ICI INVESTMENT COMPANY INSTITUTE®

RESEARCH PERSPECTIVE

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November 2010 Vol. 16, No. 1

Trends in Proxy Voting by Registered Investment Companies, 2007–2009

Key Findings

- **Registered investment companies ("funds") play an important role in corporate governance.** Updating earlier ICI work, this study examines over 10 million votes placed by funds during the years 2007 to 2009, focusing especially on two issues taking on greater prominence during those years: shareholder rights and executive compensation. How funds voted on these kinds of proposals illustrates the complexity of proxy voting and the factors funds consider in their efforts to vote in the best interests of fund investors.
- **From 2007 to 2009, funds voted more than 90 percent of the time in favor of management proposals.** In this category, dominated by director elections, funds generally gave high rates of approval to directors, broadly in line with vote recommendations of proxy advisory firms. However, the proportion of times that funds withheld votes from directors increased noticeably from 2007 to 2009, in part because some funds, to express concerns about executive pay, withheld votes more often from directors on board compensation committees.
- **Funds' approval of all types of shareholder proposals climbed from 35 percent in 2007 to 50 percent in 2009.** This increase primarily reflects a change in the mix of shareholder proposals toward proposals that funds were more likely to favor. Notably, there was a sharp increase in shareholder proposals seeking the right to call special shareholder meetings ("special meetings") and proposals seeking an advisory vote on executive compensation (shareholder "say-on-pay").
- **From 2007 to 2009, funds generally gave high approval rates to special meeting proposals.** Funds voted about three-fourths of the time in favor of special meeting proposals during this period, reflecting the principle generally espoused in funds' proxy voting guidelines of favoring proposals that advance shareholder rights.
- **In 2009, funds voted nearly 60 percent of the time in favor of shareholder-sponsored say-on-pay proposals.** These proposals, which ask management to add an advisory (up or down) vote on executive compensation to the company's proxy statement, are a relatively new phenomenon in the United States. Thus, while funds supported these proposals the majority of the time, there was a spectrum of views among funds about the role and benefits of such proposals in promoting good pay practices.
- **In 2009, funds voted about 80 percent of the time in favor of management-sponsored say-on-pay proposals.** These proposals, which are fundamentally different from shareholder say-on-pay proposals, give shareholders the chance to express approval or disapproval (on an advisory basis) executive pay packages. Thus, funds expressed disapproval of executive compensation packages nearly 20 percent of the time.

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Introduction

Registered investment companies—including mutual funds, closed-end funds, and exchange-traded funds—are major shareholders in publicly traded companies. Like any shareholder, a fund is entitled to vote on proposals, called "proxy proposals," put forth by a company's board or its shareholders.

Funds and their advisers are legally obligated to cast votes on proxy proposals—called "proxy votes"—in the best interests of funds and their shareholders. Funds usually interpret this to mean that they should support proposals, whether initiated by a company or its shareholders, that are likely to promote good corporate governance and increase the value of funds' investments in companies. Toward that end, funds weigh the merits of individual proxy proposals according to numerous factors, including proposal specifics, company performance, the quality of management, and the quality and quantity of dialogue between management and major shareholders on issues of concern.

This issue of *Perspective* looks at how funds voted proxies over the period 2007 to 2009, which spans the worst U.S. financial crisis since the Great Depression. The crisis, spurred by the collapse of the subprime mortgage market, saw a sharp economic recession, a federal government takeover of Fannie Mae and Freddie Mac, and the failure or near-failure of large broker-dealers, mortgage lenders, banks, and two U.S. automakers. The crisis also exposed weaknesses in legal and regulatory structures.

In this context, this study extends earlier work undertaken by the Investment Company Institute on proxy voting and examines over 10 million votes funds placed from 2007 to 2009.[1] It focuses especially on issues that assumed greater prominence during the financial crisis.

One result of the crisis has been to intensify the search by shareholders, lawmakers, and regulators for mechanisms likely to promote the rights of company shareholders. Funds indicate—through policies laid out in fund documents—that they generally favor proxy proposals that foster their rights as shareholders in companies. During the financial crisis, funds adhered to this approach. For instance, funds continued to offer marked support for proposals that could remove barriers (such as poison pills and staggered board elections) to value-enhancing takeovers.

Indeed, funds voted more often in favor of shareholder proposals as the financial crisis unfolded, in large part because the proportion of shareholder proposals seeking enhanced shareholder rights rose. In particular, funds faced a large number of shareholder proposals asking company boards for the right to call special meetings between company annual meetings. Funds generally viewed these kinds of proposals as likely to increase their rights as shareholders and voted for them three-fourths of the time. How funds voted at a particular company depended, though, on details of the specific proposal and other factors, such as whether the company had already taken steps to institute a special meeting provision in its bylaws.

Executive compensation is another issue that assumed greater prominence during the financial crisis. On the proxy voting front, this showed up in the introduction in the United States of say-on-pay proposals. These proposals either seek or put forth an advisory vote on the compensation of company senior executives. As this study discusses, the merits of these proposals have been widely debated. Funds were generally supportive of these proposals but did not adopt a one-size-fits-all approach. In voting, they considered factors such as a company's performance, its pay practices, and company responsiveness to shareholder concerns about pay practices.

Funds also expressed disapproval of executive compensation by withholding votes from directors on board compensation committees. Although funds generally gave high rates of approval to director nominees proposed by companies, the evidence indicates that they were less willing to do so as the crisis progressed.

In sum, during the years spanning the financial crisis, funds expended considerable time and energy grappling with new issues and studying new types of proxy proposals. Funds were guided in this effort by the principle of voting for proxy proposals on their merits—according to the standards laid out in their proxy voting policies—in an effort to advance the interests of fund investors.

What Are Funds' Major Proxy Voting Obligations?

Funds and their advisers have a variety of obligations with respect to proxy voting, many of which stem from specific requirements under the Investment Company Act of 1940 and the Investment Advisers Act of 1940. The major proxy voting obligations include:

- **A fund's board of trustees, acting on the fund's behalf, is responsible for the voting of proxies related to the fund's portfolio securities.** The fund's board normally delegates voting responsibility to the fund's adviser, subject to board oversight, in recognition that proxy voting is part of the investment advisory process.
- **Federal law imposes a fiduciary duty on a fund's adviser, and this duty extends to proxy voting.** An adviser that votes a fund's proxies therefore must do so in the best interests of the fund and its shareholders and without regard to the adviser's own business interests. Thus, when voting proxies on a fund's behalf, the adviser must not be influenced by its other business interests, such as whether it manages or administers a 401(k) plan for the company whose proxies are being voted.
- **Funds and their advisers must establish and disclose written proxy voting policies and procedures.** Among other things, these policies and procedures must specify how the interests of fund investors will be protected when a vote presents a conflict between the interests of fund investors and those of a fund's adviser. A fund's board must review these policies at least annually.
- **Funds must "recall" loaned securities to vote proxies.** Funds frequently enter into securities lending programs to generate extra income, thus increasing their total return. Because the right to vote proxies passes to the borrower of the securities, funds must terminate these loans and recall the securities on loan in time to vote proxies if funds have knowledge that a material event affecting those securities will occur.
- **Unlike other shareholders, funds must disclose all the proxy votes they cast.** They do this by filing Form N-PX with the SEC. Filed each August, the form reports on votes cast in the 12-month period ending on the prior June 30 (e.g., Forms N-PX filed in August 2009 report on votes cast between July 1, 2008, and June 30, 2009).

The Proxy Voting Process for Funds

Publicly traded companies hold annual meetings at which shareholders vote on various issues. Before its annual meeting, a company's board of directors compiles a list of proxy proposals on which shareholders will vote. The company sends its shareholders a list of these proposals, called a "proxy statement," along with a ballot, called a "proxy card." Shareholders usually place their proxy votes by telephone, mail, or the Internet rather than in person at annual meetings.

As shareholders, funds have the right to vote on proxy proposals for the companies whose stocks they hold in their portfolios ("portfolio companies").[2] Funds generally seek to offer investors the highest possible returns, subject to market conditions and the funds' investment policies. Proxy voting is one aspect of this effort; funds vote for proxy proposals that are likely to promote good corporate governance and enhance the value of portfolio companies.

This approach to proxy voting is reinforced by state and federal laws and regulations (see "What Are Funds' Major Proxy Voting Obligations?" on page 3). Among other things, funds must adopt and disclose written proxy voting policies and procedures. These typically include general guidelines on how funds will vote on particular issues. Guidelines generally specify that funds will vote for accountable boards of directors and impartial audit firms; for proposals that align the interests of company employees with those of shareholders; and for proposals that increase funds' rights as shareholders and make it more difficult for company management to become entrenched or to oppose takeovers.[3]

Funds' written proxy voting policies must set forth procedures to address potential conflicts of interest in the proxy voting process. Funds and their advisers typically also employ a range of measures to mitigate conflicts of interest. For example, funds and their advisers sometimes follow predetermined voting guidelines, thus limiting discretion with respect to votes on individual proposals. Under certain circumstances, funds may vote in accordance with the recommendations of independent proxy advisory firms. Fund advisers also commonly place physical or information barriers between employees responsible for proxy voting and other employees. In addition, advisers often exclude from the proxy voting process employees whose primary duties are in sales, marketing, or external client relations, such as managing 401(k) plan business.

Trends in Management and Shareholder Proxy Proposals

Proxy proposals fall into two broad categories: management proposals and shareholder proposals. Figure 1 summarizes the proxy proposals for the 3,000 largest publicly traded U.S. companies. In this group of companies, for the 12 months ended June 30, 2009, there were 20,434 proxy proposals.

