BlackRock

30th April 2019

Mark Manning
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Submitted via email to: dp19-01@fca.org.uk

RE: DP19/1: Building a regulatory framework for effective stewardship

Dear Mark,

BlackRock[1] is pleased to have the opportunity to respond to Discussion Paper DP19/1: Building a regulatory framework for effective stewardship, issued jointly by the Financial Conduct Authority and the Financial Reporting Council (the Discussion Paper).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this discussion paper and will continue to contribute to the thinking of the FCA on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours sincerely,

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive summary

We believe that the Discussion Paper raises some important questions about the ways in which investors can undertake effective stewardship and what challenges they might face in doing so.

As explained in more detail in this response, we have some concerns about the definition of stewardship that is proposed in the Discussion Paper. While we support the desire to evolve the definition in a way that speaks to both asset owners and asset managers, we believe it should reflect a view of stewardship that more clearly differentiates between the two. It also needs to respect the fact that investors (including both asset owners and asset managers) demonstrate stewardship in different ways appropriate to their role and the choice of investment strategy or asset class. We operate in a diverse industry, and we would question how the industry could maintain aspects of this diversity if regulation sought to focus stewardship efforts in particular areas or on specific issues.

The Discussion Paper suggests that action might need to be taken to limit some differences in approach if those differences lead to certain investors pursuing stewardship activities that are not as effective as those undertaken by other investors. We explain in this response why we do not recognise this as an issue in practice. In particular, we see no problematic differences between approaches taken by alpha-seeking (often referred to as actively managed) strategies and index strategies, which the Discussion Paper raises as a possible concern. BlackRock's own experience is that investors in index strategies are committed to meaningful engagement with companies precisely because they cannot express dissatisfaction with an investment by selling it.

BlackRock ultimately takes the view that, while there is no single way to exercise effective stewardship, there are key principles that all investors (regardless of investment strategy) can draw on in their pursuit of effective stewardship. As we elaborate on below, we broadly agree with the attributes of stewardship noted in the Discussion Paper. Our view is that adherence to these key principles can be encouraged primarily through industry-led codes such as the Stewardship Code, although we see a role for certain minimum standards to be embedded through formal regulation.

In developing such standards and principles, it is important to be clear on what investors can look to achieve through their stewardship activities. The effectiveness of engagement activities fundamentally relies on the responsiveness of the boards and management of companies. They, not shareholders, direct the company's business and determine how to address any feedback that is expressed through engagement or voting. Investors play an important role in encouraging companies to evolve their practices in areas like corporate governance, but it should not be assumed that effective stewardship alone can prevent corporate failures.

Responses to questions

Q1: Do you agree with the definition of stewardship set out here? If not, what alternative definition would you suggest?

The definition of stewardship proposed in the Discussion Paper, which focuses on creating sustainable value for beneficiaries, the economy, and society is not in our view consistent with the fact that some parties have a primary duty to their clients. Asset managers, for example, have a duty to their clients to put their interests first. Stewardship – which we perform on behalf of our clients, the beneficiaries of holdings in these companies – should not be defined in a way that seeks to re-balance the investment landscape by giving equal

importance to society, the broader economy, and beneficiaries. For this reason, our suggested definition of stewardship (below) retains a focus on beneficiaries, while also recognising that effective stewardship (which supports long-term value creation) may benefit society and the economy.

In his 2019 letter to the CEOs of our investee companies, our Chairman and CEO, Larry Fink, articulated BlackRock's view that many societal issues cannot be solved without corporate leadership. We believe that companies that fulfil their purpose and responsibilities to stakeholders (employees, customers and communities as well as shareholders) reap rewards over the long-term. In our stewardship work, we speak to companies about their corporate purpose, how this informs their strategy and culture and how ultimately this underpins a long-term approach in their businesses. However, the direct aim of stewardship is not, in our view, to seek such benefits for society and the economy.

In addition, the proposed definition of stewardship also makes reference to "*responsible allocation… of capital*". We have some concerns with the way this aspect of the definition is framed. It is important to consider how this might apply in different ways to asset owners and asset managers, and also how the relationship between asset owners and asset managers will influence their respective approaches to stewardship.

