MARGARET COLTMAN
INTERIM GROUP GENERAL COUNSEL AND COMPANY SECRETARY

PRUDENTIAL PLC
12 ARTHUR STREET
LONDON EC4R 9AQ

www.prudential.co.uk

Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

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Your ref
Our ref

Dear Mr Hodge,

Review of the effectiveness of the Combined Code – second consultation

Prudential welcomes the opportunity to comment on the issues identified in the above consultation document. Prudential plc is a publicly traded company listed in London and New York and is an international retail financial services group with significant operations in the UK, Asia and the United States. Our purpose is to promote the financial well-being of our customers and their families, with a particular focus on saving for retirement and income in retirement. Prudential's portfolio of well-known and respected brands has attracted more than 21 million customers (and policy holders and unit holders) worldwide. M&G is Prudential's UK and European fund management business and has £149 billion of assets under management (as at 30 June 2009).

Further to our views which we submitted to you as part of the FRC's initial consultation, we set out below our comments, from the perspectives of both a listed FTSE 100 company and a major institutional investor, in relation to the issues raised in the second consultation document. In doing so, our comments follow the order of the issues raised in the consultation document. Prudential has also responded to the Walker Review of corporate governance in UK banks and other financial industry entities.

General comments

In our view, regulatory reforms intended for deposit taking institutions which give rise to systemic risk should not be extended to other parts of the financial sector or to corporate governance and remuneration across the entire UK corporate sector unless an equivalent need is manifest. We believe that non-banks should not be subject to additional regulation in response to a crisis that originated in the banking sector.

That said, the Walker Review's endorsement of the FRC's Combined Code and the flexibility offered by the "comply or explain" approach are welcome, though we favour a change of terminology and approach to "apply or explain", which the FRC is considering. Many of the specific recommendations of the Walker Review will further develop FRC guidance on good practice and should be helpful. It is particularly important that the principle of "comply or explain" applies in the area of remuneration to allow some room for flexibility in applying general principles to the circumstances of individual businesses.

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Specific comments

SECTION 1: THE CONTENT OF THE COMBINED CODE

Guiding principles

1. We note that the FRC has reached no conclusions at this stage on whether the Walker Review's recommendations should be extended beyond banks and other financial institutions (BOFIs) to all non-financial listed companies or to a sub-set of such companies. We repeat our views given in our earlier submission to the FRC that it is critical that the requirements of the Code are sufficiently flexible to enable different business models to function effectively.

2. Subject to the above comments, we support the three guiding principles that the FRC intends to adopt.

The responsibilities of the chairman and the non-executive directors

3. The core role of the non-executive director (NED) to challenge the proposals put forward by the executive is already set out in the Combined Code. There is a suggestion in recommendation 6 of the Walker Review that NEDs need to ensure that external analysis is sourced for discussions on risk. We do not think this is practical or desirable. As stated in our response to the initial FRC consultation, NEDs need to be able to rely on the information provided by management. Where trust between executives and NEDs breaks down, it is the responsibility of the chairman to re-establish trust or make changes, in circumstances that will be specific to the board in question.

4. The Walker Review's recommendation on the role of the senior independent director (SID) largely reiterates the role as set out in the Combined Code, although we have some reservations about the Walker Review's suggestion that the SID should "serve as a trusted intermediary for the NEDs as and when necessary". There is a risk this could cause confusion with the role of the chairman and create opportunities for conflict. It would better reflect the "backstop" intermediary role of the SID if this recommendation stated the SID should, "serve as a trusted intermediary for the NEDs only when necessary". We agree with the Walker Review's observations that the chairman is in a pivotal role between the executives and the NEDs in leadership of the board, and that the chairman should not take on an executive role. We are also in agreement with the high-level description of the chairman's role set out in the Walker Review. However, we would welcome clarification of whether it is anticipated that the Combined Code will provide a different definition of the role and responsibilities of the chairman of a BOFI board from the chairman of other companies. In our view, no case has been made for a different approach to be taken for non-bank financial institutions.

