

CHARLES SCHWAB NO LONGER UTILIZING PROPORTIONATE VOTING

By Brian Valerio & Tyler Herka

March 2020



In July of 2019 one of the largest retail brokers in the United States, Charles Schwab, announced it will no longer apply proportionate voting to routine ballot items at shareholder meetings. Alliance Advisors expects that this change will have an impact on issuers in all sectors and of all market caps for the upcoming 2020 proxy season. Alliance recommends that issuers consult with their advisors on how this change will impact voting before their next shareholder meeting.

Voting of Uninstructed Shares

Every year thousands of shareholders meetings take place and millions of shareholders are provided the opportunity to vote on the various agenda items at those meetings. Not all shares, however, end up being voted. Broadridge has reported that only 28% of retail shares are voted annually.¹ One way this issue is mitigated is that the, “New York Stock Exchange (NYSE) allows brokers [their member firms] to vote on certain items on behalf of their clients, if the broker has received no voting instructions from those clients.”² Brokers may be permitted to vote on behalf of their clients only for “routine” ballot items. Some of the frequent “routine” ballot items that brokers may be permitted to vote uninstructed shares for are: Auditor Ratification, Stock Splits, and Capital Increases of Authorized Common Shares.

For ballot items where brokers are permitted to vote uninstructed (unvoted) shares on behalf of their clients, brokers can take one of three actions: (1) they can participate in discretionary voting, (2) they can utilize proportionate voting, or (3) they can take no action (not vote the uninstructed shares). Brokers who participate in discretionary voting have historically voted uninstructed shares held by their clients in line with the board’s recommendations. Brokers who utilize proportionate voting will vote uninstructed shares proportionately to how the broker’s other underlying holders voted. Finally, brokers can take no action, which means that they will not vote the uninstructed shares, and those shares will not be represented at the meeting.

Charles Schwab had, until recently, utilized proportionate voting, but will now take no action on uninstructed shares for all proposals up for a vote.

Why is this important?

Brokers’ ability to vote their clients’ uninstructed shares is crucial for issuers with high retail ownership that rely on broker discretionary and proportionate voting to achieve the necessary quorum to hold their meetings. These issuers are typically smaller cap companies or from specific industry sectors that attract individual investors.

Charles Schwab currently has \$3.85 trillion total client assets under its management.³ This includes 12.1 million brokerage accounts and makes Charles Schwab one of the largest retail brokers in the United States.⁴ The net effect is that many issuers could see decreased retail participation, and a potential drop in their quorum, despite having no change in retail ownership. Issuers with high institutional ownership may also

¹ <https://www.broadridge.com/assets/pdf/broadridge-proxy-pulse-2019-review.pdf>

² <https://www.sec.gov/investor/alerts/votinginannualshareholdersmeetings.pdf>

³ <https://www.brokerage-review.com/investing-firm/assets-under-management/charles-schwab-aum.aspx>

⁴ *Id.*

experience this decline, and should set appropriate board expectations to reflect this new reality.

Moreover, critical “routine” proposals, which typically require a majority of outstanding shares in support for passage (such as reverse stock split or increase in authorized shares), could be impacted.

Charles Schwab’s Acquisition of TD Ameritrade

Charles Schwab announced last year that it is acquiring TD Ameritrade and the transaction is expected to be completed in the second half of 2020.⁵ TD Ameritrade, like Charles Schwab, is one of the largest brokerages in the United States and currently has \$1.32 trillion total client assets under its management.⁶ This includes 11.5 million brokerage accounts.⁷

TD currently utilizes proportionate voting for uninstructed client shares, but its acquisition could further exacerbate the problems identified above if TD follows Schwab’s lead and discontinues its use of proportionate voting. If this occurs, the loss of proportionate voting from both Schwab and TD could have a significant impact on shareholder meetings for highly retail-held issuers.

What should issuers be doing?

Issuers should identify the number of shares that were voted through the proportionate vote at their most recent shareholder meeting and determine how many of those shares were cast by Charles Schwab. If Charles Schwab’s proportionate voting accounted for a significant portion of last year’s return, the issuer should strategize how it can make up for the anticipated loss in voting. Issuers should also monitor the status of the TD acquisition and its treatment of uninstructed shares going forward.

Issuers that are predominantly held by institutional investors should complete a similar exercise with a more concentrated view on overall quorum. These issuers should also consider the impact Schwab’s reduced return will have on any other “routine” ballot items.

⁵ <https://www.aboutschwab.com/announcement>

⁶ <https://www.brokerage-review.com/investing-firm/assets-under-management/ameritrade-aum.aspx>

⁷ Id.