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BlackRock Investment Stewardship Engagement Priorities for 2017-2018

MARCH 2017

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Overview

BlackRock, as a fiduciary investor, undertakes all investment stewardship engagements and proxy voting with the goal of protecting and enhancing the long-term value of our clients' assets. In our experience, sustainable financial performance and value creation are enhanced by sound governance practices, including risk management oversight and board accountability.

It is the responsibility of BlackRock's Investment Stewardship team to engage with portfolio companies to understand their approach to corporate governance, including the management of relevant environmental and social factors. The team is comprised of over 30 specialists who engage across all geographies (with team members in New York, San Francisco, London, Tokyo and Hong Kong), taking a local approach with companies while benefiting from global insights. It is positioned as an investment function and collaborates closely with BlackRock's more than 125 investment teams to ensure team members have a long-term value mindset, engaging with companies irrespective of whether a holding is in active or passive portfolios, or both. As a significant number of our clients invest through index-based strategies, engagement is an important mechanism to provide feedback or signal concerns about factors affecting long-term performance, absent the option to sell.

Many of our engagements are triggered because companies have not provided sufficient information in their disclosures to fully inform our assessment of the quality of governance, including the exposure to and management of environmental and social factors. We ask companies to review their reporting in light of their investors' informational needs. In our view, companies that report only to meet the regulatory disclosure requirements are missing a prime opportunity to more comprehensively engage new and existing investors about how effectively a business is led and managed. Where reporting requirements are silent on an emerging issue, we believe it is important for companies and investors to develop disclosure guidelines.

We seek to engage in a constructive manner. Our aim is to build mutual understanding and ask probing questions, not to tell companies what to do. Where we believe a company's business or governance practices fall short, we explain our concerns and expectations, and then allow time for a considered response. As a long-term investor, we are willing to be patient with companies when our engagement affirms they are working to address our concerns. However, our patience is not infinite - when we do not see progress despite ongoing engagement, or companies are insufficiently responsive to our efforts to protect the long-term economic interests of our clients, we will not hesitate to exercise our right to vote against management recommendations.

BlackRock's recent paper "Exploring ESG: A Practitioner's Perspective"[1] provides insight into our views on environmental, social, and governance (ESG) factors and demonstrate the firm's focus on the impact they can have on long-term value. Our Chairman and CEO, Larry Fink, in both his 2016 and 2017 annual letters[2] to CEOs, highlighted our view that ESG factors relevant to a company's business can provide essential insights into management effectiveness and thus a company's long-term prospects.

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[1] BlackRock Viewpoint: "Exploring ESG: A Practitioner's Perspective" (June 2016), available at https://www.blackrock.com/corporate/en/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf

[2] Larry Fink's 2016 and 2017 annual letters to CEOs are available, respectively, at: https://www.blackrock.com/corporate/en-us/literature/press-release/larry-fink-chairmans-letter-to-shareholders-2016.pdf and https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter

Each year there are some engagement themes that we prioritize. Our priority themes for 2017-2018 are set out below.[3] We hope that highlighting our priorities will help company boards and management prepare for engagement with us. Some governance issues are perennial, such as board quality and performance, and will always be a focus of the Investment Stewardship team's work. Other priorities are evolving and are informed by regulatory and other market developments over time. Therefore, we strongly encourage companies to provide a detailed agenda when sending us a request for engagement. In practice, we assess whether to initiate an engagement or accept an invitation to engage with individual companies based on a range of material factors including our thematic priorities, level of concern on specific governance issues, observation of market events, and assessment that engagement will contribute to outcomes that protect and enhance economic value.

Governance

Board composition, effectiveness, and accountability remain a top priority. In our experience, most governance issues, including how environmental and social factors are managed, stem from board leadership and oversight. We will encourage engagement protocols that foster constructive dialogue including with independent directors in those situations where a director is best placed to explain and justify the company's approach. We will seek to better understand how boards assess their performance and the skills and expertise needed to take the company through its future multi-year strategy (rather than the last one). In that context, we want to understand the board's position on director turnover, succession planning and diversity. More specifically, over the coming year, we will engage companies to better understand their progress on improving gender balance in the boardroom. Diverse boards, including but not limited to diversity of expertise, experience, age, race and gender, make better decisions.[4] If there is no progress within a reasonable time frame, we will hold nominating and/or governance committees accountable for an apparent lack of commitment to board effectiveness. Further, we will encourage governance structures that enhance accountability (e.g. proxy access), limit entrenchment (e.g. annual election of directors and board evaluations), and align voting rights and economic interests (i.e. one share, one vote).

The concept of the "climate competent board" has surfaced in recent years. For directors of companies in sectors that are significantly exposed to climate risk, BlackRock expects the whole board to have demonstrable fluency in how climate risk affects the business and management's approach to adapting and mitigating the risk. We have the same expectation of boards wherever a company faces a material, business-specific risk. We would assess this both through corporate disclosures and direct engagement with independent board members, if necessary. Where we have concerns that the board is not dealing with a material risk appropriately, as with any other governance issue, we may signal that concern through our vote, most likely by voting against the re-election of certain directors we deem most responsible for board process and risk oversight.

