Fundsmith

Fundsmith Stewardship Report 2021

Fundsmith
Buy good companies
Don’t overpay
Do nothing

Fundsmith

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Introduction

Welcome to Fundsmith's 2021 Stewardship Report. This document, following the 12 Principles for Asset Owners and Asset Managers outlined in the Financial Reporting Council's (FRC) updated UK Stewardship Code 2020 and having regard to UK rules implementing the requirements of the EU Shareholder Rights Directive 2007/36/EC (as amended), details how we allocate, manage, and oversee capital to generate value for our investors.

The FRC defines stewardship for the updated Code as:

> **"The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society".[1]**

As a long-term, buy-and-hold investor in the companies we choose to buy, stewardship is not only part of our fiduciary duty but an essential and implicit component of our investment strategy. Fulfilling our responsibility as stewards is a key contributor to ensuring the success of our investment approach. This report explains how Fundsmith has applied the Code's Principles over the 12-month period beginning 1st January 2021 and, in doing so, gives details on how Fundsmith understands stewardship, the policies and processes used to encourage and support it, and how we performed as stewards of our investors' capital during 2021.

This report was discussed and approved at the Fundsmith LLP Management Committee meeting on the following date, as evidenced by the minutes of that meeting.

Date of Management Committee meeting: 29 March 2022

Signed, Terry Smith, CEO and CIO

[1] https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

Principle 1

Signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, environment, and society.

Purpose, culture, and values

Fundsmith was founded in 2010 as a fund management business responding to what the founding partners saw as failings in the investment industry. At the time, many of the equity funds available in the UK were consistently under-performing their benchmark, holding too many companies in their portfolios making them indistinguishable from the market as a whole, and reducing investment returns through expensive overtrading. Put simply, many equity funds were over-priced, under-performing and offered little difference from an index tracker.

Fundsmith was created to offer investors something different to the options available at the time. Through being different, the founding partners aimed to offer something better in line with Sir John Templeton's axiom that "if you want to have a better performance than the crowd, you must do things differently from the crowd". We launched our first fund, the Fundsmith Equity Fund, with the purpose of running the best fund there has ever been, and to provide retail investors with the best fund they have ever owned. By "best" we mean the fund with the highest returns over the long term, adjusted for risk. Our focus on this has remained unchanged since our inception.

Our business model is derived from this desire to be better. We run funds, both open and closed ended, that invest in high-quality companies for the long term. These high-quality companies grow and compound in value over the long term, generating value for our clients and beneficiaries. Most important to the success of our business model is ensuring we are operating Fundsmith as the kind of the high-quality company we would look to invest in. We apply exacting standards to potential investments to produce a portfolio of resilient businesses with excellent performance across a small number of equity funds. Minimising the costs we incur on behalf of our customers while implementing our strategy also sits at the heart of our business model. We do not charge investors entry or exit fees. Instead of the typical 'annual management charge', or 'ongoing charges figure' firms use to compare themselves, both of which fail to account for the incremental costs of trading, we consider total cost of investment (TCI) to be a more appropriate benchmarking tool, as it recognises all the costs our investors incur whilst owning our products.

Fundsmith prioritises transparency, integrity, and conviction across all our activities as an asset management firm, including our responsibilities as stewards of our investors' capital. The firm operates with a flat management structure and minimal hierarchy, fostering a collegiate culture with strong diversity of thought. Our structure aims to remove bureaucracy and allow dynamic decision making, supported by our Management Committee. All employees have access to Fundsmith's management.

Our investment beliefs and strategies

When Fundsmith was first established in 2010, we published an 'Owner's Manual' outlining our purpose, approach to investing, and strategy. We want those investing with us to understand our investment beliefs and approach, so they know exactly what we are and aren't offering. We like to compare investing to competing in the Tour De France; the overall winner of the Tour (the "yellow jersey") never wins every stage. Similarly, we don't expect to outperform every quarter, or even year, but we do expect the companies we invest in to compound in value by more than the average company over the long-term. Our Owner's Manual for the Fundsmith Equity Fund remains essentially the same as it was in 2010 and can be found on our website. We also write an annual letter for our investors, which is published on the respective fund's website. The letter shows some of the key metrics we look for in the companies we have invested in and how (little) they have varied over time. Fundsmith Equity Fund's 2021 letter is available here.

Our investment strategy is simple and builds from three basic principles: buy good companies, don't overpay, and do nothing. At Fundsmith, we believe that over the long-term, this approach will generate superior risk-adjusted returns compared to our peers. The high-quality businesses we invest in are predictable, have defensive characteristics, and invest their capital at rates of return substantially above their cost of capital. We believe that the most important driver of a business' returns is whether it is in fact a good business. Of the 96,000 listed equities in the world, we have identified fewer than 300 across all our fund products that qualify as being "good", according to our criteria.

Good businesses are those that can sustain a high return on operating capital employed, in cash. We are not just looking for a high rate of return, but a sustainably high rate of return, which means we invest in businesses with significant distinct, competitive advantages. An important factor is repeat business, usually from consumers. A company that sells many small items every day is better able to earn consistent returns over the years than a company whose business is cyclical, like a steel manufacturer, or lumpy, like a property developer. This approach rules out many businesses that do not sell directly to consumers or make goods that are not consumed at short, regular intervals. We look for businesses that typically have an advantage over the market via some form of intangible asset (brand, distribution network, technology etc.) that helps to sustain a high rate of return on the capital they employ. Further, we like businesses that can reinvest some of those returns at the same high rate. This approach comes from the belief that over the long-term a company's share price will compound at about the rate of return that the underlying business invests its capital. Therefore, the key is the business's rate of return, not the share price.

There are many industries in which we don't believe a good company could ever exist due to specific factors that make it impossible to generate a high return on capital employed, or through little control of pricing, as with many commodity-based industries. For example, we can confidently say that we will never invest in a mining company, an oil and gas company or a bank. Alongside this, our high-quality business screen removes some of the most environmentally and/or socially damaging industries such as airlines, energy, automotive and biotechnology. We avoid these as we believe their business models are unsustainable and they will struggle to generate sufficiently high returns over the long-term.

We analyse companies in the widest possible sense, considering their negative impact on the environment and society as well as any positive contributions they may have through research and development. Environmental, social and governance ("ESG") factors are becoming increasingly important to all companies and can significantly influence their long-term performance. We view damaging activity across any of these factors as taking profits from tomorrow to fund today. Companies with poor performance in these areas may struggle to sustain the high return on capital our companies must have. As long-term investors, we won't invest in companies that generate returns and profits unsustainably, as we want to own these businesses forever. We also expect the management of investee companies to act like owners of the company, prioritising capital allocation to benefit the business over the long term. We believe this approach makes us good stewards of our investors' capital.

We believe that detailed research and developing a deep understanding of the companies before we invest is the best way to build a portfolio that performs over the long-term. Our research process is detailed and is the most important part of our investment strategy. We use this research and our in-depth knowledge of the companies in our investable universe to build concentrated portfolios of high quality, resilient, global growth companies.

When we identify a good company, we don't want to overpay if we choose to invest in its stock, but we also realise that to buy superior businesses you may need to pay a higher valuation. As Warren Buffet said, "it's far better to buy a wonderful company at a fair price than a fair company at a wonderful price". Our goal is to buy securities that will grow and compound in value over time. These securities must offer free cash flow yields that are high relative to long-term interest rates and relative to the investments already selected within our portfolios or the other investment candidates in our investable universe. The securities should also offer yields that are similar to, or better than, what we would get from a bond. We calculate the free cash flow of every company after tax and interest but before dividends and other distributions and after adding back any discretionary capital expenditure that is not needed to maintain the business. This avoids penalising companies for investing capital at high rates of return to grow their business, which is exactly what we want.

Finally, once we have invested in a company, we aim to do nothing. Ironically, this is the part of the process when we are most active. In doing nothing, we try to only buy and sell a company based on its fundamentals, not on whether the share price is going up or down. This discipline means that we avoid the temptation of rebalancing our portfolios and keep trading to a minimum, reducing costs and consequently the charges for our investors.

We constantly monitor our companies after investing and rigorously continue to evaluate whether there are any changes in approach or new factors that might affect the company's long-term performance. If we identify an issue with an investee company, we follow the engagement, escalation and voting practices outlined in our report on Principles 9, 11 and 12 respectively, to promote resolutions that support the long-term performance of the company.

These investment beliefs are followed and complied with across the four investment strategies that we operate: Fundsmith Equity Fund (FEF), Fundsmith Sustainable Equity Fund (FSEF), Smithson Investment Trust (SSON), and Fundsmith Emerging Equities Trust (FEET). The same research process is followed by each strategy, which involves defining an investable universe of good companies, all of which meet our strict investment criteria. The resulting investable universe forms the basis for the respective fund portfolios.

Enabling effective stewardship

Fundsmith was set up to be a long-term shareholder in high-quality companies that will generate superior long-term returns, adjusted for risk. We want to invest in companies that can and will sustain their operations indefinitely as, ideally, we want to hold the shares of investee companies forever. Our fundamental approach to investing means that stewardship is not a "bolt-on" concern, but a crucial aspect in ensuring the success of our value proposition to clients. As our approach to investment is entirely focused on the long-term, many of the day-to-day actions we take are designed to ensure we acting as effective stewards of investors' capital. Our report on Principle 2 discusses how our governance is structured to support stewardship, and our report on Principle 7 goes into more detail about how stewardship is integrated into our investment process.

Fundsmith's staff share the firm's investment beliefs and many of the firm's employees have significant amounts invested in the firm's products. We encourage this, as we believe it aligns our incentives with those of our investors. We view this as an important aspect of good stewardship as it means we invest our client's capital as though it were our own, as for many of Fundsmith's employees it is.

How have we done?

Since inception (Nov 2010–Dec 2021), our main UK Fund, the Fundsmith Equity Fund, has generated returns of 571% (annualised: 18.6%), compared to 287% (annualised: 12.9%) for the MSCI World. Not only have we outperformed the index but have done so with less risk. Since inception, the Fundsmith Equity Fund has had a Sharpe ratio of 1.31 compared to the MSCI World's 0.78. The Sharpe ratio is a measure of risk-adjusted returns, with a higher number indicating a better risk to return profile. Even though our strategy has now been running for over a decade, market cycles can be longer than that and, just because we have performed well so far, there is no guarantee that we will continue to do so. As such, we keep reassessing the quality of our companies and the risks they face.

