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INVESTMENT STEWARDSHIP REPORT: ASIA-PACIFIC

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Engagement and Voting Highlights

Engagement with Indian Companies on Climate Change Risk Disclosure

Climate risk has been be one of the key engagement themes that the BlackRock Investment Stewardship (BIS) team has prioritized for 2017-2018. The team's recent work on this issue and involvement with external initiatives, such as the Task Force on Climate-related Financial Disclosures (TCFD), has helped inform our engagements as well as our assessment of company reporting and management on the topic. Beyond our 2017 proactive engagements in the Americas with nearly 30 companies on carbon related risks (discussed in our Americas Q2 2017 report), we also engaged with Indian companies on climate change risk and opportunity.

India's current population exceeds 1.2 billion and is expected to exceed China as the world's most populous country within seven years[1]. The energy needs of such a large population have resulted in India being the fourth largest emitter of greenhouse gases (GHGs). However, on a per capita basis India's GHG emissions are approximately 1.9 tonnes compared to the United States' 16.1 tonnes.

As part of the Paris agreement[2], India committed to establishing the Intended Nationally Determined Contribution[3], which is comprised of certain goals, including:

1. Reducing emissions intensity of its gross domestic product (GDP) by 33 to 35 percent from 2005 levels
2. Achieving an approximate 40 percent non-fossil fuel electric power installed capacity by 2030

BlackRock engaged a number of Indian companies with the aim of understanding how these companies' strategies around energy production align with the Indian Government's commitment to climate change. Our engagements also provided an opportunity for our team to share our perspective on the TCFD and to encourage disclosure aligned with its framework. We believe that the TCFD's preliminary disclosure recommendations around four thematic areas — governance, strategy, risk management, and metrics and targets — offers a useful framework for company reporting. We provide more detail on how we will engage on climate risk on our Stewardship website.

Prior to our engagement meetings, our team undertook an extensive review of relevant company reporting with the aim of identifying substantive climate risk and opportunity disclosure gaps. One company, for instance, had not released a sustainability report since 2013. For one company which manufactures scooters and motor bikes we raised the issue of plans for the introduction of electric vehicles. The company discussed some plans regarding the introduction of electric two and three wheel vehicles however in their view they did not consider electric vehicles to be much of a threat to their current operations. We further discussed the rapid development of electric vehicles in the region and expressed our concerns of the lack of understanding of this progress of technology in this area and the potential impact on sales in three to five years

As these instances suggest and our analyses and engagements revealed, these companies are still at the early stage of incorporating climate change risks and opportunities into their business strategy. Our meetings allowed us to explain why such disclosures are important; namely, it allows us to understand how the companies' board and management are responding to these challenges from the standpoint of corporate strategy. Ultimately, effective responsiveness to climate change, under the backdrop of changing government regulations and shifting consumer demands, provide the BIS team insight into the board's overall quality and effectiveness. We plan to have follow up engagements to monitor the progress of these companies and intend to continue to report on these engagement outcomes.

[1] https://esa.un.org/unpd/wpp/Publications/Files/WPP2017_KeyFindings.pdf
[2] UN Climate Change Paris Agreement, available at http://newsroom.unfccc.int/paris-agreement/; United Nations Framework Convention on Climate Change, available at http://unfccc.int/resource/docs/2015/cop21/eng/10.pdf.
[3] http://www.justclimateaction.org/india-s-indc.html

India

1 In a case study demonstrating our focus on governance (also identified in our 2017-2018 engagement priorities), in particular board composition and structure, Investment Stewardship also engaged an Indian chemical manufacturing company where we identified a significant number of independent directors with an excess of ten years of board service. For our team, this raises questions around appropriate succession planning. While we recognize the importance of retaining board-level continuity so that companies can carry out their long term strategies, we also believe in the merits of injecting new thinking, or refreshment, through the identification and recruitment of independent directors to the board.

Our engagement led to a positive outcome, notably the company acknowledged a need for such board refreshment and agreed to begin implementing an appropriate succession plan for its independent directors.

We are encouraged by this constructive engagement outcome and will monitor the company's commitment to governance best practices.

