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Institutional Investors in Corporate Governance

Edward B. Rock
University of Pennsylvania Law School, erock@law.upenn.edu

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Abstract: This chapter examines the role of institutional investors in corporate governance and whether regulation is likely to encourage them to become active stewards. It considers the lessons that can be learned from the US experience for the EU's 2014 proposed amendments to the Shareholder Rights Directive. After reviewing how institutional investors fit within the historical evolution of finance, the chapter documents the growth in institutions equity holdings over time. It explains how institutional investors are governed and organize share voting before turning to two competing hypotheses to account for the relative passivity of institutional investors: the excessive regulation and the inadequate incentives hypotheses. In evaluating these hypotheses, it reviews the results of the SEC's attempt to incentivize mutual funds to vote their shares. The chapter concludes by highlighting the role of hedge funds in catalyzing institutional shareholders, along with some of the risks associated with such highly incentivized actors.

Keywords: institutional investors, corporate governance, regulation, EU, Shareholder Rights Directive, share voting, incentives, Securities and Exchange Commission, mutual funds, hedge funds

1. Introduction

> Shareholders—the corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance. However, there is evidence that the majority of shareholders are passive and are often only focused on

> short-term profits. It therefore seems useful to consider whether more shareholders can be encouraged to take an interest in sustainable returns and longer term performance, and how to encourage them to be more active on corporate governance issues.[2]

Like poets and revolutionaries, corporate law scholars and policy makers dream. If only we could find the silver bullet, the wonder drug, we could solve the manager-shareholder agency cost problem that is the focus of much of corporate law. For a while in the 1980s, some thought that the hostile tender offer was that magic potion. Then, beginning in the late 1980s, attention shifted to institutional investors, where it has stayed, on and off, ever since. Noting that shares of publicly held corporations are largely held by institutions, and that shareholding among institutions is concentrated, some have viewed institutional investors as having the potential to act as the responsible owners that corporate law seems to presume: shareholders that, by virtue of their holdings, will have the skills and incentives to keep an eye on managers and check departures from maximizing firm value, to prevent "short termism," and to do whatever else one wants responsible owners to do.

As with other utopian dreams, reality has proved to be less exciting and less transformative. In this chapter, I try to synthesize what we have learned about institutional investors in corporate governance over the last 30 years or so.

2. Who and what are "institutional investors"?

Robert Clark provides a basic framework for understanding how institutional investors fit within the historical evolution of finance.[3] The first stage, characteristic of the nineteenth century, was the age of the promoter-investor-manager, exemplified by Rockefeller or Carnegie. The second stage, characteristic of the first part of the twentieth century, was the age of the professional business manager who took on the management of the corporation, while leaving the financial claims to the owners of shares. This stage was exemplified by managerial giants such as Alfred Sloan who led the way in creating the modern, publicly held business corporation. The third stage, characteristic of the late twentieth century, was the age of the portfolio manager in which the selection of the financial claims (stock, bonds, etc.) was professionalized, while leaving the beneficial ownership to the capital supplier. This age of financial intermediaries is the age of the institutional investors, with great stock pickers like Peter Lynch as representative heroes.

In this age of intermediated finance, the investment function—where to invest money that is being saved—is separated from the savings decision, and given to professionals, the "money managers." By professionalizing the investment function, which had been bundled with the savings decision, the third stage parallels the professionalization of the management function that characterized the second stage of capitalism. The most prominent "traditional" intermediaries are public and private pension funds, mutual funds, insurance companies, and endowments (collectively referred to as "institutional investors"). More recently, as will become apparent later, activist hedge funds have emerged as a distinct category of specialized professional investors.

Clark's description, and the above taxonomy, is most applicable to economies with corporations with dispersed public ownership, most prominently the US and the UK. In economies dominated by publicly held firms with concentrated ownership, such as the countries of continental Europe, this description is less accurate but the trend lines point in the same direction. In this chapter, I primarily focus on the US experience, with secondary attention to drawing lessons for the UK and continental Europe.[4]

As is now widely recognized, institutional ownership of equities has been transformed over the last 60 years. In 1950, institutions held $8.7 billion in equities (6.1% of total); in 1980, institutions held $436.2 billion in equity (18% of total); in 2009, they held $10.239 trillion (40.4% of total).[5] In this growth, mutual funds have been especially prominent, going from owning $70 billion in 1980 to $7.2 trillion in 2009.[6]

The effect of this growth has been to concentrate ownership of publicly held firms in institutional hands. Between 1987 and 2009, the institutional ownership in the top 1000 US corporations grew from 46.6% to 73%.[7] In 2009, the 25 largest corporations by market value had an average institutional ownership of over 60%.[8]

The concentration of ownership within these firms is impressive as well. Table 1, drawn from data in the 2010 Conference Board report, shows institutional ownership in the 25 largest corporations, and the ownership of the top five, ten, 20, and 25 institutions in each. As this table makes clear, both the level and the concentration of institutional ownership in even the largest companies is high.

[Insert Table 1 near here]

Two factors seem to have driven the trends over time: regulation; and market forces. The extraordinary growth of institutional investors in the US owes much to the 1974 enactment of ERISA which mandated that pension commitments be fully funded by segregated pools of assets.[9] This led to the creation of independent corporate pension funds to fund “defined benefit” plans (in which employees’ pensions were a certain percentage of final salary). It also eventually pushed corporations to shift to “defined contribution” plans in which the employer and employee each contribute to a taxadvantaged retirement account (almost invariably managed by a mutual fund) to support the employee after retirement. From an employer's perspective, the great virtue of a "defined contribution" plan is that it is fully funded from the beginning and all investment risk falls on the employee. From an employee's perspective, the benefit of a defined contribution plan is complete portability, a significant advantage for a mobile workforce.

At the same time, the growth of institutional investors has made them remarkably efficient managers of capital. Vanguard's Index 500 fund allows investors to invest in a basket of securities that tracks the S & P 500 stock index for as low as five basis points (i.e., 0.05% per year).[10] This extraordinarily low price reflects, among other things, massive economies of scale.

When all these factors are brought together, the critical fact that must ground any analysis of corporate governance is the "de-retailization" of the capital markets.[11] Any sensible discussion must begin from the fact that between 60% and 70% of the shares of medium and large public corporations are held by institutional investors, and that even in the largest corporations, a significant percentage of the shares are held by a handful of investors.

3. The governance of money managers

The governance of money managers themselves is quite varied. There are four or five different models, as illustrated by some of the leading firms. First, there are for-profit asset managers, some of which are publicly held (e.g., BlackRock and State Street are both NYSE companies), while others are privately held (e.g., Fidelity Management & Research Company, which acts as the investment advisor to Fidelity's family of mutual funds).[12] Included in this group are (for-profit) insurance companies and savings institutions.

