INVESTMENT STEWARDSHIP REPORT: ASIA-PACIFIC

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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 with Australian banks amid misconduct charges

1 The 2018 Royal Commission, an investigation into the financial services industry, established after series of banking and financial planning scandals, published an interim report, which identified misconduct on the part of senior staff of four major banks and other significant financial institutions over a period of several years. Media coverage of the Royal Commission has been extensive. Three of the four major banks held their annual general meetings (AGMs) in December 2018. Significant focus was placed on executive remuneration, in particular, bonuses paid to the CEOs following the revelations made at the Royal Commission.

The four major banks have a privileged position in the Australian economy. They are provided a guarantee from the Australian Federal Government relating to deposits up to AUD$250,000 and have protection from takeovers from legislation known as the "Four Pillars Policy". As such, it is important for the four banks to manage their "social licence to operate". The Australian public views excessive executive remuneration as a social issue. There was outcry from the Australian public in relation to the short-term bonuses (predominantly paid in cash) paid to the executives of three of the four banks. One of the banks, whose senior executives were exposed as having behaved egregiously, reduced the short-term incentive for the CEO and other senior executives to zero and lowered the fees paid to non-executive directors by 20%. At its November AGM, shareholders supported the board's actions with respect to the reduction of bonuses to zero. By contrast, the other three banks all received a "first strike"[1]. While they each demonstrated some discretion by reducing short-term incentives to their executives, many shareholders did not find these measures sufficient.

BlackRock engaged with each of the chairmen of the remaining three banks in advance of the respective December AGMs. In these meetings, we expressed our concern that the boards had not taken into account the significant concerns of both shareholders and members of the public regarding the payment of bonuses at a time when serious misconduct had been exposed at all four banks. There was strong public perception that such bonuses were not warranted in the current circumstances. In our view, the banks had not considered their social licence to operate when awarding cash bonuses. Given the outcome of voting, we will engage further with these chairmen to ensure that going forward, their social licence to operate and any behaviour by management that has impaired such should be taken into account when determining bonus awards.

Independent director engagement in South Korea

2 BlackRock was invited to participate in an inaugural shareholder roundtable with independent directors organized by the largest steel maker in South Korea. The event was officially hosted by the independent chairman of the board, along with six other independent directors. The event was the company's first in-person meeting between the independent directors and the company's international shareholders.

The company was established by the Korean government in the 1960s with the aim of achieving self-sufficiency in steel for post-war South Korea. During its 50-year history, the company has grown to

[1] In Australia, the Corporations Act requires listed companies to submit a remuneration report to a non-binding shareholder vote at the Company's Annual General Meeting (AGM). A "First Strike" occurs when a remuneration report vote garners an "against" vote of 25% or greater. If this occurs, the company's subsequent remuneration report must explain whether shareholders' concerns have been taken into account, and either how they have been taken into account or why they have not been taken into account. The "Second Strike" occurs if a subsequent remuneration report again receives an "against" vote of 25% or greater. If this occurs, shareholders will vote at the same AGM to determine whether the directors will need to stand for re-election with 90 days. If this resolution passes with 50% or greater, then a "spill meeting" will take place within 90 days and those who were directors when the report was considered will be required to stand for re-election.

become one of the top five steel producers in the world, and is widely regarded as a symbol of the country's economic success. Since its privatization in 2000, the company has however demonstrated an inconsistent long-term corporate strategy -- it has continued to diversify its business but with uneven success. Over the past 20 years, the company has experienced four CEO changes where a distinct pattern emerged: one CEO would aggressively invest into various non-core businesses, followed by the subsequent CEO who would streamline the largely inefficient ventures created by his predecessor. In 2015, under the leadership of the former CEO, the company divested from, or wrote off, 19 subsidiaries and affiliated companies.

During the roundtable, this inconsistency in corporate strategy was a predominant topic of the conversation. Investors wanted reassurance that the aforementioned pattern will not continue under the rein of the new CEO who started in July 2018.

