

M&G and the UK Stewardship Code

Introduction

The UK Stewardship Code was first introduced in 2010, setting the benchmark in the UK for institutional investors to meet ownership responsibilities in respect of their holdings of UK equities. The Code is voluntary and operates on a comply-or-explain basis. The Financial Reporting Council, the independent regulator overseeing financial reporting, accounting & auditing and corporate governance, monitors compliance with the Code.

M&G has been supportive of the Code since its inception. As an asset manager, we seek to add value for our clients by pursuing an active investment policy through portfolio management decisions, maintaining a constructive dialogue with management and by voting on resolutions at general meetings. Our investment teams and dedicated Corporate Finance & Stewardship team are committed to active engagement with investee companies to enhance value for our clients.

We recognise the importance of accountability to our clients for the stewardship of their assets and comply fully with all of the Code's principles in respect of UK-listed equity investments.

M&G's approach to stewardship and governance is detailed in the Responsible Investment section of our website (See *'Issues Arising from Share Ownership'*). Our compliance with the principles of the UK Stewardship Code is detailed on the following pages. We obtain independent assurance of our compliance with the Code, a copy of which can be found on the M&G website (See *'Stewardship Assurance Opinion'*).

At M&G, we aim to generate superior long-term returns for our investors. Whether we are investing in equities, fixed income or property, we see ourselves as stewards of our clients' assets and take seriously the responsibilities that come with this. The approach taken by the Fixed Income, Real Estate and Multi Asset teams is outlined in the Responsible Investment section of our website.

For further information on our stewardship or corporate governance approach, please contact Rupert Krefting, Head of Corporate Finance & Stewardship (rupert.krefting@mandg.co.uk).

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities

M&G manages funds on behalf of clients on both an active and passive basis. Our approach to equities investment is set out in the *'Issues Arising from Share Ownership'* publication, providing guidance on our expectations of the companies we invest in, how we monitor investee companies and our engagement activities with those companies that fail to meet our expectations. Whilst UK-listed companies are the primary focus, we endeavour to extend these principles to our overseas-listed equity investments as widely as we can, taking into consideration local regulations and market practice.

For active funds, we seek to add value for our clients by pursuing an active investment policy, through portfolio management decisions, by maintaining a constructive dialogue with management and by voting on resolutions at general meetings. Decisions on initial investment, ongoing ownership and, ultimately, divestment are made on an informed basis and following extensive research, which continues throughout the period in which we are invested. Meetings with companies occur on a regular basis, enabling us to monitor company developments over time and assess progress against objectives.

Stewardship activities of monitoring and engaging with investee companies, as well as voting at shareholder meetings and reporting to clients, is undertaken by the investment teams, analysts and members of our Corporate Finance & Stewardship team on an integrated basis. To ensure an integrated approach, regular investment meetings are held with investee companies (and meetings with potential investee companies) with representation from each team.

Approach to Stewardship for UK Equity Investments

Our approach to stewardship continues to evolve and we regularly reflect on our activities, reviewing and revising our policies when appropriate. We outline below how our stewardship responsibilities are discharged at the different stages of the life of an investment (the decision to invest, the decision to hold an investment, and ultimately the decision to divest):

1. Investment decision to buy shares in a company

Investment decision-making is undertaken by our fund managers, who determine whether a company is appropriate for a specific fund mandate. In general, at M&G, the intention is to hold an investment over the medium to long term.

We only invest in companies after undertaking extensive research based on information, research and analysis from both our in-house analysts and external sources. This is likely to include reviewing a company's published materials, brokers' research, meeting with directors and visiting company premises. The effort that goes in at the start of the investment process forms the base from which our stewardship activities build. We seek to fully understand our investments; their opportunities and risks.

