BlackRock Investment Stewardship

Proxy voting guidelines for Chinese securities

Effective as of January 2021
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If you would like additional information, please contact:
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These guidelines should be read in conjunction with the BlackRock Investment Stewardship Global Principles. For companies with more than one listing, including a listing outside of China, we expect companies to apply corporate governance practices of the jurisdiction with the highest standards.

Executive Summary

We believe BlackRock has a responsibility to monitor and provide feedback to companies, in our role as stewards of our clients’ investments. BlackRock Investment Stewardship (“BIS”) does this through engagement with management teams and/or board members on material business issues including environmental, social, and governance (“ESG”) matters and, for those clients who have given us authority, through voting proxies in the best long-term economic interests of our clients.

BlackRock has developed guidelines for the key markets in which it invests. The market specific guidelines incorporate the legal framework as well as the specific practices of each market. There may be slight variances due to differing market practices.

Our policies for China are based on the Company Law, Securities Law, Listing Rules of Shanghai and Shenzhen Stock Exchange, and the Code of Corporate Governance promulgated by the China Securities Regulatory Commission (the CSRC) and other relevant guidelines such as the Guidelines of Introducing Independent Directors to the Board of Directors of Listed Companies¹ established also by the CSRC. These all have in common the principles of accountability, transparency, fairness and responsibility.

Our approach to voting and corporate engagement is also informed by guidance on exercising ownership responsibilities issued by organizations such as the United Nations (the Principles of Responsible Investment) and the International Corporate Governance Network. We are actively involved in these and a number of other regional and global organizations and believe our principles are consistent with their guidance.

“Comply or explain” approach

The Code of Corporate Governance is implemented on a comply-or-explain basis. Companies are allowed to not adopt recommended practices as long as a cogent explanation has been provided for non-compliance with the particular practice. BlackRock expects companies that do not follow recommended practices to provide explicit justification of any deviation by explaining how these serve the interests of the company’s shareholders.

Engagement

BlackRock looks to companies to provide timely, accurate and comprehensive reporting on all material governance and business matters including ESG issues. This allows shareholders to appropriately understand and assess how relevant risks and opportunities are being effectively identified and managed. Where company reporting and disclosure is inadequate or the approach taken is inconsistent with our view of what supports sustainable long-term value creation, we will engage with a company and/or use our vote to encourage a change in practice.

BlackRock views engagement as an important activity; engagement provides us with the opportunity to improve our understanding of the business and ESG risks and opportunities that are material to the companies in which our clients invest. As long-term investors on behalf of clients, we seek to have regular and continuing dialogue with executives and board directors to advance sound governance and sustainable business practices, as well as to understand the effectiveness of the company’s management and oversight of material issues. Engagement is an important mechanism for providing feedback on company practices and disclosures, particularly where we believe they could be enhanced. We primarily engage through direct dialogue but may use other tools such as written correspondence to share our perspectives. Engagement also informs our voting decisions.

¹ http://www.csirc.gov.cn/pub/newsite/flfbflfg/bmgf/sss/gszl/201012/t20101231_189696.html
We may also participate in joint intervention with other shareholders where concerns have been identified by a number of investors. Alternatively, for our active holdings, we may consider reducing our holding in a company which is unresponsive to shareholder concerns; or for index as well as active holdings, we may publicly oppose management who are unresponsive to these concerns.

**Proxy voting approach**

BlackRock is one of the world’s largest institutional investors, with extensive investment and engagement experience globally. BlackRock aims to vote at 100% of the annual and extraordinary shareholder meetings where we have the voting authority to do so.

These guidelines will be used to assist BlackRock in assessing proposals presented at shareholder meetings. When assessing any proposal put to shareholders BlackRock takes into account the unique circumstances of the relevant company and our assessment of the impact of such a proposal on the sustainable growth of the company. We aim to engage with management or members of the board, as appropriate, on contentious and high profile issues before determining how to vote.

These guidelines are divided into ten key themes as follows:

- Boards and directors;
- Supervisory board;
- Accounts, statutory reports, auditors and audit-related issues;
- Capital management;
- Capital structure, mergers, asset sales, related-party and other special transactions;
- Strategy, purpose, and culture;
- Compensation and benefits;
- Environment and social issues;
- General corporate governance matters;
- Shareholder proposals

**Boards and directors**

The performance of the board is critical to the economic success of the company and the protection of shareholders’ interests. As part of their responsibilities, board members owe fiduciary duties to shareholders in overseeing the strategic direction and operation of the company. For this reason, BlackRock focuses on directors in many of our engagements and sees the election of directors as one of our most important responsibilities in the proxy voting context.

**Director elections**

We support boards whose approach is consistent with creating sustainable long-term value. This includes the effective management of strategic, operational, and material ESG factors and the consideration of key stakeholder interests. Our primary focus is on the performance of the board of directors. The board should establish and maintain a framework of robust and effective governance mechanisms to support its oversight of the company’s strategic aims. We look to the board to articulate the effectiveness of these mechanisms in overseeing the management of business risks and opportunities and the fulfillment of the company’s purpose. Disclosure of material issues that affect the company’s long-
term strategy and value creation, including material ESG factors, is essential for shareholders to be able to appropriately understand and assess how the board is effectively identifying, managing, and mitigating risks.

Where a company has not adequately disclosed and demonstrated these responsibilities, we will consider withholding our support for the re-election of directors whom we hold accountable. We assess director performance on a case-by-case basis and in light of each company’s particular circumstances, taking into consideration our assessment of their governance, sustainable business practices, and performance.

