# INVESTMENT STEWARDSHIP REPORT: EUROPE, THE MIDDLE EAST AND AFRICA

## Q3 2018

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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

## Engaging across the spectrum of short- and long-term strategy

1 Over the past several years, BlackRock's Chairman and CEO Larry Fink has emphasized in his annual letter to CEOs of leading companies the need for investors to have better visibility into the long-term value creation framework of public companies. We recognize that companies operate in a fast-paced environment where they may have to address shifts in the economic landscape. The ability of boards and management to navigate turbulent times is often a key driver of a company's success.

During our engagements, we evaluate whether or not board members spend sufficient time with management on company strategy. Time and again, we hear from frustrated board members who have trouble balancing time spent on compliance issues with time spent on long-term strategy.

A recent engagement with two board members at a French electronics company underscored how boards must respond to a fluctuating marketplace. The company representatives explained that their position in the marketplace is being challenged by technology giants like Google and Alibaba that have created their own payment systems, limiting competition. In order to limit the "uberisation" risk whereby a new competitor disrupts the market by using a new technology or a different business model, the company has established an internal start-up hub and invests in a venture capital fund to monitor and participate in the competitive environment. They have also made numerous external acquisitions, in order to offer new payment solutions or obtain new technologies. Our engagement affirmed that the board's current the level of expertise in relation to corporate strategy was being appropriately applied.

We also had multiple engagements with a Belgian telecommunications company around its long-term strategy. Specifically, we expressed concern about the lack of transparency in their capital allocation policy and in their strategic framework. Several investors had publicly voiced their concerns that the company was being managed only in the interest of the controlling shareholder. However, during the engagement, our team was pleased to learn that the company intended to present a new strategic plan and dividend policy for the future. Moreover, we told the chairman of the board that we would welcome the appointment of new sufficiently qualified independent board members to represent minority shareholders' interest on the board. The chairman of the board explained that the board was aware of investor concerns and planned to appoint an additional board member. While we were happy with this outcome, we will monitor the future developments and the disclosures made by the company.

In conclusion, we believe board members should have the sufficient time availability and relevant skillset to contribute effectively to the breadth of issues before the board. As both the short- and long-term strategies evolve, and new risks and opportunities emerge, a board's composition should evolve accordingly. Shortening board mandates in markets with four or five year board terms could be a way to facilitate this turnover and avoid entrenched boards.

## Evolving the conversation on gender diversity

2 We continue to engage with companies on the importance of diversity as a driver of board effectiveness, feature of quality leadership, and a driver of human capital management practices. Specific to gender diversity, we seek to understand how companies are considering gender balance in the boardroom and across the organisation. At the executive level, progress on gender diversity remains mixed which could be a function of the differences in attitudes and efforts underway to address gender diversity in leadership positions.

This divergence was evident at two companies we engaged on the topic this quarter. One of these companies, a Nordic insurance company, has approximately 40% its board seats and management votes filled by women; however, no women serve on the executive committee. We shared this observation with the chairman of the board who acknowledged this as not being ideal, expressing his belief that this was due to a shortage of skilled female executives in the market and the nature of the financial services profession being unappealing to women. Consequently, the chairman did not feel the need to employ measures to explicitly increase female representation on the executive committee, within a defined timeframe. This engagement highlighted the need to probe companies' on headline numbers to understand if the company's culture is conducive to enhancing diversity throughout the firm and conducive to creating equal leadership opportunities for diverse talent. We will continue to monitor developments at the company and intend to engage further on this topic.

By contrast, we engaged with a global technology and communications company that cited the need for interventions to make progress and had a more structured approach in place to address gender diversity. Highlights of their strategy include senior sponsorship, short and long term gender representation targets in place, remuneration links to KPIs around gender diversity in hiring and team composition. We were encouraged by this thoughtful approach and will deliberate the impact of these measures in future engagements.

## Board quality and effectiveness

3 Board composition, effectiveness and accountability remain a key focus area with companies, as we consider these to be crucial factors in the long-term success of a company. For this reason, we concentrate on how boards assess their composition and performance, and seek insight into how nominating committees evolve and refresh their boards to ensure the necessary skills and expertise to deliver on the companies' multi-year strategies.

We believe an opportune time to get a fresh outlook on a board's effectiveness is shortly after the appointment of a new chair. In this context, the BlackRock Investment Stewardship (BIS) team meet with two recently appointed board chairs.

