Fundsmith LLP

Responsible Investment Policy

Fundsmith
Buy good companies
Don't overpay
Do nothing

Contents

Introduction

Fund managers have always had a fiduciary duty to act as responsible investors.

In recent years, initiatives such as the United Nations Principles for Responsible Investment (UN PRI), the UK Stewardship Code, and various other UK, US and EU regulations have sought to give added meaning to the word 'responsible'. These have focused on how fund managers integrate environmental, social, and governance (so-called "ESG") considerations into their investment processes and how they act as stewards of their investors' capital. Since we believe that all relevant information should be considered when making investment decisions, it is self-evident that ESG factors are highly material when one aims, as we do, to be a long-term investor in the equity of high-quality businesses.

This document sets out what we mean by "responsible", including the way in which we think our approach is if not unique then unusual; how we integrate sustainability into our investment process; and how Fundsmith engages with the companies we own on our investors' behalf.

Fundsmith funds do not use UK sustainable investment labels as they do not have sustainability goals. Sustainable investment labels help investors find products that have a specific sustainability goal.

Fundsmith's Approach to Responsible Investment

Understanding Fundsmith's approach to responsible investment first requires an understanding of how we approach investing itself. When Fundsmith first started in 2010, we published an 'Owner's Manual' alongside the launch of our first fund, the Fundsmith Equity Fund.

The Owner's Manual was designed to provide our investors with a better understanding of what we were aiming to achieve before investing with us by detailing our investment philosophy and how we intended to implement it. The original Owner's Manual remains essentially unchanged from its first publication in 2010, and each of our subsequent funds have their own versions. We believe that the very existence of these documents is a hallmark of being a responsible investor and steward of our investors' capital.

Each manual details the most important aspect of our investment approach: our aim to buy high quality companies that will consistently grow and compound in value and to hold these businesses forever. This approach means we focus on identifying companies that generate a high return on the capital they employ, in cash, across the entire business cycle. Importantly, the businesses we seek can sustain these high returns over the long term. We look for these sustainable returns over the long term, as over this time period it is hard for a company's share price to earn a significantly different return than the business which underlies it. For example, if an investor invests in a business earning a 15% return on capital employed and owns it for 40 years, it is likely that the shareholder will make a return that runs close to 15% per annum. Conversely, if that investor invests in a high-quality business with a return on capital of 30% and holds it for the same period, even if you pay an expensive looking price, the result will be significantly better. The ability to sustain a high return on capital employed is essential in delivering the long-term increase in the value we want as a long-term investor.

A fundamental part of our investment research process is assessing the business's environmental and social impact and the quality of their corporate governance. The risks and opportunities resulting from these factors have the potential to significantly influence a company's ability to sustain high returns over the long term and, consequently, their investment potential.

We see companies that have a large, negative impact on the environment and/or society as essentially inflating current profits at the expense of future earnings. While companies may be able to externalise the cost of damaging behaviour in the short term, over the longer term these costs are forced back onto the business, reducing the returns they are able to generate. This is becoming increasingly apparent as awareness of the negative impacts some companies have grows. These can be costs imposed on businesses through legal and regulatory interventions as governments act to prevent and penalise such behaviour. You only need to look at the fines BP and Volkswagen faced following their environmental scandals at $20bn and $24.7bn respectively as evidence of this, albeit extreme. Some estimates claim the total cost of the Deepwater Horizon oil spill to be more than $60bn once BP had finished paying for environmental remediation, compensation and adaptation measures.

Company revenues may also be reduced as customers are lost through a perception of poor sustainability practices or unsustainable/unsafe products, reducing earnings and the returns the company is able to generate. Businesses could also face higher costs as existing and potential employees demand greater compensation to work for companies deemed to have excessive negative impacts as well as through higher debt costs, or from greater disruption to their supply chain.

The high-quality businesses we seek typically have lower exposure to the risks discussed above due to the nature of their operations and, should these risks be present, these companies should be aware and effectively managing them to mitigate their potential impact on performance. These qualities are part of the reason they are able to sustain their high returns over the long term.

