Proxy Voting by Exchange-Traded Funds

An Analysis of ETF Voting Policies, Practices and Patterns

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Executive Summary

Exchange-traded funds (ETFs) are an important and growing segment of the securities markets and have amassed considerable voting power through their equity holdings. This study examined the proxy voting policies, guidelines and recent voting records of seven of the largest exchange-traded fund sponsors. We found that, among these large ETF sponsors, there is considerable variation in the voting patterns and philosophies of these funds. This variation is highlighted by how the seven funds voted during the 2008 proxy season at a sample of twenty-one specific votes on a variety of important governance and social policy issues. On one end of the spectrum, Profunds voted with management on only 5 of the 21 proposals in our sample; at the other end, Rydex voted with management on 19 of the 21 proposals – with the remaining funds falling in between.

We found some evidence that the three largest ETF sponsors – Barclays Global Investors, State Street and Vanguard – who together have a dominant share of the ETF market, are somewhat less likely to vote against management on management proposals and shareholder proposals than are most of the smaller fund sponsors. On the other hand, the three largest ETFs also appear to withhold votes from incumbent directors at a greater number of companies than the smaller funds. This likely indicates the use of "withhold" votes against directors as a substitute method for expressing dissatisfaction with certain management practices, rather than voting against management on specific proposals. Our voting review also found that funds that relied heavily or exclusively on a proxy advisory firm for their voting guidelines tended to vote against management more frequently than those that did not.

The votes examined were generally consistent with the written voting policies of the funds, although we identified a few cases where votes appeared to be potentially contrary to a fund's written voting policies. Case-by-case voting policies are utilized by many of the funds – where voting decisions are based on the specific facts and circumstances at a particular company, as well as on the issue being voted – and explain some of this consistency.

There were also significant differences between the ETFs in terms of the level of detail and length of their proxy voting guidelines, with firms relying on guidelines provided by proxy advisory firms tending to have the most detailed – and also the most prescriptive – voting guidelines. Proxy voting guidelines ranged from lengthy documents describing highly detailed voting guidelines on a wide range of issues to very cursory guidelines that stipulated voting with management on virtually all issues.

I. Introduction

Exchange-traded funds, or ETFs, represent one of the most popular and rapidly growing investment vehicles of the last decade. Retail and institutional investors, as well as financial advisors, have gravitated to the use of ETFs for a variety of purposes ranging from short-term trading and sector rotation to tactical asset allocation and tax efficiency.

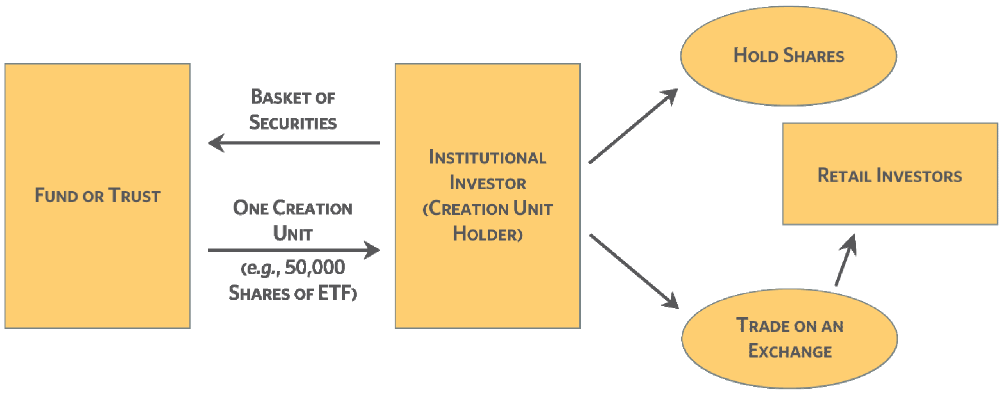
ETFs generally share several characteristics that have made them popular with investors, including continuous pricing, low expense ratios, tax efficiency and the ability to track either specific sectors or indices or entire market segments. This has led to a surge in growth for ETFs in their fifteen-year history, from a single fund in 1993 to approximately 750 ETFs with more than a half trillion dollars in assets under management in the United States alone as of year-end 2008. This study assesses the impact that the growth of ETF assets is having on proxy voting and corporate governance by examining the voting policies and recent voting records of the largest U.S. ETF sponsors. The study covers the following seven ETF sponsors – Barclays Global Investors (iShares), State Street Global Advisors (SPDRs), Vanguard Group (Vanguard ETFs), Invesco Ltd. (PowerShares), ProFunds (ProShares), Rydex Investments (RydexShares) and WisdomTree Trust (WisdomTree ETFs). Together, these companies' ETFs account for approximately 94 percent of ETF assets listed on United States exchanges.

