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BlackRock Approach to Executive Remuneration 18th January 2017

BlackRock has published a paper which sets out its approach to executive remuneration in Europe, the Middle East and Africa. The key themes are summarised below.

"We believe that remuneration committees are in the best position to make remuneration decisions and should maintain significant flexibility in administering remuneration programs, given their knowledge of the strategic plans for the company, the industry in which the company operates the appropriate performance measures for the company, and other issues internal and/or unique to the company."

Quantum

- Pay should only be increased each year, if at all, at the same level as the wider employee workforce and in line with inflation. BlackRock expects a strong supporting rationale where a significant pay increase is given that is out of line with the rest of the workforce.
- The board should consider the **pay ratio between the CEO and the rest of the executive team**, looking at both the fixed and the total remuneration.
- Benchmarking should not be used to justify pay increases. Pay increases should reflect changes to the scope of the role and its complexity. Changes in company capital size are not considered an appropriate proxy for the complexity or justification for an increase in salary. Boards should wait a number of years post M&A before increasing remuneration to ensure the executives are delivering sustained performance.
- The results of benchmarking should be disclosed, particularly the peer group selected.
- Pension contributions are expected to be in line with the rest of the workforce for new contracts. Any downgrade of the workforce's pensions should also be applied to executive directors.

Alternative remuneration structures

BlackRock does not discourage remuneration structures which differ from market practice, echoing the Executive Remuneration Working Group in its belief that there should not be a "one size fits all" approach. Companies 'should structure executive

remuneration plans that best suit their company taking into account such factors as the company's pay policy, strategy and business cycle'.

Where companies introduce restricted share schemes:

- This should not result in a more complex pay package.
- The value of awards should be reduced by at least 50% compared to the variable pay previously available.
- Vesting/holding periods should have a longer timeframe, preferably a minimum of five years.
- A performance underpin should be applied.
- Shareholding requirements should be increased to at least 400% of fixed pay, which should be maintained for at least two years post-departure.

Linking pay and performance

- BlackRock believes that executive pay should be linked to 'strong and sustainable returns over the long-term, as opposed to short-term hikes in share prices'.
- There should be **multiple performance metrics**, the majority of which should be financial and at least 60% should be based on quantitative criteria.
- Retrospective disclosure should be provided on the performance achieved, broken down by measure, for quantitative and qualitative metrics.
- There is a preference for "input" metrics, which are 'within management's control to create economic value over the long-term', rather than "output" metrics such as TSR or EPS. Companies are also encouraged to use metrics related to the creation of value of the company, such as economic profit or a comparison of ROIC and the cost of capital. 'ESG-type' performance measures should be linked to material issues and they must be quantifiable, transparent and auditable. There should be no adjustment for currency fluctuations.
- Where used, BlackRock express a preference for relative TSR (as opposed to absolute) and for the exclusion of the potential effect of share buybacks and acquisitions on EPS calculations.
- Short-term and long-term incentive plans should be based on different sets of performance measures.
- When the vesting period of long-term incentive is two years or less, due to a short business cycle, an explanation should be provided and there should be a sufficient subsequent holding period post vesting.

Discretion

 Remuneration committees should maintain significant flexibility in administering remuneration policies and policies should allow the remuneration committee to use discretion to make adjustments as a result of unintended consequences. Where discretion is used this should be explained and justified.

Recruitment

• If there is a large disparity between the pay package for a newly appointed director and that of the former incumbent this should be explained in detail.

Engagement and voting

BlackRock expects public disclosures to be the primary mechanism for companies to

explain their executive remuneration practices. BlackRock may engage with companies on remuneration related issues, preferably independent members of the remuneration committee, where concerns are identified or where they seek to better understand a company's approach to executive remuneration.

BlackRock expects remuneration committees to consider and respond to the shareholder voting results of relevant proposals at previous years' annual meetings, and other feedback received from shareholders, as they evaluate remuneration plans. At the same time, remuneration committees should ultimately be focused on incentivising long-term shareholder value creation and not necessarily on achieving a certain level of support.

BlackRock will systematically vote against a remuneration report where:

- **Performance criteria for the vesting of long-term awards are not disclosed** or it is explicitly stated there will not be any disclosure around the performance criteria.
- Long term plans allow for re-testing.
- Retrospective/in-flight changes are made to performance criteria.

BlackRock will consider voting against members of the remuneration committee and/or the Say on Pay proposals for example where:

- Threshold, target and maximum remuneration outcomes are not aligned with company performance.
- The connection between strategy, long-term shareholder value creation and incentive plan design is insufficiently demonstrated.
- Remuneration is excessive relative to peers without appropriate rationale, including the appropriateness of the company's selected peers.
- An overreliance on discretion or extraordinary pay decisions to reward executives without clearly demonstrating how these decisions are aligned with shareholders' interests.
- Disclosure is insufficient to allow BlackRock to undertake pay analysis.
- A lack of board responsiveness to significant investor concerns.

BlackRock will also usually vote against one-off transaction awards and retention awards.

Deloitte view

As the majority of companies are finalising their Policy review and drafting their remuneration report, the BlackRock paper is a timely reminder that companies should adopt the structure that best supports their long-term interests and that a clear rationale for the choice of remuneration structure and performance measures is expected and shareholders also expect a transparent explanation of remuneration decisions and outcome.

BlackRock's stance on pension echoes the Investment Association's stated concerns over the difference in pension provision between executive directors and the wider workforce and is likely to become an increased area of focus.

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