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INVESTMENT STEWARDSHIP REPORT: ASIA-PACIFIC

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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

Engagements with our active investment team to enhance merger offer in South Korea

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In March 2018, the largest automaker and second-largest "chaebol" (family-controlled conglomerate) in South Korea announced a restructuring plan that involved the spin-off of certain businesses from its listed auto-parts maker, which would then be merged with its listed logistics company. Shareholders of the auto-parts maker would receive shares in the logistics company in exchange for the assets being transferred.

The deal would allow the automaker to improve its corporate governance by unwinding its circulatory ownership structure and also effect a succession of control to the founder's grandson. The South Korean government has been calling on chaebols to reduce circulatory ownership in order to improve corporate governance and ownership transparency[1]. The market reaction to the announcement was negative, and soon attracted global media attention as a prominent hedge fund launched a public campaign highlighting the disadvantages of the restructuring plan, and calling for the group to pursue an alternative structure by creating a holding company.

Korean law is highly prescriptive in setting the fair value and share price when it comes to mergers, and Investment Stewardship engaged extensively with the group over months to better understand the details of the transaction terms, as well as provide our views on the fairness of the plan.

Working closely with the BlackRock's Fundamental Equities team, Investment Stewardship concluded that the terms in the deal were materially unfavorable for existing shareholders of the auto-parts company, and accordingly BlackRock would not support the proposal. Our team also coordinated with the ETF and Index Investments (EII) teams to ensure that BlackRock retains and, if needed, exercises the right of withdrawal (put back option) that is provided to dissenting shareholders.

Just days ahead of the shareholder meeting, the group called it off, acknowledging the negative feedback, which highlighted a lack of communication with shareholders prior to formulating the proposal. The group asserted that it would engage with shareholders, return to the drawing board, and craft a more shareholder-friendly plan.

The senior management of the group visited BlackRock on May 30, 2018 and acknowledged that BlackRock's communication on the intention to vote against the proposal was a consideration in the management's decision to cancel the transaction. We will continue to engage with the management teams of the group and its listed affiliates to provide our feedback as they work to identify a more equitable solution.

Pursuing board accountability in India

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In January 2018, the promoters (controlling shareholders) of the Company lost a significant arbitration case involving the sale of another company in 2018 that the promoters owned.

Following the court ruling, banks that had extended loans to the promoters invoked the shares of the Company that had been used to pledge against the debt, and sold them in the market.

[1] Circulatory ownership means company A owns company B which in turn owns company C, which again owns company A. This is viewed as a poor governance structure making it challenging to decipher ownership and accountability. From a regulatory perspective, the government has been aiming to move companies towards developing holdings structure, where ownership and accountability become more transparent.

As a result, the promoters effectively lost their promoter status in the Company and resigned from the board in February 2018, along with two directors appointed by the resigning promoter directors.

The down-sized board, in an attempt to salvage the Company from its financial distress, announced its intention to invite strategic investors into the Company. More than five international bidders indicated their interest. The bidding process had proven turbulent with a number of extensions and re-opened bidding. This has raised serious concerns within the investor community due to lack of transparency around the bidding process, possible unequal due diligence access for bidders as well as questionable decisions by the board.

In April 2018, a group of minority shareholders with a 12% stake requisitioned an Extraordinary General Meeting (EGM) to appoint three new independent directors and remove the four incumbent board members including the Chairman, citing their failure to act in the best interest of all shareholders and the Company. The board accepted the shareholder request and immediately appointed the three candidates as new independent directors, subject to retroactive approval at the EGM on May 22, 2018.

Investment Stewardship, together with BlackRock's Fundamental Equities team, engaged with the board extensively over the last two months, having private dialogues with both the incumbent (and now ousted) Chairman, as well as the new independent directors nominated by the shareholder group.

