BLACKROCK

BIS Call for Evidence – A Long-term focus for corporate Britain

Introduction

We are grateful for the opportunity to participate in this call for evidence on a long-term focus for corporate Britain. By way of introduction, BlackRock is the world's largest asset manager, managing over $3 trillion for a variety of pension funds, governments and retail investors across a multitude of asset classes, including fixed income, equity, alternative funds and retail products.[1] As a longstanding investor in UK companies we are keenly interested in having a regulatory framework that supports efficient and sustainable capital markets. Our detailed comments to the questions asked are below. We would also like to make the following observations.

We believe that a combination of market transparency, sound market regulation and good corporate governance, including the protection of shareholder rights, makes the UK an attractive place both to invest and to list. The tendency to evolution over radical change in these areas has resulted in a broadly predictable environment that encourages a long-term approach by both companies and investors. A commitment to continual refinement is demonstrated by the fact that practices are adapting to the lessons learned from the economic crisis, for instance, with changes to the UK Corporate Governance Code and adoption of the Stewardship Code.

In our opinion, a discussion on changes in behaviour in UK equity markets based on turnover as evidence of a move away from long-term equity investment could lead to erroneous conclusions. Over the past decade or so financial markets have become increasingly sophisticated, enabled by enhanced technology, and the range of participants has increased dramatically. This provides investors with more choices and the markets with more liquidity. At one end of the spectrum trading has definitely increased. However, at the other, the level of investing in indexed funds has increased so these core holdings are very stable indeed. In between, our experience suggests that traditional long-term, mainstream investors are continuing to invest as they always have done. Over the same period, the commitment by UK-based investment managers to corporate governance programmes has increased significantly.

Overall, we believe that the UK framework is sound and encourages appropriate behaviours on the part of companies and investors. Nonetheless, we welcome this review and have below made some suggestions for your consideration.

Questions

The Board of Directors

1. Do UK boards have a long-term focus – if not, why not?

   In our experience, the majority of UK boards do have a long-term focus. The business cycle of different industries may impact what is considered the long-

[1] More information about BlackRock is here: http://www2.blackrock.com/global/home/AboutUs/index.htm

term in relation to a particular business and may influence investment strategies and operational management. But overall we believe that the duties of directors under Section 172 of the Companies Act 2006 to act to promote the long-term success of the company are widely understood and realised.

2. Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

   We consider the provisions of the Companies Act sufficient for allowing boards to identify the beneficial ownership of the company. In our experience, most shareholders tend to make themselves known to companies even when they have a shareholding below the 3% threshold in order to be included in company communications. The discovery provisions under Section 793 which enable companies to identify the entities at the various levels in the investment chain are generally effective and we believe could usefully be more widely adopted across European Member States. This does make it relatively straight forward for companies to identify the investment and voting decision-makers with whom they may wish to communicate. We do not believe that requiring shareholders to disclose holdings, and changes to them, under 3% would be informative to companies or the market. Rather, we suggest that the noise created would be misleading. We do recognise, however, that in some circumstances, such as during a takeover bid, share registers can change quickly which can make it difficult for boards to have full information. But we believe that the requirements of the Takeover Panel address this issue.

Shareholders and their role in equity markets

3. What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

   We agree with the point made in the discussion paper, namely, that "the consequences of the international investment markets have been overwhelmingly positive for the UK" for the reasons outlined on the paper. In our view, the most significant implication for corporate governance is that non-UK domiciled investors may have different expectations of companies and themselves when it comes to engagement. The role of the investor is viewed differently in different markets, thus it may not be the case that overseas investors accept that they ought to engage with the companies in which they invest. Those that do see engagement as part of their role may take a different approach to shareholders with a presence in the UK and thus will not necessarily behave in a way that the company expects. Both these factors may make engagement a less effective mechanism than may be desired.

