BlackRock Investment Stewardship Engagement Priorities for 2019

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BlackRock Investment Stewardship

BlackRock, as a fiduciary investor, undertakes all investment stewardship engagements and proxy voting with the goal of protecting and enhancing the long-term value of our clients' assets. In our experience, sustainable financial performance and value creation are enhanced by sound governance practices, including risk management oversight and board accountability.

2019 Engagement Priorities

We are committed to providing transparency into how we conduct investment stewardship activities in support of long-term sustainable performance for our clients. Each year we prioritize our work around engagement themes that we believe will encourage sound governance practices and deliver the best long-term financial performance for our clients. Our priority themes for 2019 are a continuation and evolution of those identified last year and are set out below. We hope that highlighting our priorities will help company boards and management prepare for engagement with us and provide clients with insight into how we are conducting stewardship activities on their behalf. Some governance issues are perennial, such as board quality and performance, although the areas of focus may change over time. These will always be a core component of the Investment Stewardship team's work. Other priorities are evolving and are informed by regulatory and other market developments.

Governance

Quality leadership is essential to performance. Hence, board composition, effectiveness, diversity, and accountability remain a top priority.

Corporate Strategy and Capital Allocation

A clear articulation of corporate strategy and capital allocation provide a clear sense of the direction a company intends to take.

Compensation that Promotes Long-Termism

Executive pay policies and outcomes should link closely to long-term strategy, goals, and performance.

Environmental Risks and Opportunities

Disclosure provides enhanced understanding of board and management oversight of policies, risk factors and opportunities that drive long-term financial performance.

Human Capital Management

In a talent constrained environment, companies should focus on sound business practices that create an engaged and stable workforce.

Our Engagement Philosophy

BlackRock's Investment Stewardship team engages with portfolio companies to encourage them to adopt corporate governance and business practices aligned with long-term financial performance. The team is comprised of more than 40 professionals across all regions (with team members in New York, San Francisco, London, Tokyo, Singapore, Hong Kong, and Sydney), taking a local approach with companies while benefiting from global insights. It is positioned within the firm as an investment function. The team collaborates closely with the members of BlackRock's 125 investment teams to ensure team members have a long-term value mindset and to share their perspective on governance practices. The team engages with companies in the same long-term frame, irrespective of whether a holding is in alpha-seeking, factor, or indexing strategies. As a growing number of our clients invest through index-based strategies, engagement is an important mechanism to provide feedback or signal concerns about governance factors affecting long-term performance, absent the option to sell.

We initiate many of our engagements because companies have not provided sufficient information in their disclosures to fully inform our assessment of the quality of governance. We ask companies to review their reporting in light of their investors' informational needs. In our view, companies that embrace corporate governance as a strategic objective – as opposed to a compliance function – are more likely to generate sustained financial returns over time.

BlackRock takes an engagement-first approach, emphasizing direct dialogue with companies on governance issues that have a material impact on financial performance. We seek to engage in a constructive manner and ask probing questions, but we do not to tell companies what to do. Where we believe a company's governance or business practices fall short, we explain our concerns and expectations, and then allow time for a considered response. As a long-term investor, we are willing to be patient with companies when our engagement affirms they are working to address our concerns. However, when we do not see progress despite ongoing engagement, or companies are insufficiently responsive to our efforts to protect the long-term economic interests of our clients, we may signal our concern by voting against management.

In practice, we assess whether to initiate an engagement or accept an invitation to engage with individual companies based on a range of material factors including our prior history of engagement with the company, our thematic priorities, level of concern on specific governance issues, observation of market events, and assessment that engagement will contribute to outcomes that protect and enhance the economic value of our clients' investments. We strongly encourage companies to provide a detailed agenda when sending us a request for engagement.

