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Contents

Engagement and Voting Highlights 2

Engagement and Voting Statistics.. 7

Active Ownership and Responsible Leadership 8

Market Developments and Trends 10

Engagement and Voting Highlights

Engaging on material social and geo-political risk in the mining sector

1 Over the last several quarters BlackRock's Investment Stewardship (BIS) team has participated in extensive engagements with a global copper mining company experiencing material social risks associated with one of its mines in Indonesia.

This case study illustrates how our engagements aim to understand a company's management of social risks that can impede or challenge their license to operate. For this company, a significant portion of its revenue is derived from a geographic region where effective government and labor relations are critical. The company's inability to reach an amicable agreement with the Indonesian government has dramatically impacted its ability to export goods as a result of suspended licenses and inconclusive contract negotiations. Furthermore, as company negotiations with government officials have slowed production, the local labor force has been effected with staff cutbacks and limited schedules, fueling strikes and violent disputes.

Our engagements have helped us better understand the complexities associated with local regulation requiring the conversion of operating licenses, imposed export taxes, contract timelines, and required ownership divestment. In particular, in late 2016, Indonesia unveiled legislation that required foreign mining companies to switch to a new licensing agreement that required up to 51% divestment, allowing the government entity majority ownership.

However, the sale price of the ownership stake has yet to be agreed upon. As of August, the company valued the mine at $16 billion, suggesting a large investment from the government to purchase additional ownership at market value. During our last engagement with the company, neither a price nor an anticipated close date had been settled on.

As we continue to speak with the company on progress into 2018, this engagement example underscores the importance of material disclosure of social and geo-political risks inherent in some industries and business operations. Clear articulation of the company's approach to government relationships and their license to operate can, in such instances, help investors like BlackRock determine the efficacy of policies and programs aimed at mitigating long-term risk exposure for the company and its shareholders.

By contrast to the discussed above, one leader within the mining space with which we've engaged has worked towards mitigating these risks by employing an ownership mentality with the governments with which they conduct business. This major gold company has recently discussed with us their approach for more sustainable operations that focus on ensuring equitable partnerships with government entities and the communities in which they operate. This approach has changed the way in which the company conducts business, but has also helped allay geo-political risk by strengthening relationships with local governments. In particular, the company is working to structure both new and existing mining contract agreements to ensure a 50/50 split of revenues with the local government and tangible ownership in the asset.

Through our engagements we are able to better understand the way in which companies approach business from a material social risk perspective. While both companies face similar geo-political and social risks, their differing approaches to partnership and structuring contracts can impact business continuity and can tangibly effect long-term value creation.

Activist contests in focus

2 BIS' engagement approach in proxy contests is to speak to management teams and boards separately from the dissidents. We engage the company to understand whether the issues identified are substantive and, if so, how management plans to address them. If the activist is seeking board seats, we usually meet with the nominees in advance of the shareholder meeting to understand what skills and experience they would bring to the board. We also try to assess whether the candidates would be a constructive member of the board. Where appropriate, we include our portfolio managers in these discussions. Our goal is to ensure that we have enough information to make an informed vote decision. After these engagements, we deliberate internally and generally reach a consensus view. Our vote decisions are determined by our assessment of which outcome best aligns with the long-term economic interests of our clients.

In cases where we concluded that change was necessary at the board level, we supported the dissidents.

In any given N-PX disclosure period (July 1st through the end of June the following year), our average support for dissident campaigns fluctuates based on a wide variety of factors and is strongly dependent on the individual campaign and company situation.

Factors that we consider in our evaluation include sustained long-term value creation, feasibility of the proposal for change, as well as our engagements with management and the board (historically and during activist involvement). During the 2016 / 2017 N-PX reporting period, the team supported 19% of dissident campaigns.

In Q4 2017, activists focused on two companies due to shrinking market share, margin erosion, and long-term underperformance. In both instances, BlackRock explored company culture, business practices, and the companies' recently-announced transformation initiatives. Ultimately, in both cases, the team was not fully satisfied that the company had addressed investor and dissident concerns.

At one company, we supported two of the dissident nominees who we felt could bring some new perspectives to the board. We expressed our concerns with the chairman of the board, as well as the chair of the audit committee. Although the incumbent directors held onto their seats, we believe that our vote sent a strong message to the company that board refreshment could be beneficial moving forward. We anticipate engaging the company over the next year to discuss the implementation of its public commitments that were made during the course of the proxy contest.

