ICI VIEWPOINTS

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Funds and Proxy Voting: Funds Vote Thoughtfully and Independently

During the 2017 proxy voting season, registered investment companies—including mutual funds, exchange-traded funds (ETFs), and closed-end funds—cast more than 7.6 million votes for proxy proposals submitted by either management or shareholders of corporations held in the funds' portfolios. Some of those proposals were straightforward; others were more controversial. But in every case, a fund adviser had a duty to evaluate the proposal and act in the best interest of the fund and its shareholders.

Fund advisers take this duty seriously—and that's borne out by ICI's analysis of proxy voting data for the 2017 season.

Preliminary tallies by ICI Research show that funds vote largely with management on management proposals—reflecting the fact that the vast majority of those proposals (81 percent) are routine votes on uncontested elections of directors or ratification of a company's audit firm. On shareholder proposals, funds' votes are more likely to diverge, based on each fund's investment objective and the fund adviser's assessment of whether a particular proposal serves the interests of that fund's shareholders.

And one finding comes through the data clearly: fund advisers don't automatically follow anyone's recommendations. In particular, funds' votes diverge from the recommendations of Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm. That matters, because some critics claim that funds' voting is largely dictated by recommendations from proxy advisory services such as ISS and its main competitor, Glass, Lewis & Co.

In two recent *ICI Viewpoints* posts, we analyzed the types of proxy proposals shareholders submitted during the 2017 proxy season and how those have changed over the years. We also took a look at the identities of the proponents who offered those proposals. Now we're going to examine how funds actually voted on 2017 proxy proposals and how their votes compare with ISS recommendations.

How Funds Vote: Policies and Process

First, however, it's important to understand how funds approach proxy voting.

Proxy voting is the mechanism through which shareholders register their preferences on corporate issues. As shareholders in public companies, funds participate in the proxy voting process on behalf of the investors whose assets they steward. Funds take this responsibility seriously.

Federal law places on a fund's adviser a fiduciary duty to cast votes on proxy proposals in the best interest of the fund and its shareholders. Unlike other investors, funds and their advisers are required by law to establish and disclose written proxy voting policies and procedures that specify, among other things, procedures for addressing potential conflicts of interest in the proxy voting process and how funds may vote on issues. To discharge their fiduciary obligations, funds evaluate individual proxy proposals according to numerous factors, including, among other things, the specifics of the proposal, company performance, and the quality of a company's management.

How Funds Vote: Considering a Range of Factors

In voting proxies, funds consider carefully a range of factors that may include:

- What vote—"for," "against," or "abstain"—would best advance the interests of the fund and its investors?
- Would a "for" vote be consistent with the fund's proxy voting policies and procedures?
- Has this identical proposal appeared on the company's proxy statement in previous years and failed to pass?
- What are the details of the proposal?
- Is the proposal one that can be implemented effectively, or would it impose material costs in excess of any benefit?
- Does the proposal address the general interests of the company's shareholders, or just interests of the particular shareholders who sponsored the proposal?

How Funds Vote: The Role of Proxy Advisory Firms

In carrying out their proxy voting duties, fund advisers may engage the services of a proxy advisory firm such as ISS or Glass Lewis. Proxy advisers offer a range of services including:

- assisting with administrative tasks (e.g., generating proxy voting reports);
- compiling information for funds' annual proxy voting filings with the SEC on Form N-PX;
- executing proxies according to clients' instructions (e.g., voting fund proxies according to rules the fund has previously specified to the proxy adviser); and
- preparing research reports with recommendations on whether to vote "for," "against," or "abstain" on specific proxy proposals.

Given the scale of funds' proxy voting responsibilities—in 2017, the average mutual fund voted on 1,504 separate proxy proposals—many fund advisers value the administrative and analytical support that proxy advisory firms can provide.

Some funds, however, do not use the services of a proxy adviser. And some of those that do use the firms do not subscribe to the proxy adviser's research or vote recommendations. Even among funds that do subscribe, funds point out that those vote recommendations are not dispositive.

Those statements are supported by the data on funds' actual voting. Those data demonstrate that, contrary to the claims of some commentators, funds do not vote mechanically according to the vote recommendations issued by proxy advisers.

How Funds Vote: The Data, Please

As Figure 1 shows, in 2017, funds voted "for" almost 94 percent of proxy proposals submitted by management. In comparison, the proxy advisory firm ISS recommended voting “for” about 93 percent of management proposals. This is not surprising. As noted before, the vast majority of management proxy proposals are for routine business items, such as the ratification of the company’s auditor or the uncontested election of a member of the board of directors. Virtually all (99 percent) of the routine proposals passed.