2. Monitoring Investments

Regular monitoring, including open and purposeful dialogue with investee companies, enables us to determine whether an investment remains appropriate. **Further details of our investment monitoring process are outlined in Principle 3.**

Corporate governance is a key factor in investment decisions at M&G, and environmental and social factors are increasingly important. Our Corporate Finance & Stewardship team, which is responsible for aspects of monitoring, is integrated into the investment team. The Corporate Finance & Stewardship team is focused on company engagement and voting activities. Members of this team will discuss issues with the investment team throughout the day and will routinely attend company meetings hosted by the investment teams, as well as initiating meetings with non-executive directors on specific areas of engagement (which may also be attended by the investment teams).

Engagement

M&G will proactively engage on any issue which may, potentially, affect a company's ability to deliver long-term sustainable performance and value. **Further details on the range of issues that might be covered in company engagement, along with when and how activities are escalated are provided in Principle 4.**

When companies consistently fail to achieve our reasonable expectations, we will actively promote changes. These changes might range from the formulation of a new strategy to the appointment of new directors. It remains the prerogative of the investment team to sell shares based on their valuation assessment.

Voting

Alongside our monitoring and engagement activities, we exercise our right as a shareholder to vote on resolutions on behalf, and in the interests, of our clients, thereby holding companies to account.

Voting at shareholder meetings is undertaken with the long-term interests of the respective company in mind. Our voting decisions are guided by our voting guidelines, which are derived from our *'Issues arising from share ownership'* publication.

Details of our voting policy and process are provided in Principle 6.

3. Divesting from an investment

At some point, the Fund Manager may decide to divest from a holding. This might be for a variety of reasons, including that the company is no longer suitable for the fund mandate, the outcome of engagement is unsatisfactory or as a result of the investment team's valuation assessment. Investment decision-making is undertaken by our fund managers.

Principle 2

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

It is a fundamental requirement for a financial services firm such as M&G to act in the best interests of its clients and/or its beneficiaries, and identify and manage conflicts of interest. This is central to our duty of care. Accordingly, it is important for our clients to know that M&G will use all reasonable endeavours to identify conflicts, manage them effectively and treat our clients fairly.

M&G has a comprehensive Conflicts of Interest Policy which reflects both the nature of our business activities and our ownership structure (including any potential conflicts arising from our ownership by Prudential plc).

M&G staff are required to complete annual mandatory conflicts of interest training to ensure they understand all conflicts of interest that arise by virtue of the roles they perform, and are aware of the process for identifying and reporting conflicts so that they can be managed in an appropriate manner. The *M&G conflicts of interest disclosure statement* can be found on our website.

In identifying the conflicts of interest that may arise when providing services to our clients, M&G will take into account the following:

- a) Whether any M&G entity is likely to make a financial gain, or avoid a financial loss, at a client's expense (**firm versus client conflict**)
- b) Whether a client is disadvantaged or makes a loss when an employee or other person connected to an M&G entity makes a gain (**individual versus client conflict**)
- c) Whether a client makes a gain or avoids a loss where another client makes a loss or is disadvantaged (**client versus client conflict**)
- d) Whether an M&G entity, employee or fund benefits at the expense of another M&G entity or fund (**intra group conflict**)

Conflicts that arise from personal activities of employees (for example, outside appointments, involvement in public affairs, personal political donations and personal investments) are also closely monitored and managed.

On occasion, we may encounter conflicts of interest related to our stewardship activities. It is incumbent on all investment professionals and members of the Corporate Finance & Stewardship team to identify and manage such conflicts, in line with the wider M&G Group Conflicts of Interest Policy. In all such instances, our objective is to ensure that these conflicts are identified and managed appropriately to ensure our clients' best interests are served.

Examples of conflicts that may arise in relation to stewardship activities are provided below. The potential conflicts arise both in the way the investee company monitoring and engagement is managed, and in relation to voting activities where M&G is voting on resolutions.

In each case, where a conflict arises, the conflict is identified and reported in line with the wider M&G Group Conflicts of Interest Policy, and an appropriate plan for mitigating the conflict is agreed. This might include referring the matter to the M&G Conflicts of Interest Committee for deliberation.

