



M&G Equities' approach to responsible investment

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Introduction

At M&G, we understand the importance of our role as stewards of our clients' assets and as an active manager, both for the benefit of our clients as demonstrated by our investment returns, and for society as a whole, by providing capital to those companies that need finance to expand and create jobs and wealth.

We believe that the long-term success of companies is supported by effective investor stewardship and high standards of corporate governance. We think that if a company is run well, it is more likely to be successful in the long run. Social and environmental issues can also have an important impact on a company's performance and successful development. We therefore look at how companies address these issues when we analyse them.

M&G's Corporate Finance and Stewardship team are advocates of responsible share ownership and oversee our stewardship of the companies we invest in. Regular meetings with company directors allow us to identify whether a company's strategy is aligned with our interests as long-term shareholders. Our active engagement with companies helps us to understand the issues affecting them and, where appropriate, to encourage positive change.

Active voting is also an integral part of our investment approach – we believe exercising our votes adds value and protects our interests as shareholders.

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.

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 expect clear accountability of executive management as an essential part of corporate governance.

Well-balanced boards should include an appropriate number of independent directors who offer a diverse range of skills and experience. They 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.

In our view, the role of the chairman and chief executive should be separate and the chief executive should not succeed the 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.

Voting policy

Investment and voting decisions are always taken by individual M&G fund managers in the best interests of our customers and to avoid any potential conflicts of interest.

Conflicts are managed in accordance with M&G Group Conflicts policy, which is published on M&G's website. Where a potential conflict arises, the matter will be referred to the M&G Conflicts of Interest Committee, which meets quarterly and is chaired by a non-executive director of M&G. In order to ensure the protection of our customers' 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 and help the mechanics of our voting process, but our voting decisions are determined by a combination of the investment team and our voting policy published on M&G's website.

In the UK, we seek to vote on all resolutions at shareholder meetings, with votes being disclosed quarterly on the M&G website. Any shares on loan are recalled whenever there is a vote on any material issue affecting the value of shares held. An active and informed voting policy is an integral part of our investment philosophy. 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 good corporate governance.

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

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 agreeing to irrevocable undertakings, especially early on in a process, is rarely in the best interests of our customers.

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 offer or 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 transaction. The transaction 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.

Return to investors

Directors should seek to deliver sustainable total shareholder returns 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 that are achieving high growth rates and/or high internal rates of return on projects.

When a company is unable to generate returns that 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.

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 value can be diluted 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.

M&G encourages 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 and to help underwrite new issues.

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.

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 a binding shareholder vote for the policy every three years. This policy 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 that vest, rather than for share option schemes. We expect directors to have a direct shareholding in the company that 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.

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.

Responsible Investing

M&G has long been an active advocate of responsible investing and we are a Tier 1 signatory 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 customers. 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.

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 that 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.

Reporting to clients

We report quarterly to clients on how we discharge our stewardship responsibilities, as specified in investment management agreements. We also obtain independent assurance of our stewardship activity, which is published on the M&G website.

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