Composition of the board of directors

Regular director elections also give boards the opportunity to adjust their composition in an orderly way to reflect the evolution of the company’s strategy and the market environment. BlackRock believes it is beneficial for new directors to be brought onto the board periodically to refresh the group’s thinking and in a manner that supports both continuity and appropriate succession planning. We expect companies to keep under regular review the effectiveness of its board (including its size), and assess directors nominated for election or re-election in the context of the composition of the board as a whole. This assessment should consider a number of factors, including the potential need to address gaps in skills or experience, the diversity of the board, and the balance of independent and non-independent directors. We also consider the average tenure of the overall board, where we are seeking a balance between the knowledge and experience of longer-serving members and the fresh perspectives of newer members.

Board independence

At a minimum we believe independent directors should comprise at least one-third of the board for these directors to represent an effective voice. Ideally, a board should consist of a majority of independent directors.

In cases where the board is not at least one third independent and where no explanation has been provided, BlackRock may consider voting against the re-election of the chair of the nomination committee, and/or the chair of the board, particularly if there are other corporate governance concerns.

Assessment of independence

We expect there to be a sufficient number of independent directors, free from conflicts of interest or undue influence from connected parties, to ensure objectivity in the decision-making of the board and its ability to oversee management.

An independent director is a director who is not a member of management (a non-executive director) and who:

- Does not have, and does not represent a shareholder with, a substantial shareholding in the company;
- Has not within the last five years been employed in an executive capacity by the company or another group company, and has not been appointed a director immediately after ceasing to hold any such employment;
- Has not within the last three years been a principal or employee of a material professional adviser or a material consultant to the company or another group member;
- Is not a material supplier or customer of the company or another group member or an officer of or otherwise associated directly or indirectly with a material supplier or customer;
- Has no material contractual relationship with the company or another group member other than as a director of the company;
- Is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director’s ability to act in the best interests of the company;
- Is not an immediate family member of any of the aforementioned; and
• Is not connected through interlocking directorships with the company.

Conflicts of interest

BlackRock believes that all independent directors should be free from material conflicts of interest. Non-executive directors, their immediate family or a related professional company, who or which have provided material professional services to a company at any time during the last three years, may be placed in a position where they may have to make decisions that may place their interests against those of the shareholders they represent. BlackRock may vote against the election/re-election of a director where an identified conflict of interest may pose a significant and unnecessary risk to shareholders. All potential conflicts of interest should be declared prior to appointment and at each board meeting in relation to any specific agenda items.

Separation of chairman and CEO position

We believe that independent leadership is important in the board room. There are two accepted structures for independent board leadership: 1) an independent chairman; or 2) a lead independent director. We generally consider the designation of a lead independent director as an acceptable alternative to an independent chair if the lead independent director has a term of at least one year and has powers to: 1) introduce items on board meeting agendas; 2) call meetings of the independent directors; and 3) preside at meetings of independent directors. Where a company does not have a lead independent director that meets these criteria, we generally support the separation of chairman and CEO and may vote against the election or re-election of a non-independent chairman.

Length of service

BlackRock believes that shareholders are best served when there is orderly renewal of the board. This should result in directors with accumulated experience while at the same time introduce fresh minds and experience to the board as well as provide adequate succession planning. An effective renewal process will ensure non-executive directors do not serve for such lengths of time that their independence may be impaired although this is not a severe concern in China because the CSRC has a guiding opinion which caps the tenure of independent directors at six years.

BlackRock may consider voting against the re-election of directors who have been on the board for a significant period of time and especially if there is no evidence of board renewal.

Board effectiveness

To ensure that the board remains effective, regular reviews of how it makes decisions and the information it receives should be carried out and assessments made of gaps in skills or experience amongst the members. In identifying potential candidates, boards should take into consideration the diversity of experience, expertise and perspectives of the current directors and how that might be augmented by incoming directors. Diversity recognizes differences relating to gender, age, ethnicity, and cultural background. Our publicly available commentary explains our approach to engaging on board diversity.

We believe that directors are in the best position to assess the composition and optimal size of the board, but we would be concerned if a board seemed too small to have an appropriate balance of directors or too large to be effective.

We expect the board to establish a robust process to evaluate the performance of the board as a whole and the contributions of each director. BlackRock believes that annual performance reviews of directors and the board contribute to a more efficiently functioning board.

Share ownership by non-executive directors

BlackRock believes listed companies should have a clear and disclosed policy on non-executive director share ownership. We believe that non-executive directors should have some “skin in the game” in order to align their interests with those of public shareholders. Such policies should require non-executive directors, within a reasonable amount of time after joining the board, to accumulate a meaningful investment.
Where a non-executive director continues serving on a board and fails to accumulate a meaningful investment and other significant corporate governance issues exist, BlackRock may vote against the individual.

**Nomination procedure**

The company should have a formal and transparent procedure for the appointment and re-appointment of directors. The board should adopt a procedure that can ensure a diverse range of candidates to be considered. Such procedure may involve the engagement of an external professional search firm.

When nominating new directors to the board, there should be detailed information on the individual candidates in order for shareholders to assess the suitability of an individual nominee and the overall board composition. These disclosures should give a clear sense of how the collective experience and expertise of the board aligns with the company’s long-term strategy and business model. We also expect disclosures to demonstrate how diversity is accounted for within the proposed board composition, including demographic factors such as gender, ethnicity, and age; as well as professional characteristics, such as a director’s industry experience, specialist areas of expertise, and geographic location.

The procedure for the nomination and evaluation of the board should be disclosed in the corporate governance section in the annual report. We seek information to understand how the board composition reflects the company’s stated strategy, trends impacting the business and succession expectations. Where this information is not provided, BlackRock may consider voting against re-election of members on the nomination committee.