<u>Definition of Exchange-Traded Funds</u>

According to the U.S. Securities and Exchange Commission (SEC) website, exchange-traded funds, or ETFs, are investment companies that are legally classified as open-end companies or Unit Investment Trusts (UITs), but that differ from traditional open-end companies and UITs in several important respects. First, ETFs do not sell individual shares directly to investors, but issue their shares in large blocks known as "creation units." These creation units are generally purchased by institutions, which then often split them up to sell individual shares on a secondary market. Investors who want to sell their ETF shares have two options: 1) sell individual shares on a secondary market, or 2) sell creation units back to the ETF. Both purchases and sales of creation units are generally handled through the exchange of the underlying securities that comprise the ETF portfolio, rather than with cash. [1] Figure 1 illustrates the creation of an exchange-traded fund.

While ETFs originally focused on equity indexes, in recent years they have broadened to include commodities as well as actively managed equity, fixed income, REIT, and currency funds. Inverse and leveraged ETFs have also proven popular since their introduction in 2007 and target date ETFs (so-called "lifecycle" investments) debuted in 2008. ETF sponsors continue to proliferate, as do the asset classes addressed by ETFs, exchange-traded notes (ETNs) and similar products. As Joseph Keenan, an ETF expert and managing director at BNY Mellon recently noted, "The ETF acronym has morphed into a catch-all that includes a wide range of diversified and undiversified offerings in both fund and trust structures – some with different tax treatments and trading limitations.” [2]

Figure 1 – Creation of an Exchange-Traded Fund



Source: 2008 Investment Company Institute Fact Book

History and Development of ETFs

As one of the fastest growing new investment products of recent decades, exchange-traded funds have garnered both praise and criticism from various factions of the investment community. ETF supporters herald them as a liquid, low-cost and tax-efficient alternative to index mutual funds and a powerful new tool offering greater flexibility to investors and financial advisors. Detractors argue they represent another new investment vehicle designed to foster excessive trading and short-term speculation. Without a doubt, however, ETFs have become a transformative force in investment markets and have entered the investment mainstream.

Origins of the ETF: While the launch of the S&P 500 SPDR on the American Stock Exchange (Amex) in 1993 is often cited as the first ETF, there were certainly precursor products that could lay credible claims to this title. Some have suggested that the Equity Investor Fund, First Exchange Series – AT&T Shares (ATF), formed in 1983 by Merrill Lynch as a way for investors to participate in holding the new AT&T and the seven “Baby Bells” created by the government-mandated break-up of AT&T, was the first true ETF. The ATF fund eventually led to the development of a series of HOLDRs trusts that allowed investors to trade a fixed basket of securities, launched by Merrill Lynch in 1998, and which could be seen as the origin of the ETF.

HOLDRs have underlying portfolios that are unmanaged and static, however, whereas the most common form of ETFs today are based on benchmark indexes that are managed. Listed trading vehicles based on indices traded briefly on the American Stock Exchange and the Philadelphia Stock Exchange in 1989 in the form of index participation shares, but these were soon scrapped after a successful lawsuit by the Chicago Mercantile

Exchange and the Commodities Futures Trading Commission, which argued that the products were essentially futures contracts that were required to trade on a futures exchange.

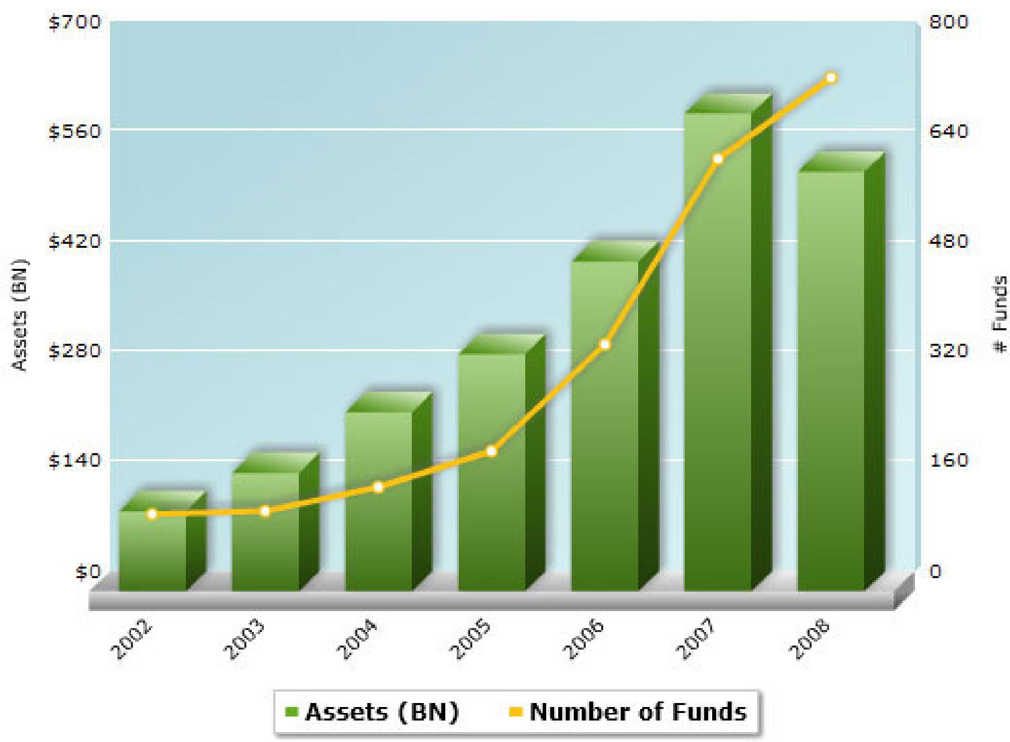
Later, after a five-year battle for regulatory approval, the Amex launch of the S&P 500 SPDR in 1993, with State Street Bank as trustee, started the ball rolling for a slow buildup of index-based ETF products during the 1990s. The Midcap SPDR, based on the S&P 400 Midcap index, was launched by the Amex and Bank of New York in 1995; Morgan Stanley and Barclays Global Investors followed in 1996 with their World Equity Benchmark Shares (WEBS); in 1998, Merrill Lynch brought out the Select Sector SPDRs in conjunction with State Street Global Advisors and the Amex introduced the Diamonds Trust (DIA) based on the Dow Industrial Average; and finally, in March 1999, the Nasdaq 100 Trust (QQQ) rocketed out of the gates, gathering $11 billion in assets in its first year. [3]