We engaged with a European retailer to discuss with the new chairman's perspective on board composition in light of the company's appointment of new management and its new corporate strategy and the sector's evolving landscape. Based on our mapping of the incumbent board's profile to the company's strategy, we identified a skills gap related to digital expertise in a disrupted industry. We were pleased to learn this is a priority area for the chair, along with augmenting the breadth of the board's experience in key geographical areas. We discussed the company's strategy and how the board would approach establishing strategic milestones. We also discussed the company's development of a more sustainability-focused brand (e.g., phasing out burning unsold merchandise, phasing out the use of real fur) and how the designers' creative vision to develop such a brand aligns with the company's overall corporate strategy. It was clear from our engagement that the chairman has taken a comprehensive approach to learning about the various aspects of the business, its strategy and its material risks in order to determine how the board's composition should evolve going forward.

We also met with a UK property company to discuss the chairman's perspective on board priorities. The company received significant opposition regarding executive pay at this year's AGM. The board's quality of oversight also came under scrutiny. Our objective was to understand the new chair's strategy to rebuild trust with the public and with shareholders, as well as to put the company in a better position to be able to focus on strategy rather than media fallout.

In order to assess these topics, we discussed the chair's view on sector considerations (e.g., continued pressure on homebuyers, uncertainly from Brexit) and how the company aims to address them. We also discussed the company's culture, the management team's strengths and weaknesses, and talent development opportunities within the organization. Finally, we discussed board composition in order to get the chair's views on the skills, experiences and personal characteristics needed to navigate the sensitive situation, and how it should evolve in the near to medium term. Overall, we are satisfied that the chair is cognisant of the challenges faced by the board and company, and is being pragmatic about the pace and scope of any evolution. We will continue to monitor developments and engage with the board during this period of change.

Another measure of board quality and effectiveness is the ability to oversee the execution of the company's strategy by the management team. This was the case in our engagement with a UK healthcare company: At their 2018 shareholder meeting, the board's failure to effectively engage with shareholders resulted in only 41% of votes in support of the company's proposed remuneration report and just over 20% against the re-election of the remuneration committee chair. The company has since invested a considerable amount of time meeting with investors to provide reassurance that the board is acting in the best interests of shareholders.

We focused our dialogue with the company on board effectiveness ahead of the 2018 shareholder meeting, particularly the board's ability to mitigate the imminent risk of an adverse vote result in light of an apparent lack of commitment to change. While the remuneration plans were generally in line with our guidelines, we were concerned with components of the company's remuneration practices, including the growing emphasis on short-term performance and also the adoption of less challenging requirements for the long-term incentive plan. We pushed for the succession of the remuneration committee chair, noting that the long tenure and the lack of responsiveness to shareholder feedback merited a shakeup in the committee's leadership.

During a recent meeting with the company we were pleased with the board's commitment to addressing our long-standing concerns around their remuneration structure, namely by making a shift towards a greater focus on long-term performance. We also welcomed the proposal for the succession of the chair of the remuneration committee, which will take place ahead of the 2019 shareholder meeting.

## Succession planning: anticipation is key

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We view board and director succession planning as a critical aspect of sound corporate governance practices, and ultimately the longevity of the company. For this reason it remains an engagement priority for the team. During these engagements we expect companies to articulate a clear process for both an orderly and a sudden change of CEO. Our discussions on succession planning also cover the vital role of the board chairman and ongoing board member changes. Engagements allow us the opportunity to probe the effectiveness of the board's oversight of management and how the board is holding management to account for its decisions.

In Q3 2018, we engaged with a UK company in the construction industry. Among other issues, we were keen to discuss succession planning both at the board and executive levels. At the management level, succession planning is an issue because of the long tenure of the CEO and the CFO. This is also a significant challenge at the board level where, even if a new chairman is deemed independent on appointment (due to a tenure of slightly less than nine years) the board must scope out new directors to ensure a sound pipeline for future succession needs.

In this case, it was particularly important to closely monitor the situation as the chairman had noted that there was no suitable internal replacement for the CEO role. While we appreciate the specificities of their decentralised management structure and the lack of internal candidates it produces, succession planning remains a significant risk for the company in the case of a precipitating event.

We are closely monitoring the succession of the chairman. While the board appears to prefer appointing an external candidate, no individual has yet been identified despite the relatively long tenure of the current chairman. It also raises questions about the composition of the current board.

