



Revised and Extended Remarks at Harvard Roundtable on Corporate Governance

Keynote Address: “The Goldilocks Dilemma”

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Cambridge, Massachusetts
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Good morning and thank you to Lucian¹ for inviting me to share some thoughts on investment stewardship to kick off the 2019 Corporate Governance Roundtable.

Academic Theories on Investment Stewardship

Corporate governance and investment stewardship have caught the attention of companies, asset owners, asset managers, academics – including several here at Harvard – as well as non-governmental organizations (NGOs), policy makers, and the media. This heightened attention has generated a number of academic articles focusing on these topics, and many people have formed views based on specific studies.

While many of these theories are interesting, as one works through the various papers in which they appear, it becomes apparent that several theories conflict with each other. For example, John Coates has “The Problem of Twelve”, in which a small group of individuals, predominately from index fund managers, will effectively have control over the majority of US public companies.² Meanwhile, Lucian Bebchuk and Scott Hirst have a theory that index fund managers do not have sufficient incentive to pursue stewardship activities and therefore only pursue superficial efforts. In “The Specter of the Giant Three”, they look at the same facts as John Coates and conclude that these same asset managers do not sufficiently use their potential influence on companies.³ My remarks today will focus on why each of these hypotheses is false, and I will provide a practitioner’s perspective on how we at BlackRock approach investment stewardship as part of the overall investment process.

¹ Lucian Bebchuk, James Barr Ames Professor of Law, Economics, and Finance, Director, Program on Corporate Governance, Harvard Law School.

² John C. Coates, “The Future of Corporate Governance Part I: The Problem of Twelve”, Harvard Public Law Working Paper No. 19-07 (Mar. 14 2019). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337.

³ Lucian A. Bebchuk and Scott Hirst, “The Specter of the Giant Three”, Harvard Law School John M. Olin Center Discussion Paper No. 1004 (Oct. 9, 2019). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3385501.

Exhibit 1: Academic theories of investment stewardship

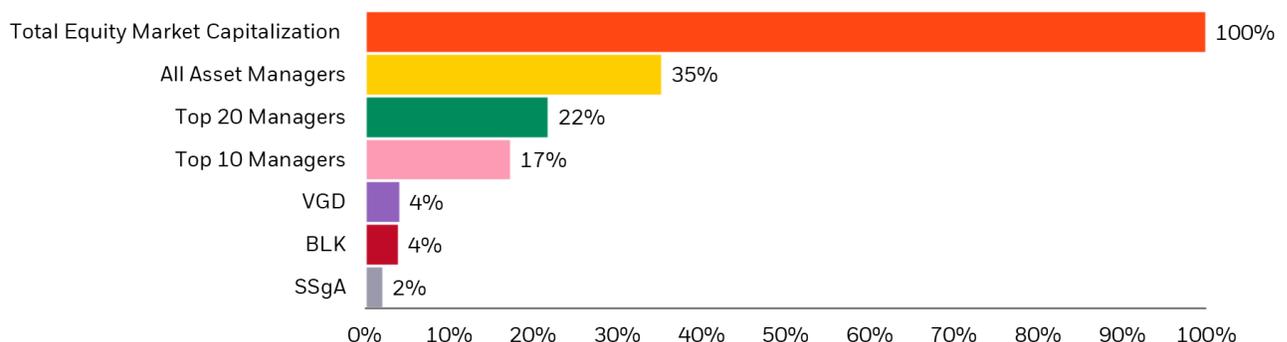


Who controls the assets?

The issue of ‘control’ is central to this discussion of investment stewardship. To start, the ‘largest shareholder’ is not necessarily the same as the ‘controlling shareholder’. Examining the majority of US public companies – and certainly ‘large cap’ public companies – the largest shareholder holds only a single digit percentage of shares outstanding.

Let us look at some numbers that address who owns stocks and who manages these equity assets. One of the overlooked facts here is that the majority of equity assets globally are managed directly by asset owners. Aggregating across all external asset managers as of year-end 2017, this cohort represents 35% of equity ownership. Furthermore, the Top 10 asset managers represent only 17% of equity ownership, as shown in Exhibit 2. The missing pieces include assets managed in-house, primarily by pension plans and sovereign wealth funds. Another important factor is activist investors who take concentrated stakes in specific companies. Furthermore, activist investors often take seats on companies’ boards where they have a significant holding.

Exhibit 2: Breakdown of global equity market capitalization



Source: Asset managers’ AUM: Pensions & Investments (data as of Dec. 31, 2017); Total Equity Market Capitalization: World Federation of Exchange Database, BIS (data as of Q2 2017), HFR, Cerulli, Simfund (data as of Nov. 2017), iShares GBI (data as of Nov. 2017), Global Heat Map, McKinsey Cube (data as of December 2016). P&I data is self-reported and may not be comprehensive of all managers everywhere. Total equity market capitalization data includes institutional and hedge fund figures sourced from McKinsey Cube data as of the previous year due to data availability constraints.

In looking more closely at voting and control issues, it is important to note that quite a few large institutional asset owners outsource the management of their assets while choosing to vote proxies for themselves. We estimate that 25% of BlackRock's large separate account mandates are managed for clients who vote their own shares. For example, Washington State Investment Board (WSIB) considers voting a key part of their fiduciary duty to their beneficiaries as they described in their letter to the FTC.⁴

And while many academic studies use Form 13F data to measure ownership stakes, this data is not reliable. First, not all investors are required to file Form 13F. For example, company executives are exempt from filing, as they are individual shareholders not institutional shareholders. Additionally, asset managers have interpreted aspects of 13F differently. Firms interpret the types of reportable 'voting authority' differently, creating discrepancies in how they report. The bottom line is 13F data problems potentially invalidate academic analyses that rely on this data.

As Exhibit 2 above shows, Vanguard, BlackRock, and State Street Global Advisors currently manage approximately 4%, 4%, and 2% of global equities, respectively. In the *Specter of the Giant Three*, Bebchuk and Hirst assume that these managers will continue to grow at the rate they have for the past few years.⁵ While their projections are arithmetically correct, this assumption ignores multiple external variables that can change what products, asset classes, or managers are in or out of favor at a given time, and that translates into changes in growth rates.

Looking back over the past few decades, the list of the Top 10 asset managers has changed significantly. Who remembers Bankers Trust, Wilmington Trust, Kemper Financial Services? Each of these firms was a top 10 asset manager by total AUM in 1990, when BlackRock was barely on the viewfinder as a 2-year-old startup.⁶ Likewise, Deutsche Asset Management was a top 10 firm by total AUM in 2000, and PIMCO was a Top 10 firm by total AUM in 2010.⁷ However, neither Deutsche nor PIMCO are in the top 10 by total AUM today. The point being: this is not a static group. Looking at the asset management industry today, the growth rate over the past five years of Dimensional Fund Advisors' (DFA) equity AUM is 9%, while the growth rate of the equity AUM over the past five years of Bebchuk and Hirst's "Giant Three" ranges from 2% to 12%, suggesting potential changes to the ranks of the largest asset managers in the future.⁸

While we are looking at the data, let's consider the oft-repeated statement: "Index funds are surpassing active funds". While this is factually true, this statement is only part of the story. I call this 'the denominator problem'. Mutual funds, including open-end funds and exchange-traded funds (ETFs), represent 35% of US equities and 21% of global equities.⁹ The remainder

⁴ Washington State Investment Board, Letter to the Federal Trade Commission (FTC) Re: FTC Hearing #8: Competition and Consumer Protection: Holdings of Non-Controlling Ownership Interests in Competing Companies (Dec. 3, 2018). Available at: https://www.ftc.gov/system/files/documents/public_comments/2018/12/ftc-2018-0107-d-0002-163005.pdf.

