BLACKROCK®

INVESTMENT STEWARDSHIP REPORT: EUROPE, THE MIDDLE EAST AND AFRICA

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Engagement and Voting Highlights

Ongoing governance and human capital concerns at a UK retailer

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To reflect our ongoing concerns with a UK retailer's corporate governance practices, we withheld support from a number of management proposals at the company's annual general meeting (AGM) this quarter. Following a shareholder proposal relating to the company's human capital management strategy at last year's AGM and our participation in a group investor meeting which also covered the matter, the company does not appear to have demonstrably improved its disclosures to sufficiently alleviate our concerns around the company's management practices. We, therefore, voted against the re-election of the non-executive directors who were serving on the board at the last AGM, as well as the Founder/Chief Executive.

In recent years, we have met with different members of this retailer's board to discuss broader governance matters including director independence, skills and competencies. However, we remain concerned with the company's director succession planning practices. The board currently lacks gender diversity – the only woman director recently stepped down. The company has stated that it is actively seeking applications from female directors. We anticipate the ongoing controversy surrounding the company's working practices could make director recruitment challenging. We view these types of recruitment gaps as indicative of poor succession planning and board processes. This recruitment gap also demonstrates the challenge of having only one woman director on a board. BIS voted against the re-election of the nomination committee members for the ongoing ineffective implementation of director succession planning. These committee members were also non-executive directors that were on the board at the time of last year's AGM. Approximately 12% of unaffiliated shareholders voted against the re-election of these directors this year, which is considerable given that over 50% of the company's voting power is controlled.

> A company's workforce is a key resource and can be a competitive advantage, particularly in a sector like retail. For this reason human capital management is an engagement priority for BlackRock. We engage on this topic to assess how companies ensure adherence to practices that foster workforce stability, engagement and well-being. In our view, board and senior management oversight of accountability on human capital is a critical contributing factor in sustained company performance.

We also raised concerns over the company's audit practices. Specifically, the company continues to pay its auditors more fees for non-audit work than for audit work, including in relation to advisory services in the last year. This raises the potential for a conflict of interest. We voted against the authority of the board to fix auditors' fees and abstained on the re-appointment of the auditor given the ongoing investigation into their questionable advice in 2016 regarding related party transactions.

Our second voting case study in our 2017 Q1 EMEA Quarterly Commentary provides additional details on our ongoing engagement and voting history with this UK retailer.

Relocation expenses raise concern

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BIS believes that exceptional compensation awards, such as excessive relocation packages, are not in shareholders' interests. Where we see extraordinary pay items, we generally expect a robust business case to be made for it. We outline our expectations around one-off awards within the Executive Remuneration section of our voting guidelines; however, these guidelines are not intended to be an exhaustive or a prescriptive list of requirements.

Last quarter, a UK energy supply company disclosed in its remuneration report a substantial one-off payment to reimburse its chief executive for relocation expenses within the UK. Among other things, the payment covered the stamp duty on a UK property owned by the chief executive and the reimbursement of the associated income tax.

Although the relocation arrangements were covered under the company's remuneration policy, we expect remuneration committees to apply an appropriate level of discretion to executive remuneration decisions. In our opinion, executives should be sufficiently remunerated to manage their affairs – without the need of an unduly generous supplemental relocation reimbursement – when relocating within a country. BIS withheld support for the remuneration report and, consistent with our voting guidelines, also withheld support from the remuneration committee members. We discussed our expectations and voting decision with the company prior to the AGM. The board is considering updating its remuneration policy to reflect our concerns.

Holding an audit committee to account

3 During this quarter the BIS team engaged with a large British telecommunication company regarding an accounting fraud scandal at one of its southern European operations. We spoke with the chairman of the audit committee in order to better understand the accounting irregularities that were identified and to discuss the remediation plan that the board was implementing. The company explained that detecting the accounting irregularities was difficult because a number of employees, including executives, had lied to the internal audit department and to the audit committee. The issues identified by the audit committee include the lack of qualified accountants, as well as low turnover and high internal promotion rates in the internal audit team. The company had been working with the same audit firm for more than 30 years. The company acknowledged that the fraud could have been avoided had the company been more diligent in its auditor compliance oversight.

