INVESTMENT STEWARDSHIP REPORT: ASIA-PACIFIC

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

Shedding light on Japanese board structures

1 Japanese company boards have long been criticized for lacking sufficient independent director oversight. This corporate governance problem received renewed attention when Japan's Financial Service Agency (FSA) proposed guidelines encouraging companies to make one-third of all board members independent[1].

BlackRock's Investment Stewardship team recognizes that independent directors may allow for more independent oversight of management. However, we also believe that inflexible policies (those related to percentages or finite numbers of independent board members) overlook the complex history of board structures in Japan, and the current trends towards structural improvements.

The role and structure of the board of directors (BoD) in Japan differs significantly from that of public company boards in other regions. Typically, the BoD is responsible for business execution rather than monitoring and oversight. For this reason, the number of independent directors on boards has historically been low. We believe that determining the appropriate threshold of director independence requires a more thorough review of the current boards and their evolution.

In addition, Japan's predominant board structure is the dual-board structure. Specifically, the BoD oversees business execution while the Audit & Supervisory Board of Kansayaku provides oversight of the BoD. Typically, the BoD meets at least once a month to discuss/approve business execution matters. Kansayaku board members attend BoD meetings as a non-voting members. Additionally, Kansayaku boards typically meet at least once a month. The board of Kansayaku is established to remain majority outside/independent. Until 2015, 97% of Japanese companies operated under this structure and approximately 75% of public Japanese companies still operate under this structure.

Today, Japanese companies have three board structure options:

1. Dual board structure with the Kansayaku board (representing approximately 75% of public companies in Japan)
2. Single-tiered board with an audit and supervisory committee (introduced in 2015, representing 22% of public companies in Japan)
3. Single-tiered board with a three committee structure (representing 3% of public companies in Japan)

Due to its unique structure, the Kansayaku system is often misunderstood by foreign investors, (who now account for around 30% of the ownership of Japan listed companies). On account of this, Japanese corporate law was revised to permit companies flexibility when considering how their boards operate. The second structure aims to create a 'middle ground' in that it is more reflective of western-styled single-tiered board yet maintains the benefits and practices of the traditional Kansayaku board system. This has allowed companies to appoint more independent directors to the BoDs, with independent directors of the Kansayaku board serving on the BoDs with voting rights, while maintaining a similar role.

At the same time, a number of companies using the traditional Kansayaku board structure have also enhanced their board oversight functions by establishing an advisory nomination and remuneration committee, mainly comprised of independent directors. Japanese companies (particularly the larger ones), are demonstrating a willingness to continuously review and adapt the structures and roles of their boards through these various changes.

[1] https://www.fsa.go.jp/en/refer/councils/follow-up/index.html

Conclusion:
Applying a binary voting policy that focuses on the number or percentage of independent directors does not fully recognize the range of developments in board structures.

The introduction of Japan's Corporate Governance Code (Code) in 2015 requires, on a "comply or explain" basis, that boards have at least two independent directors. Unquestionably, the Code has contributed to an increase in the percentage of boards with independent directors. The change has also caused a sudden shortage of qualified experienced independent directors, as companies ended up calling on the similar pool of independent director candidates, in response to the requirements of the Code.

For this reason, the BIS' APAC team believes it is far more constructive to engage with companies and review their existing governance practices in light of these changes. We view this as a more productive approach to a complex and evolving market practice, rather than reducing this important governance issue to a vote box-ticking exercise.

A former CEO and founding family member seeks board seat in Japan

2 BlackRock engaged with an electronic component company regarding the appointment of a director who was the former CEO and a member of the family that founded the company. He stepped down as CEO after the company's business was deeply troubled due to delays in shifting its strategy following the collapse of the solar panel market to which the company was significantly exposed.

