LEADING-EDGE INVESTING

Herald Investment Management Limited
2020 Stewardship Code Report

Spring 2021

Stewardship at the heart of the Herald approach

Over **1,500**
one-on-one meetings per year

Invested in over
300
quoted and unquoted companies

Research from over
70
providers

Signatory to
UN PRI

The core of Herald's ethos rests on the aim of being long term supportive shareholders. The stewardship process entails actively engaging and interacting with investee companies and where required helping to effect change in issues that are important to the governance or future sustainability of those companies. We actively encourage management to think about employees, customers and broader stakeholders ahead of short-term shareholder returns, and firmly believe that this leads to the best long-term outcomes for outside shareholders.

- Aim to be long term and supportive shareholder
- Fundamental analysis is central to investment decisions.
- ESG factors considered as part of the investment case.
- Engage with management teams of all investee companies on a broad range of issues, including ESG.
- Three client funds with different remits, with 90% of assets invested in smaller quoted companies.
- Consistent provider of primary capital to early-stage companies.
- Actively investing in companies which enable lower power consumption and the production of renewable energy.
- TMT sector naturally low carbon and below the market average for carbon consumption.
- Our governance structures are reviewed by our Board and by the Boards of our clients on a recurring basis.
- Stewardship policies are regularly updated.

Contents

This is a report of Herald Investment Management Limited’s stewardship activities with reference to the FRC’s 2020 UK Stewardship Code. In order to evidence effective stewardship, signatories to the code are required to annually report on the activities they undertake to fulfil their stewardship responsibilities and the outcomes of this activity.

UK Stewardship Code Principles

1	Purpose, strategy and culture	4
2	Governance, resources and incentives	7
3	Conflicts	10
4	Promoting well functioning markets	13
5	Review and assurance	18
6	Client and beneficiary needs	21
7	Stewardship, investment and ESG integration	24
8	Monitoring service providers	29
9	Engagement	31
10	Collaboration	36
11	Escalation	39
12	Exercising rights and responsibilities	42

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, the environment and society.

REPORTING EXPECTATIONS

Context

Signatories should explain:

The purpose of the organisation and an outline of its culture, values, business model and strategy

Purpose
Herald Investment Management Limited ("Herald") was established in 1993, initially to invest in smaller quoted companies in the technology, media and telecommunications ("TMT") sectors.

Business model
We believed that early-stage companies in the TMT sectors that required development capital could be profitable investments because technology opens up new markets which smaller, entrepreneurial companies can exploit. We felt that investors recognised this opportunity but were deterred from investing directly in these companies by the high stock-specific risk and the illiquidity of such investments.

Initial strategy
Herald Investment Trust PLC ("HIT") was established, as a closed-end investment vehicle to invest in smaller companies with high stock-specific risk and poor liquidity. The closed-end vehicle diversifies the risk and provides more liquidity than the investee companies.

Subsequent strategic developments
Knowledge of the sector gained from hundreds of investments in smaller quoted companies has since been applied in a UCITS fund, Herald Worldwide Technology Fund ("HWTF"), for larger quoted companies, and two venture partnerships. The strategy of Herald and the strategy of Herald's clients' funds are regularly reviewed by the relevant Boards and remains valid and current.

Creating long-term value
In HIT a material proportion of the portfolio, consistently c17% at any one time, has been in early-stage loss-making companies which can often be held for an extended period through to profitability and further growth. The companies in this incubator element of the portfolio obviously evolve over time. Some which were early-stage loss making microcaps at the time of initial investment are now significant companies and have often returned multiples of book cost in value to our investors. There tends to be a natural life cycle for each investment.

Their investment beliefs, i.e. what factors they consider important for desired investment outcomes and why

Key factors we look for in companies we invest in
Competent management, with integrity and a desire to build a business. Pricing power which can often be achieved through intellectual property, patents, know-how, branding, or the network effect (e.g. certain internet companies). Recurring revenue streams are also attractive and are found in subscription, rental models and maintenance contracts. Organic growth is preferred to companies built through acquisitions. Straightforward balance sheets, cash generation, and transparent and appropriate remuneration policies.

Activity

Signatories should explain what actions they have taken to ensure their investment beliefs, strategy and culture enable effective stewardship.

Being long-term investors of primary capital, we are proud to have invested, without tax incentives, over £500m in primary capital for developing companies. On average, the top 20 holdings in our flagship fund have been held for c12 years and have a combined value of 6x book cost. On a number of occasions, we have rejected takeover approaches where we believed more value could be achieved over time.

Active investment management is key
We are active managers, investing in a range of over 300 quoted and unquoted companies using fundamental analysis. We rarely invest without meeting management and sometimes visit the operations of the companies. We usually meet management twice a year during the ownership period and meet hundreds of other potential investments each year. Unfortunately, this has not been possible since March 2020 because of the

Covid environment, but numerous video meetings have been held instead. Video meetings are inferior to meeting management in person, particularly initial interactions with unknown management teams. We have therefore been unable to undertake our normal level of due diligence but have uncharacteristically invested in small proportions without a face-to-face meeting. These new investments are marginal as a % of total assets. The longer the Covid limitations, the more difficult this will become.

Outcome

Signatories should disclose:

How their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making; and

"It does what it says on the tin" We defined the mandate at the launch of our funds, because it was a strategy that we believed would generate value for shareholders...

An assessment of how effective they have been in serving the best interests of clients and beneficiaries.

…and 25 years later the mandate is essentially unchanged, and the returns speak for themselves.

Principle 2

Signatories’ governance, resources and incentives support stewardship.

REPORTING EXPECTATIONS

Activity

Signatories should explain how:

Their governance structures and processes have enabled oversight and accountability for effective stewardship within their organisation and the rationale for their chosen approach.

Herald's board approves the stewardship approach and policy and reporting thereon. The firm's investment managers and compliance staff have collaborated in defining our stewardship approach and policy to ensure it is both appropriate and can be successfully executed.

As an FCA regulated firm we are subject to the governance requirements of the senior management arrangements and systems and controls section of the FCA Handbook (SYSC). These are set out in our compliance manual, which references the FRC stewardship code and requires staff to adhere to it.

Under SYSC, all significant matters are apportioned to relevant senior managers, and we will ensure that their statements of responsibility are amended to make appropriate references to stewardship.

They have appropriately resourced stewardship activities, including:

a) their chosen organisational and workforce structures.

Ultimately, stewardship responsibility lies with the Herald fund managers who engage with company management teams and undertake the appropriate analysis. In the smaller quoted company environment in particular we believe delegation of this would be irresponsible because there is insufficient independent analysis.

b) their seniority, experience, qualifications, training and diversity.

The Herald investment team's senior members have decades of individual experience investing in TMT companies globally with unusually diverse backgrounds.

c) their investment in systems, processes research and analysis.

The investment process is research-intensive with six investment professionals, two trainee analysts and a research associate in New York, conducting over 1,500 one on one meetings a year with companies.

In addition, we have paid research agreements with over 70 providers.

d) the extent to which service providers were used and the services they provided; and

Bank of New York Mellon provides fund accounting services for HIT. Bank of New York Mellon also provides custody and depositary services directly to the client. Link Asset Services are the registrars, and Praxis the company secretary.

For the HWFT UCITS fund, fund accounting, custody, depositary and registrar services are provided by Northern Trust.