Asset owners are primarily responsible for asset allocation and selection of investment strategies. One might therefore conclude that the reference to responsible allocation of capital in the context of asset owners means them having to make their asset allocation and investment strategy decisions deliberately to achieve a 'responsible' outcome. This presents certain difficulties, in our view, as there is unlikely to be consensus on what constitutes a 'responsible' outcome, leaving uncertainty as to how assets should be invested.

Asset managers, by contrast, are concerned with the investment process (encompassing investment decision-making and the activities carried out during the life of an investment), which is managed according to the mandates they are given by their clients (the asset owners). If the responsible allocation of capital in this context means the integration of stewardship insights at the point an investment decision is made on behalf of a client, we do not see this as universally applicable. The relevance of stewardship insights to the investment decision is dependent on the investment strategy and key parameters chosen by clients, who as a group will have a diverse range of desired approaches that need to be respected by their asset managers.

Given this range of potential investment approaches, there are practical differences between how stewardship insights can be integrated into them. One clear difference is that between index-tracking strategies and actively managed strategies. In the former case, there is an important role for stewardship to play during the life of an investment in meeting the expectations of clients, as there is no option to sell a security while it remains a constituent of the index, even if there is dissatisfaction with that investment. Asset managers have no discretion to decide on the constituents of an index chosen by the asset owner – the rules on what is to be included within a given index are determined by the index provider (for example, FTSE Russell, MSCI or Standard & Poor's). In the case of actively managed strategies, asset managers are able, within the key parameters set by their client, to decide which securities to make allocations to, and may (depending on the mandate they have from their client) draw on insights designed to make the investment more 'responsible' (for example, by favouring investments with specific social goals). Different clients will have different expectations in this respect, though, and it may be the case that their preferred approach is to prioritise other goals – including selling investments that they are dissatisfied with rather than engaging in stewardship activities over the longer-term.

We therefore recommend that any definition of stewardship is flexible enough to account for the differences in the roles of asset owners and asset managers. Our suggested definition of stewardship is:

> *Stewardship is looking after the assets of beneficiaries that have been entrusted to the care of others in a way that protects and enhances the value of those assets. This involves, on the part of asset owners, appropriate allocation of the assets and, on the part of asset managers, close and continuous oversight of investments. Effective stewardship is likely to lead to long-term benefits for society and the economy.*

Q2: Are there any particular areas which you consider that investors' effective stewardship should focus on to help improve outcomes for the benefit of beneficiaries, the economy and society (eg ESG outcomes, innovative R&D, sustainability in operations, executive pay)?

As discussed under Question 1, we do not believe it is the purpose of stewardship to directly seek outcomes that benefit the economy and society, however we expect that encouraging long-term value creation is likely to lead, in the long term, to these benefits.

We also consider that flexibility is an important facet of effective stewardship. We perceive there to be a variety of issues that different investors consider to be material when allocating capital. The relative importance of issues can similarly change over time, as the corporate landscape evolves and investors adjust their focus. Any expectation that stewardship activities focus on specific issues defined in regulation or codes may constrain investor choice in this respect, and such an approach is unlikely to be able to remain in step with evolving concerns.

Taking the example of environmental, social and governance (ESG) factors: BlackRock works to broaden and deepen its understanding of, and – where relevant and to the extent possible (i.e. in line with clients' expectations and where feasible given the particular investment strategy) – the integration of sustainability-related insights and data into the investment process across all investment teams. Our approach is to incorporate information that is considered material to a particular investment (which we believe should include material ESG-related information) so far as that is consistent with the client's or fund's risk and return objectives (which will in turn depend on the nature of the investment strategy the client chooses).

Ultimately, however, while asset managers may seek to consider ESG-related drivers of long-term financial value in the execution of their mandates, the factors to be analysed are continually developing as different information becomes available. Equally, the final decision as to which social, environmental or ethical values are appropriate for their investment portfolio remains with the asset owner (based on the degree of alignment with their investment policy). Managing assets according to the client's mandate is the essence of the duty always to act in the best interests of the client.

Q3: To what extent do the proposed key attributes capture what constitutes effective stewardship? Which attributes do you consider to be most important? Are there other attributes that we should consider? If so, please describe.