High quality companies also seek to enhance and add resilience to their growth through effective long term capital allocation. High quality businesses are particularly adept at achieving this through investment in research and development that drives innovation in the products and services they offer. This innovation allows the company to increase the efficacy and sustainability of their existing products/services, create new and superior alternatives to competitors, and to meet areas of unmet demand. This not only means the company can grow larger but is also how many companies have a significant positive impact on the world.

If you accept thus that we aim to own high quality businesses forever as opposed to engaging in short term trading of shares of any quality in the hope the stock price will go up, the question isn't, 'why should you include sustainability considerations into your research process?', the question rather becomes, 'how could you not?'.

Exclusions

We construct the portfolios for each of our funds from an investable universe (IU) of companies which all meet the quantitative and qualitative characteristics we look for. We exclude any company involved in the production, sales, or distribution of controversial weapons from all of our funds' IUs. Controversial weapons include anti-personnel mines, cluster munitions, chemical and biological weapons, white phosphorus, depleted uranium weapons, and nuclear weapons.

Fundsmith also complies with all applicable sanction laws and regulations, including those imposed by the UN, US, UK, and EU, and maintains appropriate systems and controls to reduce or eliminate the risk of dealing with sanctioned countries, individuals, or entities. As part of this we exclude any company operating, domiciled, or listed within, or those generating substantial[1] revenue from, any country identified by the United Nations Security Council's Sanctions[2] and those high-risk jurisdictions subject to a 'Call for Action', as identified by the Financial Action Task Force[3].

[1] Greater than 5% of revenue

[2] https://www.un.org/securitycouncil/sanctions/information

[3] https://www.fatf-gafi.org/home/

Good Company Screen

Our IUs are created using quantitative and qualitative criteria to identify what we think are the highest quality companies that can sustain a high return on capital over the long term. We don't depend on external research, instead conducting it all internally using publicly available information.

These high quality businesses, or 'good companies' as we call them, are filtered out from the poor ones using a series of financial screens combined with a qualitative assessment of how the company generates its returns. We are strong supporters of the notion that if it's a good business, we'll see it in the numbers. Good businesses make high returns on the capital that their investors and lenders have provided them. Good businesses generally exhibit the quality of a significant moat through high gross margins. Good businesses are able to take some of their high returns and reinvest them back into the business at similarly high rates. Good businesses make their profits in cash.

On top of these financial screens, we layer a series of investment principles. A good business does not require leverage to make these high returns. A good business has advantages which are hard to replicate. A good business makes its money from a very large number of small, predictable transactions as opposed to having to win a couple of large contracts each year. Good businesses have obvious and readily understandable paths to growth allowing them to continue investing more capital at high rates of return.

This initial screening means that before we have used any sustainability-related overlay, we have screened out huge swathes and whole sectors of the market. Many of these are sectors having a large, negative impact on the environment/society. Across our funds, it is extremely unlikely that we would ever invest in a mining, defence, oil and gas, or utility company.

We then look to assess the ability of companies to sustain these good company characteristics over the long term. Understanding how a company's wider impact may affect returns is a core component of our company assessments. Sustainability risks, or the risks resulting from a business's environmental, social or governance performance that could cause a material, negative impact to long-term performance are central to this. The sustainability risks we consider include the following:

- **Environmental risks.** These are the risks a company may be exposed to as a result of their contribution to the degradation of the natural environment and/or depletion of natural resources, or their over reliance upon them.
  Climate risks:
  - **Physical risk.** This covers the risks a business faces as a result of the physical impacts of climate change. This includes a company's exposure, in both their direct operations and supply chains, to both acute risks resulting from extreme weather events and chronic risks due to changing long term weather, rising sea levels and/or biodiversity loss.
  - **Transition risk.** Transition risks are those associated with the move to a low carbon economy. These can be rising costs resulting from policy, regulatory or technological factors, or market-driven changes due to changing investor/consumer sentiment.
- **Social risks.** Social risks result from poor practices within a company's supply chains, particularly regarding poor labour standards and human rights abuses, as well as from the company's direct activities such as how it treats/protects its own employees, data protection and how it promotes diversity.

