Vanguard

Vanguard Investment Stewardship Insights

Securities lending and proxy voting at Vanguard

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Understanding securities lending at Vanguard

Securities lending is a common practice among asset managers, whereby the asset managers lend securities from their portfolios to banks and broker-dealers, whose clients, in turn, use the borrowed securities for short selling or other strategies. In exchange, the lending asset manager gets a fee and collateral. The collateral, usually cash, is reinvested in fixed income investments for additional revenue. That additional revenue is typically very modest. However, an effective securities lending program can generate additional income for fund investors that offsets a fund's expense ratio.

At Vanguard, we return all securities lending revenue, net of our expenses incurred in running the program, to Vanguard-advised funds and, ultimately, to the fund shareholders.[1] Just as we do in other aspects of investing, Vanguard emphasizes conservatism in securities lending, seeking to safeguard shareholders from associated risks. We take an investor-centric, risk-conscious, and value-based approach to securities lending.

Securities lending and proxy voting

When a fund's security is on loan, the fund retains economic exposure to the security and is protected via the collateral it holds. However, the fund does not have voting rights for the security until the shares on loan are returned by the borrower. If the shares are on loan over the record date for a shareholder meeting, the fund will not be able to vote those shares on matters put to a shareholder vote.[2] Vanguard balances the dual objectives of optimizing revenue from securities lending to bolster investor returns and exercising the funds' voting rights in the interests of fund shareholders on key matters subject to shareholder approval.

Vanguard's Investment Stewardship team uses a robust screening process to identify upcoming votes where material matters may be on the ballot. The team does so to the extent possible given varying disclosure practices regarding shareholder meetings in different markets. These votes may include corporate transactions, contested director elections, the discharge of directors, and other binding resolutions that could impact the long-term performance of the company. If such matters are identified prior to the record date for the company's shareholder meeting, we may recall shares currently on loan and/or restrict further lending until after the record date has passed.

1 Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

2 A record date is a specific date set by a company to determine the shareholders who are eligible to vote at shareholder meetings.

Recent case studies

As with other proxy voting matters, each of the potential trade-offs between lending revenue and voting on material matters at shareholder meetings is evaluated on a case-by-case basis.

Below are recent examples to help illustrate Investment Stewardship's process in action:

- In advance of the shareholder meeting at a U.S. machinery company, a dissident shareholder nominated a slate of five directors for election to the company's board. Contested director elections, also known as proxy contests, can impose significant impacts on a company, potentially changing the composition of a company's board of directors and influencing a company's strategy. In this case, our team identified the funds' votes as being potentially significant—if the dissident nominees were to be elected, they would then constitute a majority of the board. As a result, we recalled the Vanguard-advised funds' shares on loan prior to the record date.
- In instances where the Vanguard-advised funds do not have any shares on loan, the Investment Stewardship team may look to determine if a temporary restriction on future lending of the shares should be put in place in advance of an upcoming shareholder meeting. Earlier this year, we learned of a potential acquisition of a U.S. metals and mining company that would require the approval of the target company's shareholders. At the time, the Vanguard-advised funds did not have any of the target company's shares on loan. Nevertheless, understanding the importance of a vote to approve the sale of a company—particularly a vote that required support from a majority of outstanding shares—we chose to place lending restrictions on shares of the target company until after the record date for the shareholder meeting had passed.
- Another instance where shares were restricted and recalled occurred at a Spanish biotechnology company. In advance of the company's 2024 shareholder meeting, concerns were raised by shareholders regarding the board's level of oversight of the company's financial disclosures and its responsiveness to investors. On the ballot at the shareholder meeting was a proposal to discharge the board, a routine proposal in the Spanish market. This proposal served as a symbolic vote of confidence in the company's board and would have effectively approved the activities of the company's management and the board during the 2023 fiscal year. Given the concerns regarding board oversight and board responsiveness, we decided to restrict and recall shares ahead of the record date in order to vote the Vanguard-advised funds' full ownership position in the company.
- In cases where there is a high level of certainty in eventual voting outcomes—such as with controlled companies—we may choose to maximize lending revenue for the Vanguard-advised funds in lieu of voting on otherwise significant matters. For example, this year, we became aware of a majority owner's intent to nominate director candidates to the board of a U.S. specialty retailer. Given the dissident's majority ownership of the company's shares, the outcome of any vote was likely to be determined by the controlling shareholder. Therefore, we determined it was in fund shareholders' best interest to prioritize lending revenue over voting rights in this case.

Vanguard publishes information regarding its voting and engagement activities, including the funds' proxy voting policies, Insights, and quarterly reports, to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our effort to provide useful disclosure of Vanguard's investment stewardship activities. We aim to provide clarity on Vanguard's positions on governance matters beyond what a policy document or a single vote can provide.

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