M&G and the UK Stewardship Code 2020

Asset owner approach

April 2021

Introduction

UK Stewardship Code 2020

The UK Stewardship Code 2020 sets high stewardship standards for both asset owners and asset managers. The Code comprises a set of 'apply and explain' principles, but does not prescribe a single approach to effective stewardship. Instead, it allows organisations to meet the expectations in a manner that is aligned with their own business model and strategy.

The 2020 code reflects the fact that the investment market has changed considerably since the publication of the first UK Stewardship Code in 2010, with significant growth in assets other than listed equity, including fixed income, real estate and infrastructure. These investments have different terms, investment periods, rights and responsibilities, and signatories to the 2020 Code need to consider how to exercise stewardship effectively, and report accordingly, across asset classes.

Of note, environmental -- particularly climate change -- and social factors, in addition to governance, have become material issues for investors to consider when making investment decisions and undertaking stewardship.

About M&G plc

M&G plc is a FTSE100 savings and investments business, serving individual savers and institutional investors in 28 markets. We were formed by the merger of Prudential plc's UK and Europe life insurance operation (asset owner) and M&G Investments, the international asset manager. On 21 October 2019, we demerged from the international financial services group Prudential and listed on the London Stock Exchange as an independent business. Our aim is to make our innovative savings and investment solutions available to more customers and clients around the world.

The relationship between the Asset Owner and the Asset Manager

For the purposes of stewardship, M&G plc can be thought of as comprising two entities within the same group, the asset owner and the asset manager mentioned above. The asset owner broadly corresponds to the old Prudential UK life business, while the asset manager corresponds to M&G Investments. The asset owner and the asset manager function independently, but are aligned to a common business purpose defined at the level of M&G plc.

The asset owner is responsible for sourcing and distributing financial products to a number of different types of customers, including retail customers, institutional investors such as pension schemes, and investment platforms. These products include with-profits policies, annuities, and unit-linked funds. The investment strategies for these products differ, and are tailored to the requirements of each product, but may include multiple asset classes spread across a number of mandates or investment vehicles.

The asset owner appoints asset managers to manage its investment portfolios. Asset managers are appointed for their expertise in generating sustainable risk-adjusted returns, net of fees, over the long term, for a particular asset class or investment strategy. The primary asset manager that the asset owner uses is M&G Investments.

The asset owner endeavours to appoint asset managers that it deems to be best-in-class for an appropriate fee. The asset owner can, and does, appoint asset managers that are external to the M&G plc group. Among the external asset managers that the asset owner has appointed are Blackrock, Eastspring Investments, PPMA, and Value Partners LLP.

The asset manager in turn can, and does, manage assets for third party customers that are not the asset owner. Indeed, while the asset owner is an anchor investor in many of the asset manager's investment strategies, it does not make use of every investment strategy that the asset manager offers.

The relationship between the asset manager and the asset owner is intentionally kept at arm's length in order to ensure that customers receive the best possible outcome. The asset owner endeavours to treat the asset manager as it would an external manager. Where the asset manager has been appointed to manage a portfolio, it has met the same criteria and reached the same standards as any external asset manager.

As both asset manager and asset owner, we are now reporting our stewardship activities in line with the 2020 Code. In this report, we provide an overview of our stewardship approach as an asset owner, specifically outlining how we adhere to the Code.

Our asset manager Stewardship Code report for 2020 is available here.

UK Stewardship Code 2020

2020 principles for asset owners and asset managers	
	Purpose and Governance
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.
2	Signatories' governance, resources and incentives support stewardship.
3	Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.
4	Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.
5	Signatories review their policies, assure their processes and assess the effectiveness of their activities.
	Investment approach
6	Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.
7	Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.
8	Signatories monitor and hold to account managers and/or service providers.
	Engagement
9	Signatories engage with issuers to maintain or enhance the value of assets.
10	Signatories, where necessary, participate in collaborative engagement to influence issuers.
11	Signatories, where necessary, escalate stewardship activities to influence issuers.
	Exercising rights and responsibilities
12	Signatories actively exercise their rights and responsibilities.

Source: Financial Reporting Council 2019

Disclosure by Principle

The following sections set out how the asset owner complies with the various principles of the 2020 Stewardship Code, with supporting examples. The disclosure is laid out by principle. Unless otherwise stated, when we refer to 'the asset manager' in this document, we mean M&G Investments.

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'

M&G plc

Purpose

Our purpose is to help people manage and grow their savings so they can live the life they want, while making the world a little better along the way.

Strategy

The Group's aim is to maintain and further strengthen our position as a leading provider of differentiated, outcome-orientated investment solutions to retail customers and institutional clients. The Group's strategy is underpinned by our core objective: to grow and manage our customers' savings with tailored solutions and to invest responsibly and with care. Our responsibility is to create the best customer outcome in terms of general well-being in line with our fiduciary duty, taking into consideration financial security. We embed sustainability in everything we do, as we believe a well governed business, run in a sustainable way, will deliver better outcomes for customers and stronger, more resilient returns for shareholders.

Business model

Caring for customers for more than 170 years

We have been serving individual savers since 1848 and continue to help millions of people to manage and grow their savings. We also work with financial partners around the world to help their clients build and manage their investments. We serve more than 800 institutional clients such as pension funds and insurance companies.

Serving a wide range of customers and clients

We believe our customers are our customers because of they prefer the quality of our savings and investment solutions, and appreciate the care with which we look after their money. Our investment practices are driven both by our purpose, which is centred on helping each customer manage and grow their financial resources, and our values, which guide our investment practices to help customers achieve the financial outcomes they want in a sustainable way.

Individual savers and investors

Customers invest directly with us to save for their family's future or draw an income from long-term savings.

Institutional clients

We partner with pension funds, insurers and others to design investment solutions.

Professional investors

We work with financial partners worldwide to meet their clients' investment needs.

