Demystifying Proxy Voting: How do Institutional Investors Vote Shares?

ESG Global Advisors

The exercise of voting rights as a company shareholder is a fundamental tenet of investment stewardship. How do institutional investors approach proxy voting in practice, how much influence do proxy advisors really have, and how can public company issuers meet emerging expectations?

The Influence of Institutional Investors

Globally, institutional investors typically own 40-70% of the outstanding shares of public companies.[1] Assets in the trillions of dollars give some institutional investors significant ownership of large listed companies, with positions commonly exceeding 5% ownership, and often over 10%.[2] Given their influence on capital markets, it is important that public company issuers understand the decision-making processes used by institutional investors in voting their shares.

Proxy Advisory Firms

The largest institutional investors may hold thousands of companies in their portfolios, voting at thousands of annual and special meetings per year on tens of thousands of ballot items. Dealing with this volume can be costly and requires significant resources, so many institutional investors subscribe to the services of proxy voting advisors. It is estimated that combined, the two largest proxy advisory firms, Institutional Shareholder Services (ISS) and Glass, Lewis & Co. (Glass Lewis) control 97% of the proxy advisory market.[3] ISS covers approximately 44,000 meetings in 115 countries per year.[4] Glass Lewis covers approximately 20,000 meetings in 100 countries per year.[5]

Proprietary Voting Policies

The proxy advisory firms' service offerings that are best known among issuers are the research reports and vote recommendations. The information contained in company circulars is reviewed and aggregated to offer analysis of both management and shareholder proposals. Advisory firms also produce voting recommendations. These are based on proprietary voting policies developed by each proxy advisory firm based on regulatory developments, current market practices, ESG trends, and academic literature. The voting policies are publicly disclosed and developed in consultation with market participants. Both ISS and Glass Lewis have processes to solicit feedback from a range of stakeholders, including issuers, based on public consultations or invitations to comment. Many institutional investors provide extensive feedback, which is highly valued by the proxy advisors.

Custom Voting Policies

Although the proxy advisory firms offer voting recommendations based on their own proprietary voting policies, most institutional investors actually cast their votes based on their own unique proxy voting guidelines. These "custom policies" usually address a range of voting considerations for frequently-encountered management and shareholder proposals. Typically, they are updated annually based on evolving proxy voting issues and ESG trends. Glass Lewis notes that the "supermajority of Glass Lewis clients vote according to a custom policy or via a custom process for reaching a vote decision"[6] and ISS reports that over 400 institutional investor clients, including 85% of their top 100 clients, use a custom policy.[7]

Voting Platforms

For the largest institutional investors, the main value offered by proxy advisors may be assistance with vote execution and the technical elements of the proxy voting process. The voting platforms, ISS ProxyExchange and Glass Lewis Viewpoint, provide an efficient, convenient and cost-effective way for investors to manage the mechanics of voting. They allow them to receive electronic ballots, easily execute votes for millions of shares, conduct recordkeeping, disclose vote decisions and rationales, and access important voting information for clients. Proxy voting would be more resource-intensive, costly and likely error-prone without this technical support.

Updated:
February 2020

1 https://www.oecd.org/daf/competition/ownership-structure-in-publicly-listed-equity-capital-markets-ecgi-conference.pdf
2 https://www.bloomberg.com/professional/blog/vanguard-blackrock-lead-rise-passive-ownership/
3 https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/
4 https://www.issgovernance.com/about/about-iss/
5 https://www.glasslewis.com/company-overview/
6 http://www.glasslewis.com/wp-content/uploads/2019/02/GL-Compliance-Statement-2019.pdf
7 https://www.issgovernance.com/file/publications/iss-roundtable-comment-letter.pdf

Concerns about the impact of proxy advisory firms on vote results have been widespread and seem likely to lead to further regulation in the United States.[8] In fact, the major proxy advisory firms, including ISS and Glass Lewis, recently agreed to greater voluntary oversight.[9] Since the vast majority of investors vote according to their own custom policies, it is unclear whether these interventions will lead to the enhanced proxy voting outcomes desired by issuers.

Implications for Companies

It is critically important for companies to understand whether their largest investors vote according to proxy advisor policies or their own custom voting policies. In addition, since custom voting policies almost always allow for the use of a significant amount of discretion, companies should understand the ESG priorities of their largest investors, as those priorities will inform how that discretion is exercised when voting decisions are made. This understanding is becoming increasingly important as the use of shareholder proposals becomes more popular and more institutional shareholders are prepared to support them. For example, during the 2019 U.S. proxy voting season, environmental and social shareholder proposals represented 55% of all shareholder proposals filed[10] and they received a record level of shareholder support.[11]

Companies should understand the proxy voting policies and approaches used by their key investors, and how they relate to their ESG priorities. A robust understanding of investors' approach to ESG and proxy voting can help avoid surprising vote results and inform a company's approach and response to shareholder proposals.

About ESG Global Advisors

ESG Global Advisors bridges the gap between companies and investors on environmental, social and governance (ESG) factors. A multi-disciplinary team with significant investor and corporate experience, we are uniquely positioned to offer expert advice to companies and investors on material ESG factors that drive long-term value, including climate change. We assist companies and boards of directors with:

- Understanding how investors integrate ESG factors into investment processes and stewardship
- Developing strategies for managing material ESG factors to generate superior long-term value
- Developing approaches to ESG-related disclosure and engagement with shareholders

Learn more at www.esgglobaladvisors.com.

ESG Global Advisors

ESG Global Advisors Inc.
100 King Street West Suite 5600
Toronto, ON M5X 1C9
647.264.0463

Updated:
February 2020

8 https://www.uschamber.com/event/corporate-governance-making-the-case-reform. Subsequent to the first publication of this report, in November 2019 the Securities and Exchange Commission proposed new rules for proxy advisors on conflict of interest disclosure and enabling issuer feedback on research: https://www.sec.gov/news/press-release/2019-23
9 https://www.irmagazine.com/regulation/proxy-advisers-agree-greater-independent-scrutiny?utm_content=97173519&utm_medium=social&utm_source=twitter&hss_channel=tw-53035614
10 ISS Analytics. An Early Look at 2019 US Shareholder Proposals. 2019
11 ISS Analytics. Early Review of 2019 US Proxy Season Vote Results. 2019