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Alert

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Heads Up for the 2018 Proxy Season: BlackRock Updates its Proxy Voting Guidelines

By Ellen Odoner and Aabha Sharma

BlackRock recently published its updated Proxy Voting Guidelines for U.S. public companies. The guidelines are in keeping with the perspectives expressed in BlackRock's October 2017 Investment Stewardship Global Corporate Governance and Engagement Principles and CEO Laurence D. Fink's most recent annual letter to public company CEOs. Overall, the guidelines indicate that BlackRock – like a growing number of other significant institutional investors – intends to use its proxy voting power to effect change where it believes circumstances warrant and is deeply focused on environmental and social (E&S) risk reporting and engagement. Key takeaways are as follows:

Board Independence: BlackRock expects a majority of directors on the board, as well as all members of key committees, including audit, compensation, and nominating/ governance committees, to be independent. BlackRock may vote against directors serving on key committees that it does not consider to be independent under its standards, which it notes are "typically more stringent" than stock exchange standards "when evaluating the independence of founders, family members, and other business relationships." The guidelines call out the following "common impediments to independence": (1) employment by the company or a subsidiary as a senior executive within the past five years; (2) status as a founder of the company; (3) substantial business or personal relationships with the company or the company's senior executives; (4) family relationships with senior executives or founders of the company; and (5) greater than 20% equity ownership in the company.

Board Oversight: BlackRock may vote against committee members and/or individual directors where (1) the board has failed to exercise oversight with regard to accounting practices or audit oversight (which may be suggested by substantial accounting irregularities); (2) executive compensation appears excessive relative to performance and peers (and the compensation committee has not already substantially addressed the issue); (3) the board is not composed of a majority of independent directors (excluding controlled companies); (4) the director has acted (at that or another company) in a manner that "compromises his or her reliability in representing the best long-term economic interests of shareholders"; or (5) a director has a pattern of poor attendance at board and committee meetings (generally attendance at less than 75% of combined board and applicable key committee meetings).

Overboarding: BlackRock's view is that a CEO should only sit on one public company board beside his/her own, while outside directors should sit on a maximum of four public boards, and may vote against overboarded directors.

Board Responsiveness: BlackRock may vote against committee members and/or individual directors where the board has not substantially addressed shareholder concerns. An offered example: where the board fails to implement a proposal that receives a majority of votes cast and, in BlackRock's view, the proposal directly affects shareholders' fundamental rights or long-term economic interests.

Board Diversity: BlackRock may vote against nominating/governance committee members of companies lacking board diversity. In addition to boards being comprised of a "diverse selection of individuals . . . [with] competing views and opinions," BlackRock "would normally expect to see at least two women directors on every board." Michelle Edkins, Managing Director and Global Head of BlackRock's Investment Stewardship Team, recently stated that with respect to companies that have not made much progress on board diversity, particularly gender diversity, if "we have engaged in prior years, we will be voting against the reelection of members of the governance committee unless there's a very credible explanation for lack of progress."

Classified Boards: BlackRock's position is that directors should be re-elected annually. BlackRock will typically support proposals requesting board de-classification.

Board Leadership Structure: In the absence of a significant governance concern, BlackRock will defer to boards to determine their leadership structure. In the event of a combined chair/CEO model, BlackRock will generally support the designation of a lead independent director if he/she has the authority to provide formal input into board meeting agendas and to call and preside at meetings of the independent directors. The guidelines provide a chart illustrating examples of responsibilities under each board leadership model.

Dual or Multiple Class Share Structures: BlackRock believes companies that either already have or are considering dual or multiple class share structures "should review these structures on a regular basis or as company circumstances change, and receive shareholder approval of their capital structure on a periodic basis via a management proposal on the company's proxy."

Clawback Proposals: BlackRock will typically support shareholder proposals for recoupment from any senior executive whose compensation was based on faulty financial reporting or deceptive business practices or whose behavior caused direct financial harm to shareholders, reputational risk to the company or resulted in a criminal investigation, even if these actions did not ultimately result in a material restatement. This would include the amount of settlements paid by the company arising from such behavior.

Proxy Access Fix-It Proposals: BlackRock, in general, supports market-standardized proxy access proposals, which allow a shareholder (or group of up to 20 shareholders) holding 3% of a company's outstanding shares for at least three years the right to nominate the greater of up to two directors or 20% of the board. BlackRock will generally oppose shareholder proposals requesting outlier thresholds where a 3/3/20/20 provision exists.

Environmental & Social Risk Reporting and Engagement: As discussed in our alert available here, a growing number of the world's largest investors are calling for enhanced transparency regarding the identification and management of E&S risks. BlackRock expects companies to identify and report on material, business-specific risks and opportunities and to explain how these are managed. Disclosure should include key E&S performance indicators, actual performance against these kpi's, any peer group benchmarking and verification processes the company uses, any global standards it has adopted and how legal compliance issues are managed. Where BlackRock has concerns about poor management of material E&S issues, BlackRock may vote against the election of directors or support an E&S shareholder proposal. In deciding its course of action, BlackRock will assess the nature of its engagement with the company on the issue over time, including whether the company has already taken sufficient steps to address the concern, is in the process of actively implementing a response, or there is a clear and material economic disadvantage to the company in the near-term if the issue is not addressed.

With regard to climate risk in particular, BlackRock commends the disclosure guidance provided in the Financial Stability Board's Task Force on Climate-Related Financial Disclosures and the Sustainability Accounting Standards Board's sector-specific disclosure standards. For companies in sectors that are significantly exposed to climate-related risk, BlackRock "expect[s] the whole board to have demonstrable fluency in how climate risk affects the business, and how management approaches adapting to, and mitigating that risk." When evaluating shareholder proposals related to climate risk, BlackRock will take into account the robustness of the company's existing disclosures and its engagements with the company and board members over time.

In response to the growing demand from institutional investors for data covering E&S topics, Institutional Shareholder Services (ISS) announced this week the launch of Environmental & Social QualityScore, a new component of ISS' corporate profiling and scoring solution for institutional investors. A more detailed discussion of E&S QualityScore is forthcoming.

Other Issues: The guidelines set out BlackRock's stance on additional corporate governance issues not covered above, including auditor and audit-related issues, capital structure proposals, mergers, asset sales and other special transactions, executive compensation, equity compensation plans, and other general corporate governance matters.

ENDNOTES

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Please contact any member of Weil's Public Company Advisory Group or your regular contact at Weil, Gotshal & Manges LLP:

Howard B. Dicker	View Bio	howard.dicker@weil.com	+1 212 310 8858
Catherine T. Dixon	View Bio	cathy.dixon@weil.com	+1 202 682 7147
Lyuba Goltser	View Bio	lyuba.goltser@weil.com	+1 212 310 8048
Adé K. Heyliger	View Bio	ade.heyliger@weil.com	+1 202 682 7095
P.J. Himelfarb	View Bio	pj.himelfarb@weil.com	+1 202 682 7208
Ellen J. Odoner	View Bio	ellen.odoner@weil.com	+1 212 310 8438
Alicia Alterbaum	View Bio	alicia.alterbaum@weil.com	+1 212 310 8207
Kaitlin Descovich	View Bio	kaitlin.descovich@weil.com	+1 212 310 8103
Erika Kaneko	View Bio	erika.kaneko@weil.com	+1 212 310 8434
Reid Powell	View Bio	reid.powell@weil.com	+1 212 310 8831
Niral Shah	View Bio	niral.shah@weil.com	+1 212 310 8316
Aabha Sharma	View Bio	aabha.sharma@weil.com	+1 212 310 8569