BLACKROCK FOCUS ON COMPANY-SHAREHOLDER ENGAGEMENT

MANAGING DIRECTOR MICHELLE EDKINS ELABORATES ON BLACKROCK'S APPROACH TO CORPORATE GOVERNANCE ACTIVISM, AND OUTREACH TO ISSUERS.

By Nicole Noutsios

BlackRock is the world's largest asset manager with approximately $4.6 trillion under management and is keenly focused on company-shareholder engagement. This past February, BlackRock Chairman and CEO Larry Fink sent his annual letter on corporate governance to all the CEOs at S&P 500 companies, as well as the leaders of large European corporations.

Building upon recommendations made in previous years, Fink's letter addresses concerns such as "short-termism" and urges corporate leaders to take a longer-term perspective on planning and execution. He also suggests that companies need to clearly communicate to Wall Street the company's strategic objectives. He included several strategies companies can pursue that will enable them to become less vulnerable to short-term influence and more successful at creating long-term value.

In sum, Fink's recommendations and requests have the potential to influence the practices of executives, boards and IROs in a number of key areas.

Thinking Long-Term Versus Quarterly

Fink discussed the importance to BlackRock that companies resist short-term pressures and instead invest for long-term growth. He even suggested that companies could, over time, move away from quarterly guidance. BlackRock believes that companies could frame quarterly reporting as a sort of "EKG" that can be compared against a "baseline EKG" to show movement on strategic initiatives.

"Today's culture of quarterly earnings hysteria is totally contrary to the long-term approach we need," Fink wrote. "To be clear, we do believe companies should still report quarterly results – 'long-termism' should not be a substitute for transparency. But CEOs should be more focused in these reports on demonstrating progress against their strategic plans than a one-penny deviation from their EPS targets or analyst consensus estimates."

Articulating Long-Term Plans

Along with asking companies to think longer term, BlackRock is asking them to provide shareholders with detailed plans each year on how they will create long-term value. BlackRock considers board input to be an essential component of the planning process, and thus requests that chief executives "explicitly affirm" that their boards have reviewed strategic plans.

"We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation," Fink wrote. "Additionally, because boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their boards have reviewed those plans. BlackRock's corporate governance team, in their engagement with companies, will be looking for this framework and board review."

Elevating Focus on ESG Factors

Fink suggests that some companies have not paid enough attention to the risks and opportunities that environmental, social and governance factors pose. He says companies should not dismiss these factors as not "core," when around the world we can see the importance world leaders place on them. Fink cites the Paris Accord as one example. In the end, BlackRock believes that how well or poorly a company responds to ESG issues can have definite financial implications.

"At companies where ESG issues are handled well, they are often a signal of operational excellence," Fink wrote. "BlackRock has been undertaking a multi-year effort to integrate ESG considerations into our investment processes, and we expect companies to have strategies to manage these issues."

Weighing Activists' Proposals

One reason clearly articulated plans are so important is that they allow long-term investors to have continued "faith" in a company's vision. Without support from longer-term shareholders, a company can be more exposed to pressure from shorter-term interests, including activists. Although they think that long-term strategies should come from companies themselves instead of through proxy fights, BlackRock reports voting with activist shareholders 39 percent of the time in 2015.

"Those activists who focus on long-term value creation sometimes do offer better strategies than management," Fink says. In those cases, BlackRock's corporate governance team will support activist plans.

Ongoing BlackRock Strategy

To gain more insight into Blackrock's ongoing strategy, *IR Update* magazine interviewed Michelle Edkins, a managing director at BlackRock and global head of its investment stewardship team of 22 specialists based in five key international regions. Edkins' primary responsibility is overseeing the team's engagement on corporate governance, including environmental and social factors, with the companies in which BlackRock invests on behalf of clients. Each year the team votes at more than 15,000 shareholder meetings and engages with 1,500 companies globally.

Corporate Governance

IR Update: What was BlackRock's intent in publishing Larry Fink's 2016 Corporate Governance Letter?

Edkins: The intention of the letter that BlackRock CEO Larry Fink sent in February 2016 to 1,300 company CEOs globally was to outline our views on how companies can shape the conversation in relation to long-termism. As a fiduciary and significant shareholder in thousands of companies, we feel a very real responsibility to represent our clients' interests to companies we invest in on their behalf and, in that way, to be good stewards of their capital. We believe that good corporate governance – in terms of quality leadership at board level and quality management by executives – is critical to the long-term value creation by companies that our clients depend on to reach their financial goals.

In the letter, we set out four key things that companies could do to encourage an ecosystem consistent with long-term investment. First, CEOs can lay out annually their strategic framework for long-term value creation, and equally important, explicitly affirm that their Boards reviewed those plans. Further, once these plans are established, companies can move away from providing quarterly earnings guidance, and can frame quarterly reporting as an "EKG" against long-term "baselines." They can also better report on, and explain how they are addressing, the long-term risks, and opportunities, relating to the environmental, social and governance (ESG) factors inherent in their businesses. Finally, CEOs can use their voice to promote public policies that support long-term investment, including: tax and other provisions consistent with longer investment holding periods and increased public investment – and private financing – for the infrastructure needed to sustain thriving economies.

