Issues arising from share ownership

Contents

M&G Investment Management Limited

May 2016

1. Share ownership

Companies should seek to achieve long-term investment returns for their shareholders, thereby contributing to a successful economy. Shareholders, as providers of equity capital, are the ultimate owners of companies.

Company boards must consistently satisfy both customers 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.

M&G seeks to add value for its clients by pursuing an active investment policy through portfolio management decisions, by voting on resolutions at general meetings and by maintaining a continuing dialogue with company management. Meetings with companies will therefore occur on a regular basis. This enables us to monitor company development over time and assess progress against objectives.

As a general policy 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 changes. These changes might range from the formulation of a new strategy to the appointment of new directors.

In these circumstances we would initiate discussions with the Chairman and/or financial advisors. We may also speak to independent directors and other shareholders. Wherever possible we seek to achieve our objectives by agreement and in a confidential manner, but may be prepared to support a requisition for a Meeting to enable shareholders as a whole to vote on matters in dispute.

Much comment on institutional shareholder neglect of under-performing companies fails to recognise the function of stock markets which allocate capital to the more successful companies, and limit access to capital by the less successful. It is always the prerogative of a shareholder to dispose of an investment.

M&G supports the UK Stewardship Code.

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2. Board structures

It is 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 of executive management as an essential part of satisfactory corporate governance.

Properly structured boards should include an appropriate number of independent directors who will contribute, inter alia, to formulation of strategy and ensure that appropriate risk management procedures are in place. We expect these directors to play a key role as members of the audit, remuneration and nomination committees and to ensure that succession planning is properly addressed.

Our strong preference is for the roles of the chairman and chief executive to be separate. We would seek persuasive justification when the roles are combined or when a chief executive succeeds to the chairman's position. In these circumstances we would expect the senior independent director to be appointed as deputy chairman.

In the UK we support the unitary board structure which recognises the common duties and responsibilities of company directors and increases the accountability of executive management both to the board and to shareholders. Companies with two tier Boards should also encourage management accountability to shareholders.

We also believe that full accountability to shareholders is best achieved by the annual re-election of all directors.

3. Voting policy

Investment and voting decisions are always taken by individual M&G fund managers in the best interests of ultimate beneficiaries in order to avoid any potential conflict of interest.

Conflicts are managed in accordance with M&G Group Conflicts policy. Where a potential conflict arises, the matter will be referred to the Equities Business Board and any decision as well as the underlying rationale will be documented and available to clients upon request.

In order to ensure the protection of our clients' interests, the policy will apply in the same way to any shareholding in M&G's parent company, Prudential PLC, as to all other investee companies.

Voting advisory services may provide useful background information but do not determine any voting decision.

We seek to vote on all resolutions at shareholder Meetings, with votes being disclosed quarterly on this website. Any shares on loan are recalled whenever there is a vote on any issue affecting the value of shares held. 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 and to protect our interests as shareholders. We consider the issues, meet the management if necessary and vote accordingly.

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 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 does serve a useful purpose by reinforcing the Board's accountability to shareholders. A short presentation on the company's activities and strategy gives shareholders an opportunity to hear about the business directly from the management.

We are not in favour of shares with restricted voting rights.

We would oppose any move to mandatory voting which would reduce the general quality of voting and thereby reduce the accountability of the Board to shareholders.

4. Take-over bids

Valuation by stock markets is an important benchmark for monitoring Board performance. For a quoted company the take-over bid, or merger, can be a necessary and important protector of shareholder value.

Our general policy is to support incumbent management in good standing. We reserve the right to support hostile bids when the management have either consistently failed to respond to the reasonable expectations of shareholders or where, in our judgement, the level of a bid fully recognises the future prospects of the company. We will give a fair hearing to the arguments of both sides and recognise that irrevocable undertakings are rarely in the best interests of our clients.

We also seek to ensure that fair valuations apply to agreed takeovers. This is particularly true for 'nil-premium' mergers which may, in effect, be takeovers with the offeror failing to pay the requisite control premium.

Management buy-outs or public to private transactions can give rise to serious conflicts of interest, but in some circumstances may be an effective means of delivering value to shareholders. In these instances we look to the independent directors on a Board to take control of the process. This process should be designed to be transparent and non-exclusive with information being made available to all competing bidders.

In cases where we are a significant shareholder in a potential offeree company we encourage direct consultation at an early stage.

5. Return to investors

Directors should seek to maximise total shareholder return arising both from long term share price appreciation and from dividend payments.

In circumstances where risk adjusted returns exceed a company's cost of capital, we encourage companies to invest, subject to maintaining appropriate controls and capital structure.