BIS believes the company's remediation plan represents an appropriate first step in establishing the necessary protocols to prevent such auditing failures. Nevertheless, we voted against the re-election of the audit committee members consistent with our preferred approach to hold members of the relevant key committee accountable for material governance concerns. We will continue to monitor the developments related to these accounting failures and engage with the company, if appropriate.

We view the audit process as an essential evaluation of the company's current and future financial health. We pay close attention to the composition and the performance of audit committees and hold their members responsible for overseeing the management of the audit function. Through our engagement work we have come across a number of cases in which weak audit processes and practices have resulted in value destruction.

Working towards improving remuneration in the UK

4 In May 2017, we voted against the remuneration report of a UK publishing company and, consistent with our voting policy, voted against the re-election of the members of the remuneration committee. We withheld support from management on the basis of a misalignment between pay and economic value creation, despite the remuneration committee's downward discretion.

Our concerns were shared by the majority of shareholders and this advisory say-on-pay resolution was rejected at the AGM.

BlackRock Investment Stewardship's say-on-pay framework is based on an analysis of remuneration arrangements in the context of the company's stated strategy, value drivers, and performance. We believe that remuneration committees are in the best position to assess the performance of management and make remuneration decisions given their knowledge of the strategic plans of the company. However, we do not hesitate to engage with companies and express our concerns through our vote when our evaluation concludes that executives' compensation is misaligned with value creation.

Following the AGM, we engaged the company on two occasions to explain our views on the structure of the executives' incentive plan. We noted that adjustments to a plan may be required in the event of unanticipated outcomes. We also expressed our preference for performance measures that are within management control and closely tied to long-term economic value creation.

The outcome of our engagement with the company is not yet clear. We do recognize the company's proactive efforts to engage on the matter and view our ability to share our perspective as a positive development. We will continue to monitor the developments relating to the remuneration policy and intend to engage with the company if necessary.

Protecting shareholders' interests in a merger

5 In assessing mergers, asset sales or other special transactions, our primary consideration as a fiduciary investor is the long-term economic value to our clients. Boards proposing a transaction need to clearly articulate their economic and strategic rationale. We will review a proposed transaction to determine the degree to which it enhances long-term shareholder value. We prefer that proposed transactions have the unanimous support of the board and have been negotiated at arm's length. BIS may seek reassurance from the board that executives' and/or board members' financial interests in a given transaction have not adversely affected their ability to place shareholders' interests before their own.

We applied this analysis leading up to our extensive engagement with both the Chairman and the CEO of a UK payment technology company in relation to an offer the company received from a US peer/competitor. BlackRock has been the largest institutional investor in the company since its initial public offering (IPO) in 2015.

BIS' concerns relating to the merger offer included:

(i) the valuation and the offer price which we considered inadequate given the quality of the company's assets
(ii) the combined entity having to surrender its UK listing, resulting in many of our clients not being able to hold the shares in the new entity due to fund structures or restrictions on their investable universe (hence being forced sellers)
(iii) the speed by which the transaction was agreed by the management and the board leaving them no time to consider dialogue with other potential suitors

As the result of BlackRock's feedback (as well as similar feedback received from other investors), the bidder has taken steps to amend the structure of the offer. The new improved offer includes an improved valuation, the commitment to a secondary London listing, and the appointment of a number of the company's directors to the board of the combined entity. Overall, we were pleased that the revised terms addressed a number of our concerns.

Climate risk engagements shed light

6 BIS engages with companies around climate risk to better understand how anticipated consequences and scenarios could impact their business strategy and to promote the integration of these issues in company decision-making processes.

In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD), established under the auspices of the Financial Stability Board, published its final recommendations. BlackRock was a member of, and actively involved in, this industry-led initiative; we believe the recommendations provide a consistent framework within which companies can consider climate risk, adapt their governance and their strategy, and improve their reporting. Through our engagements with management teams and board members this quarter, we sought companies' views on the TCFD to understand how companies might apply the guidance to their management and reporting practices.

Our recent engagements with certain non-executive board members and investor relations managers, even of large emitters in the airlines and materials industries, revealed an unfamiliarity with the TCFD. We found this was surprising given institutional investor interest and the media's coverage of TCFD in the past 18 months.

European Union banks and climate risk

Our engagements also revealed that some companies viewed disclosure of climate risk as a compliance exercise. We observed this compliance mindset even among members of the [UNEP FI TCFD pilot project][1], which is developing tools and indicators to improve their assessment and disclosure of climate-related risks. Where we find companies insufficiently willing to respond to our concerns on how they manage climate risk, we take this into consideration when we exercise our voting rights.