Performance management or reward programmes have incentivised the workforce to integrate stewardship and investment decision-making.

The investment managers are investors in the funds and the management company. Their interests are aligned with those of shareholders to make returns in the long term.

Outcome

Signatories should disclose:

How effective their chosen governance structures and processes have been in supporting stewardship; and

We have found that our reputation for being long-term, long-only, supportive shareholders leads investee companies to seek Herald as a shareholder. When we cornerstone a fundraising, it is often easier for companies to complete the required funding given our track record of delivering strong long-term returns to shareholders.

We believe that we have appropriate governance structures in place, but they are under constant review to ensure best practice.

How they may be improved.

Our current governance structures are reviewed by the Board and by the Boards of our clients on a recurring basis. We will also review other managers' reports when they become available; no doubt scope for improvement will emerge.

Principle 3

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

REPORTING EXPECTATIONS

Context

Signatories should disclose their conflicts policy and how this has been applied to stewardship.

Conflicts – policy
Our policy to minimise conflicts has been to have clients with different mandates. Indeed, to avoid potential conflicts, approaches made to manage segregated funds making investments within the remit of Herald Investment Trust PLC have not been pursued.

Our staff dealing rules prohibit direct investment in stocks in the TMT remit except in exceptional circumstances with prior written permission from Herald's board.

Activity

Signatories should explain how they have identified and managed any instances of actual or potential conflicts related to stewardship.

Identifying and managing conflicts
Clear procedures have been established for staff to follow to report actual or possible conflicts of interest concerning stewardship - or any other matter - to the Compliance Officer. If the Compliance Officer's initial review indicates a likelihood of impacting a client's interests, then steps to avoid, mitigate or resolve the conflict are considered. At this stage, the matter will be referred to the chief executive or Herald's Board. If the conflict cannot be avoided, it will be disclosed to the client and discussed with them to ensure an equitable resolution.

Persuading a company to cut dividends rather than staff
During the coronavirus outbreak, we encouraged a company to cancel a dividend when they were considering cutting employees' salaries. While this could be perceived as a conflict, we believe that it is in the long-term interests of shareholders and the business's sustainability to behave fairly towards staff. If the company's financial state was precarious enough to justify salary cuts, it was surely too precarious to pay a dividend.

Clients co-investing
Historically some venture investments were or became public, and the investment trust co-invested. Co-investment conflicts are always disclosed and discussed with the independent board of the relevant investment funds.

Outcome

Signatories should disclose examples of how they have addressed actual or potential conflicts. Conflicts may arise as a result of:

Ownership structure.

Benefits of independent ownership
Herald benefits from an independent ownership structure and is not exposed to many of the conflicts that might affect financial conglomerates.

Investing in small quoted companies is not scalable. As Manager we have been energetic in buying shares in the investment trust for cancellation. Buybacks could be perceived as a conflict because it reduces the Manager's fee. As Manager, we take the long-term view that investors' performance and liquidity are more important than maximising the short-term fee income.

Business relationships between asset owners and asset managers, and/or the assets they manage.

Focused management
Herald's concentration solely on providing investment management services for only three client funds whose remits differ considerably reduces the scope for possible conflicts with its clients.

Differences between the stewardship policies of managers and their clients.

As client fund boards review and endorse our stewardship practices and policies, this has not been an issue.

Cross-directorships.

There are no cross-directorships between Herald and its clients. Herald does control the Ventures LP's through their general partners, and group entities and staff have holdings and other indirect interests in those partnerships. These partnerships are currently in run-off and realising their few remaining holdings.

Possibilities for conflicts exist but are limited and already highly visible. None occurred in 2020.

Bond and equity managers' objectives; and

Herald only manages equity holdings limited to the technology, media and telecommunications sectors, so there are no conflicts with any bond managers' objectives.

Personal dealing

Personal dealing in stocks within the target TMT sectors is prohibited. In extreme situations this is only waived with written board permission. This avoids any scope for front running or selling shares ahead of a client.

Client or beneficiary interests diverging from each other

Not applicable as clients have the opportunity to invest or divest in Herald's listed investment vehicles, and not directly alongside Herald in individual stocks.

Principle 4

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

REPORTING EXPECTATIONS

Activity

Signatories should explain:

How they have identified and responded to market-wide and systemic risk(s), as appropriate.

Identifying and responding to market-wide risks

There are over 5,000 companies in the Herald TMT remit globally and there are few if any individual risks that impact on these companies at the same time. Even in a global pandemic, some investee companies have benefited from greater demand and improved financial performance. The technology sector in particular benefits from supplying the consumer, governments and enterprises in all sectors across the globe, with different demand cycles.

Clients face investment risk due to market volatility. Government stimulus and low-interest rates have caused valuations within our target sectors to increase, and this may reverse. This derating risk could be amplified by companies whose profits are adversely affected by economic conditions, emerging competitors and other factors. We encourage investors in our funds to take a long-term view and make them aware of conditions across the market cycle.

Herald's response to increased market-wide risk has been to keep a cash buffer to support investee companies who require further capital and deal with our investment mandates' liquidity requirements.

Identifying and responding to systemic risks

Illiquidity is the most significant systemic risk to the investment trust portfolio managed. Being forced sellers can have an extremely adverse effect on realisable values.

We rarely take stakes above 10% for liquidity reasons and do not generally take stakes of more than 5% in loss-making businesses, and HIT is closed ended.

Having the right fund structure is key

Herald Investment Trust PLC, which accounts for over 90% of the assets we manage, invests in illiquid smaller quoted companies. HIT is a closed-end vehicle so shareholders cannot redeem their funds but sell at a discount to net asset value at times of stress. Companies require permanent capital and investors want liquidity. An investment trust is an appropriate structure to balance these sometimes-conflicting requirements

Geopolitics & natural disaster

The majority of companies in the portfolio depend on the use of computers. Ultimately the supply chain is heavily dependent on manufacturing in China, and semiconductors in Asia. Any prolonged disruption to this supply chain could cause an adverse effect. The greatest perceived risk would be an earthquake in Taiwan, a geopolitical dispute between China and Taiwan or a virus not being contained in any key component supplier. The lead time to build new semiconductor fabrication plants and other manufacturing capacity is long, and the skillset deep and hard to migrate.

The decline of the public markets

We have identified the longer-term risk that the companies we would like to invest in do not choose to float on public markets. The number of companies in the core markets of the US and UK is reducing with takeovers far exceeding IPOs. In recent years private equity has gained assets and market share versus public markets. They benefit from reduced regulatory costs, but lack of regulation poses other risks. In addition, private equity benefits from more efficient tax structures and utilises more financial leverage. Governments could choose to change the tax benefits as financial leverage adds risk. For companies to flourish long term they need stable permanent capital, while investors prefer the potential to sell at any time. Private equity offers neither of these, and for the wider economy it is an inferior form of ownership than the permanent capital that the public markets have offered for extended periods.

Regulation is itself a systemic risk

The ever-increasing burden of regulation is raising costs for all participants in public markets. It is deterring many companies from seeking a public listing leading to a fall in the number and quality of quoted companies. A reduction in the number of investors willing to invest in and support small quoted companies means an increasing number of companies are owned by private equity or venture capital, often using a capital structure with significant debt levels. This became an issue in the United States following the introduction of Sarbanes Oxley and is increasingly evident in Europe. The particular frustration is that the responsibility lies with the fund managers who spend less time investing, not concentrating on markets, or working longer hours.