Second, there are "mutual" and nonprofit management companies. For example, Vanguard's management company is owned by the Vanguard funds, and thus indirectly by Vanguard participants,[13] while CREF, the College Retirement Equity Fund, is a nonprofit corporation whose trustees are directly elected by participants, with votes weighted by dollar amount in an account.[14]

Third, there are public-employee pension funds in which the governing managers or boards are appointed by politicians or directly elected by voters. At CalPERS, the board includes six elected members, three appointed members and four ex officio state officials.[15] The NYCERS board "consists of eleven members: the Mayor's Representative, the City Comptroller, the Public Advocate, the heads of the three unions with the largest number of participating employees, and the five Borough Presidents."[16] By contrast, the NY State & Local Retirement System is headed by the elected NY State Comptroller.[17]

Finally, there are the union-related funds that have been prominent governance activists. With respect to shareholder proposals, which require minimal investments, the AFL-CIO has filed proposals using its $28 million "Reserve Fund."[18] The joint union-employer pension funds (known as "Taft-Hartley Plans" after the key regulation) collectively hold approximately $400 billion in assets (of which $100 billion is in common stock), but have not been active, largely because discretion is delegated to outside money managers in order to avoid the risk of liability under ERISA.

Governance structure affects activism in predictable ways. The union funds pursue a labor agenda. The public pension funds respond to political pressure.[19] For-profit money managers such as BlackRock rarely engage in aggressive activism, although increasingly they engage with companies and support dissident shareholders.[20]

4. The organization of share voting by institutional investors

With the thousands of public companies held by institutional investors, each with an annual meeting and a variety of matters to vote on, voting shares is a huge task. Major institutional investors establish dedicated proxy voting departments that are responsible for developing voting guidelines and voting proxies.

To get a sense of how proxy voting is organized at major institutional investors, and what sort of people are involved, consider Exxon Mobil's three largest shareholders: BlackRock, State Street, and Vanguard, each of whom owns more than 3% of the company.[21] At BlackRock, for example, there is a "Corporate Governance and Responsible Investment" (CGRI) team that acts as a central clearinghouse across its various portfolios.[22] The CGRI team has 20 professionals working out of six offices around the world,[23] has responsibility for voting proxies, and has developed general Proxy Voting Guidelines.[24] Since 2009, the group has been headed by Michelle Edkins, who has made a career of corporate governance analysis, previously as managing director at Governance for Owners and, earlier, as Corporate Governance Director at Hermes in London.[25] Chad Spitler, Global Chief Operating Officer for the CGRI team has a similar background.[26] Daniel Oh, VP for the Americas on the CGRI team, was previously part of the corporate governance team at State Street, and still earlier was a corporate governance advisor at ISS.[27]

At State Street, the:

> Corporate Governance Team is responsible for implementing the Proxy Voting and Engagement Guidelines (the “Guidelines”), case-by-case voting items, issuer engagement activities, and research and analysis of governance-related issues. The implementation of the Guidelines is overseen by the SSgA Global Proxy Review Committee (“SSgA PRC”), a committee of investment, compliance and legal professionals, who provide guidance on proxy issues as described in greater detail below. Oversight of the proxy voting process is ultimately the responsibility of the SSgA Investment Committee.[28]

Rakhi Kumar leads the group as the head of Corporate Governance.[29] A Yale MBA, she spent time earlier in her career at Proxy Governance Inc.

At Vanguard, proxy voting is delegated to the “Proxy Voting Group,” which, in turn, is overseen by the “Proxy Oversight Committee” made up of senior officers and reporting to the board.[30] The Proxy Voting Group applies the general proxy voting guidelines to specific instances, and is responsible for:

> (1) managing proxy voting vendors; (2) reconciling share positions; (3) analyzing proxy proposals using factors described in the guidelines; (4) determining and addressing potential or actual conflicts of interest that may be presented by a particular proxy; and (5) voting proxies. The Proxy Voting Group also prepares periodic and special reports to the Board and any proposed amendments to the procedures and guidelines.[31]

The Proxy Voting Group is led by Glen Booraem, who joined Vanguard in 1989 and has spent his entire career in fund accounting and administration roles.[32] In addition to leading Vanguard's corporate governance program, he is also responsible for fund accounting, administration, and compliance services.[33]

Other major institutional investors organize the proxy voting/corporate governance functions the same way. At Fidelity, Mark Lundvall is the Vice President of Investment Proxy Research, having earlier worked on corporate governance and compliance at Vanguard.[34] Gwen Le Berre, Director of Proxy & Governance at Charles Schwab, is responsible for the development of Schwab's corporate governance policies and oversees the implementation of its proxy voting guidelines.[35] She came to Schwab from BlackRock's Corporate Governance and Responsible Investment group, with similar functions at Barclays.[36] Not surprisingly, some corporate governance professionals have spent time at a proxy advisory firm such as ISS, Proxy Governance Inc., or IRRC.[37] Public pension funds, such as CalPERS and CalSTRS, approach corporate governance and proxy voting in the same way.[38]

Given the number of companies in the portfolio, and the legal pressures to vote shares, the role inevitably includes a compliance function. Simply voting the shares, without even considering *how* to vote them, is an enormous task. In addition, especially in recent years and especially at the largest institutional investors, these groups have become increasingly active in corporate governance. From an incentive perspective, however, these activities are not treated as an investment function: unlike portfolio managers, the compensation of governance professionals is not typically linked to the performance of the portfolios.

Proxy voting groups at institutional investors invariably subscribe to the major proxy advisory firms ISS and Glass Lewis. From what one can tell from the outside, there is a significant difference in the use made of the information and recommendations of those services.[39] At institutions with large in-house proxy voting groups, ISS and Glass Lewis are mainly useful as information aggregators.[40] Smaller institutions seem to rely more heavily on the proxy advisory firms' recommendations.[41]

On high-value, high-profile issues such as contested mergers, proxy voting groups consult with the managers of the portfolios that hold the relevant shares. Otherwise, portfolio managers are typically less involved. Indeed, some report that portfolio managers sometimes oppose governance activism for fear that it may make it more difficult to arrange meetings with management.

5. The promise of institutional shareholder activism

The EU's 2011 Green Paper accurately expresses the conventional view that "the corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance."[42] The frustration, going back at least as far as Berle and Means (1932), is that shareholders in public corporations with dispersed ownership do not perform that function. Much corporate law scholarship and policy making has focused on how to remedy or adapt to this failing.[43] The move towards ensuring that the board of directors is dominated by independent directors can best be understood as one type of solution to the lack of shareholder engagement: because shareholders themselves do not monitor managers, we need a new player in the boardroom to play that role for the benefit of passive shareholders.

Likewise, for some, hostile tender offers can provide a lever of managerial accountability that passive shareholders do not supply.

In the late 1980s, with the decline of the hostile tender offer, attention shifted to the rise of institutional investors as a potential solution to the separation of ownership and control. Institutional investors combined large stakes with professional management, at a time when the increased concentration of shareholdings reduced the costs of collective action. Perhaps, optimists thought, institutional investors would emerge from their historic lassitude that was summarized by the phrase "Wall Street Walk": shareholders dissatisfied with management would (or should) sell their shares rather than engage in corporate governance activism. With the increased institutional holdings, perhaps institutional investors would emerge to provide the missing lever of corporate governance, to "hold the management to account for its performance."