**Regular accountability**

BlackRock believes that directors should stand for re-election on a regular basis, ideally annually. In our experience, annual re-elections allow shareholders to reaffirm their support for board members or hold them accountable for their decisions in a timely manner. When board members are not re-elected annually, we believe it is good practice for boards to have a rotation policy to ensure that, through a board cycle, all directors have had their appointment re-confirmed, with a proportion of directors being put forward for re-election at each annual general meeting.

**Disclosure of director information**

BlackRock expects the following information to be disclosed in the annual report and company website, and the meeting circular when a director is seeking election/re-election:

- Directors’ full name and age
- Date appointed to the board (in the case of re-election)
- Brief biography detailing the directors’ educational background, working experience, and any other board positions held
- Specific discussion on the skills and experience the director is expected to contribute to the board
- The company’s assessment of the director’s independence including details of any current dealings with the company

Particularly when a director is seeking election/re-election it is imperative the above information is provided to allow us to determine whether to support the appointment. Where this information is not forthcoming, BlackRock may consider voting against the election/re-election of that director.

**External board mandates**

As the role of a director is demanding, directors must be able to commit an appropriate amount of time to board and committee matters. It is important that every director has the capacity to meet all of his/her responsibilities - including when there are unforeseen events – and therefore, he/she should not take on an excessive number of roles that would impair his/her ability to fulfill his/her duties.
BlackRock expects companies to provide a clear explanation of the capacity to contribute in situations where a board candidate is (1) a director serving on more than six public company boards; (2) a chairman of another listed company, or (3) an executive officer at a public company and is serving on more than two other public company boards. When looking at the number of board mandates, BlackRock will usually count as one board membership all memberships on boards of listed companies in the same group, except when the subsidiaries operate in different sectors.

BlackRock may vote against the election/re-election of a director where there is a risk the director may be over-committed in respect of other responsibilities and/or commitments (taking into account outside employments and/or board mandates on private companies/investment trusts/foundations). In the case of an executive officer, we would vote against his/her election/re-election only at external boards.

BlackRock may vote against the election of an outside executive as the chairman of the board as we expect the chairman to have more time availability than other non-executive board members. We expect the company to explain why it is necessary for an external executive to lead the board of directors.

Meeting attendance

Although not required, BlackRock believes a listed company should make full disclosure of the attendance of all directors at board and relevant committee meetings in the annual report because this is an important indicator of whether directors are discharging their duties to shareholders effectively.

Directors should ensure they attend all board and relevant committee meetings. BlackRock will consider voting against a director who fails to attend fewer than 75% of board and relevant committee meetings over his or her past term of being a director, unless compelling reasons for the absenteeism have been disclosed. However, BlackRock will disregard attendance in the first year following appointment as the director may have had commitments made prior to joining the board.

Committees

 Appropriately structured board committees provide an efficient mechanism which allows the board to focus on key issues such as audit, board renewal, compensation, risk and any other issues deemed important. Board committees can also provide an important role dealing with conflicts of interests.

BlackRock expects all companies to establish an audit committee and encourages all companies to establish nomination and compensation committees. All committees should have written terms of reference which should, inter alia, clearly set out the committee’s roles and responsibilities, composition, structure, membership requirements and the procedures for inviting non-committee members to attend meetings. All committee terms of reference should be made public on the company’s website.

All committees should be given the power and resources to meet their obligations under the terms of reference. This will include the right of access to management and the ability to select service providers and advisors at a reasonable cost to the company.

The chairman of a committee should be independent. It is preferable for the chairman of the board not to chair board committees as this may lead to a concentration of power in a single director.

BlackRock expects all companies to disclose whether the key committees are established, and if so, the composition of the key committees, the frequency of committee meetings, and the attendance record of each member on the committee.

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2 Chinese companies are only required to disclose the meeting attendance record of independent directors at board meetings in the annual report.
**Audit committee**

The audit committee should comprise only non-executive directors and a majority of independent directors, an independent chair and with at least one member having appropriate accounting or related financial background.

The terms of reference for the audit committee should have appropriate powers to determine the scope of the audit process, review the effectiveness of the external auditor, assess, review and authorise non-audit work, have access to the internal audit process and to make recommendations regarding the appointment and removal of the external auditor.

Where a risk committee has been established in addition to an audit committee, clear disclosure needs to be made on the responsibilities of each committee and how they interact.

BlackRock generally does not support the election of an executive director to be on the audit committee. Where the audit committee does not comprise a majority of independent directors and the chair is not independent, BlackRock will consider voting against the re-election of the non-independent members of the audit committee particularly if there are other corporate governance issues. Further, where there is evidence showing failure of the audit committee relating to the preparation of financial statements, fraud and general accountability to shareholders, we will consider voting against the re-election of members of the audit committee.

**Compensation committee**

The compensation committee should comprise a majority of independent directors and have an independent chair. The responsibilities of the compensation committee should include a review of and recommendations to the board on issues including but not limited to:

- The company’s compensation, recruitment, retention and termination policies for senior executives;
- Executive director and senior executives fixed and performance-based compensation to ensure that executives are motivated to pursue the long-term growth and success of the company; and
- The compensation framework for non-executive directors.

Where BlackRock believes the compensation committee has failed in its role, we will consider voting against the re-election of the chair/members of the committee.

**Nomination committee**

The nomination committee should comprise a majority of independent directors and have an independent chair. The responsibilities of the nomination committee should include a review of and recommendations to the board on issues including but not limited to:

- Assessing the competencies of all directors to ensure the board has an appropriate range of skills and expertise;
- Implementing a plan for identifying, assessing and enhancing director competencies;
- Reviewing, at least annually, the succession plans of the board;
- Ensuring the size and composition of the board is conducive to making appropriate decisions;
- Reviewing the time required of each non-executive director to undertake their role and whether non-executive directors are meeting that requirement;
- Ensuring a process for the evaluation of the performance of the board, its committees and directors and reporting the process to shareholders in the corporate governance report in the annual report;
- The appointment and re-election of directors; and
• Maintaining a watching brief on the development of management and potential for senior executive succession planning from the level below senior executives.