This engagement also provided an opportunity to discuss a significant material environmental issue facing the company. A pesticide manufactured by the company remains legal in India; however, the product is banned in 46 other countries. In 2013, 23 children attending school in Bihar died due to poisoning from the pesticide. During our engagement, the company's managing director rejected the findings by police that the deaths were linked to the pesticide. Two days after the 2013 accident, the United Nations Food and Agriculture Organization announced that the pesticide should be banned in developing countries. The company maintains that, because it is still legal to produce and sell the pesticide in India, it has no intention of discontinuing the product line. Investment Stewardship discussed the significant reputational risk if more deaths are associated with the pesticide and how such a future event could impact global sales of the company's other products.

In response, we requested the company establish an environmental management practices committee comprised of both senior management and independent directors, to be chaired by an independent director. With the committee reporting its findings on a regular basis, we believe the board will be more appropriately informed on this and other environmental risks to the company. We look forward to continuing our dialogue with the company and will report on these engagement developments.

Humans Right and Community Impact

2 Dating to 2016, BlackRock has had in-depth discussions with a Chinese copper mining company whose main copper mine has been at the centre of controversies relating to severe pollution of the region's agricultural lands, fisheries, and watershed. It has been estimated by non-governmental agencies (NGOs) that as many as 420,000 people have been exposed to higher health risks, including elevated incidence of cancer, as well as loss of livelihood.

The area where the mine is located is rich with minerals, particularly copper. In addition to the mine run by the company, there are a number of small non-ferrous mines in the area. Copper mining and smelting started in the region as early as the Tang Dynasty (618AD – 907AD). Industrialized mining and smelting started in the 1960s with Chinese state-run operations.

Following up on our 2016 engagement, this year the BIS team made a visit to the mine along with members of the management team. During our prior 2016 engagement, the company explained that it was responsible for part of the pollution given the general lack of awareness and minimal environmental protection measures that were in place when mining first began. We learned that, since 2006, the company has ramped up its investments in environmental protection technology and equipment. The company has invested a total of RMB3.4 billion (US$501.5m) in environmental protection facilities, of which over RMB1b (US$147.5m) was invested to improve the environmental performance of the mine in question. Such investments included water treatment to remove pollution from a river, building an acid water storage reservoir that can manage a 20-year heavy rain event, and construction of additional acid water drainage pipes. With these enhancements, the company meets and exceeds relevant national standards for waste discharge. Furthermore, all discharges are monitored on a continuous basis by the local Ministry of Environmental Protection. To date in 2017, there have been no incidences of waste water discharge.

The company's compensation program to affected communities consists of paying RMB1m (US$147,503) per year to the local government, with the responsible government agency determining the recipients and payment amounts. The company concurs that, given the complexity of the issue and the large number of stakeholders involved, the issue is best managed by the local government and remains committed to this continued co-operative multi-stakeholder process.

Despite these substantive environmental, social and governance (ESG) challenges, the company's annual corporate social responsibility report remains limited in its disclosures. During our engagement, we emphasized the importance of greater transparency and, specifically, asked the company to disclose greater detail on the management and oversight of key environmental performance indicators (to include performance targets) of its major mines. We also encouraged the company to provide regular updates on the remediation and compensation of the impacted community. While the company was receptive to our recommendations improvements have yet to materialize.

In summary, our engagement provided us with some reassurance that the company is committed to improving its environmental footprint and to the remediation process. However, our engagement afforded us the opportunity to express our view on the importance of expanded sustainability disclosure. We will continue to monitor the situation and intend to work constructively with the company to effect improved transparency and oversight on these issues.

Forced / Child Labor in Supply Chain

3 As part of our commitment of ongoing engagement, BlackRock met again with a Korean steel maker and its majority owned subsidiary, both listed on the Korea Stock Exchange, to discuss human capital management challenges within its supply chain. Specifically, the subsidiary's textile plants in Uzbekistan is one of the biggest corporate buyers of Uzbekistan cotton. According to International Labour Organization (ILO) and NGO reports, the Uzbekistan government has for decades been forcing millions of children, students, and public employees to harvest cotton every year during the cotton harvesting season.

BlackRock's Investment Stewardship team has had annual engagements with both the subsidiary and the parent company since 2014 in order to monitor progress on this important issue. The subsidiary established a corporate social responsibility (CSR) team in June 2013 to manage environmental and social issues. The team has repeatedly requested the Uzbekistan government to accept the independent monitoring of the ILO, which finally occurred in 2014 when the Uzbekistan government signed a Decent Country Work Program (DCWP) agreement with the ILO. The CEO of the subsidiary also wrote a letter to the Uzbekistan government in 2014 and 2015 requesting more disclosure on the progress of the DCWP and offered to contribute to the program.