Figure 1

Proxy Proposals for the Largest Publicly Traded U.S. Companies, 2009*

Type of proposal	Number of proposals	Percentage of proposals
Management proposals	19,788	96.8%
Of which:		
Election of directors	15,055	73.7
Ratification of audit firm	2,351	11.5
Other management proposals	2,382	11.7
Shareholder proposals	646	3.2
Totals	20,434	100.0

*Proxy proposals for companies in the Russell 3000 with shareholder meetings from July 1, 2008, to June 30, 2009.
Sources: ISS Corporate Services and ICI calculations

Management Proposals

A company's board of directors initiates management proposals. These are primarily proposals that management must by law submit to company shareholders. For example, a company's shareholders annually elect or reelect a board of directors. In addition, a company must typically seek shareholder approval to make fundamental changes such as altering proxy voting rights or rules, altering a company's capital structure (e.g., increasing the number of authorized shares of common stock), instituting or renewing equity incentive plans for company employees, executing mergers or company reorganizations, or changing a company's governance structure (e.g., changing its articles of incorporation). The requirements for such approval stem from state corporation laws, federal tax laws, exchange listing standards, the company's governing documents (i.e., articles, bylaws, or charters), and other regulations.

Director elections. Most management proposals concern the election of boards of directors. These accounted for 74 percent of all proxy proposals in 2009. Directors are usually nominated by the incumbent board of directors and run unopposed. Only a tiny proportion of director elections are contested,[4] such as during a "proxy contest," where a dissident shareholder (or sometimes a group of shareholders) offers an alternative slate of directors, typically in an attempt to address underperformance ("operational activism") or encourage the sale or merger of the company ("transactional activism"). Though a dissident shareholder could seek to take control of the company by replacing a majority of the board, virtually all recent proxy contests have been for a minority of board seats.

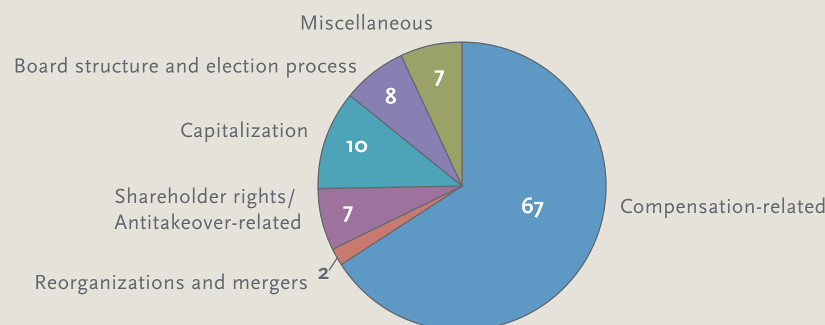
Audit firm ratification. Although they are not required to do so, most companies also ask their shareholders to ratify the company's choice of an audit firm. In 2009, of the nearly 3,000 component companies in the Russell 3000, 2,351 asked their shareholders to ratify the choice of audit firm.

Other management proposals. Other management proposals accounted for 11.7 percent (2,382) of all proxy proposals put to shareholders in Russell 3000 companies in 2009. The majority of these (67 percent) were compensation-related proposals (Figure 2), such as those seeking shareholder approval to institute or renew equity-based incentive plans. Because management must typically seek reapproval of such plans every few years, compensation-related proposals have historically been by far the most common type of other management proposal (Figure 3).

Figure 2

Other Management Proxy Proposals, 2009*

Percentage of management proposals other than director elections and audit firm ratification



**Based on 2,382 "other management proposals" at companies in the Russell 3000 with shareholder meetings from July 1, 2008, to July 30, 2009*
Note: Percentages do not add to 100 percent because of rounding.
Sources: ISS Corporate Services and ICI calculations

Figure 3

Other Management Proxy Proposals, 2002–2009

Percentage of management proposals other than director elections and audit firm ratification

Category	2002	2003	2004	2005	2006	2007	2008	2009
Compensation-related	76.4%	77.5%	69.5%	69.7%	65.1%	61.9%	59.7%	67.1%
Capitalization	13.0	11.2	12.3	11.6	11.8	10.2	9.2	9.7
Shareholder rights/Antitakeover-related	2.5	3.5	5.3	4.4	7.5	8.9	10.2	6.7
Board structure and election process	2.0	2.2	2.4	2.9	2.3	3.4	7.8	7.6
Reorganizations and mergers	4.2	3.1	6.9	4.0	3.5	5.7	4.4	1.8
Miscellaneous	1.8	2.5	3.6	7.3	9.9	9.9	8.7	7.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total number of proposals	**1,963**	**1,976**	**2,415**	**2,148**	**2,235**	**2,001**	**2,206**	**2,382**

Sources: ISS Corporate Services and ICI calculations

Shareholder Proposals

Securities and Exchange Commission (SEC) Rule 14a-8, promulgated under the Securities Exchange Act of 1934, allows a shareholder who has continuously held either $2,000 in market value or 1 percent of a company's stock during the last 12 months to submit a proxy proposal to be considered and voted on at the company's annual meeting.[5] Shareholder proposals are usually nonbinding: to avoid being disqualified under Rule 14a-8, such proposals typically recommend, rather than require, that a company's board of directors take some kind of action.

Shareholder proposals, though varying widely in substance, typically comprise a small fraction of all proxy proposals—just 3.2 percent in 2009. That year, shareholder proposals fell largely into four broad categories (Figure 4):[6]

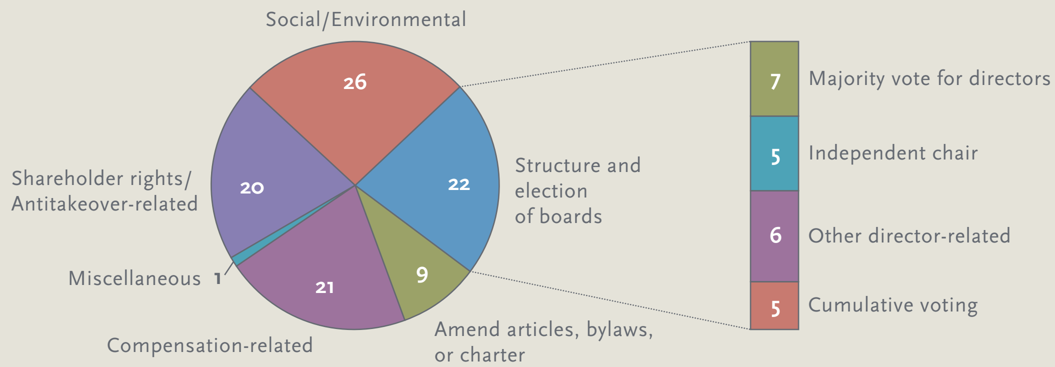
- social and environmental issues such as human rights, animal welfare, and climate change (26 percent)
- structure and election of company boards (22 percent)[7]
- compensation-related proposals (21 percent)
- shareholder rights/antitakeover-related proposals (20 percent)

Since 2002, there has been a decline in the proportion of shareholder proposals relating to social and environmental issues (Figure 5). In contrast, the proportion of compensation-related proposals has increased. Shareholder proposals to amend company bylaws or charters have seen a strong upsurge since 2006, rising to nearly 10 percent of all shareholder proposals by 2009. The great majority of these bylaw proposals asked fund boards to amend corporate charters or bylaws to allow shareholders under specified conditions to call special shareholder meetings.