4. What are the most effective forms of engagement?

   Engagement in our experience ranges from discussions to build mutual understanding or to get a certain perspective on an issue through to intensive efforts to bring about change at a company. We believe that the most effective engagement is done in a shareholder value, rather than compliance, context. It ought to be an investment activity and the approach taken adapted to the situation. We believe that engagement should be confidential as the

issues covered are nearly always complex and tend to be sensitive. Engaging in cooperation with other investors can be effective but in our experience even where there is agreement as to the problem it can be very difficult to agree a single course of action or timeframe in which it ought to be taken. For this reason, it is important to recognise that in most engagements shareholders make representations to board members and management, who must then decide what to do. However, one of the lessons we learned from the financial crisis is that we ought to be more direct and potentially less patient with companies where we are concerned that management are not acting in shareholders' interests. There is a limit to what can be achieved through engagement and sometimes the most prudent response is to sell the shares of a company whose management is unresponsive to shareholder concerns.

5. Is there sufficient dialogue within investment firms between managers with different functions (i.e. corporate governance and investment teams)?

   The level of interaction between the investment and governance teams seems to depend largely on an investment firm's stance on corporate governance, stewardship and engagement, including voting. At BlackRock, the Corporate Governance and Responsible Investment team is part of the Portfolio Management Group and is based in five key regions, the US, Europe, Japan, Hong Kong and Australia. Its work is integrated with that of the portfolio managers and investment analysts. In addition, we have in each region an oversight committee of senior investment professionals from the relevant parts of the business to guide and monitor the work of team to ensure it meets our stated objectives. In practice, we meet jointly with company representatives where the issue being discussed has both strategic and governance dimensions, for example, a takeover bid or succession planning. Where the purpose of the meeting is specific to either financial assessment or corporate governance (including social, ethical or environmental factors) then either the portfolio managers or the governance specialists will meet with the company and will debrief the relevant colleagues as required. In this way, we believe we ensure that corporate governance factors are taken into consideration in investment decision-making and, equally importantly, we focus our corporate governance programme on matters that are material to the economic sustainability of companies.

6. How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publically how they have voted?

   We believe that voting is an important form of engagement as it is the formal mechanism for holding directors to account for their work on behalf of shareholders. It involves the broadest level of monitoring of our investment universe. It is, in our view, a sound discipline to review at least annually the structures and policies in place at each company and the extent to which they have proved effective in underpinning performance. But voting against management resolutions is only effective in bringing about change if there is also a clear explanation of the issue of concern and the response sought from the company, i.e. engagement.

   We believe that it is important for asset managers to disclose to clients how they have voted. Whilst we do make our voting public on our website annually

it is unlikely this is of use to our clients over and above the reporting they already receive. In our experience, the most significant cost in producing the public reports (which take a different format to our client reports) is the time team members spend collating and verifying the information, which is time that could be spent on engagement.

7. Is short-termism in equity markets a problem and, if so, how should it be addressed?

   In the context of this discussion, we would suggest that it is important to distinguish between the different participants in 'the market'. The different characteristics of each – sell-side, buy-side, fiduciary, proprietary – influence the way they operate. Even within the fiduciary investment manager subset of which BlackRock is part there is a spectrum of different investment strategies, with different investment horizons, as dictated by client demand. We recognise the factors discussed in the working paper as potential drivers of short-termism. However, these pressures can be resisted and, in context, each has its purpose. We do not have any evidence to suggest that there has been a marked increase in short-term behaviours either by investors or by company directors or management. As noted above, higher market turnover is not necessarily an indicator of a lesser commitment to overseeing companies by long-term investors. Much of the turnover is derived from strategies that are deliberately short-term in nature and not intended to influence directors. We suggest more research needs to be undertaken to clarify the situation in relation to the duration of investment by shareholders. Even investors with a relatively constant holding will buy and sell for a number of reasons, including changes to client mandates, retain fund flows, rebalancing of an index or revised views on the prospects for a sector or a company. We believe it would be helpful to have an understanding of how long investors stay on the share register of companies even if their holding changes over time. Finally, we are concerned about the claim in Paragraph 4.25 that "… fund managers can generate income for themselves through fees related to the number of portfolio changes…" and that this is a driver of turnover. Fund managers do not generate revenue for themselves in this way; indeed the increased costs of frequent trading will reduce returns to the fund manager.

8. What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?

   We do not have any evidence indicating a paucity of investment managers taking a long-term focus in their investment decisions nor that taking a long-term view leads to better investment outcomes. There is, as noted above, a broad spectrum of participants in the financial markets, some of whom may allocate the capital they are responsible for investing in a short-term strategy. However, those taking investment decisions must use their professional judgement as to when to transfer capital from one company to another and it is not clear that encouraging long-term holdings is either necessary or would lead to better performance of the economy as a whole. Further, we do not concur with the implication that there are 'good shareholders' and 'bad shareholders'. Companies coming to the public markets ought not to expect to be able to determine who is on their shareholder register. The best way for companies to

get the shareholders they want is to communicate effectively and perform well against the board's stated strategic objectives.

