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Funds and Proxy Voting: The Mix of Proposals Matters

By Morris Mitler, Sean Collins, and Dorothy Donohue

Proxy voting is in the news and on the minds of policymakers, corporate executives, and investors. The Securities and Exchange Commission (SEC) will focus on a number of issues related to proxy advisory firms, shareholder proposals, and technology and innovation to make the proxy process more efficient at a staff roundtable on November 15. Major corporate issuers—organized as the “Main Street Investors Coalition”—are agitating against the voting practices of institutional investors, including registered funds.

Registered investment companies, including mutual funds, exchange-traded funds (ETFs), and closed-end funds, are deeply interested in these debates. As fiduciaries to their shareholders, funds have a duty to consider proxy issues related to their portfolio stocks and act in the best interests of fund shareholders—a duty that funds embrace. And for more than a decade, funds have been the only investors required to disclose all of their proxy votes. As a result, registered funds’ votes draw enormous attention—even though these funds hold less than one-third of the stock of corporate America.

In 2008 and 2010, ICI Research used those fund disclosures to analyze trends in funds’ proxy voting from 2007 through 2009. Our findings then: funds take proxy voting seriously, cast their votes thoughtfully, and favor proposals that they perceive to enhance the value of portfolio companies for fund shareholders. Each fund votes its shares in the interests of its own shareholders.

Given the renewed interest in proxy voting, we are updating that research with data from 2010 through 2017. This is the first of three *ICI Viewpoints* posts presenting preliminary results of that work. In this piece, we’ll show how the proxy voting landscape has changed over the past 15 years.

But first, we should explain how funds discharge their proxy voting responsibilities.

A Primer on Proxies

Like other shareholders, funds are entitled to vote on proxy proposals put forth by a company’s board or by its shareholders. Proposals offered by the board are usually referred to as “management proposals.”

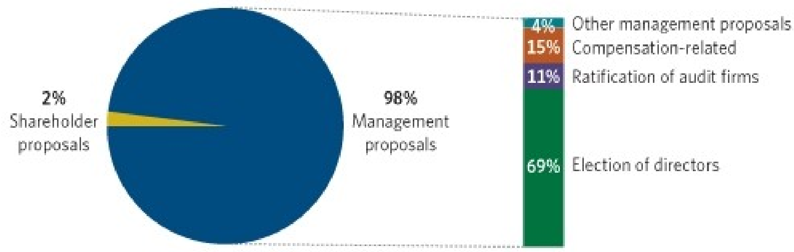
As part of their fiduciary duty to fund shareholders, a fund’s board of directors is responsible for proxy voting. A fund’s board typically delegates proxy voting responsibilities to the fund’s investment adviser, in recognition that proxy voting is part of the investment management process. A fund adviser must have policies reasonably designed to ensure that it votes proxies in the best interests of the fund and its shareholders. Those policies must address material conflicts that may arise between the interests of the fund and those of the adviser in casting proxy votes.

In developing proxy policies, funds may take into account a number of factors, including consistency of the policy with the fund’s investment objective and whether to consider particular categories of proposals similarly or on a case-by-case basis. Factors such as a fund’s investment objective may lead different advisers to reach different conclusions about the expected impact of a proxy proposal (e.g., a merger proposal). Similarly, the same adviser, as the agent for several funds, might reach different judgments when voting for different funds (e.g., funds with or without a specific social or environmental investment objective) and for other advisory clients. As a result, an investment adviser’s votes on a given portfolio company’s proxy proposal might vary among its advisory clients.

Figure 1

Proxy Proposals for the Largest Publicly Traded US Companies, 2017

Percentage of total



Note: This figure represents proxy proposals for companies in the Russell 3000 Index with shareholder meetings from July 1, 2016, to June 30, 2017. Components may not add to the total because of rounding.

Source: Investment Company Institute tabulations of ISS Corporate Services data

For funds, voting proxies is no small job. In the 2017 proxy season, funds cast 7.6 million votes on 25,859 proposals on corporate proxy ballots. The average mutual fund voted on 1,504 separate proxy proposals. While shareholder-sponsored proposals often draw considerable attention, they make up less than 2 percent of the total (Figure 1). Among the 25,377 management proposals, 80 percent are routine matters—for example, uncontested elections of directors and ratification of a company's audit firm.

