

# A guide to the proxy voting chain



Proxy voting is crucial in ensuring shareholders can fully exercise their ownership responsibilities without having to attend thousands of AGMs.

However, where an onlooker might assume that each vote can currently be carried out at a touch of a button this could not be further from the case. As it stands today, the proxy voting process is structurally inefficient with too many hurdles that lead to delays, participant confusion and even incorrect vote tallies. We have identified areas where shareholder frustrations can be alleviated and a number of emerging best practices which could help improve the overall proxy voting process.

At Legal & General Investment Management (LGIM), we make a conscious decision to never abstain from voting. And with over £1 trillion in assets under management,<sup>1</sup> this means we rely on the proxy voting process more than most investors. But due to the inefficiencies in the current model, we often

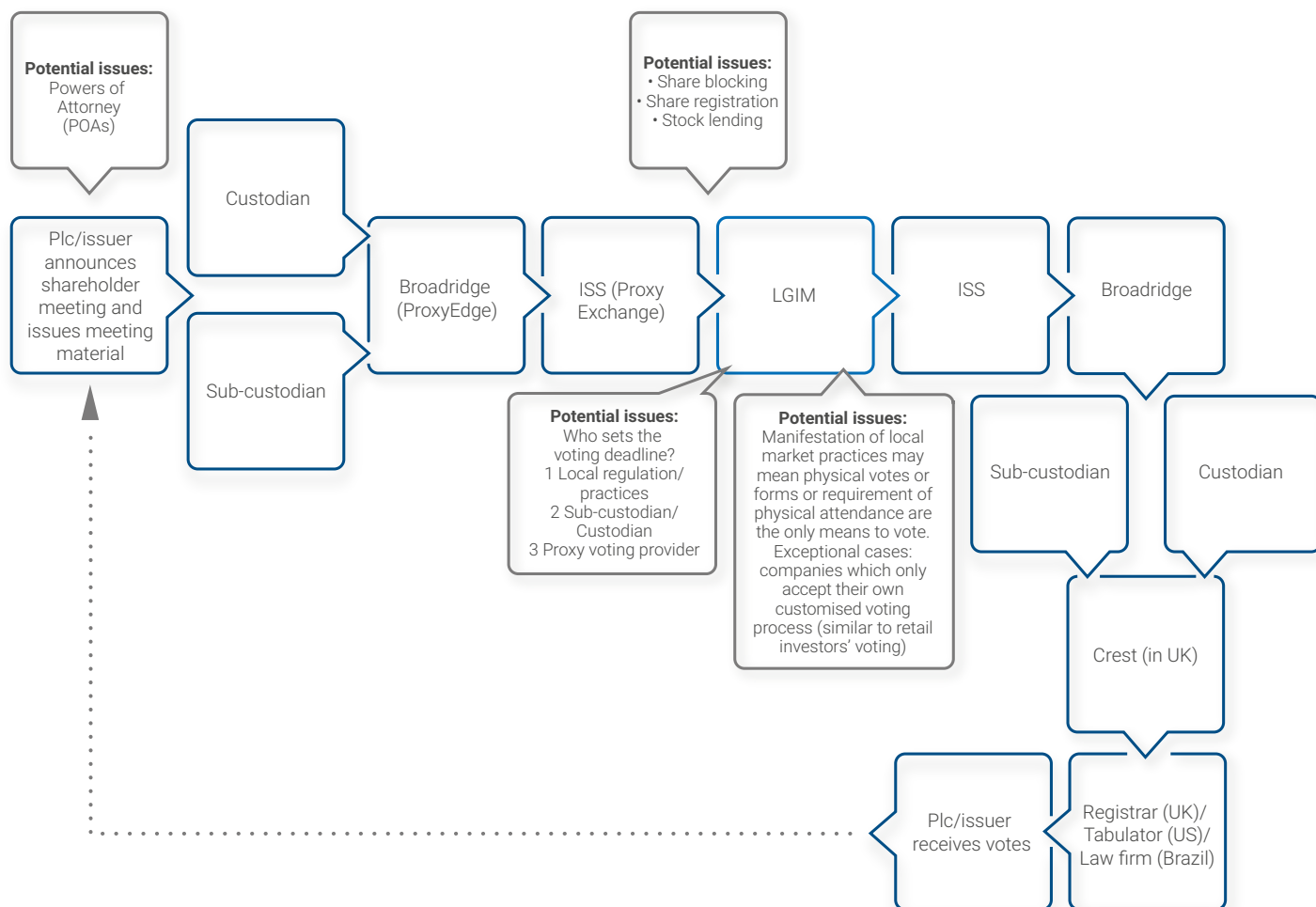
recognise company boards' concerns about a failure to receive confirmation of any particular vote, or the inability for a company to engage with our Investment Stewardship Team to change a vote once the process has already started. This guide helps explain the issues in voting deadlines, country and market specific requirements, intermediaries and the effect of regulation.

## Today: The tortoise and the hare

In 2019, it is technically possible to vote "at the touch of a button", via blockchain technology, by the shareholder on the voting platform and for the issuer to see the votes instantly. But the current system in place, with multiple intermediaries communicating via SWIFT, local market practices and regulations and issuers' ad hoc individual voting requirements, undermines this.