In the wake of these challenges, we have been impressed by the incumbent management's leadership in restructuring its business (by boosting sales in specialized materials and by reducing its fixed cost). While we believe significant shareholders may make a valuable contribution to the work of the board, in this case, we found no convincing rationale for bringing back the former CEO. We were also concerned by the lack of clarity regarding the role he would have within the board. We believed that the required skills for the board had changed as the company began expanding its overseas business. As a result, we decided to vote against the appointment of this founding family member at the Annual General Meeting.

Korean Annual General Meetings (AGMs) pose logistical challenges

3 The AGM season for APAC kicked off with Korea in March. Due to a regulation that calls for listed companies to hold their AGMs within 90 days from the end of the fiscal year, more than 95% of all Korean AGMs are held in March. Compounding this concentration problem is the fact that most companies select Fridays to hold their meetings.

Notably, 61% of all companies held by BlackRock funds held their respective AGMs on three Fridays in March, presenting a significant logistical challenge in company engagements and timely vote execution. We try to alleviate this situation by doing as much engagement around governance and anticipated voting issues as possible outside the voting season. Considering that most Korean companies also file meeting circulars just two weeks before the meeting date, the concentration of meetings on certain dates within the one month window continues to act as a pain point for diversified institutional investors that vote in Korea.

BlackRock will continue to engage with companies to ask that AGMs be held on other weekdays apart from Fridays, while urging regulators to introduce measures – such as easing the 90-day AGM deadline – to alleviate the chronic concentration problem that poses a hurdle to shareholders casting informed votes.

A managerial shakeup at a large Korean construction company

4 Last year, BlackRock met with the CEO and Chairman (executive chairman) of a large Korean engineering and construction company that clashed with many of its investors over a controversial 2015 merger. According to the executive chairman, that experience led to significant changes in relation to how the board views its role and

accountability to shareholders, and promised that it would introduce changes to its board composition as well as strengthen communications with shareholders.

At its AGM in March, the company followed through with the executive chairman's promises by introducing some meaningful changes. Notably, the board separated the role of CEO and chairman, with the former executive chairman resigning from his executive position to focus on his chairmanship of the board. While the chairman is not independent, this displays a positive step towards diffusing the authority and influence that used to be concentrated in one individual director.

In addition, the board has addressed the call for more diversity on its board by nominating a foreigner as an independent director for the first time in the company's history. More importantly, the candidate brings management experience to the board, having previously served as a C-level executive at a large American multinational conglomerate. This is a significant step forward for any Korean company, given the prevalence of academics and former bureaucrats serving independent directorships on Korean boards. The company informed BlackRock that it has already laid out the travel plans with the France-based director to secure in-person attendance, to ensure his effective contribution to board discussions.

Lastly, the board has announced a 3-year annual dividend policy of Korean Won (KRW) 2,000 per share effective until 2019. The dividend represents a nearly four-fold increase from KRW 550 in FY2016, and according to the company, the board has formulated the policy to address shareholders' requests for higher levels of return of capital and to improve transparency and predictability around capital management.

BlackRock will continue to work with the company and monitor the progress of the board in its efforts to improve board quality as well as investor communication.

Navigating a board versus union dispute in Korea

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During a Korean financial holding company's Extraordinary General Meeting (EGM) in November 2017, a labor union lodged shareholder proposals to appoint its own independent director to the board and to amend the company's articles of incorporation. The amendment proposal was positioned as a means to curb the CEO's influence on key board decisions such as the appointment of chief executives of the company's subsidiaries. BlackRock engaged with the board, noting that the board did not provide shareholders with its views on the labor union's proposals in the meeting circular nor proxy solicitation documents. While the board explained that publicly opposing the labor union's proposals may further erode relationships with the labor union, we emphasized that shareholders expect the board to explain its position on issues put to a vote in situations such as this in order to help shareholders make informed voting decisions.

Failing to generate enough shareholder votes at the EGM, the labor union came back with similar proposals at the company's AGM in March. This time, the board provided a detailed rationale on why it opposed to the labor union's proposals, removing any confusion that shareholders may have. While BlackRock engaged both management and the labor union representative prior to voting, we ultimately supported all of the board's proposals primarily based on the logic that the board had publicly disclosed.

