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INVESTMENT STEWARDSHIP REPORT: EUROPE, THE MIDDLE EAST AND AFRICA

Q4 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

From management to oversight

1 In EMEA, some companies are appointing a departing chief executive officer (CEO) or a former CEO after a 'cooling-off period' as Chairman of the board (or Chair of the supervisory board where this is the relevant model).[1] From our perspective, this is a practice we generally do not support. In both cases the appointment of a former CEO as Chair of the same company provides an opportunity to discuss the benefits of having a clearly independent, senior non-executive director as Chair to lead the board.

In response to this development, over the past few months, we have engaged with several companies in various sectors on their approach to board succession planning. Our engagements have given us the opportunity to understand each respective company's process, to stay abreast of new developments and also to share our expectations.

Some of the directors we engaged explained that appointing a former CEO as a non-executive director provides a variety of benefits to the company. The common refrain is that it can provide the board with a director with deep understanding of the company's business model as well as the expertise to grapple with the company's operational challenges. It can also help minimize the disruptions brought about by the management succession process. Sometimes, the appointment of a departing CEO as a non-executive director – often in these cases to the role of Chair – can smooth the transition of that person out of a business function when he or she has been key to the development of the company.

From our perspective, there are substantial risks as well. For one, it may be difficult for a former CEO to accept that the company will operate differently than it did under his / her direction. It may also be difficult to revisit strategic decisions that the now Chair sponsored as CEO. A former CEO might also struggle to bring to the role of Chair the perspective that is likely to come from experiences outside the company, thus potentially diluting his or her utility. And, moving a CEO from a role focused on execution to one focused on oversight can also create tension at the management level. For example, the board sets executive compensation and controls the tenure of the new management.

Regardless of these challenges, appointing a departing CEO as Chair can be symptomatic of underlying weaknesses in the company's succession planning process. Even if the suitability for the role of the departing CEO can be justified in particular circumstances, we explain to companies with whom we have engaged that the lack of suitable candidates among incumbent board members can raise questions about its composition. For these and other reasons, a company's attempts to manage the 'key person risk' that is associated with a departing CEO may not be best served by appointing that individual as Chair. Other options, including appointing the founder as a non-executive director, can aid the transition.

In cases when a board is considering the immediate appointment of a departing CEO as Chair, we encourage companies to consult with shareholders and provide clear reasons for their decision. This would be considered as material non-public information and should be appropriately handled by consulted parties. Regardless, we believe that such an appointment should always be seen as part of a transition. Strong mechanisms to offset the potential concentration of power should be implemented and the company should simultaneously seek out separate independent candidates.

[1] It is more common in markets such as Germany and France but it also exists in the UK (although the most recent iteration of the UK corporate governance code clearly states that a CEO should not become Chair of the same company and that, on appointment, the Chair should be independent, which implies the individual not having been an employee in the last 5 years). In Germany, it is common practice to appoint as Chair of the supervisory board a former CEO after the two year cooling-off period provided for by the corporate governance code in that market.

In the case of the appointment of a former CEO of the company, we would expect a significant cooling-off period to ensure independence of thought upon appointment, recognizing that a minimum period of time may be provided for by local codes and regulations. We would also expect a convincing rationale about why he or she is the best candidate for the position of Chair.

Sudden succession planning in response to extraordinary events

2 In our prior EMEA Q3 quarterly report we emphasized that succession planning is a critical aspect of sound corporate governance. Effective succession planning promotes the right skills and experience needed to successfully execute the company strategy. In this prior report, we discussed an evolving situation at a Danish bank that was facing allegations of money laundering, which resulted in the departure of the CEO. In Q4, the board's proposed CEO nominee was rejected by the Danish Financial Supervisory Authority (FSA) for lacking sufficient industry experience. In the wake of this decision, the board Chair and audit committee Chair subsequently stated their intention to step down from the board at an upcoming extraordinary general meeting called by one of the bank's largest shareholders, with two other directors announcing their intention not to seek re-election at the next annual meeting. In an unusual step, this long-term shareholder nominated two new board members. The board agreed that extraordinary and extensive changes were necessary as part of the process of recovering the confidence of all the bank's stakeholders.