Circumstances where BlackRock may consider voting against the re-election of the chair and/or members of the nomination committee include but are not limited to:

• If the composition of the board continues to reflect poor succession planning, renewal or other composition deficiency;

• If the committee approved the nomination or re-election of an individual who has demonstrated a lack of integrity or inability to represent the interests of shareholders or who has an actual or perceived material conflict of interest that poses a risk to shareholders; or

• If the committee fails to hold a meeting in the reporting year.

Risk oversight

Companies should have an established process for identifying, monitoring, and managing key risks. Independent directors should have ready access to relevant management information and outside advice, as appropriate, to ensure they can properly oversee risk management. We encourage companies to provide transparency around risk measurement, mitigation, and reporting to the board. We are particularly interested in understanding how risk oversight processes evolve in response to changes in corporate strategy and/or shifts in the business and related risk environment. Comprehensive disclosure provides investors with a sense of the company’s long-term operational risk management practices and, more broadly, the quality of the board’s oversight. In the absence of robust disclosures, we may reasonably conclude that companies are not adequately managing risk.

Supervisory board

China has adopted a two-tier structure of board governance. In addition to the board of directors, there is also a supervisory board. According to the Company Law of the People’s Republic of China, the supervisory board is authorized to check the financial affairs of the company and to ensure that board directors and senior managers have fulfilled their obligation of fidelity and diligence; and when they have not, propose to remove a director or senior manager and demand rectifications.3

The supervisory board must have a minimum of three members, comprising shareholder and employee representatives. No less than one third of members are required to be employee representatives. The supervisory board should be independent of the board of directors, and thus, directors, managers, and financial officers should not be supervisors. BlackRock will generally support the re-election of members of supervisory boards where the structure of the supervisory board meets the legal requirement. However, BlackRock will consider voting against the re-election of a supervisory board member where we have concerns regarding the performance of the candidate or when the candidate has a relationship with the external audit firm.

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3 Article 54 of the Company Law of the People’s Republic of China.
Accounts, statutory reports, auditors and audit-related issues

Accounts and statutory reports

BlackRock recognizes the critical importance of financial statements, which should provide a true and fair picture of a company’s financial condition. Accordingly, the assumptions made by management and reviewed by the auditor in preparing the financial statements should be reasonable and justified.

The accuracy of financial statements, inclusive of financial and non-financial information, is clearly of paramount importance to BlackRock. Investors’ views on financial materiality are developing to encompass a broader range of risks. Over time, we expect increased scrutiny of the assumptions underlying financial reports.

In this context, audit committees or equivalent play a vital role in a company’s financial reporting system, by providing independent oversight of the accounts, material financial and non-financial information, internal control frameworks and Enterprise Risk Management systems. BlackRock believes that effective audit and risk committee oversight strengthens the quality and reliability of a company’s financial statements and operations and provides an important level of reassurance to shareholders.

We hold the members of the audit committee or equivalent responsible for overseeing the management of the audit function. Audit committees or equivalent should have clearly articulated charters that set out the committee’s responsibilities and have a rotation plan in place that allows for a periodic refreshment of the committee memberships.

We take particular note of critical accounting matters, cases involving significant financial restatements or ad hoc notifications of material financial weakness. In this respect, audit committees should provide timely disclosure on the remediation of Key and Critical Audit Matters identified either by the external auditor or Internal Audit function.

The integrity of financial statements depends on the auditor being free of any impediments to being an effective check on management. To that end, we believe it is important that auditors are, and are seen to be, independent. Where the audit firm provides services to the company in addition to the audit, the fees earned should be disclosed and explained. Audit committees should have in place a procedure for assessing annually the independence of the auditor and the quality of the external audit process.

Comprehensive disclosure provides investors with a sense of the company’s long-term operational risk management practices and, more broadly, the quality of the board’s oversight. The audit committee or equivalent should periodically review the company’s risk assessment and risk management policies and significant risks and exposures identified by management, the internal auditors or the independent accountants, and management’s steps to address them. In the absence of robust disclosures, we may reasonably conclude that companies are not adequately managing risk.

Auditors and audit-related issues

The appointment of the auditor and the auditor’s compensation needs to be reviewed and approved by shareholders on an annual basis. BlackRock expects the audit firms to be well qualified to undertake the task on behalf of shareholders. When a listed company proposes to appoint a different audit firm, BlackRock expects the company to provide a reasonable explanation for changing its audit firm, assuring shareholders that there are no disputes with company management connected with the auditor ceasing to hold office. Where no explanation is provided, BlackRock may consider voting against the appointment of a new audit firm and against the re-election of members on the audit committee.

BlackRock’s view is that a demonstrably independent audit is essential for investor confidence. BlackRock expects companies to make detailed disclosure of auditor compensation. Where non-audit fees exceed the level of audit fees in any year, BlackRock will review the nature of the non-audit fees and any explanation provided by the company for the significant level of non-audit fees. Full details of all non-audit work should be disclosed. Where non-audit fees exceed the fee for the audit we believe there is a risk that the independence of the audit may be impaired. In such cases we may consider voting against the re-appointment of the external auditor and against the re-election of members on the audit committee.
Capital management

Allocation of profits/dividends

In China, companies are required to submit to shareholders for approval the allocation of income. These proposals are generally not contentious and are supportable. However, where dividend payout ratios appear, without explanation, to be too high or too low BlackRock may consider voting against relevant individuals on the board.