As alluded to above, BlackRock agrees with the comment in the Discussion Paper that there is no single way to exercise effective stewardship, but we do believe that there are common threads which together support the pursuit of effective stewardship. We broadly agree with the attributes of effective stewardship set out in the Discussion Paper, which we discuss in turn below.

A clear purpose

As set out by our Chairman and CEO, Larry Fink, in his 2019 letter to the CEOs of our investee companies, BlackRock believes that a company's success begins with a clear embodiment of its purpose in its business model and corporate strategy. We see purpose as a company's fundamental reason for being – what it does every day to create value for its stakeholders. On behalf of BlackRock's clients, the shareholders in the companies in which we invest, we look to understand the companies' strategic framework for long-term value creation and expect this to have been reviewed by the companies' boards.

BlackRock's own purpose is to help more and more people experience financial well-being. We see a strong alignment between this and our stewardship activities, which are focused on protecting and enhancing the long-term economic value of our clients' assets through engagement (including proxy voting) with the companies we invest in on their behalf. The priority we give to our stewardship activities can be seen in the continued investment in BlackRock's Investment Stewardship team (which was discussed in Mr Fink's letter to CEOs in 2018), which we believe will foster even more effective engagement with companies.

As regards the reference in the Discussion Paper to asset managers exercising stewardship across asset classes and across international portfolio holdings, please see our response to question 4 below.

Constructive oversight, engagement, and challenge

As discussed in detail in a number of BlackRock's publicly available materials on its approach to stewardship,[2] we believe that this is a core part of stewardship. Engagement helps us assess a company's approach to governance and related factors in the context of its specific circumstances.

BlackRock's Investment Stewardship team seeks to engage in a constructive manner with companies. Our aim is to build mutual understanding and to ask probing questions, not to tell companies what to do. Where we believe a company's business or governance practices fall short, we explain our concerns and expectations, and then allow time for a considered response. BlackRock has an engagement-first approach to stewardship. As a long-term investor, we are willing to be patient with companies when we see through our engagement that they are working to address our concerns. However, our patience is not infinite – when we do not see progress despite ongoing engagement, or companies are insufficiently responsive to our efforts to protect the long-term economic interests of our clients, we will exercise our right to vote against management recommendations.

Our views on the integration of stewardship insights into investment decision-making are already noted above in our responses to questions 1 and 2 above.

Culture and institutional structures that support effective stewardship

We support the ambition to foster an industry-wide culture of stewardship in which stewardship activities across the investment community are appropriately aligned with clients' and beneficiaries' financial interests over their chosen investment time horizon. We also agree that the culture of the institutions involved and their own governance structures are important factors in this.

[2] More information on BlackRock's approach to investment stewardship can be found on our Investment Stewardship website, our Global Corporate Governance Guidelines and Engagement Principles, and our Statement on compliance with the UK Stewardship Code

In our view, one key aspect is the appropriate management of potential conflicts of interest. BlackRock's commitment to managing such conflicts (or perceived conflicts) is explained in the publicly available materials referenced above. BlackRock's Investment Stewardship team maintains a number of policies and procedures that seek to prevent undue influence on BlackRock's proxy voting activity.

Disclosure and transparency of stewardship

We support transparency within stewardship, and BlackRock is committed to the appropriate disclosure of our approach and our activities.

We believe it is important to ensure that investors (both asset owners and asset managers) are first and foremost transparent on their approach to stewardship. As we expand on below in response to questions 4 and 5, this includes explaining the resources they employ, how they are employed (i.e. the activities through which they exercise stewardship over assets) and the universe of assets to which their approach is applied.

We currently inform clients about our engagement and voting policies and activities through direct communication. In addition, we publish a significant amount of information about our stewardship approach and activities to our website (as referenced above). In all regions, we publish our engagement priorities and our voting guidelines. On a quarterly basis, we publish regional reports which provide an overview of our investment stewardship engagement and voting activities during the quarter, including market developments, speaking engagements, and engagement and voting statistics. Each year we publish an annual report, an annual engagement and voting statistics report and our full voting record.

Our approach seeks to provide a balanced mix of public and private reporting, reflecting our fundamental belief that keeping the details of our engagements with issuers private between the asset manager and the asset owner builds the trust necessary to support effective dialogue. We believe it is important to make a distinction between what can reasonably be made public without undermining the trust on which engagement is based, and what is best kept private between the parties in order to encourage change.