6. How best to explain institutional investor passivity? Two competing hypotheses

Given the traditional passivity of institutional investors, policy makers needed to understand why they had played so minor a role in corporate governance. Two explanations were offered: excessive regulation; and inadequate incentives.

6.1 The "excessive regulation" hypothesis

In the late 1980s, Mark Roe and Bernard Black separately catalogued the dizzying array of regulatory barriers to activism found in state corporate law, federal securities law, federal regulation of investment companies (mutual funds), state insurance company regulation, and pension regulation.[44] Moreover, as Roe demonstrated, many of these barriers were erected as part of a political decision to *prevent* institutional investors from playing an active role in corporate governance.

Together, these analyses implicitly proposed "excessive regulation" as the explanation for why institutional investors, despite their size and expertise, were not more active in corporate governance. If only these largely unnecessary regulations were reduced or eliminated, they seemed to suggest, we could expect institutions to take a more prominent role.

6.2 The inadequate incentives hypothesis

During this same period, other scholars argued that the source of institutional investor passivity was to be found in their lack of or misaligned incentives.[45] Institutional investors are intermediaries, competing against each other for investors' funds. Many of the largest institutions offer low-cost diversification, by tracking stock indices or the equivalent.

This industry structure has a variety of implications, almost all of which point away from serious engagement with corporate governance. First, the market for money managers is highly competitive, with money flowing to funds offering higher returns. To the extent that competing funds track indices, superior returns can *only* come from lowering costs, leaving little money for activism. Outside of the hedge fund sector, discussed below, even "active managers" will typically only depart slightly from an indexing strategy.[46]

Second, the costs of activism are borne by the activist while the benefits are enjoyed by all the shareholders, potentially leading to both "rational apathy" (when the private costs exceed the private benefits) and the "free rider problem" (when shareholders refuse to incur costs, hoping to benefit from other shareholders' activism). As shareholding becomes more concentrated, and the costs of coordination among shareholders drops, both of which have occurred in the last 20 years, shareholders can capture more of the gains, allowing them to move beyond rational apathy.

Third, institutional investors' revenue model is typically a percentage of assets under management. In such a system, the dominant incentive is to increase fund or fund complex size. This can be done via a variety of avenues, including both marketing and performance. There is thus a link with fund performance, but it will be indirect.

Fourth, money managers may have perverse incentives with regard to activism: to the extent that funds depart from an index, but still compete with managers of similar funds, a fund's *relative* performance improves when "underweighted" companies in their portfolio perform *badly*.[47] If Fund A has 4% of X Corp and 2% of Y Corp, and competes with Fund B, with 4% of X Corp and 4% of Y Corp, the worse that Y Corp performs, the better Fund A's relative performance vis-à-vis Fund B. Indeed, to the extent that relative performance is determinative, Fund A would have a financial incentive to vote against a merger that would benefit Y Corp or elect incompetent directors.

Fifth, consistent with the old "Wall Street Rule," noted above, portfolio managers still believe that involvement in everyday corporate governance is a tough way to make money and would prefer to devote their efforts to selecting better investments. Moreover, corporate governance activism can make it difficult for portfolio managers to gain access to the management of portfolio companies, making their jobs more difficult.

Finally, asset managers face a variety of conflicts of interests. It is difficult to compete for corporate pension business while criticizing the company. When the asset manager is part of a larger group including an investment bank, the bankers may pressure asset managers not to antagonize current or prospective clients by, for example, voting against the CEO's pay.[48]

6.3 A natural experiment: partial deregulation of institutional investors

In the years since 1990, concentration of ownership has continued to increase and many of the regulations that Black and Roe identified have been relaxed. Thus, the 1992 reform of the proxy rules allows institutions to talk with other institutions about the performance of the management without fear of liability for improper solicitation of proxies.[49] Regulation Fair Disclosure, effective in 2000, prevents corporate managers from punishing active investors by providing selective disclosure of important information only to friendly portfolio managers, thereby protecting active shareholders from at least one form of retribution.[50]

Yet institutional investors have not emerged as shareholders' champion. While not conclusive, the evidence strongly suggests that the primary explanation for institutional investor passivity is inadequate incentives, rather than excessive regulation.

7. Can we fix the incentive problems?

7.1 The European Commission's 2014 proposed amendment to the Shareholder Rights Directive

The European Commission, as reflected in the opening quote, has been frustrated by the same shareholder passivity that has frustrated US observers.[51] In its recent proposal to amend the Shareholder Rights Directive,[52] it observed that:

The financial crisis has revealed that shareholders in many cases supported managers' excessive short-term risk taking. Moreover, there is clear evidence that the current level of "monitoring" of investee companies and engagement by institutional investors and asset managers is sub-optimal. Institutional investors and their asset managers do not sufficiently focus on the real (long-term) performance of companies, but often on share-price movements and the structure of capital market indexes, which leads to suboptimal return for the end beneficiaries of institutional investors and puts short-term pressure on companies.

Short-termism appears to be rooted in a misalignment of interests between asset owners and asset managers. Even though large asset owners tend to have long-term interests as their liabilities are long-term, for the selection and evaluation of asset managers they often rely on benchmarks, such as market indexes. Moreover, the performance of the asset manager is often evaluated on a quarterly basis. As a result many asset managers' main concern has become their short-term performance relative to a benchmark or to other asset managers. Short-term incentives turn focus and resources away from making investments based on the fundamentals (strategy, performance and governance) and longer-term perspectives, from evaluating the real value and longer-term value creative capacity of companies and increasing the value of the equity investments through shareholder engagement.[53]

To address this lack of engagement, the Commission has proposed a variety of measures, including the requirement that institutional investors and asset managers develop and disclose (on a "comply or explain basis") a policy on shareholder engagement that addresses how institutional investors and asset managers will take action: "(a) to integrate shareholder engagement in their investment strategy; (b) to monitor investee companies, including on their non-financial performance; (c) to conduct dialogues with investee companies; (d) to exercise voting rights; (e) to use services provided by proxy advisors; (f) to cooperate with other shareholders."[54] In addition, institutional investors would be expected to disclose the results of their policies, how they vote and general meetings, and an explanation for how they vote.[55] The proposal also seeks to encourage institutional investors to incentivize asset managers to manage for the medium- to long-term performance of assets.[56]

Are these attempts to encourage or force institutional investors to play a more significant and productive role in corporate governance likely to succeed? In this regard, it is worth reviewing the US experience with a very similar set of reforms.

7.2 The 1988–2013 mutual fund "experiment": imposing obligations on mutual funds

In 1988, the Department of Labor issued the legendary "Avon Letter" which declared that proxy voting rights are plan assets subject to the same fiduciary standards as other plan assets.[57] In subsequent letters, the DOL amplified on this responsibility.[58] Since then, the SEC has repeatedly made clear that, under the Investment Company Act and Investment Advisors Act, the voting of proxies is a matter of money managers' fiduciary duties.

