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BlackRock Seeks to Reframe the Conversation on Investment Stewardship

"The Investment Stewardship Ecosystem" positions BlackRock's activities around engagement, activism, ESG and proxy voting in a public policy context

A new white paper published this past Wednesday by BlackRock entitled "The Investment Stewardship Ecosystem" is a subtle but forceful defense of the investor's investment stewardship activities. Though the message presented by the article is consistent with BlackRock's previous writing on the importance of investment stewardship to generating long-term sustainable performance from portfolio companies, the authors also present rebuttals to the critiques of its voting and engagement activities (and of one particularly provocative quote from Chairman and CEO Larry Fink's 2018 Annual Letter to CEOs). Viewed as a whole, the white paper can be interpreted as a reframing of BlackRock's investment stewardship function within a public policy context, taking into account the roles and influence of key stakeholders, asset owners and fellow asset managers.

Highlights of the White Paper

The 18-page report is divided into sections that detail the relationships among market participants, describe investment stewardship and BlackRock's approach, highlight data on voting patterns and define how the investor views ESG considerations. For some readers, the information contained in the white paper may be well-known: several pages are dedicated to defining key stakeholders and their roles in the broader discussion of investment stewardship activities. This content is likely geared toward bringing an outside individual (such as a legislator, for example) up to speed on how a complicated facet of the investor world functions.

However, for a reader more familiar with current themes in U.S. corporate governance and recent issues facing BlackRock, other topics and themes are notable for their inclusion:

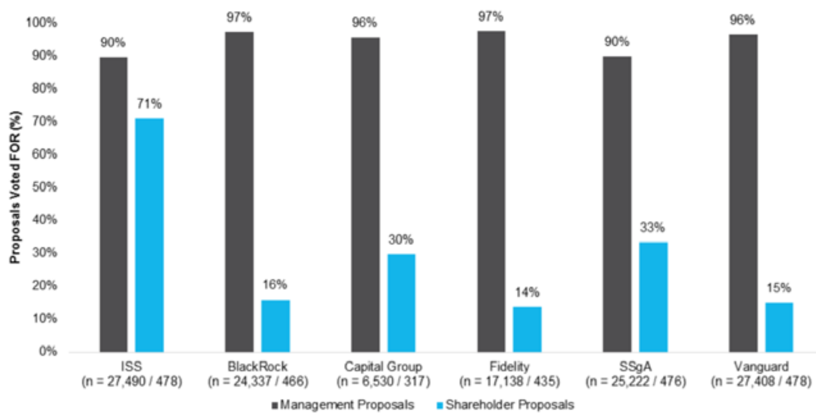
- The white paper begins with a quote from Larry Fink's 2018 Annual Letter to CEOs, including a reference to corporate societal impact that struck a nerve with companies and commentators and initiated some unexpected media attention in January. Two paragraphs later and highlighted in bold text, BlackRock clarifies that "…our number one focus is on generating long-term sustainable performance." The pairing of these statements (and a number of other observations throughout the white paper) seem intended to defuse a concern for readers of the January letter who thought BlackRock planned to use client assets to advance a social or political agenda.

- On index inclusion and the unequal voting rights debate, BlackRock reiterates its position that regulators, not index providers, should set corporate governance standards on topics such as unequal share structures. While this pro-regulator position is not broadly held among the institutional investor community, the discussion concludes with an observation that BlackRock believes "one share for one vote" is the preferred governance structure. BlackRock's primary concern appears to be that broad market indexes should reflect the "investable marketplace" and not select out a handful of companies based on governance criteria more appropriate for a tailored specialty index.

- BlackRock describes its approach to investment stewardship as an "…engagement-first approach, emphasizing direct dialogue with companies that have a material impact on financial performance." BlackRock highlights that it held nearly 1,500 direct engagements globally in the fiscal year ending June 30, 2017 (and more recent data is available on its website).

- BlackRock observes that "…proxy advisors can have significant influence over the outcome of both management and shareholder proposals." However, later in the white paper, the authors write that there is a "...misperception that the voting records of most large asset managers are highly correlated amongst asset managers and with the recommendations of proxy advisors." As evidence, BlackRock provides a breakdown of approximately 28,000 ballot items voted upon at Russell 3000 companies in 2016-2017 of which 27,000 were on routine management topics. Comparing its record to both ISS voting recommendations and peer asset managers, BlackRock posits that an analysis of shareholder proposals can provide "...greater insight into the variation in voting records and approaches to investment stewardship among different types of investors."

Exhibit 8: Inclusion of Routine Management Proposals Increases Misperception of Similarities in Voting Records



- One of the most interesting observations raised in the white paper is that BlackRock either does not have a voting mandate for or is conflicted from voting approximately 17% of its assets in equity holdings. This clarification is intended to highlight the distinction between assets under management and voting power, which are often conflated. However, even with this reducing voter power, BlackRock's holdings are still very significant at most issuers and, on a relative basis, we expect BlackRock's conflicts and client-directed voting to be similar to that of other large asset managers.

- Finally, the report is emphatic about the link between environmental, social and governance factors and enhancing the risk-adjusted financial performance of portfolio companies. This oft-repeated message is a response to assertions from some commentators that ESG engagement is intended to advance non-financial goals.

Takeaways for Issuers

Whether through its annual letter to CEOs, vote bulletins on its website or frequent appearances in the media, BlackRock has become increasingly public about its expectations and priorities for portfolio companies. A close reading of this white paper surfaces a number of key tension points that BlackRock's investment stewardship team is navigating in the realm of public policy.

While most discussions of the role of investment stewardship are geared toward an investor or issuer audience, here, BlackRock has placed its investment stewardship efforts within the evolving public policy discussions of market preferences and standards. In doing so, BlackRock is attempting to reframe the broader debate over whether large asset managers have accumulated, and are wielding, too much power.

As the asset management industry continues to evolve toward greater concentration of holdings, large asset managers such as BlackRock will be under increasing pressure to justify their approaches to proxy voting and engagement. With a range of legislation and regulation in process that could alter the complex landscape of investment stewardship and proxy voting, it is reasonable to expect that other stakeholders will follow BlackRock's lead in engaging with the market more broadly to ensure their viewpoints are heard.

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