Since 2014, the subsidiary started to perform annual audits at its own factories in Uzbekistan to ensure there is no use of forced labor / child labor at its own facilities. Since 2016, the CSR team started to provide CSR training for the employees of its Uzbekistan factories, most of whom are Uzbekistan citizens, in order to raise awareness of the issue. A reporting line has also been established for employees to report any incidences of forced labor / child labor inside or outside of subsidiary's plants, although no reporting has been made thus far.

The subsidiary also runs two after school educational programs near one of its facilities to prevent children from going to the cotton farms after school. The programs have proven to be successful and the company is evaluating the feasibility of setting up a third one. Moreover, the company also sets up a medical camp every year to offer free treatment for eye diseases that are commonly seen among the local people due to exposure to strong sunshine.

Despite these efforts, the subsidiary's public disclosure around the issue remained limited. Over the course of our multi-year engagements with the company and its parent, we repeatedly emphasized the importance of transparency and requested the subsidiary disclose its polices around these issues and provide regular updates to the progress made. Our engagement proved fruitful in this respect — during the latest discussions we were pleased to receive the confirmation from the subsidiary that it would be publishing its first sustainability report later this year in accordance with the Global Reporting Initiative's (GRI) G4 standards. A dedicated sustainability section will also be added to its website where the Uzbekistan cotton issue will be featured in details along with the other key environmental and social issues of the company.

Based on our engagements, we believe the companies are committed to addressing these industry challenges which are being led by the World Bank, the ILO, and the Uzbekistan government.

Consistent with our recommendation, we are encouraged by the subsidiary committing to provide greater transparency around its policy and management of this issue going forward.

We plan to continue our engagement.

Challenges of Labor Shortages in Japan

4 We spoke to numerous companies over the years about the issue of operating in a talent constrained environment. Beyond uneven wage growth and technological transformation eliminating millions of jobs for lower-skilled workers[4] BlackRock recognizes that labour supply shortages can equally constrain the long term continuity and success of companies. This is particularly evident in Japan where the ratio of active job openings to applicants in April 2017 stood at 1.48, a historical high level which exceeded the ratio's peak back in 1990. Japanese retail operators are particularly exposed to these labour shortages.

In light of these human capital management challenges, BlackRock engaged with one of the major convenience store chain operators to understand how they were responding. The company confirmed that labour shortages are a fundamental risk for the industry and noted that they are increasingly challenged in their ability to hire and retain part-time workers. The engagement also shed light on the fact that heightening competition within the industry has led to a significant increase in the number and types of services rendered, including facilitating payments of utility bills, ticket sales for music or sports events, and parcel shipments. Collectively, these functions have made the cashiers' job more difficult and less desirable than other part-time jobs. The company explained that the expansion of these services has also resulted in a lowering of productivity of cashiers. As a result of these substantial operational challenges, the company plans to conduct a full review of its operations with the goal of improving productivity while simultaneously ensuring long term access to human capital. Our engagement helps us better understand an industry dynamic in the context of a company's strategic framework for long-term value creation; in this instance, the company demonstrated a commitment to operational reform by improving human capital management. We will continue to monitor and report on the company's efforts.

Price Fixing Scandal in the US Operation

5 A Japanese automobile parts supplier pleaded guilty to price fixing of automotive parts installed in cars sold the US. The company was fined over US$100m, resulting in the company reporting a loss for the 2017 fiscal year (April 2016 – March 2017). The company

[4] BlackRock Chairman and CEO Larry Fink discusses these human capital challenges in his 2017 annual letter to CEOs at https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter.

subsequently announced pay cuts for several executive directors along with establishing control measures to prevent the recurrence of price fixing. Despite these efforts, we remained concerned that the preventative measures may be inadequate. We found the company's disclosure to lack the appropriate level of detail given the gravity of the circumstance. In light of our analysis of these factors, our team did not support the re-election of top executives and voted against the payment of a retirement bonus for directors and executives. The intent of our votes against management is to signal to the company that we seek improvements in the company's price fixing mitigation strategy and reporting on compliance efforts.