Figure 4

Shareholder Proxy Proposals, 2009*

Percentage of all proxy proposals sponsored by shareholders

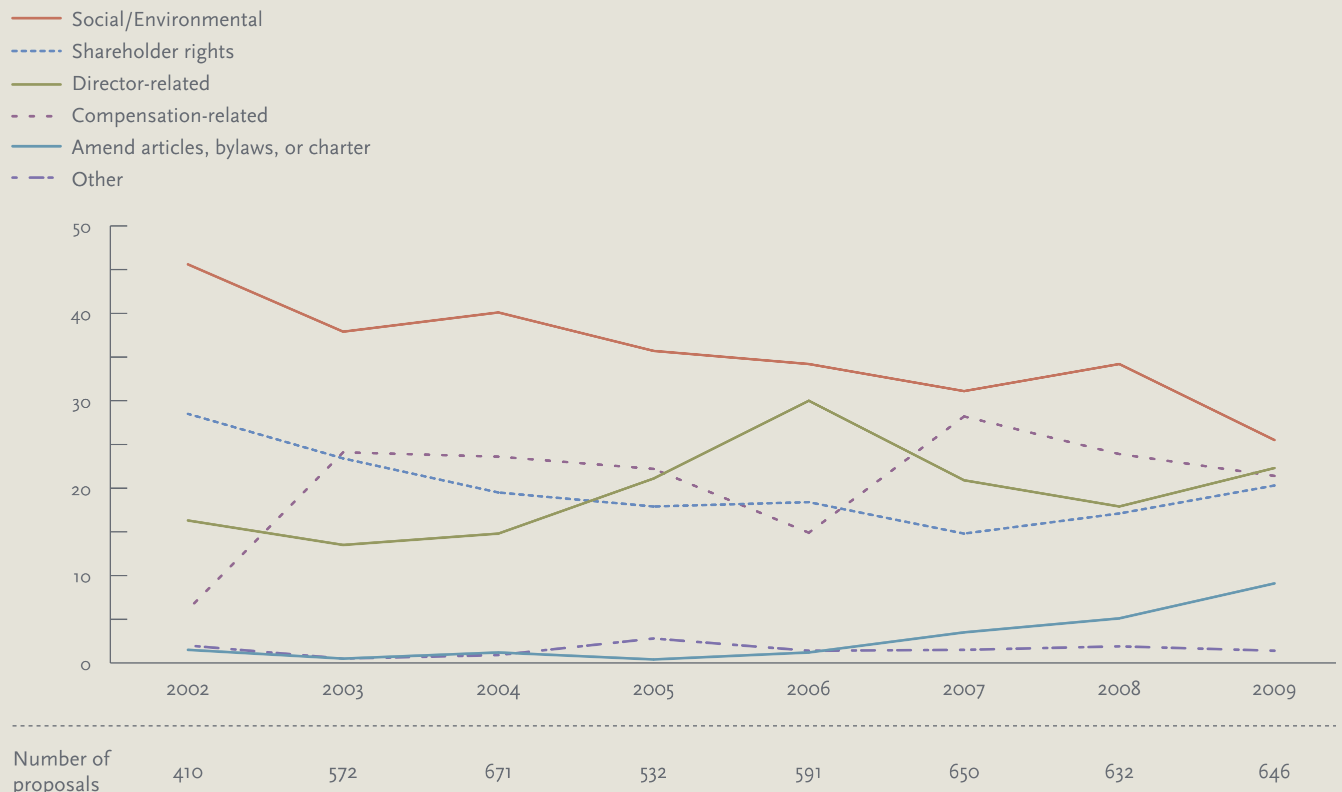


*Based on 646 shareholder proxy proposals at companies in the Russell 3000 with shareholder meetings from July 1, 2008, to June 30, 2009.
Note: Percentages in pie chart and bar do not add to 100 percent or 22 percent, respectively, because of rounding.
Sources: ISS Corporate Services and ICI calculations

Figure 5

Shareholder Proxy Proposals, 2002–2009

Percentage of the annual number of shareholder proposals



Sources: ISS Corporate Services and ICI calculations

Shareholders who sponsor proxy proposals may be individuals or institutional investors such as labor unions, defined benefit pension plans, advocacy groups, and others including funds. These groups represent diverse interests and, as a result, tend to focus on different kinds of proposals. For example, religious organizations, advocacy groups, and socially responsible investing ("SRI") investors focused predominantly on social and environmental issues from 2007 to 2009 (Figure 6).

In contrast, unions focused mainly on the structure of company boards and executive compensation. State and local defined benefit pension plans have focused about equally on social and environmental issues and board structure and executive compensation issues. Although sponsored primarily by a handful of individuals (see "Who Sponsors Shareholder Proxy Proposals?" on page 9), proposals by individuals have spanned a broad range of issues.

Figure 6

Sponsorship of Shareholder Proposals by Type of Proposal and Proponent, 2007–2009[1]

		Type of shareholder proposals:					
Proponent	**Total**	**Shareholder rights/Anti-takeover**	**Board structure and election process**	**Compensation-related**	**Social and environmetal**	**Bylaw and charter amendments**	**Other**
Individuals	643	154	267	138	47	17	20
Unions	421	5	155	205	43	0	13
Religious organizations	234	0	10	29	195	0	0
State and local defined benefit pension funds	225	3	41	50	120	3	8
Advocacy groups[2]	100	0	1	7	91	0	1
SRI investors[3]	78	1	14	13	53	1	0
Registered investment companies ("funds")	84	1	5	8	67	2	1
All others	93	13	19	25	23	0	12
Total	1,882	177	512	476	639	23	55

[1] Based on sponsorship of shareholder proxy proposals at companies with meetings from July 1, 2006, to June 30, 2009. Excludes omitted or withdrawn proposals. Some proposals are cosponsored; each sponsor is counted separately. Because some proposals have multiple sponsors, the total number of sponsorships may not equal the total number of shareholder proposals in Figure 1.

[2] Advocacy groups are defined here as nonprofit organizations whose primary activities are intended to advance certain causes such as human rights, welfare, and environmental issues.

[3] SRI investors are defined here as registered investment advisers that manage their clients assets (typically those of high net worth individuals investing through separately-managed accounts) in an effort to achieve specific financial and social objectives. Registered investment companies with a mandate to engage companies on social and environmental issues are included in the "funds" category.

Sources: ISS Corporate Services and ICI calculations

Who Sponsors Shareholder Proxy Proposals?

The majority of shareholder proposals are sponsored by a small number of proponents. For example, over the period 2007 to 2009, shareholders sponsored a total of 1,882 proposals at the 3,000 largest publicly traded U.S. companies (see figure below). Just 12 separate proponents sponsored about half of these proposals (976), with three individuals by themselves accounting for nearly 25 percent of all proposals. Remaining shareholder sponsors were much less prolific; 246 other shareholders on average sponsored 3.7 proposals each, or slightly more than one proposal per year.

Majority of Shareholder Proposals Are Sponsored by a Relatively Small Number of Proponents, 2007–2009[1]

Sponsor	Number of proposals sponsored	Percentage of all proposals	Cumulative number of proposals	Cumulative percentage of proposals
John Chevedden and affiliates[2]	267	14.2	267	14.2
New York City Pension Funds	147	7.8	414	22.0
United Brotherhood of Carpenters Pension Fund	94	5.0	508	27.0
Evelyn Davis	91	4.8	599	31.8
Gerald Armstrong	89	4.7	688	36.6
AFSCME Employees Pension Fund	67	3.6	755	40.1
AFL-CIO Reserve Fund	64	3.4	819	43.5
LongView Funds	42	2.2	861	45.8
People for the Ethical Treatment of Animals	36	1.9	897	47.7
International Brotherhood of Teamsters General Fund	29	1.5	926	49.2
Trillium Asset Management	26	1.4	952	50.6
Action Fund Management/Free Enterprise	24	1.3	976	51.9
246 other sponsors	3.7[3]	48.1	1,882	100.0

[1] *Based on 1,882 shareholder proposals at the 3,000 largest publicly traded U.S. companies for the proxy vote reporting years 2007 to 2009.*

[2] *Includes proposals sponsored by John Chevedden, Ray Chevedden, and proposals submitted by Kenneth Steiner, William Steiner, Lucy Kessler, and the Rossi family, whose proposals are often submitted by John Chevedden on their behalf.*

[3] *For 246 other sponsors, the number of proposals sponsored is the average number of proposals per proponent.*

Sources: ISS Corporate Services and ICI calculations

Who Sponsors Shareholder Proxy Proposals? *continued*

Sponsors of shareholder proposals are selective, typically focusing on only the very largest publicly traded companies. In 2009, for instance, of Russell 3000 companies, only 301 received a shareholder proposal. These 301 companies were about 10 times larger than companies in the Russell 3000 that did not receive a shareholder proposal. Why sponsors focus on the largest companies is uncertain. Some researchers have suggested that shareholders may believe that large companies have market power that can be tapped to bring about desired changes.[8] Shareholders may also target large corporations because name recognition attracts media attention that may have spillover effects to other, less well-known companies.[9] Also, it may simply be that those who sponsor proxy proposals primarily own large-cap stocks and, in an effort to enhance the values of their portfolios, primarily target large companies.[10]

The amounts that shareholder sponsors have invested in the companies they target varies widely. Some sponsors, such as state and local defined benefit pension plans, have investments totaling hundreds of millions of dollars in target companies. On the other hand, some sponsors have very limited investments in the companies their proposals target.[11] For example, in 2009, the median investment that individuals held in the companies their proposals targeted was $11,273. But 25 percent of the time, individuals had invested less than about $4,000 in the companies their proposals targeted.[12]

Regardless of the type of sponsor, the size of the target company, or the value of the sponsor's investment in a target company, funds will vote "for" or "against" such proposals on their merits. For example, funds' voting guidelines typically specify that they will vote for proposals seeking to eliminate antitakeover provisions—such as supermajority voting provisions, dual-class stock, and classified boards—which in recent years have been sponsored primarily by individuals.

Trends in Proxy Voting by Registered Investment Companies

This section examines how funds voted on proxy proposals from 2007 to 2009.[13] The analysis is based on more than 10 million proxy votes cast by funds over that period for the 3,000 largest publicly traded U.S. companies (constituent companies of the Russell 3000). Limited to those funds in the largest 206 to 240 fund families (depending on the voting year), the analysis includes votes cast by mutual funds, closed-end funds, exchange-traded funds, and mutual funds underlying variable annuities. It excludes votes cast by funds that focus on foreign companies. To gain insights into the evolving proxy voting process, our examination included detailed discussions with advisers of many funds.

In any year, the great majority of proxy votes that funds place concern the uncontested election of directors and ratification of audit firms. As noted earlier, these are by far the most numerous proxy proposals put to shareholders each year (Figure 7). Remaining votes were cast on other management proposals (9 percent of all votes in 2009) and shareholder proposals (6 percent in 2009).

In a given fund family, multiple funds may hold a particular stock. In many cases, but not always, funds within a complex will vote consistently on a particular company's ballot.[14] The number of unique proxy proposals that fund families vote on is nonetheless large. In 2009, among the 240 large fund families in our sample, the average fund family voted on 513 unique "other management proposals" and 244 unique shareholder

Figure 7

Proxy Proposals Voted on by Registered Investment Companies, 2009[1]

Type of proposal	Number of proxy votes placed[2]	Percentage of all proxy votes placed	Average number of unique proposals per fund family[3]
Management proposals	3,657,510	93.7%	4,748
Of which:			
Election of directors	2,879,776	73.8	3,613
Ratification of audit firm	411,435	10.5	555
Other management proposals	366,299	9.4	513
Shareholder proposals	244,281	6.3	244
All types	3,901,791	100.0	4,990

[1]Votes cast by 3,491 registered investment companies in 240 of the largest fund families on proposals at companies in the Russell 3000 during the 2009 N-PX reporting year (July 1, 2008, through June 30, 2009). Excludes registered investment companies with an international, world, or emerging markets focus. Percentages do not add to 100 percent because of rounding.