Conflicts arising from M&G's ownership of Prudential plc shares

M&G is a wholly owned subsidiary of Prudential plc.

M&G funds or segregated mandates may from time to time invest in shares of Prudential plc. Within the Prudential Group, there are also companies that invest as principal in investments in which M&G may also invest for clients.

Two conflicts arise – as Prudential plc is M&G's parent, M&G may be inclined to favour investment in Prudential; and M&G may have access to information about Prudential's corporate actions and investment decisions regarding their principal investments.

To manage these conflicts, both companies ensure that operations and investment decisions are kept separate and independent. M&G's investment decisions to buy and sell such shares, and whether or how to vote in relation to those shares, will always be solely made in the interest of our clients. The flow of information between Prudential and M&G is carefully controlled.

The rationale for voting in a specific way is recorded to ensure transparency on any voting decision.

Examples of other potential conflicts

A conflict of interest potentially arises where:

- An employee or Director of any Prudential Group company is also a Director of a company in which M&G invests;
- M&G invests in a company that is a client of M&G; or
- M&G invests in a company that is a significant distributor of M&G products.

In such instances, M&G may be conflicted, for example, in the way it deals with the Directors and/or company management, votes on their election and votes on remuneration policies that might apply to them.

Where a potential conflict arises, the conflict is reported in line with the wider M&G Group Conflicts of Interest Policy and an appropriate plan for mitigating the conflict is agreed. In determining the appropriate mitigation a number of factors will be considered. These include the nature of the relationship with individuals and the extent to which the relationship could be managed by individuals who are not conflicted, the materiality of any contracts, and the risks of the potential conflict to client interests.

Interests of clients diverge on issues being voted on

On occasion, the interest of clients may diverge on issues on which we are voting. For example, where segregated mandates are being managed alongside a retail fund, or where clients within the same fund have different views.

We are able to vote shares differentially and will assess the voting of shares against each client mandate. Where client interests diverge, then we will vote accordingly, but this is a rare event.

Generally, M&G votes by proxy at general meetings on all holdings held in active funds. On occasion, we will attend a general meeting where our clients' interests are best served by us doing so.

Principle 3

Institutional investors should monitor their investee companies

We consider it important to recognise that shareholders appoint boards of directors to manage company assets on their behalf, and to preserve and enhance shareholder value. Shareholders in quoted companies expect clear accountability by executive management as an essential part of satisfactory corporate governance.

Regular and proactive monitoring, including open and purposeful dialogue with investee companies, enables us to determine whether the board is fulfilling its mandate to shareholders and, ultimately, whether an investment remains appropriate. This monitoring process typically includes:

- arranging regular meetings with executive management, the Chairman and/or other non-executive directors
- daily monitoring of company announcements
- reviewing company results (annual & interim)
- reviewing external research materials (eg, broker research reports)
- attending company Capital Markets days for investors and site visits
- attending broker meetings to discuss investment recommendations
- engaging in specific discussions with companies on material topics, including: strategy, performance and non-financial matters (such as environmental, social and corporate governance factors; capital structures; board performance and understanding how boards are fulfilling their responsibilities; succession planning; remuneration; and culture)

- attending company engagement/corporate governance meetings (arranged by companies to enhance the engagement process and provide a forum for governance and responsible investment subjects to be discussed)
- meetings with remuneration committee chairman (in particular, where the company is reviewing its remuneration policy, or prior to general meetings where sensitive or contentious resolutions are being put to shareholders to vote on)
- corresponding with non-executive directors in instances where issues have been raised with management, but where progress on these issues is inadequate
- maintaining a record of all interactions with companies
- attending shareholder meetings

Company boards must consistently satisfy customers, shareholders and the reasonable expectations of employees, as well as acting responsibly towards society as a whole, in order to ensure success over the long term.

We expect the boards of our UK investee companies to comply with the Corporate Governance Code and with the spirit of it. It is incumbent on a company to explain the rationale for diverging from the Code's principles and, subject to this explanation, we will determine the appropriateness of the divergence on a case-by-case basis.