At the second company, we voted the overwhelming majority of shares held on behalf our clients in favor of the dissident slate. These shares represented both active and index-based funds. A small proportion of BlackRock's actively managed funds voted in favor of management, reflecting the views of the portfolio managers for those funds. Votes cast in favor of the dissidents were based on BlackRock's assessment of a few key factors. We determined that both the board and the dissidents were ultimately aligned on key goals for the company, particularly the need to evolve given global trends and the current market environment. However, our assessment also concluded that an outside perspective could help catalyze this evolution and increase the pace of change in a way that would benefit long-term shareholders. We look forward to the board's additional planned refreshment, which in turn will help the company embrace change and a broader range of perspectives.

A third activist situation this quarter resulted in a very different outcome. We engaged with a NASDAQ-listed Chinese media company where a dissident shareholder alleged that the company had failed to unlock sufficient shareholder value, as it traded at a deep discount to its net asset value. During our engagement, we were assured by the company that its capital allocation approach was common for the Chinese market. They also reiterated that the Chairman and CEO were committed to enhancing corporate governance practices going forward.

Disappointingly, contrary to our engagement discussions, in the wake of the proxy contest, the company instead issued super-voting preference shares to its Chairman and CEO, effectively giving him 56% voting control. The company said that this would prevent future proxy fights that could be "costly, time-consuming, and disruptive." On the date of the announcement, the share price dropped by more than 6 percent as shareholders priced in the cost of having their voices taken away.

Collectively, we aim to take an "engagement first" approach with the companies in which we are invested on behalf of our clients. However, trust is a fundamental element of this approach. In this particular instance, it became clear that the company's stated intentions during our engagement conversation were ultimately in direct contradiction to their decision to limit shareholder rights and not abide by governance best practices. This type of experience highlights the challenges of engaging with cross-border listed companies, where issuers follow governance practices that may be customary in their local jurisdictions, but also directly conflict with the norms of the jurisdiction where they are listed.

Climate risk and the insurance industry

3 This quarter BIS initiated engagements with six property and casualty insurance companies to better understand their approach and reporting relating to climate risk management. These companies face potentially profound financial impacts from future insured losses associated with climate change impacts and are in a unique position to provide details to investors around their climate risk governance, oversight and management practices.

BIS has sought to understand a number of key management and board oversight issues, including: how insurance companies handle the rewriting of policies in states that have a high risk of flooding, hurricanes, and fires; how companies align terms and conditions of their policies with risk-reducing behavior in their consumers; how climate risk gets elevated to the board and management; and how insurers are using catastrophe or other computer modeling tools and techniques to anticipate climate risk.

Several key messages emerged from our engagements:

- Products and pricing have developed to become more specialized. Some insurance companies are seeking to influence consumer behavior by offering reduced premiums or discounts to customers who take steps to fireproof or fortify their homes in disaster-prone locations.
- Coverage areas have shifted. Larger insurance companies no longer see it as viable to insure exposed areas such as coastal or hurricane-prone zones. As such, reinsurance and state-provided insurance has become even more critical in insuring residual risk. One company entered the micro-insurance industry to ensure countries which have more immature insurance markets are still able to obtain coverage.
- Data quality and modelling has improved to help predict weather patterns and help price products accordingly, but there is still a great deal of science that is not well-understood.
- Opportunities have also arisen. One company bought a full service construction outfit to assist customers in preparing their homes in advance of anticipated weather events, respond to damage more quickly, and eliminate some of the inefficiencies that arise when using third-party claims adjustors.

As insurance companies are in the business of valuing risk, most companies we spoke with had sophisticated policies in place to incorporate changing risk models. While some companies were leading others in terms of climate risk disclosures, we emphasized the need for appropriate governance of the issue and increased disclosures in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which are at an early stage of being understood and implemented. We intend to continue these discussions to understand if and how companies seek to align their disclosures with the TCFD.

Engagements with the most carbon-intensive companies in BlackRock's portfolios

4 BIS has continued its off-season engagements with oil, gas, and utility companies to emphasize the need for increased reporting around climate-related risks. We recently sent letters to the CEOs and general counsels of approximately 120 of the most carbon-intensive companies globally in BlackRock's aggregate equity portfolio. 28 of these are US-listed companies. These are companies that we consider to have material climate risk inherent in their business operations. We have asked them to closely review in full the TCFD recommendations and to consider reporting in alignment with its framework. In addition, we encourage companies to engage with us regarding the changes in reporting that might be necessary for the company to achieve alignment with TCFD recommendations and any anticipated obstacles.

Our analysis suggests that many companies exposed to climate risk are already reporting to some degree on their policies, adaptation strategies, and metrics for managing climate risk. We see the TCFD's recommended reporting framework as a means to achieve the comparability and consistency of reporting that is important to us as investors.