Dramatic Growth and Evolution of ETF Providers: If the 1990s were a period of innovation for ETFs, but relatively modest overall growth, the new millennium saw ETFs come of age. ETFs started the century with some $30 billion in assets spread across 30 funds – quite respectable for a new investment vehicle, but hardly a serious challenge to the then $4 trillion in equity mutual fund assets under management. In fact, investors poured $309 billion into U.S. equity mutual funds in the year 2000 alone, more than 10 times the total amount invested in ETFs at the beginning of that year. [4]

But key ETF fund providers were undaunted and began an impressive and sustained sales and marketing effort. In March 2000, Barclays Global Investors (BGI), a leading institutional index fund manager, launched its iShares family of ETFs accompanied by an advertising and educational effort. State Street Global Advisors (SSgA), another leading index manager, licensed the SPDR brand from The McGraw-Hill Companies and also cranked up its marketing efforts. Finally, in 2002, the Vanguard Group, the inventor and dominant player in indexed mutual funds for retail investors, also recognized the competitive threat and rolled out its own brand of ETF offerings, originally called Vanguard Index Participation Equity Receipts (VIPERs). The move was somewhat controversial because Vanguard founder Jack Bogle had criticized ETFs as being harmful to investors by facilitating rapid trading. Vanguard has recently begun to offer exchange-traded products for fixed-income and other asset classes.

By the end of 2000, ETF assets had swelled to more than $70 billion and, as shown in Figure 2, ETFs continued their explosive growth through 2007, before leveling out and the dropping with the decline in the U.S. stock market in 2008. As of Dec. 31, 2008, there were 747 ETFs in the United States, with assets totaling approximately $533.5 billion, managed by 22 ETF managers, according to SSgA. This was down about 12.2 percent from a total of $607.6 billion in U.S. ETFs at year-end 2007. [5] Globally, ETF assets totaled $797 billion at year-end 2007, with the top ten European ETF providers accounting for $124 billion, or nearly two-thirds, of the non-U.S. total.[6] Although a number of new fund sponsors have managed to grab a share of the overall ETF action, the early efforts by the three huge index managers – BGI, SSgA and Vanguard – have continued to yield outsized rewards for them. Together, they held nearly 87 percent of the U.S. ETF market share as of Dec. 31, 2008, with BGI alone holding a 48 percent market share, according to SSgA. (On April 9, 2009, BGI announced that it had sold its iShares ETF business to London-based CVC Capital Partners in a deal worth $4.4 billion, with a "go shop" period of 45 days. Subsequently, on June 12, 2009, Barclay's Plc announced it had reached an agreement to sell the entire BGI asset management business, including iShares, to BlackRock Inc. for $13.5 billion in cash and stock.)

Figure 2 – U.S. ETF ASSET GROWTH



Source: "ETF Snapshot: December 2008," State Street Global Advisors

The Future of ETFs: ETFs faced the biggest challenge in their history to date during 2008 as world stock markets inexorably fell. The pace of new ETF product offerings slowed during the first half of 2008, with 87 new funds launched compared with 167 new offerings during the first half of 2007.[7] Notably, 2008 also witnessed some ETF closings, primarily involving sector funds offered by small managers. Table 1 shows a breakdown of the categories of U.S. ETFs and assets by category of fund as of Dec. 31, 2008, and changes in assets during 2008.