⁵ Bebchuk and Hirst, "The Specter of the Giant Three".

⁶ Pensions & Investments.

⁷ Ibid.

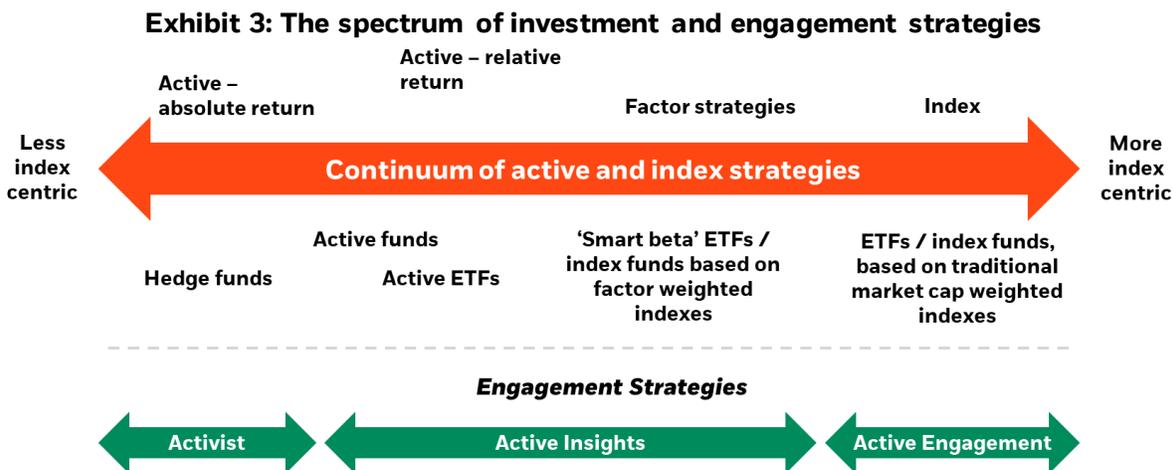
⁸ Ibid.

⁹ World Federation of Exchange Database (data as of Dec. 2018), BIS (data as of Q2 2018), HFR, Cerulli, Simfund (data as of Dec. 2018), iShares GBI (data as of Dec. 2018), Global Heat Map, McKinsey Cube (data as of Dec. 2017). Active and index projections calculated from Simfund and Broadridge data; ETF data from iShares GBI.

of global equity assets are held by pension funds, private funds, foundations & endowments, and individuals. With nearly half of US mutual funds using index strategies, this represents approximately 17% of US equities.¹⁰ BlackRock has done extensive analysis of non-mutual fund assets, and we estimate that even when these assets are included, the percent of US equities managed, whether in-house or externally, using index strategies is under 30%, far from a majority of equity assets.¹¹

Spectrum of investment and engagement strategies

You may notice that I use the phrase ‘index strategies’ instead of ‘passive strategies’. People often refer to investment strategies as ‘passive’ or ‘active’ as if there is a binary choice. In practice, however, investment strategies fall along a spectrum from pure index to enhanced index, to broadly diversified portfolios, to concentrated portfolios to long-short strategies. This is an important distinction because most of these strategies are measured relative to an equity index, and the degree of difference from index strategies to enhanced index strategies, to broadly diversified strategies, may not be as much as one would think.



In looking at flows leaving ‘active’ strategies, many investors are leaving broadly diversified portfolios with high fees and moving to pure index and enhanced index strategies with lower fees, and sometimes better returns, while still providing broad diversification. And, now investors can combine various index strategies to create what amounts to an actively managed portfolio.

Similarly, engagement strategies fall on a spectrum of their own. Engagement strategies range from activist, which advises on company strategy and seeks board seats, to active engagement, which deals with ESG issues, but does not seek board seats or to influence companies. In between is active insights, which attempts to draw perspectives from discussions with management that are more in depth than in active engagement. At BlackRock, we define engagement as encompassing both interaction with companies and the voting of proxies. Hedge funds often take an ‘activist approach’ which includes advising on company strategy and seeking board seats. On the other hand, index fund managers are, by

¹⁰ Ibid.

¹¹ Ibid. Estimates for insourced US assets assumes 20% of total institutional per McKinsey and BLK stakeholders.

definition, long-term holders of stocks and stewards on behalf of their clients. As a result, index fund managers tend to take an 'active approach' to engagement. To be clear, index fund managers do not take board seats, and their engagement is largely focused on corporate governance. As I will discuss later, index fund managers are discouraged, by virtue of the regulatory hurdles they would encounter, from telling management what to do and from coordinating stewardship activities with other managers. To complete the picture, active managers have the choice of holding or selling a stock. Active managers may also engage with companies, and many do so effectively; however, theories suggesting that these investors are somehow more engaged than index fund managers or other investors are not apparent in the marketplace.

Who runs the companies?

Another key issue in this debate is understanding how public companies are run. Some key questions to consider include: What is the role of management? What is the role of the board of directors? How does the board engage with management and make compensation decisions? How does the board of directors engage with compensation consultants?

Company management makes strategic decisions for companies, ranging from product offerings to pricing, to long-term strategy. Company management is required to act in the best interest of all shareholders. Meanwhile, boards of directors have an oversight role, and are elected as the representatives of all shareholders. Stock exchange listing rules require a majority of directors to be independent, and corporate governance norms have evolved to limit the number of boards that an individual director serves on.

Exhibit 4: Quantifying who runs US public companies

Over 28,000 individuals oversee public companies in the US alone, including:

- 3,948 CEOs
- 24,259 board directors

Source: FactSet, as of Mar. 26, 2019. Note that in a few cases, there are CEOs that are the CEO of more than one public company, these CEOs have only been counted once. The number of board directors does not include directors that are also CEOs to avoid double counting, nor does the number of board directors double count directors that may serve on more than one board.

As shown in exhibit 3, there are over 28,000 unique individuals involved in running and setting strategy at US companies alone, including nearly 4,000 CEOs and over 24,000 board directors. And that is before accounting for the diverse investor base I discussed earlier or the influence of proxy advisory firms and compensation consultants.

How does Executive Compensation Work?

While some identify say-on-pay as a potential theoretical mechanism for 'control', the nature of say-on-pay votes tells a different story. Say-on-pay votes are retrospective advisory votes, designed to inform boards of directors of shareholder sentiment towards executive

compensation for the previous year. For the 2019 N-PX year, more than three-quarters of say-on-pay votes passed with over 90% of the vote, and only 2% were defeated.¹²

Compensation consultants are an often-omitted piece of the puzzle. Approximately 90% of large companies use a compensation consultant to assist them in determining compensation packages for executive, especially for CEOs.¹³ Based on a review of company filings, there are more than 10 compensation consulting firms that are frequently used.¹⁴

Exhibit 5: Top compensation consultants

Top 10 Compensation Consultants	
Rank	Consulting Firm
1	Frederic W. Cook & Co.
2	Meridian Compensation
3	Pay Governance
4	Pearl Meyer & Partners
5	Semler Brossy Consulting Group
6	Towers Watson
7	Mercer
8	Exequity
9	Compensation Advisory Partners
10	Compensia

Source: Equilar. As of Mar. 2019.

