

Proxy Stewardship Project

Report on Special Convenings of Endowments on Commingled Fund Proxy Voting

Rockefeller Brothers Fund, New York City, October 15, 2009

Rockefeller Philanthropy Advisors, San Francisco, October 21, 2009

Representatives from philanthropic and educational endowments gathered at two special convenings on commingled fund proxy voting during October 2009. The main convening took place at Rockefeller Brothers Fund's New York offices on October 15, 2009, and a West Coast briefing was organized the following week at Rockefeller Philanthropy Advisors' San Francisco offices. The meetings were convened by Dr. Neva R. Goodwin, with the assistance of Rockefeller Brothers Fund, Rockefeller Philanthropy Advisors, the Center for Social Philanthropy at Tellus Institute, Confluence Philanthropy and Sustainable Endowments Institute. In New York, the endowments were joined by Marc Mayer, the CEO of Grantham Mayo van Otterloo, one of the largest managers of endowment assets in the United States, to begin constructive dialogue about potential solutions to the problem of passive proxy voting on environmental, social and governance (ESG) issues by the managers of commingled funds commonly used by endowments.

Background

Many philanthropic and educational endowments (henceforth "Endowments") have increasingly become more active stewards of their investment assets by thoughtfully voting their shares by proxy on a wide range of matters brought before corporate annual meetings – from corporate governance issues, such as excessive executive compensation, to social and environmental issues, such as sustainability reporting and climate change policies, among other pressing concerns. Unfortunately, Endowments regularly find themselves unable to express their voice and votes as responsible shareowners because many institutions today do not hold stock directly. Rather they are invested with fund managers who pool their clients' assets together in "commingled funds" and cast proxy votes according to their own guidelines rather than in line with their clients' concerns. There are good financial reasons for using commingled investment vehicles, but the voting records of leading commingled fund managers show that they typically defer to corporate management rather than support best practices on environmental, social and corporate governance issues.

The goal in organizing these convenings was to begin a process that will open constructive dialogue with investment managers widely used by Endowments. It was hoped that the convenings would provide an opportunity to discuss possibilities for a collaborative, financially viable solution, such as the development of parallel pooled funds for clients that would prefer to have their shares voted according to guidelines more aligned with their concerns as long-term responsible investors. Such a solution would not alter investment strategy, only provide a more responsive approach to proxy voting. Preliminary research conducted by the Center for Social Philanthropy and Sustainable Endowments Institute identified several leading asset managers with whom to begin these discussions, including State Street Global Advisors, the largest manager of endowment assets in the US, and GMO, the fifth largest. Preliminary discussions have occurred with both managers, and GMO agreed to send Mr. Mayer to begin discussions at the New York meeting.

Discussions in New York

On October 15, 2009, at Rockefeller Brothers Fund's new offices in New York, Neva Goodwin opened the meetings by presenting the overall problem of proxy voting by commingled fund managers, and a panel from the convening committee, including Josh Humphreys from Harvard University and the Center for Social Philanthropy and Mark Orlowski from Sustainable Endowments Institute presented various aspects of the problem and proposed the potential solution of creating parallel pooled funds that would vote according to more responsive ESG guidelines. Because GMO agreed to send its CEO and one of the participating endowment trustees also sits on the GMO board, much of the convening focused on the specific case of GMO, an organization that runs most of its institutional commingled funds as mutual funds, subject to the organizational and disclosure requirements of the Investment Company Act of 1940 ("1940 Act"). As mutual funds, GMO's commingled funds must report their proxy voting annually to the US Securities and Exchange Commission. Public reporting of proxy voting allows groups such as ProxyDemocracy to analyze proxy voting data, and Mr. Orlowski presented visualizations of these proxy voting data not only for GMO but also for State Street and Goldman Sachs, highlighting the wide divergence among proxy voting patterns among leading endowment asset managers.

GMO responded very constructively to our proposals, though Mr. Mayer made no commitments other than to continue the dialogue. It remains unclear whether the structure of the 1940 Act would limit the ability of GMO to run a parallel pooled fund or to open a different share class that might vote according to a different set of proxy voting guidelines, but Mr. Mayer was open to further exploration and discussion of the issue.

A wide-ranging discussion among participants followed the presentations and Mr. Mayer's comments. There was considerable discussion of the role of proxy advisers and the benefits and drawbacks of relying upon their voting guidelines. Although many endowments use proxy advisers in their own proxy voting, concern was expressed about giving proxy advisers too much power over proxy-voting decisions, especially in the context of industry consolidation. It appears that groups of (reasonably) like-minded asset owners would do best to develop their own sets of guidelines, independently of both the proxy advisers and investment managers. Many participants expressed frustration about the multiple challenges they have encountered when trying to develop their own voting policies and guidelines. Because of this, participants were generally receptive to the idea of developing a set of guidelines by endowments themselves for the broader community of endowments.

The impact of proxy voting was also discussed. Given that corporate management is under no obligation to accept the outcome of votes, some wondered whether proxy voting was the best tool for holding corporations accountable. Opinions differed, but most agreed that it is an important way for shareowners to express their concerns about the policies and practices of public corporations. Other impact opportunities were discussed, such as mission-related or socially responsible investing in support of issues of concerns (climate change was singled out as one prominent example), engaging with management directly or through broader investor networks, or influencing SEC regulation related to transparency and accountability of corporations for their environmental, social and governance impacts. Most agreed that the impact of proxy voting could

certainly be strengthened by other forms of engagement. However, it was also recognized that in the US the proxy and by extension proxy voting are the communication tool between investors and the boards that represent them. It was also mentioned that companies and corporate counsels tend to take resolutions filed by shareholders very seriously.

Participants generally supported the idea of extending dialogue with other managers and raised the prospect of beginning dialogue with investment consulting firms commonly used by endowments to select and evaluate their managers. Client dialogues are already beginning with a variety of investment consulting firms about proxy voting and other responsible investing issues. Participants also agreed that a common set of voting guidelines or principles needed to be elaborated, but that they also needed to remain broad enough to garner the support of endowments that remain relatively new to the process of active proxy voting on ESG issues, including several in attendance. The convening agreed to support the organizational efforts to lead the manager engagement, the research and information sharing among endowments, and the development of guidelines.

Discussions in San Francisco

At the October 21 meeting in San Francisco, the discussion among endowments, though much briefer than the one in New York, followed a similar path. There was strong support expressed for the work that had been done up to now, and there was enthusiasm among those present for the creation of a set of voting guidelines that would represent an endowment point of view and could be adopted by the Boards of endowments. The idea of working together with other endowment clients of asset managers to explore creating parallel funds that would vote shares according to these guidelines was considered very appealing.

Action Agenda

Following the convenings, the organizers have agreed to formalize the initiative into a **Proxy Stewardship Project**, which would provide a platform for the following actions:

- 1) Developing Proxy Stewardship Principles**, which would serve as the foundation for proxy voting guidelines on ESG issues for endowments, their managers and consultants;
- 2) Continuing constructive engagement with GMO;**
- 3) Extending dialogue with State Street** by drafting a letter addressing concerns over proxy voting, signed by a leading group of Endowment clients;
- 4) Following up with participants and other interested parties** and clients in order to gather information about other managers and investment consultants and to coordinate other engagements with targeted managers; and
- 5) Conducting deeper research** on managers and their voting records in order to shape the terms of future dialogue.

The Project actively welcomes additional participation. For more information, please contact Neva Goodwin (neva.goodwin@tufts.edu) or Josh Humphreys (jh@socialphilanthropy.org).