Figure 1

Fund Votes on Management Proposals During the 2017 Proxy Season

	Funds[1]	ISS[2]	Percentage of shares voted in favor[3]	Percentage of proposals passing	Number of proposals
All management proposals	93.8%	92.9%	95.2%	98.6%	25,377
Election of directors	94.2	93.1	95.7	99.6	17,847
Ratification of audit firm	98.3	99.4	98.7	99.3	2,796
Other management proposals	96.0	92.5	94.8	97.1	4,734
Shareholder rights/Antitakeover-related	87.3	93.3	90.7	64.8	310
Capitalization	90.3	90.1	90.9	97.1	170
Director-related	94.0	93.6	98.2	88.4	121
Compensation-related	88.8	87.6	90.9	97.8	3,745
Of which:					
Say-on pay	88.7	87.5	90.9	97.2	2,523
Other	89.0	88.0	90.7	98.9	1,222
Mergers and reorganizations	97.7	98.3	97.7	97.7	221
Miscellaneous	88.3	87.7	89.2	96.0	167

1 This category is measured as the number of US-registered investment companies recording a “for” vote for proposals in a given category, divided by the total number of votes that funds cast.

2 This category is measured as the number of times ISS recommended voting “for” a proposal in a given category, divided by the total number of recommendations ISS made in that category.

3 This category is measured as the number of shares voted in favor, divided by the total number of shares voted, including shares owned by shareholders who abstained from the vote.

Note:This figure represents votes cast by US-registered investment companies during the 2017 N-PX reporting year (fiscal year July 1, 2016, to June 30, 2017). It excludes votes on securities listed on foreign stock exchanges.

Source: Investment Company Institute tabulations of Form N-PX data and ISS Corporate Services data

For management proposals, there is an evident correlation between how funds voted and ISS vote recommendations. That reflects the routine nature of the proposals and their general acceptance by all voting shareholders.

That correlation breaks down, however, when funds vote on shareholder proposals (Figure 2). Shareholder proposals tend to be much more debated than management proposals. Consistent with that, there is greater divergence between how funds voted, what ISS recommended, and vote outcomes. Taking all shareholder proposals as a group, funds voted in support nearly 35 percent of the time. This compares with ISS recommendations to support almost 65 percent of all shareholder proposals. This wide gap suggests that funds reach their own voting decisions, largely independent of recommendations from proxy advisory firms.

Figure 2

Fund Votes on Shareholder Proposals During the 2017 Proxy Season

	Funds[1]	ISS[2]	Percentage of shares voted in favor[3]	Percentage of proposals passing	Number of proposals
All shareholder proposals	34.6	64.7	29.2	13.1	482
Shareholder rights/Antitakeover-related	49.0	76.6	43.9	32.9	70
Social/Environmental	25.2	55.4	20.3	2.5	241
Of which:					
Political contributions and related proposals	34.5	86.3	25.2	0.0	69
Board structure and election process[4]	48.9	81.8	41.2	26.5	121
Compensation-related	28.4	70.5	24.1	4.0	25
Amend articles, bylaws, or charter	32.9	50.0	0.0	0.0	2
Miscellaneous	5.5	12.5	13.0	9.1	23

1 This category is measured as the number of US-registered investment companies recording a “for” vote for proposals in a given category, divided by the total number of votes funds cast.

2 This category is measured as the number of times ISS recommended voting “for” a proposal in a given category, divided by the total number of recommendations ISS made in that category.

3 This category is measured as the number of shares voted in favor, divided by the total number of shares voted, including shares owned by shareholders who abstained from the vote.

4 This category represents shareholder proposals calling for, or related to, declassifying boards are included in “antitakeover-related” shareholder proposals.

Note:This figure represents votes cast by US-registered investment companies during the 2017 Form N-PX reporting year (fiscal year July 1, 2016, to June 30, 2017). It excludes votes on securities listed on foreign stock exchanges.

Source: Investment Company Institute tabulations of Form N-PX data and ISS Corporate Services data

Moreover, Figure 2 highlights that funds exercise judgment in weighing different types of shareholder proposals. Fund votes tended to vary both by the types of issues raised and by the details of the individual proposals within a given category.

For example, funds frequently voted to support shareholder proposals relating to corporate governance: Figure 2 shows that funds voted “for” almost half the time in support of shareholder proposals related to board structure and election process. They showed similar support for proposals related to shareholder rights—proposals that typically limit company management’s ability to defend against takeovers. For shareholders, these proposals often improve the chances for transactions that could add value to a company.

In contrast, funds in aggregate tended to provide considerably less support for shareholder proposals related to social or environmental issues—voting “for” such proposals 25.2 percent of the time. Funds with a mandate from their shareholders to support social and environmental goals—often described as socially responsible investing (SRI) funds—typically offer much higher support for such proposals, voting “for” these proposals almost 90 percent of the time. That makes sense: these funds tell investors that they will invest consistent with the objective of advancing social and environmental goals.

This *ICI Viewpoints* series has provided a preliminary look at our analysis of fund proxy voting data. But the message is clear: fund advisers are meeting their obligation to cast votes on proxy proposals in the best interest of their funds and fund shareholders.

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

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