The SEC raised the stakes in 2003 when it promulgated two related releases that together imposed an obligation to disclose proxy voting policies and proxy votes on registered investment management companies (the managers of mutual funds) and investment advisors (the individuals who work for the managers of mutual funds).[59] In promulgating these new rules, the SEC focused on (1) mutual funds' large holdings; (2) advisors' and investment management companies' fiduciary obligations to their investors to vote proxies responsibly and in the interests of the investors; (3) mutual funds' historic passivity; and (4) the potential for conflicts of interest between mutual funds duties to their investors and their commercial interests. One can almost feel the SEC's frustration that, despite 15 years of emphasizing money managers' fiduciary responsibility to vote proxies, nothing much had changed.

The SEC justified imposing new obligations on mutual funds on two grounds: (1) investors' "fundamental right" to information on how mutual funds vote and (2) the ways in which transparency will allow investors to hold mutual funds accountable for how they vote, thereby controlling conflicts of interest and inducing more responsible "stewardship":

> Proxy voting decisions by funds can play an important role in maximizing the value of the funds' investments, thereby having an enormous impact on the financial livelihood of millions of Americans. Further, shedding light on mutual fund proxy voting could illuminate potential conflicts of interest and discourage voting that is inconsistent with fund shareholders' best interests. Finally, requiring greater transparency of proxy voting by funds may encourage funds to become more engaged in corporate

> governance of issuers held in their portfolios, which may benefit all investors and not just fund shareholders.[60]

Further, the SEC seemed to expect that disclosure of mutual fund proxy voting would lead investors to choose funds based on how active they are in corporate governance:

> A number of commenters, including an overwhelming number of individual investors, strongly supported the Commission's proposal to require a fund to disclose its complete proxy voting record. Many of these commenters stated that this disclosure would improve shareholders' ability to monitor funds' voting decisions on their behalf and that it would allow investors to make more informed decisions when choosing among funds . . .
>
> After careful consideration of these comments, we continue to believe that requiring funds to disclose their complete proxy voting records will benefit investors by improving transparency and enabling fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies.[61]

In addition, the SEC expected that "more conscientious" mutual fund voting would lead to increases in firm value:

> A third significant benefit of the amendments comes from providing stronger incentives to fund managers to vote their proxies conscientiously. The amendments could increase the incentives for fund managers to vote their proxies carefully, and thereby improve corporate performance and enhance shareholder value. The improved corporate performance that

> could result from better decisionmaking in corporate governance matters may benefit fund investors. In addition, other equity holders may benefit from the improvement to corporate governance that results from more conscientious proxy voting by fund managers. We note that assets held in equity funds account for approximately 18% of the $11 trillion market capitalization of all publicly traded US corporations, and therefore funds exercise a considerable amount of influence in proxy votes affecting the value of these corporations.[62]

Further, the release provided guidance on what sort of proxy voting policies mutual funds should have:

> We do expect, however, that funds' disclosure of their policies and procedures will include general policies and procedures, as well as policies with respect to voting on specific types of issues. The following are examples of general policies and procedures that some funds include in their proxy voting policies and procedures and with respect to which disclosure would be appropriate:
>
> - The extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party;
> - Policies and procedures relating to matters that may affect substantially the rights or privileges of the holders of securities to be voted; and
> - Policies regarding the extent to which the fund will support or give weight to the views of management of a portfolio company.

> The following are examples of specific types of issues that are covered by some funds' proxy voting policies and procedures and with respect to which disclosure would be appropriate:
>
> - Corporate governance matters, including changes in the state of incorporation, mergers and other corporate restructurings, and anti-takeover provisions such as staggered boards, poison pills, and supermajority provisions;
> - Changes to capital structure, including increases and decreases of capital and preferred stock issuance;
> - Stock option plans and other management compensation issues; and
> - Social and corporate responsibility issues.[63]

Finally, the SEC gave advice on how funds might handle conflicts of interest:

> Advisers today use various means of ensuring that proxy votes are voted in their clients' best interest and not affected by the advisers' conflicts of interest. An adviser that votes securities based on a pre-determined voting policy could demonstrate that its vote was not a product of a conflict of interest if the application of the policy to the matter presented to shareholders involved little discretion on the part of the adviser. Similarly, an adviser could demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party. An adviser could also suggest that the client engage another party to

> determine how the proxies should be voted, which would relieve the adviser of the responsibility to vote the proxies.[64]

7.3 The effects of the SEC release

Mutual funds complied with the requirements of the release. They now have proxy voting guidelines[65] and disclose their proxy voting.[66] Not surprisingly, funds have adopted voting guidelines that rather closely follow the SEC guidelines for what such guidelines should look like. Thus, guidelines typically take positions on general governance matters like classified boards, independent directors, anti-takeover provisions, and compensation.

Note how the SEC's release shapes the *substance* of mutual funds' engagement. By describing "best practices" for proxy voting guidelines, the SEC has effectively mandated a particular "guidelines" approach to shareholder engagement, and rejected the perfectly respectable view that governance is endogenous to firms. It would take an unusually assertive and brave mutual fund to announce the following (entirely fictional) approach:

> We believe that there are no general principles or best practices in corporate governance. Rather, we believe that optimal governance depends on firm specific factors and that market pressures, even in the absence of regulation, drive most firms to adopt optimal governance arrangements. In addition, we believe that most shareholder voting is irrelevant to firm value, a distraction to corporate management, and does not contribute (and can interfere with) maximizing the financial performance of your fund. Therefore, we will routinely vote with management unless we become aware of a specific problem at a particular

> company. In those cases, we will decide how to vote on a case by case basis, taking into account all factors and discussing issues with management and other shareholders.

I am not aware of any funds that have announced this approach, even though such an approach, many believe, would be optimal for investors in widely diversified funds.

The SEC, in emphasizing money managers' fiduciary duties, and the extent to which conflicts of interest may breach those duties, created a compliance challenge. By then indicating that reliance on guidelines or a predetermined policy of voting based on "the recommendations of an independent third party," the SEC gave a boost to "guideline based voting" (noted above), as well as to the proxy advisory industry. A subscription to ISS and Glass Lewis can be viewed as a kind of "ERISA insurance."[67]

So the SEC achieved its immediate goal, namely the routine disclosure of proxy voting policies and proxy votes. But has this disclosure led investors to choose funds based on those policies or votes? And has this new disclosure mandate increased firm value?

