Broadridge

Ready for Next

Mutual fund proxy for the modern era

Conquering proxy challenges through innovation to increase shareholder engagement

Unlike public companies and closed-end funds, open-end mutual funds and exchange-traded funds (ETFs) are not required to hold annual meetings. They are, however, required to gain shareholder approval on certain issues, such as changing how the fund operates, what investments it holds, or even who is elected to the fund's board. Rules pertaining to how many shares are required to be present (quorum) at the meeting and, of those, what percentage are needed to cast votes in favor (passage) vary depending on the state of incorporation. The process can be complex, time-consuming, and costly.

In recent years, attaining the quorum and votes needed for passage has become more difficult, largely due to several factors:

- The impact of discretionary voting.
- Restrictions in contacting shareholders via mobile phones.
- Persistent retail shareholder apathy.

The average time to complete a proxy campaign has increased from 41 to 57 days. This adds cost and impacts shareholder satisfaction.

In order to change this dynamic, a thorough assessment of the underlying issues driving today's proxy process — and what steps can be taken to streamline all aspects of the process and improve results — is required.

Mutual funds, unlike public companies, are held predominantly by retail shareholders. The topics covered in the ensuing pages will shed insight on the challenges as well as the solutions being developed.

In this paper, we will examine:

- How funds approach the proxy process after materials are created and filed with the SEC.
- How SEC rules impact the vote.
- How shareholder composition increases or decreases the cost and time spent to attain quorum.
- The actions that can and, in many cases, already are being undertaken to make the process more efficient and less costly.

IN THIS WHITE PAPER

Start with the basics: The heritage and legacy of the mutual fund proxy process

Proactive voter engagement is critical, whether that's at the ballot box or with mutual fund proxy voting.

For mutual fund shareholders, the proxy vote is an opportunity to make their voices heard. Common proposals can include a merger or other management changes, a change to the fund's investment objective, or the election of trustees or directors. The Board must first determine that the proposal is in the best interest of the shareholders and the fund, and then the proxy process must be conducted to obtain shareholder approval.

Practicing good corporate governance means educating shareholders on their rights, the importance of their participation in the process, and how proxies may affect them. It is essential that they are educated and can actively participate.

State and federal laws

Many proxy voting requirements are governed by state and federal laws. On the federal level, the basic framework of the Investment Company Act of 1940 (40 Act) requires shareholder approval of certain proposals. For these proposals, funds are required to obtain a quorum of greater than 50% of the outstanding shares and a favorable vote of 67% of the voted shares. As an alternative, the 40 Act allows funds to meet the requirement by obtaining at least 50% of all outstanding shares in favor.

However, director elections are determined by state law and company bylaws and often have lower quorum and passage requirements. Funds may also have varying deadlines, quorum, and passage requirements depending on the state of incorporation and their bylaws.

A wide range of shareholder types

Mutual funds encompass different types of shareholders (e.g., retail and institutional investors), all of whom engage with the proxy process in distinct ways. Given this complexity, funds rely on third parties to help ensure shareholders are educated about the meeting proposals. Third-party involvement also helps ensure the integrity of the vote and that the voting process is conducted efficiently, accurately, reliably, and securely through audits, cyber-security, and business continuity plan controls.

The many investor and account types involved in a mutual fund proxy event

Retail holders*	Omnibus accounts	Trusts
Institutional holders*	Controlled shares	Annuitants
ERISA plans and IRA holders	Non-objecting beneficial owners (NOBO) and objecting beneficial owners (OBO) holders	Insurance company accounts

