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A Financial Times Service

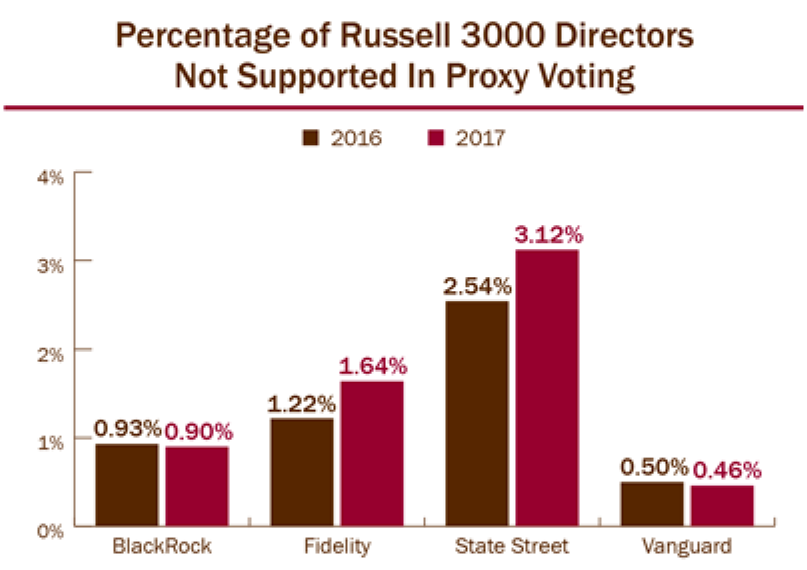
‘Against’ Votes by Institutional Investors Spike

By Brooke Fox December 18, 2017

The world’s most powerful institutional investors were more willing to cast withhold votes against board directors in 2017, a sign that the way board directors engage with shareholders may be about to change. As *Agenda* has reported, Vanguard Group, BlackRock Inc, State Street Global Advisors and Fidelity all announced new initiatives that suggested they would impose a higher level of scrutiny on directors of companies in their portfolios to elicit changes that were in the best interests of their shareholders. As it turns out, they’re being true to their word.

“We have started taking voting action against more directors, primarily because we are holding them accountable for some of the views that we want and we expect them to be implementing,” says Rakhi Kumar, head of corporate governance for State Street. “But by and large, I would say [we still have] a very high level of support for directors.”

BlackRock and Fidelity did not respond to requests for comment for this article, but their voting records suggest they are following State Street’s lead.



Source: *Fund Votes*

During the 2017 proxy season, Vanguard, BlackRock, State Street and Fidelity cast more than 1 million votes in board director elections for the Russell 3000. Supporting votes were withheld from 6.1% of the candidates, or almost 1,000 directors, according to an Agenda analysis of data from Fund Votes. These numbers represent an 18% increase over last year’s proxy season, which saw support withheld from a combined 5.2% of directors, or just over 800. Specifically, State Street and Fidelity increased withheld support the most among directors in the Russell 3000, while BlackRock and Vanguard remained relatively flat. Among directors in the S&P 500, all investorsexcept Vanguard voted against more directors in 2017 than in 2016.

“I know that Vanguard, State Street and BlackRock have all added to their governance teams within the past year, so this issue is definitely not going away,” says **Zally Ahmadi**, director of corporate governance and executive compensation at **D.F. King**, an **AST** company. “If anything, it’s becoming a larger and larger point of focus for the institutional investors.”

Indeed, in the last three years Vanguard’s investment stewardship team has doubled, BlackRock has hired 11 analysts, and State Street’s team has tripled in size.

State Street, which has been vocal about taking a more active role in engaging with portfolio companies, cast the most votes against board directors in the Russell 3000, withholding support on 3.1% of director elections, or about 480 votes. Fidelity came in second, dissenting on 1.6% of its votes, followed by BlackRock with 0.9% withhold votes and Vanguard with 0.46%.

The increase in votes against board members represent a shift among large institutional investors that have come under pressure to increase their engagement with portfolio companies. With a combined $5.86 trillion in market cap, these four companies own 21% of the entire public equity market. There is not a single S&P 500 company that does not have one of these four investors among their top five largest shareholders.

