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BLACKROCK ASKS COMPANIES TO DELIVER SOCIAL VALUE AND SUSTAINABLE, LONG-TERM FINANCIAL GROWTH

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BlackRock's updated proxy voting policies and annual CEO letter reflect evolving investment stewardship priorities and a continued focus on sustainable, long-term growth

In January 2018, BlackRock extended the public outreach of its investor stewardship priorities and shareholder engagement agenda with the publication of BlackRock CEO Larry Fink's annual letter. The letter is addressed to the CEOs at S&P 500 companies and large European corporations. In February, the investment company also released updated U.S. proxy voting guidelines. With over $6 trillion in assets under management, BlackRock is one of the largest asset managers in the world and has become one of the most influential forces in shaping the agenda and framework under which public companies engage with their investors, particularly on strategic, governance, environmental and social issues. Due to its size and scope, BlackRock is a significant shareholder of the common stock of many publicly listed companies.

In preparing for the current 2018 proxy season, companies should consider whether any of the updates to BlackRock's voting policies could impact voting on ballot items. For example, BlackRock has narrowed its over-boarding policy for sitting CEOs and more specifically codified its position on voting on environmental and social issues. Companies should also consider whether to incorporate changes into their relevant corporate governance policies and procedures, corporate disclosures and shareholder engagement programs. Looking to off-season engagement, BlackRock indicates that companies should be prepared for a deeper and more comprehensive level of engagement on key issues.

Annual Letter to CEOs

In January, BlackRock released Larry Fink's annual letter to CEOs at S&P 500 companies and large European corporations. With the headline caption "A Sense of Purpose", the letter observes that, in circumstances where governments are failing to provide for the future, society increasingly is turning to the private sector and asking that companies respond to broader societal challenges. In one of the letter's most remarked-upon passages, Mr. Fink contends the following:

"...the public expectations of your company have never been greater. Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must

> Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders."
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> *– Larry Fink, BlackRock Chairman & Chief Executive Officer*

not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

It is not yet clear how BlackRock will implement these tenets within the context of its fiduciary obligations and governance program. The letter also heralds a "new model for corporate engagement" arising from the fact that index investors like BlackRock are more actively engaging with portfolio companies in order to meet their fiduciary duties to their own clients.

BlackRock contends that this expanded engagement will help it understand and support the long-term growth prospects of its portfolio companies, as well as articulate issues that are important to BlackRock's clients. Index fund providers increasingly characterize themselves as permanent capital, without the flexibility to express displeasure with a company's governance, operations or management by selling their position. The three largest institutions – BlackRock, Vanguard, and State Street – collectively own an estimated 18.5% of the S&P 500, and are therefore increasingly able to promote the views on governance, environmental and social issues.

These are progressive themes, building upon the positions that BlackRock and other investors have taken over the past several years. The letter also provides some details for companies and their advisors around these broader themes that may be more useful when tackling the day-to-day business of preparing proxy statements, 10-Ks and sustainability reports as well as engaging with investors.

Key Takeaways Include:

- **Long-term strategy:** Each company is expected to explain its strategic framework and explicitly affirm that such framework has been reviewed by the board of directors. BlackRock posits that the lack of definitive information about corporate, long-term strategies for value creation has directly contributed to the rise of activism and proxy fights. BlackRock considers such continuous activities potentially wasteful of shareholder assets.
- **Board oversight:** Directors are expected to be more deeply involved with oversight of long-term strategy. This includes oversight of environmental, social and governance matters that BlackRock views as essential to sustainable growth.
- **Increased engagement:** BlackRock plans to double the size of its engagement team to 60 people. Going forward, the team will focus more on year-round engagement with portfolio companies on substantive matters, including the companies' long-term strategy and how they are integrating environmental, social and governance (ESG) issues

into their investment process. The letter contends that investor engagement has been too focused on short-term results and annual meeting and proxy votes.

- **Board diversity:** Board and workforce diversity remains a focus for BlackRock.

Notable Updates to BlackRock's Proxy Voting Guidelines

On the heels of the CEO Letter, BlackRock released updated U.S. proxy voting guidelines which reflect and codify the evolution in BlackRock's positions on some important topics that are widely relevant to public companies. The policy updates focus on the issues of board oversight and sustainability. Among other updates, the following are noteworthy:

- **Director over-boarding:** BlackRock's polices now indicate that CEOs should just serve on one other board besides their own (for a total of two boards). Previously two outside boards was deemed acceptable. In addition, BlackRock continues its policy that outside directors should sit on no more than four boards.[1]
- **Board gender diversity:** BlackRock's policies stress the importance of boards comprising a diverse selection of individuals bringing to bear a range of experiences and competing views and opinions. In particular, on gender diversity, BlackRock now will "normally expect to see at least two women directors on every board." Failure to account for diversity on the board may cause BlackRock to recommend against the election of nominating/governance committee members. Relating to the issue of board composition, BlackRock also states that they are not opposed to long-tenured directors and do not view long-tenure as compromising a director's independence.
- **Engagement on E&S issues:** BlackRock expects companies to identify and report on their business-related environmental and social (E&S) risks and opportunities and how they are being managed. BlackRock will consider the nature and extent of a company's engagement over time on environmental and social issues, including climate risk, when considering whether to support a related shareholder proposal. Their evaluation process will include and analysis of steps the company has already taken, or whether the company is in the process of implementing a response to material E&S threats, as well as the possible material economic disadvantage to the company in the near-term if the issue is not addressed.
- **Climate risk:** BlackRock expects companies to explain how their business may be affected by climate change and convey their "governance around this issue through corporate disclosures." If a company is in a sector that is "significantly

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exposed," the entire board is expected to have "demonstrable fluency in how climate risk affects the business, and how management approaches adapting to, and mitigating that risk." BlackRock cites the Financial Stability Board's Task Force on Climate-Related Financial Disclosures and the Sustainability Accounting Standards Board sector-specific disclosure standards for reporting on climate-related risks and opportunities. In voting on climate risk related shareholder proposals, BlackRock will consider, in addition to the above factors, the robustness of a company's disclosure and management of the risk as communicated to Blackrock during the engagement process.

- **Board leadership structure:** BlackRock will continue to defer to boards in determining the appropriate board leadership structure. BlackRock continues to support a lead independent director structure when a company has a combined chair/CEO, so long as such director has a term of at least one year and is responsible for providing input on agendas, calling meetings of the independent directors and presiding at meetings of independent directors. The guidelines now include a chart with examples of how the different structures impact the leadership responsibilities with respect to board meetings, agendas and board communications.
- **Dual-class capital structures:** BlackRock believes that companies with dual or multiple class structures should review them regularly or as company circumstances change, and "receive shareholder approval of their capital structure on a periodic basis via a management proposal."

In summary, BlackRock's governance priorities for 2018 reflect a continued emphasis on the relationship between sustainability and long-term financial performance. In addition, the company has emphasized the importance of climate change and board diversity as significant factors for companies to consider in crafting thoughtful governance programs for its stakeholders.

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[1] *Note, that BlackRock's updated policy for a total of two boards is similar to that of Glass Lewis' with one important difference. Glass Lewis policy applies to executive officers while Blackrock's policy applies to CEOs only.*