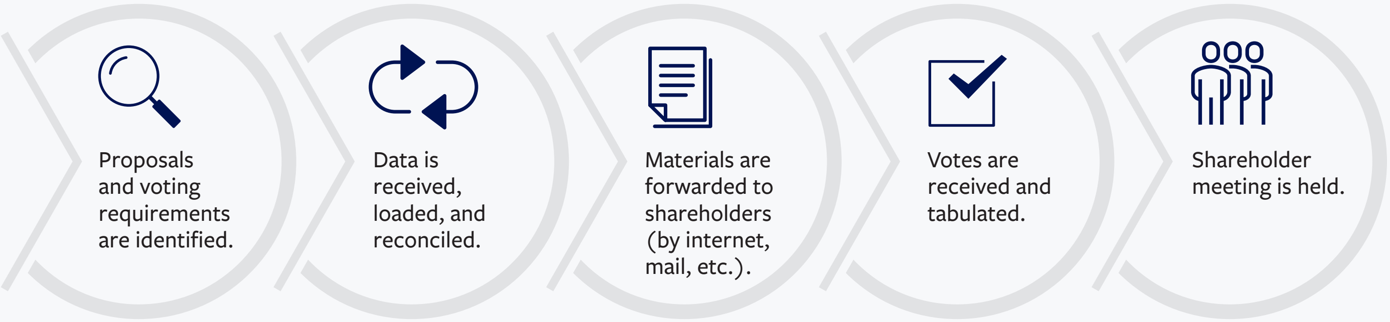
*Includes Separately Managed Accounts.

How the mutual fund proxy process works

As matters needing shareholder approval arise, fund personnel, usually in the legal department, often with outside counsel as well, draft proxy materials and file a preliminary notice of proxy (NPS) with the Securities and Exchange Commission (SEC). Once comments are received and responded to, the fund can then proceed with the proxy itself. This includes the initial distribution of proxy materials to shareholders. Votes are then tabulated to confirm that quorum has been obtained, and if not, subsequent communications are made to solicit votes. Once quorum is reached, the fund holds a shareholder meeting.

The process involves many parties, including internal (legal, administration, distribution, the transfer agent) and external (financial printer and solicitor) stakeholders. This paper will focus on how the fund approaches the process after the materials are created and filed with the SEC.

The mutual fund proxy process typically includes:



The problem:
Reaching quorum has become more difficult

Despite advancements, funds still find it challenging to engage retail shareholders.

According to the Investment Company Institute (ICI), over 52% of US households owned mutual funds in 2022,[1] up from about 6% in 1980.[2]

Generally, shares of public companies are owned predominantly by institutional shareholders that vote their proxies. However, most shareholders in mutual funds are retail investors. These shareholders tend to hold fewer shares and often require multiple communications before they cast a vote. In the past, participation efforts focused on reminder mailings and phone calls to unvoted shareholders. These campaigns were time-consuming and costly for funds, as well as inconvenient for shareholders.

Strategies to obtain quorum may involve direct communications with shareholders, contact with financial advisors, or both. The communication process repeats itself until sufficient votes have been received to achieve quorum and passage. If the fund has not received sufficient votes, it generally adjourns the meeting until management is able to obtain enough votes, at which point a new meeting date can be set. The fund's goal is to avoid adjournment, which is not only time-consuming, but costly for the fund and shareholders.

Although many positive enhancements to proxy communications have been made, there is still much to be done to increase retail shareholder engagement.

These newer challenges of today can be grouped into three categories:

1. Education and shareholder apathy.
2. Regulatory constraints, particularly related to mobile phone engagement.
3. The reduction of discretionary voting.

1. Education and shareholder apathy

Shareholder apathy, lack of incentive, and inadequate education on the shareholder's role and its importance to corporate governance are significant hurdles to increasing retail proxy voting. A number of factors contribute to why retail investors don't vote:

- **Inexperience:** Shareholders are not aware of the process and their rights as shareholders.
- **Education:** Shareholders and their advisors may not understand the purpose of proxy voting and corporate governance, as well as the costs involved with not voting.
- **Apathy:** Shareholders often simply do not see the benefits of engagement or why it's important to vote their proxies.
- **Insignificance:** Shareholders with few shares often don't think their vote will make a difference.

