

Ms Susannah Haan
Financial Reporting Council
Fifth Floor
Aldwych House
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London WC2B 4HN

14th April 2010

Dear Ms Haan

I enclose our response to the FRC "Consultation on a Stewardship Code for Institutional Investors".

In order to help your analysis of responses we wish to emphasise some specific aspects of our response.

- 1 Ownership and development of the Stewardship Code should remain with the Institutional Shareholders Committee.
- 2 In the spirit of comply or explain, fund managers may decide to explain that their duties to their clients result in them choosing not to participate in the FRC initiative.
- 3 Consequently the current FRC proposal is likely to have the unintended consequence of weakening the link between active fund management and responsible share ownership.
- 4 Voting service agencies and investment consultants are not shareholders.
- 5 Overseas based shareholders are unlikely to change their current approach to stewardship.

We should be pleased to discuss any aspects of our response with you.

Yours sincerely



Huw Jones
Director of Corporate Finance

Response by M&G Investment Management Limited to the Financial Reporting Council's Consultation on a Stewardship Code for Institutional Investors

April 2010

Summary of Response

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Response

M&G is an active investment manager and as a responsible shareholder believes that communication with investee companies should address both business performance and corporate governance.

Constructive dialogue with the Boards and executive management of investee companies lies at the core of our investment approach which does deliver the support for the Combined Code sought by the FRC. Regular meetings with management occur and a wide range of relevant topics are discussed.

Our voting records and investment led approach to corporate governance (Issues Arising from Share Ownership) are publicly available on our website.

It is the responsibility of company Boards to act in the best long-term interests of shareholders and we are concerned that micromanagement by shareholders would undermine Board authority. We would caution against raising expectations of achieving a consensus view from shareholders having a wide range of investment objectives but we do have a dialogue with other shareholders when appropriate.

Sir David Walker's review of the governance of banks compares the advantages of limited liability for shareholders versus the unlimited liability of the tax payer, and suggested the need for an enhanced level of governance from shareholders. The primary aim of the limited liability structure is to allow the limited company to take entrepreneurial risks with the aim of creating shareholder wealth. As Lord Myners recently stated in his address to the ICGN this "provides access to resources that no other model of economic organisation could achieve". Limited liability does not imply a dereliction of ownership responsibilities. Additional regulation and solvency requirements should apply to financial institutions associated with systemic risk.

1 INTRODUCTION

1.14 **The FRC has identified the following policy objectives against which to judge a Stewardship Code, on which it would welcome views.**

We believe that the Institutional Shareholders Committee is best placed to develop the Code and to monitor its application.

1.16 **The FRC is seeking views on whether it should accept oversight of the Code in its current form, or whether amendments should be made before the FRC does so.**

We believe that development of the Stewardship Code should remain with the Institutional Shareholders Committee which would review the Code each year and encourage investment managers to follow the Code. Institutional investors should indicate on their websites whether or not they support the Code, and in any event the subject is addressed within client investment mandates.

M&G participated at all stages in the evolution of the Institutional Shareholders Committee Statement of Principles, and has supported that statement as a recognition of responsible share ownership.

M&G also supported the modification of the Statement of Principles into the Stewardship Code as set out in the FRC consultation. We believe it is appropriate to encourage recognition of principles of stewardship by a wide range of investors, both in the UK and internationally, following many different approaches to investment management.

We are concerned that the FRC's approach to the Stewardship Code is likely to have the unintended consequence of encouraging many investment managers to explain that they prefer to follow their own investment style, which may or may not recognise responsible share ownership. If commitment to the Stewardship Code were to be mandated, it is highly likely that many investment managers would choose to sub-contract stewardship issues to voting agencies, and thereby break the essential link between fund management and responsible share ownership.

"One size does not fit all" and there is a real danger that the proposed comply or explain approach to stewardship would become a box ticker's charter, rather than the encouragement to responsible share ownership which M&G would like to see.

1.17 **Views are also sought on which institutional investors and agents should be encouraged to apply the Code on a "comply or explain" basis, what they should be asked to disclose and to whom, and the monitoring arrangements that should be put in place.**

The Combined Code on Corporate Governance requires companies to state whether or not they have complied and to provide details when they have not. We believe a similar public statement from fund management organisations is sufficient, bearing in mind that specific client expectations lie within investment mandates.

2 BACKGROUND AND RECENT DEVELOPMENTS

2.18 **The FRC would welcome any insights on lessons which may be learned from experience outside the UK.**

We would argue that the UK has one of the more effective corporate governance structures. There is a risk that increasingly onerous disclosure and compliance regimes applied to stewardship would result in fund management organisations sub-contracting their voting and disclosure requirements to third party agents and thereby breaking the essential link between investment management activity and responsible share ownership. We believe that this did occur when the ERISA regulations were introduced in the USA.

3 THE COVERAGE OF THE CODE

- 3.6 The FRC would encourage all UK institutional investors to apply and report on the Code regardless of whether or not they are subject to mandatory requirements, and would welcome views on whether there are any barriers or other reasons that would prevent or discourage them from doing so.**

Subject to client confidentiality and reasonable cost implications we do not envisage any significant barriers to describing our approach to stewardship.

- 3.9 Views are invited on whether agents such as voting services agencies and investment consultants should be encouraged to commit to the spirit of the Code, and, if so, how this could be done.**

(see also response to 2.18)

These organisations are not shareholders and may not recognise disciplines of fund management. Stewardship is unlikely to be enhanced by a box ticking approach to governance.