- **Governance risks**. Poor corporate governance within a company can generate risks from the failure to observe the rights of minority shareholders, ineffective executive compensation policies, lack of engagement with stakeholders, business ethics failures or deficient controls on company management.

  We also look at the opportunities presented to businesses through their sustainability-related performance. Companies with strong sustainability credentials are likely to retain and attract new consumers and may also find it easier to attract and retain talent, benefitting future performance and further helping them to maintain/improve the qualities listed above. Where possible, we would like to see the companies allocating their capital towards research and development in the products/services they offer, improving their efficacy and reducing any negative environmental or social impacts they may have, while also innovating to find new solutions to problems to create a positive impact.

  The way in which we integrate the assessment of these risks and opportunities into our company assessments differs depending on the company in question. We aim to understand the risks associated with the company in the widest possible sense, i.e., the risks associated with their direct activity, supply chain, the lifecycle of end products, and in the interaction with end users/customers. We also assess how effectively the company is mitigating these risks, should they be present and material. The risks we consider span a spectrum which goes from minor or incidental, through costly and significant and on to existential. Some examples of the risks and opportunities we consider are as follows:

- A company's supply chain presents both environmental and social risks, the former more operational, the latter more reputational. When it comes to the supply of raw materials, our companies are not hypothesising about future events but dealing with the reality of climate, geopolitical and supply-and-demand issues on a daily basis.

- Our companies are trying to make products or provide services which are better for the planet and society as a whole. Elevators are 90% more energy efficient today than they were as recently as the 1990's, beverage bottles in clear plastic make them easier to recycle, and hotels are doing away with single-serve plastic shampoo bottles. As well as this, food and beverage companies are trying to remove salt, sugar and fat from their products, social media companies are spending billions trying to remove harmful content from their platforms and tobacco companies are attempting to transition their businesses to so-called 'reduced risk products'.

  – This presents our businesses with the opportunity to find new consumers in areas of previously unmet or currently expanding demand while reducing the harm they do.

  – There are also costs to this. In some cases, companies are undertaking what is probably the biggest change to their business model in a hundred years, with obvious risks.

  – Additionally, there are unintended consequences. The craze for almond milk has significantly exacerbated the decline in the bee population. Biodegradable plastics degrade into microscopic plastic pieces that get even deeper into the food chain. The desire to replace our dependence on palm oil may well be pushing us towards a reliance on crops that cause even more rainforest destruction. Balancing these pros and cons is an important consideration for our companies and for us.

- Our healthcare companies are under pressures from all sides to, simply put, reduce prices and improve patient outcomes. Some of our companies are direct beneficiaries of these trends in that they supply the technical expertise to advise on these changes, the equipment that monitors the results or the testing services which certify them.

- Historic hot-button issues such as animal testing have not gone away and have been joined by a whole raft of new ones such as 'flygskam' (flight shaming). The tendency of real or perceived social pressures to affect company managements, particularly in terms of M&A activity or the allocation of management resources, is a challenge from an analytical and investment perspective.

- The generally negative light in which 'big business' is perceived has exacerbated product liability issues and costs, which in any event have been exacerbated by the tendency on the part of companies to cut down on oversight roles, which are perceived as non-revenue producing.

- Management compensation plans, which detail how executives at companies are paid, are all too often not structured to align management incentives with those of long-term shareholders. Executives are frequently incentivised by metrics that encourage the growth of the company without considering the costs of that growth, or paid by metrics that they have no control over, such as total shareholder return.