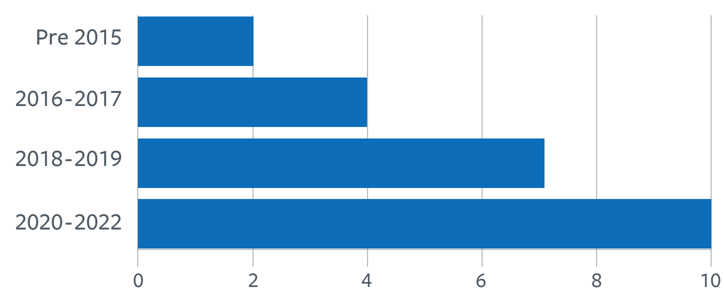
2. Mobile phone constraints

The proliferation of cell phone use has created a huge challenge for reaching retail shareholders. Regulatory constraints, such as the Telephone Consumer Protection Act, limit the ability to communicate with shareholders via their cell phone numbers. As more shareholders move away from landlines, phone solicitations reach fewer shareholders. In addition, security features on phones (caller ID, call blocking, etc.) make it harder to reach shareholders.

3. The reduction of discretionary voting[3]

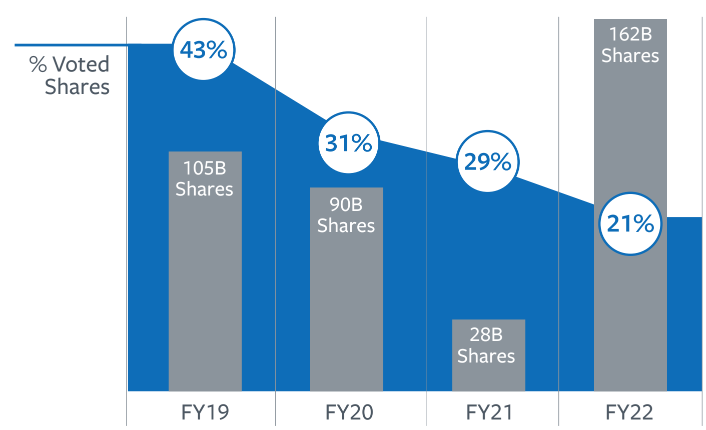
New York Stock Exchange (NYSE) rules allow for brokers to issue votes on behalf of their underlying beneficial accounts if the broker does not receive instructions by a specific time prior to the meeting. This is known as discretionary voting. Several large brokers have stopped issuing discretionary voting during the last few years.[4] It's unclear if this trend will continue, but if it does, it will make it even harder and more costly for funds to reach quorum.

Number of brokers not providing discretionary votes is increasing



This shift in discretionary voting has a direct impact on the percentage of shares voted. Review a real-life case study on page 7.

Percentage of voted shares is decreasing



IN ACTION:

Case study on the impact of discretionary voting

Challenge

A large U.S. index trust recently forwarded proxy materials to shareholders in each of the funds in the trust.

Quorum requirement: Based on the state of incorporation, the quorum to hold the meeting was 50%. That meant 50% of the outstanding shares in each of the funds on the record date had to cast a vote.

A brokerage firm held 31% of the shares in beneficial interest for underlying shareholder accounts.

NYSE rule

Per NYSE rules[5], the firm could vote unvoted shares with “discretion.” In most cases, these shares were either voted as management recommended or on a proportionate basis. Voting shares proportionately did not change the favorable percentages, but it did allow the fund to increase quorum. This is a common practice with Director/Trustee elections. They are considered routine in nature; the “discretionary” vote is often sufficient to allow the fund to attain a quorum and hold the shareholder meeting.

Results

In this instance, the broker withheld its discretionary vote, which, due to the large size of the broker’s position, significantly hindered the ability to get to quorum.

With all other discretionary shares being voted, at meeting date the fund had a quorum of 50.082% and was able to hold the meeting without additional time and cost being incurred. The meeting was held — and the proposal passed.