Q4: What do you think is the appropriate institutional, geographical and asset class scope of stewardship? How can challenges associated with issues such as the coordination of stewardship activities across asset classes, or the exercise of effective stewardship across borders, be overcome?

BlackRock is a global firm that combines the benefits of worldwide reach with local service and relationships. Consistent with that global approach, we believe there are overarching principles of corporate governance that apply globally and provide a framework for more detailed, market-specific assessments. As a result, BlackRock's engagement priorities and principles (discussed in response to question 5 below) are set globally.

Strategically located in BlackRock's US, European, Japan, Singapore, Hong Kong and Australia offices, the BlackRock Investment Stewardship team uses its scope to facilitate constructive dialogue with portfolio companies and contribute to the global discourse on stewardship. From our perspective, effective and meaningful corporate governance requires a global team in order to build a deep understanding of the risks and opportunities of our portfolio companies across markets, regions, and sectors. At the same time, we recognise the need to understand the local market's culture and regulatory environment (including local stewardship codes) and can seek to achieve this understanding through our local presence (as part of the wider global team). We feel this approach gives the team credibility with companies and clients as we understand the context within which they operate and are part of their ecosystem.

In determining the appropriate asset class scope of stewardship, it is important to acknowledge the inherent differences between the rights (and potential influence) owners of certain securities have compared to others. Shareholders in public companies, for instance, have effective voting rights on a variety of issues impacting those companies, and opportunities for meaningful engagement and dialogue with them. Whilst such opportunities may exist for investors other asset classes to some extent – for example, at the point of investment in a bond offering – the same dynamic will not exist within engagement relating to such investments. Fundamentally, bondholders do not have equivalent voting rights to shareholders and vote only in exceptional circumstances. We therefore take the view that a flexible approach needs to be adopted to stewardship across different asset classes, that different situations may require different stakeholders to be involved, and that there is consequently a need to avoid a one-size-fits-all approach.

Q5: We welcome examples of how firms with different objectives and investment strategies approach stewardship. In particular, we welcome input on how stewardship practices differ across active and index-tracker funds, in the following areas:

- ***i. How firms prioritise and conduct stewardship engagements***
- ***ii. What investments firms have made in stewardship resources***
- ***iii. How stewardship activity is integrated in investment decisions.***

BlackRock's investment stewardship efforts, which includes our direct engagement and voting activities, aim to ensure companies deliver long-term, sustainable growth and returns for our clients. We do not vary our approach to engaging based on the investment strategy – in other words, our engagement work is 'mandate neutral'. Our fundamental underlying goal is clearly relevant to all clients and means that in its engagement activities BlackRock's Investment Stewardship team engages with companies on behalf of clients invested in both alpha-seeking and index strategies.

As regards voting, BlackRock's portfolio managers in alpha-seeking strategies nonetheless have full discretion to vote the shares in the portfolios they manage based on their analysis of the economic impact of a particular ballot item. What is best for an investment/client when it comes to a specific voting item can vary from portfolio to portfolio, and as a result portfolio managers may from time to time reach differing views on how best to maximise economic value with respect to a particular investment. Portfolio managers may, and sometimes do, vote shares in the portfolios under their management differently from one another. However, because BlackRock's clients are mostly long-term investors with long-term financial goals, ballots are frequently cast in a uniform manner.

As discussed in more detail below in response to question 6, we would question the perception that there are differences between firms managing alpha-seeking and index strategies based on apparently different incentives and abilities to conduct engagement. This is not our experience of what is happening in practice.[3] More than investment strategy, the decision whether to carry out stewardship activities in-house; or to outsource to a proxy adviser; or to carry out a blend of both will, in our view, have a greater impact on a firm's approach, the extent and depth of their activities and the resources committed to stewardship.

[3] It is also not the conclusion reached by Professor John Kay in his Review of UK Equity Markets and Long-Term Decision Making. At page 39 of his Interim Report (February 2012), Professor Kay noted in relation to large firm managing index strategies: "*We were in no doubt that these companies took corporate engagement seriously. They have the scale to mount engagement activities at a cost which is a very small fraction of their funds – passive or active – under management.*" The Interim Report is available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31544/12-631-kay-review-of-equity-markets-interim-report.pdf.

