INVESTMENT STEWARDSHIP REPORT: EUROPE, THE MIDDLE EAST AND AFRICA

Q2 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

Engagement on executive pay and governance

1 This quarter, remuneration continued to be a top engagement and voting priority for our team across EMEA markets in light of the continued increased scrutiny of executive pay policies and outcomes. The following examples demonstrate the nature of these engagements, often carried out over several years. We recognize that it takes considerable effort to achieve a balance between rewards that recognize executive performance and the interests of long-term shareholders, but we believe it is something that effective boards can deliver.

The importance of board quality and accountability in overseeing executive pay

BlackRock views company directors as the agents of shareholders, providing direction, leadership, and effective oversight to management. In our view, director competency and accountability are crucial for sound corporate governance, and therefore the creation of long-term shareholder value. A high-quality and effective board consists of capable directors able to oversee the execution of the company's long-term strategic objectives, to make critical judgments, and to ensure consistent and robust dialogue with management.

We often measure a board's quality through its use of discretionary power, such as the decisions it makes in relation to executive pay. It is noted between our global and EMEA guidelines that boards should have the flexibility to apply discretion as needed, for example through clawback measures, to make adjustments to executive pay received as a result of unintended outcomes from incentive plans. This includes repayment of rewards where they were not justified by actual performance. More generally, our preference is for incentive plans to use "input" performance metrics as these are within management's control.

In practice, we find boards are too often defending excessive pay-outs on the basis of contractual provisions. Our case study below underscores how critical it is for remuneration committees to get these two points right.

Earlier this year, we expressed concern about the quality of decision-making at the board of a UK homebuilder. The sector has benefitted significantly from the government's 2013 Help-to-Buy scheme, which provided a government loan to home buyers. In the case of the aforementioned company, the impact on sales and share price was material. The result was a significantly higher than expected pay-out under the company's long-term incentive scheme, which had been adopted prior to the launch of the government scheme. We consider it part of the board's responsibility to be aware of the impact of changes in the company's operating environment – in this case, the government scheme – and to take actions to ensure that governance structures evolve, as necessary. In December 2017, both the board chair and the remuneration committee chair resigned as a result of the expected Long-Term Incentive Plan (LTIP) pay-out, acknowledging the unintended consequences of the plan design. It is clear to us that the remuneration committee could have better assessed the potential influence of external events in the establishment of its 2012 LTIP.

Another clear measure of a board's effectiveness is how it responds in a time a crisis. Our direct dialogue with board directors help provide nuanced insight. BlackRock subsequently engaged extensively with the acting board chair and the new remuneration committee chair on the issue of the vested awards under the 2012 LTIP. Our discussions centred on understanding what discretionary powers had been available to the board in relation to the awards that had vested, both prior to the performance hurdles being met and after the resultant pay-out was determined. We also sought to understand what mechanisms were available to the board to ensure that any pay-out of future tranches would be for management performance, rather than the influence of external events.

We welcome the modifications ultimately made to the vested awards and for future awards; however, we question whether the board was sufficiently proactive in overseeing pay in the intervening years. While we are sympathetic to the limitations placed on board discretion by the design of the 2012 plan, we believe the committee could have acted more swiftly and decisively to protect shareholder interests by tempering this pay-out.

In order to avoid the recurrence of these situations, we are asking board members the following questions:

- How do they ensure management is rewarded for their own performance and not for external events outside of their control?
- Do they have ultimate discretionary power, above the terms of the contract, to adjust any performance measurement or final quantum paid?

Evolving executive remuneration practices following extensive engagement

2 Larry Fink has acknowledged in his 2018 CEO letter that shareholder engagement has been too focused on annual meetings and proxies voted, and that if engagement is to be meaningful and productive it needs to be a year-round conversation about improving long-term value. This is a key message we share with investee companies during our engagements.

In this regard, for many years we have engaged with companies about executive remuneration, one of our five key engagement priorities. Our engagements on this topic are multi-faceted; they include periodic consultations and regular review of the EMEA voting guidelines. These steps provide an opportunity to outline our evolving views and expectations. This year, our executive remuneration guidelines were also updated to cover restricted shares schemes, an alternative model that has gained prominence.

