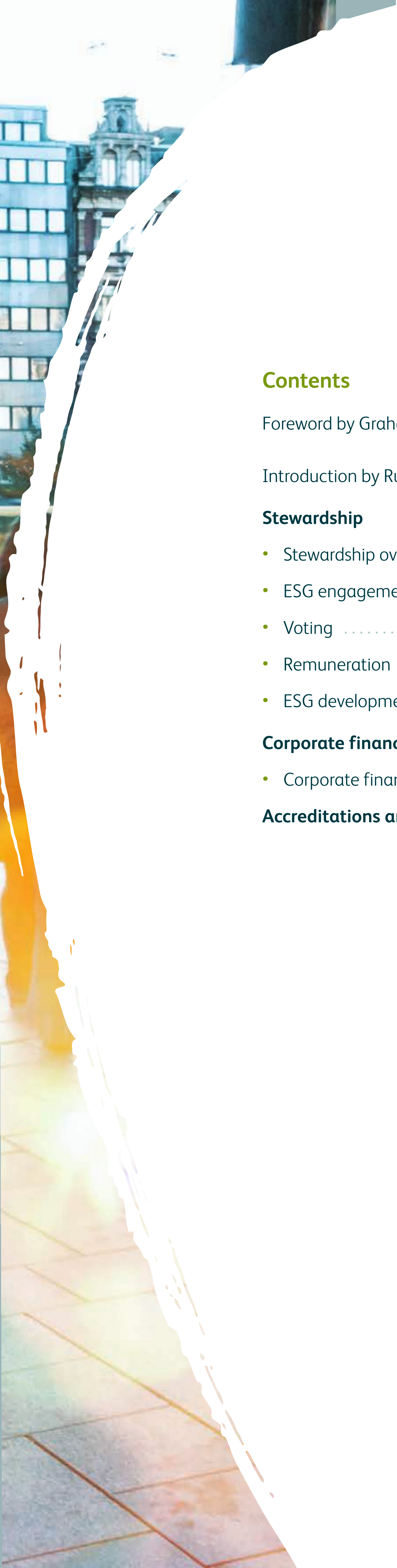
For Investment Professionals only

M&G INVESTMENTS

Corporate Finance and Stewardship Report 2018

Responsible Investing



Contents

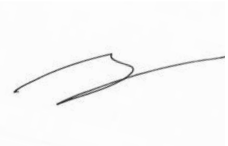
Foreword

At M&G we are, first and foremost, stewards of our customers' assets, and we take seriously the responsibilities that come with this role. Our responsible approach to investment management is long-term, and we encourage all our investment professionals to think creatively, act with conviction and work collaboratively to meet our customers' changing needs.

Today we manage the long-term savings of millions of people across Europe, Asia and the Americas. Our customers include individual investors and savers and a wide variety of institutional investors, including pension schemes, life insurance providers and global banks. Meeting the expectations of this diverse client base means sticking to our principles; taking a responsible, active and long-term approach, which considers all the relevant financial and non-financial elements of our investments.

In this vein, we encourage responsible practices in our investee companies through active engagement with company management, while using our votes to protect the interests of our customers as shareholders. Working closely with management of the companies in which we invest helps to ensure they are delivering the best possible long-term, risk-adjusted returns. This includes considering the environmental, social and governance (ESG) practices of those companies, where these issues can represent material long-term risks and opportunities.

Our customers, meanwhile, want to know what our responsible approach means in practice; how ESG factors are being considered, how we are voting on their behalf and what our company engagements actually entail. In that regard, this report provides an overview of the activities we have carried out over the past year, and demonstrates how we use our position as long-term, active investors to promote good practices at our investee companies. I hope you find it informative.



Graham Mason
Chief Investment Officer

Introduction

Welcome to M&G's Annual Corporate Finance and Stewardship Report for the year ended 31 December 2018.

Our team's two overriding objectives for the year were to help increase M&G's profile as an active fund manager and to continue our journey of integrating ESG (environmental, social and governance) into our investment processes. Little did we know at the start of the year that M&G would be involved in two high-profile examples of active ownership that were both extensively covered in the media, with both Aviva attempting to redeem its irredeemable preference shares at par and then Unilever trying to simplify its business and retreat to the Netherlands. In both cases we were able to demonstrate that, by being active and standing up to the boards of investee companies, we can protect the interests of our clients as shareholders.

On ESG, we have made strides in helping our fund managers to ask more searching 'E' and 'S' questions, while the heads of both fixed income and equity research have committed to devising M&G's own proprietary ESG scorecard for all our investee companies. This is still in the development phase but demonstrates how much progress we have made in mindset. As a client recently reported to us: 'ESG is no longer a nice to have – it is a licence to play.'

Other clear priorities for the coming year include staff training, to ensure everyone who works at M&G understands our role as a responsible investor, and working collaboratively through ESG-focused committees, to make sure all our business units are aligned in their ESG practices and that new products are fit for purpose. We will also be exploring more deeply some of the ESG-related challenges the world is facing, from single-use plastics to anti-microbial resistance, publishing our thoughts on what investors need to consider around these pressing issues.

Of course, arguably, the most pressing issue any of us face is climate change, and the publication of the Intergovernmental Panel on Climate Change (IPCC) report, COP24 in Poland and even melting arctic ice blocks outside the offices of Bloomberg have all helped to garner much needed press attention on the topic, reminding us that action is needed now if we are to limit the effects of climate change. Along those lines, we at M&G have started looking at the carbon footprint of our portfolios and have joined the United Nations Environment Programme Finance Initiative (UNEP FI) pilot scenario analysis tool so that we can start analysing the climate risks to our portfolios.

In this report we detail some of the actions and initiatives that M&G has been involved in over the past year, offer case studies of our voting and engagement activities and provide examples of our interactions with external parties. I hope that you enjoy reading this report and that it gives you a better insight into M&G as a responsible investor.

Rupert Krefting

Rupert Krefting
Head of Corporate Finance and Stewardship

Stewardship overview

M&G's Corporate Finance and Stewardship team supports our equity investment teams on a range of issues that can affect our investments over the long term, and works collaboratively with other investors across our wholesale and institutional business.

The team coordinates M&G's Stewardship activities, engaging with companies on a number of issues from corporate governance to environmental sustainability, alongside the investment teams. Closely linked to this engagement work, the team undertakes M&G's voting responsibilities at shareholder meetings, which we see as one of our central responsibilities as long-term shareholders.