The next largest discretionary vote was 8.5%. If this advisor had also elected to withhold its discretionary vote, the fund would not have attained a quorum and likely would have needed to send additional correspondence to shareholders, thus delaying the meeting and incurring further cost. Any additional brokers withholding their discretionary votes would have further impacted the vote.

Future ramifications

Although quorum was ultimately not impacted, this is a real example of the potential impact of withholding discretionary votes. If more firms decide not to provide discretionary votes, or if the brokers that have already implemented this practice have even slightly more shares than in this situation, quorum will be at risk.

The solution: Innovations that are making a difference

Recent innovations are helping.

Innovations and enhancements to the proxy voting process (see figure 1) have evolved over time to help address the challenge of attaining quorum.

Figure 1

These enhancements to current methods are increasing participation, while reducing costs:

- Streamlined and enhanced traditional paper communications
- Notice and Access (N&A)
- Phone communications
- Investor education
- Vote Propensity Analysis
- Social media

While shareholders still respond to physical packages that require them to return a signed proxy ballot, the use of electronic voting has gained acceptance. In addition, new technologies and methods have been helpful to funds in increasing shareholder engagement. Shareholders can vote shares via the internet, mobile voting apps, social media, electronic mailboxes (an email inbox hosted by a broker or other third party for investor use) and/or text messages (see figure 2). For example, through the Broadridge ProxyVote™ app, 606 million shares were voted during the 2023 proxy season.

Streamlined and enhanced traditional paper communications

- Consolidated ballots afford the opportunity to vote multiple positions from a single card or electronic ballot, reducing friction and taking out cost.
- Enhanced packaging allows funds to amplify the message by more efficient use of the envelope/email and the material included in the solicitation.

Notice and Access (N&A)

N&A is a delivery method that involves a paper notice sent through the mail that alerts shareholders about an upcoming shareholder meeting and how to access proxy materials and vote. The notice directs shareholders to access proxy material on the internet and, if desired, to vote their shares. The adoption of N&A significantly reduced costs by decreasing the number of large physical proxy mailings.

Phone communications

In addition to the traditional methods of outbound and inbound calling, funds can record and forward short messages to shareholders, providing valuable information about the proposals to encourage participation.

Figure 2

Solicitors now have more tools to solicit votes from shareholders

Traditional	New options
Reminder mailings	Enhanced packaging
Reminder e-mails	Social media messages
Outbound calling	Texting/SMS
Postcards	Mobile apps
Outbound phone messaging	Investor Q&A for advisor use

Investor education

The primary way shareholders can make their opinions heard is by voting on shareholder resolutions at fund meetings convened for that purpose. The challenge is educating them about the process, the issues involved, and their ability to make their voices heard. Some best practices to address this and educate shareholders include:

- Increasing the visibility of proxy voting importance and how to participate in the process through messaging in other communications, such as the new annual and semi-annual Tailored Shareholder Reports, which are designed to be more investor-friendly and help educate investors about their funds.
- Incorporating corporate governance and proxy voting into fund communications. Elevate the topic in the same way that performance, fees, and holdings are explained.
- Using standalone communications in advance of proxy events, emphasizing their importance and impact. Repetition is important to making investors aware of the importance of corporate governance and cost savings.

In addition, many mutual fund investors use advisors (e.g., managed accounts) who take on the obligation to receive the proxy materials and vote. This results in shareholders having limited insight into the proxy voting issues or topics. Although advisors have a fiduciary obligation to vote in the best interest of the shareholder, there is usually limited cross-communication with their clients, so shareholders are not informed about the process and the issues being considered. This presents an opportunity for advisors to highlight the work they do to vote in the best interests of their clients — and emphasize this value-added service.

Types of fund communications used to educate shareholders:

Today, mutual funds are required to send a range of communications to help inform prospective investors and current shareholders, from annual reports and semi-annual reports to prospectuses and statements of additional information. Fund managers may also make supplemental information available in fund profiles, fact sheets, tax and distribution information, and fee disclosures. Each of these publications is meant to help keep shareholders informed about the nature of their investment. Fund managers are required to proactively distribute many of these documents to shareholders. In addition to fund-specific materials, shareholders may receive periodic account statements that show personal performance and fund account transactions.