I have not found any evidence that investors seeking to maximize returns pay *any* attention to either the policies or the votes. In particular, I cannot find any evidence that investors *choose* funds based on how the fund voted its proxies. There is, however, evidence that labor and environmental groups use the voting reports to determine whether mutual funds comply with the groups' guidelines, and to criticize those that do not.[68]

Further evidence of compliance with the SEC requirements, and of the transformation of proxy voting into a "compliance function," is the creation of "proxy voting groups" at large mutual fund complexes, described above, staffed with people whose compensation does not depend on the performance of the companies or funds for which they vote proxies. The very existence of these groups indicates portfolio managers' *lack* of interest in voting routine proxies (although they clearly do weigh in on major decisions like mergers). Given that portfolio managers select investments and are judged based on the performance of the investments they select, this itself is strong evidence that an individual fund's routine proxy voting does not have any measurable effect on performance. The lack of incentive compensation for proxy voting groups eliminates any straightforward "pay for performance" penalty for votes that reduce firm value. Although mutual funds reliably support "performance compensation" for portfolio companies because of the incentive effects, proxy voting groups are not, themselves, compensated in this way.

With ten years of experience with the SEC's mutual fund release, we can begin to measure the effect of these mandates on firm value. The preliminary results are not encouraging. In an important paper, Larcker, McCall, and Ormazabal (2014) use the Dodd-Frank mandated "say on pay" votes to study the impact of proxy advisory firms on shareholder voting and firm value.[69] Their key findings are:

> First, consistent with prior research, proxy advisory firm recommendations have a substantive impact on say-on-pay voting outcomes. Second, a substantial number of firms change their compensation programs in the time period *before* the formal shareholder vote in a manner consistent with the features known to be favored by proxy advisory firms in an effort to avoid a negative voting recommendation. Third, the stock market reaction to these compensation program changes is statistically *negative*.[70]

The first two findings support the conventional wisdom. Consistent with other research, the recommendations by ISS and Glass-Lewis have a significant effect on how mutual funds vote. The second finding confirms that, when proxy advisory recommendations matter, portfolio firms will tailor their conduct to comply and thereby avoid a negative recommendation.

The most important, and intriguing, finding is the third; namely, that complying with ISS guidelines to avoid a negative recommendation is correlated with a *decline* in firm value. Larcker et al. interpret this result as suggesting that "the outsourcing of voting to proxy advisory firms appears to have the unintended economic consequence that boards of directors are induced to make choices that *decrease* shareholder value."[71] An alternative explanation for the results is that firms identify themselves as out of compliance with proxy advisory firm recommendations by disclosing these changes, and that "lack of compliance" is evidence that firms are badly governed, leading to a fall in stock price. If, however, this were the explanation, then one would predict that *future* performance of these firms would decline; Larcker et al., however, show that this is not the case. As interesting and suggestive as these results are, more research is clearly needed to determine whether and to what extent proxy advisory firms' recommendations are value increasing or decreasing.

What can we learn from the last 25 years during which the US has experimented with using fiduciary duties and disclosure to induce mutual funds, an important subset of institutional investors, to be more active in corporate governance? The most immediate lessons are discouraging. While regulation clearly changes behavior—it led mutual funds to adopt proxy voting guidelines, to disclose their proxy voting, and to subscribe to proxy advisory services—it failed to achieve its core goal, namely, transforming mutual funds into shareholders' champions that assume a role in corporate governance commensurate with their shareholdings. Indeed, in an example of the law of unintended consequences, the effects of the effort may well be negative on the core measure of firm value. Not surprisingly, the fundamental incentive structure outlined above—in which institutional investors, as intermediaries, have minimal incentives to become active in corporate governance—seems to undermine even the best-intended regulatory intervention. It is very difficult to force anyone to be free.

There is little reason to believe that the European Commission's proposals will fare any better. If enacted, one can predict that institutional investors and asset managers will reliably comply (rather than explain why they did not), will dutifully create and disclose policies for engagement, and will disclose their votes at general meetings. Likewise, one can predict that institutional investors will turn to proxy advisors for assistance. Finally, one suspects that this greater engagement will not increase firm or portfolio value.

8. The new reality: institutional investors and activist hedge funds

But these negative assessments may be too quick. Although traditional institutional investors have not emerged as active "stewards," there has been a more modest, although still important, change in institutional investor behavior: institutional investors are engaging with management in a much more active way than ever before; and, rather than always supporting management, institutional investors are now willing to support hedge funds and other corporate governance activists when they are convinced that doing so will increase firm value.[72] As one hedge fund manager explains, "The brute force of ownership is not required anymore because the big institutional players listen to both sides and are willing to back the activist fund if they believe in them . . . You can win with persuasion and ideas."[73]

Hedge fund activists include some familiar names from the 1980s like Carl Icahn and Nelson Peltz, as well as newer players like Bill Ackman, Daniel Loeb, and Jana Partners. Although exact figures are hard to come by, Icahn is said to have $20 billion available,[74] while Ackman has around $12 billion.[75] Overall, corporate activist hedge funds are estimated to have a total of around $100 billion.[76] While these are very large sums, they are small relative to the amounts managed by the largest institutional investors such as BlackRock ($3.7 trillion), State Street ($2 trillion), Vanguard ($1.8 trillion), or Fidelity ($1.6 trillion). They are also small relative to the market capitalization of the largest companies. As of January 31, 2014, the median market cap for the S & P 500 was $16 billion; the smallest market cap was $3 billion; the largest $450 billion.[77]

Hedge funds, in contrast to traditional institutional investors, engage with particular companies over firm-specific issues. Their activities can usefully be divided into corporate governance activism (e.g., pressuring management over business issues such as asking management to spin off a division, nominating a "short slate" of directors, and pushing for changes in corporate financing such as buying back stock or paying a dividend), and corporate control activism (e.g., blocking acquirers from completing a merger, blocking targets from agreeing to a merger, pushing the board to sell the company, and even making bids for the company).

The biggest difference between hedge funds and traditional institutional investors is hedge funds' business model. For traditional institutions, activism, when it occurs, is a response to unexpected and undesired problems that emerge in portfolio companies. Once problems arise, institutional investors must decide whether to sell the position (the "Wall Street Walk"), to intervene to improve it, or to do nothing. As we saw above, institutional investors' incentives to intervene are very weak.

By contrast, for activist hedge funds, activism is ex ante and strategic.[78] Activists first identify a problematic company, then decide whether intervention can improve matters. If activists conclude that an intervention is warranted, they buy a stake in order to intervene. When combined with high-powered performance-based incentives (typically between 1% and 2% of money under management plus between 15% and 20% of gains), hedge funds, unlike traditional institutions, have strong financial incentives to get involved. When an engagement is effective, the gains to the hedge fund can be huge. Moreover, activist hedge funds typically do not have the same conflicts of interest as institutional investors, as they do not sell money management services to portfolio companies.

The links between activist hedge funds and traditional institutional investors are critical to understanding hedge funds' influence and institutional investors' contemporary roles in corporate governance. First, because activist hedge funds do not have sufficiently large positions to prevail in medium or large cap companies, they must convince the other shareholders—mainly the traditional institutional investors—to support them. Hedge funds play an important "catalyst" role in facilitating shareholder action.