The ultimate goal of any executive compensation program should be to incentivize senior executives to enhance their respective company’s performance relative to prior years and its competitors for the benefit of all shareholders. But it is company boards – not shareholders – that are making these compensation decisions. In setting executive compensation, boards consider a range of factors. For example, they generally start with a peer group comparison provided by a compensation consultant that analyzes executive compensation packages of companies within the same or similar sectors. The processes around setting executive compensation are very transparent, as each company discloses in its proxy statement: (i) the role of the compensation committee; (ii) which compensation consultant, if any, the board of directors retained; (iii) a peer group analysis, including which companies were in the peer group; and (iv) details on salary, performance bonus, long-term incentives, and perquisites.

Another overlooked factor in executive comp is the role of proxy advisors. Nadya Malenko, Associate Professor of Finance at Boston University, estimates that negative ISS recommendations drive a 25% decrease in support for say-on-pay proposals.¹⁵ Similarly, Jill

¹² FactSet, using the US Securities and Exchange Commission (SEC) Form N-PX filings for Russell 3000 companies for the period Jul. 1, 2018 to Jun. 30, 2019.

¹³ Ryan Chacon, Rachel E. Gordon, Adam S. Yore, “Compensation Consultants: Whom do they serve? Evidence from Consultant Changes” (Jan. 11, 2019). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281133.

¹⁴ Equilar. As of Mar. 2019.

¹⁵ Nadya Malenko & Yao Shen, “The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design”, *Review of Financial Studies*, Vol. 29, No. 12 (Dec. 2016). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2526799.

Fisch, Professor of Business Law at the University of Pennsylvania Law School, finds ISS' recommendations are a significant driver of say-on-pay vote results.¹⁶ Unsurprisingly, compensation committees and their consultants often solicit the input of proxy advisors to garner a favorable recommendation on say-on-pay votes.

As a shareholder, BlackRock considers executive compensation an important element in attracting, rewarding and retaining key talent for the companies in which we invest on behalf of our clients. As we explain in our stewardship commentary, we don't recommend a one-size-fits-all approach.¹⁷ Instead, we look for alignment of interests, albeit with significant flexibility for boards to determine the appropriate executive compensation packages. At BlackRock, we believe that companies should explicitly disclose how incentive plans reflect strategy and incorporate drivers of long-term shareholder value; these disclosures should include the metrics and time frames by which shareholders should assess performance.

To reiterate, while permitting shareholders to express their views on executive compensation after-the-fact, say-on-pay votes do not dictate how much executives will be paid, nor do they set out the components of executive compensation packages. As compensation packages become better aligned with long-term value creation and shareholders' interests, companies have seen an increase in the affirmation in say-on-pay votes. Ultimately, decisions of executive compensation belong to boards of directors of public companies.

Most votes are not contentious

From reading media stories, one would think every shareholder vote is hotly contested, with extremely close voting outcomes. However, in reality, very few votes are contentious, with most overwhelmingly voted in one direction, either 'FOR' or 'AGAINST'. To put this in perspective, in the most recent proxy season in the US, there were approximately 31,500 ballot items, of which 444 were shareholder proposals, and 2,330 were say-on-pay votes.¹⁸

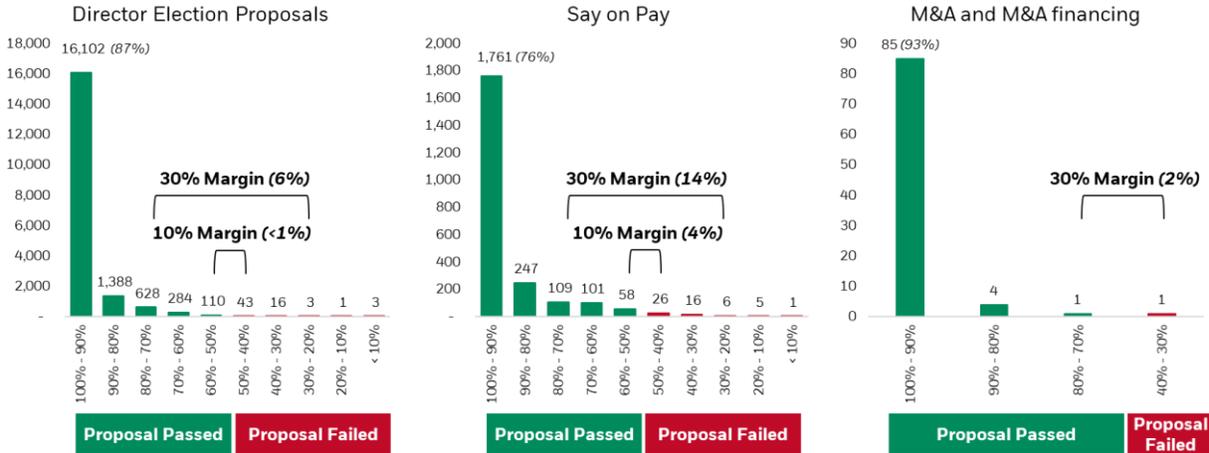
First, there is overwhelming support for company directors in director election proposals. As shown in Exhibit 6 below, 94% of director elections were won by a margin greater than 30%, and fewer than 1% of director votes were determined by a margin of less than 10%. Next, 86% of say-on-pay votes were won by a margin greater than 30%, and 95% were won by a margin greater than 10%. Likewise, 98% of M&A-related votes were won by a margin greater than 30%.

¹⁶ Jill Fisch, Darius Palia, Steven Davidoff Solomon, "Is say on pay all about pay? The impact of firm performance", Harvard Business Law Review, Vol. 8 (2018). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3046597.

¹⁷ See BlackRock, "BlackRock Investment Stewardship's approach to executive compensation" (Jan. 2019). Available at: <https://www.blackrock.com/corporate/literature/publication/blk-commentary-our-approach-to-executive-compensation.pdf>.

¹⁸ Total US ballot items: BlackRock Investment Stewardship 2018-2019 Annual Report. Number of shareholder proposals and say-on-pay votes: Proxy Insight based on the SEC Form N-PX filings for Russell 3000 companies for the reporting period of Jul. 1, 2018 through Jun. 30, 2019.

Exhibit 6: Support for management proposals



Source: FactSet using U.S. Securities and Exchange Commission (SEC) Form N-PX filings for Russell 3000 companies for the period of Jul. 1, 2018 to Jun. 30, 2019.

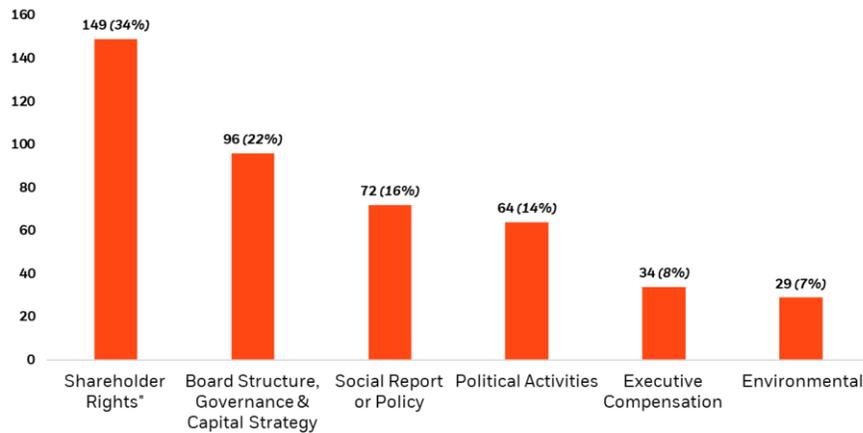
The rationale for the use of the 30% and 10% thresholds is that according to several commentators, the three large index fund managers are providing a ‘swing vote’ – or will be soon. However, these charts demonstrate that no individual manager has anything close to a swing vote type of influence on director elections, say-on-pay, or M&A situations. Even if you assume (i) that these firms grow to each control 10% of the equity votes – which is more than twice their typical voting power today in large cap companies – and (ii) that these firms all vote the same – which their voting records show that they don’t – the vast majority of votes would still not be influenced by this theoretical voting bloc.

