

BlackRock Investment Stewardship's approach to executive compensation

The following describes the beliefs and expectations of BlackRock Investment Stewardship (BIS) related to executive compensationⁱ practices, our Say on Payⁱⁱ analysis framework, and our typical approach to engagement and voting on Say on Pay. We provide our views on this issue in somewhat more detail than other issues covered in our various regional proxy voting guidelines because of the particular focus on executive compensation matters following the adoption of Say on Pay regulations in a number of markets. This approach is generally meant to be global in scope, although we acknowledge that Say on Pay and relevant disclosures are not applicable to every jurisdiction.

The key purpose of executive compensation is to attract, reward, and retain competent directors, executives and other staff who are fundamental to the long-term sustainable growth of the company, with reward for executives contingent at least in part on controllable outcomes that add value. BlackRock believes that each company should structure their executive compensation policies and practices in a manner that suits the needs of that particular company given the broader context and environment it operates in.

We expect proxy disclosures to be the primary mechanism for companies to explain their executive compensation practices. We may engage with companies, preferably independent members of the compensation committee of the board, where concerns are identified or where we seek to better understand a company's approach to executive compensation. BIS may also decline opportunities to engage with companies where we do not have any questions or concerns or believe that existing company disclosures sufficiently address the issues at hand. Engagement is most likely to be meaningful and mutually beneficial if the company is already advanced in its remuneration setting process, i.e. it brings to the discussion a final or nearly final proposal and accompanying rationale as to why the proposal is in shareholders' best long-term economic interests. We do not think it is appropriate or useful for companies to engage with us primarily for the purpose of gaging our support in advance of the annual general meeting.

Beliefs and expectations related to executive compensation practices

- We believe that compensation committees are in the best position to make compensation decisions and should maintain significant flexibility in administering compensation programs, given their knowledge of the strategic plans for the company, the industry in which the company operates, the appropriate performance measures for the company, and other issues internal and/or unique to the company.
- Companies should explicitly disclose how incentive plans reflect strategy and incorporate drivers of long-term shareholder value; this discussion should include the metrics and timeframes by which shareholders should assess performance.
- BlackRock believes that executive compensation plans should allow compensation committees to have discretion to make adjustments as a result of unintended outcomes from plans. Where discretion has been used by the compensation committee we expect disclosure relating to how and why the discretion was used and further, how the adjusted outcome is aligned with the interests of shareholders.
- We support incentive plans that foster the sustainable achievement of results. Although we believe that companies should identify those performance measures most directly tied to shareholder value creation, we also believe that emphasis should be on those factors within management's control to create economic value over the long-term, which should ultimately lead to sustained shareholder

returns over the long-term. Similarly, the vesting timeframes associated with incentive plans should facilitate a focus on long-term value creation, as appropriate to that particular company.

- We expect full disclosure of the performance measures selected and the rationale for their selection.
- While we do support the concept of compensation formulas that allow shareholders to clearly understand the rationale for compensation decisions, we do not believe that a solely formulaic approach to executive compensation necessarily drives shareholder value. BlackRock believes that compensation committees should use their discretion in designing incentive plans, establishing pay quanta, and finalizing compensation decisions, and should demonstrate how decisions are aligned with shareholder interests. Where a compensation committee has used its discretion in determining the outcome of any compensation structure we expect transparency with respect to how and why discretion was used.
- BlackRock does not discourage compensation structures that differ from market practice. However, where compensation practices differ substantially from market practice, *e.g.* in the event of unconventional incentive plan design or extraordinary decisions made in the context of transformational corporate events or turnaround situations, we expect clear disclosure explaining how the approach taken is in shareholders' best interests.
- We understand that compensation committees are undertaking their analysis in the context of a competitive marketplace for executive talent. We acknowledge that the use of peer group evaluation by compensation committees can help ensure competitive pay; however we are concerned about the potential ratchet effect of explicit benchmarking to peers. We therefore believe that companies should use peer groups to maintain an awareness of peer pay levels and practices so that pay is market competitive, while mitigating potential ratcheting of pay that is disconnected from actual performance.
- We expect companies to select peers that are broadly comparable to the company in question, based on objective criteria that are directly relevant to setting competitive compensation; we evaluate peer group selection based on factors including, but not limited to, business size, relevance, complexity, risk profile, and/or geography.
- We do not believe that arbitrary limits on potential compensation are necessarily in shareholders' best interests if those limits have the potential to cap performance. However, we expect compensation committees to ensure that incentive plans do not incentivize excessive risk taking beyond the company's determined risk appetite and that rewards are reasonable in light of returns to shareholders.
- We do not set forth a preference between cash, restricted stock, performance based equity awards, and stock options, amongst other compensation vehicles. We acknowledge that each may have an appropriate role in recruiting and retaining executives, in incentivizing behavior and performance, and in aligning shareholders' and executives' interests. Compensation committees should clearly disclose the rationale behind their selection of pay vehicles and how these fit with intended incentives. We also observe that different types of awards exhibit varying risk profiles, and the risks associated with pay plan design should be in line with the company's stated strategy and risk appetite.
- We expect compensation committees to consider and respond to the shareholder voting results of relevant proposals at previous years' annual meetings, and other feedback received from shareholders, as they evaluate compensation plans. At the same time, compensation committees should ultimately be focused on incentivizing long-term shareholder value creation and not necessarily on achieving a certain level of support on Say on Pay at any particular shareholder meeting.