Prioritising and conducting engagement

We prioritise our stewardship engagements through an in-depth analysis of which companies present material risk to long-term returns for our clients and according to a globally agreed set of investment stewardship engagement priorities. Our corporate governance and engagement principles and the related market-level voting guidelines set out the governance practices BlackRock considers to be supportive of long-term value creation by companies. Our engagement promotes the adoption of these practices. We do this at the market level by engaging in the public policy debate and at the company level through direct dialogue and voting.

We engage with companies for five main reasons:

- We are preparing to vote at the company's shareholder meeting and need to clarify the information in company disclosures.
- There has been an event at the company that has impacted its performance or may impact long-term company value.
- The company is in a sector or market where there is a thematic governance issue material to shareholder value.
- Our corporate governance risk analysis has identified the company as lagging its peers on environmental, social or governance matters that may impact long-term value.
- A company requests a meeting to discuss substantive governance matters.

Through engagement, we seek to evaluate how companies manage the material sustainability-related risks and opportunities within their businesses, and we believe that engagement helps build mutual understanding on any issues where we are concerned that a company's practices fall short. It also helps us assess a company's approach to governance and other material issues in the context of its specific circumstances.

BlackRock has developed a set of engagement priorities which help to guide and shape our ongoing evaluation of companies. The priorities have evolved in line with market norms and emerging practice and are reviewed regularly. Some governance issues factored into the priorities are perennial, such as board quality and performance, although the areas of focus may change over time. Other priorities continue to evolve and are informed by regulatory and other market developments.

BlackRock's investment stewardship engagement priorities in 2019 are:

- Governance – board composition, effectiveness, diversity, and accountability remain top priorities.
- Corporate strategy and capital allocation – a clear articulation of corporate strategy and capital allocation provide a clear sense of the direction a company intends to take.
- Compensation that promotes long-termism – executive pay policies and outcomes should link closely to long-term strategy, goals and performance.
- Environmental risks and opportunities – disclosure provides enhanced understanding of board and management oversight of policies, risk factors and opportunities that drive long term financial performance.
- Human capital management – in a talent constrained environment, companies should focus on sound business practices that create an engaged and stable workforce.

As noted above, BlackRock takes an engagement-first approach, emphasising direct dialogue with companies on issues that have a material impact on financial performance. We generally prefer to engage in the first instance where we have concerns and give

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management time to address or resolve the issue. As a long-term investor, we are patient and persistent in working with our portfolio companies to have an open dialogue and develop mutual understanding of governance matters, to promote the adoption of best practices and to assess the merits of a company's approach to its governance. Engagement is therefore not one communication or conversation. We have ongoing private dialogue with companies year on year to explain our views and how we evaluate their actions on relevant issues over time. Where we have concerns that are not addressed by these conversations, we stand ready to vote against proposals from management or the board with a view to holding the company or board accountable.

Stewardship resources and integration into the investment process

The longer-term nature of this approach helps to explain the priority BlackRock gives to our stewardship activities and the resources that are allocated to them. Our Chairman and CEO, Larry Fink, specifically referred in his letter to CEOs in 2018 to increased investment in BlackRock's Investment Stewardship team, which we believe will continue fostering effective engagement with companies. In the last year on which we reported (1 July 2017 to 30 June 2018, we held over 2,000 company engagements, voted at over 17,000 meetings in approximately 90 markets, and participate actively in over 30 global, regional and market-level organisations and initiatives to advance good practice and to share perspectives on ESG integration and stewardship.[4]

Our resources also mean that the Investment Stewardship team can, where relevant and to the extent possible, work with colleagues investing in companies to analyse the material ESG factors relevant to their investment decision-making. Our investment stewardship efforts benefit from firm-wide data and insights on sustainability-related factors, and (again, where relevant and to the extent possible) our investment teams benefit from the sustainability insights derived from our stewardship activities – a powerful, positive feedback loop. As already discussed above, the point at which stewardship insights are relevant and possible to integrate in the investment process will largely depend on the asset class and investment strategy in question. We believe, for example, that there is an especially important role for stewardship to play in meeting the expectations of clients investing via index strategies, because there is no option to sell a security if you are dissatisfied with that investment. Stewardship can be, and is, performed therefore during the on-going management of the investment.

