

Capital Securities Corporation

Stewardship Report 2019

1. Stewardship policies

As an asset owner, our company uses its own funds to invest through brokerage, proprietary trading and underwriting businesses to seek interests for shareholders. Our company also participates in corporate governance by attending shareholder meetings, exercising voting rights, and appropriately communicating and interacting with board directors or managers of investee companies, in order to protect the rights and interests of asset owner. Our company regularly discloses the fulfilment of stewardship responsibilities on its website or annual report, which are updated at least once a year.

Our company fulfills the following stewardship responsibilities:

(a) ESG is incorporated into investment process

Our company's proprietary trading department and Capital Investment Management jointly formulate a list of selected stocks, which is used for proprietary trading after being reviewed by the risk management department. Our company exercise voting rights of the stocks it owns through electronic voting. Moreover, our company announced in 2020 to incorporate environmental, social and corporate governance (ESG) into the scope of investment engagement and action.

Our company's fixed income department sets a minimum rating standard for bond credit rating. Moreover, our company issues investment decision-making prior to investment and trading, which includes not only financial analysis of an investee company but also a review on whether the investee company is associated with any negative news (e.g., whether it fulfils social responsibilities, corporate integrity and environmental protection), in order to assess its investment value. During the process of investment decision-making, our company assesses various risks associated with the investee company on an overall basis in accordance with the stewardship principles.

(b) Risk assessment on an investee company

1. Proprietary trading

Risk management measures are as follows:

- (i) Execute stop-loss and profit-taking mechanisms during proprietary trading in accordance with the company's "Risk Management of the Proprietary Trading Department"
- (ii) Our company shall not hold more than 10 percent of the total issued shares of any domestic company. The total amount of the cost of the securities issued by any domestic company held by our company shall not exceed 20 percent of our company's net worth.
- (iii) Our company shall not hold more than 5 percent of the total issued shares of any foreign company. The total amount of the cost of the securities issued by any foreign company held by our company shall not exceed 10 percent of our company's net worth.
- (iv) The total amount of our company's investment cost in holdings of equity securities issued by a single related party may not exceed 5 percent of our company's net worth.

(v) Assessment: trading personal shall review the inventory of securities daily.

2. Underwriting business

Our company regularly reviews relevant news, announcements, financial performance, market risk, credit risk, liquidity risk, operational risk, legal risk, strategy risk and other risks of an investee company. Our company manages risks by conducting quantitative and non-quantitative assessments on whether major shareholders have integrity issue and whether there are abnormal shareholdings of directors/supervisors or changes in managerial level and finance personnel.

3. Derivatives products

Derivatives products are issued based on a list of underlying securities published by TWSE and TPEX. Changes in hedging positions are passively generated by the changes in investor trading and dynamic greeks. Relevant trading is considered a hedging behavior rather than an active investment behavior.

4. Fixed income

The limits of holding bond positions issued by a single company are as follows:

- (i) NTD2.0bn of secured or unsecured corporate bonds, financial bonds or securitized products rated at twAAA; NTD3.0bn of corporate bonds issued by Taipower; NTD1.5bn of bonds rated at twAA+~twAA- and NTD1.0bn of bonds rated at twA+~twA-; or based on the approval and resolution of the review committee. Our company shall adjust the aforementioned positions within one quarter if they exceed limits due to rating downgrade.
- (ii) If the total amount of the convertible bonds issued exceeds NTD500mn, the investment in such target shall not exceed 15 percent of the total bond issuance value (based on a combined calculation of proprietary trading, asset swap and CLN). If the total amount of the convertible bonds issued are below NTD500mn, investment shall not exceed 500 units (based on a combined calculation of proprietary trading, asset swap and CLN). The holding of bonds issued by a single company is capped at NTD1.5bn for TCRI1~2, NTD1.0bn for TCRI3~4 and NTD600mn for TCRI5~6 (TCRI7~9 are not accepted).
- (iii) Foreign bonds held by our company shall be rated investment grade (BBB- or higher by S&P, or corresponding ratings by Moody's and Fitch Ratings), and the holding positions shall be statistically evaluated by country and by sector on a regular basis. All positions exposed to risks are to be reported in monthly meetings.

Stop-loss control:

- (i) If annual trading losses in foreign-currency bonds (including realized and unrealized gains and losses) reach half of the annual profit target of fixed income department, early warning/control will be triggered, and hedging shall be undertaken with the submission of a review report.
- (ii) Structural adjustments on duration, region and rating shall be carried out if annual trading losses (including realized and unrealized gains and losses) reach 1 percent of the positions

approved by the operational plan.

