LARRY FINK'S 2023 LETTER TO INVESTORS: KEY TAKEAWAYS FOR BOARDS

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Larry Fink's annual Letter to CEOs has become an anticipated dispatch that sets the tone for the upcoming proxy season, and this year's edition is no exception. There were two notable differences in Fink's approach to the letter for 2023:

- Fink has issued one letter this year to all stakeholders as he states we (shareholders, investors, corporations, government, etc.) are all in this together and will need to work together on big global issues
- While ESG clearly remains an imperative for Blackrock, the tone of the letter shifts towards the broader sentiment that ESG strategy is an important part of business strategy and that climate risk is investment risk

This article provides a summary of themes from the 2023 letter and provides our perspectives and key takeaways for consideration.

Trust & Fiduciary Duty

Blackrock's CFO refers to dollars invested with Blackrock as "units of trust" that belong to their clients, and their fiduciary duty to their clients is central to everything they do. Blackrock's scaled model and its diversity in investment offerings that are centered on empowering clients has resulted in it being the highest-performing financial services stock in the S&P 500 since their IPO in 1999.

Takeaway for Boards: A continued focus on the best long-term interests of the corporation's stakeholders (including shareholders and employees) should naturally drive long-term value creation. Board's should remain focused on this simple concept, especially in complex strategic discussions.

The Consequence of Easy Money & Regulatory Change

Since the financial crisis of 2008, the markets have been defined by aggressive fiscal and monetary policy and subsequently in recent years we have experienced inflation at levels not seen since the 1980s. Fink highlights three consequences/potential consequences of years of "easy money":

1. Dramatic interest rate increases
2. Asset-liability mismatch (i.e. failure of Silicone Valley Bank)
3. Liquidity mismatches as years of lower rates drove some asset owners to trade lower liquidity for higher returns

Fink believes today's banking crisis will place greater emphasis on the role of capital markets, and he expects governments will stay focused on fighting inflation and continue to raise rates. After years of growth being driven by government spending and low interest rates, Fink notes the world now needs the private sector to grow economies, and that leaders in both government and corporations need to work together to unleash the potential of the private sector.

Takeaway for Boards: Reprieve from inflation is unlikely to occur in the near future, and while this may create opportunity for the private sector, Boards will need to continue to be mindful of the impact of inflation/monetary policies. As it relates to executive pay decisions, this may require thoughtfulness in the process to set targets and evaluate performance, particularly for financial metrics, recognizing companies will be impacted differently based on their industry.

Global Economy

Fink states that recent global events (COVID-19 pandemic, Russia/Ukraine war) have resulted in companies and countries looking to ensure they are not dependent on supply chains exposed to geopolitical tensions, resulting in a more fragmented global economy. This fragmentation of the economy brings risks, but also opportunities, and North American may be the biggest beneficiary given the large labor force and abundant natural resources with the potential for both energy and food security.

Takeaway for Boards: Continuing to be mindful of geopolitical risks/exposure is critical, particularly when considering how a "think local" mentality may impact strategy and operations.

"Silent Crisis" of Retirement

Lower market-return expectations, higher housing and healthcare costs, and the shifting of retirement risks to individuals have made it challenging to support increased longevity and saving for retirement. Money kept as savings in the bank (as individuals lose faith in the market) will not generate the returns necessary for retirement relative to money invested over decades.

Takeaway for Boards: The prevalence of defined benefit and defined contribution plans continue to decline in Canada and have been replaced by long-term incentive plans that align payouts to shareholder value creation which support Fink's statement that retirement risks have been shifted to individuals.

Global Energy Transition

For years, climate risk has been viewed as investment risk. Fink notes that changes to government policy, technology, and consumer preference will create significant investment opportunities and ultimately determine the pace and scale of decarbonization. Over half of the companies in the S&P 500 are now voluntarily disclosing scope 1 and 2 emissions, which helps stakeholders better understand how the energy transition is progressing. Fink believes the oil & gas sector will play a vital role in meeting global demands and ensuring energy security and a successful energy transition. As governments introduce acts such as the Inflation Reduction Act in the US, there are significant opportunities for investors to allocate capital to the energy transition.

Takeaway for Boards: Stakeholders expect transparency. While still somewhat voluntary, we expect to see reporting requirements/disclosure of progress towards energy transition to increase. The impact of the global energy transition (and how it ties back to basic ESG goals/principles) should be a strategic priority for all Boards in Canada regardless of size/industry, and despite the unknowns of government policy and regulatory changes.

Transforming Proxy Voting

Fink believes that voting choice can enhance corporate governance by bringing new voices into shareholder democracy. Democracy, however, only works when participants are informed and engaged. As a result, asset owners need to invest the time and resources to make informed decisions. While proxy advisors play an important role, they are limited in number and therefore lack a breadth of viewpoints. Fink believes the industry would benefit from more proxy advisors who can add diversity of views on shareholder issues.

Takeaway for Boards: While proxy advisors remain influential, Companies may continue to evolve their disclosure practices and approach to ensure all shareholders have access to relevant information to vote their own proxies independently should they chose to do so. We continue to see an evolution towards plain English (less "legalese"), charts/visuals, bullet form points, and a well drafted "letter to shareholders" to support shareholders in their review of disclosure.

Developing Leadership & Culture

The letter closes with insightful commentary on the importance of developing leadership and culture. The past three years have challenged corporate culture and successful CEOs understand the need to build bonds with all stakeholders, especially their employees. Blackrock research shows a strong correlation between companies with strong relative culture and values ratings and stock returns. Fink notes that in a world where companies' ability to attract the best talent can mean the difference between success and failure, building bonds that go beyond a paycheque has never mattered more. He believes the major challenge for the next generation of leaders is bringing people back to the office to forge the cultural bonds a company needs to succeed.

Takeaway for Boards: Boards and Committees are leaning in on the "S" of ESG. This includes reporting on metrics such as diversity, inclusion, and employee engagement, all of which drive culture. As companies continue navigating their "return to office" in a variety of ways, Boards should lean in and ask management how the policies/practices may be impacting cultural as people are often a company's biggest asset and turnover is a large expense.

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