To learn more about shareholder education, please visit ShareholderEducation.com

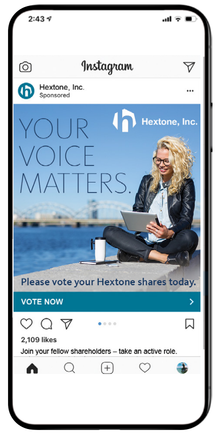
Vote Propensity Analysis

Vote Propensity Analysis (a Broadridge tool) uses past voting data to improve the predictability of a campaign and to help lower its associated costs. Funds, or their agents, can review shareholder vote participation during a period of time and assign a vote propensity score based on historic vote returns, prior communications, and voting methods. With this information, higher-scoring, more engaged shareholders can be targeted with reminder communications. The number of communications sent to shareholders with lower scores who rarely vote can be reduced, also cutting costs.

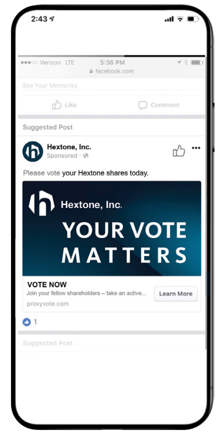
In addition to developing propensity scores that identify the investors most likely to vote, these populations can be analyzed further and segmented using demographic tools. The result is more targeted communications at lower cost, which can help funds reach quorum more efficiently. Review a real-life case study below.

Social media

Another recent innovation provides firms the ability to reach shareholders where they are — on social media. Firms can match their shareholder lists against the top social media platforms and use targeted messages to increase engagement.

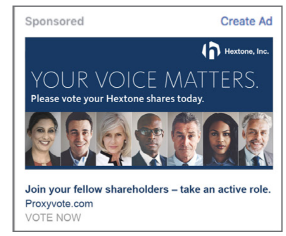


Instagram: Top-ranked among millennials



Facebook audience network: Extend your reach to mobile apps

Facebook: Top-ranked among baby boomers and Gen X



IN ACTION:

Case study on how Vote Propensity Score helped fund complex reach quorum faster

Challenge

Proxy Event:
Change of control event requiring shareholder approval

Quorum needed across 100 funds

Strategy

Applied Vote Propensity Score (VPS) to three segments:

- Shareholders who have had an opportunity to vote in the past but have never voted (VPS = 8.07%).
- New shareholders who have no voting history (VPS = 19.89%).
- Shareholders who have voted previously (VPS = 51.82%).

Focused reminder communication on the 52% of shareholders with a prior history of voting.

Results

Reached quorum without an adjournment.

For accounts with prior voting history, median vote return date was:

- 30 days faster than for accounts who have participated in prior campaigns but not voted.
- 15 days faster compared to new shareholders.

Significant cost savings realized due to the need to send fewer communications and incurring no meeting adjournments.

Other enhancements and changes that could further improve the process

Reminder mailings, phone calls, and mobile apps will all continue to play an important role when it comes to getting the vote. To address the growing challenges affecting proxy, however, funds should also consider new options that could significantly improve the process and reduce the time and cost to reach quorum.

These innovations could reduce time and cost to reach quorum:

- Advance voting instructions
- Investor mailboxes
- Smart regulatory reform

Advance voting instructions

Advance Voting Instructions (AVI) enable shareholders to register their voting preferences in advance of a proxy campaign. Today, only institutional investors are allowed to use AVI. Many institutional investors use proxy advisory firms such as ISS or Glass Lewis to set up and house their voting instructions.

Types of AVI

- Voting with management's recommendations
- Voting against management's recommendations
- Voting with proxy advisor recommendations
- Voting in alignment with selected large institutions or based on specific interest groups (e.g., organizations focused on environmental, social, and governance (ESG) issues), or cause-related groups

After proxy materials are distributed with pre-populated ballots, these instructions can be used for every shareholder vote, including mutual fund proposals. Institutional shareholders can review and confirm their votes before submission.

