The Harvard Law School Forum on Corporate Governance and Financial Regulation
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Fixing the Problems with Client Directed Voting

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In their recent post on the Forum entitled *Restoring Balance in Proxy Voting: The Case For "Client Directed Voting* (available here), Frank Zarb Jr. and John Endean advocate Client Directed Voting (CDV), and describe how CDV might work. However, their model suffers from a significant problem. As envisioned by Mr. Zarb and Mr. Endean, CDV would offer beneficial owners only three choices: (1) to vote in proportion to other retail shareholders; (2) to vote as the board recommends; (3) to vote "contrary to the board's recommendation." This approach offers no improvement over the old discredited system of broker discretionary voting. In fact, proportional voting is a practice that violates the core governance principle of one-share-one-vote and increases the risk of manipulative practices. What is needed is an efficient model of CDV that is contextual and that can be customized to individual companies and their circumstances.

It is possible to conceive of a much more robust model for CDV in which retail investors would have access to a variety of meaningful choices for directed voting. CDV make sense if it could be structured to offer retail beneficial owners (RBOs) meaningful and customized voting choices, an audit trail, regular reporting and annual contract renewal.

To be meaningful, CDV should provide RBOs an array of voting analyses and choices from different types of institutional investors and other groups, including public pension funds, environmental and social investors, long term centrists such as TIAA-CREF, labor unions, advocacy investors, etc. It is interesting to speculate whether or how activist institutional investors, short-term investors or hedge funds might participate in a CDV system. It is also interesting to consider whether the voting recommendations of proxy advisory firms might appear on CDV platforms, with or without accompanying analyses.

Clearly the proponents of CDV would like to encourage standardized voting (e.g., "Vote my shares in the same way as TIAA-CREF unless I instruct otherwise."). This might well be the choice of RBOs for annual meetings where companies are performing well, governance practices are sound, no contested resolutions are on the ballot and there are no other controversies or disputes. But even in these increasingly rare cases standardization makes sense only if real options are available and easily accessible to RBOs. Informed choice is important because the annual election of directors is no longer viewed as “routine” and shareholders increasingly want to scrutinize such factors as a company’s governance and annual compensation decisions as a measure of the independence and strategic competence of corporate boards before deciding how to vote.

Election contests are arguably the most important cases where RBOs are looking for objective voting guidance. It is unclear whether or not proponents think CDV mechanics and platforms would be applicable in proxy fights or how they might be adapted to the demands of multiple proxy mailings, revocations, etc.

CDV mechanics need to be carefully worked out:

- As a first step, participating institutional investors would have to agree to make their voting decisions available in a central database sufficiently in advance of shareholder meetings to allow time for RBOs to review and decide how to vote — probably a week before the shareholder meeting. Given current practices and the pressures of the proxy season, timeliness could be a problem.

- Broadridge or some other service provider would have to collect the voting decisions from participating institutions electronically, format the data to align with meeting agendas and proxy cards and make it accessible to RBO subscribers promptly.

- The voting platform would presumably be administered by the same service provider that collects the data. It is possible, however, that proxy advisory firms and large record-keepers such as Computershare might develop their own proprietary platforms, thereby increasing competition and reducing costs.

- RBOs would want end-to-end vote confirmation, enabling them to track their voting instructions into the final tabulation.

- Companies would want an audit trail to ensure the accuracy of the voting results on contested matters, on shareholder resolutions or in case of a close outcome.

- RBOs should have access to periodic summary reports of their voting decisions.

- The CDV agreements between RBOs and their financial intermediaries should be renewed annually. This would be particularly important in cases where RBOs select a default voting process and later want to review other options. Also, as new institutional investors join the CDV system and make their voting decisions available, or where institutions change their investment orientation or voting policies, RBOs should be informed and offered an opportunity to reconsider their choices.

- In the absence of voting options, customization, accountability mechanisms and other controls, CDV could be criticized as “dumbing-down” exercise or a thinly disguised alternative to broker discretionary voting, which is no longer permitted.

Early advocates of CDV proposed it as an antidote to quorum problems that they worried might result from the abolition of broker discretionary voting. As I have said in various comment letters, there are much easier and simpler ways to avoid quorum problems. In my view, the issue of quorum does not need to be considered in designing or evaluating CDV.

It is worth noting that although CDV has been discussed primarily in connection with voting by retail customers whose shares are held in broker name, it might prove useful to other types of investors as well. The ability to piggy-back on the voting instructions of well-regarded institutional investors could be attractive to other institutions, trust accounts, mutual funds and other entities whose shares are lodged in banks rather than brokers. A long-term design for CDV should bear this in mind and not consider solely the needs of individual investors in broker accounts.

This model requires the willingness of institutional investors and advocacy groups to make their voting decisions known in advance of shareholder meetings. In addition the technology must be developed to collect this information in a voting platform accessible to beneficial owners – all in the short time frame available during annual meeting season. Until we have such capabilities in place, it seems to me counterproductive to introduce a system of CDV that perpetuates old problems.