During the course of the engagement, BlackRock requested:

- A clear and transparent bidding process with equal access to due diligence for all interested bidders
- A detailed and quantifiable disclosure by the board on the evaluation process to be disclosed when the winning bid is announced
- No interim changes to the board prior to the shareholder-requisitioned EGM, to ensure that shareholders' preference be reflected in the composition of the board

Just days ahead of the EGM, three of the four directors to be voted for removal voluntarily resigned. Additionally, the Chairman was removed from the board by shareholders with close to 90% voting in favor of his removal. The three independent directors nominated by the shareholder group received near-unanimous support by shareholders. The new board announced the re-opening of the bid for a stake in the Company's hospitals business.

Lack of remuneration disclosure in China

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BlackRock initiated an engagement with a Chinese food processing company to better understand the Company's executive remuneration practice. The Company recently granted its CEO a large amount of shares, with a value of US$278 million, representing 2.39% of the issued capital. The grant was made under a Share Award Plan (the Plan) that was adopted before the company's 2014 IPO. The Plan was structured such that its term and conditions – to include number of shares to be awarded, vesting schedules, and performance hurdles – could only be amended by the CEO and a non-executive director. Last year, these two individuals distributed the maximum number of shares allowed in the Plan to the CEO alone.

While this grant to the CEO aligned with the terms of the Plan, the Company did not provide its rationale for granting all the shares allowed under the Plan to the CEO despite eligibility extending to a wider pool of participants. In addition, the company failed to provide disclosure of performance hurdles for the CEO.

Our engagement indicated that the Company did not appear to have a formal executive remuneration policy. The Company was also less than forthcoming when asked about the rationale behind the specific grant, asserting that minimal disclosure was due to the Plan having been adopted pre-IPO.

BlackRock voted against both the director who was on the remuneration committee and the proposal to authorize the board to fix remuneration of directors, given the lack of disclosure around remuneration policy and the lack of transparency surrounding the significant share grant to the CEO.

Governance concerns at a Hong Kong-based apparel company

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BlackRock engaged with a Hong Kong-based apparel and accessories company upon reviewing the Company's share award scheme and related-party transactions, both of which were found to be problematic. The proposed share award scheme provided insufficient disclosure on several fronts, including: (1) a rationale for determining the number of Restricted Stock Units (RSUs) to be granted; (2) the performance metrics; and, (3) the vesting schedule. Beyond these disclosure gaps, we were also concerned that independent directors could potentially act as participants in the scheme. Participation by independent directors in performance-based remuneration can confuse their oversight role of management. Additionally, related parties were being granted RSUs despite a lack of details relating to the recipients and the amounts being offered.

Adding to our concerns over the implementation of the Company's award scheme, the Company had a number of questionable related-party transactions involving rental of premises owned by the CEO and his family.

The Company's response to the concerns BlackRock expressed was insufficient to convince us to support the management and, as such, we voted against the resolutions in relation to the award scheme and the re-election of a member of the remuneration committee.

Shortly after our engagement, the Company was accused by a short-seller of questionable accounting practices, misleading disclosures and unjustifiable related-party transactions. The stock price swiftly fell and trading of shares was suspended. Trading resumed after the Company issued a nine-page response to the allegations made by the short-seller. Additionally, the CEO resigned due to these problematic governance provisions.

Taiwanese proxy contest insight

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This quarter, a large Taiwanese financial holdings company (FHC) faced a proxy contest in the wake of an ongoing merger-related dispute. One large shareholder proposed new board of directors to facilitate better management of the dispute, as well as the pursuit of other business and governance improvements. The Taiwanese dissenting shareholder is a family-owned asset management firm that was set up in early 2017.

BlackRock engaged with both the incumbent board as well as the dissenting shareholder to understand both parties' short-, medium- and long-term strategies for the FHC, as well as the potential skills and talents that of director nominees proposed by the respective groups could bring to the Company's board.