How institutional AVI works

1. Institutional shareholder selects global voting preferences based on their own preferences or aligned with a third-party policy.
2. When there's a meeting, the shareholder receives proxy materials according to their preferred delivery method (e.g., paper, electronic, etc.).
3. The institutional shareholder could still vote in opposition to their AVI. If they don't, their pre-selected preferences are applied and voted.
4. Post-meeting results are provided.

PASS-THROUGH VOTING

Pass-through voting is another recent innovation that enables funds to engage their shareholders by asking them how they would vote the shares of the underlying securities in the fund. Pass-through voting can reinforce the importance of corporate governance and voting, which in turn could extend to voting their fund holdings (or even to their non-fund holdings). Unlike AVI, pass-through voting can be implemented **without** regulatory changes.

For more information about pass-through voting, download the Broadridge pass-through voting white paper >>

ProxyVote for retail shareholders

Under current SEC rules and guidance, retail shareholders are not permitted to establish AVI. As a result, extending AVI to retail investors would require SEC guidance.[6]

That said, there are ways to increase retail shareholder engagement without rule changes. Recent enhancements to the Broadridge ProxyVote app, for example, make it easier for retail shareholders to participate in corporate governance. The new features help investors view relevant proposal information more easily and quickly, preset their voting preferences on topics that matter most to them, see their votes counted as cast, and receive automatic updates on final results.

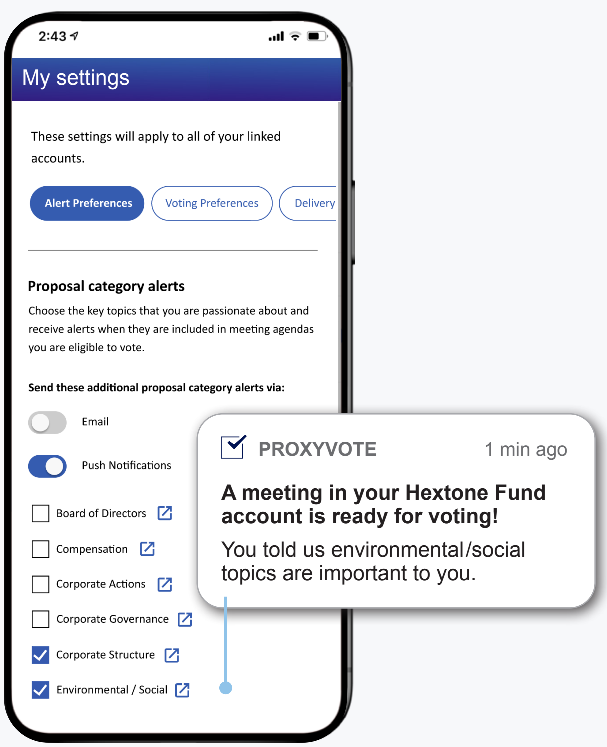
Alerts

Shareholders may opt into weekly emails that contain information on votable meetings based on their preferences. For example, a shareholder interested in board of director elections could receive an alert or email when there is a board of directors vote for a fund they own. Other topics of interest may include executive compensation or ESG policies. In response to these weekly emails, investors will be able to automatically vote their shares.

Preferences

This new feature allows retail shareholders to preset if they want to vote "For" or "Against" management on different types of proposals. When there is a vote at a fund they own, they will receive an alert and will see the proposal and their prefilled vote. They will have an opportunity to link directly to the proposal in the proxy statement and then submit their vote. If the SEC were to provide guidance allowing AVI, the investor's preset votes could be submitted automatically after they were notified and provided the opportunity to review proxy materials and make informed decisions. This new technology would enable and increase informed voting by retail investors.