Second, the border between the "investor" side and the "issuer" side has become increasingly permeable, with increasing mobility of corporate governance professionals between the investor and issuer "sides" of the table. Stephen Brown, Director of

Corporate Governance at TIAA-CREF, recently became the CEO of the Society of Corporate Secretaries and Governance Professionals.[79] Bess Joffe, by contrast, left Goldman Sachs to become Managing Director of Corporate Governance at TIAA-CREF.[80] Linda Scott, managing director at Governance for Owners and, before that, Director of Corporate Governance at TIAA-CREF, is now SVP and Associate Corporate Secretary at JPMorgan Chase.[81] Abe Friedman, founder and managing partner of CamberView Partners, a boutique advisory firm that advises issuers, came from BlackRock. Chris Young, after six years as Director of M & A and Proxy Fight Research at ISS, is now managing director and head of contested situations at Credit Suisse where he advises issuers.[82] And, of course, John Wilcox, after a long career at the leading proxy solicitor Georgeson, became SVP and head of corporate governance at TIAA-CREF, and is now chairman of Sodali, Ltd., which works with issuers in developing institutional investor relationships.[83]

Third, and critically, a significant (but undisclosed) amount of activist hedge fund capital is raised from traditional institutions. According to the 2010 Conference Board report, hedge fund and other alternative investment assets have grown from under $2 billion in 1990 to around $1.5 trillion in 2009.[84] This growth has been fueled by institutional investment. As of 2009, the largest 200 defined benefit plans had invested around $70 billion in hedge funds alone.[85]

Institutional investor investment in activist hedge funds potentially align interests in a variety of interesting ways. First, it insulates institutional investors from criticism by those opposed to the activists’ agenda, and avoids antagonizing portfolio companies and incurring the wrath of portfolio managers. Second, encouraging activism through hedge funds allows for much higher-powered financial incentives than would be politically acceptable within institutional investors. Third, the arrangement allows for a division of labor, with the hedge funds developing expertise in pressuring management. Having induced activism through investments in hedge funds, institutional investors quite reasonably may choose to take a more passive reactive role. Fourth, the investments partially align the financial interests of the institutional investor and the hedge fund. Finally, major institutional investors only invest in hedge funds after significant due diligence. The process associated with institutional investors' *investment* in hedge funds provides some assurance to the general investing public of the activists' bona fides. Institutional investors are now far more willing to consider proposals for change made by the activist hedge funds than they used to be.

At the same time, hedge funds' high-powered financial incentives create grounds for concern. Hedge funds exist to make money, and will likely attempt to do so, whether or not it benefits shareholders as a group. Thus, for example, hedge funds have sought to acquire companies and, of course, sought to do so at the lowest possible cost. Hedge funds have also used tactics such as "empty voting" that serve the hedge funds' interest at the expense of the other shareholders.[86]

The potential constraints induced by the need to form a coalition can be usefully illustrated by the Air Products/Air Gas battle.[87] In 2012, Air Products, an industrial gas producer, launched a hostile bid for Air Gas, a supplier of gas delivered in canisters. Air Gas, which had a staggered board and a poison pill, resisted Air Products' above market bid on the grounds that it undervalued the company. Eventually, Air Products launched a proxy fight to elect a short slate of directors. Air Products nominated three independent directors who were committed to taking a "second look." After prevailing in a hard-fought contest, with support of ISS, hedge funds, and traditional institutions, the newly elected directors, with separate counsel and investment banking advice, surprised many by concluding that the Air Products offer, though a premium above market value, substantially undervalued Air Gas, and became the most vociferous proponents of resisting the Air Products offer. Air Products ultimately refused to raise its offer, and the bid failed. Air Gas's stock price has remained above the offer price and, in fact, has increased nearly 50%. The newly elected outside directors seem to have been right.

From a corporate governance perspective, one of the most interesting features of the battle was that Air Products did, in fact, identify and elect genuinely independent directors and not a slate committed to selling the company.[88] The best explanation one heard for this "unusual" tactic is that the institutions and the hedge funds that held Air Gas shares were genuinely unsure of the value of Air Gas, and would not have supported a more partisan slate.

The world has changed when F. William McNabb, III, chairman and CEO of Vanguard, publicly salutes certain interventions by activist hedge funds:

> The nature of activist investing has changed significantly since the 1980s. Today, we're seeing a greater trend toward constructive activists rather than destructive activists. Activists are not inherently good or bad. They often raise legitimate questions.
>
> And when they raise legitimate questions and tie their business cases to long-term shareholder value—that gets our attention. There have been a number of cases where a board wasn't asking the right questions

and eventually lost touch with how the company was being run, and how it was being perceived by investors. I'll share two instances where Vanguard has sided with activist campaigns in recent years.

- **Canadian Pacific Railway**: In 2012, activist Bill Ackman went in and identified some vulnerabilities in Canadian Pacific Railway. We agreed—as did many other large investors—that the company had been poorly run and governed. Ackman brought in an experienced CEO and a number of directors they thought could make a difference. It's been an activist success story—by and large.
- **Commonwealth REIT**: Another example of us supporting an activist: Earlier this year, Corvex and Related Companies waged a successful campaign to replace the entire board of Commonwealth REIT. This was a company with a track record of poor performance and poor governance, and they were ultimately held accountable. Commonwealth was using a third-party management firm, RMR, that was run by family members of Commonwealth leadership. RMR extracted value from the public company. They didn't operate it well, but they were paid well nonetheless. We supported wiping the slate clean. In the case of Commonwealth, we were the largest shareholder. We were important to Corvex's case, but at the end of the day, I don't think they needed us. 81% of Commonwealth shareholders voted to remove the company's board.[89]

The constraining effects of coalition building have some interesting implications. We should be more worried about cases in which hedge funds can act on their own than when a coalition with other shareholders is required. Thus, for example, the squeeze-out threshold in the EU for completing a takeover under the Takeover Directive (95% in Belgium, Germany, France, Italy, and the Netherlands; 90% in Spain, Sweden, and the UK)[90] is an invitation to hedge funds to acquire a blocking position. Especially at the 95% level, it would seem close to "hedge fund malpractice" not to buy a blocking position, especially in private equity deals in which the sponsor's financing requires owning 100%. Similar hold-out problems can be created by "majority of the minority" provisions, whether in a controlling shareholder context or a management sponsored LBO. This suggests that such provisions should be used sparingly. It also raises the possibility that the doctrinal effect of such provisions should be revisited.[91]

9. Conclusion

The preceding discussion suggests that, try as we might, we are unlikely to transform institutional investors into "stewards" of portfolio companies. The emergence of activist hedge funds raises an even more fundamental question that applies equally to institutional investors: do we, as a society, actually *want* shareholders to act like owners? Highly incentivized, focused actors can be and often are socially disruptive. In the US during the 1980s, the disruption accompanying hostile tender offers resulted in anti-takeover legislation, as well as judicial decisions that limited shareholders' ability to proceed unilaterally.[92] Mark Roe's political history of US corporate finance provides numerous examples of regulatory pacification of active or potentially active shareholders.[93] Whenever hedge funds have emerged as activists, they have produced a backlash as their single-minded, incentive-driven focus—whether on shareholder value maximization or blocking a transaction or exploiting ambiguities in bond contracts—has made people nervous. The rise of hedge funds in Europe has led to calls to constrain them.[94]

When one reads the EU Green paper and the Commission's proposal to reform the Shareholder Rights Directive, one gets the distinct impression that shareholders who act too much like shareholders, with single-minded focus on maximizing shareholder value today, are *not* what is sought. Too often, it seems, with a focus on maximizing profits, they push for unpleasant things like closing plants, moving work to China, firing employees, or putting competitors out of business. Rather, the EU seems to be searching for a very different sort of shareholder, a shareholder more like a rich uncle who, while demanding, is ultimately focused on doing what is best for the family as a whole, one who "can be encouraged to take an interest in sustainable returns and longer term performance" even at the cost of lower returns. The US experience makes clear that traditional institutions and hedge funds are not this sort of investor and it is unlikely that regulation can transform them into this sort of "patient capital."