The team is responsible for coordinating M&G's participation in various external initiatives and investor collaborations, including the UK's Investment Association, the Investor Forum, the Institutional Investors Group on Climate Change and the Asian Corporate Governance Association, among others. The team also supports M&G's Responsible Investment Advisory Forum in maintaining our relationship with responsible investment-oriented organisations, in particular the UN-backed Principles for Responsible Investment (UNPRI).

Across our business, M&G's investment teams are increasingly incorporating environmental, social and governance (ESG) considerations into their decision-making and active-ownership practices. This approach is strongly aligned with M&G's longstanding principles as an active, fundamentals-focused investor. ESG incorporation is also a growing focus for the wider financial industry and our customers, as well as for governments and regulators.

During the course of 2018, the Corporate Finance and Stewardship team built on the support provided to the investment teams in relation to ESG research and analysis, helping to ensure that all of the relevant risks and opportunities associated with a company, or the sector in which it operates, are acknowledged and understood. We have continued to improve the availability of information for clients on our stewardship activities, and remain committed to the ongoing evolution of our processes to ensure companies are held to account, and to effectively communicate our activities.

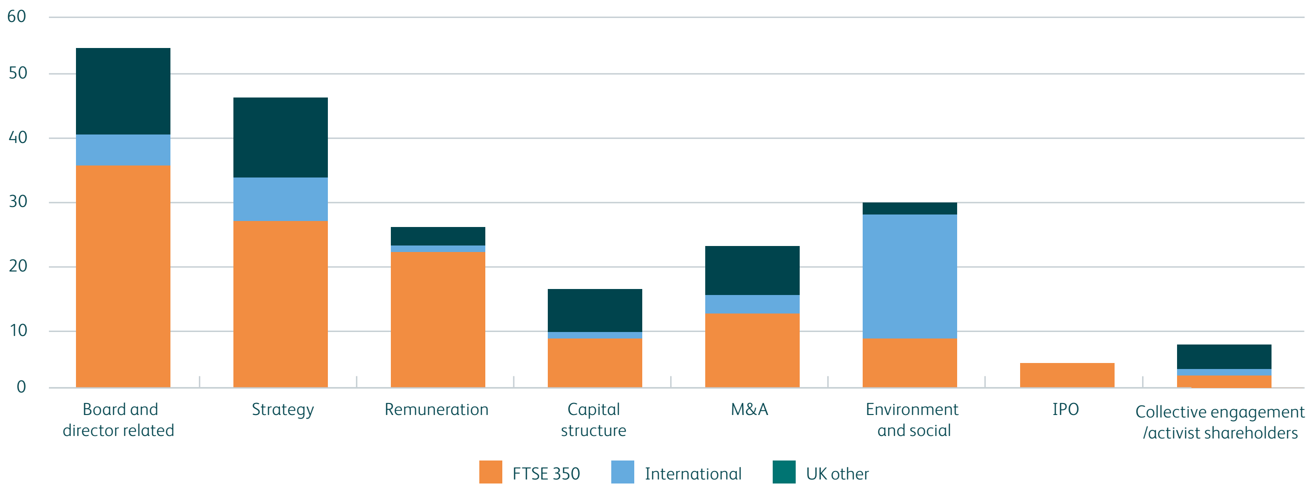
ESG engagement

In 2018, M&G attended 1,403 meetings, of which 623 were with the management of UK companies (including 403 meetings with companies in the FTSE 350) and 780 international companies. The M&G Corporate Finance and Stewardship team had 208 additional meetings with company chairmen and/or directors and/or executives, including 115 with FTSE 350 companies and 38 with international companies, as highlighted in the graph below.

Our fund managers believe that the long-term success of companies is supported by effective investor stewardship and high standards of corporate governance. We believe that if a company is run well, it is more likely to be successful in the long term. Social and environmental issues can also have an important impact on company performance. Well-managed companies take these issues into consideration as part of their successful development.

The Corporate Finance and Stewardship team coordinates M&G's Stewardship activities, fulfilling this role on behalf of our clients across different markets. This involves engaging with investee companies, alongside the investment teams, on issues including board composition, strategy, culture, capital allocation, executive remuneration, mergers and acquisitions and social and environmental responsibility.

Engagement activity by issues covered



Engagement Framework

In terms of reporting, M&G has historically used case studies as a means of outlining our stewardship activities. This approach has now been developed to demonstrate the systematic process around engagements in which we have a specific objective and seek particular outcomes. Prior to commencing the engagement that objective is clearly set out, then actions and outcomes are recorded through the life of the engagement. Examples of some of these engagements in 2018 are outlined below.

Aviva – Capital structure

Issue: In the first quarter of 2018, Aviva published its preliminary results and, for the first time, announced that it could cancel its irredeemable preference shares at par, saving the company significant amounts of interest payments. The preference share prices fell around 30% following the announcement.

Objective: To regain our customers' lost value in the two classes of preference shares that M&G owns by persuading Aviva not to undertake a capital reduction at par. We also sought to get the company to change its Articles of Association so in future any cancellation is only done with the permission of the preference shareholders (and not all of the ordinary shareholders).

Action: We, along with other investors, undertook a collective engagement with Aviva's chairman.

Outcome: Aviva announced that it would not cancel its preference shares – the different classes of preference shares subsequently recovered between 14% and 24% in value. In addition, any investors who suffered a loss by selling the preference shares immediately after the announcement were recompensed by Aviva, which was estimated by Aviva to be £30 million of compensation. The campaign to change the Articles of Association continues.

Background: Insurer Aviva's actions triggered a collective engagement led by M&G on behalf of M&G, Invesco, GAM and Edentree, who in total hold 29% of the preference shares and over 6% of the ordinary shares. A collective meeting with the chairman of Aviva, which M&G chaired, followed, and then a second letter on behalf of the same group was sent, with BlackRock and LGIM joining. Aviva subsequently announced that it would not cancel the preference shares, which was a very positive result, but we then sent further correspondence requesting the company publicly clarify that any vote on the redemption of the irredeemable preference shares would require the separate consent of the holders of the preference shares, and that the company should change its Articles of Association to reflect that. The chairman felt that no further action was necessary, but we will continue to campaign for the change.

Unilever –Corporate structure

Issue: We became concerned with consumer giant Unilever after the company announced its intention to move from a dual corporate structure to a single structure, based in the Netherlands. As a result, Unilever would drop out of the FTSE 100 and cause a number of M&G funds to become forced sellers, with a subsequent capital gains tax bill for some of our customers.

Objective: To persuade the board of Unilever to abandon its attempt to unify the company and, as a result, remain in the FTSE 100 so that relevant M&G funds could retain their shareholding in the business.