Our experience of markets where there are incentives for long-term shareholders, such as enhanced dividends or additional voting rights, leads us to discourage this course of action. The mechanisms tend to be complex and to have unintended consequences, such as entrenching management and the directors closely aligned with the block holders rather than generally increasing the long-term focus of the shareholder base or the company. We have no evidence to demonstrate that they have enhanced the economic performance of the companies or the economies in which they operate.

9. Are there agency problems in the investment chain and, if so, how should they be addressed?

   We recognise that there are agency problems in the investment chain, just as there are in many walks of life. The Stewardship Code and the UK Corporate Governance Code both address the agency problems inherent in the investment chain and provide jointly a framework for dealing with them. This is further reinforced by conduct of business rules and other client protection regulations. We believe that more effective communication and proactive engagement between the various agents and principals is the key to limiting agency problems and ensuring expectations are met.

   We suggest that wider adoption over the next 12 to 18 months of the Stewardship Code by investment firms, institutional investors and others such as investment consultants will result in a better understanding of the conflicts of interest and how these might impact decision-making and other behaviours of the various parties in the chain. The transparency required by the Stewardship Code should also provide comfort that any conflicts of interest are being adequately addressed and regularly reviewed. As the Stewardship Code only recently came into force we suggest that no further regulatory changes should be made until its effectiveness can be reviewed. When the Stewardship Code is reviewed in due course it would be appropriate to give particular consideration to the issue of conflicts of interest and assess the extent to which the provisions of the Code have resulted in robust procedures.

10. What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

    We are not aware that there is a need for greater transparency about the role of fund managers, their mandates and their pay. To the extent more high level information is needed in the public domain, the Stewardship Code requirements that investment managers explain their approach to stewardship activities and their duties to clients are adequate.

    Fund managers are the agents of their client thus their role is determined by client demand as are the mandates under which they manage money for clients and the fee structure. These vary considerably as they are a matter of private contract and can be, at some level, commercially sensitive or confidential to the client. We suggest that public disclosure of remuneration details of individuals is probably of most interest to competitors and may well result in peer benchmarking and ratcheting up of pay, as has been evident in public

company executive pay. We believe that the Stewardship Code framework provides the most suitable context for an investment manager which wishes to make public their overarching approach to remuneration in terms of structure and alignment with client interests.

For our part, we see it as our responsibility to provide our clients with sufficient information to support their assessments of our performance and any subsequent decisions. Accordingly, there is full transparency with all clients, both institutional and retail, on the mandate under which we manage their money. We report to them on performance and other investment-related matters in accordance with our agreement with them, generally on a quarterly basis. Further, we provide them with a range of informational material on our various investment funds, our assessment of key developments in the market and the wider economy that may impact them, and our overall philosophy as a fiduciary investment manager. We explain in our Stewardship Code statement our approach to engagement and voting and how we ensure we are acting in clients' best interests in that area. We believe that our approach to transparency is similar to that of other investment managers.

Directors' remuneration

11. What are the main reasons for the increase in directors' remuneration? Are these appropriate?

    We suggest executives' remuneration has increased for four key reasons: transparency (and the resultant benchmarking), globalisation of companies, global mobility of individuals and (perversely) the bias towards share based pay.

    Transparency on executive director remuneration helps shareholders assess 'value for money' and whether they are incentivised to deliver shareholder returns. However, it also allows accurate comparison between companies as to the 'market rate' and gives executives negotiating power. A global UK company with the majority of its business based outside the UK will naturally benchmark itself against its direct competitors (which are US or Asian in most industries) and thus they import pay inflation. This has a trickle down effect in as much as the UK median against which others assess their own remuneration increases. Similarly, the willingness of a cadre of senior executive management to move internationally creates pressures, given higher levels of executive pay in the US and Asia (in certain sectors). For companies without a sound succession planning process, a chief executive threatening to go abroad over pay is a serious, and easily addressed, predicament. Finally, share-based incentives are, in the UK, relatively complex because of the myriad of performance conditions and, anecdotally, often their value is heavily discounted by executives because the payout is unpredictable. Accordingly, the levels of awards demanded are higher and have increased further as the emphasis on performance pay has increased. Yet it seems that the actual payouts are not always that closely linked to shareholder returns. Better discussion in the Directors' Report on Remuneration explaining and justifying the actual payments made under the policy in the context of long-term performance might be helpful to our understanding.