The data we use to inform our assessments of a company's sustainability comes from a variety of sources:

- **Qualitative ESG and innovation database**. We have built and continually update a database of all the qualitative information a company has provided on its own sustainability efforts from their sustainability reports, earnings calls, press releases, annual reports and/or their website. These pieces of information are tagged and categorised within approximately 100 different topic tags, under the main categories of environmental, social, governance, and innovation. These tags are updated to reflect current issues of global concern and to incorporate new factors. This allows us to look across the entire investable universe for all funds by these topics and to have a record of what a company has said/what has been said about a company regarding an issue across several years.

- **Quantitative Assessment.** We collate data across a variety of environmental, social and governance and innovation metrics reported by companies. Not all companies report the same numbers and even fewer use the same methodology or have them assured to the same standards. Hence, we don't rely on these numbers. We do, however, think that they still offer some insight into the absolute and relative impact of a company compared to its peers. We like to measure the impact per millions of free cash flow generated. We do this analysis because we want the companies we invest in to grow and compound in value, which may increase some of their impacts. Rather than penalising a company for growing, we want to assess how efficiently they have achieved that growth.

- **External reputational risk rating.** We utilise an independent assessment of negative reputational risk from environmental, social and governance issues called the RepRisk Index, provided by RepRisk. RepRisk scans over 150,000 public news sources from around the world in 23 different languages every day, creating a company score based on the severity, reach and novelty of the respective issues a company is deemed to be responsible for.

This service is used in two ways by Fundsmith:

- First, it serves as a proxy for the overall negative impact a company may have as it provides us with a way to rank the companies within our investable universe in absolute terms. We can then adjust these rankings based on any significant positive impacts, or where we think RepRisk's score may be overstated due to its focus on the negative impacts.
- Second, it acts as a catch-all for any negative news regarding a company that our usual news filtering services may miss.

We do all our sustainability-related analysis in-house and do not use external sustainability ratings in our assessments. Our issues are less with the ratings themselves (although they are far from perfect) and more with the fund management industry's overreliance upon them. Due to the debt-like scoring used by these ratings, they are widely used as an objective and absolute score and are used to outsource challenging and contentious judgements regarding sustainability to the third parties. However, these ratings are not absolute and are entirely subjective.

The majority of these ratings use a methodology that scores companies on an intra-industry basis. Ratings are calculated by scoring a business's performance against a series of sustainability-related factors that the data provider has deemed to be material to the company's industry and ranking them against industry peers. This approach is taken as individual industries face a specific set of challenges. For example, there are factors that clearly apply to an oil and gas or mining company that are hardly relevant to a healthcare business. Despite this intra-sector assessment, investors too often use these ratings to compare companies between different sectors as the ratings generate what appear to be comparable scores.

Not only do we dislike the use of these ratings on this basis, but we question the spurious level of accuracy and analysis used given the clear challenges facing even the most responsible companies in measuring their environmental and social impact. These ratings often use the existence of policies as an indication of a company's overall sustainability in lieu of actual measurements of a business's impact. While policies are a great opportunity for companies to discuss how they would like to respond, they are not an indication as to how they are currently acting, nor how they would actually respond should the situation arise.

When we have finished performing these screens and assessments, we end up with what we call our 'investable universe'. Each fund has its own investable universe containing businesses that share the same high quality traits. Because these traits are relatively rare, our investable universe for each strategy is very small, containing around 80 stocks in each. The portfolios are then built from the respective IU based on current valuations, liquidity, and diversification.

Fundsmith Stewardship Fund

The investible universe for the Fundsmith Stewardship Fund is created from the universes of 'good companies' that underly our Fundsmith Equity and Smithson strategies.

The Fundsmith Stewardship Fund follows the same initial process as our other funds and applies two additional screens following after the 'good companies' have been identified. We use these screens to prevent companies entering the strategy's investable universe that we assess as having an unmitigated unsustainable impact on the world.

Sustainability Screening

The first screen we operate is our sector exclusion screen. This screen is in place to prevent investment in companies operating in what we consider to be unsustainable industries. The screen excludes any company from the Fundsmith Stewardship Fund's investible universe if they are classified by MSCI's Global Industry Classification Standard (GICS) as operating within, or generating a substantial[4] proportion of revenue directly from, the industries and sub-industries listed below.