Financial advisers and paraplanners

We have a range of products, educational and business development services to help financial advisers and paraplanners to serve their clients better.

Culture and values

Care

We act with care – treating customers, clients and colleagues with the same level of respect we would expect for ourselves. And we invest with care, making choices for the long term.

Integrity

We empower our people at M&G to do the right thing, honouring our commitments to others and acting with conviction. Our business is built on trust and we do not take that lightly.

Our principles

Our principles guide how we do business, and what matters most in our decision making.

- Impact – using our financial power as a force for good
- Inclusion – opening up opportunity for more people around the world
- Innovation – focusing on changing things for the better

ESG, sustainability and stewardship priorities

M&G acknowledges the importance of the wide spectrum of ESG issues, and has investment strategies in place for many of them. Nevertheless, M&G plc has the following key priorities in the ESG, sustainability and stewardship space:

- Investing to mitigate climate change – we target net zero greenhouse gas emissions across our business operations by 2030, and across our investment portfolios by 2050.
- Diversity and inclusion – we are committed to improving diversity and inclusion within our organisation, and championing such improvements within other organisations. We target 40% female representation and 20% representation by ethnicity / nationality in our senior leadership by 2025.

Asset owner

The asset owner continues to trade under the Prudential name. The asset owner has a set of investment beliefs which are aligned to both M&G plc's principles and values, as well as to the asset manager's investment beliefs. A summary of these is shown in Appendix 1. These beliefs are the bedrock of our investment strategies.

One of the asset owner's investment beliefs is that we take a long term, multi-generational approach to investing on behalf of our customers. We understand the importance of ESG factors in investment decisions and their potential to materially impact our customer and investment outcomes. As long-term investors across our With Profits, annuities and unit-linked businesses, we in our role as an asset owner believe that businesses and behaviours that reflect ESG best practices, and which are aligned with our values of Care and Integrity, are better-positioned to deliver sustainable success over time horizons that meet present and prospective customer needs.

Our priority is to invest in the solution, and to actively steer our investee companies towards more sustainable practices. We rely on our investment managers to actively engage with our investee companies on our behalf, to protect and enhance the long-term value of our assets, assessing their engagement processes and ensuring they comply with the standards set out in Shareholder Rights Directive II and the UK Stewardship Code. However, we recognise that we cannot always effect the change we wish to see, and there are certain behaviours with which we do not wish to be associated. In such instances, we may exclude a particular company from the portfolio in question.

The asset owner ensures that customer needs are taken into account by means of good asset-liability management. When designing our investment strategies, we take care to match investment outcomes with the requirements of the liabilities of the book of business in question. These requirements may be defined along several dimensions – e.g. meeting of guarantees, time horizon, lapse rates and maximum levels of risk – with reference to the needs of those customers whom the asset owner has written the business for.

Example

Our PruFund product range has products available at a number of different risk levels, reflecting a customer's appetite for investment risk. Customers may select Cautious and Growth versions of PruFund, or from our PruFund Risk-Managed range with pre-defined investment risk levels.

We set our strategic asset allocations for our PruFund range with respect to the required risk levels, the profile of expected cashflows, projected lapse rates and our customers' preferred time horizon. The latter is generally long, as our customers purchase PruFund as a savings vehicle prior to retirement. Our PruFund investment strategy is multi-asset, investing globally across equities, fixed income, property and alternative assets. This diversifies our investment strategy and allows us to calibrate the level of investment risk appropriately.

As asset owner, we measure our success in meeting customer requirements in a number of different ways. The needs of our annuity customers and our unit-linked customers are met if they receive the investment outcomes defined for them when they bought the product. The interests of our With Profits and our corporate pensions customers are represented on an ongoing basis by two independent committees, the With Profits Committee and the Independent Governance Committee. The asset owner investment team, the Treasury & Investment Office (T&IO) have regular dialogue with these committees to enable customers' needs to be met. For 2020, there was great focus across these committees on how the asset owner investment strategies can be made more sustainable, and how climate risk can be mitigated going forward.

Principle 2

'Signatories' governance, resources and incentives support stewardship'

M&G Plc's governance structure

M&G is a leading savings and investments business which was formed in 2017 through the merger of Prudential plc's UK and Europe savings and insurance operation and M&G Investments, its wholly-owned international investment manager.

The board of M&G plc is ultimately responsible for all M&G's stewardship activities. ESG, sustainability and stewardship activities are sponsored by the Chief Executive Officer.

Specific governance of ESG activities continues to evolve, but for now decisions in this space are taken separately within asset owner and asset manager using existing governance structures. There is dialogue between asset manager and asset owner ESG teams to ensure that the decisions are appropriately aligned.

M&G plc has set up a firm-wide ESG project that aims to more deeply embed ESG, sustainability and stewardship considerations throughout the organisation.

Asset owner

Governance

Our governance structure ensures that discussion and decision making is carried out at the appropriate level of the company, dependent on the potential magnitude or importance of the matter, and in a timely manner. Decisions are then conveyed to the relevant teams in order to be implemented.

The asset owner manages its investments through its Treasury & Investment Office, which is headed by a chief investment officer, the Head of Treasury & Investment Office. Within the Treasury & Investment Office are a number of teams tasked with ensuring customers receive good investment outcomes. Among the relevant teams within the Treasury & Investment Office from an ESG and Stewardship perspective are the Manager Oversight team and the ESG & Regulatory team. A schematic showing the organisation and component teams of the Treasury & Investment Office is available in Appendix 2.