Some industry observers think the boom in ETFs may be ending. But industry insiders contend that the recent drop in assets is simply a function of declining markets, not a reflection on the relative merits of ETFs themselves. Some evidence for this is provided by the fact that ETF trading as a share of total equity trading continues to climb. According to one ETF tracking source, IndexUniverse.com, ETFs represented nearly 43% of all U.S. equities traded in November 2008.[8]

Table 1: ETF Assets and Change in Assets and Funds by Type in 2008

Category	December 31, 2008		Change during 2008		
	# of ETFs	*Current Assets (MM)*	*Change in # of ETFs*	*Change in Assets (MM)*	*Asset Change %*
Broad	10	$14,322	0	(1,622)	-10.2
Commodity	22	$32,854	2	7,197	28.1
Currency	19	$3,393	8	(129)	-3.7
Dividend/Fundamental	106	$9,582	5	(4,841)	-33.6
Fixed Income	52	$56,459	4	21,694	62.4
Global	23	$3,843	10	(1,401)	-26.7
International	131	$104,015	42	(60,932)	-36.9
Inverse/Leveraged	104	$21,711	42	12,100	125.9
Sector	118	$50,368	-20	(7,336)	-12.7
Size	33	$175,400	2	(21,520)	-10.9
Specialty	83	$7,208	25	(236)	-3.2
Style	46	$54,376	-2	(17,113)	-23.9
TOTALS	**747**	**$533,532**	**118**	**(74,141)**	**-12.2**

Source: Data from "ETF Snapshot: December 2008," State Street Global Advisors

One thing is certain: ETF providers continue to see opportunities for new products. A large number of ETFs and other exchange-traded instruments remain in registration. Worldwide ETF assets under management may hit $1 trillion by next year and could double that amount by 2011, says Deborah Fuhr, global head of ETF research and implementation at BGI, the largest ETF sponsor. Fuhr believes that managers will flock to ETFs when they predict a market rally and contends that ETF asset inflows from Europe, Asia and the Middle East will offset any weakness in the U.S. market.[9]

II. A Review of ETF Voting Policies and Practices

This chapter summarizes and compares the general voting policies and procedures of ETF sponsors. Published voting policies and guidelines were obtained, where available, from each of the seven ETF sponsors included in this study. In most instances, these voting guidelines can be found either on the website for the fund sponsors, in fund prospectuses or in supplemental statements to those prospectuses. The guidelines reviewed ranged from comprehensive documents describing voting policies in considerable detail for a wide range of proxy issues to much more summary documents addressing fewer issues. Some funds have their own custom policies, while others rely heavily, or even exclusively, on the guidelines of proxy advisory firms.

<u>Summary of Major ETF Sponsor Voting Policies and Procedures</u>

<u>Barclays Global Investors</u>: The iShares ETF funds are voted according to proxy voting guidelines adopted by their fund advisor, Barclays Global Fund Advisors (BGFA), a wholly-owned subsidiary of Barclays Global Investors (BGI). The iShares funds have also delegated voting responsibility to BGFA. As such, our review of the voting guidelines for BGI's iShares funds is based on a 16-page BGI publication entitled "Published Voting Guidelines for U.S. Securities" dated March 2008. (Links to all available proxy voting policies are included in an appendix to this report on page 29.) A committee of senior BGI executives oversees BGI's proxy guidelines and voting process, and grants authority to a Director of Corporate Governance and Proxy Voting to carry out voting and vote operations utilizing both internal BGI staff and external vendors.

BGI states in its voting policy that it "seeks to make proxy voting decisions in the manner most likely to protect and promote the long-term economic value of the securities held in client accounts." It says its policies "are intended to support economically advantageous corporate practices" while "leaving direct oversight of company management and strategy" to boards of directors. BGI adds that it strives to use its proxy voting "to encourage companies to follow practices that enhance shareholder value, increase transparency and allow the market to value corporate assets appropriately."

Regarding securities lending, BGI notes that its view of the priority and relationship between proxy voting and securities lending "is driven by our clients' economic interests." It says that it has found that "generally the likely economic value of casting most votes is less than the securities lending income, either because the votes will not have significant economic consequences or because the outcome of the vote would not be affected by BGI recalling loaned securities in order to ensure they are voted." BGI says it reviews the process and benefits of voting securities on loan periodically to determine whether any modifications in its policies or procedures are warranted.

BGI maintains one of the more detailed and nuanced custom voting policies of the ETF sponsors, as set forth in its publicly available documents. Almost all major corporate governance issues are decided on a case-by-case basis, or at least contain a carve-out that provides for instances where the company may vote contrary to its general position. For instance, the company states that it will generally support equal voting rights for all shareholders. However, in cases where a dual-class stock already exists at a company, BGI will consider multiple factors, including the historical context of the dual-class structure, the level and nature of control associated with the existing structure, and the general responsiveness of the board regarding shareholder concerns.