Issuance of equities and equity-linked securities

The issuance of equities and equity-linked securities such as convertible bonds requires the approval of shareholders. Further, companies are required to provide detailed information around the issue manner, size, price, places if it is a private placement, and the intended usage of the raised proceeds.

BlackRock reviews such equity financing requests on a case by case basis where the key considerations include the effect of ownership and earnings dilution to existing shareholders, the company’s current capital structure, the intended usage of planned proceeds and how it aligns with the company’s business development strategy, and the rationale of why other financing methods are not explored. BlackRock generally does not support the issuance of new shares to a controlling shareholder at a deep discount unless a cogent explanation is provided.

Issuance of debt instruments

The issuance of debt instruments such as corporate bonds, short-term and mid-term notes also requires approval from shareholders. The amount of outstanding debt instruments after issuance is capped at 40% of the last audited net asset value of the company.

BlackRock’s view is that the board and management is in the best position to decide how to best utilize its debt capacity and optimize its capital structure. Moreover, the CSRC has stringent requirements on the profitability and credit rating of companies applying for debt issuance. Because of the tight regulatory environment, BlackRock does not view such proposals to be problematic and generally votes in favor.

Application of bank credit lines

Chinese companies routinely ask for shareholder approval at the annual general meeting for the proposed aggregate credit lines from commercial banks during the year. We view this is purely a commercial activity and best left with the board and management. BlackRock generally votes in favor of such proposals.

Provision of loan guarantees

Chinese companies routinely provide loan guarantees to subsidiaries and associates (and joint ventures), and sometimes affiliates and unrelated parties. When the cumulative amount of such guarantee provision exceeds a certain threshold as prescribed in details by the Listing Rules of the Shanghai and Shenzhen Stock Exchange, shareholder approval is required for any subsequent guarantee provision.

BlackRock generally supports the provision of loan guarantees to subsidiaries. We also support the guarantee provision to associates (and joint ventures) if the guarantee provision is proportionate to the company’s equity stake in the associates. We generally do not support the provision of loan guarantees to affiliates, particularly a controlling shareholder, or unrelated parties unless a cogent explanation is provided.

Provision of loans

Companies at times propose to provide loans, often termed financial assistance, to subsidiaries and associates, and sometimes affiliates and unrelated parties. These loan provisions need to be approved by shareholders.
BlackRock generally supports the provision of loans to subsidiaries. We also support the loan provision to associates (and joint ventures) if the loan provision is proportionate to the company’s equity stake in the associates. We generally do not support the provision of loans to affiliates, particularly a controlling shareholder, or unrelated parties unless a cogent explanation is provided.

**Capital structure, mergers, asset sales, related-party and other special transactions**

The capital structure of a company is critical to shareholders as it impacts the value of their investment and the priority of their interest in the company relative to that of other equity or debt investors. Pre-emptive rights are a key protection for shareholders against the dilution of their interests.

**Dual class shares**

Effective voting rights are basic rights of share ownership and we believe strongly in one vote for one share as a guiding principle that supports effective corporate governance. Shareholders, as the residual claimants, have the strongest interest in protecting company value, and voting power should match economic exposure.

In principle, we disagree with the creation of a share class with equivalent economic exposure and preferential, differentiated voting rights as it violates the fundamental corporate governance principle of proportionality, and results in a concentration of power in the hands of a few shareholders, thus disenfranchising other shareholders and amplifying any potential conflicts of interest. However, we recognize that in certain markets, at least for a period of time, companies may have a valid argument for dual-class listings. We believe that such companies should review these share class structures on a regular basis or as company circumstances change. Additionally, they should receive shareholder approval of their capital structure on a periodic basis via a management proposal at the company’s shareholder meeting. The proposal should give unaffiliated shareholders the opportunity to affirm the current structure or establish mechanisms to end or phase out controlling structures at the appropriate time, while minimizing costs to shareholders.

As always, independent directors are expected to protect the interests of all shareholders and BlackRock will potentially vote against re-election of independent directors in companies with dual class share structures if valid concerns arise relating to the economic interests of unaffiliated shareholders being compromised.

**Mergers, asset sales, related-party, and other special transactions**

In reviewing merger and asset sale proposals, BlackRock’s primary concern is the long-term interests of our clients as shareholders. While these proposals vary widely in scope and substance, we closely examine certain salient features in our analyses. For mergers and asset sales, we assess the degree to which the proposed transaction represents a premium to the company’s trading price. In order to filter out the effects of pre-merger news leaks on the parties’ share prices, we consider the share price over multiple time periods prior to the date of the merger announcement. In most cases, business combinations should provide a premium. We may consider comparable transaction analyses provided by the parties’ financial advisors and our own valuation assessments. For companies facing insolvency or bankruptcy, a premium may not apply. Where the transaction involves related parties we expect the board to establish a committee comprised of independent directors to review the transaction and report to shareholders. There needs to be a clear favorable business reason for any such transaction.

Unanimous board approval and arm’s-length negotiations are preferred. We will consider whether the transaction involves a dissenting board member or does not appear to be the result of an arm’s-length bidding process. We may also consider whether executive and/or board members’ financial interests in a given transaction appear likely to affect their ability to place shareholders’ interests before their own.
**Related-party transactions**

Related-party transactions (RPTs) are common at Chinese listed companies. These are transactions between the company and its related-parties, as defined in details in the Listing Rules of the Shanghai and Shenzhen Stock Exchange. According to the materiality of the transaction, it may need to be disclosed or submitted to a shareholder meeting for approval. Any shareholder who has a material interest in the transaction must abstain from voting on the resolution. All related-party transactions need to be vetted by independent directors.

