INDEX ACT
INVESTOR DEMOCRACY IS EXPECTED

For years, the popularity of passive investing through mutual funds and exchange traded funds (ETFs) that track indices, like the S&P 500, has been increasing, finally surpassing actively managed funds in 2018 and only continuing to grow. Investors have unequivocally benefited from lower fees and greater diversification. However, with only a handful of investment advisers dominating the space, this also means that corporate voting power is increasingly concentrated.

The "Big 3" investment advisers (Blackrock, Vanguard, and State Street) who manage many of these passive investment funds:

- Manage over $20 trillion in combined assets;
- Vote around 25% of all votes cast at annual meetings;
- Are the largest owner in around 90% of the S&P 500 companies;
- Manage 82% of all assets flowing into investment funds over the last decade; and
- Control between 73 percent and 80 percent of the exchange-traded fund (ETF) market.

These investment advisers leverage this voting influence, even though the shares are held on behalf of millions of American investors who invest in index funds simply to obtain diversification and track market returns in a cost effective way. Also, because these passive funds exist to track broad swaths of the market, the asset advisers are not truly invested in the governance or success of the hundreds or thousands of portfolio companies. This ability to consolidate and vote millions of voting shares has taken the power from individual investors and permanently distorted the corporate governance ecosystem. This problem will only grow as the popularity and ubiquity of passive investing continues to grow.

The **Investor Democracy is Expected (INDEX) Act** would return the voting power in corporate governance to individual and active investors who are invested – literally and figuratively – in the success of the companies that they own. Deconsolidating this voting power will neutralize the dominance of the investment advisers and foster a healthier, more competitive, and democratic corporate governance ecosystem.

Congress has previously recognized and rectified imbalances in corporate governance by prohibiting investment brokers from voting in shareholder elections unless the beneficial owner has instructed the broker to do so. Congress recognized then that "final vote tallies should reflect the wishes of the beneficial owners of the stock and not be affected by the wishes of the broker that holds the shares…"

This principle should hold true for investment advisers and their investment funds as well. The INDEX Act takes this inspiration, and seeks to level the playing field for investors regardless of whether they invest through a broker or passive investment fund.

SUMMARY

The **INDEX Act** would amend the Investment Advisers Act of 1940 to require investment advisors of passively-managed funds to vote proxies in accordance with the instruction of fund investors, not at the discretion of the adviser.

- **Covered Funds**: Includes passively-managed funds that are private funds, employer-sponsored retirement funds, defined benefit and contribution pension plans, and TSP funds.

- **1% Voting Power Limitation**: To limit costs and not inundate fund investors with votes of every portfolio company (for example, the Vanguard Total Stock Market Index Fund holds 4,000+ companies), voting choice is only required if the investment adviser holds more than 1% of a company's voting securities.

- **Routine Matters Exception**: Investment advisers cannot vote without instructions from fund investors, except for routine matters, like ratification of auditors, which will avoid concerns about shareholder meeting quorums. Most notable matters, such as changes of control, director elections, and shareholder proposals are not routine.

- **Mirror Voting Exception**: For shareholder votes requiring a majority or more of the outstanding stock (e.g., merger approval), advisers may "mirror vote," where their votes are proportionately cast to not affect the outcome.

- **Disclosure and Broker Obligations**: Investment advisers must provide proxy statements and other materials to fund investors. Investment advisers that provide vote recommendations must permit third-party recommendations on a non-discriminatory basis that allows for a broad diversity of views.

- **Cost Burden**: Expenses for implementing pass-through voting are required to be borne by the funds or their investment advisers, and not by the portfolio companies.

- **Safe Harbor**: An investment adviser can simply refrain from voting altogether and avoid the costs of obtaining fund investor instructions. A safe harbor protects the decision to not vote from breaching any duty under federal or state law.

CONTACT David_Pigue@Sullivan.senate.gov