A major energy company enhances its governance and disclosure

5 In December 2017, an international oil and gas company announced an end to its prohibition on outside directors meeting with shareholders. We welcome this evolution in their corporate governance engagement position and the enhanced shareholder access we expect it to bring. Over the past several years, as part of our ongoing engagement with the company, we repeatedly requested to meet with independent board directors to better understand the board's oversight of the company's long-term strategy and capital allocation priorities amidst major strategic challenges and a regulatory inquiry (including but not be limited to oversight of climate risk). Over this time, the company had declined to make directors available, citing a non-engagement policy between independent board members and shareholders. BlackRock has clearly expressed its expectation that, at a minimum, the lead independent director (and other directors, as relevant) of a company should be willing to meet with shareholders. Direct board contact allows us to more fully assess the board's governance, processes, and its oversight of a range of key risks pertaining to long-term strategy and capital allocation. Due, among other things, to the company's unwillingness to allow director access, we voted against the re-election of the lead independent director and the chair of the committee responsible for setting this policy in both 2016 and 2017. Earlier in December 2017, the company also announced its plan to improve its climate risk disclosure to include energy demand sensitivities, implications of two degree Celsius scenarios, and positioning for a lower-carbon future. BlackRock supported a 2017 ballot measure that sought such improved transparency.

Responding to the opioid crisis

6 The rapid rise in the accessibility of opioids has created one of the deadliest drug crises in American history. Drug makers, pharmaceutical distributors, pharmacies, and insurance companies have come under intense scrutiny for their role in making these drugs available along the drug pipeline. Whether or not a company has direct involvement in the production or marketing of addictive substances, the opioid epidemic has cast a shadow across the entire industry — raising concerns around corporate responsibility and enterprise risk management practices, along with presenting legal and reputational risks. As a long-term steward of our client's assets, BIS has undertaken a systematic series of engagements across the pharmaceutical and health insurance industry to better understand how companies are handling controlled substances and their marketing.

One company with which we engaged, had experienced significant government and legal inquiry around their opioid controls. Consequently, this company needed to implement a new and more rigorous compliance program including a robust system of controls to monitor distribution and to ensure an appropriate set of procedures are followed. BIS also engaged around the company's board oversight of the issue. In particular, we sought to understand how and when issues get escalated to the board and how the board provides insight and direction to the executive team regarding compliance. We learned that some companies were overseeing this risk as part of their audit committee functions and others needed to strengthen their procedures around allocating responsibility within the board as well as the broader organization.

Because reputational risks can also materially impact a company's valuation, BIS engaged around the importance of developing a culture of operational excellence and integrity as well as the need for compliance and governance to operate independently and appropriately. In an effort to take positive steps towards mitigating these risks, one distributor issued a white paper describing the efforts it is now taking to protect the safety and integrity of its pharmaceutical supply chain. These include: developing supply chain security programs and order monitoring initiatives which help prevent the diversion and abuse of prescription opioids while also ensuring the availability of appropriate treatments for patients with serious illnesses and injuries. Another company involved in drug manufacturing discussed its work on the antidote to opiate overdose, its grant-making efforts relating to that antidote, and its work on developing abuse-deterring drug alternatives. Another company distilled the issue to the need to achieve "target therapeutics" – supplying medicines only to those who need them and avoiding giving drugs to people for whom they will not work.

BIS views the concerns around opioids both as a governance and risk management issue and will continue to engage to emphasize the need for systemic management and board oversight. This should include clear allocation of responsibilities throughout the organization and well-articulated protocols for product management.

Engagement and Voting Statistics

Americas Engagement Statistics[1]

	Level of Engagement[2]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
180	127	29	24	55	37	118

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

Americas Region Voting Statistics[1]

Country	Number of meetings voted	Number of proposals	% of meetings voted against one or more management recommendations	% of proposals voted against management recommendation
USA	426	3,017	26%	9%
Canada	17	65	11%	3%
Latin and South America	76	356	30%	10%
Americas Region Total	519	3,438	26%	9%

[1]The Americas engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on January 4, 2018 and both are a reflection of 4th Quarter 2017.

[2] 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 Americas 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:

- **The Sustainability Accounting Standards Board (SASB) — New York**

BlackRock's Global Head of Investment Stewardship is a member of the Investor Advisory Group (IAG) of the Sustainability Accounting Standards Board (SASB). The IAG convened in New York for its November meeting to review its success in achieving IAG goals over 2017, and to set focus areas for the coming year. A highlight of the meeting was a dialogue between IAG members and corporates, including representatives from four companies which in 2017 published sustainability information using the SASB standards: Host Resorts International, JetBlue, Kilroy Realty, and NRG Energy. IAG members also heard from other companies about the challenges they perceive to reporting using SASB standards. The IAG's main goal in 2018, which the BIS Americas team plans to support, will be to encourage more issuers to report using SASB standards.

