sifma
asset management group

ASSET MANAGEMENT FUNDAMENTALS

Proxy Voting - How Investors Engage with the Companies They Own

What is Proxy Voting?

Publicly traded companies hold shareholder meetings at which key issues are presented to a shareholder vote. Proxy voting enables the company's shareholders to submit their votes on each matter without attending the meeting in person.

What matters are voted on by shareholders?

Matters subject to shareholder vote are determined by legal and regulatory requirements and a company's governing documents. When issuers call annual or special meetings, shareholders receive notice and descriptive information about the matters to be considered. These matters may include the election of directors, approval of equity compensation plans, and changes in capital issuance, among others. Individual shareholders, however, can also submit proposals for inclusion on the company's ballot for consideration by other shareholders. However, the vast majority of ballot matters are non-controversial and receive very little, if any, attention.

Investors, including individuals and mutual funds, who own shares in a publicly traded company have the right to vote at its shareholder meeting (either by attending the meeting or voting by proxy).

Mutual funds and investment advisors must have proxy voting policies that describe how they may vote on various matters subject to a shareholder vote.

When Does an Asset Manager Vote?

Some investors retain an asset manager to manage their own account(s) (rather than investing through a commingled vehicle). These investors either vote themselves or rely on the asset manager advising their account to make voting decisions for them. In these cases, the asset manager typically makes investment decisions for the investor and incorporates voting into their services.

Instead of maintaining their own holdings, many investors prefer to invest through commingled funds, such as mutual funds or private funds. Each commingled fund has a specific investment objective and pools investor money to purchase assets consistent with that objective. An asset manager makes investment decisions for the fund to buy or sell financial instruments, including company stock. While fund shareholders hold shares of the fund and are economically exposed to stocks (and other securities) held by the fund, they do not

directly hold portfolio company shares or voting rights for those shares. The fund's manager votes portfolio company shares on behalf of the fund pursuant to their proxy voting policies.

Recently, some mutual funds have begun to enable fund investors to make their own policy selections from a menu of options, directing how the fund should vote their proportionate shares (sometimes referred to in the industry as "investor choice," "proxy voting choice," or "pass-through voting").

Separate account clients can obtain information from their adviser regarding votes made on their behalf. For fund investors, the SEC requires mutual funds to make annual disclosures of their proxy voting activities via Form N-PX.

Recent SEC amendments expanded voting disclosures occurring after July 1, 2023. Among other things, the changes require more detailed information, presentation in a machine-readable format, and more disclosure on "say on pay" matters.

How Do Asset Managers Make Voting Decisions?

As a fiduciary, the asset manager is obliged to make investment and voting decisions in the best interest of the client. Like investment decisions, managers can have different perspectives on voting and what views are in the "best interest" of the client.

Since 2003, Securities and Exchange Commission Rule 206(4)-6 has required investment advisers to adopt proxy voting policies to document their approach and give clients more information about their practices. Each company and each vote are unique, but policies typically outline general voting philosophies. For example, a policy might state that the manager typically supports or opposes the election of directors based on independence, conflicts of interest, job performance, term limits, or personal liability. Policies often address how a manager approaches potential changes to voting rights, capital structures, takeover defenses, selection of auditors, and executive compensation.

What is the Role of Proxy Advisors?

Votes cast at shareholder meetings can be numerous and complex. To provide research and recommendations that assist those making voting decisions, investors and managers may utilize firms called "proxy advisors." These firms provide multiple services and clients will often use some, but not all, services. Among other things, these firms identify upcoming votes, conduct research to better understand the proposals, and provide voting recommendations based on a range of policies, including some of which are customized directly by the client. Some clients, while not reliant on the proxy advisor's recommendation, utilize them primarily as a data gathering mechanism.

Proxy advisors do not own voting stock and are not a substitute for investment decisions made to buy or sell. Proxy advisors can operate as an independent source of information and efficiently cover and research a high volume of votes. A recommendation from a proxy advisor may have varying degrees of impact on a

shareholder's voting decision. It can be a starting point for a voting decision, a second and independent perspective, or a means of determining a vote if the manager has a conflict of interest. While proxy advisors can make recommendations on specific votes, asset managers ultimately make voting decisions based on their own proxy voting guidelines, which may or may not align with the recommendations of the proxy advisor.

What is a Proxy Card?

A proxy card is the mechanism through which a shareholder grants a representative of the company the right to vote on their behalf. The proxy card lists the proposals (such as director nominees), the valid voting options for each proposal (such as "for" or "against"), and the recommendation of company management on each proposal. In most cases, company management recommends a vote "for" each proposal put forth by the company.

In cases where a dissident shareholder proposes its own slate of director nominees, proxy cards issued by both the company and the dissident must include all the possible directors. This universal proxy card – required since August 2022 – enables shareholders to easily mix their votes between the management and dissident slates on a single ballot.

What is Pass Through Voting for Mutual Funds?

While institutional separate account clients can either delegate voting authority to their asset manager or retain voting authority and vote proxies themselves, mutual fund shareholders do not currently have voting authority with respect to the fund's portfolio holdings because they own shares of the fund, not the underlying portfolio securities. That said, funds may offer different approaches that seek shareholder direction to inform the manager's voting decisions.

Some asset managers are piloting voting programs that give shareholders greater influence on fund voting decisions based on their proportional fund ownership.

These programs employ a variety of approaches when seeking shareholder input. For example, a manager could vote in proportion based on shareholder input, which could involve casting a mix of "for" and "against" votes on the same proposals. Another manager might survey shareholders and cast all the fund's votes for the direction with the most shareholder support. Another manager might not consider shareholder preferences to be binding, but rather a helpful directional signal for consideration as they decide how to vote. Another alternative is for fund shareholders to establish standing instructions or select from a range of voting policies from proxy advisors that are applied to votes as they arise (as opposed to weighing in on individual votes).

These voting programs are in their infancy. Questions remain about the level of shareholder interest in these programs, their implementation costs, and operational feasibility.

What is Mirror Voting?

Mirror voting is a proxy voting policy that commits to voting shares in a way that "mirrors" others voted. Such a mechanism diminishes discretion over voting. By committing to vote shares in proportion to all other such stock voted by all other holders, the adviser does not exercise voting control. Mirror voting typically comes up in circumstances where a fund or adviser has a conflict of interest or holds large positions. Some companies or regulations place limits on how much an individual owner or manager can control. Votes for shares below a threshold are handled in the ordinary course, but voting shares above the threshold may require different treatment. In such a case, a manager can commit to voting those shares in the same proportion as the issuer's shareholder base, subject to a variety of operational constraints. In that way, votes are cast rather than lost, but votes are made in close proportion to decisions made by other shareholders and the voter's discretion is limited.

What is the Difference Between Proxy Voting and Stewardship?

The term "stewardship" typically means all the various mechanisms a fiduciary uses to work on behalf of their clients and investors to advance their long-term economic interests. Proxy voting is typically a key component of stewardship, but stewardship also covers other activities such as direct engagement with companies on specific issues. Importantly, different advisers and funds may have distinct approaches to stewardship, including as relevant to the unique investment objectives and strategies of a particular fund.

***

About SIFMA and SIFMA AMG:

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. For more information, visit http://www.sifma.org.

January 2025