During the 2016 voting season, for example, a UK industrials company proposed a restricted share scheme to replace its long-term incentive plan. At that time, we did not support the pay policy due to concerns over the rationale and the structure. We observed a significant level of investor dissent about the proposed changes to its pay policy which received a significant 72% votes against the resolution at the 2016 annual general meeting (AGM).

We continued to engage with the company about its remuneration plans on three occasions during 2017 and twice in 2018. At the 2018 AGM, we were pleased to see that our earlier concerns had been addressed. Consistent with our guidelines, the revised plans incorporated a 50% reduction in the maximum variable opportunity for the restricted plan versus the former long-term incentive plan due to the increased certainty of these schemes. We were also encouraged by the greater alignment this latest proposal provided between investors and executives through increased vesting / holding periods and increased shareholding requirements.

Engaging around extraordinary awards in the UK

3 During the 2018 voting season in the UK a number of companies sought our input on proposed extraordinary awards beyond the parameters of those companies' own remuneration policies. Some of these awards were part of packages proposed for new hires and some were intended to top up variable incentives to existing executives.

We look at these proposals on a case-by-case basis to assess the merits of the additional remuneration. In our guidelines, we make clear that we expect to see companies carefully evaluate recruitment packages or one-off awards. For the former, we feel that hiring offers should account for the nature of the role within the context of the size of the company and the complexity of the role. We also believe that when buyout awards are necessary, they should be made in shares or comparable performance-restricted incentives which are clearly linked to the company's strategy.

On the other hand, we expect one-off rewards to be used on a limited basis and supported by detailed disclosures in the companies' remuneration reports. In our experience, it is common for remuneration policies to include an additional buffer or cushion above the cap which effectively is designed to capture any exceptional situations that might merit increased awards. Therefore, we are usually wary of proposed awards that are still beyond these already extended limits.

During the second quarter, we engaged with a financial services company that proposed a large award for an executive. The proposal would have effectively doubled the executive's total variable compensation, which was already paying at maximum. The supporting rationale offered by the company fell short of our expectations and it was partially linked to a specific transaction. We usually oppose one-off awards linked to transactions as these awards could create an incentive for executives to undertake unnecessary (and at times value-destroying) acquisitions. Moreover, the value of such transactions are typically realized over a longer period of time whereas the awards for the executives are materialized in a much shorter timeframe.

We also engaged with a major healthcare company that proposed a recruitment package structured in a way not covered under the company's shareholder-approved policy. During our extensive engagements with the board on the proposed hiring offer, we took comfort in the detailed explanation they provided to justify how the awards were aligned with long-term shareholder value.

Relocation expenses – the good, the bad, and the many shades of grey

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During the 2018 voting season we saw an uptick in the number and types of one-off relocation expense packages presented for shareholder approval at the AGM under the company's executive remuneration policy. Investment Stewardship considers these arrangements on a case-by-case basis and in line with our views of one-off awards. While we acknowledge the business need to relocate executives from time to time, we also believe that executives should be fairly remunerated in order to manage their own affairs. Although we never micro-manage companies, we expect all companies to establish certain safeguards including, but not limited to disclosure / clear rationale, performance conditions, caps and claw-backs.

In Q2 2018, we engaged with an Anglo-American mining company about a relocation package for a CFO moving from Australia to the UK. We had a number of concerns with this allowance, in particular the stamp duty provisions and associated uncapped tax gross-up on a house purchase.

In this case we considered the relocation package in the context of salary, replacement awards stamp duty and gross-ups, finally concluding that it was excessive. As we found the arrangements fell short of our expectations, we voted against the remuneration report and the re-elections of the members of the remuneration committee at the annual general meeting (AGM) of this company.

We also engaged with management at a French retail company where we expressed reservations about ongoing housing benefits provided to an executive. We found the company has continually failed to provide compelling rationale for the additional €1mn payment and did not disclose the process for determining the size of such payment, which in effect closely matched the executive's annual salary. Reflecting our ongoing engagement, we have previously provided feedback to the company about our expectations; however, there has been no improvement in the level of disclosure provided to shareholders. These payments also are recurring annual payments which we believe fall outside the nature of a relocation expense. In light of these and other concerns over its executive remuneration arrangements, we were unable to support the remuneration policy at the AGM, and consistent with our voting guidelines we withheld support for the re-election of the remuneration committee members.