On occasion, we may support resolutions that are not compliant with the Code – which we believe are the right courses of action for the given circumstances or which progress towards compliance – after discussion with the company on the specifics.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities

As a general approach, we are supportive of the management of the companies in which we invest. However, when companies consistently fail to achieve our reasonable expectations, we will actively promote change. These changes might range from the formation of a new strategy to the appointment of new directors.

M&G seeks close dialogue with its investee companies and is prepared to become an insider in order to facilitate dialogue on price sensitive matters such as transactions, capital raisings, takeovers and changes in management. Appropriate procedures are in place to manage such information.

M&G will engage on any issue that may potentially affect a company's ability to deliver long-term sustainable performance and value to our clients. Issues may include, but are not limited to:

- business strategy
- performance
- financing and capital allocation
- governance
- risk
- management and employees
- acquisitions and disposals
- operations
- internal controls
- membership and organisation of governing structures and committees
- sustainability
- remuneration policy, structures and outcomes
- culture
- environmental and social responsibility
- quality of disclosure

The approach taken by our investment team and Corporate Finance & Stewardship team will be issue specific. Wherever possible, we seek to achieve our objectives by agreement and in a confidential manner, but may be prepared to support the requisition of a meeting, or requisition a meeting ourselves, to enable shareholders as a whole to vote on matters in dispute.

M&G's resources are generally applied based on a range of factors, including the materiality of the issue and the size of M&G's holding. Our focus will be on issues that are likely to be material to the value of the company's shares. As a general rule, where M&G's holding is a small fraction of the company's total capital, and a small fraction by value of a fund, there will be proportionately less resource applied to engagement (reflecting the reality that M&G's influence is less significant).

We would always seek to discuss any contentious issues before casting our vote, in order to ensure that our objectives are understood. To M&G, confrontation with boards at shareholder meetings represents a failure of corporate governance.

Escalation is normally conducted by the investment team alongside the Corporate Finance & Stewardship team, and may involve meeting with the company's Chairman and/or Senior Independent Director, the executive team, other shareholders and/or company advisers. In a limited number of cases, it may be appropriate for the Chief Executive Officer of M&G or the Chief Investment Officer, Equities to be involved.

We believe company boards must consistently satisfy customers, shareholders and the reasonable expectations of employees, as well as acting responsibly towards society as a whole, in order to ensure success over the long term. Focused intervention will generally begin with a process of enhancing our understanding of the company's position and communicating our position to the company. This might include initiating discussions with the Chairman and/or the company's advisers. We may also speak to senior independent directors or other non-executive directors and other shareholders. The extent to which we might expect change will vary, depending on the nature of the issue. In any event, we expect companies to respond to our enquiries directly and in a timely manner.

We expect the boards of our UK investee companies to comply with the Corporate Governance Code and the spirit of it. It is incumbent on a company to explain the rationale for diverging from the Code's principles and, subject to this explanation, we will determine the appropriateness of the divergence on a case-by-case basis. On occasion, we may support resolutions that are not compliant with the Code – which we believe are the right courses of action for the given circumstances or which progress towards compliance – after discussion with the company on the specifics.

In the case of Board appointments, remuneration and corporate activity, shareholders are likely to be given the opportunity to vote on the company's approach. Where we remain unhappy with the proposed outcome of an intervention, or where the rationale is unconvincing, we will vote against relevant resolutions and, potentially, the reappointment of those directors responsible for the proposals with whom we have engaged. This is assessed on a case-by-case basis.

Ultimately, as an active shareholder, where the outcome of our engagement is unsatisfactory, we have the option to dispose of an investment.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate

M&G is willing to act collectively with other UK and overseas investors where it is in the interests of our clients to do so. We endeavour to maintain good relationships with other institutional investors and support collaborative engagements organised by representative bodies and others. M&G is a member of the Investment Association, with a large number of M&G representatives actively participating on a range of Investment Association committees. We have committed to participate in the Investor Forum, which was set up to increase proactive collective engagement.