During Q4, we had another engagement with the outgoing Chair of the bank to discuss the recent resignations. Our conversation centered on the nomination process for the two new board appointments proposed by the large shareholder, which received unanimous support from the board. The chairman explained the need for fundamental change to rebuild trust and the bank's reputation. We discussed challenges around wholesale board turnover and the need for individuals with fresh perspectives and different backgrounds to see the bank through the next few years.

We also engaged with the large shareholder's representative to further understand the process and rationale for the two new board appointments as well as the process to find a new CEO. Our meeting enabled us to evaluate the skills and experience of the candidates in relation to the overall board composition, as well as their potential role in navigating the bank through a challenging and unusual period. Our discussion also allowed us to assess the interim CEO arrangements and consider this individual's role in terms of the ongoing investigations.

We expect the situation to continue to evolve during 2019, and we will continue to monitor developments and engage the company's directors as necessary.

Financial institutions begin disclosing their approach to climate risk

3 We have taken a global approach to our climate risk engagements, engaging globally with 232 companies across 10 sectors in the past annual reporting period. Notably, we had multiple engagements with 55 of these companies, a number of which are the most carbon-intensive companies globally in BlackRock's aggregate equity portfolio. We sought to better understand corporate views on the recommendations from the Task Force on Climate-related Financial Disclosures (TCFD) and to encourage companies to consider using the framework in their reporting in due course.[2]

[2] The TCFD and its recommendations were the result of the G20 Finance Ministers asking the Financial Stability Board to look at ways in which investors, lenders, insurers, and other stakeholders could take account of and better manage climate-related risks. BlackRock has actively contributed to the development of the recommendations.

This quarter, in EMEA we continued our engagements on this topic. Our EMEA team engaged a number of financial institutions where we shared our views on the TCFD, and emphasized the importance of improving climate-related disclosures. Our engagements this quarter have highlighted that certain financial institutions – particularly banks and insurance companies – are beginning to report on how their businesses are: (1) impacted by climate risk; (2) impacted by the transition to a low-carbon economy; and; (3) explaining how climate-related issues are captured in their lending due diligence.

Our engagements reveal that companies are still grappling with a fulsome disclosure of climate risks in alignment with the TCFD recommendations. For example, several companies we engaged are participating in a collaborative pilot project through which a number of banks are aiming to find ways of doing scenario-based, forward-looking assessment (and providing corresponding disclosure) of climate-related risks and opportunities through the development of scenarios, models and metrics. We believe this progress demonstrates both a willingness on the part of companies to evolve their approach, while also reinforcing our observation – as is the case with many governance improvements – that such change processes and reporting can take time.

Our understanding of how financial firms are grappling with these challenges was aided by our engagement with one UK bank before and after they committed to cease financing new coal-fired power plants worldwide (save where they had existing commitments). The bank sees the publication of its policy as increasing transparency and driving widespread action on climate change. This initiative couples with the company's public commitment to support TCFD disclosures.

In a separate engagement with a Spanish bank, we discussed their plans to report on climate risk in alignment with the TCFD recommendations by 2020. The bank detailed the challenges that they had encountered around developing this reporting, which include reaching appropriate levels of certainty on some of the metrics inherent in the framework, but indicated that it was taking part in the aforementioned pilot project to help find solutions to this type of issue. In another engagement with a Swiss reinsurer, we learned that the company is similarly working through challenges it faces with reporting in line with the TCFD recommendations. From our conversations, it is apparent that the industry is still in the early stages of reporting on factors relating to impact assessment and the stress testing of its analysis.

Our engagements also shed light on the fact that company directors are increasingly recognising that frameworks like the TCFD are key to managing and reporting climate risks, particularly given the ongoing economic impact from climate-related extremes.[3] We expect to have many more conversations with companies over the coming quarters about how they are enhancing their respective climate risks disclosures through implementation of the TCFD recommendations (or otherwise) to meet investor expectations.