Likewise, we voted against a related-party transaction between the CEO and a French investment company regarding the executive's relocation allowance. We understand that companies might grant one-off awards when an executive moves to another country, similar to relocation arrangements for employees more generally. However, we do not believe shareholders should have to bear these costs on a recurring basis as they do not relate anymore to the "relocation" but actually to the "living conditions" of the executive. The salaries paid to the corporate officers should be sufficient to cover their day to day costs of living.

An international hotel group provides another example of a joining incentive which we were unable support. An internal candidate based in the UK but on an expat package from the US had been promoted to CEO. The board believed it was appropriate to shift him to a UK remuneration package after his appointment to the board. In recompense, the board decided to cover the costs of this "localization". Given that all expat packages eventually expire and other employees are not given transitional assistance, the board was unable to justify its decision for the additional payment in this case.

At a UK defense company, as part of the contractual arrangements for the CEO, the company paid a relocation package that reimburse the reasonable costs of moving from the US to the UK. Consistent with our expectations the company provided good disclosure, ensured there was reasonable protection in the form of a cap on the one-off expense that was expressed as a percentage of base salary. These matters were included in the company's executive remuneration report which we supported at the company's 2018 AGM.

Protecting minority shareholders' interests

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In our stewardship activities, we aim to protect and enhance the value of our clients' assets. As minority shareholders in a very large number of listed companies, we recognize the potential conflicts of interest might arise between controlling and minority shareholders.

In Q2 2018, we witnessed the resolution of a long-running take-over battle between a chemical company (the Company) and a building products company (the Acquirer). The Acquirer was trying to take over the Company by buying the stake of the controlling family. The controlling family had the majority of the voting rights but less than 1/5th of the shares due to a dual class share structure, which means that the Acquirer would have gained control without making a tender offer and without offering a premium to minority shareholders if the operation went through. The Company's board had opposed this transaction and had been in conflict with the controlling family for several years.

In May 2018, an agreement was reached and the litigation between the Company, the Acquirer and the controlling family has ended. Later in June, several proposals related to the agreement were approved by shareholders at a special meeting. The Acquirer bought the controlling family stake and then sold back to the Company a portion of its stake with a premium.

Although the payment of a significant premium[1] to buyback a portion of the stake of the Acquirer ultimately represents a cost for minority shareholders of the Company, the final outcome is positive with regards to corporate governance and shareholders' rights:

[1] The company purchased a 6.79% capital stake (23.7%in voting rights) from SWH for CHF 2.08 billion, representing a CHF 795 million premium (or 62 percent) over the market value as of May 9, 2018 (unaffected date)

- the elimination of the opting out clause and share transfer restriction from the articles of association - making it mandatory for a shareholder exceeding one-third of the voting rights to make a public tender offer;
- The conversion to a single class of registered shares and the instruction of a one share one vote capital structure - consistent with corporate governance best practices;
- The cancelation of the repurchased shares and the termination of the special expert committee;
- The retrospective approval of the remuneration of the board of directors for the period 2014-2018 which was voted down for 3 consecutive years by the former controlling family in the context of the dispute.

Employee stock ownership: a delicate balance

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BlackRock generally believes that stock ownership is an effective way of enhancing the alignment of interests between employees and shareholders. It can also be an effective way to incentivise employees and attract talent.

Notably, the French Treasury has recently announced legislative measures to further promote employee stock ownership, an initiative we support.[2] However, we have concerns where employee stock ownership plans expand to more than 10% of the issued share capital as we consider that at this level they become excessively dilutive to existing shareholders. These concerns are exacerbated, when a 20% discount is offered to the participants and/or when the company has differentiated voting rights. In general, we are mindful that a high level of employee ownership combined with double voting rights could be used as an anti-takeover defence.