[2]Proxy votes cast are tallied by the number of times funds voted on particular proxy proposals, not by the number of shares that funds voted.

[3]Fund families differ in the companies that their funds own. The proxy proposals on which families must vote therefore differ, and not all families are called upon to vote on the same array of issues in each category. Thus, the average for "All types" is not the sum of the averages for the separate types of proposals.

Sources: ISS Corporate Services and ICI calculations

proposals. Due to this volume of proposals, voting requires considerable time and resources, as funds analyze proxy proposals in an effort to vote in the best interests of fund investors.

Figure 8 summarizes how funds voted during the three-year period 2007 to 2009. For comparison, the figure also reports the vote recommendations of three major proxy advisory firms: ISS Corporate Services (ISS), Glass Lewis & Co. (Glass Lewis), and Proxy Governance, Inc. (PGI).[15] The vote recommendations of these firms are often influential.[16] The percentages of shares voted in favor of these proposals are shown next in the table. The rightmost columns report the percentage of proxy proposals that passed.[17]

How Did Funds Vote on Director Elections?

Funds typically give high approval rates to the slates of directors nominated by companies. From 2007 to 2009, funds voted more than 90 percent of the time in favor of director nominees. These approval rates were on par with the vote recommendations of the three proxy advisory firms and with the result that virtually all director nominees were confirmed (rightmost three columns of Figure 8). Thus, throughout the financial crisis, director nominees continued to receive high overall approval and reelection rates.

There are several reasons for the high percentage of "for" votes that funds give directors. First, most directors stand for election unopposed; only in rare cases are elections contested. Second, the vast majority of director nominees receive positive vote recommendations from proxy advisory firms. Third, funds' voting guidelines often state that they will vote for management's proposed slate of director nominees unless there are extenuating circumstances.

Funds sometimes list in their written proxy voting guidelines examples of extenuating circumstances. For example, voting guidelines sometimes indicate that funds will withhold votes from directors who failed to exercise good judgment, did not attend at least 75 percent of board or committee meetings, or took actions considered contrary to the interests of company shareholders (such as enacting a poison pill without shareholder approval).[18]

In addition, when a fund views a company's executives as too richly compensated or regards pay practices as problematic, it may withhold votes from directors who sit on the board's compensation committee. Research indicates that withholding votes from directors can send a powerful message of shareholder dissatisfaction to a company's board and may lead the board to make substantive changes.[19]

Figure 8

Proxy Votes Cast by Registered Investment Companies Compared with Vote Recommendations of Proxy Advisory Firms, 2007–2009[1]

Percent

	Funds[2]			ISS[3]			Glass Lewis[3]		
Type of proposal	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**
Management proposals	**92.6%**	**94.0%**	**90.6%**	**93.1%**	**93.7%**	**89.3%**	**84.8%**	**86.5%**	**83.8%**
Of which:									
Election of directors	92.7	94.0	90.3	92.7	93.2	88.2	82.8	84.7	82.8
Ratification of audit firm	98.0	99.0	98.9	99.9	99.7	99.9	96.2	98.4	96.1
Other	85.5	86.9	83.5	89.2	90.1	86.2	88.6	87.2	78.2
Of which:									
Shareholder rights/ Antitakeover-related	94.0	95.7	89.2	96.4	96.0	88.5	97.4	96.3	84.9
Capitalization	82.3	83.8	86.3	90.2	91.7	91.8	84.4	77.1	70.1
Director-related	92.7	94.1	90.3	92.7	93.2	88.2	82.3	84.8	82.8
Compensation-related	83.3	85.4	82.6	87.4	89.0	85.1	86.7	86.7	78.5
Mergers and reorganizations	95.6	91.2	88.7	97.9	91.0	86.7	99.1	88.9	87.5
Miscellaneous	97.4	98.8	98.4	99.2	99.4	99.5	95.6	98.0	95.6
Shareholder proposals	35.2	31.1	49.8	57.9	58.0	76.0	41.3	40.6	58.8
Of which:									
Shareholder rights/ Antitakeover-related	67.9	78.2	67.5	75.5	91.8	78.5	75.3	90.7	73.2
Social/Environmental	13.9	13.2	20.6	31.7	32.6	48.2	4.7	4.0	21.6
Board structure and election process[4]	41.5	35.7	48.7	64.9	69.2	90.5	86.4	79.1	93.1
Compensation-related	40.0	35.9	47.5	74.3	74.4	87.8	42.1	56.2	68.2
Amend articles, bylaws, or charter	79.7	68.4	69.6	100.0	100.0	98.5	36.8	55.2	65.6
Miscellaneous	1.4	2.9	16.3	0.0	0.0	31.9	0.0	16.9	4.5
All types	**87.9**	**89.5**	**87.7**	**90.2**	**91.0**	**88.5**	**81.2**	**83.1**	**82.3**
Memo: Total fund votes included	**3,292,340**	**3,198,957**	**3,901,791**						
Total number of funds included	**3,128**	**3,045**	**3,491**						
Total number of fund advisers included	**206**	**223**	**240**						

Continued on next page

Figure 8 Continued

Proxy Votes Cast by Registered Investment Companies Compared with Vote Recommendations of Proxy Advisory Firms, 2007–2009[1]

Percent

	PGI[3]			Percentage of shares voted in favor			Percentage of proposals passing		
Type of proposal	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**
Management proposals	**N/A**	**97.3%**	**97.0%**	**97.4%**	**94.3%**	**92.6%**	**98.1%**	**99.7%**	**99.7%**
Of which:									
Election of directors	N/A	96.8	96.7	95.2	94.8	92.9	99.9	99.9	100.0
Ratification of audit firm	N/A	100.0	100.0	98.6	98.5	98.3	100.0	99.9	100.0
Other	N/A	98.3	96.0	83.7	84.6	83.8	95.8	97.0	96.7
Of which:									
Shareholder rights/ Antitakeover-related	N/A	97.9	98.8	82.8	82.3	78.1	91.7	87.7	84.4
Capitalization	N/A	100.0	98.7	80.0	76.9	82.5	95.8	95.8	94.7
Director-related	N/A	96.9	96.7	95.2	94.8	92.9	98.3	99.9	99.9
Compensation-related	N/A	98.6	96.1	85.0	86.1	84.6	96.8	98.7	98.4
Mergers and reorganizations	N/A	89.8	99.6	75.9	81.4	84.9	96.7	96.3	100.0
Miscellaneous	N/A	99.8	99.7	97.0	97.9	97.8	97.9	99.7	99.6
Shareholder proposals	**N/A**	**22.8**	**34.0**	**30.1**	**30.1**	**36.9**	**15.5**	**17.0**	**24.9**
Of which:									
Shareholder rights/ Antitakeover-related	N/A	31.8	41.0	55.3	60.8	53.3	52.2	68.3	57.3
Social/Environmental	N/A	29.2	41.8	15.0	13.8	17.7	2.1	1.0	3.0
Board structure and election process[4]	N/A	25.7	38.0	34.1	34.0	41.6	16.9	17.1	25.7
Compensation-related	N/A	7.9	13.1	28.6	30.2	36.8	4.2	4.5	13.2
Amend articles, bylaws, or charter	N/A	31.8	53.5	57.4	47.8	52.1	68.2	42.9	54.2
Miscellaneous	N/A	16.8	39.0	11.1	11.1	16.5	0.0	0.0	0.0
All types	**N/A**	**91.9**	**93.1**	**92.5**	**92.4**	**91.0**	**95.5**	**97.2**	**97.5**

[1] Votes cast by registered investment companies during the 2007, 2008, and 2009 N-PX reporting years (fiscal years July 1 to June 30). Excludes registered investment companies with an international, world, or emerging market focus.

[2] Measured as the number of mutual funds recording a "for" vote for proposals in a given category, divided by the sum of "for," "against," and "withhold" votes and abstentions.

[3] Measured as the number of "for" recommendations for proposals in a given category, divided by the total number of recommendations made.

[4] Shareholder proposals calling for, or related to, declassifying boards are included in "Antitakeover related" shareholder proposals.