When the new CEO announced an ambitious 5-year plan that involves capital expenditure of approximately USD $4 billion investors wanted the board to publicly provide details of the plan, including targets for return on investment. BlackRock suggested the board develop and publicly communicate a clear capital management strategy in order to alleviate investor concerns over value-destructive non-core business expansion. In addition, BlackRock suggested the board improve its disclosure on CEO compensation, which would allow investors to gauge whether the board is rewarding the CEO for outcomes that align with the company's long-term capital management strategy.

The event was meaningful as it unveiled a clear disconnect between the board and shareholders on the evaluation of the company's past track record. It also clarified issues that need to be communicated more transparently. The chairman assured attendees that the board will continue to host such roundtable annually.

Engaging a Hong Kong utility on governance and occupational health and safety

3 As part of our long-term engagement efforts with BlackRock's top holdings, we engaged with a major Hong Kong-based utility company to continue our discussion on board-related governance and oversight. We specifically sought to address two issues: (1) recent changes to the board's composition and occupational health and safety (OH&S) oversight in light of some contractor and employee fatalities in recent years.

The company secretary indicated that both the board and the nomination committee recognize that certain board members, including some independent directors, have served for an extended period of time. It was acknowledged that the board needs to be refreshed in an orderly manner to ensure that it is equipped with the right skills and experience to guide the company for the future. The company pointed out that it had taken some measures to address these issues. For example, a new independent director and a non-executive director were added to the board in August.[2] However, despite the company secretary emphasizing that long tenure and board size were being actively reviewed, there was still no concrete plan to deal with the issues at the time of our discussion. We also addressed the appointment of the chairman's 26-year old son as a non-executive director, which the company explained was a reflection of the family commitment to the business. The company assured there was no imminent plans to elevate the young director to a more senior position.

On the issue of its safety record, the company noted that OH&S management is a material issue and all fatality incidents are immediately reported to the board. Moreover, the disappointing OH&S record and fatality incidents have had a direct impact on the

[2] An independent director is a director on a board of directors who does not have a material or pecuniary relationship with company or related persons. A non-executive director is a member of a company's board of directors who is not part of the executive team.

performance-based compensation of senior management. In light of these incidents, a new OH&S head was recruited. Additionally, the company instituted a more comprehensive OH&S policy with a stronger focus on the management of contractors. We viewed that the board's oversight and the enhanced procedures detailed during our engagement adequately addressed our concerns. We intend to continue monitoring the company's OH&S records to assess the effectiveness of its revised safety program.

We agreed to meet and continue our discussion on board-related issues at least annually. BlackRock also suggested the company formalize the role of the lead independent director and consider having that lead independent director communicate directly with investors on governance and board-related issues.

Facilitating governance enhancements at a Hong Kong property group

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Ahead of the annual general meeting of a major property developer in Hong Kong, we engaged with the company to better understand the structure and functioning of the board, as well as the company's long-term strategic development plans. We met with representatives from the company's investor relations and finance teams, including an executive director who sits on the board.

Similar to other major family-controlled property developers in Hong Kong, the company has performed quite well financially while there is room for improvements in its corporate governance practices in order to enhance investor confidence and market ratings on the company. We were encouraged to find the company had made some advances in enhancing its governance practices in response to some of the recommendations during our engagement last year. For instance, the chairman had stepped down from several other boards to reduce his workload and to remove the interlocking directorship with another company. Additionally, a new independent director was appointed in an effort to refresh the board and lower the average tenure of the board's independent directors. Prior to this appointment, the average tenure of independent directors for the company was over 20 years.

Despite these board governance enhancements, the existing composition of the board could challenge its abilities to execute its functions effectively. Notably, the company appears to be taking a compliance-driven approach to governance. The number of directorships of the chairman, for example, was likely reduced in response to impending changes in the Hong Kong Exchange's requirements.[3] Also, contribution from Independent Non-executive Directors (INEDs) seems to be limited given the duration of a board meeting typically takes just an hour. The company seems to have implemented various sustainability initiatives, including adopting new technologies, but the projects appear to have been championed by certain key executives with little input from independent directors. We also note that the board lacks Mainland Chinese representation despite a large portion of revenue is coming from an expanding China portfolio whose contribution to the group continues to increase.