Broadly speaking, there are two types of related-party transactions: 1) one-off transactions, typically asset purchases or disposals; 2) recurring RPTs that are within the ordinary course of business, usually in the form of an ongoing goods and services purchase and provision agreement.

BlackRock assesses one-off RPTs on a case by case basis. Key factors we take into consideration include the strategic rationale and the fairness of the transaction terms. Moreover, BlackRock expects the company to disclose in detail the decision-making process the board has gone through and the process the independent directors have gone through to arrive at their recommendation to minority shareholders.

Recurring RPTs involving the purchase and provision of goods and non-financial services are disclosed in the annual report in details and are subject to annual approval by shareholders. In most cases, these transactions are within the normal course of business and are transacted at arms-length terms. Where disclosure is sufficient, BlackRock generally finds these proposals supportable.

**Financial services agreements**

It is common among Chinese State-Owned Enterprises (SOEs) to establish a finance company within the business group (hereinafter referred to as Group Finance Companies (GFCs)). GFCs are set up to provide a range of financial services (mainly deposit, loan and settlement related) to the group member companies. The main purpose is to better utilize capital within the same group by channeling funds among members through the GFC as companies are banned from directly borrowing from or lending to another corporate entity. GFCs are typically majority owned by the unlisted group parent, which also controls the listed company. A listed company obtains services from a GFC by entering into a financial service agreement, which requires shareholder approval once every three years.

BlackRock recognizes the merits of dealing with a GFC compared to a commercial bank, such as preferential deposit and loan interest rate, and expedited and customized settlement services. However, we are concerned with certain risk aspects unique to dealing with GFCs. While GFCs are subject to the same capital requirements and are also monitored by the China Banking Regulatory Commission (CBRC), as a private entity there is not the same level of transparency compared to large commercial banks, the majority of which are listed. Another key difference is that a GFC only deals with member companies within the same group whilst a commercial bank deals with all participants in the economy. As a result, GFCs are exposed to risks concentrated in a business group while a commercial bank’s risk is much more diversified. Moreover, transactions with GFCs are related-party transactions and therefore exposed to conflicts of interest. An extreme example of such conflicts left unchecked is a listed company being exploited by the group as a window of financing given its access to the wider capital market.

BlackRock believes companies can mitigate these risks by establishing a robust internal review and audit process to ensure each deposit at and loan from the GFC is has a sound business and capital management rationale. Companies should also aim to achieve a level of transparency beyond the minimum requirement around transactions with GFCs and GFCs themselves. BlackRock may consider voting in favor of a financial service agreement if in our assessment a company has set up an effective risk management mechanism in place to address the conflict of interest, and has disclosed sufficient information about the GFC and the transactions with it. Relevant information includes but is not limited to:

- Rationale behind the deposit and loan limit requested;
- Decision-making process of placing deposits and obtaining loans from the GFC;
- Key financial metrics of the GFC such as loan to deposit rate, capital adequacy ratio, amount of non-performing loan;
• Activities other than taking deposits and making loans that the GFC may engage such as equity investments, entrust loans, and finance leasing;

• Interest rates paid on deposits and charged for loans by deposit and loan type;

• The corporate governance structure of the GFC and its loan approving process; and

• Percentage of the company’s capital deposited at the GFC versus that at a commercial bank.

BlackRock expects such disclosure to be made not only in the meeting circular when shareholder approval is being sought once every three years but also in the annual report so that investors get to review these transactions and the financial strength of the GFC on an annual basis.

**Strategy, purpose, and culture**

Strategy, purpose, and culture are more nuanced than many aspects of governance. An understanding of these matters, the involvement of the board in their articulation as well as oversight of their implementation are key for long-term investors to assess the company’s ability to generate value over time. BlackRock thus seeks from companies clear and insightful explanations in this area, and for transparency on these matters to become the norm for Chinese listed companies.

BlackRock expects companies to articulate the strategic milestones against which shareholders should assess performance, specifically, public disclosure of financial targets to be shared with all shareholders, for instance long-term return on capital or alternative criteria of value-creation. We expect companies to provide information on how the board contributes to strategy, purpose, and culture and oversees management’s implementation of the agreed plans and policies.

In the absence of this information, and/or when we have concerns, we believe that engagement is preferable to voting to communicate expectations on these matters to the company. In our engagement we will underscore the importance of a clear articulation of strategy, purpose, and culture by the board. These aspects should be well-understood both by management and staff as well as transparent to investors to be able to assess if management and the board are exercising appropriate stewardship of resources and, over time, the company is moving consistently in the direction stated.

**Compensation and benefits**

The key purpose of compensation is to reward, attract and retain competent directors, executives and other staff who are fundamental to the long term sustainable growth of shareholder value, with reward for executives contingent on controllable outcomes that add value. BlackRock expects a company’s board of directors to put in place a compensation structure that incentivizes and rewards executives appropriately and is linked with performance that aligns with shareholder interests, particularly the generation of sustainable long-term value. We would expect the compensation committee to carefully consider the specific circumstances of the company and the key individuals the board is trying to incentivize. We encourage companies to ensure that their compensation plans incorporate appropriate and rigorous performance metrics consistent with corporate strategy and market practice. We use third party research, in addition to our own analysis, to evaluate existing and proposed compensation structures. We hold members of the compensation committee or equivalent board members accountable for poor compensation practices or structures.

The level of director and executive compensation is generally not excessive at Chinese companies. However, compensation is only disclosed as a lump-sum number for each director and senior executive in the annual report, without a breakdown of the pay components such as base salary, performance bonus, and benefits. This provides little transparency around the compensation structure of directors and senior executives, and therefore leaves investors incapable of learning whether senior executives is properly incentivised to manage the company in a way that is in the long term interest of shareholders.
BlackRock expects companies to disclose the compensation paid to each director and senior executive and the breakdown of the payment. Where there is performance-based pay, companies should also disclose the key performance metrics selected and the rationale for their inclusion, e.g. why these metrics are suitable considering the company’s development stage, business strategy, and the nature of the industry the company is in.