N/A = not available

Sources: ISS Corporate Services; Glass Lewis & Co.; Proxy Governance, Inc.; ICI calculations

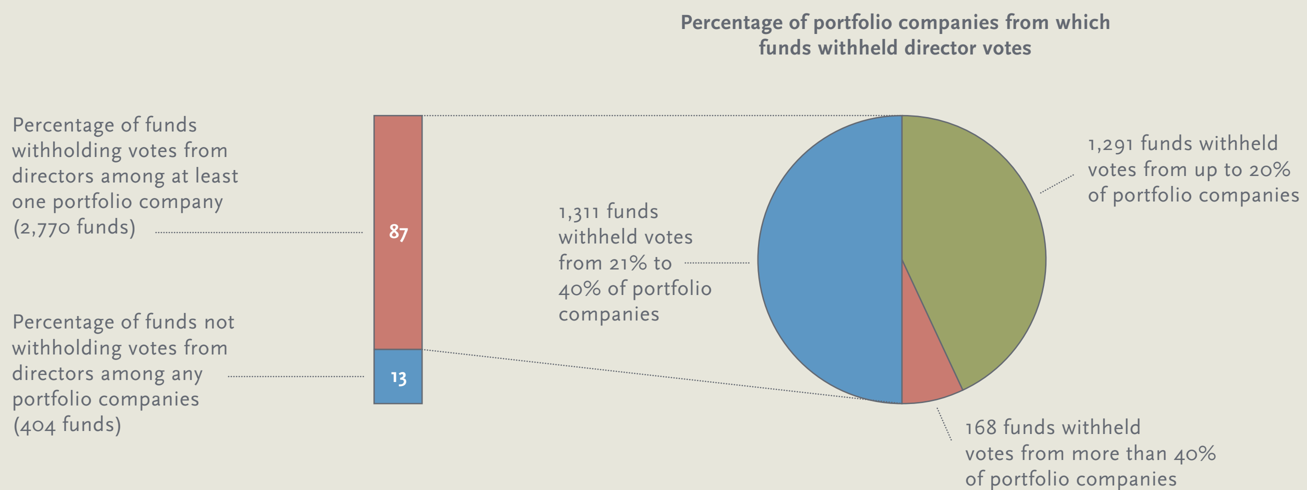
As Figure 9 illustrates, extenuating circumstances arise with some frequency. The bar tabulates the number of funds that withheld votes from directors in 2009. Only 13 percent of funds voted to confirm all director nominees for every portfolio company. The great majority of funds (87 percent) withheld votes for at least one director at one or more portfolio companies. Funds that withheld votes were not shy about doing so. For example, among funds that withheld votes for director nominees, nearly half (1,311 funds) withheld votes at between 21 to 40 percent of their portfolio companies (see pie chart in Figure 9). The typical (i.e., median) fund among these 1,311 funds held 72 portfolio companies and withheld votes for one or more directors at 20 companies.

There is evidence that funds' support for directors deteriorated somewhat during the financial crisis. On average, funds withheld votes from 7 percent of directors in 2007, but 10 percent in 2009 (Figure 8). In part, the higher withholding rate in 2009 reflected the increased disclosure about executive compensation that the federal government required companies to add to their proxy statements after 2006. In light of this increased disclosure, some funds reported an increased propensity to withhold votes from directors on compensation committees to express disapproval of executive compensation packages.

Figure 9

Funds Express Dissatisfaction with Company Boards When Circumstances Warrant*

Percentage of funds withholding votes from directors



**N-PX filing year July 1, 2008, to June 30, 2009, for funds holding at least 10 portfolio companies.*
Sources: ISS Corporate Services and ICI calculations

How Did Funds Vote on "Other Management Proposals"?

Funds generally gave high, though more moderate, support to "other management proposals," voting in favor of such proposals on average 85 percent of the time from 2007 to 2009 (Figure 8). These high rates are evident in each of the six subcategories of "other management proposals" and are broadly in line with the vote recommendations of the proxy advisory firms.

Voting patterns on "other management proposals" remained relatively constant during the financial crisis. This constancy is consistent with funds' voting guidelines, which often specify that funds will give substantial weight to the vote recommendations of a company's board absent mitigating guidelines or factors.[20] This specification recognizes that management (with oversight from the company's board) is responsible for day-to-day operations and longer-term planning. In addition, some funds take the view that voting for management proposals is appropriate in light of companies' ongoing enhancements to corporate governance practices.[21] Funds can also "vote with their feet"—if a fund deems a company to be ineffectively managed, the fund may sell its investment.

How Did Funds Vote on Shareholder Proposals?

Funds, proxy advisory firms, and shareholders in general looked somewhat more favorably on shareholder proposals in 2009 than 2007. For example, in 2007, funds voted 35 percent of the time in favor of all types of shareholder proposals. That figure jumped almost 15 percentage points to 50 percent in 2009. Approval rates given by the proxy advisory firms jumped by similar amounts. For example, Glass Lewis recommended voting in favor of 41.3 percent of all shareholder proposals that funds voted on in 2007 but 58.8 percent in 2009.

The rise in the overall approval rate that funds gave to shareholder proposals came primarily because of a change in the mix of proposals toward those that funds were more likely to favor. First, the number of shareholder proposals seeking to amend corporate bylaws or charters (Figure 5) sharply increased. That increase, combined with a high average approval rate (e.g., 70 percent in 2009), helped raise the overall percentage of times funds voted in favor of shareholder proposals.

Second, the mix of compensation-related proposals shifted away from proposals seeking specific limits on pay practices and toward say-on-pay proposals, which were more likely to receive funds' approval. As a result, fund voting in favor of compensation-related proposals rose from 40 percent of the time in 2007 to 48 percent of the time in 2009.

From here, this study takes an in-depth look at how and why funds voted as they did on special meeting and say-on-pay proposals. Both types of proposals were relatively new to proxy voting in the United States. As a result, funds faced new challenges and issues in deciding how to vote. How funds voted depended on a variety of concerns, including the specifics of individual proposals, whether funds viewed the proposals as likely to add shareholder value, the circumstances of the companies targeted, funds' voting guidelines, and funds' efforts to engage companies in discussions related to the subject matter of the proposals.

A Closer Look at Shareholder Proposals to Amend Bylaws

As noted earlier, there has been a marked increase in the number of shareholder proposals seeking bylaw amendments to allow shareholders the right to call a special meeting. This right offers certain benefits. For example, shareholders may be able to vote to replace directors who have acted contrary to the interests of shareholders before the company's next annual meeting. Such a case could arise, say, if a board refused to consider an attractive offer to buy the company. As noted, funds generally favor measures that increase their rights as company shareholders.

However, funds do not always favor special meeting proposals. Special shareholder meetings can impose significant administrative and financial costs on a company (for, e.g., preparation and distribution of proxy materials and the solicitation and tabulation of votes). Moreover, funds may find the specifics of certain proposals contrary to the interests of fund investors.

Should Shareholders Always Favor Shareholder Proposals?

Commentators have strongly suggested that shareholders serve their interests best by always voting in favor of shareholder proposals. For example, in a recent report on mutual fund proxy voting, the American Federation of State, County and Municipal Employees (AFSCME), a labor union, states that it "considers a vote 'for' shareholder proposals to be more likely to serve shareholder interests."[22] Or consider ProxyDemocracy, a nonprofit organization whose website implies that those investors who vote most frequently in favor of shareholder proposals do a better job of making public corporations accountable to company shareholders.[23]

This is a simplistic view of proxy voting. The fact that *one* shareholder sponsors a proxy proposal does not mean that *all* (or even most) shareholders will view the proposal as beneficial. Whether a particular shareholder (including a fund) favors a shareholder-sponsored proxy proposal will depend on a range of factors. What are the proposal's details? How does the shareholder feel about the company's management and performance? Is the proposal infeasible or costly? Is the proposal likely to raise or lower the price of the company's stock? Has management been responsive to shareholder concerns? Is the proposal poorly drafted or too restrictive?[24] Do independent proxy advisory firms favor the proposal?

Even proponents of the "always vote yes" approach appear to grapple with these complexities, sometimes voting "no" on shareholder proposals. For example, AFSCME in some cases acknowledges that "voting against a shareholder proposal...may be in shareholders' best interests."[25] Consistent with this view, AFSCME, which votes proxies for its defined benefit pension plan, voted in 2009 against 35 shareholder proposals, including proposals seeking to limit executive compensation, requesting that companies study climate change, eliminating or reducing antitakeover defenses, asking a company to hire an adviser to help maximize shareholder value, and asking a tobacco company to reduce nicotine levels in its products to nonaddictive levels. On one type of shareholder proposal—a request to relocate company headquarters to North Dakota—AFSCME voted "yes" for half of companies and "no" for the other half.[26] One can understand the rationale for such votes only by studying the details of these proposals, the companies to which they apply, the surrounding circumstances, and the all-important question of whether the shareholder views a particular proposal as serving its interests.

Indeed, an "always vote yes" approach can lead to outcomes that are clearly contrary to the interests of company shareholders. To take an extreme example, in 2008, an Exxon Mobil shareholder submitted a proxy proposal asking the company to amend its bylaws to deny shareholders the right to submit shareholder proposals without prior approval by Exxon Mobil's board.[27] If shareholders had voted "yes," the proposal's implementation would have drastically limited the ability of Exxon Mobil shareholders to sponsor proposals. Exxon Mobil's board—as well as the proxy advisory firms ISS, Glass-Lewis, and PGI—recommended voting against this proposal. Shareholders gave it a very low approval rate (only 2.8 percent of shares voted in favor).

For example, special meeting proposals offered by shareholders in 2009 specified that a shareholder or group of shareholders owning 10 percent of a company's stock may call a special meeting at any time for any reason. A variety of considerations affected funds' voting positions on such proposals. Some companies argued that a 10 percent ownership threshold might be too low to prevent activities contrary to the interests of long-term shareholders, a concern shared by some funds.[28]

In addition, some of the companies targeted by the 2009 special meeting proposals already had special meeting provisions in their bylaws at an ownership threshold greater than 10 percent. Some funds indicated that they viewed the 2009 shareholder special meeting proposals as unnecessary for these companies.

Finally, proxy voting is not the only way funds addressed the issue. For example, in cases where a company did not already have a special meeting provision, some funds noted that they wrote to company boards or engaged management in discussions. This led a number of companies to adopt special meeting provisions with ownership thresholds ranging from 20 percent to 25 percent.