How they have worked with other stakeholders to promote continued improvement of the functioning of financial markets.

Promoting a well-functioning financial system - our participation in the Quoted Companies Alliance

Herald is a member of the Quoted Companies Alliance ("QCA"), which champions the interests of small UK companies and has raised concerns about the effective functioning of smaller-company equity markets with stock exchanges and regulators, press and government for many years. In general, the success of such representations in promoting the importance of small companies and the technology sector and ensuring a benign investment environment has been limited. Small company equity markets continue to shrink, and we are concerned that there is a temptation for the most exciting new technology companies to remain in private ownership for longer. This limits the opportunity of wider society to participate in the ownership of and benefit from the growth of dynamic companies and may reduce support for the capitalist approach to wealth creation.

There is a constant stream of regulations and legislation written with large companies in mind that are generally disproportionate when applied to smaller early-stage companies. Herald contributes to the development of the rules that govern smaller companies through its participation in various QCA committees including the QCA secondary markets group and the QCA remuneration committee which produces the guide outlining best practice for UK small companies to follow. We believe that regulation should be flexible and proportionate. The QCA Corporate Governance Code, the code generally followed by small companies trading on the AIM market, is a leading example of such an approach that can suit growth companies.

The role they played in any relevant industry initiatives in which they have participated, the extent of their contribution and an assessment of their effectiveness, with examples; and

Paying for research under MiFID II

We believe that we were central to the amendment to MiFID II enabling companies to pay for research. We feared small companies could become orphaned with no secondary market liquidity if insufficient research on them was available.

QCA remuneration

We have participated in drafting the QCA's remuneration guidelines.

How they have aligned their investments accordingly.

Maintaining liquidity

As stated above for liquidity reasons we rarely take stakes over 10% and do not generally take stakes of more than 5% in loss-making businesses to ensure we can reinvest and have other co-investors to participate in follow-on funding.

Outcome

Signatories should disclose an assessment of their effectiveness in identifying and responding to **market-wide** and **systemic risks** and promoting well-functioning financial markets.

The closed-end structure of the smaller companies fund has enabled us to provide capital to companies in times of stress, and maintaining a cash buffer to be deployed in times of market dislocation has helped us outperform the markets in times of recovery in the 2000-2001 downturn and the 2008-9 financial crisis.

Market-wide risks are those that lead to financial loss or affect overall performance of the entire market and include but are not limited to:

Changes in interest rates.

Neither a borrower nor a lender be...
Minimal or no leverage is used within the funds managed. Portfolios are invested almost entirely in equities; fixed interest investments for liquidity management are only made in short-term Government securities. Lending is minimal, invariably to portfolio companies at fixed rates. Changes in borrowing rates have little effect on the portfolio. However, unexpected changes in interest rates may impact equity market valuations.

Some companies in the underlying portfolio have borrowings; in aggregate debt levels are lower than many other sectors. Banks do not lend readily to companies against intellectual property, which dominates in the portfolios. Increasing the cost of technology for an enterprise is incurred as a recurring operating cost. For example, capacity is rented in a datacentre rather than a lumpy capital investment. Other sectors such as property and automotive are more exposed to interest rates because higher interest rates reduce demand.

Geopolitical issues; and

The manufacturing supply chain is generally in Asia. Growing tensions between the United States and other Western economies with China poses a risk to this. Our view is that it is likely that separate East and West focused supply chains will develop to reduce this risk.

Brexit is not considered a material risk. Although a significant element of the portfolios is in UK listed companies, much of the technology sector is zero-rated such as computers and computer services under WTO rules. A large part of the hardware supply chain sits in Asia, outside of the European Union.

The growth in social media is a concern because it gives powerful communication tools to disruptive minorities, who are undermining traditional lines of authority. It is difficult to determine how this will unfold, but the trends seem to be anti-wealth creation. They may well increase taxation on corporates and investors alike and increase regulation on parts of the sector.

The coronavirus epidemic's economic damage is further increasing the probability of adverse tax changes, but at least all economies are similarly affected.

Cyber terrorism and warfare are a growing risk, but for the TMT remit provides opportunities and challenges.

Currency rates; and

The funds are denominated in sterling, but the US dollar is the dominant currency for many portfolio companies. We do not hedge currencies because the portfolios are diverse, and many investee companies have appropriate hedging strategies.

Other market risks

Systemic risks are those that may lead to the collapse of an industry, financial market or economy and include but are not limited to:

Climate change; and

The greatest perceived risk would be a natural disaster or earthquake in Taiwan, which would disrupt the all-important semiconductor supply chain. The lead time to build new semiconductor fabrication plants is long and the skillset not immediately portable.

The need to reduce carbon emissions is a driver to growth for parts of the sector in which we invest. The TMT sector is naturally lower carbon and below the market average for carbon emissions. We have directly invested primary capital in the renewable supply chain, power-efficient semiconductors etc.

We are evangelists believing that capitalism will continue to allocate capital to effectively alleviate the production of carbon emissions with technical innovation to produce clean energy and reduce consumption.

Following government commitments to ‘green’ targets, the market has woken up to the investment opportunity this presents. However, there are signs of a “green bubble” which does pose a risk to investors.

Other systemic risks

Evidently a global pandemic that causes economies to become locked down is a risk to markets and corporate profitability. However, the technology sector is likely to be best placed due to the opportunities arising from the resulting increased use of technology.

Principle 5

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

REPORTING EXPECTATIONS

Activity

Signatories should explain

How they have reviewed their policies to ensure they enable effective stewardship;

As well as the Board, the fund managers and compliance team have contributed to reviewing and revising the firm's stewardship approach and policy.

Our stewardship approach and policy has been updated to reflect the FRC's revised 2020 Stewardship Code and will be periodically reviewed and amended as and when appropriate.

What internal or external assurance they have received in relation to stewardship (undertaken directly or on their behalf) and the rationale for their chosen approach; and

The independent boards of Herald's clients have actively engaged in the review of stewardship policies and practices.

Herald is a signatory to the UN PRI. We believe that the technology sector possesses many positive long term environmental, social and governance ("ESG") drivers.

How they have ensured their stewardship reporting is fair, balanced and understandable.

The management of Herald record and review regularly voting and management engagement activities.

Outcome

Signatories should explain how their review and assurance has led to the continuous improvement of stewardship policies and processes.

Review by non-executive Directors. Candidly the considerable effort thus far has been articulating the practices we have always undertaken and improved record keeping. Albeit we have consistently voted and maintained records of that.

We have decided to subscribe to ISS for 3rd party research on governance issues, ESG Norms and controversial weapons. About half the holdings, but 70% by value of the investments in HIT are covered. There were issues for only ten holdings, none of which we were unaware. The coverage of the larger companies in HWTF provided a bit more added value. Still, it remains for discussion with our clients whether it will make any difference to our investment decisions. In particular, the most serious issues were found in Amazon, Alphabet, SAP, Apple and Samsung, and a limited number of holdings with a small exposure as suppliers to the defence industry.