The Evolution of Corporate Culture in the Services Sector

4 BlackRock has engaged with a number of board representatives at UK services companies and observed a pattern: companies that have grown through external acquisitions appear to have focused insufficiently on integrating these acquired companies into their existing business. In essence, companies face two challenges: building a common culture while simultaneously working through developing centralised functions (e.g. legal teams, marketing, and human resources).

The topic of corporate culture was consistently raised by the service companies which we engaged. While board members seem to recognise that cultural evolution within their respective firms can take time, there is

[3] The European Environment Agency's details the economic losses from climate-related extremes at https://www.eea.europa.eu/data-and-maps/indicators/direct-losses-from-weather-disasters-3/assessment-1

consensus among directors that their boards have a responsibility in setting the tone. In practice, companies identified developing a strong focus on employee engagement and investing in training programmes. One service company we engaged has decided to appoint two employee representatives to the board. This new form of board representation is a rare practice among public companies in the United Kingdom. It reflects an evolution in board composition that aims to seek employees' perspectives. We anticipate future engagements on this topic given that the new UK corporate governance code encourages boards to engage their workforce to better understand their employees' perspectives. We believe services companies are expressing a clear understanding of sector-specific issues and we appreciate their willingness to share their priorities with their investors.

Engagement and Voting Statistics

United Kingdom Engagement Statistics[1]

	Level of Engagement[2]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
93	77	7	9	7	11	86

EMEA ex United Kingdom Engagement Statistics[1]

	Level of Engagement[2]			Topics Discussed*		
Number of engagements	Basic	Moderate	Extensive	Environmental	Social	Governance
63	45	14	4	9	17	59

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

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	125	1,355	24%	6%
EMEA ex United Kingdom	326	3,065	38%	8%
EMEA including United Kingdom Totals	451	4,420	35%	8%

[1] The EMEA including the United Kingdom 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, 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 EMEA BIS 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.

The Danish Chamber of Commerce – CSR 2018 – Copenhagen, Denmark

We gave a keynote address at an event in Copenhagen organised by The Danish Chamber of Commerce, The Ministry of Business, Industry and Financial Affairs, and Danske Revisorer (FSR – Danish Auditors). We discussed the role of BlackRock Investment Stewardship, Larry Fink's 2018 letter to CEOs in relation to "purpose," and trends in sustainable investing. The conference focused on the role of companies through the year 2030 and the role of the U.N. Sustainable Development Goals. Over 300 representatives of public companies and consultants attended the event, which included a presentation by Her Royal Highness Crown Princess Mary of Denmark.

Cliff – Shareholder Dialogue: Towards a New Paradigm? – Paris, France

Cliff, a French industry body representing Investor Relations teams, invited BlackRock to present at their annual event in front of their members. We participated on a panel focused on ways for companies to appropriately respond to shareholder activism. We discussed the importance of companies focusing and communicating their long-term strategy and emphasized the importance of maintaining a regular dialogue with their shareholders. In relation to activism, we noted that poor governance practices, poorly composed boards, and excessive executive remuneration, will often help activists garner support from other shareholders.

Corporate governance event – Madrid, Spain

We participated in an investor panel at a governance event in Spain where we discussed our engagement-first approach. Attendees included corporate governance practitioners, local investors, and corporate representatives of domestic issuers. Our participation in the event provided an opportunity to reinforce our position as an actively engaged shareholder in Spain, a market where direct engagement between shareholders and board members is still not commonplace relative to some other European markets. We shared our view that constructive engagement has led to better dialogue with a growing number of Spanish companies. This is particularly relevant in Spain as the next phase of the Shareholders Rights Directive brings about higher expectations with regard to engagement between issuers and shareholders.

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 will 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. According to the petition, 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.

Prepared by BlackRock, Inc.