Fund voting patterns reflect these diverse considerations. Funds generally gave high approval rates to special meeting proposals, voting in favor of such proposals 69 percent of the time in 2009. But voting patterns varied across the companies to which such proposals were directed as well as across funds. The top panel of Figure 10 shows how funds voted across companies. The percent of times that funds voted in favor of special meeting proposals varied from a low of 54 percent at the advertising and marketing concern Interpublic Group to a high of 79 percent at the medical technology company Becton, Dickinson.

This variation also shows up in how individual funds dealt with special meeting proposals. The bottom panel of Figure 10 shows how individual funds voted on such proposals in 2009. A significant number of funds (489) always voted against the proposals, while a larger number (1,439) always voted for them. Some funds (571 funds out of 2,499) split their votes, voting for such proposals at some companies and against them at others. By comparison, ISS recommended in favor of these proposals 100 percent of the time, while Glass Lewis (64 percent in favor) and PGI (50 percent in favor) had more mixed views.

A Closer Look at Say-on-Pay Proposals

Say-on-pay proposals are nonbinding proposals relating to executive pay. Either shareholders or management may sponsor such proposals, but shareholder and management say-on-pay proposals are fundamentally different.

A shareholder say-on-pay proposal asks management to add an advisory (up or down) vote on executive compensation to the company's future proxy statements. In effect, voting on a shareholder say-on-pay proposal requires shareholders to state whether they believe that the company should allow them an overall vote on executive compensation.

A management say-on-pay proposal is quite different in that it actually gives shareholders a chance to vote (on an advisory basis) on executive compensation. A management say-on-pay proposal thus serves a different function: it asks shareholders whether they approve or disapprove of the company's executive compensation arrangements (i.e., the compensation of the company's top five executives as spelled out in its annual proxy statement).

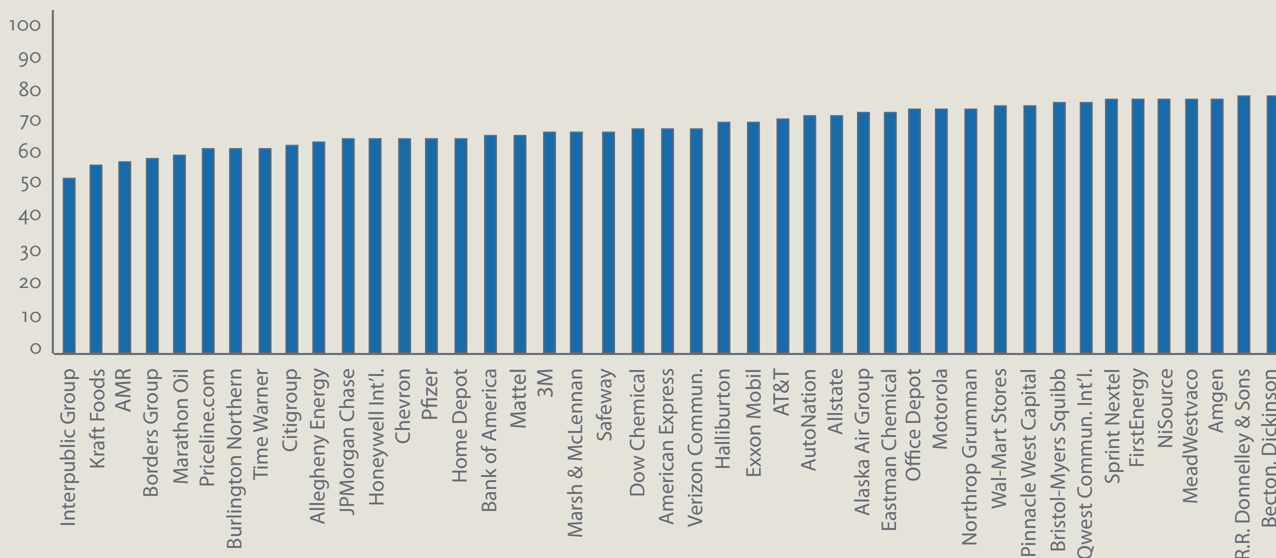
Advocates of say-on-pay proposals argue that executive compensation arrangements contributed to the financial crisis by giving executives the incentive to take large risks in pursuit of short-term profits with little or no consequences for failure.[29] They argue that say-on-pay proposals improve board accountability to company shareholders by giving shareholders a way to express their views on executive compensation, allowing boards and shareholders to work together to design compensation that gives executives strong incentives to maximize long-term firm value.[30]

Figure 10

How Funds Voted on Special Meeting Proposals Varied Across Companies and Funds*

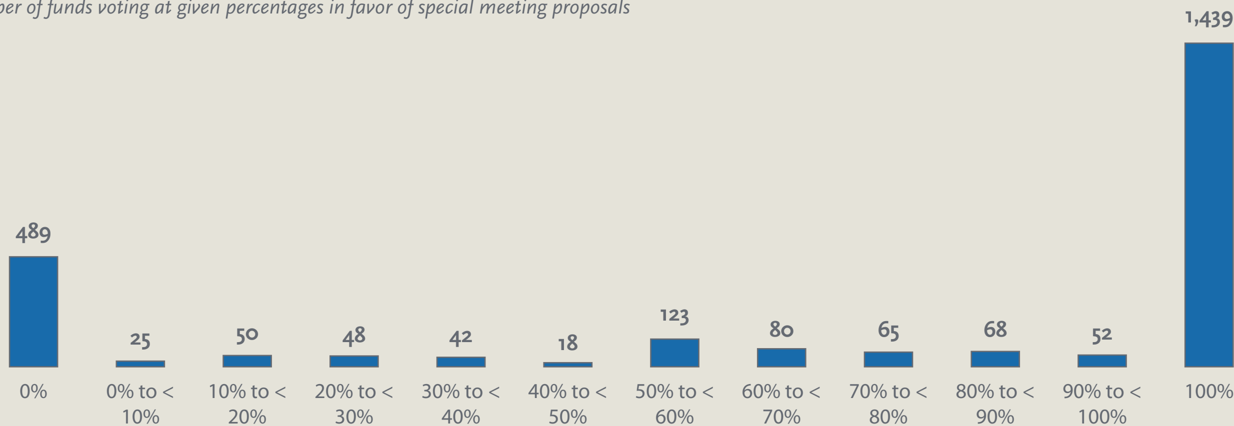
How all funds voted on special meeting proposals at given companies

Percentage of funds voting in favor of proposal at given company



How individual funds voted at all companies having special meeting proposals

Number of funds voting at given percentages in favor of special meeting proposals



*Votes cast by registered investment companies during the 2009 N-PX reporting year (fiscal year July 1 to June 30). Excludes registered investment companies with an international, world, or emerging market focus.

Sources: ISS Corporate Services and ICI calculations

Opponents argue that the details of executive pay packages are often complex and are better left to company boards, whose compensation committees have the expertise to deal with such issues in the best interests of shareholders. Say-on-pay initiatives may also be divisive, driven by special interests, or unclear.[31] If management loses a management say-on-pay vote, it might be uncertain as to what action shareholders expect management to take. Finally, opponents suggest that there may be more effective ways to express dissatisfaction with executive compensation, such as withholding votes from members of the board's compensation committee or even the entire board.[32]

Whatever the merits of these arguments, say-on-pay proposals are becoming more common. Say-on-pay originated in the United Kingdom in the early 2000s, when the government mandated an annual advisory vote on board compensation. Since then, other countries, including Australia, Sweden, Netherlands, and Norway, have introduced various forms of say-on-pay.[33]

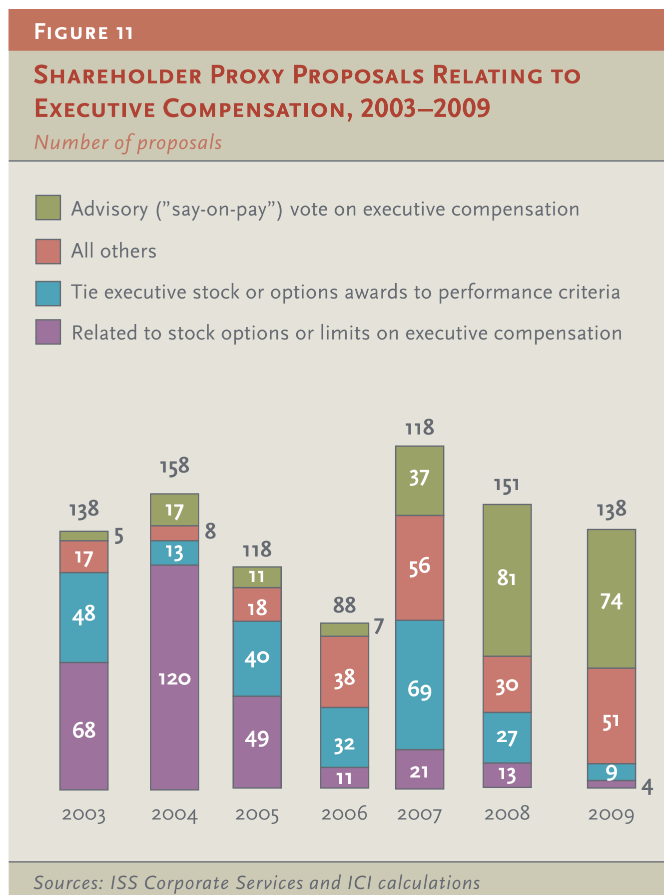


Figure 11

Shareholder Proxy Proposals Relating to Executive Compensation, 2003–2009

Number of proposals

Sources: ISS Corporate Services and ICI calculations

In the United States, executive compensation is perennially an object of shareholder proposals, but there were relatively few say-on-pay proposals before 2007 (Figure 11). Most shareholder proposals relating to executive compensation requested greater disclosure or limits on grants of stock or options or linkage of executive compensation to various performance measures.