While BGI's proxy guidelines often utilize a case-by-case approach, it has several notable exceptions as they relate to specific areas of corporate governance. The company will generally support the election of directors, but places particular emphasis on the overall independence of boards. This extends beyond just director elections to proposals that directly influence the independence of the board, such as shareholder proposals to appoint a separate and independent chairman of the board. The company will also generally vote against proposals that can be seen as having anti-takeover effects and proposals that create barriers to transactions that may provide a premium to shareholders. One such example is the company's stance on the removal of classified boards, which it supports regardless of whether such a proposal is from management or a shareholder. BGI also opposes the adoption of classified boards.

Regarding social and environmental proposals, BGI takes a case-by-case approach but says that it will generally only support such proposals if "there is a clear and substantial economic disadvantage to the company if the issue is not addressed, and that support of the shareholder proposal would enhance shareholder value in a more effective manner than through our vote on the election of directors."

<u>State Street Global Advisors</u>: The authority for voting State Street Global Advisors' (SSgA) SPDR ETFs has been delegated to SSgA Funds Management, Inc. (FM), which manages each fund. Oversight of the proxy voting process is the responsibility of the SSgA Investment Committee. The SSgA Investment Committee reviews and approves amendments to the FM proxy voting policy and delegates authority to vote in accordance with this policy to the FM Proxy Review Committee, a subcommittee of the SSgA Investment Committee. FM retains the final authority and responsibility for voting. SSgA Fund Management's voting guidelines are published in a supplement dated Dec. 19, 2008, to the Statement of Additional Information to the SPDR Series Trust prospectus.

In determining its voting policy, FM's stated intention is to maximize "the monetary value of each portfolio's holdings with respect to proposals that are reasonably anticipated to have an impact on the current or potential value of a security." FM notes that "absent unusual circumstances or specific client instructions, we vote proxies on a particular matter in the same way for all clients, regardless of their investment style or strategies."

In order to facilitate the voting process, the company retains the services of RiskMetrics Group to act as its voting agent, as well as to interpret and apply the company's general policies to individual proposals. RiskMetrics is a proxy advisory firm, one of a handful of U.S. firms (the others being Glass Lewis & Co., PROXY *Governance* Inc. and Egan-Jones) that provides proxy research, vote recommendations and voting services. On issues not directly addressed by the proxy voting policy and that are not deemed to affect the economic value of the holding, or are considered routine, RiskMetrics votes in accordance with its own recommendations. FM does not address the issue of securities lending as it applies to its proxy voting policy. It says it reviews the proxies of non-U.S. issues in the context of its guidelines, but also "endeavors to show sensitivity to local market practices" when voting these proxies, and that, in certain circumstances, it is unable to vote non-U.S. proxies.

SSgA's overall policy guidelines are relatively detailed. They are broken into two sections: a list of proposals that it generally supports and a list that it generally opposes.

Some issues, however, are not directly addressed by the voting guidelines. While the guidelines devote a good deal of attention to director elections, for instance, stressing independence and board service, they do not address proposals on majority voting. The guidelines support the annual election of directors (board declassification) only in cases where there is not a majority independent board – even though all major U.S. exchanges require a majority independent board for all companies not considered "controlled." Other relatively common proposals that are not directly addressed in the guidelines include the separation of the roles of chair and CEO, advisory votes on executive compensation and the elimination of dual-class stock.

SSgA's guidelines are strongly supportive of proposals to subject to shareholder approval, or eliminate, anti-takeover defenses (with the exception of classified boards.)
Its policy regarding social and environmental proposals is somewhat vague, but suggests that SSgA generally opposes these proposals. SSgA's guideline says it will vote against "restrictions related to social, political, or special interest issues which affect the ability of the company to do business or be competitive and which have significant financial or best-interest impact."

<u>Vanguard Group</u>: Vanguard's proxy voting guidelines are set by the board of trustees of each Vanguard fund. The boards delegate proxy voting authority to a Proxy Oversight Committee composed of senior officers of Vanguard, most of which also serve as officers of each Vanguard fund. Vanguard notes that the committee does not include anyone "whose primary duties include external client relationship management or sales." Vanguard says that its voting policies and procedures "seek to ensure that proxy voting decisions are suitable for individual funds." It adds that, "for most proxy proposals, particularly those involving corporate governance, the evaluation will result in the same position being taken across all of the funds and the funds voting as a block. In some cases, however, funds may vote differently, depending upon the nature and objective of each fund, the composition of its portfolio, and other factors." Regarding voting in foreign markets, Vanguard says that it evaluates this in the context of its guidelines as well as "local market standards and best practices" and that there are instances where it will choose not to vote due to the loss of liquidity imposed by share blocking rules or due to high costs.

Vanguard says that its "overarching objective in voting is simple: to support proposals and director nominees that maximize the value of a fund's investments—and those of fund shareholders—over the long term." It adds that under its guidelines, "each proposal must be evaluated on its merits, based on the particular facts and circumstances as presented." The company says that in making this evaluation, it utilizes information from a number of sources, including the investment advisor for the fund, management or shareholders of a company presenting a proposal, and independent proxy research services. Vanguard notes that in making its vote decisions it "will give substantial weight to the recommendations of the company's board, absent guidelines or other specific facts that would support a vote against management."