Stop-loss control for single investment target:

- (i) A review report shall be submitted to the president if unrealized losses reach 10 percent.
- (ii) If unrealized losses reach 20 percent or above, stop-loss shall be executed on at least 50 percent of the holding positions within one month; stop-loss can be suspended from executing if management by exception is applied for or if annual losses/unrealized losses are reduced down to less than 20 percent.
- (iii) The positions in foreign currency securities shall be sold or disposed if the sovereign credit ratings of issuing countries, long-term credit ratings of issuers or guarantors and bond issue ratings are downgraded to below the lowest standards set by the competent authority.

In addition to the aforementioned methods, our company's risk management department controls risks associated with investee companies through information system and related mechanisms.

(c) Protecting the rights of clients and beneficiaries

All personnel of our company shall adhere to the provisions of the Securities and Exchange Act, and may not take advantage of undisclosed information, of which they have learned, to engage in insider trading. Sales personnel of our company are required to understand the levels of risk associated with products provided to general clients, and shall not sell products which exceed the risk levels appropriate for clients or are limited to professional investors.

Our company's proprietary trading business follows an internal control system while making trading decisions. Trading decisions must comply with proprietary trading rules and shall observe market conditions to effectively adjust supply/demand relationship, so as not to interfere with the formation of fair price or the soundness of the company's operations and to avoid abnormal trading activities. Regarding clients who have signed the underwriting contracts with our company or are currently receiving consulting services, our employees are requested to comply with ethical corporate management principles, relevant procedures/code of conduct, and code of practice/conduct for corporate finance IPO personnel, in order to ensure clients' rights.

When our company engages in sales of structured products with clients who are not professional institutional investors, our company shall specify the highest potential loss or principal guaranteed rate in a prominent font or way on risk disclosure statement or individual confirmation letter, as well as the explanation on major risks, such as liquidity risk, FX risk, interest rate risk, tax risk and early termination risk.

(d) Engagement and the frequency of engagement with investee companies

Our company exercises voting rights of the stocks it owns through electronic voting every year, and regularly reviews and evaluates quantitative/non-quantitative indicators of investee companies, including relevant news, financial performance, industry overview, operational strategies, corporate governance, etc. Our company pays attention to investee companies via irregular visit, telephone interview, seminar, event, shareholder meeting and earnings conference.

2. Policies on managing conflicts of interest

Policies on managing conflicts of interest are formulated to ensure that our company executes its business based on the interests of shareholders, and to fulfill the responsibilities of institutional investor by ensuring no improper personal gains or decisions and actions.

Our company's conflicts of interest may include the following:

- (a) Trading personnel of our company fail to strictly adhere to confidentiality while making internal trading decisions and act against laws/regulations, such as leaking trading information or business secrets of investee companies and conducting private trading or insider trading.
- (b) Trading personnel trade stocks included in our company's "List of Non-tradable Stocks", which contain non-public information and cause conflicts of interest.
- (c) Company employees manipulate share prices in the course of duties to seek profits for oneself or others, or make the commitment to share profits or mutually bear losses with a third party, or ask for kickback or commission.
- (d) Sales personnel recommend products based on the amount of commission to be received instead of client's interest.

Our company's ways of preventing and managing conflicts of interest are as follows:

- (a) Set guidelines for the prevention of conflicts of interest.

Our company set internal guidelines and employee code of conduct for business execution in order to prevent and manage conflicts of interest.

1. Code of ethical conduct

- (i) Directors and managers shall prevent their private interests from interfering or potentially interfering with the company's interests and causing conflicts of interest.
- (ii) Matters, confidential information and client data that our employees learned in the course of their duties shall be managed with discretion and must not be disclosed to others or used in non-work related ways, unless otherwise disclosed by the company or made public through regulations; the same applies to resigned employees.

2. Proprietary trading of securities -- internal control measures

In order to build and systemize trading principles for proprietary trading department and flexibly allocate working capital, our company shall reinforce the prevention of conflicts of interest and conduct internal control in addition to setting up relevant procedures in accordance to this principle.

- (i) The proprietary department shall not trade the securities it recommends to brokerage department in the opposite side within five business days after making such recommendation, according to Article 44 of the Regulations Governing Securities Firms.
- (ii) Personnel of proprietary trading department shall strictly adhere to confidentiality while making trading decisions and shall not act against laws/regulations, according to Article 18 of the Regulations Governing Responsible Persons and Associated Persons of Securities Firms.