AFSCME introduced shareholder say-on-pay proposals in the United States in 2006. The number of such proposals jumped in 2007; they accounted for over half of all shareholder proposals relating to executive compensation in 2008 and 2009.

Similarly, the number of management say-on-pay proposals increased sharply in the past few years. There were no such proposals in 2007, four in 2008, and 230 in 2009. One reason for this increase was some companies' voluntary adoption of management say-on-pay proposals. Historically, company boards were not favorably disposed toward requests from shareholders to hold say-on-pay votes. In 2008, however, two companies voluntarily placed say-on-pay proposals in their proxy statements. Twelve did so in 2009, and the number was reportedly even greater in 2010.

The sharp rise in management say-on-pay proposals also reflects provisions of the federal government's Troubled Asset Relief Program (TARP). Any company that borrowed money from the federal government under TARP was required to give shareholders an advisory (up or down) vote on compensation of the company's five top executives as laid out in the Compensation Discussion and Analysis section of the company's proxy statement. The company must continue to hold such a vote each year until it repays the federal government. In 2009, funds voted on required say-on-pay proposals at 217 banks and other financial institutions.

Most recently, the Dodd-Frank Wall Street Reform and Financial Protection Act, signed into law on July 21, 2010, requires all publicly traded companies to add a management say-on-pay proposal to their proxy statements in 2011 and at least once every three years thereafter.[34]

How Did Funds Vote on Shareholder Say-on-Pay Proposals?

From 2007 to 2009, funds consistently voted about half of the time in favor of shareholder say-on-pay proposals (Figure 12). ISS and Glass Lewis recommended in favor of virtually all such proposals, whereas PGI recommended in favor of very few. Shareholder say-on-pay proposals generally failed to receive majority support.

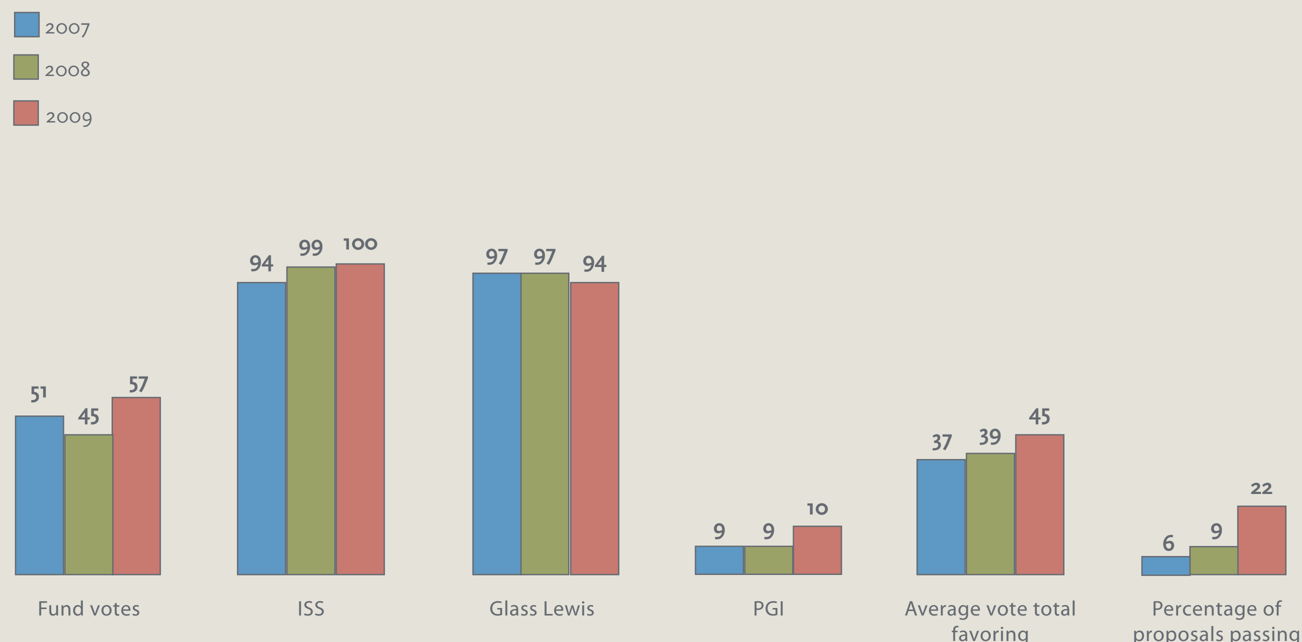
Given the assertion that excessive compensation among financial firms contributed to the financial crisis, it is appropriate to ask why funds gave substantial, though mixed, support to shareholder say-on-pay proposals. Among the factors that influenced how funds voted were the following:

- **Views differ on the need for say-on-pay proposals**. Consider the high percentages in vote recommendations by ISS and Glass Lewis, on the one hand, and the relatively low rates from PGI on the other. These varying percentages reflect differing views about say-on-pay proposals. ISS, for instance, had a policy of recommending in favor of shareholder say-on-pay proposals for all companies, largely irrespective of the level of compensation of company executives, company performance, pay practices, or another other factors. In contrast, PGI had a more selective policy, favoring such proposals when a company has systemic pay issues but advising against them for companies that follow reasonable pay-for-performance practices and that have good governance and accountability.[35]
- **Funds generally do not subscribe to a one-size-fits-all approach to voting on say-on-pay proposals**. Shareholder say-on-pay proposals have typically been worded identically regardless of the company

Figure 12

Fund Votes for Shareholder Say-on-Pay Proposals with Vote Recommendations of Proxy Advisory Firms and Vote Outcomes, 2007–2009*

Percent



**Based on 34 unique say-on-pay proposals for N-PX reporting year 2007, 70 for N-PX reporting year 2008, and 67 for N-PX reporting year 2009. These are all the proposals that funds voted on and on which ISS, Glass Lewis, and PGI all issued vote recommendations.*

Sources: ISS Corporate Services; Glass Lewis & Co.; Proxy Governance, Inc.; ICI calculations

targeted. Funds, however, recognize that pay practices differ across companies and that a given say-on-pay proposal may be appropriate for one company but not another.

- **Funds sometimes use other channels to express dissatisfaction when pay practices are problematic**. For example, if a fund believes that a company's executives are too highly compensated, it may engage company board members in direct discussions. If such discussions are successful, a say-on-pay proposal may be unnecessary. If such discussions are not successful, a fund may choose to withhold votes from members of the board's compensation committee, rather than expressing dissatisfaction by voting for a shareholder say-on-pay proposal.
- **Most of the companies that received shareholder say-on-pay proposals in 2009 were nonfinancial companies**. Thus, their activities were largely or totally unrelated to causes of the financial crisis. Many banks and other financial companies did place management say-on-pay proposals on their proxy statements.

How Did Funds Vote on Management Say-on-Pay Proposals?

As noted earlier, shareholder and management say-on-pay proposals are fundamentally different. A shareholder say-on-pay proposal asks shareholders whether they would like to have an advisory vote on executive compensation. A management say-on-pay proposal asks shareholders to register an opinion (approval or disapproval) on the company's executive compensation arrangements.

In 2009, funds voted 80 percent of the time in favor of management say-on-pay proposals (Figure 13). That percentage was a bit higher than the approval rate offered by ISS (70 percent), but lower than approval rates of Glass Lewis (89 percent) and PGI (94 percent). Put differently, funds disapproved of executive compensation packages nearly 20 percent of the time. All of the management say-on-pay proposals that funds voted on in 2009 passed.

How funds voted on management and shareholder say-on-pay proposals generally reflected different considerations. Funds cited several factors as influencing whether they voted for management say-on-pay proposals, including:

- **The particulars of each company's pay structure**. Funds apparently considered factors such as company performance, the likelihood that compensation arrangements would motivate senior executives to act in the interests of company shareholders, and the overall level of executive compensation. Funds were reportedly apt to vote against management say-on-pay proposals if pay practices offered executives excessive or inappropriate perquisites or had features such as tax gross-up policies, which are often considered contrary to the interests of company shareholders.[36]
- **The vote recommendations of proxy advisory firms**. While funds must decide for themselves how to vote, the recommendations of proxy advisory firms can nonetheless be influential. In 2009, the proxy advisory firms recommended in favor of the great majority of management say-on-pay proposals (70.1 percent for ISS, 89.1 percent for Glass Lewis, and 94.1 percent for PGI).
- **Whether funds engaged companies in direct discussions about issues of concern, including executive compensation**. Over the course of a year, some funds enter discussions with several hundred portfolio companies. Many companies actively seek guidance and feedback on compensation arrangements from funds, other shareholders, and proxy advisory firms. When companies take such guidance and feedback to heart, management say-on-pay proposals are more apt to gain approval.
- **Whether funds viewed executive compensation as appropriately restrained**. Executive compensation fell sharply in 2008 (the period to which the management say-on-pay proposals in 2009 relate) for senior

executives of many financial firms because stock and other performance-related awards declined during the recession. In fact, the senior executives of some large financial institutions received no stock or performance-related awards in 2008. TARP legislation also restricted the compensation of senior executives at companies that received federal aid.