The GICS industries excluded from the Fundsmith Stewardship Fund's IU are classified as the following (GICS classification code in brackets):

- Aerospace and Defence (201010)
- Metals and Mining (151040)
- Oil, Gas and Consumable Fuels (101020)
- Tobacco[5] (302030)
- Gas Utilities (551020)
- Electric Utilities (551010)

And GICS sub-industries:

- Brewers (30201010)
- Distillers & Vintners (30201020)
- Casinos and Gaming (25301010)

[4] Greater than 5% of revenue

[5] Including tobacco-supporting products

The Fund also excludes any company that makes a substantial proportion of its revenue or has a substantial interest in pornography.

The GICS classification provides an independent and objective assessment of a company's overall business model. However, we often find industry classifications to be a poor indicator of a company's actual business activities as these descriptions often over-simplify and group together very diverse business models. Therefore, we also exclude any company that derives a substantial proportion of their revenues from the products and services provided by the following industries, even if they aren't classified as within them by GICS. For example, Louis Vuitton Moet Hennessy (LVMH) is classified as a company within the Textiles, Apparel & Luxury Goods industry but generates almost 10% of its revenues from wines and spirits. As such, it is excluded from the investible universe.

The excluded industries and sub-industries are listed in the Prospectus, meaning we are legally bound to their exclusion.

Excessive Net Negative Impact Assessment

We then apply our second screen. This screen uses the information we have collected regarding the companies' sustainability risks, net environmental and social impact on the world, awareness of these impacts, and the credibility of the mitigation measures undertaken to reduce their risks/ impacts. We use these factors to make a judgement on a company's overall level of sustainability. This judgement assesses whether the company's net environmental and social impact on the world is firstly, negative, secondly, excessive, and thirdly, decreasing due to concerted mitigating action by the company.

We assess environmental and social impact, both positive and negative, in the widest possible sense. This assessment of negative environmental and social impacts has an inherent subjectivity, but we attempt to make our process as objective as possible by leveraging as much information as we can in our decision-making process. We think we are well positioned to make this assessment as our investable universe is small and we know the companies inside the universe intimately.

We assess the impact the business has on the environment as an entity and through the products or services it offers. We do this through a quantitative assessment of the business' environmental impact via its water consumption, energy consumption, waste generation, and greenhouse gas emissions. We use this data to assess how the business' impact has changed over time and the size of its impact at the time of the assessment. We also use the environmental commitments the business has made to understand how its impact will evolve over time.

Our assessment of the business's impact on society relies more on qualitative data as we do not believe that any metric/ metrics exist that can accurately quantify this. We use a wide range of sources, including (but not exclusive to) company reports and policies, academic research, reputable media, and trade journals to conduct this assessment. Part of this assessment is focused on how the company manages its workforce, both direct employees and those participating in its value chain. This assessment includes the company's observation of labour rights, human rights, practices relating to equality, and health and safety and employment conditions. Another component of our assessment is focused on how the business's products or services impact health and wellbeing (both physical and mental), social cohesion or divisiveness, economic inequality, and other material ethical concerns. We also use qualitative data to assess the impact that the business' products or services have on society. We gather information on both the negative and positive impacts a product or service may have.

Once we have removed the companies that we find to cause an excessive amount of environmental or social harm, we are left with the investable universe used to pick companies for the Stewardship Fund.

We do not take, and nor do we like, the relative or "best-in-class" approach some managers take to sustainability. This approach allows a sustainable portfolio to own an oil and gas, or a mining company on the basis that it is relatively less harmful than another company, or the 'average company', in its sector. We do believe that over time, some businesses that have traditionally been eschewed by responsible/ sustainable strategies might become suitable for them. We keep an open mind when tracking developments at these companies.