BlackRock's commitment to the broader integration of sustainability insights in the investment process is also clear from our statement on ESG integration.[5] This explains our ESG integration philosophy, discusses the roles and responsibilities for ESG integration work and the governance structure for these activities, and provides an overview of BlackRock's approach to ESG integration. This statement applies to all investment divisions and investment teams at the firm.

Q6: To what extent do you agree with the key barriers to achieving effective stewardship identified in this DP? What do you believe are the most significant challenges in achieving effective stewardship? We would particularly welcome views on the investment required to embed effective stewardship in investment decision-making.

BlackRock recognises a number of the challenges to effective stewardship that are noted in the Discussion Paper. One particular issue on which we see room for development concerns the standardisation of information flows, particularly material information on ESG topics that is provided by issuers.

[4] Further details of which can be found on our website, as referenced above.
[5] https://www.blackrock.com/corporate/literature/publication/blk-esg-investment-statement-web.pdf.

ESG data is improving due to technology and increased focus on transparency and disclosure, however the data is still a work in progress. More companies are developing reporting on sustainability issues, but the quality varies and we continue to see a lack of a standardised approach. That said, technology is enabling better access and processing of ESG data. At BlackRock, we are leveraging our technology platform to identify sustainability issues that are material investment considerations, and we are using big-data techniques to improve data quality and coverage. Greater consistency of approach within the issuer community would greatly improve our ability to utilise the data – something which could be aided by the further development and implementation of frameworks such as the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB).

We consider other issues raised in the Discussion Paper as potential challenges to be less compelling – in particular, the question of whether different investment strategies drive different approaches to stewardship, and whether as a result the use of one particular strategy rather than another could be a barrier to effective stewardship. The perception of differences in the approaches taken by actively managed strategies and index strategies that the Discussion Paper highlights (referencing research that suggests there may be differences in incentives and abilities to engage in "*deep*" engagement) is not, in our view, borne out by what is happening in practice.

In some cases, companies may choose to engage with alpha-seeking managers as they value the relationship and take a long-term perspective; in other cases, companies may prefer it if those managers sell rather than continue to hold their shares if they are not supportive of management. This reflects the fact that, if an alpha-seeking manager is unhappy with the management of a given company, they can reduce their position or sell the company's shares entirely, which may ultimately reduce their incentive to engage meaningfully and over a long period of time with the company. As a result, it is difficult to generalise about stewardship in alpha-seeking portfolios.

In contrast, an index fund will hold a stock for as long as it remains in the benchmark, which in practice makes them truly long-term investors. Index fund managers engage with companies and vote their proxies in order to express their views, focusing on the long-term value of the company. We recognise that some question the impact that index investors can have given they cannot sell their holdings. However, from BlackRock's perspective where we manage index strategies for our clients, it is precisely because we cannot sell that we are so committed to engagement. BlackRock can be persistent in its feedback, potentially well beyond the tenure of the current board and management, through which we aim to encourage changes in practice that enhance the long-term financial value of the company. 'In-depth' engagement may be necessary in order for this feedback process to be successful (although it is worth noting again that it remains for the boards and management of companies to determine how to address such feedback, with shareholders ultimately able to hold them to account through voting). Equally, given the importance of stewardship activities in creating long-term value within index holdings (in the absence of the ability to sell), it does not necessarily follow that index managers will not put the same level of resources into those activities as alpha-seeking managers. We therefore do not agree that index investors are in fact incentivised to avoid 'intensive' dialogue in favour of more 'routine' engagement, or do not have the ability to conduct in-depth engagement. We believe that the inverse is closer to reality.

Q7: To what extent do you consider that the proposed balance between regulatory rules and the Stewardship Code will raise stewardship standards and encourage a market for effective stewardship?

We believe there are genuine benefits to introducing minimum standards through regulation (such as the implementation of the Shareholder Rights Directive II (SRD II)), while seeking to advance best practice in the market through voluntary codes such as the Stewardship Code. The introduction of additional regulation with the goal of driving higher standards could in our view have unintended consequences, in the sense that it may create a different but less flexible set of expectations which in turn encourage a more compliance-driven approach to stewardship. We see advantages in industry-driven initiatives under which broad principles of best practice are articulated, and different signatories have the opportunity to take a variety of approaches that they can then explain to their relevant stakeholders. It is for these stakeholders ultimately to determine the quality of firms' approaches and their success in demonstrating adherence to the broad principles that have been articulated.