Shareholder proposals address “G”, “E”, and “S” issues

Shareholder proposals represent just under 2% of the ballot items in the U.S, but they are the source of virtually all of the controversy, as evidenced by the proposal topics shown in the table below. Unlike management proposals, 18% of shareholder proposals are determined by a margin under 10%, and 70% are determined by a margin under 30%.

Exhibit 7: Breakdown of shareholder proposals

Russell 3000 Shareholder Proposals by Category



Source: Proxy Insight based on the SEC Form N-PX filings for the reporting period of Jul. 1, 2018 through Jun. 30, 2019.

Over 50% of shareholder proposals voted on address governance issues, such as the separation of Chairman and CEO; the desire to modify dual share class structures; or proxy access (i.e., the right of shareholders to nominate directors on the managements slate).

In recognition of the growing influence of proxy advisors in this area, the SEC recently released new guidance related to proxy advisor recommendations and investment managers' use of proxy advisor recommendations in their voting on shareholder proposals. Briefly put, the SEC will be holding proxy advisors to a higher standard than before, indicating the importance of the quality and accuracy of data in proxy advisors' recommendations. Likewise, the SEC expects asset managers to do proper due diligence on the proxy advisors and on the shareholder proposals. We are supportive of this guidance as it largely reflects our current practices.

On the other hand, both issuers and investors have expressed concern with the recent SEC guidance on Rule 14a-8 no-action requests. The SEC has indicated that staff will no longer provide no-action letters on the inclusion of shareholder proposals in proxy statements. Unless ISS and Glass Lewis modify their policies, this may lead to unintended consequences, as both ISS and Glass Lewis automatically recommend voting against directors if a company excludes a proposal without SEC staff response or a court order. On November 4th, Glass Lewis announced that it would not be changing this policy.¹⁹

And just yesterday, the SEC voted on a proposed rule which would require proxy advisors to allow issuers to correct incorrect information in their recommendations.²⁰ In addition, the Commission proposed changes to rules around shareholder proposal eligibility requirements, proposing to raise the submission and resubmission thresholds for a given shareholder proposal.²¹ Last year, we participated in the SEC roundtable on the proxy process and submitted a comment letter²². In our letter, we identified four key principles: (i) transparency, (ii) accurate data, (iii) shareholder rights, and (iv) the use of technology. We look forward to reviewing the proposed rule, using these principles as our guide.

Voting varies significantly across managers

Historically, dissecting manager voting records had been complicated. However, new services like Proxy Insight, MSCI, and other data analysis tools have become available in the past few years to make this easier. Plus, many managers voluntarily disclose summary voting statistics on their respective websites, which is available for free and provides significant insights.

BlackRock's approach to shareholder proposals is to assess the company's current disclosures and how the company is managing the issue that a given proposal raises. As just discussed, some shareholder proposals address Environmental and Social ('E&S') issues. Often, it is the case that management is already addressing a particular issue or that an issue may not be

¹⁹ Glass Lewis, "2020 Policy Guidelines Updates – U.S., U.K., Canada, Europe, China, and more", (Nov. 4, 2019). Available at: <https://www.glasslewis.com/2020-policy-guideline-updates-u-s-u-k-canada-europe-china-and-more/>.

²⁰ See SEC, Press Release: "SEC Proposes Rule Amendments to Improve Accuracy and Transparency of Proxy Voting Advice" (Nov. 5, 2019). Available at: <https://www.sec.gov/news/press-release/2019-231>.

²¹ See SEC, Press Release: "SEC Proposes Amendments to Modernize Shareholder Proposal Rule" (Nov. 5, 2019). Available at: <https://www.sec.gov/news/press-release/2019-232>.

²² See BlackRock, Letter Re: SEC Staff Roundtable on the Proxy Process (Nov. 16, 2018). Available at <https://www.blackrock.com/corporate/literature/publication/sec-roundtable-proxy-process-111618.pdf>.

material to the company’s long-term sustainable performance. At BlackRock, we use engagement as part of our process to make informed votes.

While it’s easy to count votes in support of shareholder proposals and rank firms based on such data, doing so definitely does not provide the whole story. For example, in the past year, BlackRock engaged globally with over 1,400 individual companies on a wide range of ESG issues.²³ By comparison, there were 165 shareholder proposals in the U.S. on E and S issues in the past proxy season, which represents less than 1% of all ballot items.²⁴ And 37% of E and S proposals addressed political activities disclosure, where much of the information being sought is already publicly available on government websites.²⁵

Importantly, in many cases, we have seen companies improve on E, S, and G issues through engagements over time. In 2018, BlackRock updated its proxy voting guidelines on board diversity and sent letters sharing our position on this topic to about 30% of the Russell 1000. We used the lack of at least two women on their respective boards as a flag to have a deeper discussion on their approach to board diversity. We have been pleased to see that over 120 companies added a female board member just this year.²⁶ Likewise, BlackRock engaged with over 200 companies on climate risk, and we have seen just over a 60% increase in organizations embracing the TCFD reporting framework.²⁷ Of course, these results reflect the collective voices of multiple shareholders.

Once again, shareholder proposal support is an area where simple statistics can be misleading. In Exhibit 8, we observe a correlation between size of manager by equity AUM and voting patterns. Asset managers with stewardship responsibility for larger amounts of equity assets are clearly expressing views that are independent of ISS’ proxy advisor recommendations and of each other. Some managers voted ‘FOR’ shareholder proposals more than 75% of the time, which exceeded even ISS’ recommendations.

The subset of just E&S votes shows a similar pattern, with these smaller managers by equity AUM voting ‘FOR’ more than 83% of the proposals, exceeding ISS’ recommendations in favor of 81% on E&S proposals.²⁸

²³ BlackRock, “2019 Investment Stewardship Annual Report” (Aug. 2019). Available at: <https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2019.pdf>.

²⁴ Ibid. and Proxy Insight based on the SEC Form N-PX filings for Russell 3000 companies for the reporting period of Jul. 1, 2018 through Jun. 30, 2019.

²⁵ Proxy Insight based on the SEC Form N-PX filings for Russell 3000 companies for the reporting period of Jul. 1, 2018 through Jun. 30, 2019.

²⁶ BlackRock, “2019 Investment Stewardship Annual Report”.

²⁷ Ibid.

²⁸ Proxy Insight based on the SEC Form N-PX filings for Russell 3000 companies for the reporting period of Jul. 1, 2018 through Jun. 30, 2019.