Feedback on prior letters, which also promoted long-termism, as well as the early responses to this year's letter, suggest these messages resonate with corporate leaders around the world. The most consistent feedback is that it is helpful for companies to know they have the support of a long-term investor in taking decisions that will have a payoff down the road but requires sacrifices in the near term.

IR Update: What does BlackRock see as the most important corporate governance issue for U.S. companies during the next two years?

Edkins: As ever, it would have to be board effectiveness. Our focus is on the board of directors because, in our experience, when you get the right leadership team, strategy, operations, risk management, even crises, are handled effectively. We look at boards case-by-case

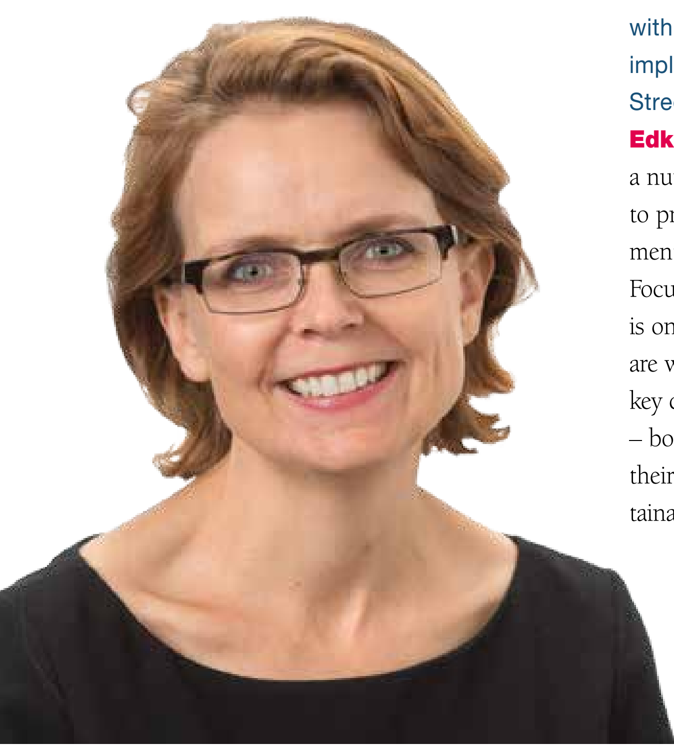
THE LARRY FINK BLACKROCK LETTER

To view the full letter from Blackrock CEO Larry Fink, visit www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2 because it's important that the board – as individual directors and as a group – clearly provide the skills and experience necessary to drive the company's long-term success.

IR Update: What is your position on board tenure and board diversity? Is BlackRock considering any new proxy voting guidelines that include limits on director tenure (such as 12 years), or call for a minimum percentage (such as 30 percent) for female board representation, as investors and regulators in Europe have adopted?

Edkins: We don't have prescriptive guidelines on tenure or age limits, or diversity. That said, we take each into account in assessing the relevance of the current directors to the business now and in the future in light of the company's stated strategy. We would normally expect a spread of ages and tenures, as that is generally an indication of a thoughtful and robust approach to succession planning for board roles. We prefer to engage companies where we have concerns about succession planning and board effectiveness, rather than to vote against directors, at least in the first instance.

In relation to diversity, we look at the professional and life experiences of the directors. On the latter point, we would normally expect a reasonable representation of directors who are not from the otherwise dominant profile in the group. Right now, the dominant profile in U.S. boardrooms is white male. At the market-level, we are a member of the 30% Club US, which is a chairman-led initiative to achieve a higher percentage of women on boards. In our experience, change in the boardroom is generally best led by those in the boardroom, and, in the United States, where there is no credible threat of a quota being introduced, it is particularly important that change is driven by corporate leaders and encouraged – through engagement – by investors.



Michelle Edkins

Communications/ Engagement

IR Update: Have you been working with other institutional investors to implement your vision of long-term Wall Street communication?

Edkins: BlackRock is actively involved in a number of initiatives at the market level to promote long-term thinking in investment and the economy more broadly. Focusing Capital on the Long-Term (FCLT) is one such initiative, where participants are working on recommendations for the key constituents in corporate governance – boards, CEOs and investors – to ensure their firms are contributing to a more sustainable economic ecosystem.

IR Update: What are your thoughts on board-investor communication?