The dissenting shareholder expressed a willingness to represent minority investors while also introducing the fresh perspective needed to tackle long-standing issues. However, we remained unconvinced with the dissident nominees' ability to effect substantive changes to the FHC in the foreseeable future. Our engagements also left us concerned that the dissenting shareholder may have a shorter-term investment horizon. Lastly, our engagements did not clarify the shareholder's motivation for its activism.

We were nevertheless aware that the incumbent board could substantially improve its corporate governance practices. Some of the issues we raised in our engagements included the over-representation of family members on the board, the disclosure gaps relating to independent director nominees, and the lack of a nomination committee. Notwithstanding the multi-year merger-related dispute and the corporate governance shortcomings, we recognized that the incumbent board had delivered stable financial results and demonstrated a commitment to improving its corporate governance.

After multiple engagements and detailed analysis, BlackRock supported the incumbent board's nominees with the exception of one independent director candidate whose independence had come into question. The annual meeting concluded with all candidates nominated by the incumbent board winning re-election.

Perspective on a shareholder proposal on shareholder repurchase in Japan

6 A Japanese shipping and warehousing company faced a shareholder proposal requesting the board to repurchase approximately 14% of the Company's outstanding shares. The proponent shareholder stated that the Company was not managing capital efficiently and argued that the Company should repurchase shares in order to improve capital efficiency.

BlackRock supports returning excess capital to shareholders; however, we believe companies must balance those practices with investments in future growth. In this case, we decided to vote in favor of the shareholder proposal because the Company had not offered a clear explanation regarding its capital management strategy. The proposal also appeared to be reasonable as it requested a modest balance sheet reduction which would not compromise any investments necessary to fund its future business growth. We also took into account unrealized gains from its real estate assets and investment securities, of which a significant portion would be available even after such assets were to be used as proceeds to fund the proposed repurchase of shares.

Using our vote to signal our governance concerns in Japan

7 BlackRock engaged with a Japanese health care company which continues to maintain a "poison pill" takeover defense without putting the plan to a shareholder vote. The Company explained that their independent committee, comprised solely of independent non-executive directors, has the authority to decide whether to maintain, revise, or abolish their anti-takeover measure and that its management team, including the CEO, was not involved in the decision. BlackRock engaged with a number of independent non-executive directors of the Company, including the chairman of the board, on overall governance practices and their decision-making process regarding the continuation of the takeover defense measure. While we were satisfied with the Company's governance practices, we also had concerns regarding the short tenure of the non-executive directors as compared with the long tenured CEO. Despite our concerns, the Company subsequently announced that several non-executive board members would be replaced, including the chairman and lead independent director with whom we had engaged.

BlackRock voted against the independent directors for not putting the takeover defense mechanism to shareholder vote as well as for the poor management of succession planning, which has resulted in a high turnover of independent directors.

Engagement on supply chain human rights management in Australia

8 BlackRock had previously engaged with a large Australian retailer with primary activities in supermarkets, discount department stores, petrol and hotels on supply chain management. The Company had been the subject of shareholder proposals requesting more transparency around supply chain management. Back in 2016, there had been several media reports accusing the Company's suppliers of underpaying migrant workers. Such allegations, particularly if escalated in social media, could have profound impact on the Company's reputation and potentially impact sales and profitability.

The Company is now very much focused on evolving their approach to supply chain human rights management. As such, the Company has significantly improved its disclosure around supply chain management and the board has approved a new policy which includes a commitment to UN Guiding Principles on Business and Human Rights. The Company has also publicly supported the introduction of a modern slavery act in Australia and is involved in shaping and driving produce industry standards, such as Fair Farms.

Our engagement covered the fact that the Company's sourcing policy is applicable to all suppliers. It now includes a grievance mechanism, a remediation plan, and a mutual recognition scheme which includes seven globally recognized industry programs. The Company has also devised four category prioritization process for suppliers (ranging from low risk, low influence to high risk, high influence) as a means of rating their suppliers.