Fundsmith publishes independent value assessments for both FEF and FSEF. Our Value Assessment analyses the Funds across seven pillars; quality of service, performance, costs, economies of scale, comparable market rates, comparable service rates, and share classes. These reports conclude that the funds provide value to our investors, and when considered alongside the strong Sharpe ratio, means we are achieving our aim of delivering strong risk-adjusted returns at a reasonable cost as consistently presented to, and expected by, our investors. The Assessment is available on our website.

We continually look for ways to improve our disclosure on our stewardship activities and will be using this report as an opportunity to explain how we interact with our investee companies to promote sustainable long-term returns.

Principle 2

Signatories' governance, resources, and incentives support stewardship.

An essential part of ensuring we are good stewards is establishing practices within our business that not only support but encourage stewardship. Our report on this principle addresses the way we do this; how our governance provides oversight and accountability for stewardship, how we select and work with our resources to ensure our stewardship activities are fully supported, and how we incentivise the integration of stewardship with investment decision making.

Governance

Fundsmith LLP continues to be wholly owned by its partners, all of whom are actively involved in the business on a day-to-day basis. As such, Fundsmith's ownership and governance structure is completely aligned with the long-term focus of our funds and the aim to ensure the long-term growth of the business.

Fundsmith's Management Committee determines the firm's strategy and oversees all aspects of the business. It is ultimately responsible for setting the tone for the approach to stewardship throughout the firm and for ensuring that the business adheres to the stewardship principles and policies it has set itself.

Fundsmith Management Committee	
Terry Smith	Chief Executive Officer & Chief Investment Officer, Founding Partner
Julian Robins	Head of Research, Founding Partner
Mark Laurence	Chief Operations Officer, Founding Partner
Paul Mainwaring	Chief Financial Officer

Table 1: Fundsmith Management Committee.

Our investment beliefs are the same across the four investment strategies we operate (Fundsmith Equity Fund, Fundsmith Sustainable Equity Fund, Smithson, and Fundsmith Emerging Equities Trust). The same research process is followed by each investment strategy, which involves defining an investable universe of "good companies" that meet our strict investment criteria, as explained in Principle 1.

Each strategy we operate has an investable universe ("IU") made from companies that meet our good company criteria and operate within the respective strategy's market capitalisation range and market classification. Before adding a new company to the IU, the research team produces a comprehensive report on all aspects of the business, looking at all factors that might affect its ability to sustain a high return on capital and grow over the long-term. This is then put to the strategy's portfolio management team, who then decide whether the company is worthy of IU inclusion. All IU inclusions are reviewed and approved by the Management Committee to assure that the "good company" process has been followed. This ensures that we have a consistency of approach and independent review of the process. The portfolio is then created from this universe.

The Fundsmith Sustainable Equity Fund's IU is created from the companies within Fundsmith Equity Fund's IU. The companies that have met FEF's criteria are subjected to additional assessments to ensure they meet our sustainable criteria. This process is discussed in more detail in Principle 7.

During 2020, as part of our review of our governance procedures, we identified the need for an internal function to provide oversight and control over our stewardship activities and responsible investment processes. As a result, we established our Stewardship and Sustainability Committee ("Stewardship Committee"). The Committee completed its first full year in operation last year, meeting three times. Its purpose is two-fold; provide a forum to align, support and review our stewardship activities and responsible investment process, and to monitor any potential entries to any of our fund's investable universes for compliance with the "do no significant harm" principle and alignment with our Responsible Investment Policy. The Committee also has authority to approve policies relating to stewardship and sustainability matters.

Should the Stewardship Committee deem a potential investee company unsuitable, their decision is final, and that company will not be admitted to the strategy's investable universe. The Committee is chaired by Julian Robins, Fundsmith's Head of Research, with representatives from each portfolio management team, the Head of Compliance, Head of Sustainability, and our Stewardship Analyst. The structure of this Committee was chosen to ensure that all areas of the business involved with our stewardship activities meet regularly to ensure they are aware of any changes in the company's approach and updated on key issues and best practice.

Julian Robins, Head of Research and a founding partner of Fundsmith, takes the conclusions of the Stewardship Committee's meetings to the Management Committee. This reflects the importance of ensuring that we are acting as good stewards of our client's capital, and our management's commitment to appropriately resourcing our stewardship activities.

Fundsmith Stewardship & Sustainability Committee	
Julian Robins	Head of Research, Founding Partner
Robert Parker	Chief Compliance Officer (Designate)
Thomas Boles	Head of Sustainability
Simon Barnard	Portfolio Manager, Smithson Investment Trust
Michael O'Brien	Portfolio Manager, Fundsmith Emerging Equities Trust
David Simpson	Stewardship Analyst

Table 2: Fundsmith Stewardship & Sustainability Committee.

Stewardship is also generated through the ongoing oversight and management of our investments. Our approach to this is detailed in Principles 9, 10, 11, and 12 of this report, and follows the practices laid out in our Responsible Investment Policy. As part of his role as Head of Research, Julian Robins oversees the monitoring of our existing investments. He decides when, in accordance with our Responsible Investment Policy, we might need to engage, escalate, or consider divesting in a portfolio company. While Julian, as chairman of the Stewardship Committee, is accountable for our stewardship activities and processes, all our research division supports our stewardship activities and work to keep our decision making appropriately informed.

The policies we use to guide our stewardship activities are subject to an annual review by the Stewardship Committee and approval from the Management Committee.

Resources

Stewardship is integrated at every stage of our investment process and is considered both implicitly and explicitly by all employees. We rely on our Research Department, including the Head of Research, to conduct the in-depth research and analysis of companies to identify those that can produce the long-term, sustainable growth our strategy relies on. Our research team consists of 11 analysts working across all our funds. Across the team, there is a total of over 140 years of experience, 5 CFAs, a variety of masters' degrees, a PhD in social anthropology and a chartered accountant. The team also has a diverse range of backgrounds from degrees in history and economics to electronic engineering and computer science. The team has a wealth of experience across the investment industry and is focussed on fulfilling our objectives as long-term investors. Their experience allows us to reliably build the resilient portfolios of high-quality businesses and to analyse any issues that may affect our view of those companies. The experience of our analysts means we have a team that understands Fundsmith's investment process and have the skills to implement it, ensuring we fulfil our obligation to our investors and create value over the long-term.

While we consider that stewardship is an inherent attribute of the entire research team, we also have a member of the team dedicated solely to stewardship activities. This extra resource also helps ensure we are correctly documenting, reporting, and communicating our stewardship activities to our investors. Our analyst has an undergraduate degree in environmental science and a postgraduate degree in global politics, and attained the CFA UK's Certificate in ESG Investing in 2021. He has specific responsibility for supporting the research team by keeping team members aware of ESG-related regulation and considerations, and best practice/any changes in the thinking of how to approach stewardship activities.

It is also important to integrate and utilise a diverse workforce to support stewardship. In support of this, Fundsmith has committed to being an equal opportunities employer and operates under a full Diversity, Equal Opportunities, and Inclusion Policy. Our recruitment, promotion and all other selection processes are conducted based on merit against an objective set of criteria, avoiding discrimination against all protected characteristics.

We use various resources to support our analysts and their research process. We collect qualitative and quantitative information from a variety of publicly available sources such as earnings reports, sustainability reports, press releases, CDP, and Bloomberg. Fundsmith Sustainable Equity Fund (FSEF) uses ESG data from Bloomberg to retrieve and calculate basic stats such as CO_2 emissions, water and energy use, as well as the amount of waste generated. We also use RepRisk's Index and Rating software to assess individual company's risk exposure to ESG issues and to benchmark the Fund against our chosen index. We use RepRisk as it avoids the 'intra-industry' approach that other ratings services implement, allows investment in 'less damaging' companies operating in highly damaging sectors.

We use these sources in combination to support qualitative decisions on the companies that can be part of FSEF's investment universe, to assess potential investments, and to monitor the companies in which we are currently invested, across all our funds. We do not make investment decisions based on an individual score RepRisk provides but use it alongside our fundamental research and analysis of a company.

Incentives

Fundsmith is owned and managed by its Partners. The Founding Partners of Fundsmith receive only a fixed percentage of the net income of the firm, so they are incentivised to achieve the long-term growth and success of the business without prioritising short-term profits. The portfolio managers (other than Terry Smith who is a Founding Partner and the majority owner of Fundsmith) have their remuneration structured to ensure they are similarly focussed on the long-term success of their Funds. All our Funds follow the same long-term, buy-and-hold philosophy and achieve this through purchasing high-quality companies in their individual investment area. We do not set short-term targets and our portfolio managers are not rewarded with respect to the short-term performance of the fund. It is important to note again that our portfolio managers are also invested in the funds they manage. This alignment of interests with our clients is an important incentive in encouraging the sustainable growth of the businesses within each fund, and as such the sustainable growth in value of their own and our client's investment.

Our incentive scheme for the portfolio managers (other than Terry Smith) depends on the long-term performance of the fund which they manage. As mentioned, active and effective stewardship from our portfolio managers is a key contributor to the fund's performance, and consequently, portfolio managers' remuneration. Further details on our portfolio managers' remuneration is available in our annual report and accounts. We consider a range of metrics combined with qualitative judgments to analyse the effectiveness of our portfolio managers' stewardship activities. However, there are difficulties in identifying and quantifying a single, holistic measure that accurately represents the many facets of our stewardship activities and achievements over the previous 12 months. We continue to work to find better ways to measure the effectiveness of our stewardship activities. Given our investment and business strategy will only succeed if our portfolio managers encourage the long-term performance of their companies through being effective stewards, we feel stewardship is adequately addressed and incentivised.

Our Remuneration Policy is available here.

Effectiveness

As discussed in our report on Principle 1, we feel that the long-term sustainable outlook we take when investing is the key driver of stewardship at Fundsmith. Our internal governance, resources and incentives are structured around generating long-term, sustainable growth in the value of the companies in which we invest. This is the aim of all our fund products. Since Fundsmith LLP's inception in 2010, we have been successful in creating long-term value for our clients and beneficiaries, and we believe that our approach will continue to do so.

Our investable universes for each respective strategy are relatively concentrated and static. Since the inception of the Fundsmith Equity Fund in 2010, we have added and removed two companies per year on average. This low turnover allows for robust oversight of the investment process and the respective strategy IUs by the Management and Stewardship committees.

However, we are aware that effective stewardship does not simply result from relying on established processes but reviewing our policies, assessing the effectiveness of our activities, and continually improving our approach. Our report on Principle 5 reviews this in more detail and explains how we typically approach the area. Even the process of producing this Stewardship Code Report has presented opportunities to assess our approach and identify areas that we can improve upon.

Principle 3

Signatories manage conflicts of interest to put the best interest of clients & beneficiaries first.

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, across all our funds, totals less than 300 companies, significantly less 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 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.