Edkins: As a founding member of the Shareholder Director Exchange (SDX), it's safe to say that BlackRock strongly supports communication between boards and investors, where it would help build mutual understanding. That said, we are not keen for engagement for its own sake. We are, as a governance community, going through an evolution in terms of engagement. Initially, it was very infrequent, even with management. Then "Say on Pay" sparked a rash of engagement solely focused on pay that is slowly fading, and the financial crisis prompted engagement by directors in certain circumstances. We still have some progress to make to ensure that engagement meetings are focused on the most material issues and help establish a communication channel between the board and the investors.

IR Update: Does BlackRock make board meeting requests often or does BlackRock only make these requests in high-profile situations (or a last resort after engagement with management has not been fruitful)?

Edkins: We would generally ask to meet with a board member – usually the most senior independent director or the chair of a specific committee – where management would seem to be conflicted. So that could be in a high-profile situation such as an unsolicited takeover bid or when an activist is calling for a breakup of the company. On the other hand, it could be something relatively routine, such as executive succession planning, where we want to understand the board's process for evaluating management performance and ensuring the next generation of leadership is being developed internally. We would also seek to meet with a director in situations where we have engaged with management on issues best reserved to executives but have had an underwhelming response, particularly if we are concerned that the issue under review has material financial consequences for the company over time.

IR Update: When BlackRock has a particular concern with a company, when does your team typically reach out to the corporate secretary, the IR officer, or both? If so, in what cases would this happen?

Edkins: Over the years, we have established good lines of communication with a significant percentage of the companies in which we invest on behalf of our clients. The point of contact will generally be determined by the company as the IR officer and corporate secretary or corporate governance professional in different companies can have quite varying roles and responsibilities. There are a number of reasons we would want to engage with management. The most common in the second quarter of the year is in relation to our voting at the shareholder meeting. We might be seeking clarification of information reported in the proxy or we might want to explain our policies if the company seems at variance to them. Either way, the intention is to ensure we are voting on a well-informed basis and that the company has a sense of any differences in thinking that might lead us to vote against management.

Outside proxy season, we engage on longer-term matters such as enhanced disclosures or board or management succession plans. We also engage with companies flagged in our internal research as lagging their peers on relevant ESG factors that have the potential to impact financial performance. Finally, we will engage where there has been a significant event, such as a product recall or an unanticipated change in leadership, to ensure we understand the implications on long-term value creation.

IR Update: Are there any best practices that IR officers should adopt to promote better engagement with BlackRock and other investors?

Edkins: I hesitate to tell IR professionals about best practices in terms of IR! But there are a few things that we find helpful. First and foremost, remember that your required disclosures (such as the proxy statement) and the company website are very effective ways to ensure that shareholders have a good understanding of the company's approach to corporate governance and the company's perspective on why that approach serves the interests of long-term shareholders. We're seeing some great innovation at the leading edge of the market – such as a letter from the board to shareholders explaining the board's priorities in the past year or interactive proxies – that others should explore and possibly emulate. Secondly, know your major shareholders and your vocal shareholders (who are not always the same) and their governance policies and voting track record. Try to anticipate what about the company's governance or which items on your agenda for the shareholder meeting might cause concern and engage in advance of proxy season to explain the company's rationale. Finally, manage your board's expectations in relation to engagement. You don't have to engage every investor on governance every year. Offering a meeting and being told by the investor that it isn't necessary should be considered "engagement lite" and taken as a sign of implicit support. As I said, none of us should be engaging for its own sake – or to make up some quota. We should be engaging with an outcome in mind and focusing on action, not activity.

Views on Activism

IR Update: There's a lot of interest in shareholder activism, its rise (and potential decline) and the level of support activists are getting from mainstream shareholders nowadays. What is BlackRock's position on shareholder activists?

Edkins: BlackRock takes a case-by-case approach to situations where a shareholder activist is pushing for change at a company. Once the activist's proposals are in the public domain, we will engage to understand their rationale and end-goal and assess the extent to which it aligns with our clients' interests as long-term investors. We also meet with management, and sometimes board directors, to understand the company's perspective on the proposals and the counter-arguments and areas of potential agreement. If the issue comes to a vote, such as for a contested slate of directors, we will vote in the way that reflects what we believe would be the best long-term outcome for our clients.

Our observation is that, on the whole, most activist campaigns have some merit. The areas of disagreement between the company and the activist or with us may be around the timeframe within which change is necessary or the focus of the proposals, particularly if it is primarily financial engineering. We are more inclined to support an activist's proposals where we believe they have merit and management and the board have either been unresponsive to shareholder concerns or don't seem to have a credible plan to address the underlying issues. We have, in the past few years, supported around 40 percent of the activist campaigns that went to a shareholder vote. But it is worth remembering that it is expensive for an activist to run a proxy fight and they tend only to do so when they are relatively confident of significant support. There are many situations, particularly in the past year, where management has settled, before even engaging with their mainstream investors, and we would not have supported the activist. IR officers have a key role to play in these situations, and having the relationships with, and sounding out the views of, the company's mainstream, long-term investors is paramount. IRU

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