Our engagements also regularly reveal companies demonstrating a deep understanding of the implications of climate change to their business.

During the summer 2017, we engaged with a French bank to understand their views on the TCFD recommendations and discussed climate risk reporting, including scenario analysis consistent with the goal of limiting the global increase in temperature to 2°C. The bank's approach to climate risks compares favorably to peer reporting. The bank is familiar with the TCFD framework and believes that its current integrated report is broadly in line with the core elements of the TCFD recommendations. The bank's strategy already includes climate change issues at both the group and division level and the bank has set clear performance targets (e.g. supporting customers improving their energy and carbon efficiency, increasing financing for renewable energies and financing environmental projects and services).

Additionally, the bank's Board of Directors has a Strategy and Corporate Social Responsibility Committee and the different divisions are in charge of the integration of environmental, social and governance (ESG) risk frameworks. The investment banking division is presumably the most exposed division to climate risks through its financing activities. Therefore, estimating the carbon exposure of the investment banking activities and halting all new financing of coal-fired power plants are considered by the bank as differentiating factors compared to peers. In the foreseeable future, climate risk scenarios will be set and used to stress test portfolios and overall, the resilience of the business model of the Group.

Also in the financial sector, we engaged with a Dutch bank on its views on the TCFD recommendations and on climate stress tests. Overall, we believe the bank has leading policies. The bank has conducted its own scenario analysis of its existing policies, and will describe its long-term risks positioned against climate risks in its next annual report. For instance, there are threshold ESG criteria in place for all loans. These help determine whether a transaction or a client can be considered sustainable. The bank also provides sustainable improvement loans to help clients move towards sustainable energy. The bank considers that its reporting is already in line with TCFD recommendations, and plans to expand on its efforts next year.

UK energy company scenario analysis for long-term decision making

BlackRock also engaged with a UK energy company to understand how it uses scenario analysis to consider climate risks / opportunities in the context of long-term decision making. We believe that an important step to assess the resilience of an organization's business model is its ability to project into the future. Scenario analysis provides one mechanism for companies to test their thinking and assumptions against a range of possible outcomes. It is particularly relevant for the energy industry to consider the material risks and impacts associated with climate risk and adaptation to a low carbon economy on its portfolio and strategy. The company framed the discussion in the context of a long-term, uncertain future given the transition of energy systems, the impact of demographic shifts, economic growth, environmental challenges, and technological advancements. Management explained that an uncertain future does not lend itself well to forecasting tools. Yet, the company believes such analysis can help the board and management 'stretch

[1] UNEP FI TCFD pilot project details are available at http://www.unepfi.org/news/industries/banking/eleven-unep-fi-member-banks-representing-over-7-trillion-are-first-in-industry-to-jointly-pilot-the-tcfd-recommendations/

its thinking' regarding multiple plausible outcomes. The real benefit of the scenarios rest in the company's agility to respond to near- and mid-term challenges as they arise.

We welcome the level of disclosure the company has provided and its long history of using scenarios. These engagements help us understand evolving practice and relative performance in this area. In future engagements with this company, and with other companies in the energy sector, we will review how scenario analysis is used to consider a two-degree world and aligns to the TCFD recommendations.

Director over boarding in EMEA

7 As part of BIS' evaluation of board quality and effectiveness, we consistently evaluate directors' board commitments. We note that over boarding continues to be an issue in a number of markets in the EMEA region and we have observed a variety of responses from companies relating to our position on this topic. We note that the topic of over boarding in the context of US companies is also discussed as a case study this quarter in our Americas 2017 Q3 Quarterly Report.

The "External board mandates" segment of our EMEA proxy voting guidelines notes that non-executive directorships are increasingly demanding and that board members will likely need to commit a considerable amount of their time to board and committee matters. For directors to effectively discharge their responsibilities, we believe that they should not serve on more than four public company boards. In the case of Chief Executive Officers, we expect that they not serve on more than two additional boards of public companies. We believe that additional commitments beyond these limits are likely to impair a director's ability to effectively contribute to the furtherance of the agendas of each of the boards on which they serve. Such over-commitments can present significant challenges in a situation where a company is facing a hostile takeover attempt, a strategic transformation, or/and pressure from activist investors, among other concerns.