5. We recognise that the increasing demands on NEDs in BOFIs means that, in the case of some NEDs, enhanced time commitment will be required. The chairman of a BOFI – or indeed any other large, complex company – needs to commit a substantial proportion of their time to that role. However, no evidence is presented as to why a guideline minimum amount of time for the chairman is needed and we urge regulators not to convert this into a prescriptive requirement, particularly for non-bank financial institutions. Within any sector, not to mention across sectors, the degree of complexity of the business models and of the strategies of individual companies as well as their risk profile varies widely. Therefore, a narrowly prescriptive approach is unlikely to be fit for purpose for a large number of companies and risks making the functioning of the board and the role of the chairman more difficult. In addition, setting a high minimum time requirement could raise a question about the independence of the chairman and could *de facto* impose an Executive Chairman. As major institutional investors, we expect the chairman of a large bank would be unlikely to be able to take on another chairmanship of a listed company. Indeed, if the role is given explicit priority as proposed, the shareholders of other listed companies would be unlikely to accept a chairman with such a restriction.

6. We are not in favour of a prescriptive minimum time commitment for NEDs being included in the Combined Code. Whilst the Walker Review's recommendation of a minimum time commitment for NEDs of 30-36 days may be considered appropriate for some banks, this approach may not be appropriate for all organisations and should not be applied to all listed companies. We feel that such time commitment will depend on the individual's own experience and ability and the complexity of the

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business of the relevant company. We believe that any over-specification of the time commitment will unnecessarily reduce the pool of available people who are qualified and have sufficiently diverse experience to carry out these roles, because it will constrain the total number of appointments they can hold. It could also preclude chief executives or executives of other companies from acting as NEDs. A prescriptive time commitment would in any event be difficult and bureaucratic to measure, given the nature of the work done by NEDs. The focus should instead be on the knowledge and experience of the board as a whole, including the quality of the contribution from NEDs, who should be encouraged to ensure that they can provide the time necessary to perform their function effectively.

7. We believe that it might be helpful to give, in the form of non-binding guidance, further clarification of the role, key responsibilities and expected behaviours of the chairman, the SID and the NEDs. We do not support further prescription of the role and responsibilities of these board members.

Board balance and composition

We set out comments on the following specific issues highlighted in the consultation document.

Whether the Combined Code gives sufficient emphasis to the need for relevant experience among the non-executive directors collectively.

8. We believe the Combined Code adequately deals with this point, as it includes the requirement for the nomination committee to assess the skills that the board requires and to report on its work in the annual report.

Whether the independence criteria and the way they have been applied by boards of companies and investors have unnecessarily restricted the pool of potential non-executive directors, and in particular whether the so called "nine year rule" has resulted in a loss of continuity and valuable experience.

9. We believe that this is potentially the case. As stated in our earlier response to the FRC, we support a relaxation of the independence criteria, in particular to enable the recruitment of retired former employees and executive directors after a shorter period than the current 5 years prescribed by the Code.

Whether the recommendation that the boards of FTSE 350 companies should comprise at least 50% independent non-executive directors has resulted in fewer executive directors sitting on boards and/or boards becoming larger.

10. We believe that this recommendation has resulted in fewer executive directors sitting on boards and/or boards becoming larger. However, we believe that it is a recommendation which is generally supported by boards.

Whether more guidance is needed, in the Code or elsewhere, on succession planning and the need to ensure that board composition is aligned with the present and future needs of the business.

11. We believe that the role of the nomination committee under the Code is already sufficient in this regard. We do not support further guidance on these topics being introduced.

Frequency of director re-election

12. We support the current position (i.e. re-election of directors every three years). If there is any change to the Combined Code on this point, our view is that compliance should be optional, not mandatory, and should apply to all directors, not just the chairman or committee chairs.

13. We do not support introducing binding or advisory votes on more specific issues, or on the corporate governance statement as a whole. Shareholders currently have the opportunity of rejecting the report and accounts and thereby give a strong statement of their concerns. For completeness, we would not support any changes that make the vote at AGMs on the directors' remuneration report anything other than "advisory" (i.e. the current position).

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Board information, development and support

14. In relation to all of the issues raised, we do not believe that providing more guidance either in the Code or in non-binding guidance is necessary. Each board must decide for itself how to deal with these issues.