The Manager Oversight team oversees all asset managers working on behalf of the asset owner (including M&G Investments). Any investment decisions are incorporated into investment strategies and processes by this team, with a focus on implications for stewardship

The ESG & Regulatory team (ESGR) owns the Asset Owner ESG investment policy. This defines a number of ESG investment principles, which in turn inform stewardship practices and guidance, ensuring that on matters regarding stewardship, and wider ESG issues, the Manager Oversight team will have a central guide to which they can refer on specific matters. In particular, the ESG investment principles require the Treasury & Investment Office to ensure that the impacts of ESG considerations on risk, return and customer interests are clearly set out. Note that treasury assets managed by M&G's PruCap entity, held at the M&G plc level and funds with commingled third party assets managed by M&G Investments are not in scope for the asset owner policy and are covered by separate policies.

The Treasury & Investment Office makes its decisions via a number of different mechanisms. There are delegated authorities extended by the asset owner company board to personnel at various levels, including the Head of Treasury & Investment Office, Head of the Manager Oversight team and the Head of the ESG & Regulatory team. The exercise of these delegated authorities is overseen by the Executive Investment Committee (EIC), chaired by the asset owner company's Chief Financial Officer.

All investment decisions, including those taken in the ESG, sustainability and stewardship space, are channelled through this governance structure, and ultimately, through the EIC, which in turn, reports to the asset owner company boards. The EIC takes into account ESG factors and the interests of customers when making its investment decisions.

This flat governance structure enables the asset owner to act nimbly and decisively in response to changes, and particularly where an issue arises that requires action. We believe that the clarity of the ESG investment principles and our investment beliefs allows us to discern what the right decision is in most circumstances, and we are able to act quickly in response.

Processes

ESG investment strategy

The ESG & Regulatory team have responsibility for designing the high level ESG investment strategy for the asset owner. This include ESG investment principles, ESG investment processes, investment research and thought leadership. These high level strategies and positions on specific ESG issues are implemented at the mandate and portfolio level by the Manager Oversight team in consultation with the ESG & Regulatory team and other stakeholders, ensuring that ESG and sustainability considerations are taken into account across the spectrum of investment activities.

Investment due diligence

For the asset owner, the Manager Oversight team, having regard to good industry practice, performs appropriate investment due diligence on fund managers to assess their ability to provide the expected investment performance or outcome for the relevant fund. Investment due diligence considers relevant factors, which include, but are not limited to: investment philosophy; key risks; key employees; investment process and implementation; stewardship process; investment performance; risk management; reputation; diversity & inclusion; and systems/IT. All monitoring of our managers' engagement with investee companies is carried out in line with our shareholder engagement policy, available at https://www.pru.co.uk/srdii/.

Investment performance monitoring

The Manager Oversight team performs ongoing monitoring of fund managers against performance benchmarks. Where the Manager Oversight team has material concerns about the investment performance of a fund manager, the team will take reasonable steps to investigate and establish the reason for the fund manager's underperformance and recommend appropriate mitigating actions through the appropriate governance channels.

Ongoing manager investment due diligence

The Manager Oversight team conducts ongoing due diligence reviews on existing fund managers to assess their continuing ability to provide expected investment outcomes.

Ongoing due diligence comprises:

- Quarterly face-to-face meetings or conference calls.
- Annual face-to-face and site visits.

Where the Manager Oversight team has material concerns over the continued suitability of an existing fund manager, the team will, again, recommend appropriate mitigating actions through the appropriate governance channels.

Mandate design

The Manager Oversight team provides advice and recommendations in relation to the component mandates (namely, an asset class managed by an underlying fund manager, for example US equity) for each of the funds.

This includes recommendations on appropriate performance benchmarks and portfolio construction constraints, and takes into account risk/return considerations, liquidity and other practical and regulatory factors. This also includes, but is not limited to, stock, sector, geographic, rating and currency constraints. The Manager Oversight team reviews the investment guidelines with the underlying fund managers annually.

Manager Selection

The Manager Oversight team is responsible for the selection of underlying fund managers. The team performs investment due diligence on shortlisted fund managers to assess their ability to provide the expected investment performance or outcome for the relevant fund. In addition, the team consider the sustainability / ESG investing practices of each fund manager to ensure they align or are congruent with those of the asset owner.

Example

Our stewardship activities are primarily exercised via our respective asset managers, both within M&G and via our *external asset managers. The ESG & Regulatory team was responsible for devising an ESG investment strategy in response to a particular theme, say companies that violated global norms. The ESG & Regulatory team then identified companies affected by those investment strategies. In identifying companies captured by our norms violation screens, the ESG & Regulatory and Manager Oversight teams engaged with fund managers to understand what discussions had taken place with investee companies, including plans to resolve and remediate in instances of alleged or verified norms violations. The outcomes of this engagement informed final decisions under our norms violation policies.*

Once the various action plans for each company were identified, the Manager Oversight team then set out and implemented what changes were required to investment portfolios in order to meet those action plans. The screen will be repeated by the ESG & Regulatory team on a regular basis.

Resources

Within the Treasury & Investment Office, the ESG & Regulatory team comprises four full time investment professionals, and the Manager Oversight team comprises eight full-time investment professionals. Three of these individuals are CFA charterholders.

These teams rely on data provided by the asset managers they oversee, alongside third party data providers, to carry out the relevant stewardship activities. Third-party screening systems are also used to identify securities and companies that require further attention from a stewardship perspective.

These teams carry out proprietary research to identify appropriate ESG investment strategies, as well as to identify suitable managers that are capable of deploying these investment strategies.

Incentives

For 2021, all employees of M&G plc's Investments division (spanning both asset owner and asset manager) have an ESG-related objective which requires each person to take into account ESG considerations in their day to day work. Achieving this objective forms part of the annual performance assessment, and success here is crucial to both a good performance rating and remuneration.

The 2021 Long Term Incentive Plan (LTIP) for executives now has a 25% non-financial component linked to specific outcomes, including in the areas of diversity and sustainability.

Other changes to incentivisation to incorporate specific ESG, sustainability and stewardship objectives are being considered. Any further developments will be reported on in 2022.