A range of factors are considered in deciding whether or not to collectively act with other shareholders including, but not limited to:

- whether we can be more effective in our engagement unilaterally or collectively,
- the extent to which the objectives of other investors are aligned with our own, and
- the potential sensitivity of the issue and the extent to which conversations with the company are confidential.

In addition, members of the Corporate Finance & Stewardship team participate on a range of external formal and informal committees related to broader shareholder issues.

Companies wishing to initiate a discussion on collective engagement should contact Rupert Krefting, Head of Corporate Finance & Stewardship (rupert.krefting@mandg.co.uk).

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity

An active and informed voting policy is an integral part of our investment philosophy. Voting should never be divorced from the underlying investment management activity. By exercising our votes, we seek both to add value to our clients and to protect our interests as shareholders. We consider the issues, meet the management if necessary, and vote accordingly.

For UK-listed holdings in actively managed portfolios, we seek to vote on all resolutions proposed at general meetings. Typically, M&G votes by proxy at general meetings, but on occasion we will attend a general meeting where our clients' interests are best served by us doing so.

In determining our vote, a number of factors will be taken into consideration, including our voting guidelines

(which are reviewed regularly), company specific information and the extent to which we have been able to obtain any additional information required to make an informed decision.

A responsible board should consult significant shareholders in advance of a company meeting, rather than risk putting forward resolutions which may be voted down. We are generally supportive of management and we aim to be pragmatic, but we will abstain or vote against the company if a resolution conflicts with our voting guidelines. We would always seek to discuss any contentious resolutions before casting our votes in order to ensure that our objectives are understood. Confrontation with boards at shareholder meetings represents a failure of corporate governance.

The Annual General Meeting serves a useful purpose by reinforcing the Board's accountability to shareholders. Where accountability is lacking we will, on occasion, use these meetings to remind the Board of its obligations to shareholders.

For our actively managed portfolios holding UK-listed shares, we seek to vote on all resolutions at shareholder meetings.

We may not vote in favour of resolutions where we are not able to make an informed decision on the resolution because of poor quality disclosure, or due to an unsatisfactory response to questions raised on specific issues. We endeavour to discuss our concerns with the company in advance of voting against a resolution.

Any shares on loan are recalled whenever there is a vote on any issue affecting the value of shares held, or any issue deemed to be material to the interests of our clients.

We disclose our voting records on our website, which are published on a quarterly basis.

Use of Advisory Services

M&G subscribes to a number of shareholder voting and information service providers, including Institutional Shareholder Services (ISS), Institutional Voting Information Services (IVIS), MSCI ESG Research, and ISS -Ethix. These inform the voting decision. However, voting decisions are always taken by a member of the Corporate Finance & Stewardship team, in consultation with the investment team, where appropriate. All of our share voting is processed via an externally provided information system that has reporting and disclosure functions.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities

We acknowledge that as active managers we need to be accountable for our actions and demonstrate that we vote in a consistent manner, based on our principles. Much of our engagement with companies is confidential, but we publish case studies of our interaction with companies on less sensitive issues. It is our intention to commence publishing our quarterly stewardship report on the website in due course.

We provide transparency on our voting activity on our website (See *'M&G and Proxy Voting'* section). This is updated on a quarterly basis. It is our intention to commence publishing our voting rationale in due course.

We report quarterly internally on how we discharge our stewardship responsibilities to a number of internal boards (where internal money is managed), obtain independent assurance of our stewardship activity (See *'Stewardship Assurance Opinion'*) and report to clients on stewardship activities on request.

M&G maintains records of interactions with companies, and we are in the process of implementing a new system for recording general monitoring activities for equity holdings. This is expected to be implemented during 2016. The Information to be retained on this database will include a record of all interactions with companies. Records of specific stewardship activities are currently retained within the Corporate Finance & Stewardship team.

All voting is processed and recorded via an external voting service on which a full record of all voting activity is retained, along with voting rationale.