Action: When news of Unilever's plans initially leaked in the first quarter of 2018 we wrote to the chairman, voicing our concern that the company would no longer be bound by the rules of the Takeover Panel and would be moving into a more protectionist environment. We spoke with the chairman upon the announcement of plans in March 2018 and additionally voiced our objection to Unilever risking leaving the FTSE 100. In late Q3, having made our views public to the media, we subsequently met with the company's chairman and CFO and communicated that we were not convinced by the main stated benefit of unification. The benefit, said Unilever, was to enable the company to make large scale M&A, involving either a demerger or an acquisition, easier to execute. We encouraged other shareholders to make their views public and engaged with the Investor Forum to rally support from its members.

Outcome: Unilever eventually abandoned the unification proposal, which we see as a success for the UK shareholder base. We have subsequently met with the chairman to discuss next steps.

Background: Having expressed our concerns to Unilever, the company reassured us that by getting rid of its Trust Office and preference shares, which had super voting rights relative to ordinary shares, these were clear signs that the company was not trying to create a poison pill. Nonetheless, concerns regarding the future uncertainty surrounding Dutch laws remained.

We gained greater clarity in the third quarter when Unilever distributed its shareholder circular. This confirmed that the company would drop out of the FTSE 100 and, for some funds, M&G would be a forced seller with a capital gains tax liability. There was also the uncertainty that the exemption for Dutch withholding tax would not get passed through the Dutch coalition government in December.

Gibson Energy – Strategy

Issue: We believed that Gibson Energy was too diversified and, in our assessment, needed to undertake a strategic review and restructure its portfolio of assets by selling non-core businesses and becoming more focused on infrastructure.

Objective: To persuade the company to divest its non-core activities and thus gain a subsequent rerating of its shares, as a result of becoming a pure infrastructure company with high-quality recurring cashflows.

Action: Having commenced our engagement in 2017, M&G continued to engage with the company throughout 2018.

Outcome: A new CEO was appointed in the second half of 2017 who commenced a strategic review and announced the sale of several non-core businesses, including the US Environmental Services business, the Canadian trucking business and other smaller business units. The divestment programme is expected to be completed in Q2 2019.

Background: In 2017, M&G published a public letter discussing our view of oil & gas integrated service provider Gibson Energy, outlining specific measures it should take to improve the business and requesting that the company undertakes a strategic review of all options to maximise value. The letter was the culmination of a long-term private dialogue between us and both the chairman and the board of directors (whom we had visited and presented to earlier in the year). We had concerns about executive management, and some of the strategic decisions that had been made, since its IPO, and believed that the company had been too slow to respond to our concerns. We have a strong preference for keeping our views private, but in this case the size of our position and the strength of our view led us to publish the letter. Gibson subsequently published a reply, and we closely monitored the company's actions to see whether it was changing its behaviour.

In 2018 M&G continued its engagement with the company, having a number of discussions with the board and management team. During Q1 2018, Gibson announced progress on a key step that we had been encouraging – the disposal of part of its US Environmental Services business. This business area has, in our view, contributed to the company trading on a low valuation relative to peers, and we are hopeful that this will trigger a positive revaluation of the company's prospects.

Vectura – Corporate structure

Issue: Need for board refreshment.

Objective: To reiterate our view that board refreshment was required, particularly following the 2018 AGM where 41% of shareholders voted against the remuneration report and 21% voted against the remuneration committee chair.

Action: Separate meetings with the chairman and the remuneration committee chairman to stress our views.

Outcome: One non-executive director retired and two new appointments were made. The company is currently reviewing its remuneration policy.

Background: We contacted the pharmaceutical company in 2017 to indicate that, while supportive at the 2017 AGM, we would not be supportive of the re-election of two directors who had both been on the board for 11 years. We subsequently voted against their re-election.

HSBC – ESG

Objective: To understand the current strategy to tackle financial crime and HSBC commitment to sustainable finance.

Action: Separate meetings with the CEO, head of sustainable finance and head of compliance.

Desired outcome: Engagement ongoing, better understanding of how company is tackling financial crime, individual country head managers now have remuneration linked to success in avoiding incidences of financial crime.

Background: We engaged with banking group HSBC on several ESG issues through 2018. These included how HSBC integrates ESG factors into its products and services, its sustainable finance strategy and its US$100 billion commitment to sustainable financing investments. We also met with the bank to discuss how it was tackling serious issues relating to money laundering and financial crime. In particular, we discussed investment to fight financial crime and the challenges of dealing with such crime when running a global organisation, as well as its information-sharing regimes. One interesting observation was that country head CEOs' remuneration is directly linked to the successful mitigation of financial crime in their respective regions.

Britvic – ESG

Objective: To understand company commitments to reduce single-use plastic, source recycled PET (rPET) and establish board oversight on environmental targets.

Action: Separate meetings with head of sustainability and CEO.

Desired outcome: Board oversight linked to remuneration.

Background: We met with the head of sustainability to understand soft drinks maker Britvic's strategy to reduce single-use plastic, improve recyclability of products, deliver innovation and demonstrate governance. We commended the company on its disclosure to date and gave feedback on the importance of its alignment with TCFD (Task Force on Climate-related Financial Disclosures) and CDP (Carbon Disclosure Project) disclosure. As a leading soft drinks business with operations in the UK, Ireland, France and Brazil, the company has committed to 2025 targets by signing up to the UK Plastics Pact. These commitments to eliminate problematic or unnecessary single-use plastic ensure: 100% of plastic packaging is designed and manufactured to be reusable, recyclable or compostable; 70% of plastic packaging is effectively recycled or composted by the consumer; and that the company sources 30% average recycled content across all plastic packaging. These are ambitious targets; however, they lack board ownership and supervision. We have tabled this for discussion at our next meeting with the CEO.

Other engagements

Royal Dutch Shell – ESG

Prompted by the 'Follow This' shareholder resolution for the 2018 AGM in May calling for Royal Dutch Shell to set clearer targets for carbon emissions reduction in line with the Paris Climate Agreement, we invested a significant amount of time considering the resolution, its validity and implications for investors. To build our understanding of what we considered a systemically important issue, we conducted one of our most extensive engagement efforts to date on an environmental matter. This involved engaging with Shell's board and senior management, discussing the topic with numerous other shareholders (individually and through our membership of industry bodies such as the IA, PRI and IIGCC), and seeking the perspective of other stakeholders, including responsible investment advocates ShareAction and Follow This, who together tabled the resolution.

We generally seek to arrive at a consensus voting decision across all funds that hold shares in a particular company, but given our recognition of the varied perspectives of our clients, in this case we elected to split our votes, with some funds voting for the shareholder resolutions and others voting in support of management. Importantly, we decided to follow up with a structured engagement programme with Shell, and also with other oil & gas companies, to ensure they are preparing effectively for the transition to a more sustainable, lower carbon economy.