The Company views grievance and remediation as integral to their new approach. The Company's objective is to establish a process which creates a consistent, global approach on how the company expects suppliers and internal stakeholders to remediate substantiated violations identified during the allegation review process. Suppliers have been receptive to the program and their questions have been centered on understanding the implementation of this new policy.

It was clear to us that the Company firmly believes in an engagement model with their suppliers. Specifically, should any suppliers not pass its original supplier assessment, the Company appeared willing to work towards a corrective action plan in order to address outstanding issue(s). This is driven by the Company's belief that their supply chain's impact on the communities in which they operate can be greater through active engagement. Conversely, being disengaged could lead to potentially more damaging supply chain risks and consequences.

Engagement and Voting Statistics

Japan Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
138	13	82	43	21	31	137

Asia-Pacific ex Japan Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
108	56	49	3	12	36	105

*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	70	346	30%	3%
APAC ex Japan, Australia, and New Zealand	2,630	26,432	50%	11%
Japan	1,651	16,845	37%	5%
Asia-Pacific Region Total	4,351	43,623	45%	8%

[2] The Asia-Pacific engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on July 5, 2018 and both are a reflection of 2nd 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 2nd Quarter 2018.

Active Ownership and Responsible Leadership

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:

- **Thai Institute of Directors – National Director Conference – Bangkok**
  BlackRock participated in a panel discussion entitled "Building Resilience in the Era of Disruption in Finance Service" at the National Director Conference hosted by the Thai Institute of Directors. BlackRock shared its views and expectations of the role and competency of listed company boards in shaping the strategy to help navigate the company through a highly disruptive business environment.

- **Thailand Securities Exchange Commission – Bangkok**

  BlackRock met with senior officials of Thailand's SEC to discuss BlackRock's stewardship program in APAC as well as key takeaways from the recent Thai AGM season. The discussion also included regulatory developments and updates in Thailand, with BlackRock providing feedback based on experience and insights gained in other markets in APAC.

- **Asia Asset Management & Changjiang Pension Insurance – The 13th Annual China Roundtable – Beijing**

  BlackRock participated in a panel on Effective ESG Investing in Pension Investment at the 13th Annual China Roundtable hosted by the Asia Asset Management Magazine and Changjiang Pension Insurance. BlackRock shared our views on long-term investment and our experience in applying ESG integration across different investment classes and investment styles.

- **Tsinghua PBCSF & Sustainable Banking Network – Global Green Finance Leadership Program – Beijing**

  BlackRock participated in a panel on Green Institutional Investors at the Global Green Finance Leadership Program hosted by Tsinghua PBCSF and the Sustainable Banking Network. BlackRock shared its views and experience on sustainable investing with a particular focus on our approach to incorporate climate change risks into the investment processes.

- **Caixin & Syntao Green Finance – 2018 China Responsible Investment Forum Summer Summit – Beijing**

  BlackRock participated in a panel on the Global Trend of ESG investing and Sustainable Investing in China at the China Responsible Forum organized by Caixin and Syntao Green

Finance. BlackRock shared our observations of sustainable investing globally and in China, and our approach to ESG integration.

- **Changing the Game in Japan's Equity Markets: An Update on Corporate Governance Reforms hosted by the Columbia Business School – New York**

  Investment Stewardship spoke on a panel to present views on how the recent corporate governance reforms in Japan have changed the environment for investors and companies, including the increase in activism in Japan.

- **The Working Group on capital markets and ESG (Liberal Democratic Party of Japan) – Tokyo**
  Investment Stewardship was invited to a working group to present views on ESG investment and key expectations for companies and policy makers regarding ESG disclosure. Topics discussed included current developments in corporate governance and stewardship in Japan from an investor perspective, as well as recent developments in integrated reporting.

