refers to requests made by a company to engage in practices that we believe may be detrimental to shareholders. For example, we do not believe 14 days' notice is sufficient time for shareholders to prepare to exercise their voting rights and so will vote Against this request.

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 fees paid are for services other than their primary audit function.

% OF VOTES TO ABSTAIN OR GO AGAINST MANAGEMENT IN Q1



This quarter, the most common reason for us abstaining or voting against a resolution was shareholder rights which accounted for **38%** of votes where we did not support management. A large proportion of these votes are the result of our policy to vote against resolutions that propose holding general meetings at 14 days' notice. We do not feel that this provides investors sufficient time to analyse the meeting materials and make informed decisions. This quarter, one other example where we voted against shareholder rights resolutions was when a company was seeking to introduce a loyalty voting structure, whereby shareholders would be awarded twice the amount of voting power after holding shares for a specified number of years. We do not feel this is appropriate, particularly where there are large management shareholdings, as it can disadvantage new and minority shareholders.

25% of abstentions and votes against during the quarter related to the appointment of directors. We have long taken the view that directors should not hold a lot of other external positions. This is because, at a time of crisis, we expect directors to have enough additional time to dedicate to the company and the issues that it is facing. COVID-19 is a case in point, where we expect company boards to be meeting more regularly and providing immediate support to their management teams. Individuals with four or five directorships may struggle to fulfil all their obligations, to the detriment of those firms and their stakeholders.

Remuneration accounted for **12%** of votes against management. We vote against excessive pay awards and awards that are not attached to sufficiently stretching performance targets. As discussed above, in light of the impact that COVID-19 is having across many sectors, we will not be supporting significant bonus awards to senior management this year. It is our strong preference that capital remains in the business during this time of uncertainty.

Concerns around the auditor accounted for **21%** of abstentions or votes against this quarter. We vote against the reappointment of the auditor when the incumbent has been in post for over ten years as we feel that their independence may have become compromised. We will also vote against auditor remuneration if they have received income from undertaking non-audit work for the firm. This is because we think it is inappropriate for the same firm to give financial advice and act as the auditor. In short, it risks compromising their independence.

Finally, we always vote against any resolution relating to political donations – it is not an appropriate use of capital in our opinion. This accounted for **4%** of total dissenting votes this quarter.

MEET THE TEAM

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Chartered MCSI
Associate, Investment Management

Alistair Currie
BCom (Hons), CA
Partner, Investment Management

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