In prior engagements, and again this year, we raised stock dilution risks that general mandates pose to minority investors; yet, our concerns remain largely unanswered. The company has continued to submit for shareholder approval a general mandate of up to 20% new shares at up to 20% market price discount. It is worth noting that this market practice is not unique to the company and is common with a number of Hong Kong listed issuers.

Lastly, our engagement addressed the fact that the company's compensation plan for directors and senior executives is designed with an emphasis on aligning with industry peers rather than company's performance targets. We encouraged the company to

[3] Conclusions of the consultation paper was published in July 2018: https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2017-Review-of-the-CG-code-and-Related-LRs/Conclusions-(July-2018)/cp2017111cc.pdf

address this and other identified governance issues. We believe our engagements may have contributed to some governance improvements, while we will monitor and evaluate the company's progress in future engagements, which will guide our voting.

Improving governance practices under family ownership

5 Subsequent to an August 2018 engagement with the Investment Stewardship team, a Taiwanese financial holding company's CFO recently visited Hong Kong to have an in-person follow-up engagement with our team. The company has a significant family ownership stake, as well as substantial family representation on its board. The company has been recovering from several scandals involving questionable related-party transactions and loan facilitations dating back to 2016. In response, the company reconstituted members of the board and senior management. While our August engagement provided detailed accounts of the incidents, this subsequent meeting provided information on the company's enhanced internal controls to ensure that similar events can be avoided in the future. We were also able to discuss the board's long-term strategy to better gauge the effectiveness of its governance structure.

According to the company, improvements to the internal control systems include making it mandatory for directors (every two months) and senior/middle managers (monthly) to report and update their related-parties (i.e. names of relatives) in their systems. All related-party transactions, regardless of the size, need to be reported and reviewed by the relevant departments and disclosed in the annual report. The company has engaged an external auditor to review the new management process over related-party transactions and subsequently provide an affirmative rating subject to satisfactory review. In addition, the company has established an Ethical Management Committee solely comprised of independent directors, and created a formal whistle blowing system that offers various reporting channels for employees.

When asked about the long-term strategy, the CFO provided some high-level comments without offering meaningful details on the action plans. We were not able to get much clarity around the process and discussion the board undertakes to review the company strategy and the effectiveness of its implementation. On board structure, we reiterated our view that the use of legal entity directors remains a less optimal governance framework. The practice allows for a private company to be listed as a director of a listed company, which is fairly common in Taiwan. We urged the company to adopt only natural person directors to truly enable shareholders to effectively elect directors.

While it appears that the company has established more comprehensive policies and stronger internal control procedures to manage issues such as related-party transactions, we believe their effectiveness will depend largely on the company culture. This still appears to be driven by the significant family shareholder. BlackRock will continue to monitor the company and conducts further engagement meetings when needed.

Corporate culture in Japanese banks

6 One of Japan's regional banks was exposed for falsifying documents to facilitate loans to individuals investing in rental real estate. In particular, the regional bank sought to provide financing for shared houses under sub-leasing agreements with the operator of such properties. Based on the circumstances, we decided that it would be prudent to engage with other regional banks that were exposed to individuals for real estate loans. In Japan, owning rental properties has been a popular solution for landowners aiming to save on taxes, notably inheritance tax. Real estate lending has been one of the few growth areas for regional banks, especially in a low interest rate environment. For context, the total balance of real estate lending by regional banks has grown over 6% in the year to March 2018 and close to 10% in recent years, compared to a 3% annual growth rate for this loan segment for mega-banks. For some

regional banks, real estate loans have exceeded 30% of their total loans.

One of the key players in the retail loan market explained that they had already established a robust credit management system before this lending scandal came to light. The system incorporates projections of the rental property market, including vacancy rates calculated based on long-term demographic trends. It also incorporates tightened credit controls in light of recent events. Another regional bank explained that their client base differed from that of the bank with improper practices; instead, they focus on high-net-worth customers with various assets that can be held as collateral.

