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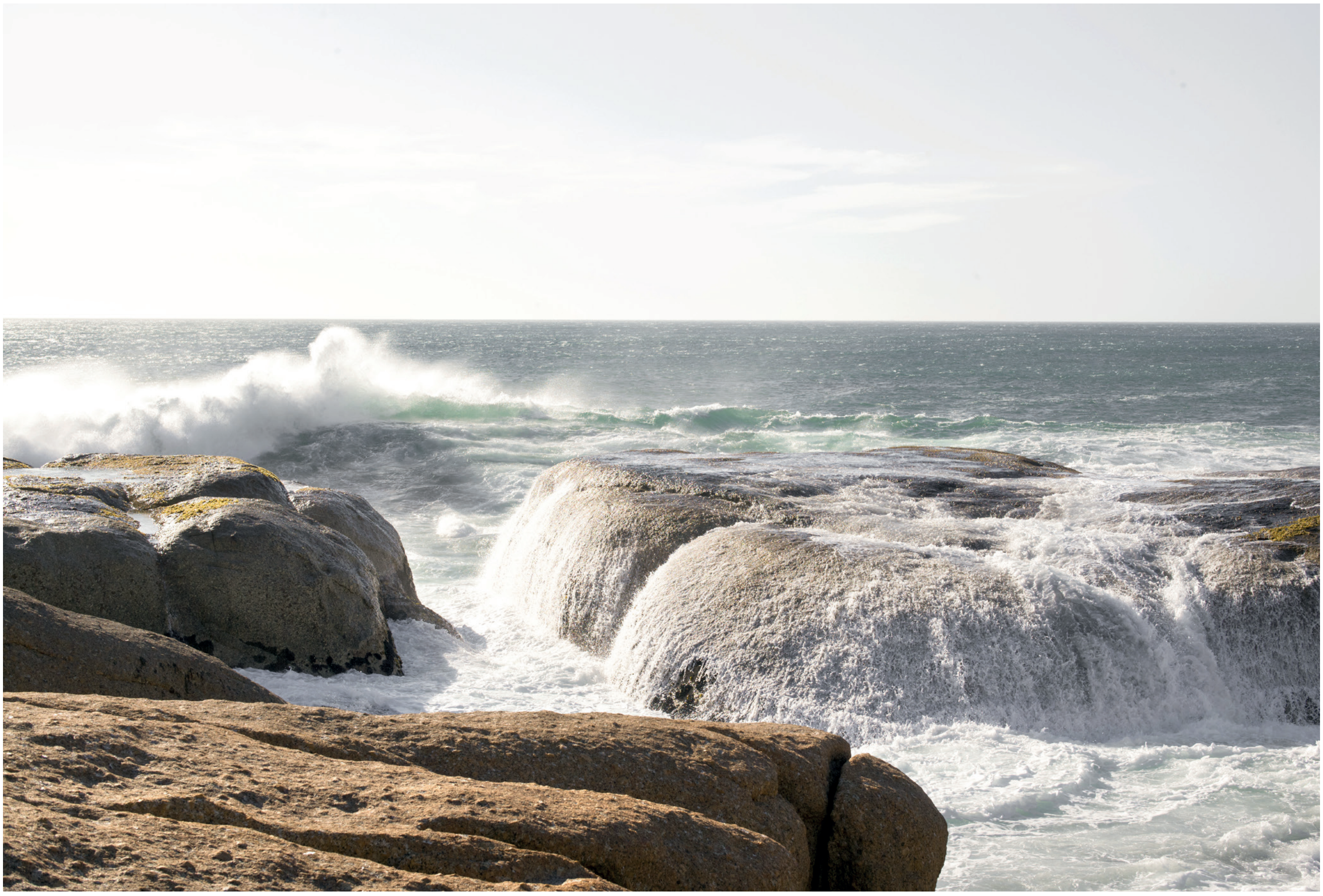
The value of the vote

How UBS Asset Management approaches its proxy voting activities



Exercising voting rights has been a cornerstone of UBS Asset Management's (UBS-AM) stewardship approach for over 20 years and we vote in over 55 markets. While not all of our clients provide us with authority to vote on their behalf, it remains a strong and effective way to voice our opinion to companies across our global positions. Realistically we can't meet or engage with all companies we invest in for our clients, however we can ensure we vote as broadly as possible.

We don't approach voting as a stand-alone, tick-the-box activity. It is completely integral to our investment approach. Our voting activities are managed and co-ordinated by our specialist Stewardship team, who work with our investment teams to ensure that our votes are consistent with our principles, that they are applied across the range of strategies and products that we manage and take into account any engagement we've had with a company.

Our Head of Stewardship, Paul Clark, is responsible for implementing our proxy voting activities. We asked him to expand on UBS-AM's approach and comment on some key trends seen in the 2019 voting season.

As UBS has a single global voting policy, to what extent do you consider different market standards?

We introduced our first global voting policy in 2002 and since then have reviewed and updated it regularly, at least annually. We base our policy on the OECD Principles of Corporate Governance as well as accepted national and global standards. While best practice can vary, and there is no absolute set of standards that determine appropriate governance under all circumstances, there are certain principles which we consider are appropriate across all companies. For that reason we have a global policy in place and we seek to apply that consistently.

However there are some areas where it is appropriate to take into account different market standards, to avoid the tick-the-box approach we mentioned previously. For example board structures in Japan differ from other markets, and unitary boards differ from supervisory board structures. So where we feel that local market standards are relevant we adapt our policy accordingly. But market specific guidelines currently represent a small part of our policy application.