Investment Stewardship

Active Ownership

Engagement

Traditional engagement used in the investment industry has largely taken two distinct forms. The first and most common form of engagement involves an investor, or a group of investors, trying to persuade a company to 'do' something that will result in, simply put, a short-term boost to the performance of the company and the share price. This can take the form of a major 'strategic' move in the form of a break-up or deal, major financial initiatives involving share buybacks, or new and ambitious public profit or profitability targets. The second type of engagements are those that attempt to get companies to end what are seen as abuses against humans, animals, the environment and so forth. As far as we can tell these two approaches are rarely linked, to the extent that it is often believed that operating a successful business and being a good corporate citizen are diametrically opposed to one another. As discussed in the earlier section of this Policy, being a good corporate citizen is a key component of a company's ability to sustain performance and grow over the long term.

Our approach to engaging with the companies we own comes directly from our desire to be a long-term shareholder in that business. When one wants to own a business for the long term, the type of engagements we pursue with companies reflects this. We firmly believe that we have made our biggest contribution as a responsible investor by making it clear to our investee companies that we will support actions that promote the long-term performance of their business and oppose the short termism that preoccupies much of the market.

This means that when we engage with our companies, our priority is to support changes and/or investment that promotes their long-term, sustainable growth and equally to oppose activities focused on maximising short-term profits. We have a track record of pursuing engagements aligned with this, dating back to our inception.

Our decision to engage with a company is made on a case-by-case basis, prompted by a variety of internal and external factors. We will only engage with a company on matters that are materially related to their operations and when we deem the matter to be a risk potentially detrimental to the business's long-term prospects.

We do not typically engage with the goal of forcing a company to implement change. As Warren Buffett said, it is important to know and stick to one's circle of competence when it comes to investing; we believe this philosophy holds when engaging. We do not pretend to be able to operate the business better than those already doing so. Therefore, we think our efforts are better spent trying to influence the incentive structures by which management make their decisions, as we discuss later. Engaging with companies is a tool we use to reassure ourselves that the company remains focused on the long term and to better understand the company's awareness and response to the risks we identify. More often than not, the good companies we own are already aware of those risks and either have plans to or are already mitigating them, or have deemed them immaterial. We think these engagements are equally as successful as those that force change within a company. Of course, if the company is unaware or not doing enough to address the risk, change may be necessary.

Our long-term approach encourages our companies to act responsibly and make decisions that support their long-term success but, in the end, we cannot run our companies for them. We can encourage 'best practice', even if best practice might be expensive or disruptive, but it is unlikely that we will be the source of what this best practice is when it comes to many of the decisions our companies must make.

From a practical standpoint, this means that we encourage our companies to maintain investment in their brands through marketing and advertising and in developing new products with research and development throughout any downturns in the economic cycle. We believe that the most sustainable companies see margin as what is left after the company has spent the necessary amount on items that will sustain the long-term health of the business. We also discourage companies from obsessing over financial metrics that are easy to manipulate in the short term, particularly earnings per share (EPS), or taking on excessive leverage that may threaten the sustainability of the business when times are tough. We remind our companies of the risks of adopting what is regrettably the default behaviour of many; ignoring or taking their true long-term shareholders for granted and pandering to the demands of those who shout the loudest. We think responsible governance involves siding with those who want to remain shareholders, not with those looking for a quick buck and the exit door. Ultimately, we believe the best defence that companies have against irresponsible predatory investors is responsible shareholders, such as ourselves.

While we do not set arbitrary 'themes' for engagement, as an increasing number of investors seem to be doing, we do have a particular view on how the executives at or companies are remunerated. Generally, we care how executives are paid and less so how much they are paid. Providing the executive remuneration scheme is aligned with the interests of shareholders such as ourselves, we see no reason not to applaud high pay. However, the problem is that most schemes are not truly in alignment. We often see remuneration policies fostering everything from poor capital allocation decisions to heavy use of adjusted numbers that are open to management manipulation, such as earnings per share, or things they can't control such as total shareholder return (TSR). The crucial, and in an increasing number of long-term incentive policies, missing ingredient is some measure of return on invested capital. Just as investors in the portfolios we manage are focused on how much of their capital we can deploy at a given rate of return, so should the management teams of the companies we invest in. Alongside a returns measure, it is also important to include some measure of growth in the remuneration policy; it is no use having one without the other. High returns without growth provides an outcome similar to that of a high yield bond as the benefits of compounding are lost. Equally, growth without adequate returns is pointless, and the phrase "Busy Fool Syndrome" springs to mind.