Exhibit 8: Shareholder proposal support

Support for Russell 3000 Shareholder Proposals (2019 N-PX Year)						
Name	Equity AUM (\$ M)	Total Votes	Votes 'FOR'	% 'FOR'	ISS Match Count	% ISS Match
BNP Paribas Asset Management	\$86,237.97	233	196	84%	158	68%
Pacific Investment Management Co. (PIMCO)	\$38,306.79	330	267	81%	299	91%
UBS Global Asset Management	\$335,865.26	420	331	79%	329	78%
AXA Investment Managers	\$75,085.92	355	275	77%	298	84%
Legal & General Investment Management	\$310,394.40	344	264	77%	272	79%
Prudential Global Investment Management	\$327,790.02	75	56	75%	73	97%
ISS	N/A	444	332	75%	444	100%
Nuveen Asset Management LLC	\$306,122.99	315	216	69%	307	97%
Invesco Advisers, Inc.	\$439,660.98	403	220	55%	273	68%
Glass Lewis	N/A	341	159	47%	226	66%
Franklin Templeton Investments	\$266,441.78	360	155	43%	196	54%
Natixis Global Asset Management*	\$221,869.90	166	71	43%	89	54%
BNY Mellon	\$396,060.00	432	177	41%	283	66%
Goldman Sachs Asset Management LP	\$300,690.00	437	149	34%	253	58%
SSgA Funds Management, Inc. (State Street)	\$1,607,230.08	444	129	29%	218	49%
Northern Trust Investments	\$478,047.96	444	124	28%	226	51%
T. Rowe Price Associates, Inc.	\$720,762.70	444	115	26%	195	44%
JPMorgan Investment Management, Inc.	\$489,504.71	429	88	21%	195	45%
Fidelity Management & Research Co. (FMR)	\$1,357,830.32	406	68	17%	163	40%
Vanguard Group, Inc.	\$3,338,495.15	441	76	17%	187	42%
BlackRock	\$2,993,884.82	444	67	15%	171	39%

Note: Total universe includes 444 shareholder proposals. Glass Lewis' Total Votes is underrepresented due to its data redistribution constrain. Per Proxy Insight, Prudential Global Investment Management's Total Votes may be low since it outsources management of equities.

Source: AUM: Pensions & Investments as of Dec. 31, 2018. Voting records: Proxy Insight based on the US SEC Form N-PX filings for the reporting period of Jul. 1, 2018 through Jun. 30, 2019. *Natixis Global Asset Management AUM sourced from 2018 Annual Financial Report.

We encourage academics to study this data to explain the disparity in voting. Some questions to consider include how much respective managers rely on proxy advisors' recommendations; whether some managers do additional research leading them to either support or oppose shareholder proposals; or whether there are other factors driving managers' voting.

Regardless of the rationale for these voting outcomes, one of the most important takeaways is to recognize that different asset managers vote differently, and rarely are the large asset managers capable of being a swing vote.

Factoring in dual share class structures

The subject of proxy voting has a touchpoint with another important corporate governance issue: capital formation. Some commentators have cited the burdens of being a public company – including the proliferation of shareholder proposals and the fear of activist investors, among others – as a deterrent to going public.

SEC Chairman Jay Clayton and others have pointed out that the number of public companies is shrinking.²⁹ In 2018, there were 4,025 public companies, down from over 5,100 in 2007 and over 8,000 in 1996.³⁰ Further, the number of initial public offerings (IPOs) is less than the

²⁹ See "Remarks at the Economic Club of New York", speech by SEC Chairman Jay Clayton (Jul. 12, 2017). Available at: https://www.sec.gov/news/speech/remarks-economic-club-new-york#_ftn7.

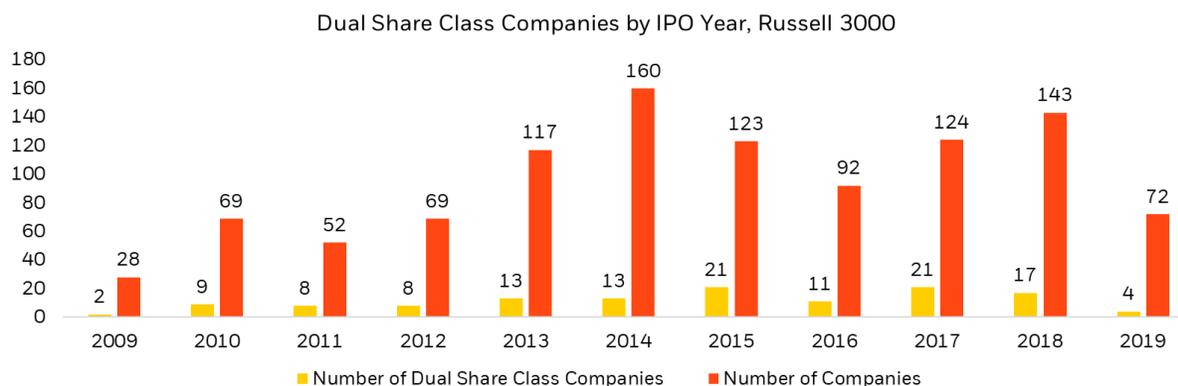
³⁰ Center for Research in Securities Prices, US Stock and US Index Databases (2016), The University of Chicago Booth School of Business.

high-water mark, albeit that number may have been artificially high.³¹ One concern expressed is that companies are going public later, precluding retail investors from participating in earlier stages of growth. And, of course, the abundance of private capital allows companies to stay private longer, making the public-private tradeoff more challenging.

As a response to deterrents against going public, some companies have come to market with dual share class structures. These cases range from situations where a founder has weighted voting rights while public shareholders have less, to the extreme case of SNAP, where public shareholders have no voting rights. This increase in dual share class structures raises a new set of issues.

Exhibit 9: Quantifying dual share class companies

Outstanding dual share class companies		
Exchange	Number of dual share class companies	Number with sunset provisions
NASDAQ	135 out of 1516	8 have sunset provisions
NYSE	176 out of 1419	9 have sunset provisions



Source: FactSet, Bloomberg, and CII. As of Sep. 27, 2019.

The Council of Institutional Investors (CII) and the International Corporate Governance Network (ICGN) have each weighed in, expressing concerns about the implications for corporate governance and shareholder rights that dual share class structures may have.³² They cite the potential for weak corporate governance and diminished accountability to shareholders and ask the stock exchanges to modify their listing standards to create a negative incentive against these governance structures.

In February 2018, the Securities and Exchange Commission’s (SEC’s) Investment Advisory Committee recommended that the SEC strengthen disclosures of the risks associated with dual share class companies.³³ Rick Fleming, the SEC’s Investor Advocate, recently gave a

³¹ See Jay R. Ritter, “Initial Public Offerings: Updated Statistics” (Aug. 8, 2017). Available at: <https://site.warrington.ufl.edu/ritter/files/2017/08/IPOs2016Statistics.pdf>.

³² See Council of Institutional Investors, “Dual-Class Stock”. Available at: https://www.cii.org/dualclass_stock. And ICGN, “ICGN Viewpoint: Differential share ownership structures: mitigating private benefits of control at the expense of minority shareholders” (Feb. 2017); available at: https://www.icgn.org/sites/default/files/2.%20ICGN%20Viewpoint%20differential%20share%20ownership_1.pdf.

³³ SEC, Investment Advisory Committee, “Recommendation of the Investor as Owner Subcommittee: Dual Class and Other Entrenching Governance Structures in Public Companies” (Feb. 27, 2018). Available at:

speech at the ICGN conference, where he noted concerns with self-dealing, insular group think, and poor controls, among a list of issues he associated with ‘unchecked corporate control’ with dual share class companies.³⁴

BlackRock has written on the topic of dual share class structures several times, starting from the perspective of finding a solution that balances the needs of issuers and the rights of investors.³⁵ BlackRock recognizes that when companies are establishing themselves in the public markets, unequal voting rights may allow founders to focus on long-term strategy and performance without exposure to outside pressures. Yet benefits dissipate over time, and dual share class structures challenges investor rights. We believe the benefits do not outweigh the loss of investor protections, over extended periods of time.

One possible solution is to require a sunset provision for dual share class structures. The listing exchange of such a company could require they automatically revert to one share one vote 5 to 7 years after going public. Alternatively, the respective listing exchanges could require the company put the future of its dual share class structure to a shareholder vote – between years 5 and 7 of being public – where all minority shareholders would be given an equal vote to decide whether or not to extend the structure.

