BLACKROCK®

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Each year, I write to the CEOs of leading companies in which our clients are shareholders. These clients, the vast majority of whom are investing for long-term goals like retirement or a child's education, are the true owners of these companies. As a fiduciary, I write on their behalf to advocate governance practices that BlackRock believes will maximize long-term value creation for their investments.

Last year, we asked CEOs to communicate to shareholders their annual strategic frameworks for long-term value creation and explicitly affirm that their boards have reviewed those plans. Many companies responded by publicly disclosing detailed plans, including robust processes for board involvement. These plans provided shareholders with an opportunity to evaluate a company's long-term strategy and the progress made in executing on it.

Over the past 12 months, many of the assumptions on which those plans were based – including sustained low inflation and an expectation for continued globalization – have been upended. Brexit is reshaping Europe; upheaval in the Middle East is having global consequences; the U.S. is anticipating reflation, rising rates, and renewed growth; and President Trump's fiscal, tax and trade policies will further impact the economic landscape.

At the root of many of these changes is a growing backlash against the impact globalization and technological change are having on many workers and communities. I remain a firm believer that the overall benefits of globalization have been significant, and that global companies play a leading role in driving growth and prosperity for all. However, there is little doubt that globalization's benefits have been shared unequally, disproportionately benefitting more highly skilled workers, especially those in urban areas.

On top of uneven wage growth, technology is transforming the labor market, eliminating millions of jobs for lower-skilled workers even as it creates new opportunities for highly educated ones. Workers whose roles are being lost to technological change are typically facing retirement with inadequate savings, in part because the burden for retirement savings increasingly has shifted from employers to employees.

These dynamics have far-reaching political and economic ramifications, which impact virtually every global company. We believe that it is imperative that companies understand these changes and adapt their strategies as necessary – not just following a year like 2016, but as part of a constant process of understanding the landscape in which you operate.

As BlackRock engages with your company this year, we will be looking to see how your strategic framework reflects and recognizes the impact of the past year's changes in the global environment. How have these changes impacted your strategy and how do you plan to pivot, if necessary, in light of the new world in which you are operating?

BlackRock engages with companies from the perspective of a long-term shareholder. Since many of our clients' holdings result from index-linked investments – which we cannot sell as long as those securities remain in an index – our clients are the definitive long-term investors. As a fiduciary acting on behalf of these clients, BlackRock takes corporate governance particularly seriously and engages with our voice, and with our vote, on matters that can influence the long-term value of firms. With the continued growth of index investing, including the use of ETFs by active managers, advocacy and engagement have become even more important for protecting the long-term interests of investors.

As we seek to build long-term value for our clients through engagement, our aim is not to micromanage a company's operations. Instead, our primary focus is to ensure board accountability for creating long-term value. However, a long-term approach should not be confused with an infinitely patient one. When BlackRock does not see progress despite ongoing engagement, or companies are insufficiently responsive to our efforts to protect our clients' long-term economic interests, we do not hesitate to exercise our right to vote against incumbent directors or misaligned executive compensation.

Environmental, social, and governance (ESG) factors relevant to a company's business can provide essential insights into management effectiveness and thus a company's long-term prospects. We look to see that a company is attuned to the key factors that contribute to long-term growth: sustainability of the business model and its operations, attention to external and environmental factors that could impact the company, and recognition of the company's role as a member of the communities in which it operates. A global company needs to be local in every single one of its markets.

BlackRock also engages to understand a company's priorities for investing for long-term growth, such as research, technology and, critically, employee development and long-term financial well-being. The events of the past year have only reinforced how critical the well-being of a company's employees is to its long-term success.

Companies have begun to devote greater attention to these issues of long-term sustainability, but despite increased rhetorical commitment, they have continued to engage in buybacks at a furious pace. In fact, for the 12 months ending in the third quarter of 2016, the value of dividends and buybacks by S&P 500 companies *exceeded* those companies' operating profit. While we certainly support returning excess capital to shareholders, we believe companies must balance those practices with investment in future growth. Companies should engage in buybacks only when they are confident that the return on those buybacks will ultimately exceed the cost of capital and the long-term returns of investing in future growth.

Of course, the private sector alone is not capable of shifting the tide of short-termism afflicting our society. We need government policy that supports these goals – including tax reform, infrastructure investment and strengthening retirement systems.

As the U.S. begins to consider tax reform this year, it should seize the opportunity to build a capital gains regime that truly rewards long-term investments over short-term holdings. One year is far too short to be considered a long-term holding period. Instead, gains should receive long-term treatment only after three years, and we should adopt a decreasing tax rate for each year of ownership beyond that.

If tax reform also includes some form of reduced taxation for repatriation of cash trapped overseas, BlackRock will be looking to companies' strategic frameworks for an explanation of whether they will bring cash back to the U.S., and if so, how they plan to use it. Will it be used simply for more share buybacks? Or is it a part of a capital plan that appropriately balances returning capital to shareholders with prudently investing for future growth?

President Trump has indicated an interest in infrastructure investment, which has the dual benefits of improving overall productivity and creating jobs, especially for workers displaced by technology. However, while infrastructure investing can stem the flow of job losses due to automation, it is not a solution to that problem. America's largest companies, many of whom are struggling with a skills gap in filling technical positions, must improve their capacity for internal training and education to compete for talent in today's economy and fulfill their responsibilities to their employees. In order to fully reap the benefits of a changing economy – and sustain growth over the long-term – businesses will need to increase the earnings potential of the workers who drive returns, helping the employee who once operated a machine learn to program it.

Finally, as major participants in retirement programs in the U.S. and around the world, companies must lend their voice to developing a more secure retirement system for all workers, including the millions of workers at smaller companies who are not covered by employer-provided plans. The retirement crisis is not an intractable problem. We have a wealth of tools at our disposal: auto-enrollment and auto-escalation, pooled plans for small businesses, and potentially even a mandatory contribution model like Canada's or Australia's.

Another essential ingredient will be improving employees' understanding of how to prepare for retirement. As stewards of their employees' retirement plans, companies must embrace the responsibility to build financial literacy in their workforce, especially because employees have assumed greater responsibility through the shift from traditional pensions to defined contribution plans. Asset managers also have an important role in building financial literacy, but as an industry we have done a poor job to date. Now is the time to empower savers with new technologies and the education they need to make smart financial decisions. If we are going to solve the retirement crisis – and help workers adjust to a globalized world – businesses need to hold themselves to a high standard and act with the conviction that retirement security is a matter of shared economic security.

That shared economic security can only be achieved through a long-term approach by investors, companies and policymakers. As you build your strategy, it is essential that you consider the underlying dynamics that drive change around the world. The success of your company and global growth depend on it.

Sincerely,

Larry

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