Principle 3

'Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first'

M&G plc

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 Conflicts of Interest Policy which reflects both the nature of its business activities and its ownership structure (including any potential conflicts arising from M&G Investments' ownership by M&G plc). This Policy applies to both asset manager and asset owner.

M&G's 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.

Asset owner

The key conflicts arising for the asset owner are those between different groups of customers, as well as between customers and the shareholder. How we identify and manage these conflicts is set out in our Principles and Practices for Financial Management (PPFM) document, for With Profits Business (https://www.pru.co.uk/funds/ppfm/), and Prudential's Statement of Unit-linked Principles and Practices, for unit-linked business (https://www.pru.co.uk/funds/psulpp/).

In general, treating customers fairly is a basic tenet of our investment processes. Every investment decision that we take is considered in light of how customers are treated, to ensure that they receive a fair outcome, with major decisions requiring input on customer fairness from customer advocates in our governance structures. These customer advocates include our With Profits Actuary and our With Profits Committee for With Profits business, and our Independent Governance Committee for our workplace pensions business. The With Profits Committee in particular is empowered to discuss and advise the asset owner company board on sufficiently material investment matters.

Our portfolios are therefore managed using well-defined decision-making principles to ensure that conflicts between the shareholders and customers, as well as between different groups of customers, are properly resolved. Certain well-defined conflicts may be managed using frameworks specifically drawn up for that purpose. For example, we have hedging frameworks and protocols to ensure that any hedging in our With Profits portfolios is carried out with appropriate regard to the interests of our customers, both in the long term and the short term.

There is also a potential conflict between asset manager and asset owner, given that that both these entities are part of the same organisation. This conflict is managed by ensuring operations and investment decisions are kept separate and independent, with the flow of information between the asset owner and asset manager being carefully controlled, whilst not being impeded. To this end, we require that collaboration only takes place on those portfolios that the asset manager manages on behalf of the asset owner. In circumstances where a general conversation is required, the asset manager and asset owner may discuss principles in generic and hypothetical terms, with the key purpose of ensuring alignment with both M&G plc's corporate values and with each other.

Other, more general conflicts are managed on a case-by-case basis, drawing on the principles previously articulated, i.e. we aim to treat all customers as fairly as possible, aiming to deliver a fair outcome.

The asset owner seeks to collaborate with the asset manager as appropriate in exercising our fiduciary duty to our clients and in the development and implementation of the ESG Investment Policy and underlying positions on specific ESG issues. For example, the asset manager was consulted in the reaching high level principles when developing asset owner positions on coal and norms violators, while fund managers and sector analysts were engaged in considering specific sectors and companies. This allowed us to utilise their familiarity with specific companies and sectors, as well as their more direct relationship with companies. These asset manager interactions enabled greater understanding of the investment rationale behind specific holdings, as well as the potential impact of exposure and dialogue with companies. Where asset owner positions run contrary to asset manager and fund manager views, the asset owner duty to customers takes precedent.

Principle 4

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

Asset owner

Work with other stakeholders to improve functioning of financial markets

Membership of and engagement with various industry initiatives allows us to gain understanding of the wider industry's thoughts on current relevant events.

The Association of British Insurers (ABI) brings insurance and long-term savings industry peers together to discuss and respond to risks, policy and regulation. Our Director of Public Policy and Regulation is Deputy Chair of the ABI Board, which directs the ABI's activities, while we have standing representation on a number of ABI committees, working groups and networks, and are regular attendees at ABI conferences and roundtables.

We have also recently joined the CRO forum, which seeks to advance risk management practices within the insurance industry.

The PRA is responsible for prudential regulation and as a result, there is a range of systemic subjects we discuss as a firm with them. This includes financial and market risks as well as operational resilience and governance, by way of examples. Among systemic risk topics that we've engaged with the PRA on recently are climate change and Brexit.

Market-wide and systemic risk

We have a robust and effective risk identification process that identifies both micro, security-specific risks and macro, market-wide and systemic risks. The mechanisms through which we identify such risks include horizon scanning, frequent and regular risk reviews, and sizing of risk appetites. Where we identify macro risks, we may choose to work with industry bodies, regulators and market participants to create risk mitigation solutions.

Example

Investing to mitigate the impacts of climate change is a major priority for M&G plc. As part of the UK financial industry, M&G plc's asset owner companies are regulated by the Bank of England, and hence is participating in the Climate Biennial Exploratory Scenario (CBES) exercise carried out by the Bank. The CBES requires participants to model their balance sheets under a number of different climate scenarios.

The asset owner has worked collaboratively with industry representative bodies such as the Association of British Insurers and other insurance peers to define response parameters, gather suitable data and standardise modelling approaches. This will enable the asset owner to understand the climate risk embedded in its own portfolios better, and create better responses to mitigate these risks. At the time of writing, this work is ongoing. More information is available in Appendix 3.

As a significant investor across various products (including With Profits and Annuities), we have a responsibility to consider and meet the needs of all our customers. Everyone within the company is tasked with identifying, assessing, managing and reporting risks within their area of responsibility. Ongoing monitoring of risks in our own and other areas of responsibility, in combination with our expertise and constant dialogue with regulatory and industry bodies, allows us to meet and exceed our responsibilities.

The asset owner's ESG priorities, including in the engagement space, are 1) to invest to mitigate the effects of climate change and 2) to improve diversity and inclusion within the asset managers that it appoints. We have aligned these with the priorities of M&G plc. Other important themes that are not related to these priorities will also be addressed.

In addition, the asset owner's ESG risk management approach is aligned to a forthcoming plc-level ESG risk management approach, which is in turn built on the existing plc-level risk management framework and the 'Three Lines of Defence' (3LoD) model. First line business areas (1LoD) identify and manage risks and are overseen by the second line Risk and Compliance functions (2LoD). The second line Risk & Compliance functions are structurally independent of the first line, providing risk oversight, advice and challenge, as well as compliance monitoring assurance. This promotes an environment where risks can be quickly identified by those closest to the issue, where risk assessments are undertaken, with appropriate governance and oversight from our second line of defence. The third line Internal Audit is empowered by the Audit Committee to audit the design and effectiveness of internal controls, including the risk management system.