ALERTS



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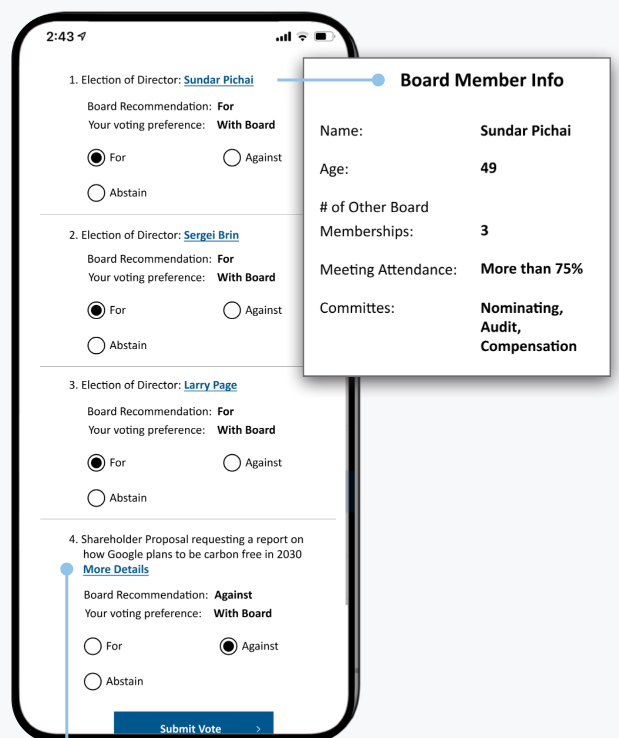


Deep link that brings the investor to the proxy statement, where they can view additional detail for the proposal before they vote.

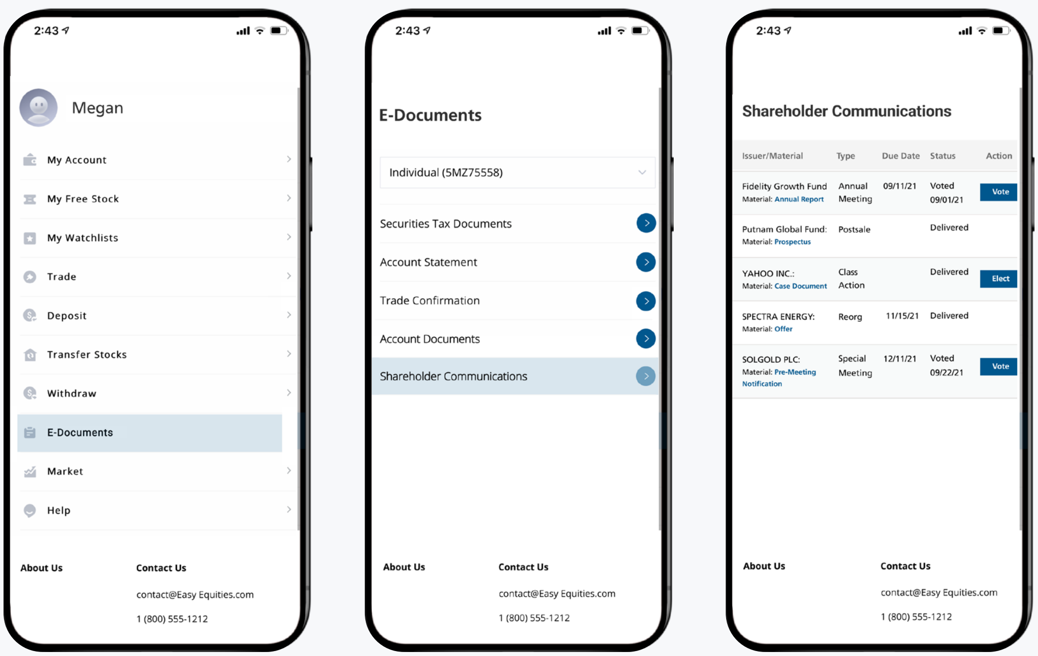
Investor mailboxes

Digital investor mailboxes are currently used to distribute financial communications in the US and other jurisdictions, such as the United Kingdom. Digital mailboxes, integrated within online brokerage platforms, serve as centralized repositories to view and distribute issuer disclosures and other investment account-related materials. The disclosures can be personalized in real time to the current security positions held within an investment account.