We agree with the point in the discussion paper that company size is also a major influence on levels of remuneration. Interestingly, as companies come through the economic crisis the ones who have done well are arguing that they need to increase their remuneration as a result of having grown and become more complex. Yet, those companies against which they are benchmarking themselves were perhaps much larger before the crisis but have not similarly and proportionately reduced the remuneration of their executives. This is another factor driving up remuneration levels across the market.

If is difficult to assess whether the factors influencing directors' remuneration are appropriate. The important thing is to be aware of them and understand their impact in individual company situations. But it has to be recognised that market forces are real and most regulatory efforts in remuneration have had unintended and unfortunate consequences.

12. What would be the effect of widening the membership of the remuneration committee on directors' remuneration?

    We believe it is the responsibility of the board of directors to determine the overarching remuneration philosophy for the entire company and the remuneration policies relating to the executive management. To the extent they do not do this well shareholders can vote against their re-election or the Directors' Report on Remuneration. We do not see any benefit from widening the membership of the committee to non-board members. It seems disproportionate to undermine the concept of the unitary board over the issue of remuneration.

13. Are shareholders effective in holding companies to account over pay? Are there further areas of pay, e.g. golden parachutes, it would be beneficial to subject to shareholder approval?

    As noted above, we believe it is the board's responsibility to determine the appropriate pay structure for a company and to ensure that it serves shareholders' interests. We are concerned that the introduction of a vote on the Directors' Report on Remuneration, whilst it has led to more engagement, has resulted in over-dependence by boards on shareholder input into the process. For our part, we participated in over 170 remuneration consultations in 2010 and we expect that a number of other investment managers committed similar resource to remuneration engagements. Despite the shareholder input remuneration overall has continued to increase, partly for the reasons outlined above, and it is difficult to assess whether it would have increased more without vote. One of the difficulties we face as investors is that we (rightly) assess a company's arguments for pay changes or increases in light of that company's circumstances. Generally, companies do present strong arguments for the changes they wish to make. But our assessment tends not to take into account the impact it will have on the trend overall. Collective engagement helps shareholders present a consistent view when there is one but different perspectives are as common in the area of pay as elsewhere in engagement. We also tend to look at structure rather than quantum, seeking an alignment with strategy and a structure that will incentivise the right behaviours. Thus, there are numerous practical obstacles to shareholder oversight of pay. We do not see the benefit in widening the scope of shareholders' role in the process.

14. What would be the impact of greater transparency of directors' pay in respect of:
    a. Linkage between pay and meeting corporate objectives
    b. Performance criteria for annual bonus schemes
    c. Relationship between directors' pay and employees' pay

    We encourage companies to discuss in their annual reports and remuneration policies (where these are different documents) how remuneration is linked to strategy and performance. Better explanations could be given by many companies retrospectively such that shareholders can assess whether the policy had the intended affect. We are comfortable with performance criteria for annual bonuses being kept confidential in circumstances where it would be commercially sensitive to publish the information. However, this places even greater onus on the board to discuss the outcomes. We do not believe that there is a meaningful way of generally assessing the relationship between directors' pay and that of employees and thus do not believe that disclosing such a ratio would improve our understanding of the company's policies.

Takeovers

15. Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?

    We believe that boards of directors generally seek to understand the long-term implications of takeovers and do understand their responsibilities in determining the best course of action in a takeover situation. Whether a board communicates the situation well to shareholders and other affected parties needs to be assessed on a case-by-case basis and is generally central to a bid defence.

16. Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

    We believe that the 'Class Tests' under the Listing Rules of the UK Listing Authority provide adequate scope for shareholders in UK listed companies to influence major transactions. We do not see how this could be applied to companies outside the UK, often times the bidders for UK companies.

Other

17. Do you have any further comments on issues related to this consultation?

    We do not have anything further to add.