- 3.13 The FRC is keen to hear from foreign investors in response to this consultation, and would in particular welcome comments on:**

- **Whether foreign investors would be willing voluntarily to commit to a Code sponsored by a UK regulator such as the FRC or a UK industry body like the ISC in respect of their holdings in UK companies;**
- **Their current practice on disclosing information on their engagement policy, including any national or international standards they follow; and**
- **Any barriers or other potential difficulties for foreign shareholders seeking to engage with UK companies.**

- 3.14 The FRC would also be interested to hear from investors who operate on a cross-border basis about any potential conflicts which might arise between requirements or codes in place in other countries and the proposed Stewardship Code.**

Whilst foreign shareholders might be encouraged to follow the Code, we think it unlikely that their preferred approach to investment management will change significantly.

4 THE CONTENT OF THE CODE

M&G supports the 7 principles as stated. Constructive dialogue with Boards and monitoring performance against a stated strategy lies at the heart of our investment approach. We have concerns about boilerplate compliance with the Stewardship Code. Whilst our responsibility is to our clients, we believe that M&G's approach also reflects the wider public interest.

- 4.2 The full text of the ISC Code is at Appendix B. Respondents are welcome to comment on any aspect of the ISC Code, but in particular views are invited on these questions:**

- **What are the responsibilities for engagement of institutional shareholders to the beneficial owners whose interests they represent? Does the ISC Code cover all the relevant responsibilities?**

Institutional shareholders have a responsibility to report to clients on their investment activities and discharge of ownership responsibilities in the manner that the client wishes. The Code covers the relevant responsibilities.

- **What are the responsibilities for engagement of institutional shareholders to the UK listed companies in which they invest? Does the ISC Code cover all the relevant responsibilities?**

As owners it is the responsibility of investors to ensure that companies are properly structured and managed for the long term creation of shareholder wealth. The Code covers the relevant responsibilities.

- **Are the respective responsibilities of the different parts of the investment chain sufficiently clear and appropriate?**

Yes

- **Does the Code strike the right balance between the need to avoid over-specification that might discourage the application of the Code and the need for it to be effective with an appropriate degree of transparency?**

Yes

- **Are there any parts of the ISC Code where further guidance is needed, or where the existing guidance should be amended?**

No

- 4.4 **Views are invited on whether the ISC Code adequately covers the content of Section E of the Combined Code.**

We believe that the Code adequately covers Section E

5 REPORTING, MONITORING AND REVIEW

- 5.2 **The FRC would welcome views on:**

- **The information that institutional shareholders should make publicly available and that they should report to clients;**

The ISC Code correctly makes no explicit recommendations in relation to Principles 3 and 4. As stated in the introduction, such dialogue underpins M&G's investment approach. We believe that the quality of dialogue with, and the ability to influence, investee companies would be significantly diminished if all such discussions are "posted" on the internet.

We do not believe that public disclosure in any more detail is appropriate. As stated previously, our voting records and investment approach are publicly available. We report to clients in a manner and frequency of their choosing. Our voting process is also audited according to AAF 01/06. We see neither need nor merit in additional layers of independent audit, and are concerned about potential cost implications.

- **The arrangements that should be put in place to monitor how institutional shareholders apply and report against the Code; and**

The Combined Code on Corporate Governance requires companies to state whether or not they have complied and to provide details when they have not. We believe a similar public statement from fund management organisations about the Stewardship Code is sufficient, without an additional layer of audit.

- **The arrangements for reviewing the operation and content of the Code.**

We believe the review of the operation and content of the Code should remain with the Institutional Shareholders Committee.

- 5.3 The FRC would welcome views on two issues: the specific information that should be disclosed by institutional shareholders and their agents, and at what level of detail the “comply or explain” principle should apply.**

The Combined Code on Corporate Governance requires companies to state whether or not they have complied and to provide details when they have not. We believe a similar public statement from fund management organisations is sufficient without an additional layer of audit.

- 5.6 Views are invited on whether public disclosure of such information is appropriate and useful, and whether other information might also usefully be disclosed.**

The ISC Code correctly makes no explicit recommendations in relation to Principles 3 and 4. As stated in the introduction, such dialogue underpins M&G’s investment approach. The IMA survey summarises fund manager’s activity. We do not believe that public disclosure in any more detail is appropriate. We would argue strongly that the quality of dialogue with, and the ability to influence, investee companies would be significantly diminished if all such discussions were to be “posted” on the internet.

- 5.10 Views are invited on the structure of the ISC Code and on the best way to encourage reporting against it on a “comply or explain” basis.**

- 5.14 Views are invited on the proposals in ISC Code for reporting to clients and the merits of independent opinions from auditors or other professional accountants. It would be helpful to have estimates of the costs incurred by asset managers in commissioning these opinions and of the benefits to asset owners.**

As stated previously, our voting records and investment approach are publicly available. We report to clients in a manner and frequency of their choosing. Our voting process is also audited according to AAF 01/06. We see neither the need nor merit in any additional layers of independent audit. We remain concerned about the potential cost implications.

- 5.21 Views are invited on the merits of the current IMA survey and other possible approaches to monitoring the overall application of the Code.**

M&G contributes to the IMA Survey which continues to provide a useful summary.

- 5.22 Subject to views expressed in response to this consultation, the FRC proposes to introduce a review process for the Stewardship Code equivalent to that already in place for the Combined Code: that is, reviews would in the normal course of events be undertaken every two or three years, would involve public consultation with those applying the Code and other interested parties, and would focus on the overall effectiveness of the Code and the “comply or explain” mechanism rather than its application by individual investors. Views are invited on this proposed approach.**

We believe the review of the operation and content of the Code should remain with the Institutional Shareholders Committee.