15. We agree that NEDs need to develop knowledge and understanding of the business, and, in the case of companies like Prudential, the financial services sector more broadly, to enable them to contribute effectively. The company itself needs to take responsibility for this, recognising that it is for them to decide what is appropriate in their own circumstances. For example, occasional visits by NEDs to a company's operating centres should enhance their knowledge of the business. We emphasise the need to avoid adopting an inappropriately prescriptive approach on matters such as induction and development programmes.

16. We support the need for NEDs to have adequate and dedicated support on all relevant matters, and it should be left to the chairman and board members to determine how this is best achieved. We would not support independent secretariats divorced from the executive and agree with the comment in the consultation document that this would reduce effectiveness and might undermine the unitary board. We would not support prescription in this area and believe that the Code is sufficient as it stands. Any deficiencies in this area should be identified by an effective board evaluation process.

17. We do not support amending the Code to encourage NEDs to make more use of independent sources of advice. We believe that the Code is sufficient as it stands on this point.

Board evaluation

18. We would support the proposal that the Code should be amended to recommend that board evaluations should be externally facilitated at least every two or three years, at least for FTSE 350 companies. Rigorous evaluation of the performance of a board is important and we further suggest the outcome of the evaluation should be discussed collectively by the board as a whole.

19. We believe that a relaxation of the Code to permit a rolling cycle of committee evaluations would be a sensible approach.

20. We believe that the high-level description of the content of the evaluation statement set out in recommendation 13 of the Walker Review is sensible. There may be sensitivities in relation to the reporting of outcomes of the board evaluation and in this regard we support the approach suggested in paragraph 4.28 of the Walker Review i.e. that as a minimum the statement should indicate that conclusions had been drawn from the evaluation and were being implemented.

21. We refer to the proposal that the board should include an "assurance statement", which would report on the board evaluation review but might also comment on other aspects of board effectiveness. We do not object to more disclosure, within the bounds of confidentiality, but we question the need for such an "assurance statement". Adequate disclosure should enable investors to make an objective assessment of a board's effectiveness.

Risk management and internal control

22. We believe that the current balance between the Code and the Turnbull Guidance in relation to the board's responsibility for strategic risks and setting risk appetite is correct. We support the retention of the current, flexible, principles-based approach of the Guidance.

23. We generally consider that individual companies are best placed to determine their committee structure and approach to risk management.

24. We believe there is no requirement to review all of the Turnbull Guidance.

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25. We do not support the mechanisms recommended for banks and financial institutions being applied to other listed companies other than where there is clear evidence to suggest it is appropriate. We also query whether non-bank financial institutions should be subject to the particular mechanisms recommended for banks (see our general comments above). It is for companies themselves to determine whether such mechanisms (e.g. having a separate risk committee) are appropriate in their own circumstances.

26. If a risk committee is established, it will be important to identify and manage gaps and overlaps between separate audit and risk committees – clear terms of reference will be required.

27. Rationalisation of existing disclosure requirements and/or provision of guidance on good communication tools are always welcomed. These should not be prescriptive, but would need to be principles-based and flexible enough to allow for changes in market disclosure trends and demands.

Remuneration

28. We would welcome consistency of approach and requirements between the various draft codes and recommendations which are currently being discussed. We consider that the requirements of the codes and recommendations should not be overly prescriptive and should take into account materiality and proportionality and different business models and organisational structures. Once finalised the updated policy on the application of "comply or explain" should be applied. Whatever approach is adopted, it should not make the UK a less competitive place in which to do business.

29. The Code requires that businesses follow good practice in remuneration. It is important though that there is not too much emphasis on executive directors' remuneration alone and that businesses are also encouraged to follow good practice and governance in managing remuneration below board level. Any disclosure on practice below board level should include the governance process and disclosure of quantum in bands for "high end" executives as defined in the Walker Review.

30. Through the various industry bodies and the advisory vote on directors' remuneration and the company's remuneration policy given to shareholders at annual general meetings, we consider that shareholders have adequate means to challenge remuneration decisions for executive directors should they so wish.