Similarly, as noted above in response to question 2, our experience is that governance and stewardship practice evolves over time. We see industry or practitioner-driven initiatives as being better placed to evolve in response to changing practice than regulation tends to be.

Q8: To what extent are there are issues with proxy advisers that are not adequately addressed by SRD II and proposed revisions to the Stewardship Code?

We are aware of the view of some commentators that proxy advisers have significant influence in the stewardship context. Specifically, it has been estimated that recommendations by proxy advisers can determine between 15% and 25% of a vote.[6] We therefore understand the desire for greater transparency on the part of proxy advisers, which is what SRD II and the proposed revisions to the Stewardship Code envisage. We believe it is too early to tell whether such changes will address the concerns that have been expressed to date around the role of proxy advisers in this area.

Our experience is that the largest asset managers do not 'follow' proxy adviser recommendations.[7] BlackRock uses data from proxy advisers as one of several inputs into our decision, evaluating each proposal on its own merits, in conjunction with our region-specific guidelines.

Q9: We welcome feedback on other specific aspects of the regulatory framework described above. In particular, we are interested in views on:

- ***i. Whether and to what extent the FCA's proposed rules for asset owners should be extended to SIPP operators?***
- ***ii. The case for regulatory rules to expand the reach of stewardship beyond listed equity***
- ***iii. Whether there is a role for UK regulators in encouraging overseas investors to engage in stewardship for their asset holdings in the UK***
- ***iv. The extent to which additional rules might be necessary either to improve stewardship quality or prevent behaviours that might not be conducive to effective stewardship***
- ***v. For differences between active and index-tracker strategies in the practice of stewardship, whether there are particular regulatory actions we should consider to address any perceived harms***

[6] Nadya Malenko and Yao Shen, Boston College, The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design (August 2016), available at: https://www2.bc.edu/nadya-malenko/Malenko,Shen%20(RFS%202016).pdf.

[7] We refer to the findings set out in BlackRock's Viewpoint entitled The Investment Stewardship Ecosystem (July 2018), available at: https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf.

vi. Whether the FCA's proposed rules to implement certain provisions of SRD II should apply on a mandatory, rather than 'comply or explain', basis.

In relation to the above points, we refer back to our responses to questions 4, 5, 6 and 7. We would highlight in particular our view that, despite the perception, we do not see in practice any issues (in terms of incentives and abilities to engage in stewardship) inherent in the management of index strategies, so do not believe there are any harms to be addressed in this respect. In fact, we see reasons why index strategies have greater incentives to engage and devote resources to doing so.

Q10: We welcome feedback on whether, to support effective stewardship, we should consider amendments to other aspects of the regulatory framework that affect how investors and issuers interact (such as the LRs, PRs and DTRs)?

As discussed in our response to question 6, we see that ESG data is improving due to technology and increased focus on transparency and disclosure, aided by the development of frameworks such as TCFD and SASB. As the TCFD and SASB standards evolve, we believe they will gain wider adoption. This, in turn, will provide investors with an opportunity to work collaboratively with companies to evolve their reporting practices and to continue to improve the relevance to investors of climate-related financial disclosures and analysis.

In view of this, we feel it may be premature to consider amendments to the regulatory disclosure framework at this stage.

Conclusion

We very much welcome this initiative on the part of the FCA (in conjunction with the FRC) to seek investors' views on the current stewardship landscape and how the industry can seek to exercise more effective stewardship.

We have sought to explain in this response BlackRock's perspective on, and experience of, the issues raised in the Discussion Paper, which looks at both evolving best practice and some potential challenges. We would be happy to discuss our views in more detail with you, should that be helpful.

Fundamentally, we take the view that, implemented and embedded appropriately, SRD II and a new UK Stewardship Code represent positive developments that will encourage more effective stewardship across the industry. As regards the central topic of the Discussion Paper, we are therefore confident that these existing initiatives can establish a regulatory framework that keeps the UK at the forefront of stewardship best practice.