Governance

Board composition, effectiveness, and accountability remain a top priority. In our experience, most governance issues, including how relevant environmental and social factors are managed, require board leadership and oversight. We encourage engagement protocols that foster constructive and meaningful dialogue, including making independent directors available in those situations where a director is best placed to explain and justify a company's approach. As we believe that the board should be a competitive advantage, we will seek to better understand how boards assess their effectiveness and performance, along with the skills and expertise needed to take a company through its future (rather than prior) multi-year strategy. In that context, we want to see disclosure regarding the board's position on director responsibilities and commitments, turnover, succession planning, and diversity. With regard to director responsibilities, we will seek better disclosure relating to a board's involvement in crisis management (e.g. cyber events, sudden departures of senior executives, negative media coverage, preparations to mitigate proxy contests) given the likelihood that such events are often material and can significantly detract from a board's ability to carry out its other responsibilities. In relation to board qualifications and effectiveness, we will continue to engage with companies to better understand their progress on improving diversity in the boardroom. In our view, diverse boards make better decisions. BlackRock recognizes that diversity has multiple dimensions, including personal factors such as gender, ethnicity, and age; as well as professional characteristics, such as a director's industry, area of expertise, and geographic location. If there is no progress on enhancing diversity at the board level within a reasonable time frame, we may hold nominating and / or governance committees accountable for an apparent lack of commitment to board effectiveness. Further, we will encourage governance structures that enhance accountability (e.g. proxy access in the U.S.), limit entrenchment (e.g. regular election of directors and board evaluations), and align voting rights and economic interests (e.g. one share, one vote).

Corporate Strategy and Capital Allocation

For several years we have asked companies to articulate their strategic frameworks for long-term value creation and to affirm that their boards have reviewed those plans. Investors expect the board to be fully engaged with management on the development and implementation of the strategy, particularly when the company needs to enhance its competitiveness and / or pivot in light of unanticipated developments. This demonstrates to investors that boards are engaged and prepared, when necessary, to transition and adapt in a fast moving business environment.

Corporate strategy disclosures should clearly explain a company's purpose, i.e. what it does every day to create value for its stakeholders. In our view, companies that better articulate their purpose and connect it with their long-term strategy are more likely to have engaged employees, loyal customers, and other supportive stakeholders[i]. This gives the company a competitive advantage and a stronger foundation for generating superior financial returns.

Companies should succinctly explain the long-term strategic goals the board and management are working towards, the applicable measures of value-creation and milestones that will demonstrate progress, and steps taken if any obstacles are anticipated or incurred.

This explanation should be refreshed periodically and adapted to reflect the changing business environment and how it might affect how a company prioritizes capital allocation, including capital investments, research and development, technological adaptation, employee development, and capital return to shareholders.

Compensation that Promotes Long-Termism

We are interested in how boards establish and explain performance metrics and hurdles in the context of the aforementioned long-term strategy setting. We expect executive incentives to use performance measures that are closely linked to the company's long-term strategy and goals. This should ensure that executives are rewarded for delivering strong and sustainable returns over the long-term, as opposed to short-term hikes in share prices. To this end, we expect companies to clearly articulate the company's balance and prioritization between "input" metrics that are within management's control relative to "output" metrics such as earnings per share or total shareholder return. Where pay seems out of line with performance, we expect the company to provide detailed justification in its public disclosures. We may seek to engage with independent directors where concerns persist. We may ask the board to explain the extent to which it considers internal pay equity and the broader macroeconomic context when setting pay. We believe that companies should use peer groups to maintain an awareness of peer pay levels and practices so that pay is market competitive, while mitigating potential ratcheting of pay that is disconnected from actual performance. We may vote against the election of compensation committee members in instances, including but not limited to, where a company has not persuasively demonstrated the connection between strategy, long-term shareholder value creation, and incentive plan design.