We have also analysed the ESG data reported through Bloomberg and Refinitiv Eikon. There are varying degrees of data on c75% of the holdings in HWTF but only c25% of the holdings in HIT, so in aggregate a third of the investments held. We are also unsure about the extent we should push smaller companies to publish more information, and in what form. It is clearly inefficient for numerous investors to ask the same questions, and we do not want to squeeze out commercially important issues for box ticking in the short timeframe we have to engage with investee companies' management. We hope that there will be some identifiable standards that emerge, and for the time being will concentrate our efforts on companies where our influence is greatest i.e. where our stake exceeds c4% of outstanding capital. We are aware for example that the big technology companies, who are at the vanguard of reducing carbon emissions often seek suppliers to have a B Corp certification, while more companies are clearly going to address the requirements of the Task Force on Climate-related Financial Disclosures standard ("TCFD"). The climate change data is clearly evolving, and we shall adapt as the availability of data emerges.

Internal assurance may be given by senior staff, a designated body, board, committee, or internal audit and external assurance by an independent third party

The non-executive directors on Herald's board, and the independent Boards of the Funds managed review our stewardship processes and policies.

Principle 6

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

Context

Signatories should disclose:

Their client base, for example, institutional versus retail, and geographic distribution.

Clients
Our direct clients are investment funds and have an underlying investor base of retail and professional clients.

Underlying investors
At the year-end investors in HIT, which accounts for over 90% of our assets under management, were estimated to be over 75% regulated professional investors, c15% on retail platforms and c7% in ETFs and index trackers at 31/12/2020. These underlying investors are predominantly UK resident. The minority of overseas investors are principally professional investors from the United States investing in HIT (c13%).

Most assets invested in our funds is under discretionary management by wealth managers, followed by institutional investors; the proportion held by retail investors may increase as the platforms gain clients. HWTF has recently been listed on several retail platforms and we are actively marketing it to wealth managers and a number of retail brokers.

Geographies
HWTF is domiciled in Dublin, HIT and the venture funds in the UK.

Assets under management across asset classes and geographies.

Portfolio investments are mainly held in quoted equities, which comprise more than 90% of assets under management. Other investments include some unquoted equities and some 'simple' equity derivatives, such as warrants, convertibles and rights. Herald had £1.6bn under management at 31 Dec 20 comprising a UK listed investment trust (£1.5bn), a Dublin based UCITS (£58m), and four venture capital partnerships (c£20m). The investment remit for all these funds is the technology, media and telecommunications (TMT) sector, globally.

The length of the investment time horizon they have considered appropriate to deliver to the needs of clients and/or beneficiaries and why.

Long-term investment horizon
We offer clients specialist management and expertise in the TMT sectors market. Companies in these sectors operate in rapidly changing industries and Herald offers the opportunity to diversify some of the risks of holding individual technology companies using a portfolio approach. Given the manager's sector focus, a degree of volatility in the portfolios is to be expected, and we would expect our clients and their investors to have a long-term investment horizon.

Recommended holding period
For Herald Investment Trust, with its additional smaller company focus and desire to invest in and grow small businesses over many years, investors must appreciate the long-term timescale commensurate with the investment strategy and the more limited liquidity available in the underlying portfolio. In times of market stress, the share price can trade at a wider discount to net assets/share exaggerating a market decline, so investors should endeavour to avoid having to sell at such times.

Activity

Signatories should explain:

How they have sought and received clients' views and the reason for their chosen approach.

Clear mandates, and independent client boards
The investment trust and UCITS that Herald delivers investment management services to have clear objectives and investment mandates and are governed by independent boards. Our equity funds regularly report to their investors on Herald's success in implementing the investment strategy and stewardship approach. The manager is available for regular meetings with investors or their representatives.

How assets have been managed in alignment with clients' stewardship and investment policies.

This is clearly stated in the Annual Financial Reports and explained to HIT Shareholders at the AGM.

What they have communicated to clients about their stewardship and investment activities and outcomes to meet their needs, including the type of information provided, methods and frequency of communication to enable them to fulfil their stewardship reporting requirements.

The boards of the client funds have primary oversight and reporting on stewardship and investment management activities is on the agenda for the funds' board meetings. The funds themselves have independent auditors and independent custodians of the funds' assets. On a six-monthly basis the funds publicly report to their investors on the fund's results and the degree to which the investment manager has successfully met the funds' investment objectives. In addition, monthly fact sheets and daily net assets/share are published. For the quoted funds, the investment manager also meets with underlying investors in the client funds regularly and will be aware of any issues.

Further ESG and stewardship information, including the managers annual voting record is available on our website.

Outcome

Signatories should explain:

How they have evaluated the effectiveness of their chosen methods to understand the needs of clients and/or beneficiaries.

As stated under Principle 1 above Herald's governance and stewardship structure has been in place for 25 years and delivered over a long-time frame.

How they have taken account of the views of clients and what actions they have taken as a result.

Shareholders in HIT and investors in HWTF have the opportunity to raise issues publicly, but to date, no remedial action has been required.

Where they have not managed assets in alignment with their clients' stewardship and investment policies, and the reason for this.

Nothing to report
Herald has not had any such failures to follow client stewardship or investment policies to report.

Principle 7

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

REPORTING EXPECTATIONS

Context

Signatories should disclose the issues they have prioritised for assessing investments, prior to holding, monitoring through holding and exiting. This should include the ESG issues of importance to them.

Assessing: focus on the calibre of senior management

We rarely invest in companies without meeting management. The highest priority is to invest in competent management. Competent management will have competent ESG policies.

As the only investments we make are in the TMT sectors, and we focus on companies with intellectual property and pricing power, environmental issues are rarely severe.

We pay particular attention to the balance sheet, and the associated filings to assess the quality of revenues, and to share-based compensation, to ensure the company is being run with appropriate management costs. It can be important in a technology company to see sufficient resources are being deployed on research and development to sustain and grow their market position. We tend to dislike excessive sales and marketing costs which can flatter growth but destroy profitability. There are regional differences here. For example, UK companies often spend too little on sales and marketing to flatter profits and cash flow, while US companies spend too much to flatter growth rates. These are important flags for sustainability, sound business practice and Governance.

Some of our investments have been at the vanguard in terms of energy efficiency and renewable energy. In 2020 ITM Power, Ballard Power and Ilika were strong contributors to performance, they operate in the field of hydrogen, fuel cells and solid-state batteries. Other investments supply components to wind turbines, energy-efficient power supplies and so on.

In HWTF Apple, Alphabet and Microsoft have all been purposeful in using renewable energy in datacentres, reducing power consumption in products etc.

Monitoring through holding and exit

If we subsequently find our confidence is misplaced our first reaction is to sell the shares but this cannot always be achieved in illiquid smaller companies. In such rare instances we encourage management change.

The focus of our investment is in developed markets which have high social standards. In the technology sector in particular few women have board positions, so there is an acute shortage of suitably qualified women to undertake non-executive positions. In smaller companies we think it inappropriate to vote against boards without diversity as long as we are confident that there is appropriate commercial and governance expertise among the independent non-executive directors.

In reviewing past poor investment decisions, we observe that the poor commercial judgment of certain non-executive directors has damaged businesses in which we invest.

Monitoring share-based compensation

The most important area where we exercise influence is in approving share-based compensation schemes. This is focused on UK smaller companies where the % of outstanding capital owned is sufficient for us to have influence. We particularly dislike the trend towards nil-cost options, with varying performance targets, where it becomes hard to quantify the cost to shareholders of running the company. We appreciate it is in shareholders' interests, and the interests of the investee company, to have properly rewarded and motivated management to retain an appropriate skill set. Still, dilution is a heavy cost to pay for this.

