INVESTMENT STEWARDSHIP REPORT: AMERICAS

Q1 2018

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Contents

The BlackRock Investment Stewardship (BIS) team publishes quarterly reports to explain BlackRock's approach to corporate governance engagement that supports long-term value creation for our clients. The examples reported give a sense of the wide range of issues our engagements and voting analyses cover. We aim to provide examples that highlight particular environmental, social and governance ("ESG") considerations, emerging practices or issues and notable company-specific developments. We also provide examples of our engagement in the public domain, such as responses to formal policy consultations and presentations or informal discussions at conferences.

Engagement and Voting Highlights

Considering culture and company structure

1 Human capital management has been a focus for the BlackRock Investment Stewardship team's (BIS) engagement, as outlined in our 2018 engagement priorities. During engagements, we seek to better understand how companies are fostering their employee base as a long-term asset of the company. Acknowledging the costs inherent in recruiting and retaining quality talent, the return on investment of an engaged workforce can aid a company's long-term success. To that end, structural practices, such as programs to promote an inclusive and diverse workforce, access to training programs, and a strong succession planning pipeline create a framework for cultivating employee engagement. Equally as important, culture is an underlying intangible that can materially impact the outcome.

With the BIS team's regional and sector specific focus, we often identify companies exemplifying best practices with regard to human capital management. Through our engagements, some companies have reported increased employee satisfaction with the implementation of pay or incentive practices that help align all levels of workers with company performance via stock ownership. For example, shares may be granted as part of an annual bonus plan, upon initial employment or as a form of superior recognition. Measurements of success vary from company to company, but overall, positive feedback has indicated a greater sense of collaboration — when employees have a vested interest in the success of the company, their direct line of work often becomes more tangible — their team's success feeds into enterprise success, and in turn personal success.

However, this approach to human capital management and ownership mentality requires careful evaluation when dual class shares of stock are involved. With dual class shares, a prominent concern is often that founders or a single controlling shareholder will retain significant influence, while common stockholders have little input into governance issues, potentially disenfranchising investors with a concentration of power.

One prominent US shipping company has received a shareholder proposal for the past several years, requesting the elimination of the stock's dual class structure. The interesting spin: Class A shares are only owned by current and former employees — of all ranks, from hourly to salaried to management. It's been this way since the company went public in 1999, and the board maintains that the resultant ownership culture that has ensured the long-term success of the company is integrally tied to this structure. As of February 8, 2017 there are over 155,000 holders of Class A shares, which have 10x the voting power of the publicly traded Class B shares.

In practice, we believe that companies with dual class shares should review these structures on a regular basis or as company circumstances change, and receive shareholder approval of their capital structure on a periodic basis via a management proposal on the company's proxy. 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.

While we maintain this stance in practice and principle, we acknowledge that culture will continue to play a significant role in the long-term success of public companies. To that end, we aim to continue exploring how an ownership mentality and employee engagement are increasingly intertwined.

Safety first

2 BIS regularly engages with companies on risk oversight — operational risk, reputational risk, structural risk, etc. In recent engagements with two chemical companies, we discussed operational risk with regard to how the companies were considering safety and preventative steps to mitigate hazards, accidents, worker injury, and community impact. Our conversations revealed an interesting dichotomy — an increasing focus on the new demands of a changing market via product offering; yet, it appeared that little had changed over the years with regard to reflection on internal processes, improvements, or enhancements in a similar fashion.

In particular, while the companies gave a clear sense of their innovations and ability to produce cleaner, more efficient outcomes for their clients, little was said about how technology, process evaluation, or even employee training might make the work environment safer. This conversation came in the wake of a chlorine spill from one of the companies' operational plants that impacted the local community and air supply. Yet, enhancements to safety appeared to be of less concern than product innovation.

However, a focus on safety can make a material, financial difference in long-term company performance.

By way of example, in October 1987, Paul O'Neill took the reins as CEO of Alcoa, an aluminum manufacturing giant, and effectively unlocked tangible value with one of his most noteworthy campaigns focused on worker safety.

At the time, Alcoa's safety record was better than most industrial companies, but accidents still happened and employees were absent from work on occasion as a result of on-the-job injury. During O'Neill's 13 years at the helm, Alcoa went from 1.86 lost work days per 100 workers to 0.2. His legacy continues today — as of 2016, the global company rate stood at .17 lost work days per 100 workers.