Our preliminary research of some of the main European indices[2] shows that there appear to be in excess of 200 companies that have one or more directors with four or more mandates[3]. BIS recognizes that some of these cases may be related to exceptional circumstances. For this reason, BIS maintains a case-by-case approach to assessing over boarding. For example, the structure of a company can be such that a director sits on the board of a parent or holding company and also on various boards of its subsidiaries. There are also some instances in which we find professional directors whose sole responsibility is to serve on boards of companies where they represent a large investor. In instances like these, we assess the specifics of the situation and may consider that the director's presence on more than four boards will not necessarily result in time commitment constraints that could lead to performance issues.

We also have seen encouraging examples of companies that are addressing investors' concerns about over boarding. We recently engaged with a UK pharmaceutical company and with a UK mining company and, in both instances, the companies committed to address our concerns in relation to certain directors who were serving on more than four boards.

Our engagements and voting reveal that issuers are still appointing new directors despite their commitments on multiple boards and in contradiction to a large number of institutional investors' voting guidelines that aim to limit director over commitments. We also have seen cases where over boarding has resulted in adverse voting results and reputational damage that could have been largely prevented. This was the case at both a UK financial services company and a South African mining company where two of their respective directors received over 20% votes against their re-election due to over boarding concerns.

Despite certain strides towards reducing board commitments, we remain concerned that it is still quite common for directors to hold four or

[2] Indices analyzed: AEX, IBEX 35, Cac 40, DAX, FTSE MIB, SMI, FTSE 250

[3] Source: Director Insight

more board seats in several markets across EMEA. As part of our commitment to improving board quality and accountability, we intend to continue to actively engage companies around the issue of over boarding.

Cybersecurity risk engagements in the banking sector

8 The risk of cyberattacks on companies is undoubtedly on the rise and we anticipate that it will continue to be a preeminent topic in our engagement with issuers. We engage with companies in a variety of sectors on cybersecurity to understand their preparedness to high impact low probability events. We discuss with companies how they ensure they have the right systems and processes in place, as well as the appropriate skill sets among the individuals responsible for cybersecurity management and oversight.

This quarter we engaged with four European banks on board oversight of cyber risk. All banks recognized this to be one of their most relevant risks, if not the key risk. A range of approaches has been adopted to help the banks manage this risk, from internal development, management and testing, to a combined approach that uses both external advisors and internal testing. Some appear to employ a fully outsourced management, testing, and review process.

Our engagements provided us with varying degrees of comfort around how the banks are addressing the issue. We are more reassured by the banks which can participate in highly detailed discussions around the processes and testing that have been, and continue to be, carried out. While we do not believe there is a guaranteed way to protect against cyber-attacks – a view echoed more than once in our discussions with the banks – we do have more confidence in the boards that can elaborate and demonstrate ongoing vigilance on the matter, including through continued board training and management adaptation.

The impact of Brexit

9 BlackRock frequently engages portfolio companies on matters relating to corporate strategy and long-term value creation. When we do engage with board members on matters relating to corporate strategy, we are keenly aware that companies may need to adapt to a changing business environment. These were among the considerations for having recently engaged with the lead independent director of a large airlines company to discuss the potential impacts of Brexit on the company's British operations. European airlines benefit from "Open Skies" agreements. These agreements allow airlines to fly over European countries in order to access different markets. European Union (EU) law requires airlines which are granted operating licenses by Member State authorities to be majority-owned and controlled by EU nationals in order for them to benefit from the right to operate intra-EU air transport services. The large number of UK investors owning a stake in a European airline could impede EU majority ownership requirements, thus testing an airline's license to operate within the EU.

With Brexit likely to have an impact on the industry, airlines representatives are participating in on-going conversations with regulators aiming to develop solutions to these and other related challenges. We will monitor the evolution of these discussions in the industry through our engagements.

Engagement and Voting Statistics

United Kingdom Engagement Statistics[4]

	Level of Engagement[5]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
54	38	16	0	5	10	52

EMEA ex United Kingdom Engagement Statistics[4]

	Level of Engagement[5]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
37	25	12	0	14	14	35

*Most engagement conversations cover multiple topics. Our engagement statistics reflect the primary engagement topic for which the meeting was called.