Attending a Chinese AGM to Promote Governance Best Practices

6 We attended the annual general meeting (AGM) of a Chinese nuclear power generation company listed in Hong Kong. By attending, we were able to directly address a couple of noteworthy issues with the board. Firstly, we addressed the board's proposal for the grant of a general mandate to issue new shares representing up to 20% of the existing capital. The mandate, if fully utilized, will result in a significant dilution for existing shareholders especially when the new shares are issued at deep discount, which is allowed to be up to 20% under the standard mandate. Secondly, we pointed out that one independent director currently serves on a total of six public boards, which may challenge his commitment to the company.

At the meeting, our concerns regarding the general mandate were acknowledged by the board; however, the company did not commit to make any amendments (we voted against the general mandate). The independent director in question directly responded to our comments, saying that he is fully committed to his duties to the company, pointing to his full attendance record for the board meetings. While his personal records do not show any signs of dereliction, he understands our concerns from a risk management perspective.

Attending the AGM also allowed us to directly commend the company for adopting integrated reporting, making it among the first in its peer group. We also recognized the company for adding one female member to the board, ending an era of an all-male board since its initial public offering (IPO). We encouraged the company to provide additional disclosure around its stated diversity assessment indicators found within its diversity policy and asked for more transparency around the governance of the diversity policy, which in our view is the key to an effective implementation of this policy.

Engagement with Australian Companies on Remuneration

7 We were approached by several companies wanting to discuss major changes to executive compensation structures. The general feedback from the chairs of remuneration committees was that incentive plans, particularly long term incentive plans (LTIPs) are too complicated and, as a result, are not fully understood by either shareholders or executives. Additionally, consensus was that the outcomes of these plans have not necessarily been aligned with performance.

In response, a number of companies are proposing to combine their short term and long term performance based plans into a single plan. These plans will intend to measure specified performance over a period of one year. Awards would be settled in a combination of cash and shares, with the shares vesting out into the long term. Some awards would vest equally over the subsequent four years, while some equal vesting awards would commences three years from the award date for a further three years. Unvested equity would be subject to clawback provisions.

BlackRock has no objections to such plans; however, we explained that we would expect a clear articulation of the performance measures that were met to trigger these the awards. We also noted that there should be transparency around the transition of existing plans to the revised plan in order to ensure that total remuneration is not increased without explanation. Additionally, we shared our expectation for a vesting schedule that is of sufficient duration so as to keep management focussed on the long term.

Engagement and Voting Statistics

Japan Engagement Statistics[5]

	Level of Engagement[6]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
119	38	68	13	8	15	118

Asia-Pacific ex Japan Engagement Statistics[5]

	Level of Engagement[6]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
51	13	29	9	8	4	51

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

Asia-Pacific 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
Australia and New Zealand	62	303	18%	3%
APAC ex Japan, Australia, and New Zealand	2,790	28,868	50%	9%
Japan	1,671	18,085	41%	6%
Asia-Pacific Region Total	4,523	47,256	47%	8%

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[5]The Asia-Pacific engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on July 5, 2017 and both are a reflection of 2nd Quarter 2017.

[6]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 Asia-Pacific 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:

- **Practising Governance Panel on Proxy Voting and Engagement – Hong Kong**

  Investment Stewardship participated in a panel discussion ahead of the Hong Kong annual general meeting season to explain our voting and engagement approach to a group of corporate secretaries from companies listed on the Hong Kong Stock Exchange. The discussion centred on the key voting issues such as general mandate to issue new shares and the election of directors.

- **BNP Paribas Panel on Decoding Sustainable Investors – Hong Kong**

  BlackRock spoke on a sustainable investment panel to an audience consisting largely of representatives from the institutional investment community. The discussion focused on how to establish effective ESG policies and the practical application of such policies. Key challenges in applying ESG investment policies were also addressed, including the issue of data quality and integrity. The panel addressed stewardship activities as a means of achieving sustainable investments.

- **The Hong Kong Investor Relations Association Panel on Institutional Shareholder Activism – Hong Kong**

  BlackRock participated in a panel on shareholder activism to a group of investor relations of Hong Kong-listed companies. BlackRock contributed to the panel by sharing our experience on active and constructive voting and engagement and why in our opinion that is critical to deliver sustainable performance for long term investors like BlackRock.

- **Australian Institute of Company Directors – Sydney and Melbourne**

  BlackRock presented to a group of leading independent directors on how institutional investors assess remuneration reports and to discuss the current shortfalls with respect to reporting of remuneration.