A focus on worker safety and injury rate was just the start — an insistence on "habitual excellence" created a cultural change, one that empowered employees to critically evaluate operations, suggest improvements, and create a framework for accountability. Simply, a focus on worker safety led to a thorough, company-wide examination of the manufacturing process, one that affected the aluminum produced and created a safer environment for workers.

Just one year after implementing these changes, the company's profits hit a record high, and by the time O'Neill retired, Alcoa's annual net income was five times higher than when he started.

Mitigating risk via proactive steps can have a profound effect on a company's product, culture, and long-term value creation. Forward thinking companies have detailed disclosure for their shareholders regarding safety practices and oversight. Additionally, if "safety" or "working environment" is a component of the executive compensation plans, best in class companies detail how these elements further contribute to company cultural and operational excellence.

Diversity on boards

3 We encourage boards to have a multi-faceted view of diversity, encompassing tenure, age, expertise, geography, race, and gender to promote robust boardroom dialogue as a result of the variety of experiences and perspectives.

In tandem with this view, we updated our US proxy voting guidelines to specify that we expect companies to have at least two women directors on their board. While gender is just one aspect of diversity, it is readily identified and quantified via standardized reporting mechanisms. Where we assess that a board inadequately articulates its approach to, and account for, diversity, or lacks a mechanism for recruiting diverse candidates, we will consider voting against the nominating and governance committee. Fundamentally, a lack of diversity or willingness to consider diversity on the board may impair board effectiveness and thus pose a material risk to long-term value creation.

In conjunction with this effort, in January 2018 the Americas BIS team sent letters to approximately 300 companies within the Russell 1000 that had fewer than two women on their board. As we take an "engagement first" approach, the team has been actively speaking with companies to better understand recruiting processes for new directors and how diversity is factored in these decisions.

We are encouraged by a number of the company responses we have received to date. For example, during an engagement with a software company, we discussed their ongoing search for two new board members and the difficulty of finding and appointing diverse individuals with executive experience in their specific industry. Despite these challenges, since our initial conversation and their receipt of our letter, the company has appointed two women to the board. We interpret this as a positive development in line with our expectation that a deliberate effort on diversity achieves results.

Advisor outreach

4 During Q1 2018, BIS invited advisors across the financial, legal, and proxy solicitor spectrum to meet the team and exchange views on the engagement process. The aim of these meetings was to clarify the way in which BIS engages with companies in our normal course of business and during contested situations. We wanted to communicate our overall approach, introduce team members as sector specialists, and open a dialogue to highlight focus areas for the team. We wanted to ensure, in particular, a clear understanding on the part of corporate advisors of how we evaluate contested situations and activist proposals. While each situation is admittedly unique, we aim to meet with both the company and the activist to best understand each point of view and proposed course of action.

We believe that the main outcome from these meetings was to encourage a frictionless process and enhance visibility and access by encouraging these advisors to connect their corporate clients with BIS, should the need arise. We also encourage companies to be proactive when they sense a special situation developing and engage BIS as soon as possible, rather than wait until the shareholder meeting.

Banking and tax reform

5 The financial sector is an anticipated beneficiary of the Tax Cut and Jobs Act, which passed on December 20, 2017. The BIS team engaged with the boards and management of a number of financial companies to understand their planned approach in both the short-term and long-term.

Aside from a simplification of the tax code, the key financial impacts are two-fold. Firstly, a reduction in the corporate tax rate from 35% to 21%, such that companies will see a clear benefit to the bottom line. In our analysis we feel that profitable companies with the majority of revenues earned domestically, such as regional banks and insurers, would benefit most. Secondly, a one-time 15.5% tax on any cash repatriated from overseas which will, initially increase taxes, but provide further cash-flow over time for domestic use. We expect that asset managers with large cash reserves held overseas would benefit most in this scenario.