BlackRock recommends additional safeguards be included. These include specifying ‘trigger events’ – such as a founder retiring, passing away, or leaving for another reason – where the shares would automatically revert to one share one vote. Likewise, the transfer of ownership to a person or entity that is not actively involved in running the company should trigger one share one vote.

As academics, regulators, and practitioners alike contemplate corporate governance and investment stewardship today, they need to consider this growing phenomenon of dual share class companies.

The common ownership theory is flawed

Given the number of academic forums and papers that have focused on the theory of common ownership and the impact the proposed remedies would have on corporate governance, I would be remiss not to address some of the flaws in this theory in these remarks.

At the most basic level, it is disturbing to note that the data used in the seminal common ownership paper – generally referred to as ‘the airlines paper’ – is incorrect. The authors of the paper observed that the dataset of asset managers’ holdings had ‘zeros’ during periods of bankruptcy.³⁶ Not understanding why, they chose to override these zeros by repeating the last observed value of the respective asset managers’ holdings prior to the bankruptcy periods. However, when a company enters bankruptcy, its stock is delisted from the exchanges.

<https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac030818-investor-as-owner-subcommittee-recommendation.pdf>.

³⁴ “Dual-Class Shares: A Recipe for Disaster”, speech by SEC Investor Advocate Rick Fleming (Oct. 15, 2019). Available at: <https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster>.

³⁵ BlackRock, “Key considerations in the debate on differentiated voting rights”. Available at: <https://www.blackrock.com/corporate/literature/whitepaper/blackrock-the-debate-on-differentiated-voting-rights.pdf>.

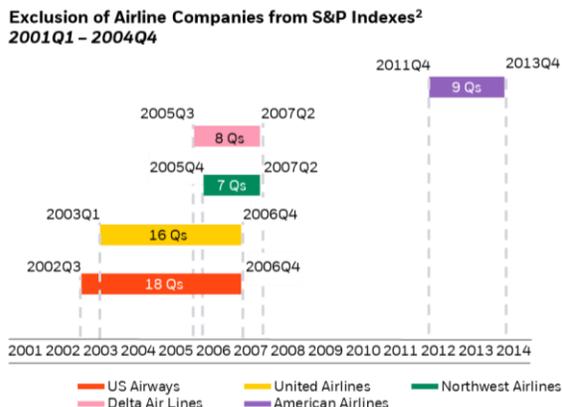
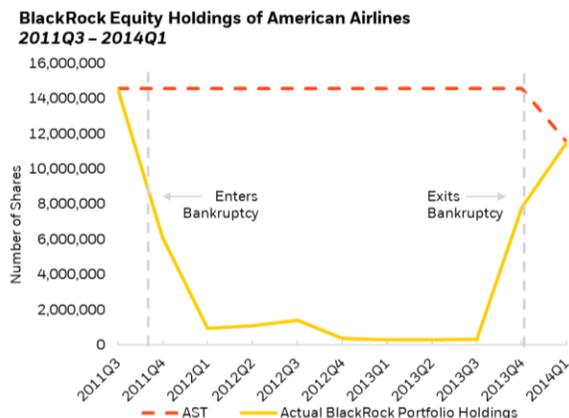
³⁶ José Azar, Martin Schmalz, and Isabel Tecu, “Anticompetitive Effects of Common Ownership”, Journal of Finance (2018). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2427345.

Subsequently, when a company is delisted, index providers remove the stock from their indexes, prompting index fund managers to sell the stock from their portfolios. Hence, the zeros found in the airlines paper’s dataset were correct.³⁷

Exhibit 10: Common ownership data is incorrect

“Holdings are not observed during bankruptcy periods. During the bankruptcies of American Airlines, Delta Airlines, Northwest Airlines, United Airlines, and US Airways, we repeat the last observed value for percentage of shares owned”

– Azar, Schmalz, and Tecu, “Anticompetitive Effects of Common Ownership”, page 16



Sources:

1. Airlines paper replication package; Thomson Reuters Spectrum; BlackRock internal data systems. The ‘Airlines Paper’ line is sourced from Thomson Reuters Spectrum and AST’s manually collected SEC Form 13F filings. Share counts are aggregated across separate BlackRock entities. Shares from 2011Q3 are ‘forward-filled’ for the bankruptcy period. The ‘Actual BlackRock Portfolio Holdings’ line for 2011Q4 - 2013Q4 is sourced from BlackRock’s internal data systems and includes shares in American Airlines that would be reported in SEC Form 13F by any of BlackRock’s entities. For quarters outside of the bankruptcy period, the values of the ‘Actual BlackRock Portfolio Holdings’ line are the same as the ‘Airlines Paper’ line.
2. SEC filings and S&P announcements.

In the example shown, the discrepancy is in the order of millions of shares, reflecting the difference between an actual ownership of less than .1% versus the authors’ assumption of 4.25%. Since five out of seven of the airlines in the study went through bankruptcies – which is an interesting point in itself – this is a significant data error that affected 28 out of 56 quarters in the study period, grossly misrepresenting the ownership of each of the large index fund managers.

In addition to the data being incorrect, a host of academic papers now challenge key aspects of the theory, including its treatment of the ‘control’ in bankruptcy; its conflation of financial incentives of asset owners and asset managers; and the appropriateness of its use of MHHI as a measure of common ownership.³⁸

Given numerous issues with the underlying research, it is quite surprising to see anyone suggest pursuing policy measures, especially measures that would be harmful to investors and

³⁷ BlackRock, Policy Spotlight: “Common Ownership Data is Incorrect” (Jan. 2019). Available at: <https://www.blackrock.com/corporate/literature/whitepaper/policy-spotlight-common-ownership-data-is-incorrect-january-2019.pdf>.

³⁸ Available at BlackRock’s Public Policy Common Ownership microsite at: <https://www.blackrock.com/corporate/insights/public-policy/common-ownership#third-party-publications>.

disruptive to the functioning of the real economy. As with dual share class structures, the corporate governance and investment stewardship implications of this debate must be considered.

Understanding the Regulatory Landscape

I would like to bring this discussion back to the practitioner’s perspective on investment stewardship – what it is and what it is not – and how this is informed by regulatory environment at present. While many people have ideas of what they would like investment stewardship to be, it is useful to start with an understanding of the relevant rules which have been established by the SEC, Department of Labor (DoL), and Federal Trade Commission (FTC).

Both the SEC and the DoL have weighed in on issuing voting guidance. In 2003, the SEC issued its proxy voting rule under the Advisers Act, outlining that investment advisers are required to adopt and implement policies to ensure they vote proxies according to their clients’ best interest.³⁹ Then in 2014, SEC Staff Legal Bulletin 20 clarified these duties.⁴⁰ In the recent guidance I mentioned earlier, the SEC clarified how managers can fulfill their duty to vote in their clients’ best interest, and how the scope of voting authority can be shaped (including the use of proxy advisors or not voting) through disclosure and informed consent.⁴¹

Exhibit 11: The stewardship regulatory landscape

Voting Guidance



Interpretations as to Engagement



While the SEC has oversight of mutual funds, the DoL has oversight of ERISA assets. In 1988, the DoL first indicated in the Avon Letter that voting is a plan asset, meaning that asset managers should generally vote shares as part of their fiduciary duty.⁴² This letter was

³⁹ See SEC, Final Rule: “Proxy Voting by Investment Advisers”, 68 Fed. Reg. 6585 (Feb. 7, 2003). Available at: <https://www.govinfo.gov/content/pkg/FR-2003-02-07/pdf/03-2952.pdf>.