Environmental Risks and Opportunities

In our Global Corporate Governance & Engagement Principles we explain that sound practices in relation to the environmental factors inherent to the business model can be a signal of operational excellence and management quality. Environmental factors relevant to the long-term economic performance of companies are typically industry-specific, although in today's dynamic business environment some, such as regulation and technological change, can have a broader impact. Previously, this priority was entitled "climate risk disclosure" given our involvement in the below-referenced Task Force on Climate-related Financial Disclosures (TCFD). This year, we expanded on this priority because many of our engagements encompass a broader set of environmental factors, ranging from climate risk, energy consumption and efficiency, water and waste management, emissions, and natural resource management. Corporate reporting should help investors and others understand the company's approach to these factors and how risks are integrated and opportunities realized. For industries facing ongoing challenges which may adversely affect a company's business strategy and operational results, we expect disclosure relating to board and committee oversight and enterprise risk management practices. In this context, we expect disclosure of the company's governance of these factors, if and how they are incorporated into the long-term strategy and risk management processes, and any metrics identified targets, along with the performance against them. This helps shareholders assess how well management is dealing with these material factors relevant to the business. Any global standards used by the company to report on such factors should also be disclosed and discussed.

We recognize that the proliferation of reporting standards creates challenges for companies and for investors. Companies report "survey fatigue" and investors find it difficult to navigate inconsistent and incomplete data. We will continue to encourage standard-setters to work together and to seek input from companies and investors. We are active in the Sustainability Accounting Standards Board (SASB) and the TCFD. We find the SASB's industry-specific guidance in the context of its environmental pillar (as identified in its materiality map) beneficial in helping companies identify and discuss their governance, risks assessments, and performance against these key performance indicators (KPIs).

We will continue our multi-year engagements on climate risk as we believe its impacts have the potential to affect companies' business models and operations. The aims of our climate risk engagements are twofold: (1) to encourage companies to provide disclosure that helps investors and others understand how a company assesses, manages, and adapts to those risks, and (2) to understand how those risks are likely to impact the business in the medium- to long-term.

To that end, BlackRock continues to be a member of the industry-led Financial Stability Board's TCFD. The TCFD published in June 2017 its recommendations around four thematic areas that represent core elements of how organizations operate – governance, strategy, risk management, and metrics and targets. This framework offers companies and investors a starting point to assess, report, and price climate-related risks and opportunities. In our view, the TCFD recommendations, which include sector-specific supplemental guidance, provide a relevant roadmap for companies and help achieve comparability and consistency of reporting.

Human Capital Management

Most companies BlackRock invests in on behalf of clients publicly state that their success is heavily dependent on their employees or talent. Often they also report that they are operating in a talent constrained environment, or put differently, are in a war for talent. It is therefore important to investors that companies establish themselves as the employer of choice for the workers on whom they depend. A company's approach to human capital management (HCM) –

employee development (including transitioning their skills to the work of the future), diversity and a commitment to equal employment opportunity, health and safety, labor relations, and supply chain labor standards, amongst other things – will vary across sectors but are a factor in business continuity and success. In light of evolving market trends, like shortages of skilled labor, uneven wage growth, and technology, that are transforming the labor market, many companies and investors consider having a high standard of HCM a potential competitive advantage. Our HCM engagement commentary explains that we seek disclosure around a company's approach to ensuring the adoption of the sound business practices likely to create an engaged and stable workforce. We expect such disclosure to provide us with an understanding of if and how boards oversee and work with management to improve performance in these areas. While reporting is still evolving, we believe in the benefit of companies moving towards a more robust disclosure of HCM metrics. For instance, the SASB provides industry-specific HCM metrics. Useful industry-specific metrics can provide companies and investors insight into the return on investment related to talent and enable companies to understand if they are outliers relative to peers from the perspective of long-term performance. Comprehensive disclosure on the issue provides investors with a sense of the company's culture, long-term operational risk management practices and, more broadly, the quality of the board's oversight. In our engagement with companies on HCM, we discuss their views on the current and prospective disclosure requirements, as well as their policies and approach to ensuring the company attracts, retains and develops the workers / employees on which its business performance depends.

[i] "Culture of Purpose – Building business confidence; driving growth – 2014 core beliefs & culture survey" available at https://www2.deloitte.com/content/dam/Deloitte/us/Documents/about-deloitte/us-leadership-2014-core-beliefs-culture-survey-040414.pdf