Vanguard's voting guidelines are available on its website. They are about four pages in length and are somewhat general in nature. The guidelines articulate a clear tendency to use a case-by-case approach in evaluating most proposals. On several issues, such as director elections, approval of stock-based compensation plans and approval of poison pills, the guidelines list the specific factors taken into account in determining how the fund votes. On many other issues, the guidelines state that it "generally" votes a certain way, allowing leeway for exceptions. For example, regarding executive bonuses, Vanguard's guidelines state that "bonus plans with awards that are excessive in both absolute terms and relative to a comparative group generally will not be supported."

The issue area where Vanguard's guidelines seem the most definitive are proposals dealing with shareholder rights and anti-takeover provisions. Vanguard's guidelines state that "the exercise of shareholder rights, in proportion to economic ownership, is a fundamental privilege of stock ownership that should not be unnecessarily limited" and that the market for corporate control should be allowed to function without "artificial barriers." The guidelines detail a strong stance opposing supermajority vote requirements and dual classes of stock, supporting confidential voting and the right of shareholders to call special meetings and act by written consent and affording shareholders the opportunity to approve poison pills within a year of their adoption.

Vanguard is the only ETF sponsor in the study that typically abstains on most social policy proposals. Vanguard's guidelines state that many social policy proposals deal with "ordinary business matters" that are "primarily the responsibility of management and should be evaluated and approved solely by the corporation's board of directors." Even when they address issues with which Vanguard philosophically agrees, Vanguard says that it typically abstains on these proposals reflecting its philosophy that these issues "should be in the province of company management unless they have a significant, tangible impact on the value of a fund's investment and management is not responsive to the matter."

<u>Invesco Ltd.</u>: The board of trustees of the PowerShares Exchange-Traded Fund Trust has delegated proxy voting authority to its adviser, Invesco PowerShares Capital Management LLC. The trust says that its board periodically reviews each fund's proxy voting record. To facilitate its voting, Invesco PowerShares says it has retained Glass Lewis & Co. to assist with proxy research and has retained Broadridge for vote execution and record-keeping services. Invesco PowerShares states that it "votes according to Glass Lewis & Co voting recommendations to the extent that there is not a material conflict of interest" and refers to a document entitled "Glass Lewis & Co. Proxy Paper Policy Guidelines." Thus, the analysis of Invesco PowerShares' voting policy contained in this report is based on that document.

Invesco PowerShares' proxy voting policies and procedures are contained in an appendix to a supplement dated Dec. 21, 2008, to a Statement of Additional Information for the Powershares Exchange-Trade Fund Trust. PowerShares says that it may choose not to vote proxies "in certain situations or for certain accounts either where it deems the cost of doing so to be prohibitive or where the exercise of voting rights could restrict the ability of an account's portfolio manager to freely trade the security in question." The company notes, for instance, that some countries utilize share-blocking, which can restrict the sale of shares that have been voted for a certain length of time. PowerShares says that for companies in countries with share-blocking, "the disadvantage of being unable to sell the stock regardless of changing conditions generally outweighs the advantages of voting" on routine items. It states that, accordingly, it "will not vote those proxies in the absence of an unusual significant vote." Invesco also notes that its ETF funds are allowed to participate in securities lending.

The Glass Lewis U.S. policy guidelines utilized by PowerShares place a primary focus on director elections, financial reporting, compensation issues and a company's governance structure. On director elections, Glass Lewis states that "boards are put in place to represent shareholders and protect their interests. Glass Lewis seeks boards with a proven record of protecting shareholders and delivering value over the medium- and long-term." In seeking to monitor board performance, Glass Lewis stresses board independence, attendance, and responsiveness to shareholder interests. In addition, it says that the board's Compensation Committee chairman should be held accountable where executive pay practices are unreasonable. It also supports proposals requiring independent chairmen, majority voting and board declassification.

The Glass Lewis guidelines include auditor ratification criteria that are the most detailed of any of the policies reviewed in this study. On compensation issues, they emphasize responsible use of equity awards and reasonable pay in comparison to peers. The guidelines also address the issue of option exchanges, stressing the importance of having a value neutral exchange which excludes named executives. In addressing governance structures, the guidelines emphasize board accountability. They indicate opposition to anti-takeover measures, such as supermajority vote requirements, and support for proposals subjecting poison pills to shareholder ratification. Finally, regarding social and environmental issues, the Glass Lewis guidelines say it prefers to "leave decisions regarding day-to-day management of the business and policy decisions related to political, social or environmental issues to management and the board except when we see a clear and direct link between the proposal and some economic or financial issue for the company."