We engaged with a French construction and concessions company prior to their AGM to discuss our concerns. The discussion provided an opportunity to clarify our position on employee ownership. The company maintains that the resultant ownership culture has ensured the long-term success of the company. However, on balance, we think that at the current level the drawbacks outweigh the benefits. Over the years, we have voted against the capital issuances for use in employee stock purchase plans at the AGM of this company for the above mentioned reasons. It is also worth noting that more than 1/5th of the votes were cast against these proposals in the recent years.

We believe that unequal voting rights introduce distortions between the level of control and the economic risk born by shareholders.

Business ethics in the pharmaceutical sector

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The BIS team engaged with the chair of the board and the CEO of a pharmaceutical company regarding the payment from the company to a US-based lawyer – with ties to high-ranking American politicians– for consulting services. The payment proved controversial for multiple reasons. First, it was viewed by some as a means of buying access to decision makers in the White House.

Secondly, the company had allegedly been involved in a series of controversies relating to payments for agreements of confidentiality. We engaged to gain a better understanding of how this contract had been entered into and what the compliance processes are to mitigate the risks of unethical behavior. We believe it is crucial for companies in this sector to focus on business ethics and compliance as there have been numerous issues in this regard over time. At the same time, some lobbying or consulting activities are legal and can be essential for companies in developing their business.

We are satisfied that the company has taken the necessary steps to address the issue and to mitigate similar future risks. Most of the top management had already been renewed and the company will appoint a new general

[2] http://www.efesonline.org/BAROMETER/EN.htm

counsel. The Chairman indicated that the board had made sure when looking for a new CEO that he would reinforce the right culture at the firm. We will keep engaging with companies in this sector on these issues to make sure that these questions stay at the top of their agendas.

Binding shareholder resolution on climate risk

8 For the third consecutive year, a U.K. advocacy group, coordinated a shareholder proposal at the oil conglomerates' 2018 shareholder meeting.

The resolution would have bound the company "to set and publish targets [relating to the company's operations and the use of its energy products] that are aligned with the goal of the Paris Climate Agreement to limit global warming to well below 2°C". These targets would need to include long-term (2050) and intermediate objectives, to be quantitative, and to be regularly reviewed. The proponent requested the company base these targets on tangible measures such as GHG intensity metrics or to use other metrics that the company finds suitable to align its targets with a well-below-2°C pathway. As the resolution was a legally binding commitment on the company, it required supermajority support for its adoption (i.e. 75% of shareholders must support it for it to pass).

Based on the company's public disclosures and our engagements with the company's management, we concluded that, at this stage, the proposal was unnecessarily prescriptive and could lead to potentially unintended consequences impacting the long-term value of our clients' assets. We therefore voted with management and did not support the shareholder resolution at the 2018 AGM.

Click here for more information about our analysis, engagements and votes in relation to this proposal. (https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-royal-dutch-shell-may-2018.pdf).

Engagement and Voting Statistics

United Kingdom Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
85	73	8	4	6	6	80

EMEA ex United Kingdom Engagement Statistics[2]

	Level of Engagement[3]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
102	85	17	0	3	5	98

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

EMEA 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
United Kingdom	422	6,348	36%	5%
EMEA ex United Kingdom	1,608	24,463	62%	12%
EMEA including United Kingdom Totals	2,030	30,811	57%	11%

[2] The EMEA including the United Kingdom 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 Investment Stewardship EMEA 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:

Business & Legal Forum – Governance and Financial Communication: Between Transparency and Business Secrecy – Paris, France

BlackRock spoke at a governance event in Paris on our expectations regarding financial communication and reporting. The event was attended by representatives of large French listed issuers. As BlackRock has been publicly asking companies to disclose their long-term value creation framework, some companies seek to better understand what we expect. Many issuers still have a compliance-centric mind set when consider about reporting. They do not want to disclose information on their strategy as their competitors could gain advantage of this information. The issue is that many of the reports comply rather than inform. Financial communication, including reporting, should be seen as an opportunity to attract and retain long-term investors. The annual reports we read are usually too long, complex and generic. As an investor, we would expect to find more information about their strategy, their operational metrics, their business model and their corporate purpose. The objective is not to have more but better and more relevant disclosure, using materiality as a guide.