- **New Zealand Continuing Legal Education (NZCLE) – Auckland and Wellington**

  BlackRock presented to the NZCLE on how institutional investors assess the quality of boards. The audience comprised company secretaries, directors of listed companies, and general counsels.

- **Ashurst Sustainable Investing Panel – Hong Kong**

  BlackRock contributed on a panel entitled, “Green and Sustainable Focussed Finance”. The discussion centred on the need for improved disclosure with respect to climate change risk. The audience comprised mainly finance lawyers.

- **Centre for Policy Development Panel on Climate Change – Sydney**

  BlackRock participated in a panel discussion on “Directors Duties and Climate Change”. The discussion centred on a recent legal opinion which concluded that directors have an obligation to consider climate change as part of their duties. The audience was comprised mainly of company directors, lawyers, and academics.

- **Hong Kong Institute of Company Directors (HKIoD) – Hong Kong**

  As part of HKIoD’s continuing education program, BlackRock presented on the topic of responsible investment and stewardship. Attendees included company directors.

- **Stewardship Asia Conference – Singapore**

  BlackRock spoke at the Stewardship Asia conference on the activities of the investment stewardship team. The audience comprised of senior global business leaders, representatives from key regional regulators, and regional asset owners.

- **Responsible Investor (RI) Asia Conference – Tokyo**

  BlackRock presented on ESG integration at the 2017 RI Asia conference, which was held at the Tokyo Stock Exchange. The panel attracted a wide group of audience members, including issuers, investors, and asset owners.

- **Investor Communications Japan (ICJ) Conference – Tokyo and Osaka**

  BlackRock presented on our approach to stewardship and provided some context and details around our proxy voting guidelines. The seminar took place in two different cities, Tokyo and Osaka, and attracted a wide range of audience members but primarily corporate investor relations practitioners.

Market Development and Trends

Hong Kong

On June 16, 2017, the Hong Kong Exchanges and Clearing Limited (HKEX) launched a consultation paper to seek public feedback on a package of proposals to broaden capital markets access in Hong Kong and to strengthen Hong Kong's listing regime. The consultation covers companies "with non-standard governance features". BlackRock will review the consultation paper and respond accordingly.

China

According to a local news article, China is planning to introduce mandatory disclosure around environmental issues for listed companies. The move is said to be triggered by recent academic research which revealed that the disclosures of environmental issues of many listed companies are inconsistent. The Ministry of Environmental Protection (MEP) and the China Securities Regulatory Commission (the CSRC), the article notes, have since entered into an agreement on the environmental disclosure of listed companies. Details are yet to be disclosed.

China

BlackRock attended the 2017 China Responsible Investment Forum which took place in Tianjin on June 6. The event was organized by the Asset Management Association of China (AMAC), the China Association for Public Companies (CAPC), and the Asian Corporate Governance Association (ACGA). The event, marking one of the first investment forums on responsible investment in China, was mostly attended by institutional investors. Topics discussed included the feasibility and applicability of ESG integration into investments in China and how to effectively measure the ESG performance of investments.

China

On June 20, 2017, MSCI approved the inclusion of China A shares into both its Emerging Markets and MSCI All Country World (ACWI) Indices. As a result, MSCI is adding 222 China A Large Cap stocks, representing approximately 0.73% of the weight, to the Emerging Markets Index. The inclusion, which begins in June 2018, will be carried out in two phases with the first step to coinciding with the 2018 semi-annual index review.

Japan

On May 29, 2017, the Japan Financial Services Agency (FSA) publicized the revision of Japan's Stewardship Code (the Code). The revision includes: (1) enhanced disclosure of voting records on an individual company proposal level; (2) strengthening of corporate governance structure of asset managers who are part of a financial group; (3) periodic review and evaluation of stewardship activities and disclosure of the results; (4) strengthened oversight by asset owners; (5) enhanced stewardship responsibilities for passive managers; and, (6) mention of collective engagement as a practice. Signatories of the Code are asked to revise their approach and policies in accordance with the new Code by the end of November 2017.

Korea

The Stewardship Code that was launched in December 2016 has started to gain traction. On June 28, it was reported that KB Asset Management submitted its plan to adopt the Code in the fourth quarter of 2017. Along with Samsung Asset management and Mirae Asset Global Investments (which announced their plans to adopt the Code a month ago), KB Asset Management's decision marked the adoption of the Code by the three largest asset management firms in Korea. Korea's largest asset owner, the National Pension Service, has yet to make a decision.

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