**Non-executive director compensation**

The role of the non-executive director is to monitor the strategy, performance and compensation of the executives and to protect the interests of shareholders in the long term. Non-executive directors should receive sufficient compensation to attract and retain suitably qualified non-executive directors and encourage them to undertake their role diligently. The executive arm and any major shareholder should not have any undue influence over the compensation of non-executive directors.

Non-executive director compensation should be structured in such a way that it aligns the interests of the directors with those of the shareholders they represent. The structure of non-executive director compensation should not provide any disincentive to resign from the board should an issue of conflict or any other issue that would impair a director’s independence arise.

Non-executive directors should receive a fixed annual fee, including additional fixed fees for board committee membership for their services. BlackRock supports non-executive directors entering into “salary sacrifice” arrangements whereby a portion of their fees is received by way of fully paid shares purchased on market.

BlackRock does not generally support the granting of options to non-executive directors as such securities do not have the same risk profile as the ordinary shares held by ordinary shareholders and therefore may not align the interests of directors with those shareholders they represent. Non-executive directors should not receive performance based compensation as to do so would more closely align their interests with those of management, whose performance and compensation they are intended to monitor on behalf of shareholders. Where options or performance based compensation have been granted to non-executive directors, BlackRock will consider voting against any such proposals and the re-election of the chair of the compensation committee.

**Equity-based incentive plan**

**Stock option/Restricted stock scheme**

It is becoming increasingly common among Chinese companies to establish a stock option/restricted stock scheme to incentivise and retain key employees. Such schemes typically require approval which is valid for three to five years after which further shareholder approval is required or another plan is put to shareholder vote. The performance period for such plans is usually 12 months.

According to the CSRC, companies may select performance metrics that measures its value creation for shareholders such as return on equity, earnings per share, and dividend per share, or metric that indicate the company’s profitability and growth such as the growth rate of net profit and revenue. The company can either choose to use its peer performance or historical performance as the benchmark. Another regulatory feature of these plans is that the total number of shares underlying all the outstanding equity-based compensation schemes shall be capped at 10% of the total amount of equity issued for mainboard-listed companies and 20% for ChiNext or STAR board listed companies.

Disclosure around such plans is fairly comprehensive. Companies are required to disclose the full list of plan participants, number of stock options/restricted stocks to be issued to each participant, exercise price of the stock option, issue price of the restricted stocks, grant schedule, and company performance measures and hurdles. Independent directors and non-employee representative supervisors are excluded from these plans.

Many Chinese companies do not have compensation committees, as a result such plans are administered by the whole board, which may include participants in the plan. Given the regulatory restrictions on issuances, and the comprehensive nature of disclosure we will support such plans as long as the overall dilution is considered reasonable and justified, despite potential conflicts of plan participants also being members of the board.
Employee stock participation plan

Starting from June 2014, companies can also establish employee stock participation plans (ESPPs) which aim to increase employee ownership in the company resulting in better alignment of the interests of employees with shareholders. There is a minimum retention period of 12 months if stocks are purchased from the secondary market, and 36 months if stocks are newly issued by the company. Generally a part of an employee’s salary is used to purchase the shares.

Such plans are subject to shareholder approval. BlackRock generally supports the idea of employees holding company stock and given the associated retention period, we think a discount in the purchase price within 10% is reasonable.

Dilution

To ensure that equity-based compensation plans operate in a way that benefits both employees and shareholders, BlackRock expects to see a limit on the amount of dilution that can occur across all schemes. BlackRock may consider voting against an options plan if it may lead to over 10% cumulative dilution over ten years inclusive of existing plans, or if a plan is not transparent in demonstrating the distribution of option awards between senior executives and other staff.

Environmental and social issues

We believe that well-managed companies will deal effectively with material ESG factors relevant to their businesses. As stated throughout this document, governance is the core structure by which boards can oversee the creation of sustainable long-term value — appropriate risk oversight of environmental and social (“E&S”) considerations stems from this construct.

Robust disclosure is essential for investors to effectively gauge companies’ business practices and strategic planning related to E&S risks and opportunities. When a company’s reporting is inadequate, investors, including BlackRock, will increasingly conclude that companies are not adequately managing risk. Given the increased understanding of material sustainability risks and opportunities, and the need for better information to assess them, BlackRock will advocate for continued improvement in companies’ reporting and will hold management and/or directors accountable where disclosures or the business practices underlying them are inadequate.

BlackRock views the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the standards put forward by the Sustainability Accounting Standards Board (SASB) as appropriate and complementary frameworks for companies to adopt for the disclosure of financially material sustainability information. While the TCFD framework was crafted with the aim of climate-related risk disclosure, the four pillars of the TCFD — Governance, Strategy, Risk Management, and Metrics and Targets — are a useful way for companies to disclose how they identify, assess, manage, and oversee a variety of sustainability-related risks and opportunities. SASB’s industry-specific guidance (as identified in its materiality map) is beneficial in helping companies identify key performance indicators (KPIs) across various dimensions of sustainability that are considered to be financially material and decision-useful within their industry.

Accordingly, we ask companies to:

- Disclose the identification, assessment, management, and oversight of sustainability-related risks in accordance with the four pillars of TCFD; and
- Publish SASB-aligned reporting with industry-specific, material metrics and rigorous targets.