Dilution of 10% over 10 years is acceptable, but there are occasions in small cash-constrained businesses when a higher level of dilution has to be accepted. This requires investment management judgment. We are inclined to sell shares or vote against boards who are issuing egregious packages, and not considering shareholder views.

Activity

Signatories should explain:

How integration of stewardship and investment has differed for funds, asset classes and geographies.

Exercising stewardship over unquoted companies

With unquoted companies in which the venture capital partnerships we manage invest, we are more proactive; our investment committee members can be appointed as directors of the partnerships' investments or may act as observers at their board meetings. We may also be instrumental in the appointment of independent non-executive directors who we believe can add value to these companies and effect introductions in smaller quoted companies.

For quoted companies we are on occasion asked to suggest or provide references for potential candidates for executive or non-executive roles.

The processes they have used to:

a) integrate stewardship and investment, including material ESG issues, to align with the investment time horizons of clients and/or beneficiaries; and

Fund managers actively engage with management to foster or improve companies' behaviours and governance and monitor the sustainability of the business model. In particular, we always encourage management to worry about optimising the share price in 5-10 years, and not a shorter-term horizon. Equally, we regularly make investments in the knowledge that a short-term return is unlikely but believe there is long-term potential.

b) ensure service providers have received clear and actionable criteria to support integration of stewardship and investment, including material ESG issues.

Not applicable.

There are no intermediate service providers between Herald and the companies over which it exercises stewardship

Outcome

Signatories should explain how information gathered through stewardship has informed acquisition, monitoring and exit decisions, either directly or on their behalf, and with reference to how they have best served clients and/or beneficiaries.

We have regularly avoided considering investments in companies where we have seen management operate inappropriately in previous roles, which is an advantage in having a narrow sector focus, and an experienced team.

There were over 300 sell transactions in 2020 in the portfolios, but the overwhelming majority by value were on valuation grounds, rebalancing or take-overs. Half a dozen stocks of modest size we elected to cut our position for poor performance, excessive receivables etc. A number of stocks we have avoided because of excessive share dilution from management incentives. We have minimal exposure to the gambling industry and have generally avoided the sector.

Portfolio carbon footprint and climate change

Environmental issues are both a challenge and an opportunity for the investment portfolios managed. The difficulty lies in the fact that on the environment, data can be hard to come by, in particular in the smaller company's portfolio where the number of portfolio companies reporting emissions data is small as a percentage. In addition, once analysed, the available information is not always as clear cut as one might envisage.

Early-stage or high growth businesses can often have misleading figures. For example, data on CO2 emissions per unit of revenue can appear inflated due to low production levels. Once data is available, it can be difficult to normalise. Whereas larger US technology companies, such as Apple or Microsoft, possess the capital to spend on achieving carbon neutrality, smaller companies are often capital constrained. They must preserve their investment dollars for their core operations. Interestingly on estimated bases, two businesses with the highest estimated emissions per unit of revenue are ‘Green’ investments; Ballard Power and ITM - one a leader in fuel cells and the other producing hydrogen electrolysers used to manufacture green hydrogen excess renewable power.

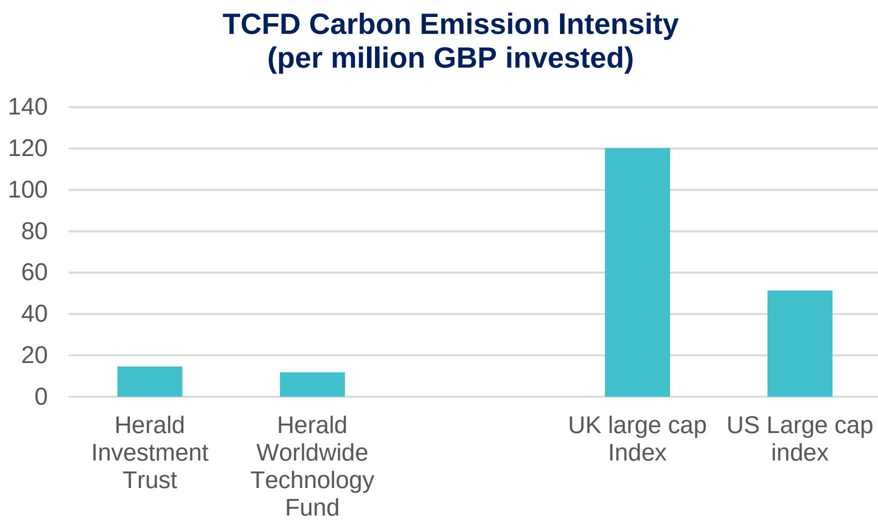
The outsourcing of supply chains complicates the analysis further. Semiconductor companies, who outsource their fabrication production plants, will outperform their integrated peers when only reviewing raw metrics. However, their product cannot exist without the manufacturing capacity offered by others.

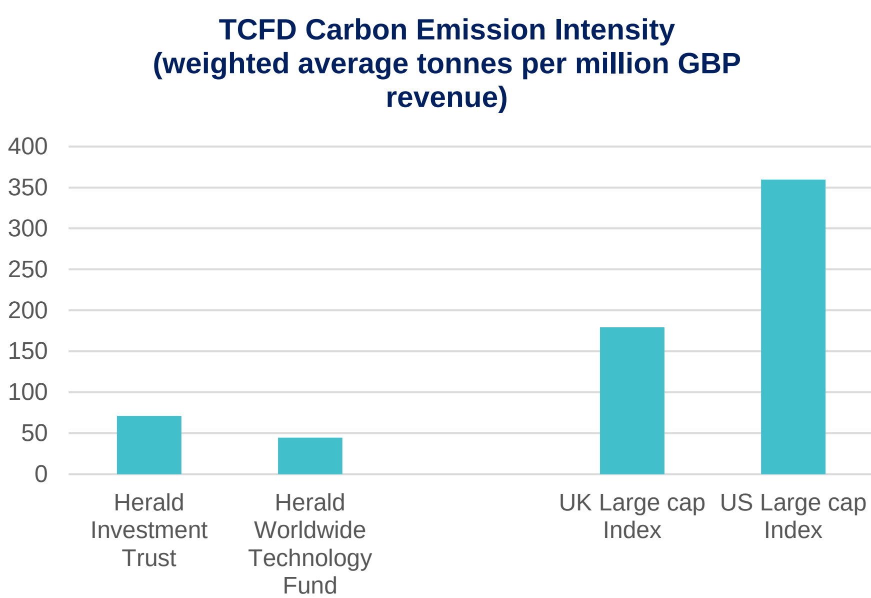
We do not take a formulaic approach and exclude companies that screen poorly based on reported or estimated data. We prefer to think holistically on each topic and engage with management on long-term environmental and sustainable issues. Where risks are identified, a dialogue approach enables us to consider the direction of travel and the problem in the broader context of global social and environmental issues. Evaluation and analysis can involve discussions many years before any relevant or regulatory-driven emissions data might become available, i.e. before the launch of a new product or prior to building a new facility.

The sector in which we invest is inherently low carbon, and as a manager, we have also chosen to invest in some specific companies that promise to contribute to decarbonising the global economy. However, the data on smaller companies’ carbon emissions is sparse, and reporting requirements vary by market and geography.