To provide further granularity on the identification, management, monitoring and reporting processes required specific to ESG risk, a team of reputational and ESG risk specialists are developing an ESG Risk Management Framework, which is due to launch in 2021. This framework will outline how we provide risk oversight and assurance in key areas such as ESG risk management culture; ensuring that risk management activity aligns to our ESG Risk Appetite statement(s); and support our ESG-related commitments and targets; with consideration of key stakeholder expectations on ESG linked to our approach to management of Reputational Risk. ESG risks are escalated within risk reporting, which is reported at both the M&G plc Executive and Board Risk Committees, reporting to the M&G plc Board.

Principle 5

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

Asset owner

Review of policies and assurance of processes

We have considered what effective stewardship means in the context of our investment processes. Principles of stewardship are integrated into our ESG investment framework, and into our forthcoming ESG investment policy. These require us to take a long-term approach and consider wider impacts than just financial risk and returns. We already consider sustainability in our risk management processes to ensure that our investment performance is repeatable and reasonable.

Effectiveness of our activities

We report periodically to a number of asset owner company boards (as well as to our With Profits Committee and Independent Governance Committee) on our oversight responsibilities. These reports are reviewed by our risk and compliance functions, and at several different levels (at team level, and again at executive level, including at the Executive Investment Committee) before being submitted to the boards. Our processes are subject to review by Internal Audit on a two-yearly basis.

In 2020, we initiated ESG, sustainability and stewardship reporting to our With Profits Committee and Independent Governance Committee. These bodies represent the interests of with-profits customers and corporate pensions customers respectively. Our reporting has initially focused on our evaluation of our asset managers' engagement and voting activity (including our internal asset manager). Our stakeholders have asked for additional data, including around specific ESG activities including climate change, and portfolio specific voting data. At the time of writing, we are sourcing the requested data in order to improve our reporting. Such feedback from internal stakeholders enables the team to identify where we could strengthen and develop in future.

Principle 6

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

M&G plc

The funds under management and administration for M&G plc as both asset owner and manager, as at 31 December 2020, were £367bn.

Asset owner

The asset owner's funds under management break down as:

With Profits	£143 billion
Unit-Linked	£16 billion
Shareholder-backed annuity and other	£38 billion

Source: M&G plc Annual Report and accounts 2020

There were also £19bn of assets under administration at the end of 2020, mainly as a result of M&G plc's purchase of Ascentric.

The asset owner's funds under management broken down by asset class are shown in Appendix 4.

Through engagement with IFAs, policyholders and via third parties, we continue to build and evolve our understanding of customer needs, expectations and views: the primary tools used are surveys and forums. Seeking input from both IFAs and end customers allows us to gain the perspectives of both professionals and members of the public, creating a more complete understanding. IFA insight also allows us to tap into the expectations and views of their underlying clients. Open-ended responses within surveys and via forums also aid in inviting more detailed insight.

The effectiveness of our chosen methods is evaluated on an ongoing basis, and this research will generally allow us to reduce perceived shortcomings in our products and related materials, or to improve investment outcomes for our customers.

Example

The asset owner has carried out market research to ascertain the appetite for sustainability investment products within its target customer groups. The market research also sought to establish the desired level of sustainability and ESG integration. Based on the insights from this research, the asset owner is designing a new suite of investment propositions based on its PruFund range that incorporates various sustainability objectives to meet customer demand appropriately. These products will be launched in 2021.

Principle 7

'Signatories systematically integrate stewardship and investment, including material environmental, social and

governance issues, and climate change, to fulfil their responsibilities'

Asset owner

Ensuring integration

The Treasury & Investment Office creates asset allocations and investment strategies to meet specific product requirements, delivering a required investment outcome to customers in line with the product risk level. These investment strategies have to be managed by a suitable investment manager that is capable of managing all risks, including ESG risks, appropriately and at the desired cost.

The asset owner relies on the asset managers it appoints to exercise appropriate stewardship and to manage ESG risks on its behalf. To this end, the asset owner only appoints asset managers that it judges are capable of doing this on its behalf.

The investment mandates awarded by the Manager Oversight team specifically reference time horizon, target return and desired risk levels for each manager. Specific ESG and stewardship requirements and restrictions are also specified, especially where a product may have an ESG tilt or strategy.

All asset managers are required to have appropriate ESG and stewardship policies, which are assessed for alignment with the asset owner's ESG policy. Asset managers whose ESG policy does not align, or does not deliver the relevant stewardship requirements, are not appointed. These ESG policies are reviewed regularly to ensure that they continue to align with the asset owner's requirements, which in turn continue to evolve and improve.

These considerations form part of the Manager Oversight team's due diligence processes, which encompass all aspects of working with a particular investment manager. In extremis, it may be that an investment mandate is withdrawn from a particular manager, if the manager is unable to manage it in accordance with the asset owner's requirements (including ESG and stewardship requirements), and placed with a new manager that has the appropriate capabilities.

When reassessing any mandate, ESG considerations are taken into account when assessing potential managers to reallocate to. Through the consideration of alignment with the asset owner ESG policy, any decision to transition away from an incumbent manager is made with ESG factors integrated.

All equity asset managers are required to provide voting records, including examples of when they have voted against management. In addition, asset managers are required to provide examples of engagement, where they have worked with a company to influence its behaviour and create an improved ESG outcome. These data enable the Manager Oversight team to assess the effectiveness of the manager's stewardship and ESG risk management on an ongoing basis.

Principle 8

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

Asset owner

Please see the process section under Principle 2, which explains our monitoring of investment performance and manager due diligence.

