

BlackRock's Annual Letter to CEOs Focuses on Doing Good and Continues to Emphasize Governance and Strategy

January 17, 2018 | Client Update | 2-minute read

Reports of [BlackRock's annual letter](#) to CEOs have largely focused on Larry Fink's exhortation that companies must serve a social purpose and "make a positive contribution to society" in addition to delivering on financial performance.

The letter also focused on "a new model for corporate governance," since index investors who cannot walk away from companies that they disapprove of must be active and engaged agents for their clients. Shareholder engagement, Fink states, have been too focused on annual meetings and proxy votes, rather than a year-round conversation about long-term value. The firm intends to double the size of its investment stewardship team over the next three years, to more than 60 people, so that discussions with companies can be "deeper, more frequent and more productive."

As in previous letters, BlackRock asks that companies explain their strategic framework and explicitly affirm that it has been reviewed by the board of directors. The lack of definitive information about corporate long-term strategies is blamed as the "central reason for the rise in activism." Directors are expected to be deeply involved with a company's long-term strategy, and able to describe the board's process for overseeing strategy when they meet with BlackRock. Directors are also "essential" to helping a company "articulate and pursue its purpose" and respond to questions from various stakeholders, in furthering BlackRock's expressed desire to see companies advance larger societal issues. Stakeholders include employees and the community.

When a company discusses strategy, it should address the effect of "societal impact" and "structural trends" on its business. One example is the impact of tax reform, in particular what companies intend to do with their increased cash flow. Otherwise, "tax changes will embolden those activists with a short-term focus to demand answers on the use of increased cash flows." If a company is targeted by activists, BlackRock encourages it to "begin discussions early" with shareholders.

BlackRock's views remain influential, as reports indicate that the three largest index-fund providers, which include Vanguard and State Street, owned more than 18% of the S&P 500 at the end of the third quarter of 2017.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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