In Q4 2018, the company announced in a joint statement with institutional investors on behalf of the Climate Action 100+ initiative, a collaborate engagement initiative of which M&G is a member, the linking of remuneration to the new targets for reducing the company's carbon footprint. The outcome highlights the value of collaborative engagement on this crucial issue, setting a benchmark for the rest of the oil & gas industry.

Samsung – governance

We held discussions with Korean firm Samsung Electronics, and a number of stakeholders, pushing for improved board governance around the company's corporate donations policy, which some ESG agencies have flagged as insufficiently robust. This follows a major bribery scandal in South Korea, in which a Samsung board member was implicated. We discussed next steps with the Asian Corporate Governance Association and other investors and continued to monitor the situation closely. While we remain concerned, we have been encouraged by significant improvements at Samsung related to shareholder returns policies and board independence and diversity. These included separating the chairman and CEO role and setting up a dedicated corporate governance committee, headed by a well-regarded (independent) professor. At country-level, South Korea is implementing stewardship and corporate governance codes, which we see as strong indicators of improving governance standards and attitudes to shareholders.

NTPC – climate change and low-carbon transition

We met with the management team of Indian power utility NTPC, which highlighted the challenges investors face when considering how to address climate change issues in different regions. NTPC is India's largest power utility (62% owned by the state) in a country which is developing at pace but relies on coal for the significant majority of its fast-growing electricity needs. NTPC has a stated intention of driving India's energy transition, as it transforms itself into the country's largest renewable power producer. We discussed efforts to improve the efficiency of current power generation, including a major ongoing process of retrofitting existing power plants to meet new norms. The board has a goal of 30% renewables generation by 2032, including targeting 10 GW of new solar capacity in the next five years, and we continue to see the company as a crucial participant in India's long-term low-carbon transition.

Microsoft – ESG

M&G hosted an ESG meeting with tech company Microsoft's chief environmental officer to discuss the environmental strategy led by the company's internal carbon pricing model. Microsoft is a pioneer in implementing an internal carbon fee that actually charges business units for their emissions (other companies use 'shadow' carbon pricing). Microsoft stated that sustainability was front-and-centre of the business and core to everything it does. It has made significant investment in its Artificial Intelligence For Earth (AI4E) project and has in place strategies to reduce emissions from data centres and policies on cobalt sourcing, among others.

As a follow-up to this meeting, we were invited to join an investor call to discuss raw material sourcing with specific guidance from the OECD and UN Principles on Human Rights. The key materials are cobalt, magnesium, aluminium and copper. On questioning, Microsoft stated that the biggest driver behind this raw material disclosure was the increasing focus by large investors who have specifically questioned its cobalt sourcing (and a related Amnesty International report, which we had also raised in our meeting).

Voting

Alongside engagement with investee companies, active voting is an integral part of our investment approach. We believe exercising our vote adds value and protects the interests of our clients as shareholders.

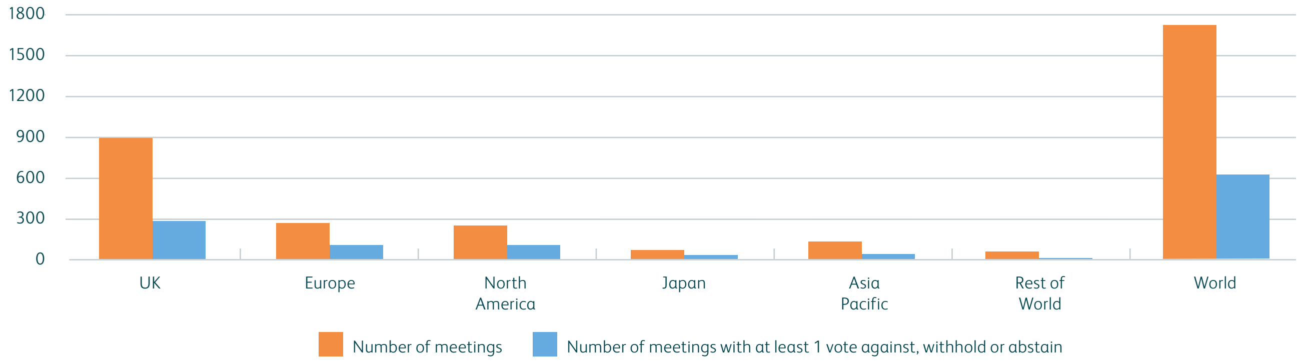
We often get asked by clients how we carry out our voting, as a number of asset managers just follow their proxy agent's advice. We use the ISS voting platform to vote and we have built, with ISS, a custom voting service that reflects our public voting policy. As company meetings arise, we use research from ISS (and voting information service IVIS for UK companies) to highlight any contentious issues that we were not aware of from previous consultations with investee companies.

Before deciding to abstain or vote against a resolution that has been flagged, we will either discuss straightforward issues within the stewardship team or involve the relevant fund managers for more contentious issues, allowing them to make the ultimate decision. We will, where possible, try to inform the company in advance if we are voting against. In most circumstances, especially on remuneration-related issues, there will have been a previous dialogue with the company.

Our starting position is to be supportive of the management of companies in which we invest. However, there are occasions when company boards put forward resolutions that we feel are not in the best interests of the company. Here we highlight some of our voting decisions taken during the year.

In 2018, M&G voted at 1,722 meetings, and at 632 meetings M&G voted against at least one resolution.

Meetings where at least one recommendation was not supported



Votes cast as against, abstain or withhold by category and region

	UK	Europe	North America	Japan	Asia Pacific	Rest of World
Directors-related	12%	29%	41%	84%	16%	55%
Remuneration	11%	26%	5%	7%	11%	31%
Capital-related	73%	28%	1%	0%	65%	8%
Corporate activity	1%	0%	0%	1%	1%	0%
Anti-takeover	0%	3%	3%	1%	0%	0%
Routine other business	3%	13%	1%	0%	7%	6%
Shareholder resolutions	0%	0%	49%	6%	0%	0%
	100%	100%	100%	100%	100%	100%

UK

The majority of our votes against management in the UK related to our policy that larger companies should not seek more than 5% disapplication of pre-emption rights, which we believe risks excessive dilution for existing shareholders.

Remuneration has remained under the spotlight. We opposed the remuneration reports and policies at a number of UK companies, most notably house builder Persimmon, advertising firm WPP, Hochschild Mining, publisher Informa, self-storage facilities provider Safestore and tobacco business Imperial Brands. Elsewhere, we opposed the remuneration report at property business Town Centre Securities where disclosure, salary increases and incentive outcomes were a concern.