<u>Example</u>

The asset owner has changed the manager of its active Asia ex Japan equity mandates following regular due diligence processes that flagged a number of concerns. Chief among these concerns was a deterioration in investment performance. In addition, significant personnel changes contributed to the view that the team would not be able to generate positive outcomes on a forward looking basis. The Manager Oversight team led the search and appointment for a new manager that would be able to deliver the desired level of investment performance.

Principle 9

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

Asset owner

To fulfil our fiduciary and stewardship duties to all our customers, we believe it is our responsibility, as a long-term investor, to work closely with asset managers that engage effectively with investee companies. Details of how the asset owner engages with investee companies can be found in our Shareholder Engagement Policy (https://www.pru.co.uk/srdii/).

The Shareholder Rights Directive II (SRD II) establishes specific requirements to encourage shareholder engagement and it is the asset owner's responsibility to work closely with our asset managers that engage with investee companies. As part of this responsibility Manager Oversight review our funds on an annual basis to monitor and ensure that our underlying managers are aligned with the M&G asset owner ESG policy. This includes a review of engagement activity on our behalf as detailed below.

The Shareholder Rights Directive II annual review covers all equity managers of segregated and pooled accounts, using the following process:

1. Policies – Each manager is asked to share their firm's ESG and Shareholder Engagement policies, to allow Manager Oversight to check alignment with M&G's corresponding policies.

2. Voting Record – The voting record of the manager is requested alongside specific examples in order to gauge whether this aligns with expectations given the policies provided, as well as in comparison with other managers.

3. Engagement – As well as examples of voting, other examples of engagement by the manager are requested and reviewed to determine if the manager implements its own Policy in a robust and consistent manner and to understand how this aligns with the M&G asset owner ESG policy. The managers are also asked how they interact with other stakeholders and how they manage conflicts of interest in connection with engagement activities, including if any conflicts have arisen over the last 12 months. In addition, Manager Oversight requests detail regarding the use of proxies and stock lending, and their associated policies where appropriate.

4. Incentivisation – Each manager is asked to disclose their remuneration policy regarding fund managers, to assess whether the link between pay and performance means managers are appropriately incentivised.

Example

Key findings of the 2020 Shareholder Rights Directive II review showed that responses of the 30 managers in scope were generally aligned with expectations. As a result, the majority of ratings were either '2 – Positive' or '3 – Neutral' at an overall level.

There was a large variance in the level of detail provided regarding the ESG and Shareholder Engagement Policies of in scope firms. In general, managers which provided less information were rated neutrally, as there was insufficient information to support a more positive view at this time. Voting engagement tended to be very high, with few managers falling below a threshold of 85% participation of eligible votes. As a result most managers scored very highly in this area. Given that this is an annual process, we will continue to review alignment with the Asset Owner Shareholder Engagement policy; through this we will build our view of in scope managers over time, ensuring that they continue to comply.

Manager Oversight will repeat the Shareholder Rights Directive II review annually, in order to ensure alignment with the M&G asset owner Shareholder Engagement policy, as well as ensuring that the managers that we have appointed to manage assets on our behalf are doing the same. Manager Oversight will also conduct a similar review of alignment of our managers with the M&G Asset Owner ESG Policy.

Key learnings from the 2020 Shareholder Rights Directive II review included:

- Proxy advisers: In order to form a stronger view regarding the use of proxy advisers, Manager Oversight intend to give managers further opportunity to elaborate as to why they do/ do not use proxy advisers, and how they are used.
- Portfolio Turnover: Manager Oversight will include the opportunity for managers to explain the reasons for changes in turnover rates over time, rather than just stated figures
- Consistency of answers: There were large disparities in the way in which managers answered the questions e.g. some responses were a few sentences, some a few pages. Manager Oversight intend to suggest a word count for questions. This

may act to make responses more consistent as well as streamlining the longer answers which were less concise and less relevant to the question in places.

On an ongoing basis, Manager Oversight will incorporate the key aspects of the Shareholder Rights Directive into our annual due diligence with our managers, and are considering how to assess this on an ongoing basis. For example, we are likely to request key updates regarding shareholder engagement on our behalf at our quarterly meetings. Alongside Shareholder Engagement, ESG and PRA requirements, there is a further requirement to gather more granular data on voting and engagement and as a result a robust and consolidated process is being developed to support these requirements.

On rare occasions, the asset owner may engage with investee companies alongside the relevant asset manager, if deemed appropriate, on issues of note.

Principle 10

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

Asset owner

As stated in Principle 9, to fulfil our fiduciary and stewardship duties to all our customers, we believe it is our responsibility, as a long-term investor, to work closely with asset managers that engage effectively with investee companies. This includes undertaking collective engagements where appropriate.

The asset owner's approach to engagement is to delegate this responsibility to our underlying managers, and to assess engagement activities on an ongoing basis to ensure they exercise stewardship in line with our requirements. Whilst we do not expect engagement in all cases, we expect our underlying managers to exercise their position as active owners where possible.

<u>Example</u>

The asset owner invests in a number of Chinese companies, including large state-owned power companies that both mine and generate electricity using coal. One of these companies is both a heavy user of coal and a large investor in renewable projects. The company has communicated its intention to add no net coal power generation (i.e. it will close older, more polluting coal plants as it opens any new plants). Whilst the company has not publicly expressed any intention to do so, the investment case rests on a belief that the company will exit its coal assets sooner than required by the Chinese government.

Although the company's opening of new plants would normally meet the standard for a portfolio exclusion, its status as a major investor in renewables was seen to mitigate this. Therefore a proposed exception to exclusion was made, monitoring the company's coal capacity and with request for further information as to the company's future energy mix and projected emissions. The exception is reviewed regularly, and no less frequently than annually.