SECTION 2: THE IMPLEMENTATION OF THE COMBINED CODE

"Comply or explain"

31. We welcome the FRC's intention to give further consideration to the proposal for a change of terminology replacing "comply or explain" to "apply or explain", and we support in principle this proposal.

The quality of disclosure by companies

32. As investors, we seek informative description of both the application of the Combined Code and the background to any areas where a company's board has decided not to apply Code provisions. Improving the quality of such descriptive reporting to shareholders is more important than any "rationalising" which may be possible. Succession planning and board evaluation are two areas which are of particular interest to long-term investors.

33. We do not believe that the costs of meeting the current disclosure requirements are significant.

34. With regard to the suggestion that the FRC or the FSA undertake greater monitoring and enforcement of "comply or explain" statements, we share the concerns of some commentators, as stated in the consultation document, that regulatory intervention could reduce the valued flexibility of the current system. We note that, as stated in the consultation document, if the FRC were to undertake such a role, it would be limited to checking whether an explanation had been provided and not whether that explanation was appropriate. We believe that this monitoring role should be left to shareholders. We

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also agree with the view of the FRC that the judgement as to whether any explanation given by a company is appropriate rightly rests with the company's shareholders.

35. We believe that a change to "apply or explain" (please see our comment in point 31 above) will help discourage both a box-ticking approach by investors and boiler-plate reporting by companies.

Engagement between boards and shareholders

36. The original (2007) ISC Statement of Principles provides a useful description of many aspects of responsible share ownership, but any attempt to encourage best practice in stewardship is, in our view, unlikely to be successful. It is not possible to have a "one size fits all" approach to investors and to fund managers representing a multiplicity of clients having many different investment objectives. Also, "quality of share ownership" needs to be left to competitive market forces. The FRC identifies the declining market share of institutions traditionally associated with responsible share ownership. It would not be appropriate for the remit of the FRC to be extended in the manner recommended by the Walker review, and thereby add to the administrative burden of those who do espouse responsible share ownership. The FRC could play an informal role in encouraging adherence to the Principles but such activity should not be referred to in the Combined Code. We note the ISC has already proposed that the Principles should be designated as a code. The ISC, which brings together the main investor bodies in the UK, is the more appropriate body to lead on oversight of this code (with informal FRC support). The ISC has already commenced a review of the Principles and we believe regular reviews are sensible, but an annual review may be more frequent than is necessary. Adherence to the Principles should not be mandated in an open capital and savings market.

37. With regard to recommendation 19 of the Walker Review, M&G's commitment to the ISC Statement of Principles is already set out on its website.

38. While we support co-operation between investors where appropriate, we are not in favour of a formal Memorandum of Understanding of the type proposed by the Walker Review, which overstates what is possible in a competitive investment market and could become quite bureaucratic and inflexible. There is a danger that additional requirements on investors in the UK market may make it less attractive and competitive.

39. We agree that disclosure of voting records to clients is good practice as set out in the Statement of Principles and M&G goes further by publicly disclosing its voting record. However, mandatory public disclosure of voting records is a significant further step with potential disadvantages such as cost and complexity resulting in loss of competitiveness. We would not support such a move and believe it should be left to fund managers and their clients.

40. We agree with recommendation 14 of the Walker Review regarding material changes in the share register but do not think it is unique to BOFI boards - in our view boards of all companies should be kept up to date with material changes in the share register as normal practice. At Prudential, this is already common practice; the Board receives regular reports on such changes. We believe that all boards should seek to understand why institutional investors do, or do not, choose to own their shares.

41. It would not be appropriate for the FRC to have a role in encouraging collective engagement – see our comments above.

42. We believe that best practice as set out in Sections D and E of the Combined Code provides appropriate guidance.

43. We concur with both the structural and behavioural barriers to regular dialogue identified in the consultation document. A company's regular results communications with the market should reinforce understanding of its longer-term strategy. Executive management meetings with shareholders will usually cover corporate strategy but the amount of focus will depend on the time horizons of the investor. We feel that it is difficult to see what additional practical (non-prescriptive) steps could be taken.

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Yours sincerely,

M.A. Coltman

Margaret Coltman
Interim Group General Counsel and Company Secretary