Managing these potential conflicts is important. Failure to do so in the normal course of business could put us in a situation where the interests of clients and the interests of the firm are at odds with one another. Given the range of investors that invest in our products and the accompanying range of approaches to stewardship, we will not change our approach in any way under the pressure of a single investor. However, should a situation arise where the majority of our investors are of a similar mind, we are prepared to adapt our approach. We communicate our investment beliefs and approach to stewardship to potential investors in our Owner's Manual and product prospectuses to ensure all investors understand and are comfortable with our approach before investing, minimising the potential for this kind of conflict occurring. Fundsmith will always act in the best interests of the majority of the respective fund's investor base.

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 and Compliance 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.

Currently, there are no conflicts of interest considered to exist at Fundsmith which we are unable to prevent or manage in such a way as to ensure the interests of our clients and beneficiaries aren't impacted. Potential conflicts may exist in relation to aspects of our business that are not material in nature, and that we believe are being effectively prevented or managed. Accordingly, these potential conflicts are not disclosed.

The application of our conflicts of interest policy to stewardship is most apparent regarding our proxy voting activity. All proxy voting decisions are made by the respective portfolio manager, executed by our Stewardship Analyst, and monitored by Compliance. A conflict of interest is most likely to occur if a personal relationship exists between the portfolio manager and the company in question.

We actively manage the risk of this conflict via a variety of methods. Firstly, all Fundsmith's staff must seek approval from Compliance before making an investment in any the companies in our funds' investable universes (IU). We also log and monitor the outside business interests of any Fundsmith employee and their connected persons with any IU company to identify any potential conflict. Our Stewardship Analyst also checks our voting decisions' compliance with our Proxy Voting Policy (see Principle 12) and our compliance team also monitor the entire proxy voting process to ensure its compliance with the Policy.

This year we identified a potential conflict of interest resulting from an outside business interest, whereby an employee's spouse works in the Human Resources department at an IU company. This potential conflict has been logged in our Conflicts of Interest Register and is now being monitored by the Compliance Department. It is highly unlikely that our voting would be influenced by this as the Fundsmith employee works in an operational department and is not involved in the proxy voting process. Additionally, as all voting activity is monitored by the compliance team and follows our proxy voting policy, any votes inconsistent with the policy would be identified by our internal processes in a timely manner.

Our Management Committee has allocated responsibility separately for supervising different areas of the business, such as client relationship management, business development, portfolio management, investment research, risk management, operations, and compliance. Fundsmith ensures that the risk management function does not carry out any portfolio management or investment research tasks and is supervised and remunerated independently from those functions to further minimise any potential conflicts. As part of Fundsmith's risk and compliance framework, the firm has a Compliance Monitoring Plan to ensure the requirements of this, and various other policies, are complied with. The compliance team are responsible for ensuring appropriate measures exist to mitigate and manage conflicts. The Management Committee is responsible for reviewing and approving these management measures. Where Fundsmith is not reasonably confident that it is able to manage conflicts to ensure that the risk of detriment to the interests of a client, fund or investors in a fund will be avoided, this will be reported to the compliance team. The team will be responsible for taking any necessary decision to ensure that Fundsmith acts in the best interest of the client, fund, or investors in the fund.

The Management Committee reviews and updates our Conflicts of Interest Policy on an annual basis. Our legal advisors provide guidance as required in relation to our conflict management arrangements. The Conflicts of Interest Register is also reviewed on a regular basis to ensure conflicts have been properly managed throughout the period and to assess if any new conflicts have arisen.

Principle 4

Signatories identify and respond to market-wide & systemic risks to promote a well-functioning financial system.

At Fundsmith, we believe that there are more systemic and potentially market-wide risks that we cannot identify than those we can. As ex-US Secretary of Defence Donald Rumsfeld once said:

> **"There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the latter category that tends to be the difficult ones."**

To best minimise the impact of the known and unknown risks, we invest in high-quality, defensive companies for the long-term. These high-quality businesses are those that can make and sustain a high return on the capital they employ and reinvest these returns to support long-term growth. In Principles 1 and 7, we expand in more detail on our definition of good companies.

Picking companies with defensive characteristics helps us build portfolios that are more resilient to market-wide and systemic risks, such as changes to interest and currency rates and other macroeconomic/geopolitical issues. There are numerous industries we will never invest in as we don't believe it is possible for a high-quality business of the kind we prefer to exist there. For example, we will never invest in banks as they rely upon leverage to generate profits and, at some point, that leverage is withdrawn. We are also unlikely to ever invest in a business reliant upon commodities, such as utility companies, as they have no control over the changing price of the materials they depend upon.

Across all our strategies, we invest in businesses that have an established track record of success, such as having a dominant market share in their product/service niche or having brands and/or patents that are challenging, if not impossible, to replicate. Our desire to invest in long-term winners is reflected in the age of the companies we invest in; the companies owned by Fundsmith Equity Fund at the end of 2021 had an average age of 95 years and a median market capitalisation of £105bn, and Fundsmith Sustainable Equity Fund an average age of 88 years and median market capitalisation of £101bn. These companies have experienced numerous economic cycles, World Wars, and technological advances and have persisted throughout.

We invest in these companies for the long-term, with the intention of holding that stock forever. This investment horizon means we encourage our companies to focus on long-term capital allocation to generate sustainable growth, as well as sustainable practises to ensure they are managing the risks they are facing in the day-to-day and long-term operation of their business. Our approach is opposed to the myopic obsession some parts of the market have which forces companies to post growth after every quarter, often pushing businesses into unsustainable short-term profit maximisation to meet these expectations. We regularly engage with companies to remind them of how little significance we put on short-term guidance or any small changes in it. This, we believe, directly contributes to a more efficient and well-functioning financial system by reminding management that not every shareholder is focused on the short-term.

We spend a great deal of time researching prospective companies and want to get to know them intimately before deciding whether to invest, identifying and assessing a variety of risks. There are of course unforeseen risks that we may not have accounted for, or a company's approach to a risk may have changed during the period in which we own the stock. Our response to this is to engage with the company, aiming to understand company management's perspective of the risk and their response to it, should it be present and material. We follow our engagement, escalation, and proxy voting processes, detailed in Principles 9, 11, and 12 respectively.

COVID-19 had a large impact on the global economy in 2020, the influence of which continued into 2021 even as global lockdowns started to subside. Global supply chains struggled to match the demand from consumers emerging from lockdown and this, combined with global worker shortages and increased energy prices (among other drivers), resulted in price inflation. The market therefore faced two challenges; supply chains failing to deliver the raw products/ingredients needed to produce goods, and the increased cost of producing those goods.

Our companies dealt with this well. The companies owned in FEF and FSEF's portfolios have well established, stable operations and strong cash flows that, when combined with their size, meant they had a variety of options available to them to navigate supply shortages. Additionally, our companies all have relatively high gross margins and typically sell price inelastic and defensive products. This meant that the companies were, and are, able to pass on inflationary pressure to consumers, allowing them to maintain their margins.

Climate change and its associated risks continued to spend time in the spotlight last year, with the United Nations Framework Convention on Climate Change's Glasgow Climate Change Conference (COP 26) occurring and the release of the Intergovernmental Panel on Climate Change's sixth Assessment Report (AR6), as well as continuing extreme weather events worldwide. It is evident that climate change-related risks and opportunities continue to gain significance when considering long-term investment outcomes.

Our investment approach means we are unlikely to ever invest in, or have exposure to, the industries that contribute most to climate change, such as oil & gas, mining, and utilities. However, we are still exposed to the risks and opportunities both the transition to a low-carbon economy and the physical impacts of climate change entail. Figure 2 in Principle 7 shows the concentration of greenhouse gas emissions in tonnes of CO_2e per million GBPs of total assets for different GICS sectors. We typically invest in companies that Global Industry Classification Standard (GICS) would classify as Consumer Staples, Consumer Discretionary, Health Care, and Information Technology, which, as the Figure shows, are significantly more carbon-efficient than other sectors. Due to this, our investee companies, and therefore Funds, are significantly less exposed to climate-related risk than those investing in the carbon-intense sectors such as Utilities, Materials, and Energy.

Despite our lower exposure to these risks, it is important to ensure the companies we are invested in are acting to reduce the potential impact of climate change and the chances of getting caught by negative consumer sentiment or new regulations through managing their emissions. As part the assessment of our companies' approaches to managing this risk, we collected data from the Science Based Targets initiative (SBTi) and company reports to calculate our Funds' alignment with the Paris Agreement, the Business Ambition for 1.5°C, and commitments to net zero carbon emissions (covering at least their direct operations, or scope 1 & 2 emissions). Table 1 details the results of this. For comparison, 19% of listed companies in G7 indices are aligned with the Paris Agreement[2]. Using the data collected, we calculated that at least 70% of Fundsmith's assets under management ("AUM") at the end of 2021 were covered by a commitment to achieve net zero emissions by 2050 at the latest. Participants in the Net Zero Asset Manager Initiative had an average of 35% of their assets in line with a net zero commitment at the end of 2021[3].

	FEF	FSEF
SBTi Commitment	75%	68%
Paris Agreement Aligned (2°C)	69%	63%
1.5°C Aligned	65%	59%
Net Zero Commitment	81%	74%

Table 3: Fundsmith Equity and Sustainable Equity Funds' carbon emission commitments as at 31/12/2021

We are engaging with the companies that we have found to be lagging the rest of the portfolio in their stated commitments. However, we have found these companies to be the ones with the lowest emissions and, therefore, the least exposed to the risks resulting from climate change. More detail regarding FEF and FSEF's environmental performance can be found as part of our annual sustainability summaries, available on our website.

We believe the way in which we construct our investable universes and portfolios helps build resilience to the risks climate change poses. Our approach to assessing the long-term sustainability of a company's returns means our research team must identify any environmental risks that could affect the company's ability to maintain high investment returns. This potential impact on investment returns is why we have always committed to not investing in the most capital intensive or environmentally damaging sectors.

Fundsmith is a signatory to the UN Principles for Responsible Investment (UN PRI). This UN-supported network of investors works to promote sustainable investment practices through incorporating environmental, social and governance ("ESG") factors into the investment process. The initiative encourages investors and, through investor engagement, companies, to think about the longer-term impacts their capital allocation decisions have, which we believe will lead to more efficient capital markets. Following the issues the PRI had with their reporting tool last year, we engaged with them to provide feedback on where the new tool added value and where the tool needed improvement.