The chairman also told us that the board had recently identified long-term strategy and succession planning as areas in need of improvement. We were encouraged by this acknowledgment and we emphasised the importance of a robust succession planning process and we will continue to monitor the situation.

## Oversight and controls – when financial crime bites

5 In this quarter we held two engagements with the chairman of a Danish bank that was facing allegations of money laundering dating back to 2007. At present, the bank remains subject to on ongoing local regulatory investigation and may come under further scrutiny from other jurisdictions. Given the scale and severity of the issue we engaged with the company to assess their governance practices including succession planning.

Amid growing pressure to hold individuals to account for the issue, we discussed both orderly and sudden succession plans for the CEO. We also reflected on potential succession and board refreshment in light of this issue and the skills/ experience needed on the board to oversee management. Soon after our engagement, it was reported that the CEO had resigned and that an interim CEO had been appointed. Whilst the internal investigation conducted by external legal concluded that the CEO met his legal obligations, it was also acknowledged that the CEO had overall management responsibility and accountability.

We discussed the board's plans for avoiding a similar situation in the future, and how they aimed to rebuild trust and confidence with stakeholders. In addition to cooperation with the authorities, the chairman outlined several measures that were already in place including improvements to the company's so-called "three lines of defence" control environment three years ago. This included strengthening of the compliance / anti-money laundering functions, including adding more professionals to that function, and firm-wide compliance training.

We will continue to monitor this issue as the situation unfolds and may engage with the chairman as more information becomes publicly available.

# Engagement and Voting Statistics

## United Kingdom Engagement Statistics[1]

| | Level of Engagement[2] | | | Topics Discussed* | | |
|---|---|---|---|---|---|---|
| Number of engagements | Basic | Moderate | Extensive | Environmental | Social | Governance |
| 50 | 44 | 5 | 1 | 3 | 8 | 47 |

## EMEA ex United Kingdom Engagement Statistics[1]

| | Level of Engagement[2] | | | Topics Discussed* | | |
|---|---|---|---|---|---|---|
| Number of engagements | Basic | Moderate | Extensive | Environmental | Social | Governance |
| 33 | 25 | 8 | 0 | 4 | 9 | 32 |

*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 | 179 | 2,466 | 30% | 4% |
| EMEA ex United Kingdom | 281 | 2,836 | 42% | 9% |
| EMEA including United Kingdom Totals | 460 | 5,302 | 38% | 6% |

[1] The EMEA including the United Kingdom engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on October 5, 2018 and both are a reflection of 3rd Quarter 2018.

[2] Basic engagement is generally a single conversation on a routine matter; Moderate engagement is technically more complex and generally involves more than one meeting; Extensive engagement is technically complex, high profile and involves numerous meetings over a longer time frame. Source: BlackRock as of 3rd Quarter 2018.

# Active Ownership and Responsible Leadership

**Speaking Events**

Members of the EMEA Investment Stewardship team spoke at or participated in a number of events over the past quarter, with the goal of furthering discussion on matters deemed important to investors and/or promoting an increased understanding of BlackRock's approach to investment stewardship. We prioritize events that enable us to connect with key constituents and thought leaders, including corporate directors, senior members of management teams, and other shareholders, including clients.

**Nordea – Nordic Sustainable Finance Conference – Stockholm, Sweden**

BlackRock presented at Nordea's Nordic Sustainable Finance Conference in Stockholm, Sweden in September 2018 on a panel titled "How to identify and ensure sustainable shareholder value". We spoke about our role as an index investor, and how we view stewardship as an integral part of our long-term strategy. We further noted that as a large investor, we are able – and feel a responsibility – to monitor the companies in which we invest and to engage with them constructively and privately where we believe that would help protect and enhance the value of clients' assets.

**Deutsche Vereinigung für Finanzanalyse und Asset Management – Governance & Stewardship Conference – Frankfurt, Germany**

The team presented at DVFA's Governance & Stewardship Conference in Frankfurt, Germany in September 2018 where we focused on our role as an international/global investor. Recognising how demand for stewardship has grown over the last ten years, the panel debated the key milestones in corporate governance practices, as well as ideas for the future. The panellists also discussed the growing intersection between stewardship and sustainability as well as the role that policymakers and regulators will play in shaping stewardship practices going forward.

