Vanguard Investment Stewardship Voting Insights

Risk oversight failure at Credit Suisse

Vanguard

May 2023

Company: Credit Suisse Group AG

Meeting date: April 4, 2023

Proposal: Item 2—Approve discharge of board and senior management; Items 7.1.a–7.2.4—Elect directors

How the funds voted

At the annual shareholder meeting of Credit Suisse, a Swiss global investment bank and financial services firm, the Vanguard-advised funds[1] voted against the discharge of board directors and senior management. The funds also did not support the reelection of two directors—the Risk Committee chair and another member of the Risk Committee—to reflect concerns regarding risk oversight.

Vanguard-advised funds' principles and policies

Good governance starts with a company's board of directors. Our primary focus when evaluating a company's governance practices is ensuring that the individuals who serve as board members and represent the interests of shareholders are capable and appropriately experienced and demonstrate effective, independent oversight of the company's management team, strategy, and risks to shareholder value.

Vanguard's Investment Stewardship team seeks to understand how boards oversee company strategy and financially material risks to long-term shareholder value. When we identify material governance failures, the Vanguard-advised funds will endeavor to engage with the company to express our concerns and understand actions the company and its board are taking to address the underlying issues. The funds may also take accountability measures such as withholding support for directors' reelection and/or supporting shareholder proposals that appropriately address the issues in question.

Analysis and voting rationale

During a period of turbulence in the global banking sector, Credit Suisse experienced a liquidity crisis in March 2023. This precipitated a Swiss government-brokered acquisition of Credit Suisse by UBS, announced that same month. Under the deal, UBS agreed to acquire all outstanding shares in Credit Suisse in a stock transaction valued at CHF 3 billion ($3.25 billion).[2] The takeover, which does not require shareholder approval, remains subject to closing conditions and is expected to close by the end of 2023.

Background

In recent years, Credit Suisse has been subject to numerous investigations and proceedings concerning business units in multiple jurisdictions. Credit Suisse suffered significant financial and reputational damages through its exposure to the default of the Archegos Capital Management fund and the Greensill Capital fund, as well as an executive spying scandal and a data leak of customer information.

1 Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third-party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

2 Credit Suisse press release, March 19, 2023: Credit Suisse and UBS to Merge (credit-suisse.com)

These incidents resulted in a series of investigations, fines, and executive turnover.

Under the Swiss Code of Obligations, a shareholder vote on the discharge of board members and senior management is required; shareholders of publicly listed companies must vote annually on the ratification of the actions of the board and senior management in the previous fiscal year. A ratification vote discharges directors from liability for board or management decisions that could have a negative effect on shareholder value and that have been fully disclosed to shareholders. In addition to releasing directors from legal liability, the discharge of board members can also be interpreted as a symbolic vote on the confidence shareholders have in a company's governance practices and whether the board and management have appropriately discharged their duties in the past fiscal year.

Events in 2023

In light of Credit Suisse's recent liquidity crisis, which demonstrated a failure of the company's risk oversight and controls, the funds voted against the discharge of directors at the 2023 annual meeting. This marked the second year the funds voted against the discharge of directors at the company because of risk-oversight concerns. At Credit Suisse's 2022 annual meeting, the funds' vote against the discharge of directors reflected concerns with identified deficiencies in Credit Suisse's risk and control framework that were in place during fiscal year 2020. An independent investigation had concluded that Credit Suisse suffered substantial losses as the result of a fundamental ". . . failure to effectively manage risk in the Investment Bank's Prime Services business by both the first and second lines of defense."[3]

The funds' 2023 votes were informed by evidence of board oversight failure, including the lack of adequate oversight of material risks, that resulted in significant destruction of shareholder value. As of March 24, 2023, Credit Suisse's stock price traded at $0.86 USD, reflecting an approximate 95% decline in shareholder value over the past five years. The pattern of materialized risks at Credit Suisse led us to consider whether the funds should withhold support for the election of one or more of the directors on the ballot to express our concern. Ultimately, we determined it was in the funds' interests to vote against the re-election of both the Risk Committee chair (who was also a company-designated financial expert on the Audit Committee and previously chaired the Audit Committee) and the longest-tenured member of the Risk Committee. These votes demonstrated our concern that the board had not adequately overseen risks or managed material weaknesses. In our view, it was in the best interest of shareholders to have some level of continuity on the board to facilitate the acquisition by UBS; as such, we determined that voting against the whole board would not be in the best interests of the funds.

Days before the annual meeting, Credit Suisse announced the withdrawal of the director discharge proposal from the ballot. Several days later, multiple directors, including the Risk Committee chair and the longest-tenured member of the Risk Committee, announced they would not stand for reelection.

What we look for from companies on this matter

Directors are elected to represent the interests of all shareholders and have important responsibilities that they carry out in accordance with their fiduciary duties, including overseeing and mitigating material financial risk. Well-composed, effective boards can enable long-term shareholder value creation for investors.

When we discuss risk management with portfolio companies, we work to assess how well the board of directors understands the company's strategy and how effectively it is involved in identifying and governing material risks. We look for directors to bring a wealth of experience and diverse perspectives to the boardroom and to provide counsel to company leaders. We look for directors to be well-informed on competitive dynamics and seek outside opinions to better challenge management's assumptions. Ultimately, boards should work to prevent risks from becoming governance failures and/or long-term underperformance.

3 Credit Suisse press release, July 29, 2021; available at https://www.credit-suisse.com/about-us-news/en/articles/media-releases/archegos-202107.html

Vanguard publishes Investment Stewardship Policy and Voting Insights to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our growing effort to enhance disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide additional clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can do. Insights should be viewed in conjunction with the most recent region- and country-specific voting policies.

The funds for which Vanguard acts as investment advisor (Vanguard-advised funds) retain the authority to vote proxies that the funds receive. To facilitate the funds' proxy voting, the boards of the Vanguard-advised funds have adopted Proxy Voting Procedures and Policies that reflect the fund boards' instructions governing proxy voting. The boards of the funds that are advised by managers not affiliated with Vanguard (external managers) have delegated the authority to vote proxies related to the funds' portfolio securities to their respective investment advisor(s). Each external manager votes such proxies in accordance with its own proxy voting policies and procedures, which are reviewed and approved by the fund board annually. The Vanguard Group, Inc., has not been delegated proxy voting authority on behalf of the Vanguard-advised funds.

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