Only a fraction of our holdings report carbon emissions data. Using Bloomberg as the source, we obtained reported carbon emissions data; older estimated data was available for other holdings but on a delayed basis. Using this data, the portfolio has low emissions relative to a market index.

Given the limited availability and reliability of data set, these graphs should be only viewed as indicative.


TCFD Carbon Emission Intensity
(per million GBP invested)
140
120
100
80
60
40
20
0
Herald Investment Trust
Herald Worldwide Technology Fund
UK large cap Index
US Large cap index


TCFD Carbon Emission Intensity
(weighted average tonnes per million GBP revenue)
400
350
300
250
200
150
100
50
0
Herald Investment Trust
Herald Worldwide Technology Fund
UK Large cap Index
US Large cap Index

Principle 8

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

REPORTING EXPECTATIONS

Activity

Signatories should explain how they have monitored service providers to ensure services have been delivered to meet their needs.

In depth operational and financial due diligence is undertaken on appointment and subsequently for all external service providers. The operational resilience of these providers is also evaluated continuingly.

The administration and custody for the funds are undertaken by BNYM and Northern Trust. However, Herald maintains a parallel fund accounting system which enables asset valuations to be produced daily and reconciled to the net asset values per share calculated by the respective administrators. Accounting and settlement issues are therefore identified and resolved promptly.

Outcome

Signatories should explain:

The action they have taken where signatories' expectations of their managers and/or service providers have not been met.

Periodic Reviews.
There are periodic reviews with BNY in particular. The Board in Dublin reviews Northern Trust, but Herald staff have visited Limerick to discuss issues,

For example:

Asset owners monitoring asset managers and investment consultants to ensure that assets have been managed in alignment with their investment and stewardship strategy and policies; or

Not applicable

Herald does not make investments on its own account other than to support its own funds

Asset managers monitoring proxy advisors to ensure, as far as can reasonably be achieved, that voting has been executed according with the manager's policies; and

Not currently applicable
We have not previously used or accessed the services of proxy advisers. The focus on small companies means that some flexibility is required. It is a key tenet of the Herald investment process that fund managers can exercise their judgment in voting. It is an abdication of responsibility to delegate this. However, we have started to subscribe to the ISS voting service to view their voting recommendations, potentially speed the voting process, and ensure that any issues have been identified. We use ProxyEdge, an electronic voting service, to exercise our voting rights and responsibilities, rather than a service provider.

Asset managers monitoring data and research providers to ensure the quality and accuracy of their products and services.

Monitoring data and research providers to ensure quality and accuracy
The engagement with ISS is recent and the quality and coverage of the analysis they provide with regards to small companies in different jurisdictions around the world is under review. Given the limited information provided by small companies operating in international jurisdictions, the information that systems such as ISS or Bloomberg capture may often be limited. Whilst ISS research may assist Herald's process, Herald continues to exercise voting decisions on behalf of its clients using its own judgement.

Principle 9

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

REPORTING EXPECTATIONS

Activity

Signatories should explain:

The expectations they have set for others that engage on their behalf and how.

Not applicable.
Herald does not engage third parties for this purpose

OR

How they have selected and prioritised engagement (for example, key issues and/or size of holding)

Aim to meet all management.
Engagement is primarily focused on periodic updates, but it can relate to raising further capital, making acquisitions or discussing takeover approaches. Generally, we try to support companies in their aims. If we are disinclined to support them, we sell the shares. This is not always possible, or in the interests of our shareholders. If there is a disagreement, we prefer to keep discussions private.

The portfolios are periodically reviewed to identify the companies with whom we have not had direct engagement over the last 6-12 months, and direct calls or meetings are generally arranged for the investments in HIT. In ventures we generally have board representation.

In 2020 we participated in 80 fundraisings with an aggregate value of £59m. Of these, 15 were IPOs, 45 were follow-on placings or rights issues for existing investments, and 20 were placings in secondary offerings, but where we were not previously shareholders. We had meetings or virtual meetings with them all. A number were rescue funding, while others were to fund acquisitions or make organic investments. Of these, 43 were in the UK.

How they have developed well-informed and precise objectives for engagement with examples.

There is a regular cycle of meetings with companies in the portfolios which helps provide a mosaic of information on the target sectors to aid stock selection. Published information and research on smaller companies can be limited, hence the need for regular meetings. Furthermore, the value of emerging companies cannot be made based on historical numbers. The future potential weighs significantly, as does the degree of confidence we have in management meeting their objectives. The number of companies met focused on TMT helps the manager build up a mosaic of information including cross-referencing between competitors, customers and suppliers. For example, management can portray an image that they provide a unique solution when companies with similar solutions have already been seen; it makes it easier to determine which companies have a differential product or service.

For larger companies in HWTF, we rarely meet top management except in a group forum. However, the quality and availability of published information is generally higher, and small companies are often suppliers or customers of large companies which provides vital feedback. From Herald's unusual perspective, we find it difficult to see how managers focussed only on larger companies can obtain the same level of in-depth understanding as our specialist approach. We rarely try to understand technology from first principles but understand sufficiently to know who will provide relevant referencing.

The three biggest new investments in 2020, all c£3m during the year, were Vicor, Fireeye and TTEC. Vicor designs and builds power high power management systems at 48volts. Vicor was raising money to expand capacity because they expect business from Nvidia. As investors in Nvidia, we know the potential for high power processors to be used in datacentres, so the raise was credible, and the shares have subsequently performed well. Fireeye referenced well as the go-to company for data breaches, and TTEC is adopting new technologies in communication centres and referenced well from other investments

Pegasystems and Liveperson. UK company D4T4 also references well at Pegasystems.

What methods of engagement and the extent to which they have been used?

Meeting company management worldwide, preferably in person

Meeting management teams is central to Herald's investment process. Over the last five years, we have undertaken more than 1,500 meetings face to face with companies globally each year. Generally, we see management from investee companies twice a year, and many other potential investee companies. This includes private companies who might go public, and we often see companies in a market sounding phase. These meetings include regular visits by the investment team to North America, Europe and Asia as well as meetings in the London and New York offices. The latter is connected to the London office with a point to point video link.

During the lockdown associated with Coronavirus, the level of interactions has been maintained, but over the telephone or video conferencing, rather than meeting in person or visiting companies. The quality of interaction is much reduced but manageable for a temporary period.

As small investors, we rarely meet with top management in the large companies held in HWTF, but there is much more publicly available information on these companies, and professional investor relations departments, who are of some use. Most importantly, we learn so much from comments from smaller companies about the sector at large. We consider ourselves privileged to spend so much time interacting with top management in small companies and have received feedback that our global perspective can provide helpful economic and market insights to managements in smaller companies.

The reasons for their chosen approach, with reference to their disclosure under Context for Principle 1 and 6; and

Research

For smaller growth companies, an appropriate valuation is difficult to determine based on historical numbers. The future market opportunity has to be considered alongside management's ability to execute. The company also needs sufficient financial resources. Analysis of financial statements is also a vital tool. Sometimes they speak for themselves, but sometimes explanations are required, such as why gross margins are moving, or why working capital is at a certain level.

How engagement has differed for funds, assets or geographies.