Additionally, we welcome evidence of collective engagement from our underlying managers. Whilst not a requirement, we expect underlying managers to aim to maximise the impact of their engagement activities to drive positive change, and we view collaboration to be an important element of this.

<u>Example</u>

Having undertaken engagement activity with a major UK oil company, and following the company's net zero strategy announcement, the asset manager requested clarity that its reported ambitions to become an integrated, sustainable energy company were viable, and that its overall strategy was in line with our investment expectations.

As part of an ongoing Climate Action 100+ engagement, the asset manager and other members of the collaborative engagement group met the company's chief executive and members of the management team.

The company's plan consists of three key elements: the company talked through the new strategy aimed at delivering on its net zero ambition; a clear financial framework balancing financial hurdles with its sustainability strategy; and a new investor proposition – focusing on how the company will pay distributions and deliver sustainable returns.

The company described the strategy as significantly informed and improved by engagement with investors, notably CA100+. It also noted the CA100+ group's public statement of support after the net zero announcement was much appreciated in getting support for its ambition. The *announcement also laid out the journey from 2020 to 2050, setting out 2030 milestones on how to create value along the way. The asset manager is supportive of the company's ambitious plans, although realise they are not without difficulties, and will continue to monitor its progress.*

Principle 11

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

Asset owner

The asset owner does not itself engage directly with investee companies, instead relying on our chosen asset managers. Our favoured approach to engaging with investee companies is active ownership practices such as shareholder voting, rather than restricting investment opportunities through exclusion.

We believe that active ownership in order to influence positive corporate behaviour is essential to generating long-term investment performance for our customers. We therefore appoint asset managers that positively influence corporate behaviour where appropriate. Any escalation of stewardship activities is done through the relevant asset managers, which we= rely upon to carry out engagement activities on our behalf.

On rare occasions, the asset owner may work closely with the relevant asset manager to exert influence on a particular issuer to elicit a desired behaviour. This is done only where deemed appropriate and where we believe the action is likely to succeed.

Example

In 2021, the asset owner worked with the asset manager to publish an open letter (together with other asset owners and asset managers) calling on a large UK services company to review its provision of free school meals. Due to the covid 19 pandemic, many schools have contracted with specialist caterers to provide meals to children learning at home, who would normally have received them at school. Some of these meals were found to be inadequate. The open letter called upon the services company to review its provision of school meals to ensure that they contained sufficient food of adequate quality in a timely fashion. The letter was issued 24 hours after the news about inadequate school meals came to light on social media.

The company responded positively and committed to reviewing its processes, in order to meet the provision requirements. We believe that the swift engagement taken was key to eliciting this response, and would not have been possible without the asset owner working closely with the asset manager.

Principle 12

'Signatories actively exercise their rights and responsibilities'

Asset owner

As stated in Principle 11, the asset owner does not itself engage directly with investee companies, instead relying on our chosen asset managers. Our favoured approach to engaging with investee companies is active ownership practices such as shareholder voting, rather than restricting investment opportunities through exclusion. We believe that active ownership in order to influence positive corporate behaviour is essential to generating long term investment performance for our customers. We therefore appoint asset managers that positively influence corporate behaviour where appropriate.

Example

The level of active engagement of our underlying managers is monitored formally on an annual basis. In the 2020 annual review we noted that voting engagement tended to be very high, with only two managers falling below a threshold of 85% participation of eligible votes, resulting most managers scoring very highly in this area. In the two cases which fell below the threshold, we acted as an Asset Owner to follow up with these managers to understand the reasoning for the low score. Through these interactions, the Asset Owner will continue to engage with these managers in the hope to influence their behaviours and improve their record above 85% in the future. Details of these engagements are included below:

- *Manager 1 (53%) – Manager Oversight have followed up with the manager to gain additional insight regarding the rationale for this low engagement presence or if it is the result of a data error. Discussions will continue with Manager 1 to identify the reason for their low voting record and discuss any plans to increase the participation rate if relevant.*