We also engage with our investor base and wider community on a range of topics including the dangers of market timing, the benefits of investing with a long-term investment horizon, and other issues that influence the functioning of global markets. Our CEO and CIO regularly contributes to the investment community through various interviews and articles, discussing the misunderstandings and risks that occur within investments, and assessing ongoing market events and trends. For example, he has previously discussed the poorly understood risks associated with investing in speculative assets, such as Bitcoin. We hope that by illuminating such issues we can encourage wider discussion around these risks and encourage more sustainable capital allocation and management.

Last year, following the risks investors in China faced as Evergrande risked defaulting on its debt, our emerging markets fund 's portfolio manager published an article discussing how we perceived and managed the risks of investing in China. The article discussed the governance issues and complicated VIE structures used to invest in some Chinese companies, aiming to help inform other investors and retail clients of the challenges and risks associated with the country. It is available to read here.

During volatile periods, falling markets, or the inevitable periods of under-performance, outflows become a risk for open-ended investment funds such as ours. Ensuring we have enough liquidity to be able to return investors' cash when they want it is essential. We have long been aware of this risk and are highly unlikely to ever invest in unlisted companies within our Funds. We have also monitored and published a liquidity measure for our open-ended funds on our Factsheets since 2012. These Funds invest in companies with large market capitalisations that are typically highly liquid meaning the risk of not being able to quickly exit investments is low.

[2] https://sciencebasedtargets.org/news/g7-stock-indexes-science-based-targets

[3] https://www.netzeroassetmanagers.org/media/2021/12/NZAM-Progress-Report.pdf

Assessing our effectiveness in identifying and responding to market-wide and systemic risks over the reporting period is challenging. Our strategies are all long-term focused; we do not focus on annual outcomes nor are they important to us. As well as this, these risks play out over a timeframe considerably longer than 12 months. For example, coronavirus continues to have substantial knock-on effects more than 24 months after the initial wave of lockdowns in the West, and climate change is not something that can be handled over the course of a year, nor can we expect our companies to respond to the risk over such a short time frame. However, we have been effective in using our stewardship activities, such as engagement and proxy voting, to ensure our investee companies are making decisions to support their long-term performance and managing their risks during the last year.

One way we can assess our effectiveness in managing these risks over this time frame is to look at how our funds performed, adjusted for risk, versus a comparable index. FEF and FSEF recorded Sharpe ratios of 1.60 and 1.95 respectively in 2021, against the index's ratio of 1.46. Clearly, our funds and their underlying companies continued to perform well accounting for the risks they faced.

Principle 5

Signatories review their policies, assure their processes, and assess the effectiveness of their activities.

Our Compliance Department and Fundsmith's Management Committee review all policies and reports internally. This ensures they are consistent with Fundsmith's investment approach and values, and that they comply with any regulatory requirements. We re-assess policies annually to ensure that we are delivering consistency across the business, reflecting new information and continuously improving. The principal policy that relates to our stewardship activities is our Responsible Investment Policy, which details the processes and activities used to integrate ESG into our investment process and our approach to engagement and proxy voting.

We aim to report on all our stewardship activities in a fair, balanced, and understandable way, as a core part of our approach. Ensuring investors understand how we behave and act on their behalf promotes good practices and market stability. Our stewardship-related reporting is done by analysts in the research department who are directly involved in the investment process and implementation of our responsibilities as stewards of investors' capital. Our Stewardship & Sustainability Committee is in place to monitor the overall reporting process and assess the output. Once approved by the Committee, reports are checked by the Compliance Department and finally by the Management Committee who give final approval.

2021 was the first full year of operation for the Stewardship & Sustainability Committee. The Committee was created to centralise discussions regarding our stewardship and responsible investment-related policies, processes, and activities. The Committee's primary responsibility is the ongoing assessment of current and potential entrants to all our Funds' investable universes. This assessment includes reviewing companies' compliance with both the "do no significant harm" principle and our Responsible Investment Policy. The Committee is also responsible for approving our UN Principles for Responsible Investment ("UN PRI") report and any other stewardship or sustainability related reporting, as well as reviewing engagement activity and significant votes across all Funds. The committee is chaired by the Head of Research and comprises the Head of Compliance, Head of Sustainability, Portfolio Managers for each fund, and our Stewardship Analyst. This means all the people involved with the implementing and supporting stewardship in the investment process are represented on the Committee.

The Stewardship & Sustainability Committee became the main assurance and assessment body for our stewardship-related activities over the last 12 months. The Committee completed a review of all inclusions and exclusions from our Sustainable Fund's IU, assessed our updated ESG Factsheet for Fundsmith Sustainable Equity Fund (FSEF) and our forthcoming annual sustainability reports for both Fundsmith Equity Fund and Fundsmith Sustainable Equity Fund, and had a key role in the production of our first Stewardship Report.

The Committee also reviews any investor feedback or external reviews we receive regarding stewardship and sustainability, such as those from fund-rating agencies. We meet with such bodies regularly to update them on our approach and respond to requests for information/due diligence questionnaires throughout the year. The feedback from these meetings and assessments is taken to the Stewardship & Sustainability Committee who assess what, if any, points from the feedback we should act upon.

We also receive a level of external assurance on our integration of stewardship and ESG through our participation with the UN PRI. The PRI assess the quality of our strategy and governance, our integration of ESG in our investment process, and our active ownership. For the last reporting period, we received a score of 'A' for our strategy and governance, 'A+' for our ESG integration, and 'A' for our active ownership (median signatory scores are A, A and B respectively). We use these scores to assess where we can improve our approach for the next reporting period.

This year we improved the assurance of our proxy voting process to reduce the risk of errors occurring throughout the proxy voting process. Vote compiling and distribution to portfolio managers was moved from Operations into the Research team, meaning more of the process is contained within one department. Checks are now made within both the Research and Compliance Departments to ensure voting decisions are in line with our proxy voting policy and interests of our clients. Compliance has also improved the vote-monitoring process, ensuring that voting decisions are consistent and traceable back to the respective portfolio manager.

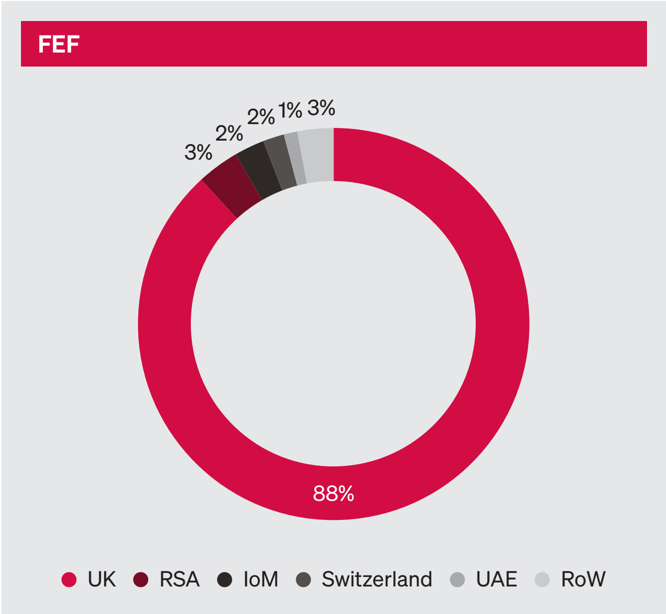
We believe that internal assurance of stewardship is appropriate given our approach, size and resources, and investment strategy. However, we are keen to ensure that any decisions we make are as unbiased as possible and we continue to explore possible ways of obtaining additional forms of assurance in relation to our stewardship activities.

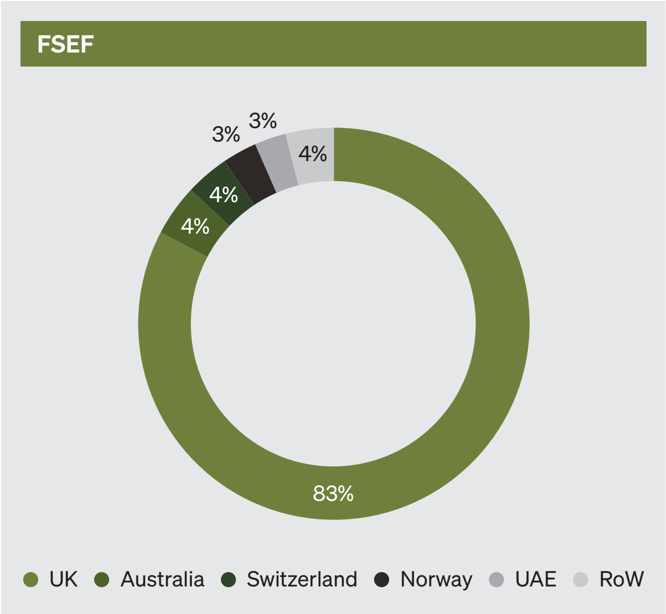
Principle 6

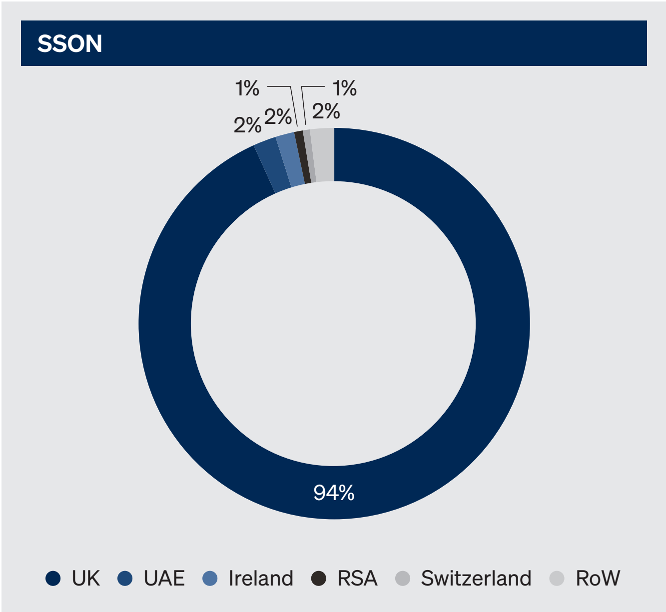
Signatories take account of client & beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Fundsmith operates a small number of fund vehicles across four investment strategies, all of which only invest in listed equities. As at 31 December 2021, Fundsmith's assets under management including segregated mandates totalled £43.4bn. Of this, 91% was invested in large cap developed markets, 8% in small and mid-cap developed markets and 1% in emerging markets. In relation to our Funds, 88% of our AUM was in open-ended collective investment vehicles, 3% in Delaware LPs and the remaining 9% in investment trusts, which are closed-ended investment companies listed on a stock exchange.