Companies may also adopt or refer to guidance on sustainable and responsible business conduct issued by supranational organizations such as the United Nations or the Organization for Economic Cooperation and Development. Further, industry-specific initiatives on managing specific operational risks may be useful. Companies should disclose any global

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See our commentary on our approach to engagement on TCFD and SASB aligned reporting for greater detail of our expectations.
standards adopted, the industry initiatives in which they participate, any peer group benchmarking undertaken, and any assurance processes to help investors understand their approach to sustainable and responsible business practices.

**Climate risk**

BlackRock believes that climate change has become a defining factor in companies’ long-term prospects. We expect every company to help their investors understand how the company may be impacted by climate-related risk and opportunities, and how they are considered within strategy. Specifically, we expect companies to articulate how they are aligned to a scenario in which global warming is limited to well below 2°C and is consistent with a global aspiration to reach Net Zero GHG emissions by 2050. The global aspiration is reflective of aggregated efforts; companies in developed and emerging markets are not equally equipped to transition their business and reduce emissions at the same rate — those in developed markets with the largest market capitalization are better positioned to adapt their business models at an accelerated pace. Government policy and regional targets may be reflective of these realities.

The public and private sectors have roles to play in aligning greenhouse gas reduction efforts with targets based on science, where available, to curb the worst effects of climate change and reach the global goal of carbon neutrality by the mid-century. Companies have an opportunity to utilize and contribute to the development of current and future low-carbon transition technologies, which are an important consideration for the rate at which emissions can be reduced. We expect companies to disclose how they are considering these challenges, alongside opportunities for innovation, within their strategy and emissions reduction efforts.

**Key Stakeholder Interests**

Given our expectation that companies operate in long-term shareholders’ interests to create sustainable value and fulfill their purpose, BlackRock believes that companies should take due account of their key stakeholders’ interests. It is for each company to determine its key stakeholders based on what is material to its business, but they are likely to include employees, business partners (such as suppliers and distributors), clients and consumers, government and regulators, and the communities in which they operate, as well as investors.

Having regard to the interests of key stakeholders recognizes the collective nature of long-term value creation, and the extent to which each company’s prospects for growth are tied to its ability to foster strong sustainable relationships with those stakeholders. Companies should articulate how they address adverse impacts that could arise from their business practices and affect critical business relationships with their stakeholders. We expect companies to implement, to the extent appropriate, monitoring processes (often referred to as due diligence) to identify and mitigate potential adverse impacts, and grievance mechanisms to remediate any actual adverse impacts. The maintenance of trust within these relationships is often equated with a company’s social license to operate.

To ensure transparency and accountability, companies should report on how they have identified their key stakeholders and considered their interests in business decision-making, demonstrating the applicable governance, strategy, risk management, and metrics and targets. This approach should be overseen by the board, whose job it is to ensure that the approach taken is informed by and aligns with the company’s purpose.

In this context, we seek to understand a company’s approach and commitment to fostering a diverse workforce and inclusive workplace culture, which contributes to business continuity, innovation, and long-term value creation. As an important component of strategy, we expect boards to oversee human capital management. Appropriate disclosures should be provided to inform investors’ understanding of how companies are seeking to establish robust human capital management practices, including their actions and targets around diversity, equity and inclusion. When a company’s reporting is inadequate, we will increasingly conclude that companies are not adequately managing such issues and may hold management and / or directors accountable.
Shareholder proposals

In most markets in which BlackRock invests on behalf of clients, shareholders have the right to submit proposals to be voted on by shareholders at a company’s annual or extraordinary meeting, as long as eligibility and procedural requirements are met. The matters that we see put forward by shareholders address a wide range of topics, including governance reforms, capital management, and improvements in the management or disclosure of environmental and social risks.

When assessing shareholder proposals, we evaluate each proposal on its merit, with a singular focus on its implications for long-term value creation. We consider the business and economic relevance of the issue raised, as well as its materiality and the urgency with which we believe it should be addressed. We take into consideration the legal effect of the proposal, as shareholder proposals may be advisory or legally binding depending on the jurisdiction. We would not support proposals that we believe would result in over-reaching into the basic business decisions of the issuer.

Where a proposal is focused on an issue that we agree needs to be addressed and the intended outcome is consistent with long-term value creation, we will look to the board and management to demonstrate that the company has met the intent of the request made in the shareholder proposal. Where our analysis and / or engagement indicate a need for improvement in the company’s approach to the issue, we will support shareholder proposals that are reasonable and not unduly constraining on management. Alternatively, or in addition, we may vote against the re-election of one or more directors if, in our assessment, the board has not responded sufficiently or with an appropriate sense of urgency.

General corporate governance matters

BlackRock believes that shareholders have a right to timely and detailed information on the financial performance and viability of the companies in which they invest. In addition, companies should publish information on the governance structures in place and the rights of shareholders to influence these. The reporting and disclosure provided by companies helps shareholders assess whether their economic interests have been protected and the quality of the board’s oversight of management. BlackRock believes shareholders should have the right to vote on key corporate governance matters, including on changes to governance mechanisms, to submit proposals to the shareholders’ meeting and to call special meetings of shareholders.

Amendments to articles of association

These proposals vary from routine changes to reflect regulatory change to significant changes that substantially alter the governance of the company. We will review these proposals on a case by case basis and support those proposals that we believe are in the best interests of shareholders.

Anti-takeover devices

BlackRock believes that transactions or practices that are intended to impede a potential takeover can be limiting to shareholders. BlackRock will generally not support proposals that introduce or renew anti-takeover devices.

Bundled proposals

We believe that shareholders should have the opportunity to review substantial issues individually without having to accept bundled proposals. Where several measures are grouped together, BlackRock may reject the overall proposal if it includes those that contradict or impede the rights and economic interests of shareholders.

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