In our engagements with regional banks, BlackRock reiterated the importance of investing the necessary resources to ensure the quality of constant checks-and-balances, which is key to preventing improper practices. We also underscore the importance of a healthy corporate culture that facilitates organizational-wide communications and a constant refresh of risk oversight, particularly in situations where real estate lending may involve third party intermediaries.

Investing in human capital in the Japanese airline industry

7 Due to a tremendous increase in demand for air travel, a shortage of airline pilots and cabin crew has become a key issue for the aviation industry in Japan. We engaged with a leading airliner that pursues a growth strategy in international routes to understand their approach to expansion plans and to evaluate their investment in employees to execute on their growth strategy successfully.

The company explained that they have continued to invest in human capital management and embarked on a number of initiatives, particularly those targeted towards female and senior employees who need support to balance child and nursing care with work. As a result, employees' average tenure of service in fiscal 2017 has increased by over 10% compared to five years ago. The company emphasised that service quality, such as the ability to handle unexpected operational irregularities, is one of their core competitive advantages. From the company's perspective, the key to maintaining high service quality is to improve the retention and productivity of experienced employees. BlackRock conducted a site visit to better understand how these initiatives are implemented and to reaffirm the company is investing in its people. These include investments in technology to optimize staffing as well as offering various work arrangements to enable staff to continue to work while having both child and nursing care supported by the company. The ability to attract and retain the female workforce through work flexibility and provision of these types of human capital investments is crucial to the effective implementation of the company's long-term strategy, especially given Japan's tight labour market and the company's rapid expansion.

Engagement and Voting Statistics

Japan Engagement Statistics[1]

	Level of Engagement[2]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
78	3	61	14	24	21	77

Asia-Pacific ex Japan Engagement Statistics[1]

	Level of Engagement[2]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
54	40	12	2	5	16	52

*Most engagement conversations cover multiple topics. Our engagement statistics reflect the primary engagement topic that formed the basis for the meeting request.

Asia-Pacific Region Voting Statistics[1]

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	274	1,439	27%	3%
APAC ex Japan, Australia, and New Zealand	853	4,956	22%	9%
Japan	132	962	32%	6%
Asia-Pacific Region Total	1,259	7,357	24%	8%

[1]The Asia-Pacific engagement statistics are sourced from BlackRock and the voting statistics are sourced from ISS Proxy Exchange on January 10, 2019 and both are a reflection of 4th 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 4th Quarter 2018.

Responsible Leadership

International Corporate Governance Network (ICGN) *Global Stewardship Disclosure Award for Asset Managers*

In December 2018, BIS was awarded the International Corporate Governance Network (ICGN) *Global Stewardship Disclosure Award for Asset Managers*. We view transparency as a key component of our investment stewardship activities and therefore provide detailed reports on our website, including global engagement principles, regional proxy voting guidelines, quarterly and annual reports, position papers and commentaries, and vote bulletins.

Speaking events

Members of the BIS Asia-Pacific 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.

Asian Corporate Governance Association Annual Conference – Beijing

BlackRock presented on the topic of effective investor-company engagement at the annual conference of the Asian Corporate Governance Association and shared our views on the key factors leading to effective engagements. We also shared our views on the importance of responsible and thoughtful voting which, in our opinion, is a form of engagement.

China Sustainable Investment Forum Annual Conference – Shenzhen

BlackRock participated on a panel on Environmental, Social and Governance (ESG) investing at the annual conference of the China Sustainable Investment Forum. The audience included investors as well as issuer representatives. We shared our views on the current state of play of ESG data and reporting.

Hong Kong Investor Relations Association Annual Conference – Hong Kong

BlackRock participated on a panel on ESG disclosure at the annual conference of the Hong Kong Investor Relations Association. We shared our views on the ESG information that we consider to be useful and why we believe meaningful ESG disclosure is beneficial for both companies and investors.

Practicing Governance Annual Report 2018 – Hong Kong

BlackRock gave a presentation and spoke on a panel discussing corporate governance practices in an event organized by Practicing Governance, an organization that aims to help listed companies in Hong Kong build capacity for good governance. We shared our views on good corporate governance practices, how companies should approach ESG issues, and our expectation of companies' disclosures in annual reports. The audience consisted of approximately 100 company CFOs, corporate secretaries, legal counsels and other professionals involved in preparing corporate annual reports.