We also want to encourage companies to integrate sustainability into their business model and give due diligence to environmental, social and governance factors. As we have previously discussed, poor sustainability-related performance might not impact profits immediately, but it has the potential to negatively influence future growth. Sustainability-related factors are becoming increasingly likely to bring material financial impacts as consumer interest and regulatory pressures continue to grow. We encourage our companies to see financial and sustainability-related factors as fundamentally linked and not separate, as we do. Almost all human and thus corporate activity leaves some kind of footprint. The question for our companies is how much of a footprint they leave relative to what they/we receive in return for our investment. For example, while we would like to see a company's level of $CO2^e$ emissions reduced, we encourage emissions to be reported in terms of intensity, usually per £m of free cash flow, to balance this with the interests of a growing business.

Escalation

In some instances, this engagement leads to change. Often it doesn't. Companies may fail to act on the issues highlighted, or their response fails to address them adequately. Should our engagement with the company fail to satisfy us, we will often escalate our activities to help the company understand our position, for example by voting against an item or multiple items at the company's annual meeting.

The decision to escalate our stewardship activities, as with our engagement decision-making process, is done on a case-by-case basis. If our initial engagement fails to generate the changes we want, we will not automatically escalate the engagement. This decision is largely, but not exclusively, based on the scale of the impact the issue may have and the length of time before those impacts are felt, supported by our research team's knowledge of the company in question. If the severity is lower and the time frame long, we are likely to continue our engagements with the company without escalation. Conversely, if the potential impact is high and the time frame short, we will escalate our stewardship activities as necessary.

A further option is choosing to work alongside other likeminded investors collaboratively. As a long-term investor, we value the relationships we build with the companies in which we invest and prefer to deal with companies directly and in private. Collaborative engagement is usually only considered when our independent engagement and escalate activities have failed to generate the change we feel necessary and cannot achieve alone.

Should previous escalation efforts prove ineffective, or the action of the company be particularly damaging to their ability to sustain their performance over the long term, our final escalation step is the sale of our shareholding in the company. We would likely do this because of consistently poor capital allocation by company management and no incentive structure present to encourage management to fix it. However, reaching the point of exiting our investments is rare.

To summarise, we would end by stressing that because the central component of our investment approach is to buy 'good companies,' we do not make investments with the intention of trying to turn a poor and irresponsible business into a good, responsible one. Our goal is to buy good businesses in the first place and provide, along with other likeminded shareholders, what might be termed the 'umbrella' under which these companies can do the right thing.

Proxy Voting

As a long-term shareholder in the companies we own, we have always taken our voting rights seriously. We assess each vote on a case-by-case basis, allowing the relevant portfolio manager to account for the specific context of the company in question. Our priority when voting is to represent the best interests of our funds, our investors, and our clients. We will always ensure that the votes we cast are consistent with the investment objectives and policies of the relevant fund. When voting, we aim to support the long-term sustainable performance and growth of the business, in turn supporting our stated objective of maximising risk-adjusted returns for our investors.

We will exercise our voting rights in nearly all circumstances; however we may opt to abstain from voting when we consider it appropriate. We do not see this as a wasted vote. We typically choose to abstain when we do not feel we are in a position to approve or reject a resolution and following the abstention we would look to pursue an engagement with the company regarding the matter.

We believe another area we perform well as a responsible investor is the fact that we do not rely on proxy voting recommendations made by proxy advisory services, the use of whom has grown rapidly during recent times. Outsourcing proxy voting decisions to a third party seems somewhat irresponsible to us. It is clear that the recommendations made by these services do not consider the interests of each users' underlying investors and may represent the interests of those proxy voting firms themselves.