<u>ProFunds:</u> ProFunds states on the ProShares portion of its website that its board of trustees "has adopted policies and procedures with respect to voting proxies relating to portfolio securities of the Funds, pursuant to which the board has delegated responsibility for voting such proxies to the Advisor subject to the board's continuing oversight." The Advisor to ProShares is ProFund Advisors LLC. It says its voting policies and procedures are "designed to maximize shareholder value and protect shareowner interests when voting proxies." The company notes that the Advisor has a Proxy Oversight Committee, composed of compliance, legal and portfolio management representatives, which exercises responsibility with regard to voting proxies and also reviews and monitors its voting guidelines. It says the committee may amend the guidelines periodically to address new or revised voting policies.

ProFunds says it contracts with the Institutional Shareholder Services (ISS) unit of RiskMetrics to assist with voting proxies and the overall proxy voting process. It notes that the voting guidelines "are maintained and implemented" by ISS and that, if necessary, the Advisor will be consulted by RiskMetrics on non-routine issues. ProFunds does not specifically address the issue of share lending on its website. In response to a request from PROXY *Governance* seeking to obtain its proxy voting guidelines, a compliance manager with ProFunds stated in a written communication to PROXY *Governance* that "ProShares contracts with RiskMetrics to assist them with the proxy voting process and utilizes their guidelines."[10] He provided a website link to a 2008 U.S. Proxy Voting Guidelines Summary from RiskMetrics.

As a result of utilizing the proxy voting guidelines of RiskMetrics, ProShares has a detailed and lengthy set of proxy voting guidelines, some 58 pages in length. In very general terms, the RiskMetrics guidelines are more prescriptive and take fewer case-by-case positions on many shareholder proposals than do the policies of some of the other ETF providers in our study. They place a strong emphasis on board independence, board accountability, shareholder rights, and opposition to anti-takeover provisions. On the other hand, the guidelines take a case-by-case approach on many management sponsored proposals, particularly as they relate to issues such as the election of directors, compensation, restructurings and mergers. In addition, the guidelines have clearly articulated positions regarding social and environmental proposals. Generally these votes are made case-by-case, balancing the economic interests of shareholders, social concerns, and industry standards.

<u>Rydex Investments</u>: Rydex's proxy voting guidelines are set by a portfolio management group committee at Rydex Investments. The committee is also responsible for identifying and resolving any potential conflicts of interest in the proxy voting process. Rydex utilizes the services of RiskMetrics' ISS division to act as its voting agent and to vote according to Rydex's voting guidelines.

Rydex notes in its voting procedures that for legal or administrative reasons, it is often unable to vote securities that, at the time of the vote, are on loan pursuant to a client's securities lending arrangement. Rydex states that it "will refrain from voting such securities where the costs to the client and/or administrative inconvenience of retrieving securities then on loan outweighs the benefit of voting, assuming retrieval under such circumstances is even feasible and/or possible." Rydex also notes that voting foreign proxies can involve significantly greater effort and cost and that it will weigh costs and benefits of voting these proxies in deciding whether to vote them.

Rydex says that its proxies are voted "in the best long-term economic interests of our clients, which generally means voting proxies with a view to enhancing the value of the shares of stock held in client accounts, considering all relevant factors and without undue influence from individuals or groups who may have an economic interest in the outcome of the proxy vote." The company's philosophy defers heavily to management on most issues. Rydex says in its guidelines that it "believes that management is generally in the best position to make decisions that are essential to the ongoing operation of the company and which are not expected to have a major impact on the corporation and its shareholders." Therefore, it will "generally vote with management on 'routine items' of a corporate administrative nature," but will "generally review all 'non-routine items' (i.e., those items having the potential for major economic impact on the corporation and the long-term value of its shares) on a case-by-case basis."

Rydex's actual voting guidelines are contained in a supplement to the Rydex ETF Trust fund prospectus (dated Oct. 31, 2008). The guidelines are summary in nature—about two pages in length. On the vast majority of issues listed, the guidelines state that Rydex votes with management. The only exceptions to this are three issues where the guidelines indicate that it takes a case-by-case approach: 1) submitting poison pills to a shareholder vote; 2) shareholder proposals to limit executive and director compensation; and 3) mergers and acquisitions. Thus, it appears that Rydex's definition of what constitutes a routine voting issue may be much more expansive than that used by many other institutional investors, because it appears to include voting for directors in contested and uncontested elections, certain board structure and shareholder rights issues and votes on most types of anti-takeover defenses.

<u>WisdomTree Trust</u>: WisdomTree Trust is a Delaware business trust registered as an investment company. WisdomTree states that it has adopted as its proxy voting policy for each WisdomTree ETF the proxy voting guidelines of its sub-adviser, Bank of New York Investment Advisors, a division of The Bank of New York (BONY), and has delegated voting authority and responsibility to BONY. WisdomTree says that its sub-adviser understands that proxy voting is a fiduciary responsibility and that it has designated a Proxy Committee with responsibility for administering and overseeing the proxy voting process and procedures. The BONY Proxy Committee includes the chief investment officer, chief trust officer, a senior portfolio officer and members of the Legal and Compliance and Portfolio Administration departments.