Engaging with overseas companies

We heavily utilise conferences in overseas markets, where we can see many companies in a short time frame (c50/week). This has become more important in recent years as reduced trading commissions and regulatory requirements to split research costs from trading have made it uneconomic for overseas brokers to bring companies to London. Overseas brokers rarely come to London now and the majority of our annual research payments of c.£1m go to overseas brokers. As explained above involvement with small companies is direct, which covers 95% of assets managed, and less so with large companies held in HWTF

Engaging with UK companies

UK companies regularly visit our office. The majority of our UK investments are on the AIM market. The corporate advisors are an important go-between between investors and companies. It is the advisors that incur our wrath if they fail to respect pre-emption on share placings, endorse capital with preferential voting rights or fail to contain egregious remuneration schemes.

Examples of engagement methods include but are not limited to:

Meeting the chair or other board members

Meetings with chairmen and non-executive directors are much less frequent (c40/year) than with executive management and generally relate to remuneration discussions or, more rarely, when there are management difficulties.

Holding meetings with management.

We maintain an audit trail of our dialogue with companies by retaining notes on nearly all meetings and all voting activity. This enables us to monitor the effectiveness of our engagements and set priorities for future engagements.

Writing letters to a company to raise concerns; and

None this year. We were tempted to write to the FCA and FRC to complain about the damage done to a client fund’s holding following accounting irregularities. When management are rogue, they manipulate figures to sell shares or raise money through fundraisings at the wrong price. This did not happen in this case, which made me confident it was poor management controls at a subsidiary level, and not anything worse. The shares collapsed with the uncertainty of the investigations, but the company continued to trade quite well. Disastrously they had to issue shares at the peak of uncertainty, so our holding was diluted by 25%. This has caused us more long-term damage than the underlying misdemeanour. We wish It had been left to shareholders to resolve.

Raising key issues through a company’s advisers

Generally, issues would first be raised with the company, secondly with a company's adviser and the last resort would be to vote against resolutions at a general meeting. A broker can usefully collate information from a number of shareholders, which can be more effective than one shareholder acting alone.

Outcome

Signatories should describe the outcomes of engagement that is ongoing or has concluded in the preceding 12 months, undertaken directly or by others on their behalf. For example:

As stated above, participated in 80 fundraisings for primary capital in 2020. In several, we offered to participate, but there were insufficient other investors. We kept to our aim of not exceeding 10% ownership, in some of these instances the companies were therefore unable to raise the required capital.

We encouraged Ilika to increase the size of their fundraising, which they did.

How engagement has been used to monitor the company.

Throughout this report, we have commented on the hundreds of meetings held with investee companies and the extensive use of internal and external research resources used to inform investment and engagement decisions. Below we summarise two specific, anonymised examples where Herald engaged with companies and attempted to effect change:

How outcomes of engagement have informed investment decisions (buy, sell, hold), or escalation:

Engaging with overseas companies

Effecting change pre-vote

In 2020 for a media company holding, incorporated overseas, and listed on AIM, we were not consulted on the structure of a new share-based management incentive scheme. There were no details made publicly available to shareholders as at the deadline for the AGM vote on introducing the scheme. Herald did not support the AGM vote. On counting the votes in advance of the meeting, the company realised it did not have shareholder support. The company withdrew the vote at the AGM. In subsequent weeks, Herald engaged with the Chair of the company's remuneration committee and the terms of the scheme were tightened, made available to Herald and we subsequently voted to approve the scheme at an EGM. The scheme was then passed.

A voice for better governance

In 2020 a European holding of Herald wanted shareholder approval at an AGM to issue up to Euro 30m of equity or convertible bonds potentially without pre-emption rights. This was a renewal of an existing permission from some years earlier. The value was approximately half the market capitalization of the company at the time. We considered this level of dilution was potentially excessive and discussed with the company. The company explained that this permission was to enable them to make acquisitions, that using the permission historically they had successfully completed several small bolt-on acquisitions. The company said that they viewed the share issuance for potential acquisitions spread over 5 years, hence less than 10% a year.

Furthermore were the company to propose a capital increase without pre-emption rights, it would provide a detailed memorandum which legally required them to disclose the reasons for the decision, for the review and approval of the board of statutory auditors, who would also need to assess the sensibility of the issue price. We decided to abstain on the resolution as we felt this balanced the need for the company to have some flexibility to make acquisitions for shares with the high level of share issuance power the company was being granted. A significant management shareholding (around 50%) in the company gave comfort that Herald investors would not be needlessly diluted. The resolution was passed, but the point has been made, and the company is likely to review the way it seeks shareholder approval for equity issuance in the future.

Principle 10

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

REPORTING EXPECTATIONS

Activity

Signatories should disclose what collaborative engagement they have participated in and why, including those undertaken directly or by others on their behalf.

The regulatory constraints on collaboration

We rarely collaborate with other investors for fear of breaching concert party rules, market abuse and competition law. This can be a frustration when rescue funding is required, and we rely on brokers to mediate. The UK system of corporate brokers is helpful to this, but it is more difficult in overseas markets.

Investments in quoted companies

In quoted investments within HIT we generally hold stakes between 1-10% of the outstanding capital, so our vote can be material in any contentious issue. In the UCITS fund, our holdings are small and immaterial, but the liquidity is greater so we can always sell.

Investment through our venture capital partnerships

The venture capital partnerships managed by Herald can and do hold substantial and sometimes controlling shareholdings in investee companies. In such cases, we seek to act, so far as possible, in all shareholders' collective interest.

Outcome

Signatories should describe the outcomes of collaborative engagement.

We are proud that the reputation we have built leads companies to appreciate our loyalty as shareholders, and we believe we constructively influence management in an amicable way in the majority of cases.

For example:

Over the last two years Herald supported Zinc Media in the process of recruiting a new senior executive team and refreshing the board. The new management team have turned the business around, widened the shareholder base and during 2020 raised equity from a number of institutional shareholders, alongside Herald, to benefit from opportunities to acquire good production teams and business through the disruption caused by the pandemic in TV production.

Collaborating with other investors to engage an issuer to achieve a specific change; or

It is our policy to be supportive long-term shareholders, and not to be activist investors. This generally means, for example, we stand our corner in fundraisings - or more. If we do not want to support management, the first course of action is to sell the shares. It is in only in problem situations where this would entail the destruction of value for our investors that mediation would take place firstly through corporate brokers. It is only in extreme instances that collaboration with other investors has been desirable. In rare instances, we have collaborated to remove directors.

Working as part of a coalition of wider stakeholders to engage on a thematic issue.

QCA

We actively engage in the QCA, where more general issues are discussed.

Herald played a key role in the committee that rewrote the QCA Remuneration Committee Guide (2020). In the UK, most smaller companies follow the QCA Corporate Governance Code and this guide, targeted at remuneration committee chairs and members, aims to assist them in being effective in their roles. The guide sets out the QCA’s views of good practice and is a companion to the QCA Corporate Governance Code. It takes account of the interests of shareholders, executives, the wider workforce and other stakeholders in small and mid-sized quoted companies. In particular, Herald focused on the controls that non-executives and shareholders have over the magnitude of share-based payments (for example, salary related caps) and encouraged consideration of ESG factors in remuneration policies. Herald also advocated the importance of remuneration committees designing schemes with the flexibility to reduce or clawback payments when a remuneration committee felt they were not fully deserved. Herald contributed significantly to the Chapter discussing shareholder communication and the importance of consulting shareholders to discuss remuneration – especially when shareholders economic interests were being diluted through the use of share-based payments and that shareholders should vote on such proposals.