All companies described some uses of this windfall (rather than simply letting it improve net earnings) and while there were deviations for each specific company, on balance, most described an approach of splitting these benefits evenly between:

1. **Rewarding employees,** with many companies opting to pay one time bonuses or increase minimum wages
2. **Investing in the business,** took the form of much needed technology upgrades
3. **Returning capital to shareholders,** in the form of increased dividends, special dividends and share buybacks, but most companies are reviewing their existing programs first

Companies with a higher majority of domestic earnings expect to see higher benefits than their more global or offshore counterparts. Over time, however, most companies expect any of the residual benefit to be "competed away" to customers. In the banking sector, the customer benefits will take the form of lower account fees, lower loan rates, or higher deposit rates, while in the insurance sector, policy holders should expect to see lower premium costs.

While we recognize the various approaches taken to capital management following the tax reform, we will continue to seek insight into the boards' process for evaluating the appropriate mix of capital allocation strategies in the context of their long-term strategy.

Engagements around cyber-security risk

6 Cybersecurity risk is an area of focus for companies across all sectors and markets. As businesses continue to digitalize their processes, customer data, intellectual property, energy sources, etc., they are more exposed than ever to unlawful access by outside sources.

Statistically, most companies will experience a cybersecurity breach at some point in time, and with it, exposure that has the potential to incur significant financial, competitive, and reputational damage. BIS views cybersecurity as a significant enterprise-wide risk that can impact all levels of a company's operational activities; managing this risk is essential to preserving corporate value over time. Recognizing that the topic is evolving, we have been engaging with companies — using various industry frameworks and the February 2018 US Securities and Exchange Commission's (SEC) guidance[1] — to learn and better understand the board and senior management's approach to assessing the cyber risks for the business, determining appropriate mitigation plans, and developing a crisis response.

For example, during an engagement with a healthcare company which had experienced a data breach, we discussed the role that third-party vendors play in the company's security chain. Not only does the company have primary responsibility within the lines of its own organization, but in the event of a breach, the company must also assess what sensitive information may have left its hands and gone to third parties outside the company's direct control. The company must then seek to identify the source of the breach and determine how to secure that data. We discussed the company's oversight of data security and the chain of reporting into the board of directors and C-Suite. The company also discussed the efforts underway to regain customer trust and goodwill that was lost in the breach.

In an engagement with an energy company we discussed the decision by the board to add a director who brings specific cybersecurity experience amidst his other credentials. The board had determined that cybersecurity risk management was a critical skillset that the company sought to have at the board level to better position it for the challenges facing the sector going forward.

In an engagement with a pharmaceutical company we discussed the board's oversight of cybersecurity risk and management's focus on early detection rather than what it viewed as the unattainable goal of total prevention. Specifically, the company undertook some targeted hiring to supplement its existing team in an effort to keep up with the increasing risks. The company detailed the process by which this team analyzes potential breach points and develops and modifies the corporate action plan to prevent and respond to a breach. The company stressed the continuous need for vigilance both within the company itself as well as along its supply chain to prevent serious breaches.

BIS will continue to engage with companies on these risks. We believe that these engagements will lead to a better understanding of the depth and breadth of the risks and to better disclosures around how boards and executive management are addressing these risks.

[1] See "Market Developments and Trends" section below.

Engagement and Voting Statistics

Americas Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
221	199	11	11	28	53	200

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

Americas Region Voting Statistics[2]

Country	Number of meetings voted	Number of proposals	% of meetings voted against one or more management recommendations	% of proposals voted against management recommendation
USA	310	2,227	24%	6%
Canada	26	209	35%	6%
Latin and South America	90	747	63%	21%
Americas Region Total	426	3,183	33%	9%

[2]The Americas engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on April 5, 2018 and both are a reflection of 1st Quarter 2018.

[3] 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. Source: BlackRock as of 1st Quarter 2018.

Active Ownership and Responsible Leadership

Larry Fink's annual letter to CEOs

Each year BlackRock's Chairman and CEO Larry Fink sends a letter to the CEOs of leading companies in which our clients are shareholders on issues of corporate governance and long-termism. In these letters he has for several years explained our expectations of companies in relation to long-term thinking:

"We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation. Additionally, because boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their boards have reviewed those plans. BlackRock's corporate governance team, in their engagement with companies, will be looking for this framework and board review."