According to our data your support for say on pay proposals fell from 72 to 44 percent last proxy season. What caused you to take a harder line?

Executive Compensation continues to be an emotive topic and a clear area of focus for shareholders and other stakeholders. As we've outlined in our voting policy, we are not seeking a one-size fits-all approach to remuneration, but we do have clear expectations and our policy outlines some specific points we consider when reviewing say-on-pay proposals.

Our voting policy is evolving to ensure that companies' compensation schemes are aligned with global best practices, with a clear focus on long-term performance-based incentives, as well as the long-term interests of shareholders. The change in our voting activity primarily stemmed from a deeper focus on remuneration structures where long-term incentive plans do not have at least 50 percent of awards subject to performance conditions and where the potential value of short-terms awards are higher than the value of long-term awards.

What issues does UBS plan to concentrate on this coming proxy season?

We have made only minor changes to our voting policy for 2020. We've been clearer on our requirements for overall average board independence which may lead to us withholding support for chair of nomination committees; we've reduced the threshold for which we'll support share issuance requests, down to 20% overall, and have included requirements for companies to have clawback policies within remuneration schemes if they are not already in place and are market best practice.

But generally we will continue to concentrate on core topics we believe to be material, being how companies are approaching and managing climate risk, including whether they report in line with TCFD recommendations, board composition, skillset, independence and diversity, and of course remuneration, particularly for UK companies, many of whom will be bringing their pay schemes back for shareholder approval.

> "It's widely accepted that climate change and the speed of global warming are two of the greatest systemic risks facing our planet today."

According to your latest voting policy, UBS may vote against the Chair if there isn't sufficient progress on climate change matters. Could you expand on this?

It's widely accepted that climate change and the speed of global warming are two of the greatest systemic risks facing our planet today. Risks which governments, policy-makers and society at large need to address as a matter of urgency. If climate change is to be limited to 1.5 degrees of warming by the end of this century, then emissions need to fall 45% by 2030 compared to 2010, reaching net zero by 2050.

In 2018, we launched a 3 year engagement program centred on climate change. We have focused this on 50 companies in the Oil & Gas and Utilities sectors where our quantitative analysis indicates that their current GHG emissions and forward looking strategy is not aligned with the targets set at COP21. We have engaged with those companies we have selected, both directly and collaboratively through the Climate Action 100+ group, on their disclosures, policies, strategy, targets and overall governance of climate risk, outlining where we believe the company need to improve and take action.

Generally, the level of responsiveness has been high and since we started our engagement we have seen some interesting progress by companies across our initial engagement objectives.

A number of companies now have climate reports that outline their views of the future and provide clear scenario analysis and reporting in line with TCFD recommendations. Some have set ambitious targets and outlined how they intend to meet those targets.

But this is not universal. And as with any topic, we want to use our vote effectively where we do not see progress against our engagement objectives. Ultimately the Chair of the Board has responsibility for setting the strategy of the company and ensuring that sustainability metrics are met. So when we see that progress is not being made we may now choose to vote against the Chair, to signal our concern. This is not a decision we will take lightly, but as I mentioned, voting is a clear way to voice our concerns.

One other update you made to your voting policy was to outline your relationship with ISS. To what extent do you rely on them?

Let me start by saying that proxy advisors receive a large amount of criticism. However, as with other intermediaries used across financial markets, they provide a valuable service to large scale global investors such as ourselves.

We have holdings in over 10,000 listed companies across 57 markets. Each of those will hold at least one, if not more than one, shareholder meeting a year. We are voting on over 104,000 proposals annually and need to source information on all of those companies' meetings and proposals as quickly as possible, given tight voting deadlines, and in English wherever possible. In addition, we have client assets with a large number of different global custodian banks and we need to provide voting instructions to each of them.

We could not achieve that in an efficient, and cost effective way without the services of a specialist provider.

However, we don't outsource our voting decisions to ISS. Our decisions are based firmly on the principles in our own voting policy. ISS are used as a data provider and they issue initial voting recommendations based on our internal proxy voting policy. We then take into account our own knowledge and research of companies, including progress of any engagement we have had, before the votes are submitted by our specialist internal team.

When revising our policy this year we felt it was important to clarify how we use ISS, to seek to avoid any confusion in that regard.

The Head of the FRC recently said the reform of audit firms could happen this year. Do you think that reform is necessary?

Investors need to be able to rely on the integrity and accuracy of financial statements. Audit quality, and audit independence, is of vital importance and the market remains limited to a small number of large providers, some of whom inevitably provide some level of additional non-audit related work in addition to regular audit services.

Through our analysis in 2019, we identified that many companies retain the same audit firm for many years, multiple decades in some cases. While this can provide continuity, it can also lead to lack of challenge and independence. Regulation seeking to have companies put audit services out to tender will become part of the process, but further competition in the market may also raise confidence.

If you could introduce one corporate governance reform, either in the UK or internationally, what would it be?

All companies must introduce a single approach for accepting shareholder votes electronically. The current different approaches and standards across the world mean shareholders are still faced with too many challenges when voting and too little transparency on outcomes. That one change would improve governance without having to change company legal structures, as more shareholders would have the opportunity to vote and could use their voice effectively. There is no excuse in this electronic age for barriers to be in the way.

This interview first appeared in the March 2020 edition of Proxy Monthly.

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