On several occasions we opposed a director's re-election. At polymer manufacturer Victrex, we considered it untenable for a non-executive to continue as a member of the audit committee, in light of his position relating to the downfall of Carillion. At Safestore we opposed the non-executive who chaired the remuneration committee over concerns about the remuneration policy. Long tenure caused us to oppose a director at investment business Temple Bar, while at the AGM of diagnostics business Blancco Technology Group, we again abstained on the re-election of directors due to our concerns over corporate governance. Disappointment with the performance of publishing firm Wilmington, meanwhile, led to the decision to abstain from voting on the re-election of the chief executive. He subsequently stepped down from this role.

It is very rare for M&G managers to vote differently across funds on the same resolutions but, despite exhaustive discussions, a common voting stance could not be agreed in respect of the shareholder resolution at the Royal Dutch Shell AGM (see engagement section above) and hence some funds voted differently.

Related to voting on UK companies, the latest edition of the UK Corporate Governance Code was published with the aim of encouraging companies to consider other stakeholders as well as shareholders.

There are also plans to publish a revised UK Stewardship Code, with consultation expected to open in January 2019. There are now 17 different national Stewardship Codes around the world. The UK Stewardship Code had been seen as the leader, but is now, in some people's eyes, behind countries such as Australia and Japan, which make specific mention of ESG. Instead of just focusing on equity and asset managers, it is thought that the new code should include all the participants in the investment chain, such as asset owners and proxy advisors, and also to extend to other asset classes such as fixed income and real estate.

Europe

European companies vary widely in corporate governance standards and this has been reflected in our voting; we voted against management on resolutions relating to capital, remuneration and directors in similar proportion. Typical issues include pre-emption rights, disclosure, and non-independent directors.

We were unable to support a number of resolutions relating to capital management, and we opposed two directors at medical device company Medtronic over concerns relating to board independence. Board independence and extended board tenure at Swedish bank Svenska Handelsbanken caused us to oppose two directors there as well. Meanwhile, aerospace and automotive component maker Lisi was a cause for concern across a number of issues. As well as opposing resolutions relating to board independence, capital management and remuneration, we also opposed a resolution to amend the company's by-laws to facilitate payment of significantly enhanced dividends to shareholders who have been on the register for more than two years.

The German Government Commission opened a consultation in October for a new German Corporate Governance Code. This is due to be in place before the Shareholder Rights Directive becomes effective in June 2019. One of the objectives of the code is 'to make the German corporate governance system transparent and understandable'. This includes making the dual governance system – along with its institutional separation of management (Management Board) and supervision (Supervisory Board), as well as the co-determination in the Supervisory Board – understandable to international investors who are often less familiar with this system. In terms of the main changes, the new German Code is supplementing the 'comply or explain' approach by an 'apply and explain' approach for the new category of the principles.

North America

In North America, we did not support management across a range of issues, in particular board independence, but also including remuneration, shareholder rights and environmental performance. As a specific example, there was a shareholder meeting to approve the acquisition of healthcare services business LifePoint Health by Apollo Global Management, which included a resolution to approve golden parachutes for directors. The terms did not meet the standards we expect and so we opposed the resolution.

The issue of shareholder rights remains in focus for investors in US and Canadian companies, in particular relating to proxy access, shareholders' right to call meetings and voting methods. eBay sought ratification of its existing threshold for shareholders calling special meetings (as a way to prevent a shareholder resolution requiring a lower threshold). Shareholder resolutions also called for companies to consider and report on their environmental risks and political activities. Energy infrastructure company TransCanada was subject to a shareholder resolution requiring the board to report on how the company is assessing long-term risks and opportunities in relation to climate change and the current transition to a low-carbon economy. The board recommended voting in favour and we were happy to be supportive. The board of materials company Trinseo disappointed us with its apparent reluctance to engage with shareholders, and we felt it necessary to abstain on the re-election of the directors, as well as opposing the remuneration resolution.

A continuing concern for us is board structure and director independence, particularly when directors have been in service for long periods. The Trump administration, meanwhile, continues to make life uncomfortable for shareholders and their proxy advisers. New guidance issued by the US Securities and Exchange Commission is designed to make it easier for companies to exclude shareholder proposals.

Japan

In Japan, a major corporate governance concern is the practice of chairmen and chief executives becoming 'senior advisers' or 'sodanyaku', where they maintain significant influence but have no accountability to shareholders. We were very pleased to see Japan Tobacco propose a resolution to remove all such positions.

Japanese house builder Sanyo Housing Nagoya sought shareholder approval for the payment of retirement bonuses to directors. We consider these to be unnecessary and ex-gratia in nature and opposed the resolution.

There have been an increased number of shareholder resolutions in Japan and we supported motions to improve disclosure of directors' remuneration and to encourage companies to vote shareholdings they have in companies that form part of their corporate association group.

Pressure is mounting in Japan for corporate governance reform and there have been some significant changes in the corporate landscape. For example, the latest iteration of the Japan Corporate Governance Code was published in June.

Asia

Proxy season for Korea falls within Q1, and companies were reportedly struggling to ensure that quorums were met following the abolishment of shadow voting, whereby companies could request uninstructed shares registered with the Korea Securities Depositary to vote. At Samsung Electronics, there was concern around the re-election of a director in light of the scandal that resulted in vice chairman Lee Jae-yong being sentenced to five years in prison. We raised a number of points with the company and decided to vote in favour.

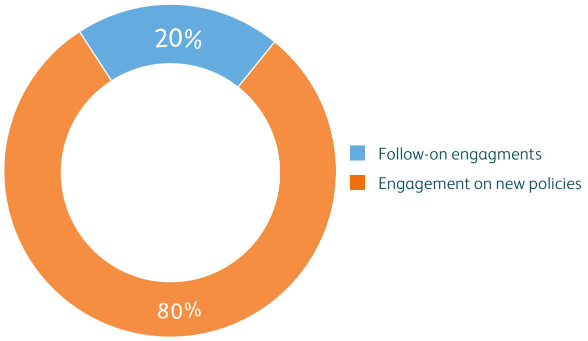
Corporate governance at Chinese companies will be affected by resolutions that create China Communist Party Committees, which 'will play a leadership role to set the right direction'.

Remuneration

The high level of consultation on remuneration matters continued during 2018, particularly in the UK, with intense focus on executive pay structures. M&G corresponded with 78 companies in 2018 in regard to new policies or changes to existing policies and with 20 companies in relation to follow-on correspondence initiated in 2017.

2018 also saw, at an industry level, a higher number of material votes against remuneration policies and remuneration reports than in the past. Some examples are highlighted below.