We also do not give permission to our custodians, who hold the shares we have bought on our investors' behalf, to lend out any of these shares as we would not be able to exercise our voting rights when needed.

While we do not have a set policy for proxy voting, we do have areas in which we will vote similarly. Remuneration is one such area, as discussed earlier. We will vote in support of remuneration policies that include both returns and growth metrics and against policies that exclude these metrics. This is not a policy however, as in some circumstances we may support a policy without growth and returns measures if, following an engagement, we find the policy is suited to the business's current situation.

Another area we have a strong opinion on is shareholder proposals. There has been an increasing number of shareholder proposals submitted at the annual general meetings of the companies we own, given their size and public-facing nature. These proposals take various forms, from governance changes such as separating CEO and Chairman roles, to requests to produce reports detailing political contributions. Increasingly however, we are seeing the same proposals submitted at a number of the companies we own during the same proxy season. The increasing demand upon investors to illustrate active ownership has seen the rise of collaborative shareholder proposals typically targeting the world's biggest companies. These proposals too often are more to provide a signal of the asset manager's active engagement rather than providing any long-term benefit for the company. In our experience, we even find that some proposals are asking for disclosures that the company is already making.

Conflicts of Interest

Fundsmith is under a regulatory duty to ensure that any conflicts of interest are managed in such a way so as to put the interests of clients first. Fundsmith's investment criteria means our investable universe is small and significantly smaller than many fund managers with comparable assets under management.

The result of this is a very low chance of conflicts of interest arising between Fundsmith, its Partners and employees, and the companies we invest in. Regardless, we still strive to avoid any conflicts of interest in our investment activities. Should any potential or actual conflicts of interest be identified across our stewardship activities, they will be recorded in our internal Conflicts of Interest Register. Fundsmith follows the procedure detailed in our full Conflicts of Interest Policy which outlines the steps we take to avoid, minimise and manage such potential conflicts.

Our Conflicts of Interest Policy follows four steps: identification, prevention, management, and disclosure. Potential conflicts of interest relevant to us may occur between our Partners, employees or any person directly or indirectly linked to Fundsmith by control (relevant persons), and a client of Fundsmith. There is also the potential of conflict between different clients. In our policy, we identify five scenarios where there is potential for conflicts of interest in our activities. These arise when the firm, or a relevant person:

- Is likely to make a financial gain, or avoid a financial loss, at the expense of a client or fund,
- has an interest in the outcome of a service provided to the client or fund or of a transaction carried out on behalf of the client or fund, which is distinct from the client's or fund's interest in that outcome,
- has a financial or other incentive to favour the interest of one client or fund over the interests of another client or fund,
- carries on the same business as the client, or carries on the same activities for a UCITS fund and for another client or clients which are not UCITS funds, and

- receives or will receive from a person other than the client an inducement in relation to a service provided to the client or fund, in the form of money, goods or services, that is not the standard commission or fee for that service.

Fundsmith's Risk Committee, assisted by the Compliance Team, have considered various situations arising from the day-to-day business of the firm from which a conflict of interest may occur, given the services and activities that Fundsmith undertakes. These are documented in the Conflicts of Interest Register which is reviewed and updated annually and ultimately approved by Fundsmith's Management Committee. The potential for additional conflicts of interest will be considered each time Fundsmith takes on a new client, considers launching a new fund, develops a new investment strategy, or undertakes a new line of business. The Conflicts of Interest Register also summarises the approach Fundsmith takes to manage and mitigate these conflicts. Where the potential for a conflict of interest has been identified, Fundsmith will seek to organise its business activities in a manner that prevents such a conflict from arising.

Where conflicts are unavoidable, Fundsmith will seek to provide measures for their mitigation and management. These management arrangements are designed to ensure that Fundsmith always acts in the best interests of its clients and puts their interests ahead of Fundsmith's. Where a conflict arises between two clients, Fundsmith will seek to treat both clients fairly.

Fundsmith

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