Say on Pay Analysis Framework

- We analyse the compensation practices in the context of the company's stated strategy and identified value drivers and seek to understand the link between strategy, value drivers and incentive plan design.
- We examine both target and realizable compensation in order to understand the compensation committee's intended outcomes, to judge the appropriateness and rigor of performance measures and hurdles, and to assess the pay plan's sensitivity to the performance of the company.
- We make an assessment of the relevance of the company's stated peers and the potential impact the company's peer selection may have on pay decisions.
- We conduct our analysis over various time horizons, with an emphasis on a sustained period, generally 3-5 years; however we consider company-specific factors, including the timeframe the company uses for performance evaluation, the nature of the industry, and the typical business cycle, in order to identify an appropriate timeframe for evaluation.
- We review key changes to pay components from previous years and consider the compensation committee's rationale for those changes.
- We examine extraordinary pay items (including but not limited to actual or contractual severance payments, inducement grants, one-time bonus and/or retention awards) to understand the compensation committee's rationale and alignment with shareholder interests.
- We may engage with companies, preferably independent members of the compensation committee of the board, where concerns are identified or where we seek to better understand a company's approach to executive compensation.
- We consider BlackRock's historical voting decisions (including whether a concern that led to a previous vote against management has been addressed, or whether we determined to support management at previous shareholder meetings with the expectation of future change), engagement activity, other corporate governance concerns at the company, and the views of our portfolio managers.
- We assess the board's responsiveness to shareholder voting results of relevant proposals at previous years' annual meetings, and other feedback received from shareholders.

Engagement and Voting on Say on Pay

- In many instances, we believe that direct discussion with issuers, in particular with the members of the compensation committee, can be an effective mechanism for building mutual understanding on executive compensation issues and for communicating any concerns we may have on executive compensation.
- In the event that we determine engagement is not expected to lead to resolution of our concerns about executive compensation, we may consider voting against members of the compensation committee, consistent with our preferred approach to hold members of the relevant key committee of the board accountable for governance concerns.
- We may determine to vote against the election of compensation committee members and/or Say on Pay proposals in certain instances, including but not limited to when:
 - We identify a misalignment over time between target pay and/or realizable compensation and

company performance as reflected in financial and operational performance and/or shareholder returns;

- We determine that a company has not persuasively demonstrated the connection between strategy, long-term shareholder value creation and incentive plan design;
- We determine that compensation is excessive relative to peers without appropriate rationale or explanation, including the appropriateness of the company's selected peers;
- We observe an overreliance on discretion or extraordinary pay decisions to reward executives, without clearly demonstrating how these decisions are aligned with shareholders' interests;
- We determine that company disclosure is insufficient to undertake our pay analysis; and/or
- We observe a lack of board responsiveness to significant investor concern on executive compensation issues.

Contact BlackRock Investment Stewardship at contactstewardship@blackrock.com

ⁱ The term 'compensation' is used as an equivalent to the words 'remuneration' or 'pay'.

ⁱⁱ The terminology can vary depending on markets but 'Say on Pay' is the generic expression referring to the ability of shareholders to vote on the compensation of executives. The vote can be advisory or binding, as well as prospective or retrospective.