Corporate strategy for the long-term

For several years we have asked companies to articulate their strategic frameworks for long-term value creation and to affirm that their boards have reviewed those plans. Many of the assumptions on which prior year strategies were based have shifted dramatically in recent months and may require companies to pivot.

[3] BlackRock's Investment Stewardship 2018 Annual Report, due out September 2018, will report on our progress on these initiatives.
[4] The Commonsense Corporate Governance Principles, which BlackRock's CEO Larry Fink signed in July 2016 address the importance of board diversity: http://www.governanceprinciples.org/

BlackRock expects companies to succinctly explain the long-term strategic goals management is working towards, the milestones that will demonstrate progress, and any obstacles anticipated or incurred. Each year this explanation should be refreshed and adapted to reflect the changing business environment and how it might affect how a company prioritizes capital allocation, including capital investments, research and development, employee development, and capital return to shareholders. In this context, we are also interested in understanding how a board addresses shorter-term goals, such as those focused on quarterly performance.

Compensation that promotes long-termism

We will be particularly focused on how boards establish performance metrics and hurdles in the context of the aforementioned long-term strategy setting. We expect executive pay policies to use performance measures that are closely linked to the company's long-term strategy and goals. This should ensure that executives are rewarded for delivering strong and sustainable returns over the long-term, as opposed to short-term hikes in share prices. To this end, we'll seek clarity on the company's balance and prioritization between "input" metrics that are within management's control relative to "output" metrics such as earnings per share or total shareholder return. Where pay seems out of line with performance, we expect the company to provide detailed justification in its public disclosures and may engage with independent directors where concerns persist. We may ask the board to explain the extent to which it considers internal pay equity and broader macroeconomic context when setting pay. We may vote against the election of compensation committee members in instances, including but not limited to, where a company has not persuasively demonstrated the connection between strategy, long-term shareholder value creation and incentive plan design.

Disclosure of climate risks

The BlackRock Investment Institute has published two papers – "The Price of Climate Change – Global Warming's Impact on Portfolios"[5] and "Adapting Portfolios to Climate Change"[6] – on climate change as an investment consideration, to which the Investment Stewardship team contributed. That work enhanced our understanding of the complexity companies and investors face in relation to climate change and has informed our engagement with companies on the anticipated impact of climate change on their business models and operations over time[7]. We believe that enhanced, meaningful disclosures are an important step towards building understanding of the impact on individual companies, sectors and investment strategies. Given climate risk is a systemic issue, we believe disclosure standards should be developed that are applicable to listed companies across each market and, ideally, that are globally consistent.

To that end, BlackRock was represented on the 32 member, industry-led Financial Stability Board Task Force on Climate-related Financial Disclosures ("TCFD"). The TCFD has released preliminary recommendations around four thematic areas that represent core elements of how organizations operate – governance, strategy, risk management, and metrics and targets. This framework offers companies and investors a starting point to assess, report, and price climate-related risks and opportunities. In our view, the TCFD recommendations, which include sector-specific supplemental guidance, provide a relevant roadmap for companies. Over the course of the coming year, we will engage companies most exposed to climate risk to understand their views on the TCFD recommendations and to encourage them to consider using this reporting framework as it is finalized and subsequently evolves over time.

[5] BlackRock Investment Institute's "The Price of Climate Change – Global Warming's Impact on Portfolios (October 2015), available at https://www.blackrock.com/corporate/en-us/literature/whitepaper/bii-pricing-climate-risk-us.pdf

[6] BlackRock Investment Institute's "Adapting Portfolios to Climate Change" (September 2016), available at https://www.blackrock.com/corporate/en-us/literature/whitepaper/bii-climate-change-2016-us.pdf

[7] For more information about our engagement on climate risk please see https://www.blackrock.com/corporate/en-us/about-us/investment-stewardship/voting-guidelines-reports-position-papers

Human capital management

Most companies BlackRock invests in on behalf of clients make the point in their public disclosures that they are operating in a talent constrained environment, or put differently, are in a war for talent. It is therefore important to investors that companies establish themselves as the employer of choice for the workers on whom they depend. A company's approach to human capital management - employee development, diversity and a commitment to equal employment opportunity, health and safety, labor relations, and supply chain labor standards, amongst other things - will vary across sectors but are a factor in business continuity and success. In light of evolving market trends like shortages of skilled labor, uneven wage growth, and technology that is transforming the labor market, many companies and investors consider human capital management a competitive advantage. In our engagement on these factors, we seek to ensure companies are adopting the sound business practices likely to create an engaged and stable workforce. As part of the engagement, we are interested to know if and how boards oversee and work with management to improve performance in these areas. Such engagement also provides a lens into the company's culture, long-term operational risk management practices and, more broadly, the quality of the board's oversight.