Fundsmith has a wide variety of investors in its Funds, from individual retail investors to large institutional investors. Across our Funds, 27% of our assets under management are from retail investors, investing in our Funds directly through our website or an investment platform, and the remaining 73% is from institutional investors, such as charities and pension funds. In our UK listed Funds (FEF, FSEF, SSON, FEET), 78% of investors are from the UK, 12% are from Europe, and Africa, Asia and the Middle East represent around 3% each. The geographic distribution of the investors in each of our strategies is shown in the graphs below.







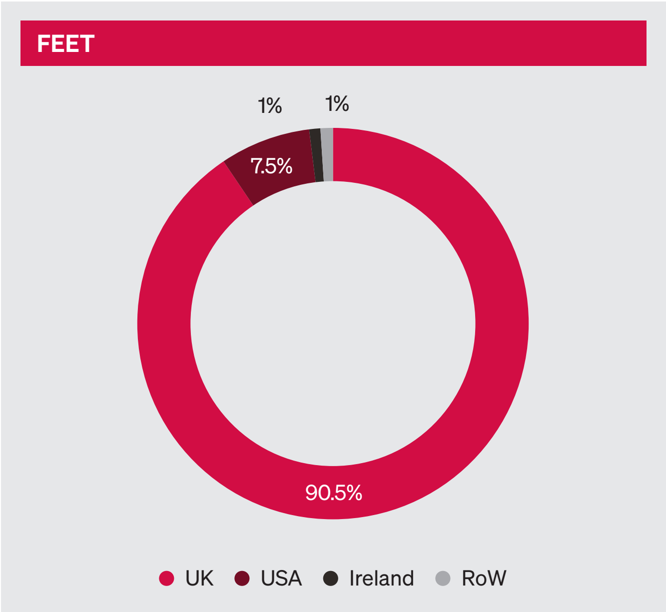


Figure 1: Fundsmith LLP funds' investors geographies

We make a concerted effort to clearly communicate our investment philosophy with investors prior to investment. We do this to ensure they have a clear idea of the way in which we operate our funds and so they can identify whether our approach is suited to their investment and stewardship policies and preferences. We believe this is the appropriate approach given the diverse range of our investor base and, in particular, the mix between retail and institutional investors, and the resources available. Adapting our approach based on the preferences of a particular investor, or group of investors, risks disenfranchising our other investors and would be contrary to our aim of building a group of like-minded investors. Hence, we emphasise that potential investors read our Owner's Manual and Responsible Investment Policy, as well as the variety of periodic reporting we publish for our funds, before investing in our products.

Most importantly, we want those who wish to invest with us to understand the long-term nature of all our strategies. Our research team spends a great deal of time identifying and researching the type of companies that we believe will provide the best long-term risk-adjusted returns. It is important to us that investors understand why we believe the types of companies we invest in will outperform and compound in value over the long-term. Providing investors with the information that supports this will enable them to have confidence in investment decisions during more volatile periods of market and fund performance. Reflecting this, our recommended holding period for investors is at least 5 years.

Unlike many other investment managers, we hold an annual shareholders' meeting ("ASM") for the Fundsmith Equity Fund and the Fundsmith Sustainable Equity Fund to which all our direct investors, retail and institutional, are invited. The ASM has grown each year and now has over a thousand of our investors in attendance. The meeting gives those investors attending an opportunity to submit questions to our CIO & CEO, Terry Smith, and Head of Research, Julian Robins, with the most recent ASM seeing almost 200 questions submitted. While there is only time to address a few of these during the ASM itself, we make a commitment to answer every question following the event. The ASM provides an effective format for us to collect feedback from our investors, both retail and institutional, as anyone in attendance may submit a question. This allows us to receive views from a variety of investors in an efficient manner which is particularly helpful given the smaller size of Fundsmith. It allows us to assess how successfully we are meeting our investors' needs via assessing key themes that emerge from the questions submitted.

Outside the ASM, we encourage questions from our clients and consider any issues brought to our attention in this way. All our responses to direct clients are conducted through the email address of a member of our sales team and not a generic mailbox. This gives our investors direct access to a representative at Fundsmith, usually Greville Ward (a Fundsmith Partner), to submit their questions, queries, or complaints. We also use this email address to send out any pertinent information, such as articles relating to Fundsmith or comments we have made, to all direct investors.

We have a sales and relationships team who engage with a variety of our investors, typically larger institutional investors. Analysts from the research team frequently take part in these engagements, allowing our investors to directly engage with those involved in the investment and stewardship decision-making process. We meet with these investors regularly and respond to the requests for information and due diligence questionnaires sent throughout the year. Our meetings typically follow on from the questions sent to us, but we also frequently engage to receive feedback on various areas, and to provide updates on the performance of the fund and our various stewardship activities.

We also have an internal Investor Relations (IR) team largely dedicated to answering routine investor queries and issues, escalating where necessary and reporting feedback to the sales and relationships team. Our sales and relationships and IR teams compile reports detailing the level of engagement they have with investors of all levels, including complaints, recurring issues, and suggestions for each meeting of the Management Committee.

Last year, responding to requests from our investors and the general increased demand for guidance on key financial topics, we started producing and publishing a series of guidance documents for our investors on tax, risk, and pensions. We have also started hosting a series of seminars on the topics which any of our investors may attend.

We periodically publish updates for all our products on their respective websites. These updates ensure that investors are kept informed about regarding a variety of information relevant to the respective fund. Our monthly Factsheets provide data and a short description of key activity within the fund over the previous month. We also publish annual accounts for all our funds. For our open-ended funds, we publish an annual Shareholder's Letter, updating investors on the Fund's performance over the previous 12-months and discussing key themes emerging from the year. For institutional investors, there are also regular fund updates from the respective Portfolio Manager.

The propagation of ESG through the investment industry has generated increased interest in and expectations for ESG-related disclosures from our investor base, regulators, and the wider community. As a result, we are looking to expand our reporting across all our funds, where appropriate and possible, in a style similar to the monthly ESG Factsheets we publish for FSEF. During 2021, we developed a new Sustainability Summary document for FEF and FSEF, which are now available on their respective websites. The document details key ESG-related information for the respective fund, as well as examples of innovation within our portfolios. We have also found this Stewardship Report to be a very effective way to communicate the outcomes of our stewardship activities to investors, particularly engagement examples and proxy voting.

Overall, it is clear to us that our investors will vote with their feet, so to speak. If we are failing to account for our clients' needs and our communication with them is not living up to their expectations, we can expect those that have trusted us with their capital to move it elsewhere. As discussed in Principle 1, our priority is to run a great business; understanding and responding to the needs of those that make operating the business possible is paramount to this. Our processes used to understand and address the needs of our investors have been, and continues to be, effective.

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues to fulfil their responsibilities.

As we outlined in our report on Principle 1, as long-term buy-and-hold investors, active and effective stewardship is an essential part of our investment approach. Our firm-wide Responsible Investment Policy, published as part of our participation in the UN Principles for Responsible Investment initiative, outlines our approach in detail. It discusses how we integrate and assess ESG issues as part of the investment process for all our products and how this assessment promotes the responsible allocation of capital. It also discusses how we use engagement and proxy voting to manage and oversee the long-term performance and value of investee companies. Our Owner's Manual and other fund literature is very clear that investors should be prepared to invest for the long-term, with a minimum recommended holding period of at least 5 years. We do not use service providers to assist with the integration of stewardship and investment. We do however use data provided by RepRisk to supplement our research on the reputational risks of current and potential investee companies resulting from ESG performance. RepRisk is discussed within this Principle and in Principle 8.

The success of our approach relies upon the long-term performance of the companies we invest in. Ensuring our stewardship activities are effective and our investment process appropriately considers ESG impacts, risks, and opportunities is therefore a fundamental component of our investment approach. Our priority is to invest in "good companies" and hold the stocks in these companies forever. All our investment strategies are equity based, and we adopt the same approach to the integration of stewardship for each of our funds and client portfolios. That being said, the challenges we face in integrating stewardship can vary depending on the geography and the size of the company in question. Accessing ESG data in emerging markets and for some of the smaller companies we invest in can be difficult and necessarily changes our approach. In such cases we engage with the company both before and during the period in which we are invested to assess management's understanding of the risks they face and how they are managing them. Regardless of the size or location of the company, we aim to vote on 100% of the proxies available to us. Principle 12 gives more detail on our voting activities for 2021.

We conduct our own internal research and use sources of publicly available information to assess the companies we invest in. We regularly engage and interact with the management of those companies to ensure that they are looking to improve their businesses and succeed over the long-term. The information we gain from the combination of our research and these interactions is the main way we assess whether to buy or sell a company, rather than what has happened to its share price.

We classify a company as good if it can make and sustain a high return on capital employed across the full business cycle. It is also notable that many of the companies that do the most damage to the environment and wider society do not meet this good company definition. We will not invest in industries such as materials, energy, or utilities as we do not find them to contain businesses with sustainable business models that fit our criteria and, as displayed by Figure 2, they are among the most carbon-intensive industries.

The good company screen leaves each of our funds with around 100 individual companies in their respective investable universes, any of which we would ideally hold forever (assuming they remain good companies) but may not currently trade at an attractive valuation or form a balanced portfolio when all held at once.

We see damaging practices towards the environment and/or society as potentially resulting in the company's failure to sustain the high returns over the long-term which we prioritise, damaging their growth and consequently investment potential. Therefore, understanding how the various ESG risks affect the ability to sustain a high return on capital invested is essential. Our research team identifies and assesses these issues and risks as an integrated part of our pre-investment research process and in the continual monitoring of IU companies.