(iii) In addition to the non-tradable securities as set forth in laws/regulations, proprietary trading department shall not trade stocks in the “List of Non-tradable Stocks” containing undisclosed information or causing conflicts of interest, according to Article 45 of the Regulations Governing Securities Firms.

3. Code of conduct for derivatives sales personnel

Derivatives sales personnel, when selling products to clients, shall perform their duties based on the principles of good faith and prudence, and comply with the following rules:

- (i) Prohibition of breaching duties, damaging the interests of the securities firm, or unlawfully seeking profits for oneself or a third party.
- (ii) Prohibition of making any agreement with or commitment to a client to share the income, or share the loss, on an investment.
- (iii) Prohibition of using non-public information of a client learned in the course of duties to seek unlawful profits for oneself or any related personnel.
- (iv) Prohibition of using untruthful promotional means directed at clients to seek profits for oneself.
- (v) Prohibition of accepting or offering improper compensation or gifts.

4. Code of conduct for corporate finance IPO personnel

- (i) Prohibition of introducing investors to companies undergoing capital increase via personal relationship or to participate in the purchase of existing shares. The purchase of existing shares during the consulting period of an IPO project shall be reported internally and reported at the VC monthly meeting, in order to jointly evaluate the fairness of the price and the selection of strategic targets.
- (ii) Prohibition of raising funds from the customers currently receiving consulting service to privately set up offshore company, purchase low-price shares via dummy account or accept investment profit-sharing from other VC or investment companies.

(b) Implement employee training

Offer continuous education through e-learning courses. Hold regular employee training and testing to inform them of relevant laws/regulations and the importance thereof. Relevant courses conducted in 2019 were as follows:

1. Advocacy on the Financial Consumer Protection Act and the fair treatment of consumers
2. Advocacy on the procedures for handling material non-public information and regulations related to insider trading
3. Advocacy on the regulations related to prohibited practices of securities practitioner
4. Training on ethical management

(c) Information control

Separate duties and functions of each business operations to maintain independence and confidentiality and to control information.

- (d) Monitor/control measures
Establish three lines of defense in the internal control system and fulfill the duties in each defense (business unit shall guard the first line of defense, legal compliance/risk management office shall guard the second line of defense and internal audit office shall guard the third line of defense). Additionally, conduct annual internal control and self-evaluation regularly to manage conflicts of interest.
- (e) Prohibition of trading stocks in the “List of Non-tradable Stocks”, which contain non-public information and cause conflicts of interest.
- (f) If an employee finds a situation that may illegally profit oneself or related stakeholders in the course of duties, he or she shall report the situation to department manager and our company’s dedicated unit. Department manager shall also provide appropriate guidance.

3. Voting policies

Our company exercises its voting rights at the shareholder meetings of investee companies in accordance with Article 5 of the “Key Points for the Exercise of Shareholder Voting Rights”.

- (a) For the securities in possession, once the notice of shareholder meeting or the meeting concerning shareholder’s rights and interests is received, it shall be submitted to finance department for signing and filing. The finance department shall notify relevant departments of the aforementioned meeting notice and file a list of meeting notices that adopt electronic voting and appoint personnel to exercise voting rights. The remaining meeting notices for which voting rights are not exercised shall be bound into a book and filed.
- (b) Regarding shareholder meeting or beneficiary meeting for the securities and beneficiary certificates in possession, in addition to relevant laws/regulations, those not adopting electronic voting and holding less than 300,000 shares may elect not to appoint personnel to attend shareholder meeting. In respect of the exercise of voting rights, finance department shall notify the department holding the securities of matters related to attendance. If a single stock is jointly owned by two or more departments, the department holding the largest stake shall be in charge of subsequent matters.
- (c) In the event that an investee company has a proposal concerning non-ordinary resolution or special controversial issue, related matter can only proceed after receiving approval from the president, or otherwise it will be treated as abstention.
- (d) Relevant departments shall fill in an application form for the letter of appointment (letter of proxy) and provide instructions on the exercise of voting rights within the time limit of the meeting according to the provisions of second paragraph of Article 5 or due to business needs. Except for the provisions of third paragraph of Article 5, this application shall be processed after receiving approval from the department manager.

1. Cast a vote in writing:
 - (i) Specify reasons of application on the application form for the appointment letter (letter of proxy), and provide clear instructions regarding the exercise of voting rights for each proposal on the appointment letter.
 - (ii) The appointed person shall return the certificate of attendance after exercising voting rights. Meeting notice, letter of appointment and certificate of attendance sealed with company stamps shall be retained by the finance department in writing for future reference.