- **BlackRock Investment Stewardship Media Roundtable – Tokyo**

  BlackRock held a media roundtable to discuss its stewardship efforts and ESG investment. Key topics covered included our stewardship priorities and activities, ESG investing efforts, the increasing demand for ESG investments, and the underlying factors driving such momentum.

Market Development and Trends

Publishing guidelines in Simplified Chinese

BlackRock's investment in Chinese companies has increased significantly over the past few years as the Chinese market opens up to foreign investors. As a result, we are engaging with an increasing number of Chinese companies, which have rather limited experience speaking with investors on corporate governance and sustainability issues. Most of our engagements are still at a stage of educating issuers on the importance of these issues, why we care as an investor, and what types of disclosure we expect companies to make. The proxy voting guidelines, which were published in Simplified Chinese in April 2018, provides a useful reference for companies to understand BlackRock's views on key corporate governance and voting issues prior to or following an engagement. The guidelines also help our stewardship efforts as we are able to reach a much wider audience than could be met through in-person engagements.

MSCI dual share class

Companies with dual class structures have emerged in the past two years as a key corporate governance concern. While this share structure has existed for a long time, recent IPOs by technology companies have raised awareness of the issue. Many market participants have expressed concern about the implicit deterioration in corporate governance standards and the lack of accountability to shareholders. One of the major index providers, MSCI, conducted a consultation on the treatment of unequal voting structures in their equity indexes. MSCI has suggested that the weighting of companies in their indexes should match the voting rights of their share structures. As discussed in our Open Letter Regarding Consultation on the Treatment of Unequal Voting Structures, we are advocates of the principle of "one share, one vote". However, we also understand that other structures may serve a purpose in certain circumstances. Importantly, we believe regulators and policymakers – not index providers – should be the guardians of stock exchange listing standards.

Hong Kong

The Hong Kong Exchanges and Clearing Limited (HKEX) completed their consultation on a Listing Regime for Companies from Emerging and Innovative Sectors. Very few of the comments and recommendations that BlackRock submitted in our response were incorporated in the final proposal, which became official in Hong Kong on April 30, 2018. A few days later, Xiaomi, a China-based smartphone maker, submitted an IPO application to HKEX under the new listing regulations, making it the first company filing for a Hong Kong IPO with a weighted voting rights structure.

Mainland China

On June 15, China Securities Regulatory Commission (CSRC) released a revised version of its Code of Corporate Governance for Listed Companies (the Code) and announced a consultation period of one month to seek feedback from the public. CSRC first released the Code in 2002 and is planning to enhance the Code such that it would be more relevant to the current market and more aligned with evolved international standards.

Major amendments included the mandatory adoption of an audit committee, disclosure of environmental, social and governance issues, and the requirement for State-owned and State-controlled enterprises to add into their Articles of Associations terms with regards to the establishment and functioning of a Party Committee at the company. Other amendments with softer tones include more emphasis on the protection of retail investors' rights, the responsibilities of audit committees and independent directors, the role of institutional investors and professional intermediaries in upholding corporate governance, and disclosure and transparency.

Japan

The Minister of Justice publicized the Interim Proposal concerning Revision of Companies Act ("Interim Proposal"). The focus of the Interim Proposal is on the rules related to procedures concerning shareholders meetings or shareholder rights, such as introducing Notice and Access, which provides issuers a way to use the Internet to provide a simpler set of materials to shareholders instead of mailing the full proxy package in print. The proposal also places a limit on the number of proposals at 5 or 10, and allows issuers the right to exclude proposals which clearly may not be in the interest of general shareholders. BlackRock is overall supportive of these proposed amendments as we believe the Notice and Access would allow companies to rationalize the process surrounding shareholder meetings and allow shareholders more time to analyze and determine voting decisions. While we do consider shareholders' right to file proposals important, we also believe the proposed rules on eligibility to submit shareholder proposals would discourage frivolous proposals and reduce the likelihood of the shareholder right being abused. The final bill is expected to be submitted to the Diet in 2019, at the earliest.

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