The board's proposals ended up generating overwhelming support by all shareholders, which suggests that the labor union might not lodge proposals at future meetings. Nonetheless, BlackRock suggested that the board work towards building a more constructive relationship with the labor union following the AGM as they are an important stakeholder for the company to engage to help ensure sustainable long-term growth.

A dispute over stock options with a property developer in Hong Kong

6 BlackRock initiated an engagement with a Chinese property developer to discuss its proposed stock option grant to be approved by shareholders at its EGM scheduled in late December 2017. We raised a few concerns to the company including 1) the size of the grant appeared excessive especially considering that half of the grant, representing five percent of the issued capital, was to be awarded to the executive chairman alone; 2) the vesting of the options was conditional on the growth rate of the net profits in 2017 compared to 2016. This seemed lax given it was already near the end of 2017 when the grant was proposed. Moreover, there were no lock-up provisions upon exercise of the options and it wasn't clear to us how the scheme could serve to align the interests of the executive chairman with the company's performance over the long-term; 3) disclosure in the circular was very limited. The circular provided no discussion of the estimated accounting cost or how the management team including the executive chairman intended to finance the exercise of the options (approximately US$667 million would be needed if the options were to be fully exercised). The company was not able to address our concerns during our engagement and, as a result, we did not support the proposed options grant. Notably, at the December 30th shareholder meeting, the "chairman proposed a resolution to adjourn from voting indefinitely all the resolutions as set out in the meeting circular, as further consideration and refinement of the resolutions are required."

Engagement on climate-related risks and opportunities in the Japanese auto sector

7 BlackRock engaged with a number of companies in the auto sector on climate-related risks and opportunities, most notably on their long-term strategy in response to the emerging Electric Vehicle (EV) technology and changes in the regulatory environment in their key markets. Through these engagement, we confirmed that the companies are taking a pragmatic approach in adapting to the EV technology including expansion of partnerships and strategic alliances with other auto makers.

For example, one auto maker with a large presence in emerging markets is taking two steps: 1) self-developing a new EV car in line with the local government's policy to promote EVs in their key market, and 2) preparing hybrid vehicles through a strategic partnership with a major automaker. We found this approach sensible given the uncertainty in the regulation of emissions as well as the timing of any technological breakthrough in car batteries likely to make EVs more ubiquitous.

Another automaker pointed out that in order to truly reduce greenhouse gas emissions, the entire production cycle needs to be taken into account. This requires a "well-to-wheel" perspective, which evaluates carbon dioxide (CO_2) emissions from a full lifecycle, beginning with oil/gas extraction, power generation, product manufacturing and shipping. This is broader than looking at CO_2 emissions from a "tank-to-wheel" perspective, which only focuses on CO_2 emissions while driving. The company is aiming to accomplish a 50% reduction of CO_2 emissions, from a "well-to-wheel" perspective by 2030 against a baseline of 2010. This emissions reduction would be driven by improved efficiency in its internal-combustion engine, along with greater use of hybrid technologies.

A motorcycle manufacturer we engaged also noted the difficulty in generating business due to a lack of demand for EVs in the marketplace. The company spoke to how motorcyclists predominantly enjoy riding as a leisure activity, preferring sporty rather than fuel efficient vehicles. However, we have confirmed that the company is also preparing themselves for EVs, once demand shifts to this new area.

Overall, we were satisfied that companies were well aware of the transition risks associated with the emergence of EV technology and take a manifold approach to pivot their strategies in response to changing needs of customers and evolving regulations. We will continue to engage with companies in the auto industry around these and other trends (like connected cars and autonomous driving) to better understand how companies might adapt their long-term corporate strategies.