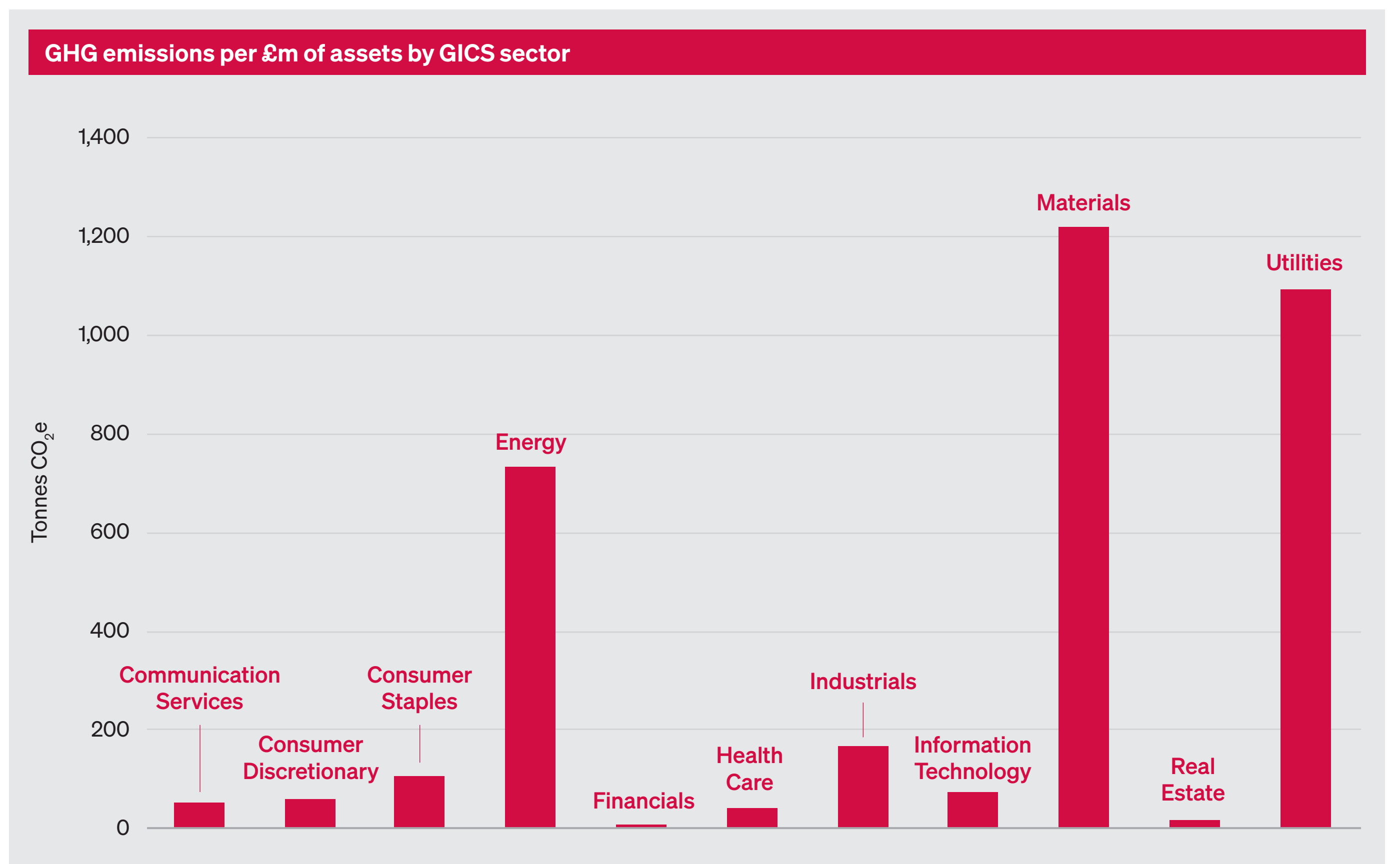


Figure 2: GHG emissions per £m of assets by GICS Sector

We consider ESG impacts in the widest possible sense, considering both the positive and negative effects that an investee company may have on the environment and/or society. We analyse and evaluate the company's environmental and social impacts, its governance policies and practice, its policies regarding dividends and executive remuneration and its methodology for assessing the adequacy of capital investments. We also also look at a company's positive impacts, such as their research and development and product innovation activities, as many of the companies in the investable universes for Fundsmith's funds are constantly striving to develop their products in ways that improve their sustainability and offer a positive impact. They achieve this through improving product efficacy, inventing new solutions to problems, or reducing the negative environmental or social impacts of their existing products. Sustainability is an area which is developing and evolving, and we expect the companies in our investable universe to be aware of this and always seeking to improve.

The ESG risks we consider are varied and differ depending on the company in question. We aim to understand the risks associated with the company in a holistic 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.

We analyse the risks associated with the company's direct activities via various metrics. For example, we use greenhouse gas emissions to judge exposure to the transitional risks associated with the development of the low-carbon economy; high concentrations of greenhouse gas emissions increase the likelihood a company will be exposed to the fines and regulations implemented to assist in this economic transition. Greenhouse gas emissions also contribute to the wider, systemic risk of climate change and is something that we monitor closely. However, as discussed in Principle 4, our investment approach means our companies are relatively small contributors to this.

Supply chains are exposed to both environmental and social risks, which can impact the normal operation and long-term sustainability of the supply chain and, consequently, the performance of the company. To assess supply chain sustainability, we look at various factors, such as identifying the presence of potential human and/or labour rights abuses or assessing the vulnerability of the supply chain to extreme weather events.

The environmental and social risks associated with the distribution, use, and disposal of the company's products is also considered. We assess the product's impact; is it beneficial, neutral, or detrimental to society? Products that are detrimental to the environment/society are more likely to suffer from negative consumer sentiment and increased regulation over time, impacting the performance of the product and potentially the performance of the business. It is also important to include an assessment of how the company is innovating to improve the impact of their products, for example introducing so-called "heat-not-burn" tobacco products, or reduced fat/salt/sugar food products.

We monitor and assess a company's sustainability risks and establish a view of its net negative ESG impacts using three main sources of data and information.

1. Our 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. The database currently has over 7,200 pages of information collected over the past 7 years.

2. Our quantitative ESG database. We collate data on environmental performance, diversity, corporate governance, and innovation reported by companies. We use this to provide a look-through of the respective portfolio compared to an index. 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 relative impact of the portfolio compared to the benchmark. Environmental stats are reported per million GBPs of free cash flow. This helps us to address the trade-off between a company's investment proposition and what its net negative impacts are on the world, within our universe of good companies.

3. External reputation 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 100,000 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:

    i. First, it serves as a proxy for the overall negative impact a company may have as it provides us with a way to absolutely rank companies within our investable universe. 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.

    ii. Secondly, it acts as a catch-all for any negative news regarding a company that our usual news filtering services may miss.

In addition to the above, we require the companies we invest in to have well-managed policies for ethical working practices and a sustainable relationship with the environment and their stakeholders. Fundsmith integrates expectations of a company's environmental, social, governance and innovation impacts on the world into our model forecasts.

We are constantly searching for ways to improve our monitoring of ESG risks and integrate them into our investment process. As the industry moves towards a more standardised method of measuring these factors, we can start developing more consistent metrics that allow a more accurate assessment of, and comparisons between, the companies within and outside our investable universes.

Fundsmith Sustainable Equity Fund (FSEF)

Our sustainable fund, FSEF, initially follows the process outlined above but also applies hard sector exclusions and a sustainability screen over the Fundsmith Equity Fund investable universe. This means that the FSEF investable universe will always be a subset of the Fundsmith Equity Fund investable universe.

The hard sector exclusion screen is in place to prevent investment in companies described as being in the following GICS industries: Aerospace & Defence, Metals & Mining, Oil, Gas & Consumable Fuels, Tobacco, Gas Utilities and Electric Utilities, and the following GICS sub-industries: Brewers, Distillers & Vintners and Casinos & Gaming. We also exclude any companies that profit from pornography and those, such as Louis Vuitton Moet Hennessy (LVMH), which despite not being classified by MSCI as in the above sectors, makes a significant proportion of its profits from them. We exclude these industries as we deem it unlikely a truly "sustainable" company could operate within them. These exclusions are detailed in the Fund's prospectus, meaning that we cannot legally invest in any companies operating in the industries/sub-industries given above.

We then apply our sustainability screen. This screen uses the information we have collected regarding FEF IU companies' sustainability risks, net environmental and social impact on the world, awareness of these impacts, and 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. The 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. Once we have removed the companies that we find to cause an excessive amount of environmental or social harm, we are left with the FSEF investable universe.

Fundsmith Sustainable Equity Fund's additional ESG criteria means companies such as Facebook (now Meta) and Philip Morris International are excluded from its investable universe, both of which are present in the Fundsmith Equity Fund's investable universe. While both companies pass our good company screen, Philip Morris International is a tobacco company so is removed by our sector exclusion screen, and Meta is excluded because our assessment concluded its net impact on society is excessively negative, and it is currently failing to mitigate these impacts.

Principle 8

Signatories monitor and hold to account managers and/or service providers.

We use very few service providers to assist our stewardship-related activities. For example, as discussed in Principle 12, we do not use any proxy voting advisory services. All our voting decisions are made independently using our analysis of the vote topic and company in question to inform our decision. Service providers are only used where we feel they are necessary and offer a material improvement to the outcome of the stewardship activity.

We use a variety of quantitative and qualitative data to assess potential investments and monitor existing investments. Our research team does all our analysis in-house using data collected directly from company websites, publications, and via Bloomberg. Data for prospective investee companies is collected from company websites through their publications of annual reports and other public documentation. We meet management, attend conferences, and read industry publications (e.g., Pet Food Digest) to help build the profiles of the companies and industries in all our respective investment universes. We also collate data on environmental emissions, diversity, corporate governance, and innovation from data companies provide themselves. It is important to note that we don't rely on any single service provider for any part of our investment process. Data from each provider is used as part of our assessment of a company's investment proposition and is never relied on exclusively.

We check the quality/accuracy of the data by cross referencing against other freely available sources. For example, we reconcile company reported greenhouse gas emissions against those provided by the CDP, which are calculated and reported separately. Though, as CDP participation grows, more companies are using this data within their own reports. We also use our relationships with investment banks for access to company management teams and for information on companies that can sometimes be more difficult to access, particularly in emerging markets. We place little value on any recommendations, opinions, or advice that research by these institutions provide, however. Each year we assess the value offered by different sell-side research providers before deciding to re-sign the contract. The Stewardship and Sustainability Committee periodically reviews the services we receive and assesses feedback from meetings we have had with providers. The Committee makes its decisions based upon the value these services add and the quality of the service provided when making their assessment.

We don't use dedicated resources for ESG data, or so-called "sustainability ratings" for our analysis, as we have doubts about the methodology and the consistency of ratings across different providers. Our main aim when analysing a company, as mentioned throughout this report, is to assess its ability to sustain a high return on capital employed across the business cycle and its capacity to invest more capital at these high rates of return. Evaluating their ability to do this relies on an understanding of the company's net impact on the world, which is assessed through the variety of metrics we collect and analyse.

To help us assess these net impacts independently, we use reputational risk scores from RepRisk. We think this acts as a strong proxy for negative impacts on the world and is better suited to our approach compared to the sustainability ratings we looked at. The service analyses over 100,000 news sources a day in 23 languages, and acts as a catchall for any negative news on a company that our usual news filtering services may miss. The data we receive from RepRisk is delivered via their online 'ESG Risk' platform, from which we can download the data we need and integrate it directly into our workflow. This allows us to quickly and efficiently access the third-party ESG-related risk assessment we use to complement our investment analysis process.