This year's letter details how BlackRock will be engaging with companies in 2018 and what we are asking of them on behalf of our clients. The letter addresses the role of companies and their shareholders in light of two major trends: (i) the retreat of government from trying to solve many long-term social issues, and (ii) the continued rise of index-based investing. Against this backdrop, public expectations of companies are growing and society is demanding that companies serve a social purpose. The time has come for deeper and more complete engagement between shareholders and companies, moving towards year-round conversations about improving long-term value.

List of recently published engagement commentaries:

1. Engagement on strategy, purpose and culture
2. How we engage on climate risk
3. How we engage on board diversity
4. How we engage on human capital
5. Our approach to executive compensation

In order to help companies understand how we engage on issues in relation to strategy, culture and purpose, we have published a document that outlines our approach and previews examples of the questions that we will be posing to the companies. Although it is premature to draw any conclusions at this early stage, our observations to date indicate that many companies are not able to fully explain their own culture and purpose. These engagement topics are indeed more nuanced than many aspects of governance. Some companies publish clear and insightful explanations of their long-term strategy, purpose and culture; we would like that to be the norm. Where necessary, we hope that our engagements on this topic can help achieve this outcome. We will continue to report on our findings in the following quarters.

U.S. Voting Guidelines update

In February 2018, the BIS AMRS team published updated Proxy voting guidelines for U.S. securities. The majority of the changes made were in an effort to refine the language of the prior policy document, removing definitions which were deemed unnecessary and re-organizing the addressed topics. In addition, a few substantive changes have been made that may slightly alter vote outcomes for the 2018 proxy season.

Below are some of the key proxy voting guideline updates:

- **Over-boarding:** we lowered the threshold by which a sitting CEO will be considered over-boarded by one outside public company. A director who is also a CEO of a public company may now sit on a total of up to two public company boards. Our policy update reflects what's now widely accepted as good practice among the companies and boards we talk with throughout the year. This is a reflection more generally that responsibilities of board members continue to increase and we want to make sure that for CEOs, being an outside board member does not detract from their CEO role.

- **Board composition and effectiveness:** we expect companies to have at least two women directors on their board. Absent constructive engagement on gender diversity within a reasonable timeframe, we may vote against the re-election of the directors on the nominating and governance committee. Diverse groups have been proven to make superior decisions. Irrespective of a company's industry, location, or size, we believe that a lack of diversity on the board undermines its ability to make effective strategic decisions.

Speaking events

Members of the BIS 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 summary of some of the events team members have spoken at during the quarter:

Director Dialogue Day 2018 — New York, New York

On March 5, 2018, BIS hosted its first Director Dialogue to engage with independent directors on a broad spectrum of topical governance issues. The event was attended by nearly 60 representatives from 27 companies including some management representatives, generally those representing the board. Michelle Edkins, BlackRock's Global Head of Investment Stewardship, introduced the Americas team, and each sector analyst discussed developments in their specific coverage areas. The team also discussed the recent changes made to our voting guidelines for U.S. listed companies and how we expect that to influence our voting.

Barbara Novick, a co-founder of BlackRock and Vice Chairman, shared public policy issues that impact our stewardship program. Barbara then interviewed Larry Fink, our Chairman and CEO, on his corporate governance letter, reactions to it since it was published in January and macroeconomic trends impacting investments. Lastly, Brian Deese, Global Head of Sustainable Investing at BlackRock, explained our evolving approach to integrating environmental, social and governance considerations – or ESG – into our investment and product development processes.

Berkeley Law Event — San Francisco, California

The new US Securities and Exchange Commission Commissioner Robert Jackson spoke on the topic of dual class companies, calling on the US stock exchanges to establish mechanisms whereby this type of structure could not exist indefinitely. He expressed concern that index providers excluding companies with dual class shares constrains investment opportunities. This could disproportionately affect main street investors, who are in mainly index vehicles, and potentially prevent them from investing in some of the highest growth companies in the economy.

BIS presented later that day on a panel entitled "Proxy Contests and Settlements in 2018: The New Calculus". We emphasized that our position as an index investor does not prevent active engagement with the companies in which we invest on behalf of our clients. As discussed in Larry Fink's 2018 letter to CEOs, because we are unable to divest from companies held in an index (i.e., "vote with our feet"), ongoing engagement conversations allow BIS to better understand how boards and management are delivering their corporate strategy and managing business risks and opportunities.