Engaging to understand the skills shortage in Australian mining

8 BlackRock met with a resource company where there was a significant holding by one of BlackRock's active natural resources teams as part of the regular dialogue. Over the last five years the resources industry has been impacted by low commodity prices resulting in declining number of students enrolling at major Australian tertiary institutions undertaking courses relating to mining. A continuing decline in mining graduates represents a looming industry labor shortage and a key risk for the company's expansion plan. In our engagement, the executive chairman explained the importance of culture in both attracting and retaining talent. Demonstrating how front of mind this human capital management risk is to the company, we learned that the board allocates at least half a day to talent management at each board meeting.

Additionally, management has established a structured graduate program and has been working with both universities and schools in order to address the issue by identifying undergraduates and high school students to encourage careers in mining. Our future engagements will seek to understand how these efforts by the board and management help address key risk.

Engagement and Voting Statistics

Japan Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
111	12	69	30	15	18	110

Asia-Pacific ex Japan Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
48	20	25	3	12	13	45

*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[2]

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	18	62	39%	6%
APAC ex Japan, Australia, and New Zealand	1,234	6,938	27%	10%
Japan	270	2,550	37%	5%
Asia-Pacific Region Total	1,522	9,550	29%	8%

[2] The Asia-Pacific 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:

- Engagement on strategy, purpose and culture
- How we engage on climate risk
- How we engage on board diversity
- How we engage on human capital
- Our approach to executive compensation

Speaking events

Members of the Asia-Pacific Investment Stewardship 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:

Korea National Assembly Roundtable Discussion — Korea

BlackRock participated in a roundtable discussion hosted by the Korea National Assembly where regulators, investors, and companies shared perspectives on how to improve corporate governance practices in Korea. BlackRock raised concern about the difficulty of exercising informed votes at Korean AGMs due to the concentration of meetings in March, as the law requires all companies to hold their AGMs within 90 days from the end of the fiscal year. BlackRock also emphasized the importance of board quality - including diversity of skills and independence for the board to adequately perform its duties, and pointed out the need for a comprehensive on-boarding for directors at many Korean companies.

Association of Southeast Asian Nations (ASEAN) Conference on the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) — Singapore

BlackRock spoke on a panel entitled “Investor Needs and Views on TCFD Recommendations” at the ASEAN TCFD Conference hosted by the Singapore Exchange (SGX) and the TCFD[4]. BlackRock shared how climate-related risk, along with other environmental and social considerations, are incorporated into BlackRock’s investment process, and why we are supportive of the framework recommended by the TCFD for disclosure on climate-related risk. BlackRock emphasized that our company engagements on the TCFD framework seek to promote meaningful discussions on how the board views and addresses climate-related risk in line with their long-term strategy and to learn how companies may be responding to these guidelines.

Tencent Investor Relations Forum — Hong Kong

BIS participated in a panel discussion on shareholder communication at the Investor Relations Forum hosted by Tencent for its investee companies. The audience included investor relations officers of Tencent’s investee companies, some of which are listed and some of which are in the process of going public.

Taiwan Depositary & Clearing Corporation (TDCC) Corporate Governance Forum — Taipei

Investment Stewardship participated in a panel discussion on “Sharing Best Practice in Active Ownership to Promote Good Corporate Governance” at the Corporate Governance Forum hosted by the TDCC. BlackRock shared its experience in engaging with issuers in Taiwan and emphasized the importance of understanding the local context when engaging on corporate governance issues. Our comments were well received by the audience, who were mostly directors of listed companies.

International Integrated Reporting Council (IIRC) Council Meeting — Japan

BIS spoke on a panel as part of the council meeting hosted by IIRC in Japan. Topics discussed included current developments in corporate governance and stewardship in Japan from an investor perspective, as well as recent developments in integrated reporting.

Japan Association of Corporate Executives (Keizai Doyukai) Management Reform Committee — Japan

Investment Stewardship was invited to speak at a panel, tailored to corporate executives in Japan. Topics discussed included ways to enhance constructive dialogue between Japanese corporates and investors in order to promote long term value creation.