To check the validity of the information RepRisk provides, we collect and store both positive and negative media coverage of our companies in our internal daily news emails. We can then compare what we've collected to what RepRisk has considered significant. We have regular contact with RepRisk to help improve their systems and feedback any issues we have had. This contact is typically twice a year. However, if any specific issues emerge between these meetings, we have a designated customer service representative we can engage with to address them.

During 2021 we had no issues with our service providers with our needs being met throughout the year. We did however take the opportunity to meet with data providers Bloomberg and RepRisk, on both occasions discussing areas of the service we received that could be improved.

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

Fundsmith's engagement policy is available as part of our Responsible Investment Policy, which is available here.

Our approach to engaging with the companies in our portfolios comes directly from our desire to be long-term shareholders in those businesses. We engage with companies to encourage sustainable business decisions that will benefit the long-term performance of the company. Practically, this means we generally support changes and/or investment that promotes long-term growth and oppose the establishment of unrealistic short-term targets and activities that negatively impact the ability to sustain high returns.

The decision to engage with a company is made on a case-by-case basis and is prompted by various factors, both internal and external. We only engage with companies regarding topics relevant to their operations and when we deem the risk to be material and detrimental to long-term performance. Engaging with a company is an effective way to generate change that reduces risk, but we do not always engage with the goal of changing the company. We use engagement to reassure ourselves and to better understand the company's perception of the potential risk. Companies are often aware of the risks we identify and either have plans to, or are currently, mitigating it, or have deemed it immaterial. We view these engagements as equally successful as those that force change within a company. Of course, if the company is unaware or not doing enough to address the risk, engagement can then be used to generate the change needed.

One key issue we frequently engage with investee companies regarding is executive remuneration. Generally, we care how executives are paid, not how much. We would like the remuneration policies of the companies we invest in to be aligned with the sustainable, long-term growth of the business. We don't like remuneration polices that are based on the kind of short-termism discussed above. We believe an effective policy includes both a measure of growth and a measure of returns, it is no use having one without the other.

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 ESG performance might not impact profits immediately, but it has the potential to negatively influence future growth. ESG factors are becoming increasingly likely to bring material financial impacts as consumer interest and regulatory pressure continues to grow.

Our approach to engagement differs slightly between our funds given the different sizes of the businesses and varying geographies they invest in. As at the end of 2021, the companies in FEF and FSEF had an average market capitalisation of £105bn and £101bn respectively, while Smithson has a much smaller average at £9.9bn and FEET smaller again at £5.4bn. Engaging with the companies in our emerging market fund is typically more difficult than in our developed market funds as these companies have fewer resources to devote to engaging with investors and the physical distances involved.

Table 4 below sets out information on our direct engagements with investee companies for each of our funds throughout 2020 and 2021.

	Total no. of engagements		% of Portfolio engaged	Average no. of engagements per portfolio company
	2021	2020	2021	2021
FEF	61	78	72%	2
FSEF	51	61	67%	2
SSON	41	50	50%	1
FEET	85	75	59%	1
Total	238	264		

Table 4: Fundsmith 2021 engagements summary

During 2021, Fundsmith, between all our products, recorded 238 engagements, meeting 83 of the 135 companies owned during the year. Most of our engagements with company management were general updates regarding the company's performance, introduction to new executives, involved discussions over their long-term strategy and capital allocation plans, and general risk management. Alongside this, we saw an increase in the number of ESG-related engagements, with such matters discussed in over a quarter of our meetings last year.

Coronavirus continued to cause challenges with engagements. Our developed world funds, FEF, FSEF, and SSON saw decreases in the number of engagements held in 2021 versus 2020. However, the proportion of portfolio companies we met during the year was maintained in FEF and increased in FSEF. FEET was the only fund that saw an increase in its number of engagements in 2021, but the number is still significantly lower than 2019 levels.

Video conferencing remained the dominant method of engagement during the pandemic-affected 2021. As discussed in our 2020 Stewardship Report, video calls accounted for around 8% of our engagements in 2019, which increased to just below 45% in 2020. This trend continued last year, rising to 84% of our engagements in 2021 as companies continued to adjust to virtual methods and the technology available continued to improve.

Some examples of our engagements with companies are detailed below.

Company	Becton Dickinson
Sector	Health Care
Country	United Kingdom
Fund	Fundsmith Equity Fund, Fundsmith Sustainable Equity Fund
Context	Social impact of faulty products
Objective	Understand how they were managing the reputational risks/ impacts and their approach to preventing faults going forward.
Activity	Met with the Corporate Secretary, CHRO, Head of IR and Director of Sustainability.
Outcome	The company explained their response to the issue and changes they were making to their reporting and product quality processes to increase transparency and minimise the risk of such issues repeating. The meeting reassured us that the company were reacting appropriately to manage the immediate risks associated with the product and taking steps to reduce future risks.

Company	Estee Lauder
Sector	Consumer Staples
Country	United States
Fund	Fundsmith Equity Fund, Fundsmith Sustainable Equity Fund
Context	Remuneration Policy
Objective	We engaged with Estee Lauder after they changed their remuneration policy before their 2021 AGM. We wanted to understand how the updated metrics benefitted the company's long-term performance.
Activity	Met with the company's Remuneration Committee Chair and a legal representative.
Outcome	The company explained why the changes were being made with reference to the impacts of the COVID-19 pandemic, and how these changes would be effective in incentivising management to prioritise the company's long-term growth. We felt the company justified the changes to the remuneration policy and were reassured that they did incentivise the long-term growth of the business. We voted in favour of the policy at the AGM.

Company	McCormick & Company
Sector	Consumer Staples
Country	United States
Fund	Fundsmith Equity Fund, Fundsmith Sustainable Equity Fund
Context	Environmental risk management
Objective	Understand how they were managing the risks they faced regarding their raw product sourcing as a result of climate change.
Activity	Met with the company's CEO and VP of Global Sustainability & Packaging Innovation.
Outcome	The company explained the variety of risks their "key ingredients" faced from climate change, their response to these risks and how they were increasing the resilience of their supply chain. We were satisfied that the company's approach to managing the risks facing their key ingredients was well understood and being adapted to sufficiently.

Company	Temenos
Sector	Information Technology
Country	Switzerland
Fund	Smithson
Context	Remuneration Policy
Objective	Understand why the company had opted to aggressively use options in management compensation, and the reasons for using IFRS metrics for incentives.
Activity	We met with various company representatives over a two-year period.
Outcome	Following an extended engagement within which we encouraged management to move away from the use of options and IFRS accounting, we finally saw changes in 2021. Temenos' updated remuneration policy opted to use more cash flow-based metrics (growth) in their long-term incentive plan and reduce their use of options. We therefore voted in favour of the remuneration proposal at their AGM.

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

Fundsmith is open to participating in collaborative engagements when we feel an issue is of sufficient severity and collaboration can achieve a result we could not alone. As a long-term investor, we value the relationships we build with the companies in which we invest. Our preference is to deal with companies directly and usually in private. Collaborative engagement is usually only considered when our independent engagement and escalation activities have failed to generate the change we feel necessary.

We also find that the increasing pressure on investment managers to engage collaboratively is resulting in more engagements that potentially serve the interests of the managers over those of the underlying company. Given our long-term approach, our interests are rarely aligned with these engagements as they typically want companies to commit to short-term targets or engage in activities that provide little to no benefit to long-term performance. Collaborative engagement is only ever exercised if it offers clear benefits to the company's long-term outlook, rather than to simply tick a box to say we've done it. We prefer speaking to management and exchanging opinions and views on different issues directly. This, we believe, is more effective than any number of investors signing a generic letter sent to multiple companies.

We are a signatory to the UN Principles for Responsible Investment and continually monitor their collaborative engagement platform to identify any collaborative engagement opportunities that are aligned with concerns we may have and match our preferred approach. Should such an opportunity be present and we feel we can offer meaningful value, we would participate. Fundsmith is also an active and full member of the Investment Association (IA) and regularly participates in industry engagements and discussions.

During 2021 FEET, our emerging markets investment trust, undertook a significant collaborative engagement. In October, Jubilant, the owner of the Domino's master franchise in India, announced a reverse book build in portfolio company DP Eurasia. Their intention was to build their stake in the company from 32.8% to 49.9%, offering to buy 25 million of the company's shares at a slight premium to the share price at the time, which we thought still significantly undervalued the business.

DP Eurasia is listed on the London International Exchange, is headquartered in the Netherlands, and has most of its operations in Turkey and Russia. The nature of the company's incorporation and the implications of Brexit meant that the company was no longer subject to takeover codes in either the UK or the Netherlands. This left minority shareholders, such as ourselves, potentially exposed to the company being de-listed if the reverse book-build was successful and Jubilant were able to buy more shares on the open market to take their stake above 50%. We were therefore left with the two options of either selling our shares for considerably less than we thought they were worth, or potentially holding shares in a de-listed company. The latter would leave the trust holding shares in a private company, which we are committed against doing.

In response to the reverse book-build we engaged with other DP Eurasia shareholders via the company's corporate advisers. Our aim was to impart our view that the offer made by Jubilant was materially under our estimation of the company's value, and to encourage other investors to support an amendment to DP Eurasia's articles of incorporation to include more protection for shareholders.

As a result of our work with other shareholders the reverse book-build attempt was rejected by 63% of the company's shareholders (excluding Jubilant), and the company has now installed temporary protection for shareholders to prevent a future de-listing, with more permanent minority protections to be formalised at this year's AGM. We see this as a successful collaborative engagement, achieving a result we could not have done working alone.

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

As discussed in our report on Principle 9, we engage with our companies with the aim of promoting their long-term performance and growth and to discuss any activities that we believe may limit their ability to sustain growth and returns over the long-term.

However, engagement may not always produce the results we desire as some companies fail to act on the issues highlighted, or their response fails to address them adequately. When we find our engagement is failing to generate change, we will often escalate our activities to help the company understand our position, or to get a more comprehensive statement from the company about why they cannot/will not make the change we seek.

Our 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.

Generally, we escalate our stewardship activities by taking the issue to the company's board of directors, sending a letter to the CEO, or by exercising our right to vote against management's recommendations at its annual general meeting (AGM). Typically, we will inform management that it is our intention to vote against a proposal at the AGM so that they have an opportunity to engage with us to exchange points of view before the meeting. As discussed in our report for Principle 10, when we feel the issue is particularly significant, we may look to collaborate with other shareholders to support our cause. While we prefer to keep our dealings with companies private, in some instances we may deem it necessary to express our concerns publicly should we feel that it increases the chances of a constructive dialogue.

Should previous escalation efforts prove ineffective, or the action of the company be particularly egregious, 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. We may also sell a holding if we believe there is an issue that will seriously impact the company's ability to make and sustain a high return on capital over the long-term. Reaching the point of exiting our investments is rare; most of our escalations are resolved through voting against management, on multiple occasions if necessary, and continuing our engagement with company executives.