2. Electronic voting:

It is not required to issue a letter of appointment. Business unit shall select the voting instructions in each proposal on the proxy letter of the meeting notice, and submit it to finance department to execute voting on electronic voting platform. The files of electronic voting record shall be retained in writing or electronic format for future reference.

- (e) Our company shall exercise its voting rights on the resolutions of its investee companies via written or electronic means according to Clause 1 of Article 177 of the Company Law.
- (f) In addition to the investee companies approved by regulators, in terms of exercising voting rights, while maximizing our benefits, our company shall not directly or indirectly get involved in a company's operations or engage in any misconduct. Our company shall also take care not to damage its corporate image, hinder sales or jeopardize public interest.
- (g) Should a securities house has any staff member on the board of directors of its investee company, its legal person should be an employee of the securities house (excluding his spouse or minor child). If that is not the case, sufficient reasons and the documents on the assignment procedures of a substitute should be provided and kept for future references.
- (h) Any unspecified conditions shall be dealt with relevant laws in the country.

Our company may not fully support the proposal(s) made by the management of our investee companies. In the event that an investee company has a proposal concerning non-ordinary resolution or special controversial issue, related matter can only proceed after receiving approval from the president, or otherwise it will be treated as abstention.

4. Elements of Stewardship Report

- (a) **Institutional investors' fulfillment of stewardship responsibilities with internal resources**

Our company's proprietary trading, corporate financing, bond, finance, and planning departments take charge of stewardship duties after deliberating on feasibility issues as they keep in step with international standards. By paying attention to the ESG trend worldwide, our company familiarizes its staff with the importance of corporate social responsibility through on-the-job training sessions.

(b) Establishing a means of communication for our stakeholders (e.g., clients, beneficiaries, investee companies or other institutional investors)

To provide a channel of communications for various stakeholders, we set up a stakeholder section on our company website for stakeholders to express their concern over different stewardship issues and topics. (<https://www.capital.com.tw/Capitalgroup/stakeholder/stakeholder.asp?xy=16&xt=16>) Our stakeholders may also contact our spokesperson through emails or express their opinions to our customer service center on the phone or through emails.

(c) On major conflicts of interest and ways to deal with them

Our company did not experience any significant conflicts of interests from 01/01/2019 to 12/31/2019.

After inspecting the self-auditing results on internal controls from different departments, competent authorities and external agencies as well as analyzing the reported cases of client conflicts and whistleblowers, we hereby confirm that we had not experienced any significant conflicts of interest during the given period. Here are some brief descriptions:

1. Self-auditing results on internal controls: based on our findings, we discovered that while our internal controls did not apply to one instance, our departments had carried out these controls on 356 instances and missed on two instances. Yet no significant internal control failures and conflicts of interests had occurred in the given period.
2. Internal auditing results: based on our findings, we discovered auditing missteps but no significant conflicts of interests.
3. Cases of client conflicts: we had closed all 18 cases arising in this period. 10 of them had not been verified to be true while the other eight had not represented significant conflicts of interest.
4. Whistleblowing cases: our documented cases did not meet the criteria and standards to be classified as whistleblowing. Nor had they been verified as a violation of company regulations.
5. External audits & disciplines: the external audits & disciplines we had undergone during this period had not shown any major conflicts of interest.

Policy effectiveness:

When carrying out duties, our employees must abide by the procedures established to prevent conflicts of interests and implement training, decentralization, information governance, firewalls, control mechanism, etc. to prevent any conflict of interest. Should any major conflict occurs that causes serious damage to shareholder interests, our company shall disclose the incident and our way to deal with it through our website, faxes, emails, telephone calls, and other means.

To prevent selfish gains or inappropriate policies or actions, insider trading or any conflict of interests while taking profits from investment targets, we have thereby devised a set of conduct codes, guidelines on proprietary trading of equities and derivative financial products to fulfill our obligations as institutional investors.

(d) Fulfillment statement, explanation on non-compliances and assessment of effectiveness of stewardship duties

Our company has signed the statement “Stewardship Principles for Institutional Investors” on 12/20/2018 and signed an updated version of the statement later on 09/20/2020, which is published on our company website (<https://www.capital.com.tw/Capitalgroup/PR/governance.asp>). Our company shall disclose information on the implementation of stewardship policies on our website or annual report. This information shall include a compliance statement or an explanation on non-compliances, attendance on a shareholders meeting of an invested company, voting at the meeting and/or other significant matters.