Table 1

Institutional Ownership concentration in the 25 largest US Corporations (by market value; as of 03/26/2010)

Company	Market value ($millions)	% of total shares outstanding held by institutions	% held by top 5 institutions	% held by top 10 institutions	% held by top 20 institutions	% held by top 25 institutions
Exxon Mobil Corp	$314,153.50	48.20%	13.40%	17.40%	22.80%	25%
Microsoft	260,131.90	63.7	17.1	23.5	29.5	31.9
Apple Inc.	209,379.00	70.8	18.5	26.2	34.5	37
Wal-Mart	208,662.50	35.9	8.6	12	15.7	17.2

Stores, Inc.						
Berkshire Hathaway Inc.	200,900.50	25	10.4	14.8	18.3	19.2
General Electric Co.	195,740.50	49.4	12.7	17	22.8	24.8
Procter & Gamble Co.	184,993.50	58	16.5	20.6	26.7	29.1
Bank of America Corp.	179,572.90	54.9	14.9	20.3	26.8	28.9
Google, Inc.	179,104.10	79.6	21.5	32.2	41.4	44.1
JPMorgan Chase & Co.	178,865.00	73.3	17.9	25.6	33	35.8
Johnson & Johnson	177,169.10	63.9	14.9	20.1	27.3	29.6
IBM Corp.	167,909.10	61.3	15.3	20.9	28.1	30.6
Wells Fargo & Co.	161,742.30	75.2	21.7	32.9	41.5	44.3
AT&T Inc.	154,870.40	55.1	16.9	23	29.1	31.4
Cisco Systems, Inc.	151,500.30	73.4	17.5	24.1	31.3	33.8
Chevron Corp.	149,481.70	62.2	17.2	22.3	29.1	31.7
Pfizer Inc.	138,285.20	69.7	16.9	22.9	30.5	33.2
Oracle Inc.	128,940.40	60.8	17.9	25.3	32.5	34.7
Coca-Cola Enterprises Inc.	125,975.00	63.5	23.6	32.5	38.4	40.4
Hewlett-Packard Co.	125,274.90	77.4	19	27.6	36.3	39.4
Citigroup Inc.	123,088.90	37.8	13.4	17.9	22.1	23.5
Intel Corp.	122,853.80	63.2	15.3	20.6	27.6	30
Merck & Co., Inc.	116,606.30	73.4	21.6	33.3	41.3	43.8

PepsiCo, Inc.	110,052.60	66.2	15.1	21.6	29	31.6
Philip Morris International Inc.	97,215.10	71.7	22.7	30	37.7	40.4
Goldman Sachs Group	91,077.10	54.9	18.8	27.4	36.4	39.2

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[9] For an overview of these developments, see Gilson & Gordon, *supra* note 4 at 878–884.

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[41] Choi, Fisch, & Kahan, *supra* note 39, 316–328.

[42] Green Paper 2011, *supra* note 2, 3. See, also, Michel Barnier, http://ec.europa.eu/commission_2010-2014/barnier/docs/speeches/20101025/speech_en.pdf: "Last but not least, shareholders must play their role fully. Too often, shareholders are only interested in the highest possible dividends. That is understandable but it fuels short-termism. We have spoken for years about shareholders rights. It is time to also talk about shareholders' obligations. All these measures put together will make a difference and lead to better corporate governance in companies, to more responsibility and more accountability. We still need to debate how we put these measures in place–but I am clear we will not be able to rely only on voluntary codes."

Barnier is European Commissioner for Internal Market and Services and a Vice President of the European Commission.

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[53] Id. at 4.

[54] Id at Art. 3f(1) at p. 19.

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[56] Id. at Art. 3g at pp. 20–21.

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[60] IC-25922 at *18.

[61] Id. at *28–*29. See, also, the SEC's benefit cost analysis:

> The amendments to the registration statement and reporting forms that we are adopting will benefit fund investors, by providing them with access to information about how funds vote their proxies.
>
> First, the amendments will provide better information to investors who wish to determine:
>
> ● to which fund managers they should allocate their capital, and
>
> ● whether their existing fund managers are adequately maximizing the value of their shares.
>
> The investment adviser to a mutual fund is a fiduciary that owes the fund a duty of "utmost good faith, and full and fair disclosure." This fiduciary duty extends to all functions undertaken on the fund's behalf, including the voting of proxies relating to the fund's portfolio securities. An investment adviser voting proxies on behalf of a fund, therefore, must do so in a manner consistent with the best interests of the fund and its shareholders. The increased transparency resulting from proxy voting

disclosure may increase investors' confidence that their fund managers are voting proxies in accordance with their fiduciary duties. Without disclosure about how the fund votes proxies, fund shareholders cannot evaluate this aspect of their managers' performance. To the extent that investors choose among funds based on their proxy voting policies and records, in addition to other factors such as expenses, performance, and investment policies, investors will be better able to select funds that suit their preferences. Further, insofar as investors may over-emphasize certain of these factors, e.g., past performance, in selecting funds, it may be beneficial to provide additional information to use in selecting funds. On a related point, we anticipate that over time, commercial third-party information providers will offer services that will enable investors to better analyze proxy voting by funds. These developments will further facilitate the benefits to fund investors from proxy vote disclosure (Id. at *72–74; footnotes omitted).

[62] Id. at *75–*76 (footnote omitted).

[63] Id. at *23–*24.

[64] Proxy Voting by Investment Advisers, IA-2106, 68 FR 6585 at *6588 (footnotes omitted).

[65] See, e.g., Vanguard's at https://about.vanguard.com/vanguard-proxy-voting/voting-guidelines/ and Fidelity's at http://personal.fidelity.com/myfidelity/InsideFidelity/InvestExpertise/governance.shtml#fulltext.

[66] https://about.vanguard.com/vanguard-proxy-voting/how-our-funds-voted/. The report for Vanguard's Index 500 fund (which tracks the S & P 500 index and thus has approximately 500 companies in it) runs to 256 pages.

[67] Leo E. Strine, Jr., Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance, 33 J. Corp. L. 1, 16 (2007).