Our approach to escalation is the same across all our strategies as we believe it is the most effective way to align management's thinking with ours, focusing on the long-term performance of the company. However, the various sizes and geographies of the companies our funds invest in means that there are some challenges in enacting this approach, particularly escalating the issue to the attention of the board or senior management.

We have limited access to top-level decision-makers at some of FEF and FSEF's holdings, given that they are some of the world's largest listed companies and our shareholdings, and therefore influence, is relatively small. It is improbable that we will be given a meeting with the CEO of Microsoft for example, given FEF & FSEF's holdings combined account for less than 0.2% of the company's ownership. Our emerging markets fund also faces challenges in accessing decision-makers in some of the countries it invests in due to the variation in governance norms and legal frameworks that companies must abide by. In these instances, we are more likely to continue engaging at a lower level within the company and use our voting rights to reinforce our point where necessary.

Some examples of escalating engagements with companies during the reporting period are given below.

Company	Church & Dwight
Sector	Consumer Staples
Country	United States
Fund	FEF & FSEF
Context	Remuneration Policy
Objective	Encourage the inclusion of metrics that incentivise the long-term growth of the business.
Activity	Voted against Church & Dwight's remuneration policy at their 2021 AGM. We then engaged with the CFO and VP of Rewards in August 2021 and escalated our engagement in September by exchanging letters with the Chair of the Compensation Committee.
Outcome	Our engagement was initiated following a vote against the company's remuneration policy in 2021. We engaged with the company following this. They explained why their chosen metrics were suitable for the business and we gave our view that the policy would be improved through the addition of a returns-based metric. The engagement failed to ease our concerns regarding their remuneration policy, and as a result we escalated our engagement by writing directly to the Chair of the Compensation Committee. The letter outlined why we thought the addition of a returns-based metric would be beneficial to the company's long-term performance. Our engagement with the company is ongoing and we will continue to vote against the policy to encourage the changes we deem necessary.

Company	Technology One
Sector	Information Technology
Country	Australia
Fund	SSON
Context	Remuneration Policy
Objective	Understand how the updated remuneration policy incentivised long-term sustainable growth.
Activity	Abstained from voting on the remuneration policy in 2020 and wrote to the company to open an engagement. Met with company representatives (CFO, Compensation Committee Chair) multiple times in 2020.
Outcome	Following an update to Technology One's remuneration policy in 2020, we wrote to the company outlining our intentions to abstain from voting on the policy at that year's AGM. We requested a meeting with the company's representatives to discuss our views. Later in the year, we met with the CFO and the Compensation Committee Chair again to discuss our preferred approach to remuneration, focusing on incentivising long-term growth and sustainable returns. The policy remained unchanged at the 2021 AGM and as a result we decided to vote against. After submitting our vote ahead of the AGM, the company offered to engage on the topic. We informed them of our decision to vote against and continue to engage with the company regarding their approach to remuneration.

Principle 12

Signatories actively exercise their rights and responsibilities.

As long-term shareholders and part owners of our funds, we have always taken our voting rights seriously. It is key for us to vote in a way that supports the long-term, sustainable growth of our investments. We will exercise voting rights in nearly all circumstances, but in some instances we may abstain from voting when we consider it appropriate. These rights are exercised for the exclusive benefit of the relevant fund and its investors. Our full voting records for 2021 are available here.

Our approach to proxy voting is laid out in our Responsible Investment Policy and Proxy Voting Policy. We do not have any "house" policies regarding proxy voting, nor do our individual funds set their own voting policies. Rather than following a policy-based approach, our portfolio managers assess matters subject to a shareholder vote on a case-by-case basis, accounting for the specific context of the company and the topic of the vote in question. All our analysis is completed in-house and set down in writing by the relevant analyst with the final voting decision made by the portfolio manager. We do not rely on recommendations made by proxy advisors.

When we exercise voting rights, we will do so in a manner that is consistent with the best interests of our funds, our investors, and our clients. We will always ensure that the exercise of voting rights is consistent with the investment objectives and policies of the relevant fund. When voting we always do so with the aim of supporting the long-term sustainable performance of the company, and to subsequently create value for our clients and beneficiaries. Individual clients cannot override this approach in either our pooled or segregated accounts. We have never and will never engage in stock lending.

All our proxy votes are submitted through voting software ProxyEdge. Our custodians input our holdings into the software which informs us of when our company's' AGMs or EGMs are occurring, what voting rights we have, the details of each proxy, and the voting deadline for each meeting.

Below we discuss our voting history for 2021, giving examples of some of our most significant votes. Significance is defined in various ways. A vote may be significant due to the size of our holding in the company, or the weighting of the company in our portfolio. Equally, it may be significant if we feel that the vote can bring about substantial, positive change in the company, or that failing to vote could result in large, negative impacts to ourselves and our clients. A vote can also be significant if it varies from our typical approach to voting on a particular issue, or if it results from previous engagement with the investee company regarding the issue.

	No. of shareholder meetings	No. of voteable proxies	% Voted		% Voted against management	
			2021	Since inception	2021	Since inception
FEF	28	468	100%	89%	6%	7%
FSEF	25	385	100%	100%	8%	6%
FEET	50	453	100%	88%	2%	2%
SSON	33	340	100%	99%	5%	5%
Total	**136**	**1646**	**100%**	**91%**	**5%**	**5%**

Table 5: 2021 proxy voting summary

Throughout 2021, our funds voted on 100% of the 1,646 proxy votes available to them, as we aim to every year. Exercising our right to vote is an important part of us fulfilling our role as effective stewards and satisfying our responsibilities to investors. Of these votes, 5% were against management's recommendations, as displayed in Table 5.

Table 6 details the proportion of our votes that were against the recommendations of management per specific topic. Across all our funds, we voted against management's recommendations for 40% of the remuneration policies/reports presented during 2021. As discussed throughout the report, we think the most effective remuneration policies are those that incentivise management to focus on the long-term performance of the company, utilising both growth and returns-based metrics. This year we have seen an increasing number of companies offering remuneration policies that do not do enough to align management's incentives with the long-term success of the business. The policies also use metrics that management either have too much ability to manipulate, such as earnings per share (EPS), or have little control over, such as total shareholder return (TSR). Fundsmith Equity and Fundsmith Sustainable Equity voted against a significant proportion of the policies presented, 47% and 58% respectively, representing 83% of FEF's votes against management and 79% of FSEF's. Our small/mid cap fund SSON voted against 34% of remuneration policies, representing 78% of all their votes against management, while FEET was against 10%.

	Board member election	Remuneration	Shareholder proposal	Other
FEF	0%	47%	13%	1%
FSEF	0%	58%	12%	3%
FEET	2%	10%	N/A	1%
SSON	0%	34%	50%	3%
Total	**0%**	**40%**	**13%**	**1%**

Table 6: % of proposals voted against management's recommendations by category

One of the remuneration policies we voted against this year was Nike's, a FEF portfolio company. We met with the company ahead of their October AGM to discuss their updated policy for 2021. The meeting failed to convince us that the remuneration policy supported the long-term sustainable growth of the business as it contained no returns-based metric, something we believe is key in incentivising sustainable long-term growth. Instead, the new policy's long-term incentive plan (LTIP) used 'relative total shareholder return' as a pay-out metric. The 'relative' component of the metric compared the performance of Nike's stock price to a basket of 18 other S&P 500 companies, very few of which could be considered comparable.

As said earlier, we dislike the use of total shareholder return as management has little direct control over the stock price of the company. One can simply look at the volatility in stock prices over the last two years to see the difficulty in managing a company's share price. On top of this, the use of 'relative' was a concern. We think companies should only be concerned with what they can control, after all, as Sir John Templeton said, "if you want better performance than the crowd, you must do things differently to the crowd".

Following the engagement, we voted against the policy. We will continue to meet with the company to encourage the development and implementation of a policy that better incentivises management to focus on the long-term performance of the business.

Despite the number of votes against remuneration policies last year, our small/medium cap investment trust, Smithson, saw a significant vote in favour of one. Sabre updated their policy in 2019, to which Smithson decided to abstain from voting, aiming to open an engagement with the company to better understand their approach to remuneration. Voting on the policy was suspended in 2020 due to the coronavirus pandemic, with the vote moved to the 2021 AGM.

Due to the impacts of the pandemic on the company, the compensation committee opted to alter the policy in 2021, changing the criteria for the short and long-term incentives. The changes were designed to focus management's attention on sustaining the business through the pandemic and we found them to be pragmatic and appropriate for the company's position at the time. As a result, we decided to vote in favour of the policy, despite it not aligning with our preferred approach to remuneration. However, as the company changed their policy mid-term, proxy advisor ISS recommended that shareholders vote against the policy, meaning it ultimately wasn't approved at the AGM.

Given the influence proxy advisory firms have in the current proxy voting process, we classify any vote against them as significant. We voted against India proxy advisor IASS regarding a board member election at Info Edge, a company in our emerging markets fund. One of the company's directors was up for re-election after spending five years as an independent director (2017-2022) at the business. The candidate had previously been an independent director at the company from 2009 to 2014 but left due to personal commitments for a period of 25 months. IASS' policy meant that the 25-month gap was not a long enough "cooling off" period to be considered as independent, and therefore they recommended voting against the resolution. We felt that the candidate was sufficiently independent and opted to vote in favour of the resolution, which ultimately passed.

We were largely aligned with management regarding board member elections last year, with the only votes against management coming from FEET. As was the case last year, we voted against the re-appointment of DP Eurasia's Chairman of the Board. We still think the fee the chairman receives is disproportionately large compared to the size of the company and the value of his holding in it. The Chairman was re-elected, and we will continue to vote against should the situation remain unchanged.

FEET also went against management's recommendations and decided to abstain from voting on the election of a director at Nestle India. We were unsure whether his previous experience made him suitable for the role, as he had no specific knowledge of the market he was entering. However, he had worked for Nestle for around 30 years, giving him intimate knowledge of how the wider company operated. We felt abstaining accurately reflected our thoughts on the election.

There was an 82% increase in the number of shareholder proposals presented in our company's AGMs in 2021 compared to 2020. Our open-ended funds, FEF and FSEF, voted against management's recommendations regarding shareholder proposals 13% and 12% of the time respectively. Most of the shareholder proposals FEF and FSEF voted in favour of were those that looked to install an independent chair at investee companies, both voting in favour of such a proposal at Johnson & Johnson, with FEF voting in favour of an independent chair at Facebook, and FSEF at Colgate-Palmolive.

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