We encourage the payment of dividends as a validation of the cash flow of the business. This includes companies which are achieving high growth rates and/or high internal rates of return on projects.

When a company is unable to generate returns which exceed the cost of capital there should be a tax efficient capital distribution from the company, preferably by dividend payments. Distribution of surplus capital achieves a re-allocation of equity capital through the mechanism of the stock market.

6. Capital raising

Capital used by companies is derived from equity, debt and other creditors. The rights of lenders and other creditors are precisely defined in law. This contrasts with the economic interest of shareholders providing the equity capital. Protection of the shareholders' position relies largely upon ownership, with the right to vote at company meetings and thereby determine company Articles and Board membership.

We support the principle of pre-emption because shareholder wealth is nearly always lost if companies raise capital for potentially wealth creating opportunities from new investors rather than raising capital on comparable terms from existing shareholders. It is therefore incumbent upon Boards to demonstrate clearly why any departure from this principle is in the best interests of the existing owners.

In order to minimise the cost of raising capital M&G promotes greater flexibility in underwriting and sub-underwriting arrangements, both in respect of fees and the period at risk. The underwriting system provides, when needed, a financial guarantee for the company seeking proceeds from the equity issue. A fee is paid to funds which provide this guarantee. At the other end of the spectrum is the non-underwritten deeply discounted issue where the costs should be de minimis but the absolute guarantee of receiving the proceeds is absent. Between these two extremes there is clearly scope for variable discounts and fee structures.

M&G encourages more efficient capital raising by investee companies, and an early dialogue with shareholders usually contributes to this objective. M&G is prepared to become an insider in order to facilitate such dialogue.

7. Remuneration policy

It is clearly in the interest of shareholders that Boards should have the ability to remunerate fairly both executive and independent directors. Remuneration levels in different companies will be a market-based judgement, taking business size and complexity into account and should reflect relative performance.

Executive director remuneration should be determined by a remuneration committee of independent non-executive directors. Accountability to shareholders is achieved by full disclosure of these arrangements which should be subject to appropriate shareholder approval of an annual remuneration report. This report should describe how the arrangements are expected to operate in practice and reference to expected values will contribute to a better understanding of their objectives.

We believe that it is important to establish a community of interest between shareholders and company directors. This is achieved by all directors owning shares and by executive directors participating in long term incentive schemes. It is appropriate that such schemes should be endorsed by a specific shareholder vote. Potential rewards should reflect business performance and the creation of shareholder wealth. Our preference is for deferred share ownership plans with dividend accrual on shares which vest rather than for share option schemes. We expect directors to have a direct shareholding in the company which is substantial in the context of their remuneration.

Boards should not sanction "reward for failure", and it has long been our position that boards should seek to mitigate termination costs. We oppose rolling contracts of more than twelve months' duration. In our view ex-gratia payments to directors should always be subject to a specific shareholder vote and in any event should not be made as a reward for the completion of acquisitions.

We contribute to the continuing development of the ABI Investment Committee guidelines on remuneration.

8. Price sensitive information

As long term shareholders we encourage a full and open dialogue with our investee companies. Within M&G the responsibility for any confidential discussions lies in the first instance with M&G's Corporate Finance and Stewardship team which has established procedures to maintain confidentiality. On occasion this results in us being in possession of price sensitive information which may result in the share concerned being placed on our restricted dealing list.

9. Corporate responsibility

M&G has long been an active advocate of responsible share ownership and is a supporter of the UK Stewardship Code. We have a dedicated Corporate Finance and Stewardship team to oversee our stewardship of investee companies.

As professional investors our overriding obligation is to act in the best interests of our clients. Many factors impact the investment decisions we make in this regard, and we believe that it is our duty to consider all of them. Ensuring the proper governance of investee companies is always central to our thinking. Our recognition of the significance of environmental and social issues to long term shareholder returns is demonstrated by M&G's support for the UNPRI.

We believe that the expression "Corporate Responsibility" describes the overall framework within which companies and investors approach their business, with particular emphasis on the environment, community and employment issues.

While growth and wealth creation remain the cornerstones of prosperity, we believe that well managed businesses should take account of wider social and environmental issues in taking their businesses forward. We find it helpful if companies publish concise and realistic policies which they adopt in dealing with these issues. We look for a well-reasoned and practical approach and recognise that this can vary according to each company's circumstances. If companies choose not to publish their policies they should give their reasons.

10. Reporting to clients

We report quarterly to clients on how we discharged our stewardship responsibilities, as specified in investment management agreements.

We obtain independent assurance of our stewardship activity.

If you would like to find out more about our approach to share ownership, please call Rupert Krefting.

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