**BlackRock Sustainable Futures event – London, UK**

The EMEA Investment Stewardship team was invited to participate in the second sustainable futures event hosted by BlackRock's iShares. During the half day event, we held a fire-side chat with BHP Billiton Ltd.'s Head of ESG Policy and Engagement. The goal of our session was to provide our clients with a better understanding of how we engage on ESG matters – incorporating the perspectives of both BlackRock and the issuer.

**Client training sessions**

We participated in training sessions with three clients this quarter as interest in our stewardship activities continues to grow. During these meetings we explained how we determine best practices across our five engagement priorities and how we engage on each. We also described the role of our team within BlackRock, with particular focus on our relationship with the active investment teams. Lastly, we talked through our ongoing enhancements to our reporting practices, including how we measure the progress and impact of our work. The clients were represented by investment professionals and members of responsible investing and corporate governance functions.

# Market Development and Trends

**New Afep-Medef Corporate Governance Code**

At the end of June, Afep (Association française des entreprises privées) and Medef (Mouvement des entreprises de France), two French issuers' organizations, published an updated version of the French corporate governance code, following a market consultation to which BlackRock had responded. In line with our thinking, the new code promotes long-termism noting that "Board[s] should endeavour to promote long-term value creation by the company at the same time as considering the social and environmental aspects of its activities".

The revised code also asks boards to monitor the diversity of the leadership teams. Finally, the code outlines stricter rules governing the departure packages of executives (e.g. removing the possibility for a retiring executive to be paid a non-competition benefit). In our view, the revised code represents a step forward. We are, however, disappointed that the idea of having a market code in France that would involve listed companies, investors and other stakeholders in the drafting of the Code was not adopted. Without greater involvement from a wider group of stakeholders, views and interests that could help further improve the governance of French companies will be missed.

**Revised UK Corporate Governance Code**

The UK Financial Reporting Council (FRC) published its revised Corporate Governance Code in July, following a consultation earlier this year to which we submitted a response**.** The new code is largely in line with our expectations, but focuses on a very broad set of company stakeholders including the company's own workforce. We believe the simplified code should refocus boards, investors and other stakeholders on the importance of the flexibility offered by its 'comply or explain' approach – a flexibility which we believe has been eroded over the years.

Overall, we are disappointed that the code contradicts its own approach by indicating a preference for three prescriptive models for boards to use to engage with the company's workforce, rather than taking a less directive approach which would encourage boards to explain why their chosen method is considered most effective for their company.

The new code will apply to accounting periods beginning on or after 1st January 2019.

**Independent review of the Financial Reporting Council (FRC)**

The UK government has launched an independent review of the FRC in order to assess the FRC's governance, impact and powers, to help ensure it is fit for the future. This review is largely a result of the Carillion inquiry earlier this year where the quality of the FRC's oversight of audit and corporate reporting was scrutinized by the Department for Business, Energy & Industrial Strategy (BEIS) and the Department for Work and Pensions (DWP) Select Committees.

As part of this review, a Call for Evidence was launched in June. BlackRock submitted a letter in response stating our overall support to improve the FRC's oversight by clarifying its roles and responsibilities, extending its sanctioning powers, and by augmenting its resources. A public debate about the role of the FRC and its means to promote transparency and integrity in business is imperative.

We believe that maintaining the status quo is *not* an option for the FRC, and we equally do not view a full overhaul of the FRC as necessary to fulfil its objective of ensuring "a strong flow of investment into UK companies so they can grow and support society".

**New Dutch Stewardship Code**

The first Dutch Stewardship Code was developed earlier this year and will enter into force on 1 January 2019. It is a timely advance of the Eumedion Best Practices for Engaged Share-Ownership of 2011. The Code will complement national, international and global stewardship principles to which BlackRock is a signatory or has endorsed. Furthermore, the Code will be an important component of ongoing obligations on pension funds, insurance companies and asset managers that arise from the revised European Shareholder Rights Directive, to be implemented by EU Member States by June 2019. Notable principles of the new Code include:

- Asset owners and asset managers should have a stewardship policy that aims to promote long-term value creation at Dutch listed investee companies
- Disclosure of full equity holding when entering into dialogue with an investee company
- Disclosure of full voting records (at an individual company level and per voting item)
- Stricter policies with respect to stock lending

We are generally supportive of the Dutch Stewardship Code. We provided feedback on the draft consultation document released by Eumedion in the fall of 2017 and will be updating our statement on compliance with the new Code in Q4 2018.

Prepared by BlackRock, Inc.