Korea Stock Exchange, KOSPI Market Advisory Committee Meeting – Seoul

We participated in the KOSPI Market Advisory Committee inaugural meeting hosted by the Korea Exchange. The event provided an opportunity for our team to share our perspective on dual-class share structures. We also discussed the importance of an independent institution providing a forum for director training to improve corporate governance practices in Korea.

Sustainable Development Goals Seminar hosted by PRI Japan Network – Tokyo

BlackRock spoke on a panel on Sustainable Development Goals (SDGs) at a seminar hosted by the Principles for Responsible Investment's (PRI) Japan Network. The audience included investors as well as issuer representatives. We shared our approach to engaging companies on material ESG factors, including SDGs that can contribute to a company's long-term financial performance.

Investor Communications Japan (ICJ) Seminar – Tokyo

BlackRock presented on the topic of proxy voting and stewardship activities at the ICJ Seminar. ICJ is the subsidiary of the Tokyo Stock Exchange and the event was well attended, with over 200 participants primarily from corporate legal and communications functions.

Vietnam Institute of Directors Annual Forum 2018 "Governing for Sustainability" – Ho Chi Minh City

BlackRock was a speaker at the inaugural Institute of Directors conference in Ho Chi Minh City, Vietnam. The conference was attended by directors of listed companies in Vietnam, as well as securities regulators and senior representatives of the stock exchange. In our presentation, we discussed environmental and social factors and the importance of operational resilience to support the implementation of long-term strategy.

Market Development and Trends

MSCI – treatment of companies with differentiated voting rights

In 2018, MSCI launched a consultation regarding the treatment of companies with unequal voting structure in MSCI Equity Indexes. Our open letter response to this consultation shares our view that "one share, one vote" is the preferable structure for publicly-traded companies. We recognize the potential benefits of dual class shares to newly public companies as they establish themselves, however, we believe that these structures should have a specific and limited duration. We believe that regulators, in conjunction with listing exchanges, should be the arbiters of corporate governance standards for publicly listed companies.

We were encouraged that in October, MSCI decided not to change its methodology in alignment with our recommendation, allowing for companies with unequal voting structures to remain eligible for inclusion in MSCI indexes.

Separately, in October an investor group including BlackRock petitioned the New York Stock Exchange and NASDAQ, asking the exchanges to amend their listing standards regarding unequal voting right structures. The petition raises that public companies listing with multiple share classes should convert their share structure within seven years of the initial public offering to a 'one share, one vote' structure.

Australia: an increase in shareholder proposals

The 2018 proxy season saw 17 shareholder proposals. Australia's shareholder proposal regime differs from other jurisdictions. To submit a shareholder proposal, a shareholder must hold at least 5% of issued equity or there must be at least 100 shareholders supporting the proposal. The proposal must relate purely to corporate governance issues such as election/removal of directors or changing the constitution. A company can reject a shareholder proposal if it relates to a management issue such as providing reports or requesting certain disclosures.

To circumvent this restriction, the proponents have been filing two shareholder proposals: one seeking to change the constitution to allow shareholder proposals (a corporate governance issue that the company cannot refuse) and the second being a "conditional" proposal which may relate to non-corporate governance issues. The first proposal ordinarily receives a low level of support.[6] BlackRock, along with many other investors, would like to see a market-wide solution to the issue as opposed to requiring each company to make a change to its constitution. However, the conditional proposals appear to be gaining support. One of these recent conditional shareholder proposals, relating to disclosure of membership of industry bodies, received 46% support.

BlackRock will assess these shareholder proposals on a case-by-case basis and engage with both the company and the proponents of the proposals.

[6] If the change to the constitution is approved, the second "conditional" proposal becomes binding if a majority of shareholders support it. Shareholder approval to change a company's constitution has never happened. Nevertheless, companies are still disclosing results of "conditional" proposals for transparency purposes.

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