Remuneration engagements



Persimmon

Much was written in the press about house builder Persimmon's 2012 long-term incentive plan, 40% of which vested on 31 December 2017, delivering £99 million of value to three executive directors. The plan was originally intended to deliver over a timeframe to 2021 and was uncapped. As a result of these payments, the chairman and the remuneration committee chairman resigned.

The senior independent director and the new remuneration committee chairman then requested a meeting with M&G to discuss our views, the best course of action and possible options for reducing further payments. Following the meeting, we wrote to the senior independent director setting out our expectations. This included the requirement for a compromise to be reached with the executives, which delivered a material reduction on quantum and increased the timeframe for delivery. We informed him that, despite being supportive of the executive team, we were considering voting against the re-election of the executive directors in recognition of the unacceptability of the arrangements.

At the end of February, the company published an announcement providing details of the compromise reached with the executives. Under this, the executives voluntarily waived their entitlement to over £50 million, agreed an extension to the holding period and capped the value of the 60% second tranche. While still considering the overall plan excessive, we were supportive of the compromise agreed and remained supportive of the executive team. On that basis, we voted in favour of the re-election of the executives. However, in view of the excessive quantum delivered, we voted against the advisory remuneration report.

As the year progressed media interest did not dissipate, and with the arrival of the new chairman it was decided to be better for the company if the CEO stepped down.

Greencore

We informed convenience food company Greencore of our intention to vote against the approval of its remuneration report. This reflected our view that the increased level of long-term incentive award was too high and, more importantly, that reducing return-on-invested capital (ROIC) metrics immediately following a significant acquisition was not appropriate. A call with the chairman and remuneration committee chairman was arranged to discuss our concerns – we then voted against the advisory remuneration report, having been unconvinced by the rationale. Greencore subsequently issued a profit warning resulting from strategic difficulties in the US, leading to a 30% reduction in the share price. In response, a significant restructuring was announced.

Aviva

Insurer Aviva proposed dropping return on equity (ROE) as a metric for its long-term incentive plan and replacing it with earnings per share (EPS), on the basis that the company was trying to become an earnings and dividend growth story, rather than an asset-based net asset value or embedded value growth story. We pushed back strongly on this point and Aviva responded to say that it would introduce an ROE underpin to the EPS metric.

Informa

Following publishing company Informa's acquisition of media business UBM, the remuneration committee proposed to alter the metrics of the long-term incentive plan for its new policy. We had two problems with the proposals: first was that the cost savings being measured related just to UBM and not to the enlarged group; and second that, in our opinion, the metrics for the return on invested capital target for the enlarged group started too low and were not stretching enough. After communicating our views to the company in March, we then voted against the new remuneration policy.

WPP

The situation at advertising company WPP was well-publicised, with the CEO resigning in advance of the board discussing the outcome of the investigation into his alleged misconduct – triggering 'retiree' status. It was clear that the board had failed to stand up to the CEO and, as a consequence, his contractual terms had no protections in them. This allowed him to set up a new competing business almost immediately. This resulted in M&G voting against both the remuneration report and the re-election of the remuneration chairman.

ESG developments and other engagements

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, and we are supportive of collaborative engagements organised by representative bodies such as the Investor Forum. Members of the Corporate Finance and Stewardship team participate on a range of external committees related to shareholder issues, while also participating in conferences, conventions and roundtables.

We are a member of the Investment Association (IA), with M&G representatives actively participating on the Association's remuneration, corporate governance and sustainability committees. We are also a member of the Asian Corporate Governance Association (ACGA), which provides a good forum for collaboration, as does the Institutional Investors Group on Climate Change (IIGCC).

Other memberships include the UK Sustainable Investment and Finance Association (UKSIF), which promotes responsible investment and other forms of finance that supports sustainable economic development, and the 30% Club, which commits us to raising the issue of gender diversity with our investee companies – this is with a view to supporting the achievement, by 2020, of: 30% women on FTSE 350 boards and 30% women at senior management level in FTSE 100 companies.

2018 – a year of notable ESG initiatives

Some notable highlights from the year included:

Responsible investment

We attended a number of responsible-investment focused events in 2018, including the 'PRI in Person' conference in San Francisco and the Responsible Investor Conference in London. For PRI, with 1,200 delegates this was its largest gathering to date. There was a huge amount of positive energy, amplified by the Global Climate Action Summit (GCAS) down the road, and a call for action to 'walk the walk' following numerous commitments on climate change. It was also a push to increase the focus on some of ESG's other areas of challenge.

Some of these, among many others, included dealing with the barriers around ESG integration, clarification on legal investor duties on ESG, the economics of inequality and the influence of politics. However, it was the risks (and opportunities) presented by climate change that dominated the agenda, including a focus on the crucial role played by forests in mitigating climate change. (M&G subsequently attended and spoke at a sustainable landscape conference, specifically looking at deforestation and how to mobilise the financial sector. This was in light of companies with exposure to deforestation in their supply chains inevitably facing financial risks from supply chain disruption, cost volatility and reputational damage.)

Meanwhile, the two-day Responsible Investor Conference in London addressed a wide range of topics, from the evolution of ESG integration to antimicrobial resistance, and ocean plastics to impact investing and the UN Sustainable Development Goals (SDGs).

Corporate governance

We attended a number of corporate governance-focused events over the year, including the International Corporate Governance Network Conference in Milan and the Asian Corporate Governance Association Annual Conference in Beijing. For the former, we were asked to speak on a panel discussing shareholder engagement with investee companies, while other topics included a framework for measuring engagement impact, the Market Abuse Regime and the difficulties of converting the Sustainable Development Goals into practical examples. Meanwhile in China, over 300 delegates attended – 60% from China and Asia and 8% from Europe. A large amount of the conference focused on ESG – integration into the investment process and ESG data – with other topics ranging from hostile takeovers to the increasing use of dual-class share structures, to how the Chinese 'party committee structure' works in practice, for both privately and state-owned enterprises.

Diversity

As part of the effort to help broaden the board candidate pool, M&G met with a member of the CFA Diversity Committee. We offered the idea of a 'module'-based course covering key skills that might be needed to transition from corporate roles to board positions. We also had an introductory call with the executive director of Women on Boards (WoB), to understand how it operates and how best to connect investee companies looking for non-executive directors with potential candidates.

Impact

In light of M&G's increasing focus on impact investment, we attended a range of impact-focused meetings and conferences, including the Global Impact Investing Network (GIIN) annual conference in Paris. GIIN has three stated goals: to preserve the principles of impact investing; to scale up capacity so that listed asset investors can help to provide the capital to achieve greater impact; and to build the impact community, again with the intention to improve the impact achieved. M&G was one of the sponsors of the event.