⁴⁰ See SEC, Division of Investment Management, Division of Corporate Finance, Staff Legal Bulletin No. 20: “Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms. Available at: <https://www.sec.gov/interps/legal/cfsib20.htm>.

⁴¹ See SEC, “Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers”, 84 Fed. Reg. 47420 (Sep. 10, 2019). Available at: <https://www.govinfo.gov/content/pkg/FR-2019-09-10/pdf/2019-18342.pdf>.

⁴² See US Department of Labor (DoL), Letter from Deputy Assistant Secretary of Labor Alan D. Lebowitz to Chairman of the Retirement Board of Avon Products, Inc. Helmuth Fandl (Feb. 23, 1988), (“Avon Letter”).

followed with a series of interpretive guidance in 1994, 2008, 2016, and 2018, largely reaffirming this position.⁴³

Next, both the SEC and FTC have offered interpretations concerning engagement with companies. The SEC requires Schedule 13D filings when a shareholder reaches a 5% threshold of beneficial ownership in a company and has the intent to change or influence control of the company.⁴⁴ Recognizing that this is intended for activist situations, the SEC allows investors to instead file Schedule 13G when the shareholder is holding with passive intent.⁴⁵ 13G filings permit a beneficial owner to engage with management on governance, social and public interest topics as part of the investor's broad efforts to promote good practices across its portfolio investments. Eligibility to file Schedule 13G is a key reason why index fund managers do not coordinate voting of proxies, as doing so would require they file Schedule 13D instead.

The FTC (together with the DOJ) has jurisdiction over implementation of the Hart-Scott-Rodino ("HSR") Act, which sets notification requirements – including filing and a mandatory 30-day waiting period – for mergers, as well as the acquisition of voting shares of a company above a certain threshold of ownership. Similar to the SEC rules, HSR has an "investment only exemption" to these requirements, in cases where shares are acquired for investment purposes only.⁴⁶

BlackRock Investment Stewardship

At BlackRock, Investment Stewardship is part of our investment function, applying to both active and passive funds. 50% of the assets we manage are equity assets, and of these, 92% are index and 8% active.⁴⁷ The index assets closely track market indexes created by others, which means whether we like a company or not – including its management, its strategy, its products – we will still hold it in these portfolios. This is quite different than actively managed portfolios that can express displeasure by 'voting with their feet' and selling the stock. Given this long-term perspective, our investment stewardship activities are focused on maximizing long-term shareholder value.

BlackRock engages directly with companies to better understand their position and strategy on material corporate governance matters. BlackRock Investment Stewardship is now 45 persons strong – the largest and most global team in the industry – which reflects our commitment to deeper, more meaningful, and more productive engagements. These individuals are strategically located in the US, Europe, Hong Kong, Tokyo, Singapore, and Sydney to be closer to the markets and the companies we cover.

⁴³ See DoL, Interpretive Bulletin 94-2, 58 Fed. Reg. 38863 (Jul. 29, 1994); Available at: <https://www.govinfo.gov/content/pkg/CFR-2001-title29-vol9/pdf/CFR-2001-title29-vol9-sec2509-94-2.pdf>. DoL, Interpretive Bulletin 2008-02, 73 Fed. Reg. 61731 (Oct. 17, 2008); Available at: <https://www.govinfo.gov/content/pkg/FR-2008-10-17/pdf/E8-24552.pdf>. DoL, Interpretive Bulletin 2016-01, 81 Fed. Reg. 95879 (Dec. 29, 2016); Available at: <https://www.govinfo.gov/content/pkg/FR-2016-12-29/pdf/2016-31515.pdf>. DoL, Field Assistance Bulletin No. 2018-01 (Apr. 23, 2018), available at: <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01>.

⁴⁴ See 17 CFR 240.

⁴⁵ Ibid.

⁴⁶ See US Federal Trade Commission (FTC), "Investment-only means just that" (Aug. 24, 2015). Available at: <https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just>.

⁴⁷ BlackRock, 2019 3rd Quarter Earnings Release (Data as of Sep. 30, 2019). Available at: <https://ir.blackrock.com/Cache/1500124326.PDF?O=PDF&T=&Y=&D=&FID=1500124326&iid=4048287>.

Exhibit 12: Quantifying BlackRock's 2019 stewardship activities

1,458 total global companies engaged

2,050 total global engagements

155,131 total global ballot items

16,124 total global meetings voted

Voted FOR a dissident candidate in **40%** of US proxy contests

Supported **28%** of dissident candidates at US proxy contests

Source: BlackRock Investment Stewardship 2018-2019 Annual Report.

In the 2018-19 N-PX year, BlackRock Investment Stewardship held 2,050 engagements with 1,458 companies based in 42 markets, and we voted on 155,131 global ballot items over 16,124 global meetings.⁴⁸

While some people think index fund managers 'always support' one side, the data shows sometimes we support dissidents and sometimes we don't. For example, during this same period, we voted 'FOR' a dissident candidate in 40% of US proxy contests (i.e., 4 out of 10 proxy contests), and we supported 28% of dissident candidates (i.e., 8 out of 29 seats).⁴⁹ Think of this as 'the law of small numbers', given the small sample size.

Simply put, by engaging directly with companies and other interested parties, we develop a better understanding of the companies and make more informed voting decisions.

Commitment to transparency

A few weeks ago, when I participated in the Harvard-PIFS roundtable "The Rise of Passive Investing: Corporate Governance, Systemic Risk and Index Construction", Lucian asserted that index fund managers are not sufficiently vocal on policy issues, and John suggested that asset managers work too secretively. I took exception with both statements then, and I will take the opportunity today to elaborate.

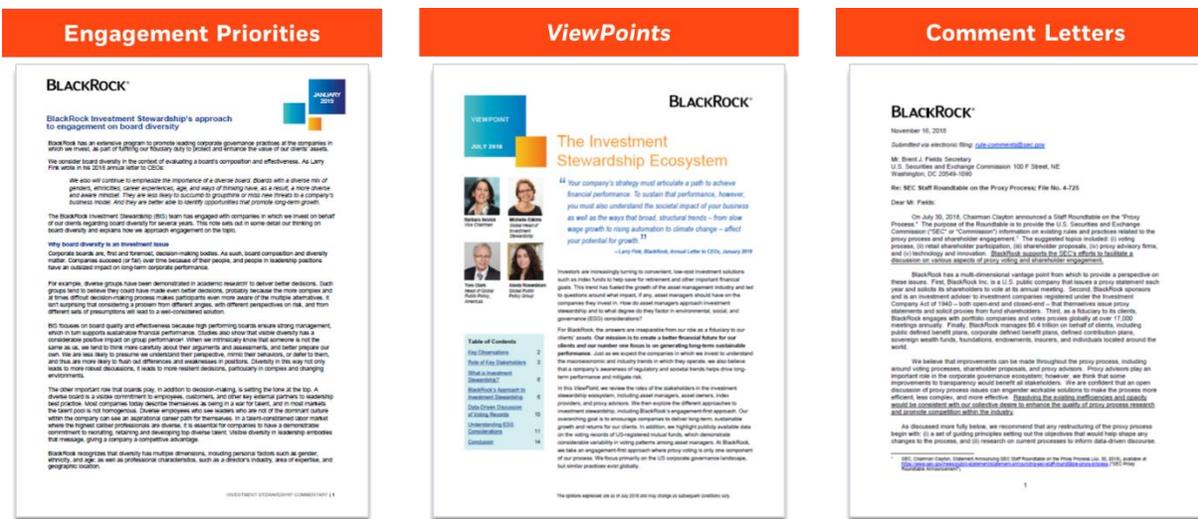
BlackRock is committed to providing a high level of transparency around our investment stewardship activities. On the BlackRock Investment Stewardship site, we have posted approximately 70 documents, including engagement priorities, voting guidelines for multiple

⁴⁸ BlackRock, "2019 Investment Stewardship Annual Report".

