Our approach to engagement on board quality and effectiveness

BlackRock

Investment Stewardship

BlackRock Investment Stewardship (BIS) encourages companies to have sound corporate governance and business practices that support the durable, long-term financial value creation that our clients depend on to achieve their investment goals. As part of our fiduciary responsibilities as an asset manager to act in our clients' financial interests, we assess a range of risks and opportunities that can affect the long-term performance of the companies in which we invest on their behalf. We engage companies to understand their approach to the material drivers of risk and financial value in their business models, provide feedback, and raise any concerns. We may signal continuing concerns through our voting, where clients have authorized us to vote on their behalf. In all cases, our voting is intended to advance the long-term financial interests of our clients as shareholders.[1]

Our investment stewardship efforts have always started with the board and executive leadership. We recognize that accepted standards and norms of corporate governance can differ between markets. However, we believe there are certain fundamental elements of governance practice that are intrinsic globally to a company's ability to create long-term financial value. One of these is a high caliber, effective board responsible for overseeing and advising management and accountable to shareholders.

Board quality and effectiveness as an investment issue

As we explain in the BIS Global Principles, the performance of the board is critical to the long-term financial success of a company and the protection of shareholders' economic interests. For this reason, BIS sees engagement with, and the election of, directors as one of our most important responsibilities. The election of directors to the board is a near-universal right of shareholders globally and an important signal of support for, or concern about, the performance of the board in overseeing and advising management.

In our view, an effective board has a number of responsibilities, including but not limited to the following:

- Establishing an appropriate corporate governance structure.
- Supporting and overseeing management in setting long-term strategic goals and applicable measures of financial value creation and milestones that will demonstrate progress, and taking steps to address anticipated or actual obstacles to success.
- Providing oversight on the identification and management of material risks and opportunities in a company's business model.
- Overseeing the financial resilience of the company, the integrity of financial statements, and the robustness of the Enterprise Risk Management framework.[2]
- Making decisions on matters that require independent evaluation, which may include mergers and other significant financial transactions.
- Having a formal plan for both anticipated and unplanned leadership succession, including key board roles.
- Establishing and overseeing executive compensation structures that help the company attract, retain, and reward key personnel, while ensuring appropriate risk behaviors, consistent with delivering long-term financial performance.

In our experience, clear definitions of the respective roles of the board, the board sub-committees, and senior management contribute to board and governance effectiveness. These responsibilities and structures may differ by company, sector, and geography, as each board tailors its approach to its company's context in light of local regulations and corporate governance norms.[3]

Given the dynamic nature of business, it is beneficial for new directors to be brought onto the board periodically to refresh the group's thinking in a manner that supports both continuity and appropriate succession planning. In our view, this refreshment should include the assessment of factors such as the need to address gaps in skills, experience, diversity, and independence. As noted in the BIS Global Principles, in our experience, directors who bring a diversity of perspective and thought into the board room minimize the risk of "group think" and can contribute to more robust discussions, more innovative and resilient decisions, and better long-term economic outcomes for companies.

How we engage on board quality and effectiveness

We take a multifaceted approach towards evaluating board quality and effectiveness. In assessing sound governance, we seek to understand the context in which a company operates, and how that influences the responsibilities and composition of the board and how it functions.[4]

We engage, as necessary, with members of the board's nominating and/or governance committee to assess whether governance practices and board composition are appropriate given the business and the broader context in which the company operates. In our engagements, we discuss various governance topics, including board composition and independent leadership, board oversight of management's strategy and approach to risk management, succession planning for key board and management roles, and the board's own nomination and evaluation processes. We look to boards to have credible responses to a range of questions on these topics that, in our experience, can demonstrate a robust approach to board quality and effectiveness, including, where appropriate:

- How the board's composition reflects the company's stated strategy, trends impacting the business, the breadth of the company's key stakeholders and succession expectations, and how the board oversees management's strategy and approach to risk management – including of material or business-relevant sustainability-related opportunities and risks.
- How the board integrates the variety of perspectives directors bring to facilitate inclusive and constructive discussions that result in sound decisions and whether the board has sub-committees responsible for oversight of key governance matters, e.g., audit oversight or director nominations.
- How the board approaches periodically bringing in new directors, including whether external advisors or search firms are used to identify candidates, the extent to which independence, diversity, skillset, and tenure are considerations, and whether the board uses mechanisms such as a mandatory retirement age or term limit to manage board refreshment.
- How the board considers regional best practices as they relate to governance structure, board composition, and the periodic introduction of new directors to the board.
- How the board evaluates and gains comfort with each director's outside commitments, particularly those to other public company boards.
- How the board assesses independent directors' ability to act in the interests of all shareholders. Generally, this would include directors being free of close affiliations with management, other directors or commercial entities that may impair their independent judgement, significant share ownership, and tenure (including the board's view of the independence of any long-tenured members).
- The board's performance evaluation process, including how it informs director nominations and management and director succession processes, and how the board develops independent board leadership including whether committee assignments are rotated on a staggered basis to foster diverse perspectives and enable directors to develop a breadth of knowledge within the board.

Endnotes

1. This commentary should be read in conjunction with BIS' Global Principles and regional voting guidelines. Other materials on the BIS website might also provide useful context.
2. Enterprise risk management is a process, effected by the entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within the risk appetite, to provide reasonable assurance regarding the achievement of objectives. Source: Committee of Sponsoring Organizations of the Treadway Commission (COSO). "Enterprise Risk Management — Integrated Framework." September 2004, New York, NY, updated in 2017.
3. For example, in Asia, where concentrated ownership structures are common, it is often the case that controlling shareholders dominate the board even if they have less than majority ownership of the company. We look to companies, through a robust selection process, to nominate non-executive directors who can bring an independent view to and influence on board discussions to help protect minority shareholder interests and the long-term financial value of the company.
4. We recognize that some companies operate across multiple geographies and regulatory regimes, which can result in differing governance and voting polices being applied by their investors. For instance, impediments to director independence may vary, as may thresholds for perceived long-tenure. Additionally, different board structures and responsibilities may influence the demands on directors. We explain in our regional voting guidelines how we assess key board issues such as director independence, tenure limits, election cycles, diversity, and time commitments in the context of local market norms and regulations.

Want to know more?

blackrock.com/stewardship | contactstewardship@blackrock.com

Prepared by BlackRock, Inc.

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