The UK audit market

Sir John Kingman published his review of the Financial Reporting Council (FRC) and recommended that the FRC be replaced by a new independent regulator with clear statutory powers and objectives, which is accountable to Parliament. Further to this announcement, there was considerable press attention on the audit market and M&G was involved in the debate. Having met the Big 4 accountants – Deloitte, PwC, EY and KPMG – M&G met with the Competition and Markets Authority (CMA) and some of the mid-tier auditors (Grant Thornton, Mazars, BDO etc). The main issues are audit quality, competition/choice and conflicts of interest. There has been a lot of negative press over the failure of auditors to prevent a large corporate failure like Carillion, and questions have been raised over whether the Big 4 are too much of a cosy club. There is no one silver bullet, but as asset managers, we can speak to corporates, and as shareholders, support changes that could help to improve competition and, therefore, the overall quality of the audit market.

Environment-related activities

During the year, we continued to participate in a range of initiatives and events addressing the risks and opportunities of climate change, including meetings organised by the PRI, IIGCC and ShareAction.

As part of our IIGCC membership, we attended a roundtable discussion with the chairmen of both Royal Dutch Shell and Rio Tinto to discuss shareholder resolutions that have been tabled at upcoming AGMs. The main focus was on the 'Follow This' resolution at the 2018 Shell AGM, so called as it follows the highly successful 'Aiming for A' resolution of two years ago, which is covered in more detail in the previous engagement section of this report. We attended a roundtable at which ShareAction ran through the group's 2017 report, particually assessing how European banks are managing climate risk.

Plastics

In Amsterdam, we attended and presented at a conference on single-use plastics, which addressed the entire value chain from the feedstock and production of 'nurdles' through the consumer goods sector. This included issues around reducing plastic and the necessary infrastructure to sort and recycle plastics at end-of-life. There was a sense that with government regulation, incoming EU directives and future support from the UN, the problem could be tackled at scale with a focus on developing infrastructure solutions in SE Asia, Africa and China. We also attended a breakfast with UNPRI on plastics, which highlighted the state of just how much plastic ends up in the oceans – and the deleterious impact it is having on biodiversity, the health of our oceans and ultimately on us, as individuals, as it enters the food chain.

We believe that investors cannot ignore the financially material impact of future regulation and the reputational risk from plastic pollution. In light of this, we have successfully engaged with a number of investee companies on how they are tackling the issues around single-use plastic and what targets they have in place to reduce and report.

Government-related activities

In 2018 M&G continued its engagement activities with the UK government, attending a number of meetings to discuss a range of topics.

We continued our interactions with the Department for Business, Energy and Industrial Strategy (BEIS) in 2018, which included introductory meetings with the director of business frameworks and the deputy director of corporate governance, an IIGCC lunch as part of Green Week with the Rt Hon Claire Perry, Minister for Energy, and a meeting at Deloitte on the audit market with Rachel Reeves, chairman of the BEIS Select Committee.

M&G was invited by the UK Department for International Development (DfID) to be part of a delegation representing the UK in a dialogue with other European countries (the Netherlands, Sweden, Norway, Finland). This was to discuss ways to effectively mobilise capital towards sustainable assets via impact investing. There was a clear intent to facilitate greater collaboration between the private and public sectors to progress development finance via the impact investing agenda. We attended a separate roundtable with DfID (and its impact investing arm CDC) to discuss the opportunities and limitations for investors around investing in sustainable development in Africa.

M&G met with the chief medical officer (CMO) of the UK Department of Health. This was to discuss anti-microbial resistance and the role that M&G could play in driving awareness and improved governance on the misuse and overuse of antibiotics in livestock bred for human consumption. This is against the backdrop of a lack of new antibiotics in the pipeline. We aimed to get better direction on whether the UK government could incentivise pharmaceutical companies to develop priority anti-microbials and a stronger steer on how M&G should engage with companies.

Other interactions with government included, but were not limited to: an Investment Association policymaker roundtable lunch with Mary Creagh MP, chair of the Environmental Audit Committee, to learn more about political priorities for environmental policy; a speech by international development secretary, Rt Hon Penny Mordaunt, detailing how the private sector can support international development globally; and an All Party Parliamentary Corporate Governance Group Breakfast on Cyber Security.

Corporate finance overview and activities

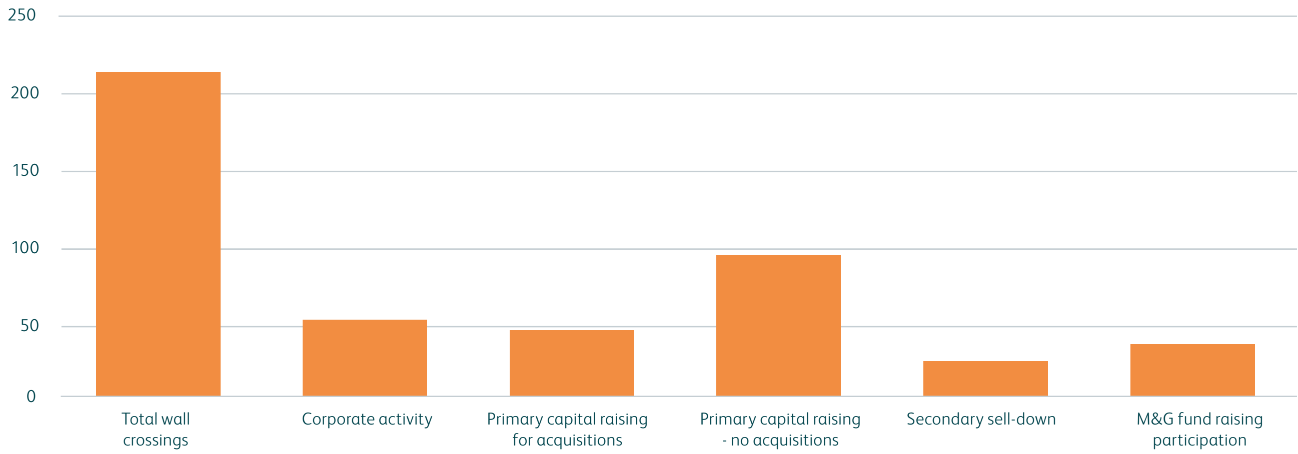
As part of our role as long-term investors, M&G plays an important part in providing capital through the equity markets for the benefit of our investee companies and, therefore, our investors.

M&G is involved with companies at all stages of their evolution in the public markets, from the initial public offering, through periods of capital raising and expansion to those companies being sold. In this way, we can provide equity capital to our investee companies to help fund their growth phases, and then recycle that capital back again into the market when we receive the proceeds for companies that are sold, often at a significant premium to the market price.