This concentration of asset ownership among these four institutional investors is largely due to retirement offerings in mutual funds and ETFs. In Q1 2017, 401(k) plan assets stood at $5.02 trillion, an increase of 61% since 2010. The share of mutual fund assets concentrated in the five largest fund complexes was 47% in 2016, and has been steadily increasing since 2005, according to the Investment Company Industry (ICI) 2017 Factbook. ICI credits the increasing concentration to growing popularity of index funds, as well as inflows to bond mutual funds.

Due to the sheer size of the assets they wield, these asset managers are often the largest investors of many of the companies in their portfolios. Vanguard leads the pack as the largest shareholder of 58% of the companies in the S&P 500, and it is the second-largest shareholder for another 30% of the S&P. Through assets it has amassed via popular mutual funds and ETFs, Vanguard has a share larger than 10% in 360 publicly traded companies.

Why Directors Received‘Against Votes’

The industry with the most votes against its board directors in the S&P 500 was Internet content information. Some big four institutional investors voted against well-known tech figures such as Sheryl Sandberg, Mark Zuckerberg and Marc Andreessen, according to an *Agenda* analysis of data from Proxy Insight.

The leisure industry had the second-most votes against directors, followed by pay TV and residential REITs. Some directors who sit on multiple boards, such as Charles Munger, John Malone and Reed Hastings, received withhold votes on more than one company's proxy.

Each of the largest institutional investors has its own process of determining whether it will withhold votes. Vanguard and State Street both said they receive research from proxy advisory firms such as Institutional Shareholder Services (ISS), but that their own guidelines determine voting decisions on board directors. Guidelines explaining what might elicit withhold votes include factors such as board independence, director tenure, board diversity, succession planning, evaluations and overboarding.

"We take a number of things into account when voting on directors," Carol Wegemann, a spokesperson for Vanguard, writes in an e-mail. "We believe good governance starts with a majority-independent board whose key committees are composed entirely of independent directors. The board's compensation, nomination and audit committees should be [composed] of all independent directors."

BlackRock and State Street occasionally shared their rationales for voting against specific board directors on their fund websites. The most cited reason for withholding support from an S&P 500 director was that the director served on too many boards — more than three or four — according to an *Agenda* analysis of data provided by Proxy Insight.

When it comes to overboarding, Ahmadi advises board directors to engage with shareholders to ease fears about lack of attention. For example, if a director is on several boards, but is at every meeting and fulfills all requirements, and the company is performing well, then he or she should mention those facts to shareholders.

Both Vanguard and State Street say they are willing to hear directors' arguments against a withhold vote on a case-by-case basis. State Street says it gives directors time to make appropriate adjustments and then monitors their progress.

"Most often companies, after a back-and-forth, understand where we are coming from, [and] they provide additional perspective. Sometimes there's a middle ground; sometimes they see our point of view and then agree to implement our suggestions," says Kumar.

Engagements can take the form of in-person meetings, phone calls or video conferences, says Wegemann.

“Continued engagement allows us to better understand a company’s strategy, so that when there are bumps in the road, we can put them in the appropriate context. Ultimately, our goal is that a fund’s final voting decision shouldn’t come as a surprise,” she says in an e-mail.

The second-most-cited reason for withhold votes was displeasure with the compensation committee’s ability to align pay with performance and peers. Companies’ failing in this regard usually resulted in votes against one or more directors on its compensation committee.

As Agenda has reported, the New York City Pension Funds sent letters to 151 companies indicating that they will be pushing for more disclosure of directors’ skills and diversity to determine “Why is this board the right board for this company?”

“This type of standardized disclosure would boost accountability and allow shareowners like the New York City Pension Funds to identify boards that are ill-suited to protect their investments due to a lack of diversity or relevant expertise,” NYC comptroller Scott Stringer said in a statement.

Other reasons for dissenting votes included a lack of support for shareholder proposals from the prior year’s proxy, excessive director tenure, lack of independence and overall poor governance.

When board directors are cited by proxy advisors for lack of responsiveness to shareholder concerns and poor attendance, they receive significantly lower votes than for other concerns, says Ahmadi. To address the issue, Ahmadi advises board directors to disclose a reasonable explanation for something like lack of attendance, such as an illness that led to missing a meeting.

“At the end of the day it’s all about explaining to your shareholders why you think your board is the best for this company,” says Ahmadi. “And if you don’t think that, you explain what steps you’re taking to get there.”