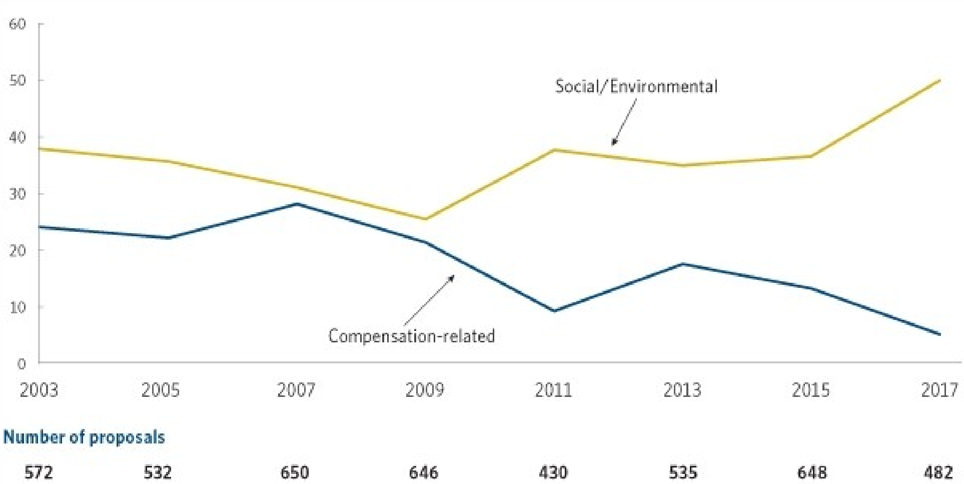
The Changing Proxy Environment

One notable finding of our analysis of proxy voting: the issues funds and other shareholders are asked to vote on have changed dramatically over the years—particularly among shareholder-sponsored proposals.

Figure 2

Shareholder Proxy Proposals, 2003–2017

Percentage of the annual number of shareholder proposals



Note: Proxy years consist of dates from July 1 of the preceding year to June 30 of the listed year. Data are plotted for every other year.

Source: Investment Company Institute tabulations of ISS Corporate Services data

For example, the number and proportion of shareholder proposals related to compensation have fallen substantially in the past several years (Figure 2). In part, that's because of the Dodd-Frank Act. Before Dodd-Frank passed in 2010, many shareholder proposals had called on management to allow shareholders to have an advisory vote on the compensation of corporate executives. These proposals were called shareholder "say-on-pay" proposals. The incentive for shareholders to offer such proposals was eliminated by the Dodd-Frank Act, which *requires* corporations periodically to solicit advisory shareholder votes on executive compensation.

At the same time, as Figure 2 shows, the number and proportion of social and environmental proposals have gone up.

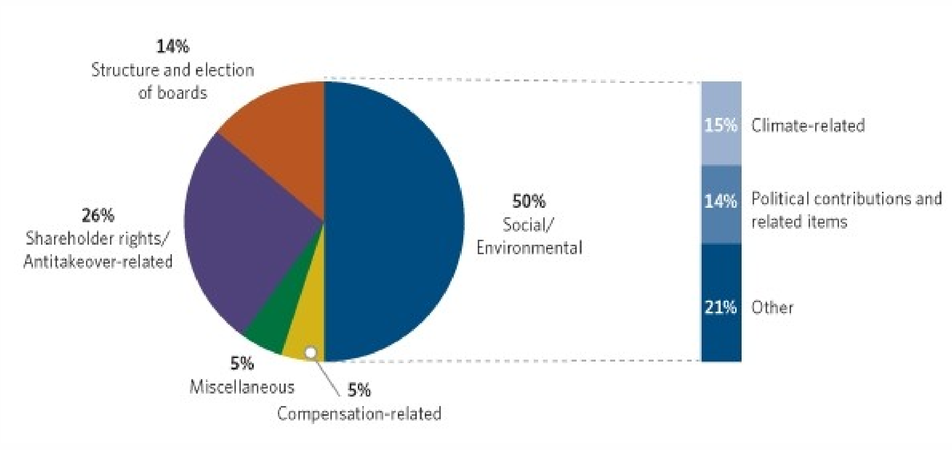
Figure 3 takes a closer look at the 482 proxy proposals that shareholders sponsored in 2017. Of those, 50 percent related to social and environmental issues. Those include climate-related proposals (15 percent of the 482 total proposals) and proposals that called for companies to disclose information on political contributions or related items (14 percent).

The “other” social and environmental category captures a wide range of shareholder proposals, but tends to reflect views that some investors may have about what actions, if any, companies should take in response to recent developments or perceived trends. For example, two shareholder proposals in 2017 called for company reports on “fake news.”

Figure 3

Shareholder Proxy Proposals, 2017

Percentage of all proxy proposals sponsored by shareholders



Note: This figure is based on 482 shareholder proxy proposals for companies in the Russell 3000 Index with shareholder meetings from July 1, 2016, to June 30, 2017.

Source: Investment Company Institute tabulations of ISS Corporate Services data

Critics of fund proxy voting often focus on aggregate measures—how funds voted, for example, on all shareholder proposals. Our research has consistently shown, however, that fund advisers carefully consider the nature of each specific proposal in determining how they’ll vote their funds’ proxies. Therefore, in evaluating how funds actually vote, it is critical to distinguish among the mix of shareholder proposals.

This post is first in a three-part *ICI Viewpoints* series on funds’ proxy voting through 2017.

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