1. Source: LGIM internal data as at 31 December 2019. The AUM disclosed aggregates the assets managed by LGIM in the UK, LGIMA in the US and LGIM Asia in Hong Kong. The AUM includes the value of securities and derivatives positions.

This is an overview of how vote instructions may travel through the global proxy voting chain:



The timeline for the chain can vary hugely, from instantaneous to several weeks if, for example, powers of attorney (POAs) are required. The deadlines set for shareholders to submit their votes vary on and will depend on local regulations and practices, as well as custodians' and sub-custodians' deadlines. In the UK, the voting deadline on the platform is often set three to seven days before the meeting takes place. In the US, that deadline is on the same day of the meeting, but in Europe it can be almost three weeks before the meeting. This means that the time investors have to analyse the proposals, read the research and make their voting decisions may be severely restricted depending on their location.

### The challenges we meet along the way

In certain countries, such as Sweden, Hungary, Egypt and Peru, POAs are required in order for shareholders to be able to vote. In other countries 'share blocking' will be practiced, this means that once the shares have been voted (or registered to vote), the shareholder can no longer trade these shares until after the shareholder meeting, potentially creating liquidity issues for investors if the voting process becomes protracted. Switzerland is a particular example of this practice. In Egypt, which also practices shareblocking, either all the shares must be voted or none at all.

Furthermore, there are the isolated market requirements of physical forms that must be filled out and signed, or the requirement of physical attendance. In exceptional cases, individual companies will require shareholders (both retail and institutional investors) manually to log into and vote on the individual company's website.

If individual shareholders decide to make use of stock lending then any stock that is on loan cannot be voted. If the shareholder wishes to vote the loaned stock, it must be recalled by the shareholder in time for voting to take place, potentially creating a delay in the vote being enabled. Alternatively, a block is put in place to prevent the shares being lent for several days or weeks depending on the voting deadline and the date of the shareholder meeting.

Multiple intermediaries undertaking manual inputs also increases the risk of human and technical error. In France, an incident occurred where several votes at various shareholder meetings were incorrectly counted due to errors in the voting chain. In one instance, the amount of miscalculation led to an incorrect adoption of a resolution.<sup>2</sup>

### The Second Shareholders Rights Directive (SRD II)<sup>3</sup>

SRD II entered into force on 10 June 2017, and member states had an approximately two-year implementation period. One of the aims of the Directive is *to improve the transmission of information along the chain of intermediaries to facilitate the exercise of shareholder rights*, explicitly stating that intermediaries must *transmit to issuers, shareholders' instructions related to the exercise of their rights*.<sup>4</sup> The Directive should therefore enable increased transparency in the proxy voting chain.

Corporate services company, Broadridge notes that SRD II will require intermediaries to pass on any votes received to the next intermediary (or issuer/issuer agent) **'without delay'**. Currently, intermediaries often hold on to shareholder vote instructions until close to the voting deadline. This allows them to manage the costs of share positions reconciliation and the volume of message traffic. However, under SRD II guidelines, intermediaries will have to adjust their practices accordingly and absorb the higher cost.<sup>5</sup>

### The disruptors driving improvements

With the inefficiencies outlined above, it is no surprise that this process is ripe for technology disruption, which could eliminate many of the verification issues that create communication and confirmation delays between parties. Proxymity, set up within Citi via its D10X programme, offers an example of the potential for such a technology solution. The company uses a core algorithm to streamline the flow of information between intermediaries, and directly connect issuers and investors.<sup>6</sup> The digital proxy platform built by Proxymity allows for instant meeting notifications and enables the extension of the voting deadlines, which in some cases may provide up to nine additional days for decision making. In addition, post-meeting vote confirmation is provided to investors via the platform.

It is not only new entrants driving change: established incumbents such as Broadridge are developing blockchain solutions to the current problems. If successful, these types of technology developments could revolutionise the proxy voting chain. The process would become far more transparent and significantly reduce the time between the voting deadline and the shareholder meeting date, thereby providing more time for shareholders to research and consider their voting decisions. A more technological solution such as a platform should also minimise human input error.

### A collaborative effort

The voting chain has for far too long been shrouded in complexity and hampered by inefficiencies. There is now an opportunity to streamline and make the voting ecosystem transparent via innovation but this requires wide-reaching support for change from companies, investors and intermediaries alike. Our corporate governance efforts in the future will be to encourage all involved parties to support these changes for the better.

2. Les Echos, AG : sept groupes du CAC 40 contraints de recompter les votes, 20 September 2018

3. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 (amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement)

4. SRD II article 3b(4) and (5), which reads as follows: *Where there is more than one intermediary in a chain of intermediaries, information referred to in paragraphs 1 and 4 shall be transmitted between intermediaries without delay, unless the information can be directly transmitted by the intermediary to the company or to the shareholder or to a third party nominated by the shareholder.*

5. Broadridge, *Shareholder Rights directive: Everything you need to know*, October 2018, page 10

6. Proxymity is one of the first initiatives to launch from Citi's D10X program, an internal strategic growth model that enables employees to take new business ideas from concept to launch. The underlying Proxymity technology was developed at the Citi Innovation Lab in Tel Aviv. (website accessed on 12 August 2019: <https://www.citigroup.com/citi/news/2018/180629d.htm>)

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