EMEA Region Voting Statistics[5]

Country	Number of meetings voted	Number of proposals	% of meetings voted against one or more management recommendations	% of proposals voted against management recommendation
United Kingdom	188	2,677	27%	5%
EMEA ex United Kingdom	266	2,658	39%	9%
EMEA including United Kingdom Totals	454	5,335	34%	7%

[4]The EMEA including the United Kingdom engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on October 4, 2017 and both are a reflection of 3rd Quarter 2017.

[5]Basic engagement is generally a single conversation on a routine matter; Moderate engagement is technically more complex and generally involves more than one meeting; Extensive engagement is technically complex, high profile and involves numerous meetings over a longer time frame.

Active Ownership and Responsible Leadership

Speaking Events

Members of the Investment Stewardship EMEA team spoke at or participated in a number of events over the past quarter, with the objectives of furthering the debate on matters deemed important to investors and/or promoting an increased understanding of BlackRock's approach to Investment Stewardship. We target events that enable us to connect with key stakeholders and thought leaders, including corporate directors, senior members of management teams, and other shareholders.

Below is a list of select speaking events from the quarter, and subject matter covered:

- **Non-Financial Reporting for a Sustainable Circular Economy: Towards Greater Policy Coherence - Brussels**

  BlackRock spoke on a panel on the investor and stakeholder perspective on the circular economy at a conference aimed at identifying best practices for non-financial reporting. The event provided an opportunity to share our views with EU policymakers and other stakeholders. BlackRock's message centered on our belief that efforts should be aimed at making ESG integration mainstream, through the development of comparable standard framework for reporting on material issues. This will enable investors to meaningfully assess how these risks and opportunities are being managed by portfolio companies across regions and industries. We suggested that regulators could help by driving the market towards a standardized reporting framework, a recommendation BlackRock shared in our June 2016 Viewpoint publication entitled, "*Exploring ESG: A Practitioner's Perspective*".

- **International Petroleum Industry Environment Conservation Association (IPIECA) Working Group – London**

  We were invited to present at IPIECA's annual reporting working group meeting in September to share our approach to investment stewardship and our expectations of companies' disclosure of the material ESG risks and opportunities. Attendees were familiar with the TCFD recommendations but expressed some concern whether interpretation by some related disclosure frameworks/data providers could negatively impact their ESG climate score and, in turn, how this would affect the investment decisions of asset managers. Whilst we recognize there is not one size that fits all for reporting and the need to therefore reflect the individual circumstances and strategy of each company, we do believe that companies should act now; we recognize that disclosure and reporting will improve over time with experience. We explained how comparable investment decision useful information on material ESG matters such as climate risk and opportunities is critically important for a global long-term investor. The association has published very useful guidance on voluntary sustainability reporting for its members covering 12 sustainability issues and 34 indicators. Greater communication about this guidance could be beneficial to a range of stakeholders.

Market Development and Trends

PRI in Person – Berlin

BlackRock attended the PRI in Person event held in Berlin from September 25th to 27th. The event focused on sustainable finance and provided us with an opportunity to learn more about the PRI's Blueprint (i.e. its 10-year strategic plan) and also to provide additional feedback on PRI's plans to increase member accountability. Several sessions related to our climate risk engagement priority and reaffirmed that climate risk continues to be a priority for asset owners and other investors. Other sessions offered an opportunity to review the global geopolitical climate, the rise of populism, and the implications of increasing social and economic inequality for a range of actors. Developments in ESG integration were also considered in other sessions to demonstrate evolving practice.

Sustainable Stock Exchange Working Group – Berlin

BlackRock has been an active member of the Sustainable Stock Exchange working group for some time given our preference for a market wide solution to ESG disclosure. We participated in a roundtable discussion in September where we had the opportunity to share our views on long-termism in investing. The meeting also enabled BlackRock to reaffirm the importance of relevant, reliable and comparable disclosure of material ESG data as decision useful information for investors.

European Commission's Expert Group on Technical Aspects of Corporate Governance

BlackRock has been appointed to the European Commission's Expert Group on Technical Aspects of Corporate Governance processing. The mandate of the group is to provide practical advice to the Commission in relation to its work on technical aspects of the corporate governance of listed companies, including the use of modern information and communication technologies in corporate governance.

Prepared by BlackRock, Inc.