⁴⁹ Ibid.

markets, commentaries on special topics, quarterly and annual reports, voting data, whitepapers, and comment letters. And that is before counting market structure, investment products, or other topics that we address on our Global Public Policy site.

Exhibit 13: BlackRock stewardship publications



For companies and clients, this means they can easily see the issues we are focused on. To put this in perspective, here are the Engagement priorities for 2019:⁵⁰

1. Governance – Board quality & effectiveness
2. Corporate Strategy and Capital Allocation
3. Compensation that Promotes Long-Termism
4. Environmental Risks and Opportunities
5. Human Capital Management

Each of our engagement priorities is explained in more detail on our site, including in many cases examples of our engagement questions. Likewise, the quarterly and annual reports we publish provide insights into our engagements with companies and our voting statistics. Our clients – the end investors – find these reports useful in understanding and monitoring our investment stewardship activities. In recognition of our efforts, in 2018, BlackRock won ICGN's Global Stewardship Disclosure Award for asset managers, and that was before we enhanced our website.⁵¹

I encourage you to look at our materials as well as those you can find on Vanguard, State Street, TIAA, and JP Morgan Asset Management's respective websites.⁵² There is a wealth of information available if you want to learn more about investment stewardship.

⁵⁰ BlackRock, "BlackRock Investment Stewardship Engagement Priorities for 2019" (Jan. 2019). Available at: <https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf>.

⁵¹ See, ICGN, "ICGN 2018 Global Stewardship Awards". Available at: <https://www.icgn.org/winners>.

⁵² Vanguard Investment Stewardship website: <https://about.vanguard.com/investment-stewardship/>. State Street Global Advisors Asset Stewardship website: <https://www.ssga.com/eu/qb/institutional-investor/en/about-us/asset-stewardship.html>. TIAA Stewardship website: <https://www.tiaa.org/public/about-tiaa/corporate-social-responsibility/stewardship-corporate-governance>. JP Morgan Asset Management, "Investment Perspectives on

Profits and Purpose are inextricably linked

BlackRock's stewardship activities play a critical part in delivering what we see as our corporate purpose: delivering financial well-being to our clients. Sometimes we get into discussions about "Friedman" vs. "Fink". However, at BlackRock, we see profit and purpose as inextricably linked.

Exhibit 14: Profit and purpose



**Profits are in no way inconsistent
with purpose..."**

Larry Fink

2019 CEO Letter

Factoring in stakeholders such as employees and clients makes good business sense. In a world of low unemployment, companies that treat their employees well will likely experience lower turnover and less costs associated with recruiting and training. Likewise, having long-term customers who make repeat purchases and recommend you to others is a strong positive for the bottom line. And, if you are wondering about communities as a key stakeholder, the Vale mine tragedy in Brazil should be a wakeup call to the importance of being allowed to operate based in part by how you treat the communities in which you work. I doubt Milton Friedman would disagree. In September, the Business Roundtable released its statement on the purpose of a corporation, reflecting the need for companies to consider multiple stakeholders, and signed by 181 CEOs.⁵³

Investment stewardship is about encouraging companies to focus on the long-term implications of their decisions with a goal of creating sustainable returns for shareholders. It is not about making social decisions. Our engagement emphasizes issues that we believe have a material impact on a specific company and its ability to deliver long-term shareholder value. For two years now, in our stewardship activities we have been speaking to companies about corporate purpose and how it aligns with corporate strategy, seeking to understand how a company's purpose informs its strategy, not to tell a company what its purpose ought to be. We see this as an extension of our fiduciary duty, and not a means for imposing social values.

Corporate Engagement & Proxy Voting": <https://am.jpmorgan.com/us/institutional/library/corporate-engagement-proxy-voting>.

⁵³ Business Roundtable, "Statement on the Purpose of a Corporation", Aug. 19, 2019. Available at: <https://opportunity.businessroundtable.org/wp-content/uploads/2019/09/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-1.pdf>.

Engaging on Environmental and Social Issues

Given the increasing attention on Environmental and Social (or ‘E&S’) issues, I would like to touch on BlackRock’s investment stewardship approach in this area. First, BlackRock has identified “Environmental Risks and Opportunities” as one of our five engagement priorities.⁵⁴

As with all of our engagements, BlackRock is focused on issues that could have a material impact on the companies we invest in on behalf of our clients. While E&S is language that can imply something separated or siloed from how a business is run, BlackRock looks at these issues as core to business operations and as areas presenting new opportunities. We find that sound practices in relation to material E&S factors can signal operational excellence and management quality. We also find that factors with long-term financial relevance tend to have impact over time and be industry specific.

While there are numerous frameworks and surveys and ratings, we have embraced SASB’s approach, which is industry-specific.⁵⁵ BlackRock’s engagement on material E&S factors has four main components: (i) governance, (ii) strategy, (iii) risk management, and (iv) metrics and targets. These four pillars are also the conceptual framework underpinning the recommendations of the Financial Stability Board’s Taskforce on Climate-related Financial Disclosures (TCFD), which we participated in developing.⁵⁶

Exhibit 15: Framework for environmental and social engagement



When a sector or a company faces a specific risk or development, BlackRock will engage the companies concerned to better understand how their board and management are addressing the situation and what governance and business practices are in place to mitigate the risks involved. Depending on what we learn, we may continue to engage and give the company time to address these issues, we may vote against one or more directors, or we may vote in favor of a shareholder proposal. Each situation is different and requires careful analysis.

⁵⁴ BlackRock, “BlackRock Investment Stewardship Engagement Priorities for 2019”.

⁵⁵ See Sustainability Accounting Standards Board, “Standards Overview”. Available at: <https://www.sasb.org/standards-overview/>.

⁵⁶ For more information see Task Force on Climate-Related Financial Disclosure (TCFD), “Publications”. Available at: <https://www.fsb-tcfid.org/publications/>.

Conclusion

Corporate governance and investment stewardship are important pillars of our economy and our capital markets. This is recognized globally, as evidenced by two decades of encouraging managers to be active stewards. Today, there are more than twenty stewardship codes across various jurisdictions.

Exhibit 15: Global stewardship codes

Representative Stewardship Codes	
Australia	Australian Asset Owner Stewardship Code
Canada	Canadian Coalition for Good Governance Stewardship Principles
Japan	Japan's Stewardship Code
The Netherlands	Eumedion Dutch Stewardship Code
OECD	G20/OECD Principles of Corporate Governance
South Africa	South Africa Code on Responsible Investing
United Kingdom	The Financial Reporting Council's UK Stewardship Code

The increased focus on stewardship has led to more transparency and, in turn, has spawned new research asking critical question: Do asset managers do *enough*? Do they do *too much*? Or, are they doing *just the right amount*? Let's call this the Goldilocks Dilemma.

To answer this question, one must recognize that asset managers represent a minority interest in any given company, and they engage and vote independently of each other to promote the economic interests of their clients, the asset owners. Key to this question is also an understanding of the roles of company management and boards of directors, and their responsibility to *all* shareholders. Plus, the stewardship regulatory environment, specific to each country, adds another layer of complexity in answering these questions.

As I have discussed, these debates need to be grounded in good data. Given the importance of compensation consultants and proxy advisors, their roles and influence also need to be factored into any future research.

We welcome what I'm sure will be a spirited and thought-provoking discussion on these issues.

Important Notes:

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