+7%
increase in shares voted
via Broadridge digital mailboxes
from 2022 to 2023

Comparing January 1, 2022 – June 30, 2022 to January 1, 2023 – June 30, 2023

Digital mailboxes allow investors to view issuer materials, such as annual reports and proxy materials, and vote within a mobile app.



For more information on digital mailboxes, visit us online. >>

Encourage smart regulatory reform

As an industry, we should all be looking for ways to improve the proxy process while maintaining a commitment to good corporate governance and voter engagement. Here's one example: The Investment Company Institute (ICI) has proposed a reduction in the 40 Act majority requirements to get to quorum.[7] They believe this would make it easier, faster, and less costly for funds to conduct shareholder meetings and obtain shareholder approval of director elections and certain other proposals.

Currently, the 40 Act requires a majority vote to implement certain matters, such as changes to fundamental investment policies, investment advisory and principal underwriting agreements, as well as Rule 12b-1 plans.[8] The ICI proposes that changes to fundamental investment policies and investment advisory and principal underwriting agreements should not require shareholder approval. Board approval, updates to the registration statement, and prior notice to shareholders would provide sufficient investor protection.[9]

A helpful next step would be a joint industry regulatory discussion, taking into account investor protection, good corporate governance, and reducing shareholder expense.

Looking forward and implementing new strategies

The proxy process is an important part of corporate governance; there are challenges that need to be overcome to help funds address low shareholder engagement. However, there are reasons for fund managers and shareholders to be optimistic.

Private sector innovation and greater use of technology and education will play a large role in improving investor participation. Analytics, automation, and digital communication channels are helping funds minimize effort and maximize the value of their outreach campaigns. Educating shareholders about the importance of their role can help inspire action. Regulatory reforms (such as AVI and 40 Act updates) could also provide alternative approaches that will help funds get to quorum more efficiently without compromising investor protection or undermining corporate governance.

For more on mutual fund proxy voting, visit us online.

[1] Mutual Funds Are Key to Building Wealth for Majority of US Households | Investment Company Institute (ici.org)

[2] ICI Viewpoints. Mutual Funds: Rated G—All Audiences Admitted; Sarah Holden and Daniel Schrass.

[3] Discretionary voting is allowed under NYSE Rule 451 and 452 for NYSE member firms. Account agreements disclose this practice to investors during account opening and reinforced by the voting instruction information included on Voting Instruction Forms (VIF). Typically, banks are not NYSE firms and therefore do not have the same ability to provide discretionary votes.

[4] The ability to rely on discretionary voting has significantly declined due to two main factors: Regulations have reduced the number of proposals that can use discretionary votes, and some large brokers have updated their policies and no longer issue discretionary voting.

[5] Other exchanges have similar requirements. See CBOE Rule 31.85(a), which explains the process and situations in which brokers may vote without voting instructions from the beneficial owner.

[6] See Concept Release on the U.S. Proxy System, SEC Release Nos. 34-62495; IA-3052; IC-29340 (July 14,2010),75 Fed. Reg. 42982 (July 22,2010) (the "Release"), pp 84-85. The Concept Release can be found online.

[7] Letter to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission, from Paul Schott Stevens,President and CEO, Investment Company Institute, dated June 11, 2019, ("ICI Letter").

[8] Section 2(a)(42) defines this as "The vote, at the annual or a special meeting of the security holders of such company duly called, (A) of 67 per centum or more of the voting securities present at such meeting, if the holders of more than 50 per centum of the outstanding voting securities of such company are present or represented by proxy; or (B) of more than 50 per centum of the outstanding voting securities of such company, whichever is the less."

[9] ICI Letter, Supra note 9, at 7-9.

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