

Funds take greater role as activists

'A less friendly attitude' and a more critical approach marks relationships with management

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Mutual funds are becoming increasingly aggressive in voting against company management and using annual general meetings to push socially responsible agendas.

“You are seeing a less friendly attitude toward director nominees, for one thing,” said Laura O'Neill, director of law and policy for the Shareholder Association for Research and Education. “It's a relatively positive sign that shows some movement toward a more critical approach to management.”

The association reviewed mutual fund proxy voting habits in 2008, and found that while most funds still voted with management 90 per cent of the time, they were more likely than common shareholders to vote in favour of shareholder resolutions at annual general meetings – funds supported resolutions 7.8 per cent of the time versus 6.9 per cent for other shareholders.

These are proposals put forward by shareholders that implore the company to make changes such as capping executive pay and changing the composition of boards to include more women directors.

While the change in support for a company's slate of directors fell only slightly – to 95.5 per cent approval in 2008 from 96.53 in 2006 – she said the decrease is indicative of a wider trend in mutual fund voting habits.

“Canadians depend on mutual fund companies to protect their retirement savings and studies have shown repeatedly that careful proxy voting adds value and manages risk for investors,” she said. “At this time of battered financial markets and depressed shareholder value, it is a positive sign that more funds are challenging management's hold on the ballot.”

Most shareholder resolutions are handily beaten back as investors vote with management, but the last year has seen high-profile victories for activist funds. Meritas Mutual Funds proposed five major Canadian banks give their shareholders a say on pay for executives last year, and after an initial setback the proposals have been accepted by powerhouses such as Royal Bank of Canada and the TMX Group Inc.

“That say-on-pay proposals were filed at banks was not by accident,” she said. “The more widely held a company, the better chance that an idea with legs can get up and run. And once that door is opened, you start to see more shareholders consider proposals.”

While 47 per cent of funds backed say-on-pay proposals in 2008 – up from 22.7 per cent in 2006 – they stopped short of wading deeper into compensation issues.

“The shareholder proposals that found strong support from the funds in our survey suggested changes to how executive compensation awards were structured,” Ms. O'Neill said. “We found very low support for proposals advocating executive pay caps.”

Meritas vice-president Brian Barsness said the compensation proposals illustrated how shareholders could sway policies that ultimately have an influence on their returns.

“The first thing we do is screen out the bad guys,” he said, as he described his socially responsible fund's approach. “But at the end of the day you're still left with imperfect companies. We can use our rights and responsibilities as shareholders to keep the companies we own accountable – whether it's socially, environmentally or financially.”

Mutual fund companies have disclosed their voting habits annually since 2006. This year's report was based on 5,560 ballots cast at 178 Canadian companies by 154 funds in 2008. Since disclosure has become mandatory, a divide has emerged between so-called socially responsible funds and those that do not include restrictions on their holdings.

Only one company – Inhance Investment Management – consistently voted along with shareholders since 2006, supporting their proposals 55.6 per cent of the time. Vice-president of strategic analysis Dermot Foley said other funds are missing the chance to look after their investments.

“There's a tendency to depend on all the parts of industry to take care of risk without doing the actual observing,” he said. “We saw what a disaster that was with the subprime crisis, when investors assumed someone had their back – and they really didn't.”

Fidelity Investments voted with management at almost every opportunity over the last three years, supporting 0.4 per cent of shareholder proposals. The company said in a statement that “it is not our job to become involved in the management of a company.”

“As a corporate shareholder, we always retain the ability to simply sell shares of a company if we disagree with the policies or directions being taken by management or otherwise lose confidence in management's direction ... A proxy vote may happen once a year. We're buying and selling stocks every day based on our fundamental research and analysis.”