- **The relatively new phenomenon of say-on-pay proposals in the United States**. Funds, like other shareholders, were still learning about these proposals and the role such proposals may play in promoting good pay practices. In addition, some funds indicated that they were waiting to see what approach, if any, Congress might take in mandating a management say-on-pay proposal for companies.

It remains to be seen whether these voting trends for management say-on-pay proposals will persist for funds and other shareholders. Given that say-on-pay proposals are a new phenomenon in the United States, voting patterns may evolve as shareholders gain more experience with them. For example, while all of the management say-on-pay proposals that funds voted on in 2009 passed, a few management say-on-pay proposals reportedly failed in the voting year ended June 30, 2010. Voting data are not yet available to assess how funds' votes may have factored into these results.

Say-on-pay is an issue that is likely to require increasing focus by funds. With all publicly traded companies now mandated by the Dodd-Frank Act to hold a management say-on-pay proposal in 2011 and then at least once every three years, funds will have to analyze hundreds to potentially thousands more management proposals each year. In adapting to this change, funds will have to devote additional time and resources to evaluating such proposals to generate outcomes that are beneficial to the interests of fund investors.

Figure 13

Funds, Other Shareholders, and Proxy Advisors Gave Substantial Support to Management Say-on-Pay Proposals, 2009

Percentage of proposals favored by funds and proxy advisory firms

Sources: ISS Corporate Services and ICI calculations

Conclusion

This study examines more than 10 million proxy votes cast by funds over the three-year period July 1, 2006, to June 30, 2009. Funds continued to vote for proposals on their merits, following principles laid out in their policies and voting guidelines. Guided by a broad obligation to vote in the best interest of investors, funds considered a range of factors, including the details of individual proposals, the performance of the companies to which they applied, the quality and responsiveness of the management of those companies, and the recommendations of independent proxy advisory firms.

Notes

[1] Throughout this article, a "year" is defined as the 12-month period ending June 30. For example, the year 2009 means the 12-month period running from July 1, 2008, to June 30, 2009. This maintains consistency with the cycle that the Securities and Exchange Commission (SEC) requires funds to follow in disclosing their proxy votes on SEC Form N-PX. Fund votes for the proxy reporting year 2010 were being reported to the SEC as this article went to press and have not yet been collated.

[2] See Collins 2008, page 9.

[3] For a detailed description of the proxy voting policies and guidelines of the largest mutual fund complexes, see Collins 2008.

[4] See Collins 2008.

[5] SEC Rule 14a-8 is intended to allow investors to express their concerns with company boards of directors and to propose alternative courses of corporate action. But the rule may also allow shareholders with a very limited financial interest in a company to exert disproportionate influence. To provide checks and balances against this, Rule 14a-8 allows a company's board to seek to omit a shareholder proposal from its proxy statement under certain conditions (see Collins, 2008). In addition, shareholder proposals may be withdrawn by their sponsors before coming to a vote, often because the company has agreed to make the requested changes. Over the three years 2007 to 2009, 14.7 percent of shareholder proposals were omitted and 26 percent were withdrawn. If a shareholder proposal is not omitted or withdrawn, it must be included on the company's proxy statement, which is printed and delivered to all of the company's voting shareholders at the company's expense (sponsoring shareholders incur none of the printing or delivery costs).

[6] For more detail on the range and types of shareholder proposals, see the discussion on pages 10–11 in Collins 2008.

[7] On August 25, 2010, the SEC adopted changes to the federal proxy rules to facilitate the ability of shareholders to nominate directors to a company's board and to submit proposals to establish procedures for the inclusion of shareholder director nominations in company proxy materials. See SEC Release No. 33-9136, available at http://www.sec.gov/rules/final/2010/33-9136.pdf. One effect of these rule changes could be an influx of the newly-permitted type of shareholder proposal.

[8] See Tkac 2006, page 8.

[9] See Del Guercio and Hawkins 1999, who note that the "threat of publicity might give…leverage with target management, and might also motivate other companies to proactively improve their corporate governance structures without being explicitly targeted."

[10] Smith 1996 notes that "[f]irm size may affect the likelihood of being targeted. If larger firms comprise a larger percentage of an institution's investment portfolio (perhaps due to indexing strategies), the expected benefits may be larger from targeting these firms since the private gain to the activist, if targeting is successful, is larger."

[11] For example, Cai and Walkling 2009 note that "most [say-on-pay] proposals are sponsored by labor unions with very small stock holdings in the companies targeted."

[12] Figures on the market value of the holdings of individuals who sponsor proposals are drawn from proxy statements that companies filed with the SEC (SEC report DEF 14A). Figures are for all individuals who sponsored proxy proposals during the N-PX reporting year July 1, 2008, to June 30, 2009, who can be identified from report DEF 14A and for whom DEF 14A reports the number of shares owned. Market values are calculated using share prices, as reported by Bloomberg, for each company as of its respective annual meeting date.

[13] Fund votes are tallied by whether funds voted "for," "withhold," "against," "abstain," or "did not vote" rather than by the number of shares each fund voted; the number of shares funds voted is not collected on Form N-PX.

[14] See Collins 2008.

[15] ISS Corporate Services is a division of MSCI, Inc., a publicly traded company. Glass Lewis & Co. is an independent wholly owned subsidiary of the Ontario Teachers' Pension Plan Board. Proxy Governance, Inc. is a wholly owned subsidiary of FOLIOfn, a privately held financial services firm.

[16] See Choi et al. 2009, who note that "ISS, in particular, has been described as exercising 'tremendous clout'…and being able to sway up to 30 percent of the vote in any particular proxy contest."

[17] In Figure 8, fund votes are tallied by funds voting on particular proxy proposals. Thus, if multiple funds in the same family each vote on the same proxy proposal, each fund's vote is counted separately.

[18] For more details, see Collins 2008.

[19] See Del Guercio et al. 2008.

[20] See Collins 2008.

[21] See, for example, "Proxy Voting Guidelines of the Putnam Funds," available at https://content.putnam.com/shared/pdf/proxy_voting_guidelines.pdf.

[22] See American Federation of State, County, and Municipal Employees et al. 2007.

[23] The ProxyDemocracy website counts funds as more "activist" (by which the website indicates that it means "holding public corporations accountable to their shareholders") if they always vote proxies contrary to company board voting recommendations. Since boards virtually always recommend voting against shareholder proposals, the ProxyDemocracy method of counting fund votes is an indirect way of arguing that funds should always vote in favor of shareholder proposals. For details, see http://www.proxydemocracy.org/fund_owners.

[24] The report by American Federation of State, County, and Municipal Employees et al. 2007 notes that a "shareholder proposal may not be in shareholders' interests because it is poorly drafted or too restrictive."

[25] See American Federation of State, County, and Municipal Employees et al. 2010.

[26] See American Federation of State, County, and Municipal Employees proxy voting decisions for the N-PX voting year July 1, 2008, to June 30, 2009, available at http://www.afscme.org/issues/19752.cfm.

[27] The sponsor of this proposal argued that in the previous year (2007), "activists and nuisance shareholders submitted 11 precatory proposals requesting that [Exxon Mobil] take action that could result in increased activist pressure and influence...[and that] the purpose of such proposals is to harass and intimidate [Exxon Mobil] into actions that it would not ordinarily undertake and that, in fact, may be harmful to [Exxon Mobil]" and its shareholders. See U.S. Securities and Exchange Commission, Schedule DEF 14A, Definitive Proxy Statement of Exxon Mobil, April 10, 2008.

[28] See, for example, U.S. Securities and Exchange Commission, Schedule DEF 14A, Definitive Proxy Statement of Motorola, Inc., March 13, 2009, available at http://www.sec.gov/Archives/edgar/data/68505/000095013709001840/c49150ddef14a.htm#117. Motorola's board, responding to a shareholder special meeting proposal in 2009, indicated that permitting "holders of 10% to call a special meeting that may serve their narrow purpose rather than those of our Company and the majority of our stockholders is neither good corporate governance, nor in the best interests of our Company and stockholders. Unlike a stockholder with a potential agenda or special interest, the Chairman of the Board and the Board of Directors have a legal fiduciary duty to represent the best interests of all shareholders. The Board believes the decision to call a special meeting should remain in the hands of our Chairman of the Board and Board of Directors in order to make sure all stockholders' interests are taken into consideration and to enable our Company's business to be conducted in an orderly fashion."

[29] For example, CFA Institute Centre for Financial Market Integrity and Council for Institutional Investors 2009 argues that "The global financial crisis represents a massive failure of oversight... Too many CEOs pursued excessively risky strategies...Poorly structured pay plans that rewarded short term but unsustainable performance encouraged CEOs to pursue risky strategies that hobbled one financial institution after another and tarnished the credibility of U.S. financial markets. To remedy this situation, stronger governance checks on runaway pay are needed."

[30] See, for example, U.S. Treasury Department 2009.

[31] Cai and Walkling (2009) state that "our evidence suggests that say-on-pay may benefit firms with questionable pay practices but can hurt firms targeted by special interests."

[32] See Deane 2007.

[33] See Davis 2007 and Dunn and Bowie 2009.

[34] See "Dodd-Frank Wall Street Reform and Consumer Protection Act Conference Report to Accompany H.R. 4173," at Section 951, available at http://financialservices.house.gov/FinancialSvcsDemMedia/file/key_issues/Financial_Regulatory_Reform/conference_report_FINAL.pdf.

[35] See RiskMetrics Group 2009 and Proxy Governance, Inc. 2010.

[36] A tax gross-up is a company policy to pay the federal tax liability of a senior executive that may come due in the event of a change in control of the company.

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