Australian Institute of Company Directors — Melbourne

BIS was invited to speak on a panel at the annual conference of the Australian Institute of Company Directors on the topic of the “New World of Stakeholder Management”. The discussion focused on the engagement process undertaken by Australian companies, the increase in shareholder proposals, as well as the disclosure of strategy and integrated reporting.

Australian Financial Review Business Summit — Sydney

Investment stewardship was asked to speak on a panel on the topic of “Shareholder Activism”. The discussion focused on BlackRock’s process of voting and engagement, our approach to proxy contests and our own activism experience.

[4] http://www.meti.go.jp/english/press/2017/pdf/0529_004b.pdf

Australian Securities and Investments Commission Annual Forum 2018 — Sydney

BIS was invited to participate in a panel on Corporate Social Responsibility (CSR). The discussion focused on CSR being strategic to a company's operation and should not be seen as a philanthropic issue. Companies should understand their footprint on society and manage effectively.

Market Development and Trends

Singapore

- On January 16, the Corporate Governance Council of the Monetary Authority of Singapore (MAS) released a consultation paper on its recommendations to revise the Code of Corporate Governance (Code). The recommendations were focused on updating the current Code to reinforce board competencies through provisions guiding board renewal, independence testing, and diversity. Other revisions include emphasis on disclosure of the relationship between remuneration and value creation, as well as the need for boards to consider and balance the needs of a wider stakeholder group.

  BlackRock submitted a response in March generally in support of the recommendations, with suggestions on how to further improve the existing Code. Some of the comments and suggestions from BlackRock included measures to i) enhance diversity policy; ii) strengthen independence testing of independent directors; and iii) additional process for the MAS to consider to reinforce the effectiveness of a separate disclosure regime for the election of independent directors.

- Following an earlier public consultation on the possible listing framework for dual class shares in 2017, the Singapore Exchange (SGX) released another consultation paper on March 28 to seek market feedback on proposed safeguards to address expropriation and entrenchment risks of dual class shares (DCS). BlackRock plans to submit a response in April.

Hong Kong

The Hong Kong Exchanges and Clearing Limited (HKEX) released a consultation paper on February 23 to seek feedback on a Listing Regime for Companies from Emerging and Innovative Sectors. This consultation paper provides details on implementation following its previous proposal and focuses on three main areas of changes: 1) biotech companies, 2) issuers with weighted voting rights (WVR) structures, and 3) secondary listings of qualifying issuers.

BlackRock submitted a response to provide our comments and recommendations. We restated our stance as an advocate of the “One-Share One-Vote” (OSOV) principle and expressed our general opposition to allowing companies to issue shares with WVRs. Meanwhile, we recognized the Exchange’s efforts to provide safeguards to mitigate the risks associated with WVR structures and proposed various recommendations such as requiring disclosure of voting results calculated both on a OSOV basis as well as based on WVRs, subjecting issuers seeking secondary listing in Hong Kong to current restrictions with regards to connected party transactions, applying the same rules across different types of issuers seeking secondary listing in Hong Kong.

HKEX is expected to launch a separate consultation to explore the option of allowing corporate entities, as opposed to individuals, to own WVRs. Our initial view is that an added layer of protection would be needed where WVRs are extended to corporates, and the HKEX should implement a timed expiration mechanism, or stipulate a regular review of corporates’ WVRs by all shareholders on a OSOV basis. BlackRock will submit a formal response when the occasion arises.

Taiwan

Following the completion of the first Corporate Governance Blueprint launched in 2013, the Financial Supervisory Commission (FSC) convened a public hearing on March 27 to seek suggestions and comments from corporate governance organizations and professionals on the focus areas for the next three years. It is expected that the next Corporate Governance Blueprint will aim to enhance corporate culture, board effectiveness, shareholder activism, disclosure quality and the enforcement of regulations.

[7] http://www.meti.go.jp/english/press/2017/pdf/0529_004b.pdf

Prepared by BlackRock, Inc.