We also discussed the trend of companies settling with activists. However, it is increasingly difficult to evaluate private settlement scenarios, as the flow of information and publicly available data during activist situations may be imperfect. Our approach is to speak with both the activist and the company during contested situations.

US Institute Chief Investment Officer Roundtable — Maria del Rey, California

BIS presented on a panel on "ESG Investing: Approaches and Challenges" with three different practitioners on this topic: an ESG data provider, an investor, and a consulting firm. The audience was made up of CIOs of financial firms. We discussed the way we integrate ESG in our stewardship processes — our team has identified certain key performance indicators that we believe will differentiate the leaders from the laggards in terms of risk management. However, challenges exist as we still lack standardized disclosure on environmental and social metrics. This has resulted in our team, for example, working closely with groups such as the Sustainable Accounting Standards Board (SASB), to help create an industry-specific, standardized reporting mechanism to produce high quality, financially material metrics that we can use in our analysis.

Conference Board Meeting — Orlando, Florida

BIS spoke at the Wall Street Session of The Conference Board's Special Joint Session of the Environmental Health & Safety (EHS) Officers' Council & Sustainability Council in Orlando, Florida. The meeting was attended by roughly 100 representatives from public companies. The conference session focused on "what investors want" in relation to ESG data. Topics discussed included the state of play in the current ESG space, how BlackRock expects the landscape to change over the next 12-18 months, and examples of what data investors are and are not looking for in terms of disclosures. We discussed the Task Force on Climate-related Financial Disclosures and the SASB as frameworks for corporate reporting and their benefits in enhancing engagements on material risk factors. Our participation allowed us to share our investment stewardship approach with EHS officers who are responsible for preparing corporate disclosures around ESG metrics.

Weinberg Center for Corporate Governance 2018 Symposium — Newark, Delaware

BIS participated in the annual University of Delaware Corporate Governance Symposium, an event which brings together approximately 250 industry practitioners ranging from thought leaders, corporate directors, senior members of management teams, and legal experts. The BIS team spoke on a panel entitled, "Governance Issues of Critical Importance to Boards and Investors in 2018," where we discussed topics ranging from board accountability, oversight of key issues like cyber security and climate risk, and board succession, recruitment and appointments in the context of diversity. The panel provided an opportunity for our team to also discuss Larry Fink's annual letter to CEOs in the context of our stewardship work and to reflect on the importance of BIS' engagement priorities in helping to shape a more robust and constructive conversation with companies.

West Coast Director-focused Events — California

In January, we spoke at five events in California to audiences largely made up of board directors. The themes of Larry Fink's annual letter to CEOs was a key focus. We also discussed "hot topics" for the forthcoming shareholder meeting season. In our view these include shareholder proposals on a range of environmental and social matters, the newly required disclosure of CEO to median worker pay ratio, and board diversity and effectiveness.

Market Developments and Trends

Regulatory updates

Appraisal ruling

In December 2017, the Delaware Supreme Court held that when considering appraisal cases, the court must give a transaction price derived from a clean auction process "heavy weight" in its judgment. This judgment effectively discourages stockholders in Delaware incorporated companies from seeking third party appraisal during contentious mergers or buyouts. In its ruling the Delaware Supreme Court reversed the Court of Chancery's previously awarded 28% premium to stockholders effected by the take-private of Dell in October 2013. Previously, in May 2017, the trial court had rejected the $13.75 per share transaction price and awarded $17.62 per share as fair value consideration.

Cybersecurity disclosure

In February 2018, the SEC published guidance focused on cybersecurity disclosure. Following a spate of cybersecurity crises at US listed companies, new SEC Chairman Jay Clayton updated guidance to emphasize the need for corporations to "take all required actions to inform investors about material cybersecurity risks and incidents in a timely fashion, including those companies that are subject to material cybersecurity risks but may not yet have been the target of a cyberattack." The guidance stated that the board of directors is responsible for these disclosures as well as emphasizing that boards should be "informed about the cybersecurity risks and incidents that the company has faced or is likely to face." The guidance also touched on other disclosure topics, notably around the purchase or sale of securities by insiders and broker dealers who may have access to privileged information.

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