We attended Moving the Market, SASB's symposium, where SASB launched its 2017 State of Disclosure Report. In this second analysis of the largest companies' annual 10-K and 20-F filings with the SEC, SASB found 73% of US-listed issuers assessed reported on at least three-quarters of the sustainability topics included in their SASB industry standard, and 42% reported on every suggested SASB topic. This is a slight increase over the previous year, but the majority of disclosure continues to be boilerplate and therefore not useful for financial analysis[3]. Harvard Business School professor George Serafeim presented research suggesting companies which demonstrate positive performance on material sustainability issues enjoy a 4.8% annualized stock price return benefit[4]. Conference speakers emphasized the benefits of SASB's approach, which is a market-led solution designed to address the problem of inconsistent sustainability disclosures aimed at investors without the need for new regulation. A panel of legal experts outlined the potential liability to companies who disclose only positive aspects of their sustainability program (of the kind often found in corporate social responsibility reports) while omitting poor performance in areas likely to have a material impact on financial or operational performance over the long term. Jean Rogers, PhD, founder and chair of the SASB, explained SASB's work to address the necessary market infrastructure, understanding, and information to enable a more efficiently functioning capital markets system.

- **US Board Director Events — Various Locations, United States**

We spoke at five events focused solely on US board directors and what investors expect of boards. The events gave us an opportunity to explain BlackRock's perspective of emerging governance trends to over 150 directors, representing an estimated 250 companies across the market

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[3] https://www.sasb.org/wp-content/uploads/2017/12/2017State-of-Disclosure-Report-web.pdf
[4] Mozaffar Khan, George Serafeim, and Aaron Yoon (2016) Corporate Sustainability: First Evidence on Materiality. The Accounting Review: November 2016, Vol. 91, No. 6, pp. 1697-1724. https://doi.org/10.2308/accr-51383

capitalization spectrum. We covered a wide range of topics including how to engage with index investors, the importance of having diverse directors on the board, the implications of investors' higher expectations of directors in relation to oversight of environmental and social factors, and how investors assess board effectiveness. During the question sessions we also covered the board's role in ensuring companies have an appropriate culture, the competitive advantage of building a diverse and inclusive workforce, succession planning for the CEO and key board roles, and how we engage during a shareholder activism campaign. We find participating in this broad-based dialogue helpful not only to present BlackRock's approach but also to enhance our own understanding of the areas of focus for directors.

- **CFA Society — Chicago**

BlackRock spoke on a panel entitled "Corporate Governance in an era of Clawbacks, ESG, Mega-Managers, and Zombie Investors" together with an ESG strategist and a peer active manager. We focused on our team's role using ESG factors in long-term value creation versus societal good. We also took time to explain the reasoning behind growing the size of the team, combining governance experts with industry experts, taking a sector-based approach and working closely with our active equity managers. The discussion pivoted to our "engagement first" approach where we discussed what we would expect out of meetings with companies in terms of agenda setting, attendees and cadence.

Market Developments and Trends

United States

In December 2017, the Delaware Court of Chancery ruled that a share class recapitalization undertaken by NRG Yield was conflicted because it was specifically designed to benefit the controlling stockholder. This decision will have broader implications for companies looking to amend or extend dual-class or controlling stockholder structures. In this particular scenario, the company chose to undergo a recapitalization because the controlling stockholder's voting power had slipped from 65% at the time of the IPO to 55% due to the company's use of stock in acquisitions. The Delaware Court of Chancery applied an "entire fairness" standard of judicial review because the transaction expressly provided a unique benefit to the controlling shareholder by extending the amount time they held majority voting control. The "entire fairness" standard is more stringent than the typical "business judgement rule," which historically applied to recapitalizations because all stockholders were treated the same. The court distinguished the precedent, by saying that prior cases did not show that recapitalizations were being done for the express benefit of one controlling shareholder. The court also provided guidance that boards of directors looking to engage in similar types of transactions going forward may be able to avoid litigation by showing that they did not act for the purpose of benefiting the controller. In this particular case, the board conditioned the recapitalization on approval by a fully empowered independent committee as well as a majority of the minority vote.

Latin America

In October 2017, the Argentine stock exchange ("BYMA") announced that it was planning to create a segment modeled on Brazil's "Novo Mercado" with a launch expected in the first half of 2018. Similar to the Novo Mercado, the new segment would have more stringent standards for disclosure and corporate governance with the aim to enhance transparency, increase liquidity and attract more retail and institutional investors.

In December 2017, BYMA signed a commitment letter with the United Nation's (UN) Sustainable Stock Exchange, joining almost 70 other stock exchanges globally committed to sharing information and working with stakeholders to promote the sustainability and transparency of capital markets. Our 2017 Americas Q1 Quarterly Report highlights some of our team's work with the UN Sustainable Stock Exchange Initiative Working Group.

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