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The elimination of broker voting in director elections[☆]

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ABSTRACT

In 2009, the Securities and Exchange Commission (SEC) reformed shareholder voting by eliminating uninstructed broker voting in director elections. We use this reform as a quasi-natural experiment to assess the value of shareholder empowerment. Using different control groups and various cross-sectional tests, we find that the reform did not increase average equity values.

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1. Introduction

The right to elect the board of directors is perhaps the most fundamental right of shareholders in a corporation. In 2009, the Securities and Exchange Commission (SEC) banned broker votes for the elections of directors.[1] Prior to the reform, registered brokers were allowed to vote at their discretion in director elections if their clients had not given them voting instructions before the annual meeting. Historically, such uninstructed broker votes were almost always cast in favor of management's nominees and amounted to approximately 11 to 14% of the votes cast (Bethel and Gillan, 2002). The stated goal of the reform was to improve corporate governance by making board elections more competitive.

For research in corporate governance the elimination of broker voting is of great interest because it provides a quasi-natural experiment to estimate the effect (if any) of shareholder empowerment on equity values. On the one hand, the reform may be beneficial for shareholders because it gives them more power to hold boards accountable in elections. On the other hand, both empirical and theoretical research recognizes that shareholder empowerment may be costly. For example, investors may lack relevant information, their intervention might discourage managerial initiative, or they might pursue specific agendas. In a survey article, Yermack (2010) discusses the costs and benefits of shareholder empowerment and

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[1] The final release by the SEC is available at https://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf.

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conjectures that the elimination of broker voting is a major governance reform that, together with two other reforms (of voting standards and proxy access), will make shareholder voting more effective.

Understanding the costs and benefits of shareholder empowerment is not only important for academics but also for practitioners. Indeed, the reform of broker voting received widespread attention and support by market participants, the business press, and by policy makers. In 2007, the Wall Street Journal (Scannell, 2007) wrote that "investors ... may soon get a boost, as the role of shareholder votes cast by brokers comes under closer scrutiny." The Council of Institutional Investors declared in 2009 that "this long overdue reform is needed now more than ever" and proxy advisor firms Glass Lewis and ISS were also strongly supporting the rule change.[2] In addition, the U.S. House of Representatives exposed the SEC to political pressure.[3]

We contribute to the literature on corporate governance by estimating the stock market's response to the elimination of broker voting in director elections. We consider nine important dates in the period between 2003 and 2009 that increased or decreased the probability that the reform would be implemented and run an event study using two different control groups. Our results suggest that the reform did not increase shareholder value. In almost all specifications we fail to find any valuation effect. In the few specifications that yield significant results, abnormal stock returns are negative. Moreover, in a cross-sectional analysis we examine subsets of firms for whom the reform was likely to be most relevant and again find no increase in value for these firms. Overall, our findings suggest that the reform was not effective and did not benefit shareholders.

Our paper is closely related to other recent studies of governance reforms. A contemporaneous working paper by Anderson and Nayar (2013) also examines the elimination of broker voting. They focus on six dates and find that the reform had a value-neutral effect on five of their six event dates, which is consistent with our results.[4] Several studies focus on proxy access. Akyol et al. (2012) and Larcker et al. (2011) study the wealth effects of attempts by the SEC to facilitate shareholder proxy access and find a negative effect on shareholder wealth, whereas Becker et al. (2013) and Cohn et al. (2016) conclude that the stock market put a positive value on shareholder proxy access. Our finding that the reform of broker voting had a neutral (or negative) effect is more in line with Akyol et al. (2012) and Larcker et al. (2011), as it points out limitations of recent governance reforms.

2. Timeline of the change in broker voting regulation

Rule 452 of the New York Stock Exchange allows brokers to vote at their discretion at annual meetings on "routine" proposals if they have not received voting instructions from their clients.[5] Uncontested director elections were considered to be a "routine" matter until 2009, when the SEC approved a NYSE proposal that classified uncontested elections as "non-routine," thus eliminating broker votes. The reform became effective for annual meetings on or after January 1, 2010.

We identify nine important event dates in the reform process. The regulation of broker voting first received attention in 2003. According to a detailed article in the Wall Street Journal (Plitch, 2003) on July 30, 2003 (event #1), the issue of broker voting has "landed on the Securities and Exchange Commission's radar screen". On November 17, 2004 (event #2), Dow Jones Newswire (Plitch, 2004) reports that the NYSE is considering a reform of its proxy voting system. In 2005, the NYSE established the Proxy Working Group with the mandate to review the exchange's voting process and especially Rule 452 on broker voting. The group held its first meeting on April 25, 2005 (event #3) and published a report on June 5, 2006 (event #4), recommending that the NYSE amend Rule 452 to eliminate broker votes in director elections.[6] On October 24, 2006 (event #5), the board of the NYSE adopted the recommendations of its Working Group and filed a proposed rule change with the SEC.

In the following year, the reform process slowed down. Dow Jones Newswires (Whitehouse, 2007) reported on September 27, 2007 (event #6) that the NYSE had put on hold any plans to eliminate broker votes. On May 21, 2008 (event #7), a detailed article on Dow Jones Newswires (Burns, 2008) reported that the elimination of broker voting seems to be "stuck at the SEC". The situation changed after Mary Schapiro was appointed by President Barack Obama as SEC Chairperson in the beginning of 2009, when the SEC published the proposed rule change for comment on February 26, 2009 (event #8).[7] On July 1, 2009 (event #9), the rule was approved by the SEC and became effective on January 1, 2010.

[2] See http://www.sec.gov/comments/sr-nyse-2006-92/nyse200692.shtml. ISS demanded already in 2003 that broker votes be abolished (see http://sec.gov/rules/proposed/s71903/iss121803.htm).

[3] See the U.S. House of Representatives, Hearing before the subcommittee on capital markets, One hundred eleventh Congress, Second Session, Serial No. 111–144.

[4] Our methodology differs from theirs in several respects. While they, like us, consider a global market index as a control group, we also use a second control group, firms registered under the Investment Act of 1940, which were exempted from the rule change. A second difference between the studies concerns the choice of reform-related event dates. While we consider nine event dates leading up to the rule change, they focus on six dates, including some of the same dates examined by us.

[5] NYSE Rule 452 lists "non-routine" matters on which brokers cannot vote without instructions from clients such as contested director elections and merger proposals.

[6] The report is available at https://www.nyse.com/why-list/partnership/advocacy/ccg.

[7] The SEC's notice of filing of the proposed rule change is available at: http://www.sec.gov/rules/sro/nyse/2009/34-59464.pdf.

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