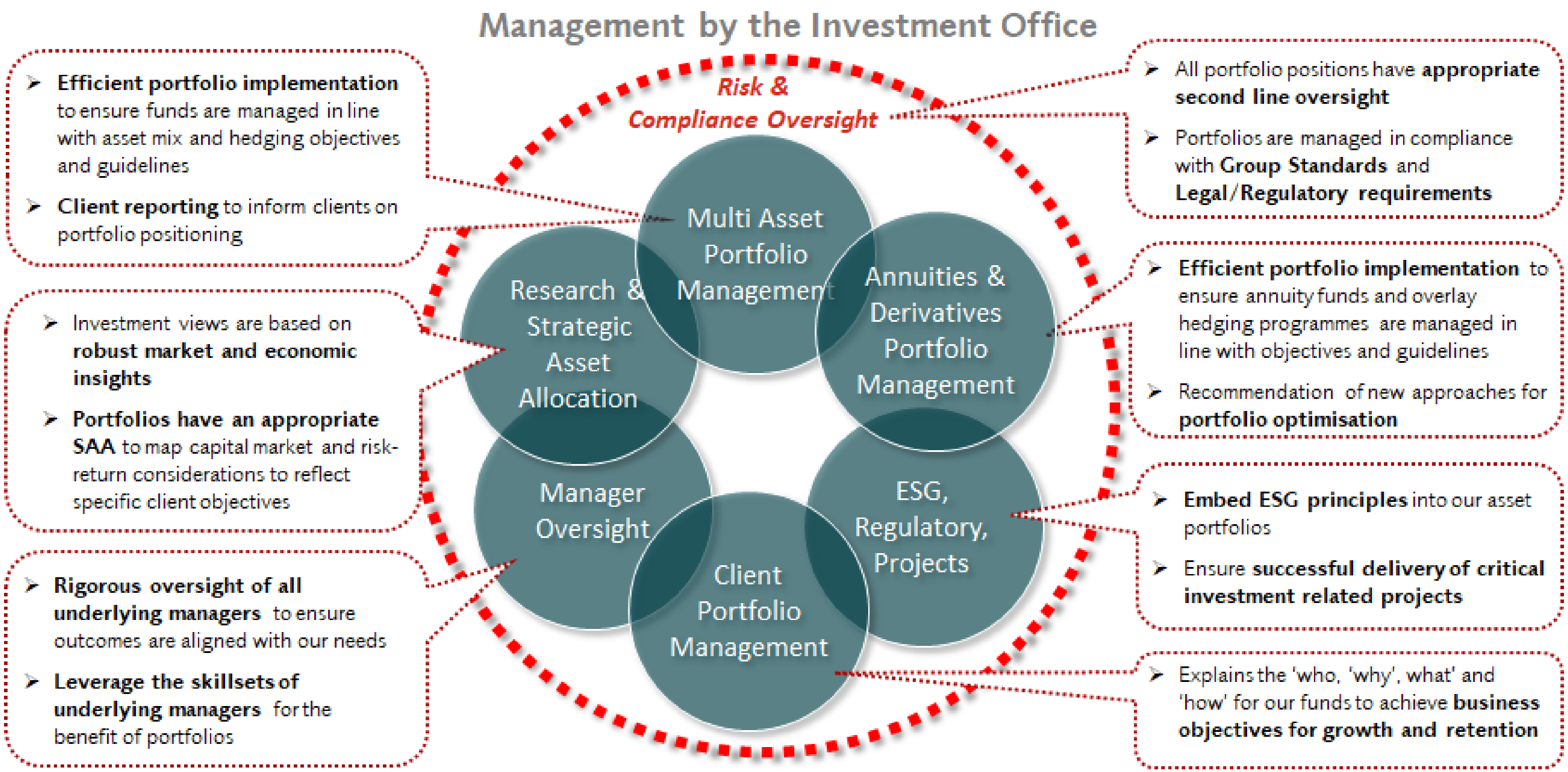
Manager 2 (59%) – This manager has clarified that it currently votes on all active UK and International and passive UK holdings. Since they do not vote on International passive holdings unless they are also held actively, the majority of the eligible votes that were not cast fell in this category. Manager 2 has advised that it is currently assessing how to vote on these International holdings which are held only passively. Discussions will continue with this manager to identify when action will be taken to improve their voting record as their approach is not in line with our asset owner Shareholder Engagement policy.

Appendix 1: M&G plc Asset Owner Investment Beliefs

Long-term approach	Diversification	Active Management	Importance of value and asset valuation	Illiquidity and complexity premium	Harvesting a credit risk premium	Evolving asset mix and new asset classes	Importance of ESG factors and risks
Offers availability of a broader investment set, looks through short-term volatility and has the flexibility to cater for the investment time horizon and liquidity requirements of specific funds	Combining different assets in a portfolio to improve an investors' risk-adjusted return, limit impact of volatility and increases the probability of an investor achieving their investment objective	Our belief in active management is dependent on the characteristics of each asset class and our manager selection skills	Valuation of an asset remains an important consideration in determining the risks and returns which we can achieve by investing in that asset	Less liquid or more complex assets should help to enhance overall returns and/or diversification in a multi-asset portfolio with a long-term horizon	The concept of a credit risk premium intuitively explains that investors are rewarded for bearing the risk that the issuer of debt may at some point default on its obligations	As part of our Strategic Asset Allocation, we review and update our asset allocations on a regular basis and respond to structural changes in the market	ESG factors influence customer outcomes in many ways. Management of ESG risks is crucial to achieving good investment returns

M&G

Appendix 2: Organisation Structure and Component Teams of Treasury & Investment Office



Appendix 3: Market and systemic risks

Climate change	Climate change is arguably the most pressing issue facing the industry, with the potential to remain so over the coming years and decades. As such, we have carried out work both independent of and in response to regulatory requirements, including: 1. Using academically established climate scenarios to inform and develop economic and capital market impacts of climate change. 2. Assessing our exposure to climate change: taking account of the polluting and green holdings we have in our portfolios, and the potential for pricing shocks to particular asset classes and sectors. 3. Investing in the solution, i.e. projects that support a carbon-neutral global economy or a transition to one. 4. Progression in embedding risks related to climate change into the entire investment process, from strategy and asset allocation setting, through to benchmark setting and manager selection. The asset owner is subject to the PRA's Climate Biennial Exploratory Scenario (CBES) exercise, which seeks to understand participants' exposure to climate change risk. The 2019 CBES applied valuation shocks to assets by sector and asset class (equity, credit or property), with shocks dependent on exposure to transition and physical climate risk under three scenarios: business as usual (no action), an orderly transition and a disorderly transition. The 2021 CBES is more ambitious, and requires participants to ask a sample of investee companies to outline their plans to address climate risk, and for the impact of the three scenarios on their businesses and balance sheets. CBES participants are then required to compile this data, translate this into valuation shocks and extrapolate these across the asset book in order to assess the total impact on their own balance sheets. It is expected that PRA requirements will evolve as both data and company awareness of risks associated with climate change improve, which will help us further our own understanding so that we may mitigate and adapt to the systemic risk posed by climate change.

Appendix 4: Asset owner funds under management split by asset class

(£bn)	With Profits	Unit Linked	Shareholder assets (including annuities)	Total
Equity Securities	65	11	-	76
Debt Securities	43	3	20	66
Loans	2		2	4
Deposits	13	1	1	16
Net derivative assets	3	-	(0)	2
Investment property	12	0	2	14
Reinsurance assets	-	0	12	12
Cash and Cash equivalents	4	0	1	6
Other	1	0	0	1
Total	**143**	**16**	**38**	**198**
Other assets under administration				19
Total assets under management and administration				**217**

Totals in the table may not sum as a result of rounding