Davis Polk

How Funds View and Vote on Shareholder Proposals

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In advance of Thursday's **SEC's Roundtable** on the Proxy Process*, it is worth considering the **three-part posts** by the Investment Company Institute (ICI) on funds and proxy voting, and **CII's FAQs** on shareholder proposal data.

CII explains that fewer than half of proposals submitted are voted on, based on data between 2004 and 2017. The SEC generally allows about 15% to be excluded, and then others are withdrawn. On average, 13% of Russell 3000 companies received a proposal, and the median number was one per year. The largest companies tend to be targeted for proposals, with the S&P 500 companies being the recipient of about 77% of them, since those companies make up a greater portion of any investment portfolio.

As described by ICI, since registered investment companies, including mutual funds, exchange-traded funds and closed-end funds, are the only investors required to disclose their proxy votes, those votes receive outsized attention even though the funds hold less than one-third of the stock of corporate companies. As ICI explains, fund advisers must have policies reasonably designed to ensure that they votes proxies in the best interests of the fund and its shareholders, which may result in different advisers reaching opposing views about the same proposal, or even leading to the same investment adviser casting different votes on one proposal for various funds, depending on a particular fund's objective or client.

In the 2017 proxy season, funds cast 7.6 million votes on 25,859 proposals. The average fund voted on 1,504 proposals, 98% of which were management proposals, and of those 80% were deemed to be routine. Shareholder proposals make up less than 2% of the total number of ballot items. Of the 482 proposals voted on, 50% related to social and environmental issues, including 15% on climate and 14% on political topics.

ICI data shows that ten proponents submitted 44% of the proposals on proxy ballots during 2017, with Chevedden and Steiner promoting 88 proposals, or 16.4%, and McRitchie and Young as the proponents for 36 proposals, or 6.7%. Individual proponents tend to concentrate on board structure and shareholder rights proposals, but a **recent blog post** by Jim McRitchie highlights the possibility of a shift in focus this season from the individual proponents to more social proposals. In 2017, socially responsible investors, which ICI define as investment advisers that manage their clients assets (typically high net-worth individuals investing through separately managed accounts) in an effort to achieve specific financial and social objectives, accounted for 43% of the social and environmental proposals.

Funds must vote their proxies on behalf of 100 million shareholders in the aggregate and vote based on a range of factors that ICI outlined, including not only whether the objective of the proposal meets the funds' goals and policies but also whether the proposal has appeared in past years and failed to pass, represents general interest of shareholders instead of the specific interests of the sponsors and whether the proposal would impose material costs in excess of any benefits. Company performance and the perceived quality of management may also play a role.

ICI provides data on how funds voted and wants to rebut claims that funds over-rely on proxy advisory firm recommendations. The data shows stronger alignment between fund voting and ISS recommendations for management proposals than shareholder proposals. For example, funds supported M&A proposals 97.7% of the time while ISS recommended in favor of such proposals 98.3% of the time. ISS supported director elections 93.1% of the time, and funds voted in favor of directors 94.2% of the time.

On shareholder proposals, ISS recommended for social and environmental proposals 55.4% of the time, but funds only supported those proposals 25.2% of the time. Overall, ISS was in favor of shareholder proposals 64.7% of the time, yet funds voted for them only 34.6% of the time. But average support for shareholder proposals during the 2017 season was 39%, which indicates that it would be highly useful for companies to know more about their shareholders if all non-retail investors, and not just funds, were required to report how they cast their votes.

*If you will be at the Roundtable, please come say hello after the panel.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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