A First Step Towards Reigning in the New Kings of Wall Street

John C. Friess, University of Michigan Law School

Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers
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On September 29, 2021, the SEC proposed an amendment to Form N-PX under the Investment Company Act of 1940 in order to enhance disclosure of proxy voting records by investment management companies. The proposal, if adopted in its current form, would standardize and augment voting records reported on Form N-PX, require disclosure of the number of shares voted and shares loaned by a fund at the time of a vote, and require website availability of fund voting records. This amendment would not only provide better protections for investors, but it would also serve as a welcome and necessary catalyst for closer scrutiny of investment management companies and their dominant role in corporate governance.

While addressed to investment management companies generally, it is clear that the proposed amendment was precipitated in large part by the substantial shareholdings amassed by the world's largest asset managers, including the "Big Three" of BlackRock, Vanguard, and State Street. In a well-documented phenomenon, these three asset mangers' median collective ownership of S&P 500 firms has risen from 7% in 2000 to 23% in 2020, with some estimates suggesting that this figure could surpass 40% by 2040 (Bebchuk & Hirst). Given that asset managers typically vote at shareholder meetings on behalf of their clients, these increasingly significant shareholdings have made the Big Three critical and decisive players in corporate governance, earning the trio another nickname: "The New Kings of Wall Street."

Initially, the ascendancy of the Big Three was welcomed as a means to carry out more effective governance of publicly listed companies. After the democratization of public markets gave rise to firms without any major shareholders, concerns developed that a widely dispersed shareholder base lacked the incentives to hold directors and management accountable. Essentially, no shareholder in a dispersed ownership system has enough skin in the game to spend the considerable time and money necessary to effectively monitor corporate actors. But, with the growth of passive investing, which brought with it a consolidated market of asset managers with major positions in US public companies, a potential mechanism to address this issue presented itself.

However, corporate governance via asset managers is fraught with significant problems of its own. Most notably, just as in the case of widely dispersed shareholders, asset managers lack the incentives to devote sufficient time, money, and attention to effective governance. This is because asset managers are not true owners of the shares they manage. Rather, in exchange for buying and selling shares on behalf of their clients, asset managers collect fees amounting to a small percentage of assets under management. Accordingly, a performance increase at any one portfolio company is negligible from the

asset manager's perspective. Therefore, asset managers have concerningly weak incentives to effectively monitor portfolio companies. This situation is exemplified by the fact that BlackRock's global stewardship team employs approximately 50 people. Despite BlackRock boasting that its team is the largest in the industry, it is not clear how around 50 people are capable of effectively monitoring thousands of companies across 85 different voting markets. Other major asset managers are situated just as poorly, if not worse.

Notwithstanding their shortage of capacity for effective governance, the Big Three have become increasingly vocal and active with respect to their proxy voting strategies, taking on a role similar to that of a conventional shareholder activist (the obvious difference being that the Big Three are not just attempting to implement their strategies at a handful of firms, but rather across nearly the entire market). Since asset managers have no capital at stake and own shares only indirectly, they rely on the Investment Manager Act of 1940, which permits clients to delegate proxy voting responsibility to their asset managers, who are then required to vote in a manner consistent with the best interest of their clients. Though this practice is indeed consistent with current law, the entire legal apparatus underpinning the procedure was created at a time when it would have been unfathomable that a few asset managers would constitute the largest shareholders in nearly every public company. Had the current landscape been foreseeable, it is not conjectural to assume that additional safeguards would have been put into place.

Consequently, it is essential that the SEC move forward with its proposal. This course of action would give investors the ability to assess whether their interests align with their asset managers' and then make an informed decision regarding whether to delegate voting authority or whether to choose a new asset manager altogether. In addition, and possibly more importantly, the amendment would give the public and its elected representatives the information they need to adequately evaluate this once unfathomable new reality, then decide how best to proceed. Given claims among major asset managers that they plan to address public policy matters such as civil rights and climate change via proxy voting, such an opportunity is becoming increasingly imperative, as it is not clear that asset managers are the appropriate entities to engineer the policy solutions to such existential challenges.

Equipped with enhanced proxy voting disclosures, investors and regulators would be better able to determine what additional measures are required to ensure that investors' interests, and the interests of the public at-large, are adequately protected from the concentration of power in the asset management industry. Accordingly, the SEC's proposal should be fully implemented as a necessary first step towards reassessing the role of major asset managers in corporate governance.