5. Engagement & Disclosure

(a) Regular attendance at engagement events and relevant data (e.g., company visits, investor conferences and shareholders meetings)

Our company seeks to communicate with the management of our invested companies by visiting these companies, attending their conference calls, seminars, investor conferences and shareholders meetings. We attended a total of 359 shareholders meetings in FY19. Our proprietary trading department attended a total of 250 investor conferences in the same year. The situation in FY20 was as follows:

1. Proprietary trading department:

From early FY20 to now, the department attended 96 investor conferences.

From early FY20 to now, the department exercised voting rights at the shareholders meetings held by 39 companies.

2. Corporate Finance Management:

The department visited 397 companies as of AUG20.

The department held investor conferences for 23 companies as of AUG20.

As of AUG20, the department attended 37 shareholders meetings held by its invested companies and voted on 195 bills without rejecting or abstaining a bill.

(b) Assessing the need to engage/interact with invested companies

To establish long-term client relationships, our company interacts with our invested companies by visiting, telephoning, emailing, organizing activities, attending shareholders meetings, investor conferences, etc. Our proprietary department, however, conducts analysis on macroeconomics, industries and stocks and attends earnings calls organized by the Taiwan Stock Exchange Corporation, Taipei Exchange and different companies in order to determine if it needs to engage in further contact with its invested companies.

(c) Engagement activities and stewardship policies

Our company seeks to understand our invested companies in areas such as human rights policies, labor rights, corporate governance, finances, operational strategies, involvement in ESG, etc. and instill in the companies the importance of ESG-related issues through dialogues and interactions at investor conferences and other activities.

(d) Issues, reasons & scope of engagement with invested companies, impact on companies & expected follow-up and impact on future investment decisions

In addition to regular business topics, during visits and other interactions, our company also taps into ESG-related issues like human rights policies, labor rights, corporate governance, finances, operational strategies and their involvement in ESG so as to boost their sense of stewardship. After these exchanges, we shall continue to show our concern for our investee companies.

(e) Partnership policies/examples with other institutional investors & partnership examples with other advocacy groups on ESG issues

Our company does not have any partnership policies/examples at the moment. Nor do we participate in any ESG advocacy group.

6. Voting disclosure

Regarding our voting at shareholders meetings, of our invested companies (307 in total), 288 used electronic voting while the other 19 used non-electronic voting. As of 1H20, there had not be any instance of objection.

Our company does not necessarily always agree with the proposals made by the management of our invested companies. Should special or controversial proposals arise, we may abstain from voting upon the approval of our President. With regard to the election of the board of directors at **D-Link (2332 TT)**, we abstained from voting (5 votes) due to the controversial nature of this election. With regard to **Teco (1504 TT)**, as major shareholder PJ group proposed to reduce capital by 10% and return the capital to Teco's shareholders, we abstained from voting (1 vote).

Compliance with Stewardship Principles for Institutional Investors

E-voting: 288 companies; non-e-voting: 19; total: 307

Item	Proposal	Number of proposals	In favor of		Objection		Abstention	
			Number of proposals	%	Number of proposals	%	Number of proposals	%
1	Acknowledgment of operational & financial reports	295	295	100	0	0	0	0
2	Earnings distribution or loss make-up	314	314	100	0	0	0	0
3	Revision of articles of incorporation or procedures	572	572	100	0	0	0	
4	Election of board of directors"	Number of companies (hosting such elections)		118	Number of companies (hosting such elections)		116	98.31
5	Disposal of board of directors	5	0	0	0	0	5	100
6	Waiving non-compete agreement for board members	190	190	100	0	0	0	0
7	Issuance of Restricted Stock Awards (RSA)	16	16	100	0	0	0	0
8	Issuance of Employee Stock Option at a price lower than the market level	1	1	100	0	0	0	0
9	Transferring treasury shares to employees at a price lower than buy-back price	1	1	100	0	0	0	0
10	Dissolution, merger, acquisition, share swap or stock split-up of a company	7	7	100	0	0	0	0
11	Capital increase (through earnings/capital surplus/bonus distribution to increase capital or raise capital in cash via issuing new shares)	49	49	100	0	0	0	0
12	Purchasing shares via private placement	17	17	100	0	0	0	0
13	Reducing capital/reducing capital in cash (to make up losses or return cash to investors)	7	6	85.71	0	0	1	14.29
14	Executing disgorgement of profits	0	0	0	0	0	0	0
15	Others	19	19	100	0	0	0	0

Note: Data received as of JUN2020 after attending shareholders meetings through the Taiwan Depository & Clearing Corporation; data received as of AUG2020 after attending shareholders meetings on our own.