In order to effect these processes, M&G is prepared to be made 'insiders' and receive price-sensitive information by investee companies for short periods of time ahead of the information being made public. Typically, this is in relation to a transaction such as an equity capital fund raising, a takeover offer or a significant management change, where it is useful for the company and its advisers to try to seek support from major shareholders – whether to finance a transaction or get feedback ahead of a management change.

The M&G Corporate Finance and Stewardship team acts as the primary contact point for the flow of this type of information into the investment team. The process of receiving price-sensitive information is known as 'wall crossing'.

2018 wall crossings



In 2018 we saw a number of sub-underwritten rights issues either to finance acquisitions or just strengthen company balance sheets. M&G has always been an active sub-underwriter and is supportive of the rights issue mechanism, which ensures that the pre-emptive rights of existing shareholders are fully protected from potential dilution.

Rights Issue Case Studies

Phoenix Group

Phoenix Group, the consolidator of closed life and pension funds, announced the £2.9 billion acquisition of Standard Life Assurance in Q1 2018. This required a £950 million rights issue over the summer to fund part of the consideration. The terms were seven new shares for every 15 existing shares, priced at 518 pence per share. As a 4% shareholder, M&G sub-underwrote £72 million of the rights issue, almost double our pro-rata entitlement.

DS Smith

DS Smith designs and manufactures corrugated packaging and plastic packaging for consumer goods. M&G, as a 2% shareholder, was wall-crossed on the proposed acquisition of packaging company Europac for £1.45 billion, to be funded through a £1 billion standby rights issue. We think this will be a key building block for the company in Western Europe, which will provide much needed capacity. The £1 billion rights issue was subsequently announced in June and M&G sub-underwrote £21 million of the issue, receiving a 0.5% commission.

Provident Financial

Provident Financial, the troubled lender to the non-standard market, announced a £331 million rights issue post the £172 million settlement with the Financial Conduct Authority over its Vanquis Bank. M&G applied for £45 million of the sub-underwriting and was allocated £12.6 million.

Galliford Try

Galliford Try, the housebuilding, regeneration and construction group, announced a £158 million rights issue to fund, inter alia, its share of cost overruns in a joint venture with Carillion (which went into compulsory liquidation) and Balfour Beatty. M&G applied for £35 million of the sub-underwriting and was allocated £5.7 million.

M&A case studies

M&G is a long-term investor and our general policy is to support incumbent management if it is well regarded. However, as part of a company's evolution, there may be times when a business is better suited to be part of a larger group or where changes are required away from the public markets and there is a buyer who is willing to pay a significant premium to the market price. In these circumstances, as an often reluctant but pragmatic seller, M&G will look to reinvest the proceeds in another company.

Melrose – offer for GKN

Melrose – which specialises in the acquisition and performance improvement of manufacturing businesses – fought a contested and hostile bid for engineering firm GKN. Melrose narrowly won this with 52% acceptances on the first closing date, having revised its offer by over 40 pence to £1.69 Melrose shares plus 81 pence in cash. This valued each GKN share at 438 pence versus the GKN share price prior to the bid of 330 pence (representing a 33% premium). The new management team at GKN initially put up what we thought was a credible defence, by unveiling a strategy to sell one business and boost GKN's margins and improve working capital for the remaining businesses. However, it then undermined this strategy, in our view, by first announcing a demerger of its two remaining divisions and then proposing to sell the automotive division to a US competitor for part cash and part shares. Receiving shares in this US-listed company, which we were unfamiliar with, was not a particularly attractive prospect. We therefore opted to side with Melrose, which is respected in the UK market for its buy, improve and sell strategy. We had an active holding in GKN (1.2%) and only 0.6% in Melrose, which was mainly passive.

Virgin Money (VM) – takeover by CYBG

Financial services brand Virgin Money recommended an all-share offer from banking group CYBG, giving VM shareholders 38% of the enlarged group. Despite this deal seeming to be better for VM's 35% shareholder 'Virgin Enterprises' than other shareholders, the deal met with approval. (Virgin Enterprises is set to get a brand-new license deal from CYBG worth up to £15 million per annum, for use of the Virgin name). VM's share price had been depressed, following its investment in its digital strategy, and we did not think a 20% premium to the depressed price was a particularly attractive offer.

Weir – acquisition and fund raising

M&G was wall-crossed by engineering company Weir ahead of its proposed acquisition of the privately owned US corporation ESCO for $1 billion. This was to be part-funded with a £350 million placing (7.4% of the issued share capital), and will significantly increase the company's exposure to the hard rock (copper/gold) extractive industries. M&G submitted a demand for £12 million in the placing representing our pro-rata holding. The deal was well received by the market and the company's share price rose 5% on the day of announcement.

Shire – takeover by Takeda

Shire, the Dublin-based pharmaceutical company, had rejected four takeover offers from Japanese rival Takeda – this followed concerns not only about the offer price but the proportion the Japanese company was proposing to pay in stock rather than cash. We spoke to the Shire chairman to encourage her to keep the dialogue open with Takeda, and she assured us that whatever happened, the status quo of remaining independent was no longer acceptable. Takeda subsequently announced an intention to make an offer of just over £49 per Shire share (0.8 Takeda shares and $30.3 in cash) – representing an offer of £46 billion which the Shire board recommended.

IWG – takeover approaches

IWG, which trades under the name Regus, is a provider of flexible workspace. The company had been in and out of talks with potential bidders since December 2017. Most recently, in the third quarter of 2018, IWG rejected three offers from Starwood Capital, TDR Capital and Terra Firma. These followed the joint Canadian approach in 2017, from Onex and Brookfield Asset Management, and the Prime Opportunities Fund approach in the second quarter of 2018, none of which reached a conclusion and talks lapsed.

Accreditations and initiatives

UNPRI A+	TIER ONE	4th	11
Strategy & Governance Score 2018	UK Stewardship Code	AODP Global Climate Index for Asset Managers	ShareAction responsible investment survey ranking

Climate Bonds Initiative	IIGCC Institutional Investors Group on Climate Change	The Green Bond Principles	PRI Principles for Responsible Investment
Revo Retail. Property. Community.	IPF Investment Property Forum	BBP Better Buildings Partnership	BPF British Property Federation
The Investment Association	The Investor Forum	UKSIF UK Sustainable Investment and Finance Association	FRC Financial Reporting Council
GIIN Global Impact Investing Network	30% Club Growth Through Diversity	ICGN	Climate Action 100+ Global Investors Driving Business Transition