[68] See e.g. AFL CIO's annual report: http://corpgov.net/2013/02/afl-cio-key-votes-survey-results-for-2012/; also have pdf on file. See, also, http://proxydemocracy.org/.

[69] Larcker, David F., McCall, Allan L., & Ormazabal, Gaizka, Outsourcing Shareholder Voting to Proxy Advisory Firms (June 13, 2014). Rock Center for Corporate Governance at Stanford University Working Paper No. 119; Stanford University Graduate School of Business Research Paper No. 14-27. Available at SSRN: http://ssrn.com/abstract=2101453 or http://dx.doi.org/10.2139/ssrn.2101453.

[70] Id. at 1.

[71] Id.

[72] Marcel Kahan & Edward Rock, Hedge Funds in Corporate Governance and Corporate Control, 155 U. Pa. L. Rev. 1021, 1045 (2007); David Gelles & Michael J. De La Merced, New Alliances in Battle for Corporate Control, NY Times, March 18, 2014 at B1, available http://dealbook.nytimes.com/2014/03/18/new-alliances-in-battle-for-corporate-control/?_php=true&_type=blogs&ref=business&_r=0.

[73] Alexandra Stevenson, No Barbarians at the Gate, a Force for Change, New York Times Dealbook, January 6, 2014, available at http://dealbook.nytimes.com/2014/01/06/no-barbarians-at-the-gate-instead-a-force-for-change/, quoting Gregory Taxin, president of $1.5 billion hedge fund Clinton Group and a co-founder of Glass Lewis & Company, a leading proxy advisor.

[74] Having returned outside investors' money in 2011, Icahn relies on his own considerable resources: Forbes estimates his net worth at $20 billion. http://www.forbes.com/sites/stevenbertoni/2013/03/27/carl-icahn-unleashed-wall-streets-richest-man-is-on-the-attack-just-ask-michael-dell/

[75] Ackman's Pershing Square L.P. Fund Rose 3.8% Last Month, http://blogs.wsj.com/moneybeat/2014/02/04/ackmans-pershing-square-l-p-fund-rose-3-8-last-month/?link=mtkw.

[76] Alexandra Stevenson, No Barbarians at the Gate, a Force for Change, New York Times Dealbook, January 6, 2014, available at http://dealbook.nytimes.com/2014/01/06/no-barbarians-at-the-gate-instead-a-force-for-change/). See also Beth Jinks and Laura Marcinek, Bankers Pitching Avoidance Advice as Activists Amass Record Cash, January 6, 2014 Bloomberg, available at http://www.bloomberg.com/news/2014-01-06/bankers-pitching-avoidance-advice-as-activists-amass-record-cash.html (estimating $89 billion in activist hedge funds as of the 2013 third quarter compared to $66 billion at the end of 2012).

77 S & P Dow Jones Indices, S & P 500 fact sheet, available at http://us.spindices.com/indices/equity/sp-500.

78 Marcel Kahan & Edward Rock, Hedge Funds in Corporate Governance and Corporate Control, 155 U. Pa. L. Rev. 1021, 1069 (2007).

79 https://www.linkedin.com/profile/view?id=18310435&authType=NAME_SEARCH&authToken=4ZBW&locale=en_US&trk=tyah2&trkInfo=tarId%3A1416926477349%2Ctas%3Astephen%20brown%2Cidx%3A1-1-1.

80 https://www.linkedin.com/profile/view?id=59185043&authType=NAME_SEARCH&authToken=RDuG&locale=en_US&trk=tyah2&trkInfo=tarId%3A1416926552024%2Ctas%3Abess%20joffee%2Cidx%3A1-1-1.

81 https://www.linkedin.com/profile/view?id=129343034&authType=NAME_SEARCH&authToken=1zYw&locale=en_US&trk=tyah2&trkInfo=tarId%3A1416926626101%2Ctas%3ALinda%20Scott%2Cidx%3A1-1-1.

82 https://www.linkedin.com/profile/view?id=12720820&authType=NAME_SEARCH&authToken=KW7l&locale=en_US&trk=tyah2&trkInfo=tarId%3A1416926864210%2Ctas%3AChristopher%20Young%2Cidx%3A1-1-1.

83 https://www.linkedin.com/profile/view?id=54229638&authType=NAME_SEAR

CH&authToken=n4CU&locale=en_US&srchid=1393914721416926968081&srchindex=1&srchtotal=348&trk=vsrp_people_res_name&trkInfo=VSRPsearchId%3A1393914721416926968081%2CVSRPtargetId%3A54229638%2CVSRPcmpt%3Aprimary.

[84] Conference Board report at Chart 20 (p. 49).

[85] Conference Board Research Report, *supra* note 5, at p. 52, Tbl 20 (this category includes all hedge funds and is thus far broader than the subset of hedge funds that engage in corporate governance activism; at the same time, defined benefit plans are a small subset of institutional investors).

[86] See, e.g., Henry T. C. Hu and Bernard Black, The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership, 79 So. Cal. L. Rev. 811 (2006).

[87] For a full description, see Air Products and Chemicals, Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011).

[88] As Chancellor Chandler pointed out, Air Products could have nominated a slate with strong priors in favor of selling, e.g., a slate of "three Bebchuks." Id. At 16 A3d at 123 n. 487.

[89] F. William McNabb III, Getting to Know You: Sharing Practical Governance Viewpoints, John Weinberg Center for Corporate Governance, October 30, 2014, available at http://www.lerner.udel.edu/sites/default/files/WCCG/PDFs/events/Transcript%20_UDel%20Corp%20Governance%2010%2030%202014_%20FINAL%20for%20UD%20website.pdf.

[90] Commission Staff Working Document, Report on the Implementation of the Directive on Takeover Bids, SEC (2007) 268 (Brussels, 21.02.2007), available at http://ec.europa.eu/internal_market/company/docs/takeoverbids/2007-02-report_en.pdf.

[91] Relatedly, bond covenants that were arguably optimal in an era of passive bondholders and under-enforcement may result in suboptimal selective over-enforcement as hedge funds overcome bondholders' classic collective action problems and exploit poorly drafted covenants, without having to convince institutional holders to join with them. Marcel Kahan & Edward Rock, Hedge Fund Activism in the Enforcement of Bond Covenants, 103 Nw. U. L. Rev. 281 (2009).

[92] For a discussion of how a self-regulating market economy stresses social relationships in a way that inevitably produces public regulatory countermeasures in a democracy, see Jeffrey Gordon, Corporations, Markets and Courts, 91 Colum. L. Rev. 1931, 1971–1982 (1991) (using Karl Polanyi's The Great Transformation as a lens through which to understand the Delaware Supreme Court's restriction of hostile takeovers in Paramount v. Time).

[93] Roe, Strong Managers, Weak Owners, *supra* note 4.

[94] Alexandros Seretakis, Taming the Locusts? Embattled Hedge Funds in the EU, 10 NYU J. L. & Bus. 115 (2013).