Herald also requested that in future that there be greater cross-referral between the QCA Corporate Governance Code and the QCA Remuneration Committee Guide, to add to the influence of the Remuneration Committee Guide.

Hundreds of UK quoted companies will use the QCA quoted companies guide as a key input when writing their remuneration policies over the next few years. Hence, it will have a material impact on behaviour, not just in 2020 but for some years to come.

Herald’s continuing participation on the QCA Secondary Markets Committee entails regular interaction with UK and European regulators and includes contributing to the feedback given by the QCA to numerous UK and EU policy proposals. Herald’s agenda is in general that rules should be clear and proportionate for smaller companies to follow. Herald continues to be an evangelist for smaller companies' importance as engines for economic growth and promotes the importance of quoted company capital markets as a key funding source.

Principle 11

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

REPORTING EXPECTATIONS

Activity

Signatories should explain:

The expectations they have set for asset managers that escalate stewardship activities on their behalf.

OR

How they have selected and prioritised issues and developed well-informed objectives for escalation.

Our preference is to have discussions with executive management, enabling us to build an effective relationship with companies. However, where it is necessary to protect and enhance our clients' long-term investment returns, we will escalate our stewardship and engagement activities.

Management teams and the broader market are respectful of Herald's investment judgment, and managements are generally motivated to ensure that we remain supportive shareholders.

When they have chosen to escalate their engagement, including the issue(s) and the reasons for their chosen approach, using examples; and

Where we have concerns about, among other things, strategy and performance, board structure and management quality, or damaging conflicts of interest or lack of independence on an investee company's board, we would generally sell the shares.

We will consider escalating our activities where (i) we are unable to sell the shares, (ii) selling shares could only be made at a distressed valuation (iii) a management change could resolve the issues, (iv) executive remuneration is excessive, (v) minority shareholder rights are being compromised or (vi) in any other situation where we consider that shareholders' interests may be at risk. Such escalations may include:

- meeting with management and/or board members to discuss our concerns.
- In UK companies discussing the situation with the corporate broker or Nomad would generally be the first choice of escalation. They also hear other shareholders' views and can speak for a broader base of shareholders to the executive and non-executive Board members. This is more difficult in overseas markets who do not have formal advisers but works well in the UK.

How escalation has differed for funds, assets or geographies

Half the assets under management are in the UK. They have a median market capitalisation below £200m of which average ownership is 4% of the outstanding capital. Given our weightings in these stocks, we have more influence on issues such as remuneration. We feel our presence in the UK market (we own c.2% of TMT stocks on AIM) means we have an important role in influencing behaviour. For some years, we have felt an obligation to actively participate both directly with companies and in wider governance discussions. On average ownership of overseas holdings in HIT is c.1% and our UCITS fund even less, so our votes overseas have less impact. Escalation is rarely needed.

Outcome

Signatories should describe the outcomes of escalation either undertaken directly or by others on their behalf.

We do not believe it is in investors' or employees' interests to make public the outcomes of escalation.

An example of an escalation is below.

In 2020 a US listed company in which Herald was invested, issued convertible preferred shares to a fund connected to the Chairman without allowing other shareholders to participate. The share price was depressed at the time. The concerns were raised with a director of the company concerned. When the resolution to permit the issuance of shares underlying the convertible was voted on by shareholders Herald voted against. Herald also withheld their vote on the re-election of the Chairman. Overall, this engagement was unsuccessful as the company's dilutive convertible shares, and the damage to shareholders' economic interests occurred in advance of an opportunity to prevent it.

Principle 12

Signatories actively exercise their rights and responsibilities.

REPORTING EXPECTATIONS

Reporting expectations for listed equity and fixed income investments are below

The vast majority of the investments - by number and value – in respect of which Herald exercises rights and responsibilities are in listed equities. Fixed income investments, typically in sovereign debt, are of limited duration and made only for liquidity or risk diversification purposes as an alternative to cash.

In addition, signatories should report on how they have exercised their rights and responsibilities across other asset classes they are invested in, where they have the ability to do so, as disclosed in their reporting against Principle 6.

The venture capital partnerships managed are being wound down and now hold only a handful of unlisted companies.

Apart from the asset classes mentioned the only other asset classes managed are a few 'simple' derivatives related to listed equity holdings, such as rights, warrants and convertibles, and some debt in the form of loans extended to investee companies.

Context

Signatories should:

Explain how they exercise their rights and responsibilities, and how their approach has differed for funds, assets or geographies.

All of Herald's voting decisions are taken internally by the investment team responsible for making voting decisions.

In gathering information and making our final voting decisions, we endeavour to engage with companies and their advisers. When voting clients' shares, we consider whether investee companies' proposals have complied with local best practice and corporate governance codes, for example, on remuneration; if not, we satisfy ourselves that exceptions are in our clients' best interests before voting.

We usually advise investee companies on those occasions where we plan to vote against management and communicate our views to the company's brokers or advisers. Publicising criticism could damage shareholders' interests when private admonishment can be effective anyway.

In addition, for listed equity assets, signatories should:

Disclose their voting policy, including any house policies and the extent to which funds set their own policies.

In all cases, our clients delegate voting discretion to Herald under the terms of their investment management agreements with the firm and do not set policies, but clients' independent boards have reviewed and agreed Herald's stewardship approach. Given the range of governance jurisdictions and levels of company maturity, the context in which a company operates is critical in informing voting decisions. Herald makes its voting decisions based on its interactions with investee companies, analysing publicly available information, broker research and information from corporate governance analysis services provided by businesses such as ISS and Bloomberg.

State the extent to which they use default recommendations of proxy advisors.

In its voting, Herald does not use the default recommendations of proxy advisors.

Report the extent to which clients may override a house policy.

Herald's two major clients are independent entities with their own boards and ultimately have the power to override any decision of the investment manager, but it would be most unusual for this to happen and indeed it has never happened.

Disclose their policy on allowing clients to direct voting in segregated and pooled accounts.

Not applicable.
Herald does not manage segregated or pooled accounts.

State what approach they have taken to stock lending, recalling lent stock for voting and how they seek to mitigate ‘empty voting’.

Not applicable.
Herald has never engaged in stock lending for any purpose

Activity

For listed equity assets, signatories should:

Disclose the proportion of shares that were voted in the past year and why.

Historic voting record is disclosed annually on Herald's website; we have consistently aimed to vote all our client shareholdings, whether listed or not.

Provide a link to their voting records, including votes withheld if applicable.

A table listing the aggregate number of votes cast for and against resolutions will be disclosed annually on the Herald website.

Explain their rationale for some or all voting decisions, particularly where:

We disclose votes that have been withheld or voted against to the boards of the relevant funds, but we will not as a matter of course disclose this publicly. We prefer to address issues privately, because we do not want to risk unnecessary damage to our clients' investments. We believe that in acting in the best interests of our shareholders, we also act in the best interests of the wider shareholder base.

Explain the extent to which voting decisions were executed by another entity, and how they have monitored any voting on their behalf; and

Voting decisions are made by Herald, and executed for listed equity assets via ProxyEdge

Explain how they have monitored what shares and voting rights they have.

Herald's GENEVA accounting system reports shares/voting rights consolidated across all client holdings daily

Outcome

For listed equity assets, signatories should provide examples of the outcomes of resolutions they have voted on over the past 12 months.

Herald does not generally believe that it is in clients’ interests that the detail of its voting record with regards to individual company votes is made public.