Center for Corporate Reporting – Annual Symposium: "Less is More" – Zurich, Switzerland

In June BIS spoke on the panel at the annual event organised by the Swiss Center for Corporate Reporting. The symposium brought together more than 250 experts in communication to discuss how to improve corporate reporting. We were part of a panel in which companies discussed their journey towards integrated reporting. We see the methodology supporting integrated reporting as valuable as it helps companies to focus on how they create value and the impact they have on society and the environment. BlackRock does not support one reporting framework in particular as long as the companies provide a clear picture of their strategy, their KPIs and the material risks that they are facing.

Université Paris-Dauphine – Activist Funds and Governance – Paris, France

BlackRock participated on a panel where we discussed the role of activist shareholders. We explained the work of the BIS team and how we engage with issuers and activists in proxy fights. We underscored the need for companies to disclose their long-term strategies, to improve their governance and to actively engage with their shareholders to avoid becoming the target of an activist. We highlighted that, specifically in these situations, the engagements we are having with the different parties and our internal discussions with portfolio managers are more important than proxy advisors' recommendations.

The UK Investor Forum – The role of collective engagement in helping to create long term value – London, UK

As an affiliate of the UK Investor Forum, BlackRock was invited to participate in a chairman and investor event they hosted. This was the second session in a series of events. Given the topic and our focus on engagement to protect and enhance the value of our clients' assets, it offered a unique opportunity for a collaborative engagement in an open and constructive manner. Through this session we could highlight our belief that effective engagement should be a year-around and multi-year process rather than focussed solely on the annual shareholder meeting.

BNP Paribas Cardif – Committed to society – Milan, Italy

BlackRock was a keynote speaker to an audience of over 300 executives on engaging with a long-term perspective. It was an opportunity to explain how investors use their voice through direct engagement and voting at companies' annual meetings, to encourage sustainable business practices that support long term value creation. The presentation also provided an opportunity to explain in more detail our engagement priorities and approach to corporate strategy, culture and purpose. We discussed the trends that we are seeing and ideas on how companies can work more closely with investors and engage on key topics. We concluded the session with a fire-side chat that allowed a more interactive discussion with the audience.

BlackRock – Education Academy – London, UK

The team presented at several internal BlackRock events. The focus of our presentations was on the growing importance of investment stewardship.

The role of investment stewardship is increasingly coming to the fore as beneficiaries, regulators and society at large demand greater transparency and accountability from companies. At the same time, boards and management remain subject to significant pressure to deliver on short-term financial metrics. In our presentations, we explored how companies reconcile these seemingly contradictory demands and review the evolving role of shareholders in fostering sustained long-term wealth creation.

ICGN – Annual conference – Milan, Italy

The team spoke on a panel entitled, "Proxy advisor best practice and investor data/research needs". The discussion focused on the Best Practice Principles for Governance Research Providers (BBP), which were introduced in Europe in 2013, as a voluntary framework for proxy advisors. In the US we are seeing the potential for much stricter proxy advisor legislation which, if implemented, is likely to seriously impact the ability of proxy advisors to serve their clients (i.e. investors). The panel also debated a number of issues in relation to proxy advisors, including: do proxy agencies have too much power in the voting process; is more regulation needed?; and, are the BPP's fit for purpose or is there scope for further improvement?

Client training sessions

As part of the growing interest of our clients in our stewardship work, we participated in training sessions with three clients this quarter. During these meetings we explained the role of our team within BlackRock, our interactions with various external stakeholders, the structure of our team and the scope of our work within the context of our engagement priorities. We talked though our reporting capabilities and explained our continued work towards increasing the transparency of our work. We also discussed in detail various high-profile and public case studies where our work has contributed to positive change at certain investee companies. The clients were represented by trustees and other investment professionals.

Market Development and Trends

Afep-Medef code consultation

Afep (Association française des entreprises privées) and Medef (Mouvement des entreprises de France), two French issuers' organizations, recently published a consultation, inviting comments on proposed reforms to their code of corporate governance for listed companies. BlackRock's response focuses on the drafting and monitoring of implementation of the code, as we believe a wider group of stakeholders should be involved. Without greater involvement from stakeholders, views and interests that could help further improve the governance of French companies will be missed.

MSCI dual share class

Companies with dual class share 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.

Prepared by BlackRock, Inc.