WisdomTree's policy further states that BONY has retained the ISS division of RiskMetrics for certain proxy-related services and that its proxies will be voted in accordance with guidelines prepared by the sub-adviser and ISS. If its guidelines "do not address how a proxy should be voted, the proxy will be voted in accordance with ISS recommendations," WisdomTree's policy states. The company also notes that "if an investment professional believes that it may be in the best interest of a Fund to vote in a manner inconsistent with ISS' recommendations, such investment professional must contact the Proxy Committee and complete a questionnaire to allow the Proxy Committee to review the recommendation and consider such other matters as it deems appropriate to determine that there is no material conflict of interest between the sub-adviser and the Fund with respect to the voting of the proxy in that manner."

WisdomTree's voting policy does not specifically address securities lending. It does say that there "may be circumstances under which Sub-Adviser may abstain from voting a client proxy for cost reasons (e.g., non-U.S. securities)" and that its sub-adviser must "weigh the costs and benefits of voting proxy proposals relating to foreign securities and make an informed decision with respect to whether voting a given proxy proposal is prudent…"

Regarding its specific voting guidelines, WisdomTree says its sub-adviser "will generally vote 'for' management proposals on routine business; case by case on management proposals related to directors (though 'for' routine matters and 'against' classification of the board); case by case on management proposals related to a company's capitalization, reorganizations or merger proposals, and non-salary compensation issues; 'against' management proposals on anti-takeover related proposals; and 'against' or case by case on most shareholder proposals, including social issues." PROXY *Governance* attempted to obtain the more detailed voting guidelines utilized by WisdomTree but was unable to procure them.[11]

Comparison of ETF Voting Guidelines

In spite of significant differences in the level of detail of the guidelines provided by the various fund sponsors, as well as in the policy positions contained in them, some important similarities can be seen in most of these policy guidelines. A side-by-side comparison of the voting guidelines on 33 proposal types for the ETF sponsors examined in this study is shown below in Table 2. With the exception of Rydex, which votes with management, all of the funds use a case-by-case policy approach to analyze both contested and uncontested director elections (although as is discussed in the next chapter, they apply this approach very differently in terms of how frequently they withhold votes from directors.) Similarly, all of the funds make company-specific decisions on mergers and acquisitions, and all except Rydex review other types of restructurings, spin-offs and liquidations on a case-by-case basis as well.

This pattern is quite similar for management-sponsored proposals dealing with capital structure changes and compensation issues. While not every ETF policy examined specifies a position on each specific proposal in these areas, for those that do – again with the exception of Rydex – virtually all use a case-by-case approach.

When it comes to management-sponsored proposals seeking to institute governance structures or bylaws that can serve as anti-takeover defenses, a case-by-case approach again predominates among the funds on most proposals, but many of the funds also have guidelines to vote against management on some takeover issues. For instance, on management proposals seeking to adopt a classified board (admittedly a rarity in recent years) most funds have adopted a guideline to vote against these proposals.

On shareholder proposals involving board governance issues, there is greater variability in positions among the fund guidelines. Some funds, such as BGI, generally take a case-by-case approach to these issues, while others, such as ProFunds and Invesco, are generally in favor of these proposals and Rydex is generally opposed to them. Shareholder proposals dealing with compensation issues are typically dealt with on a case-by-case basis by most of the funds, including Rydex. Two of the biggest funds –

BGI and Vanguard – oppose "Say-on-Pay" advisory votes on compensation, however, while ProFunds supports them.

Shareholder proposals seeking to eliminate takeover defenses and assert shareholder rights are given nearly unanimous support in the voting guidelines of the funds in this study – again with the exception of Rydex, which votes against proposals to eliminate classified boards and supermajority vote requirements. ETF guidelines for these proposals showed both the highest degree of conformity among the funds and the greatest willingness to oppose management's position.

On social and environmental proposals, there are clear differences in the policy guidelines for the funds. ProFunds is the most supportive of these proposals, while Rydex generally opposes them and Vanguard Group abstains on them. The other funds have guidelines that take a case-by-case approach to these issues.

Table 2: A Comparison of Major ETF Voting Policies

Director Elections	BGI	SSgA	Vanguard	Invesco	ProFunds	Rydex
• Uncontested	CBC (for)	CBC (for)	CBC (for)	CBC (for)	CBC	For
• Contested	CBC	CBC	CBC	N/A	CBC	For
• Reimburse Proxy Solicitation	N/A	N/A	N/A	N/A	CBC (for)	For
Mergers and Restructuring						
• Mergers and Acquisitions	CBC	CBC	CBC (for)	N/A	CBC	CBC
• State Reincorporation	CBC	CBC	N/A	N/A	CBC	For
• Spin-offs	CBC	N/A	N/A	N/A	CBC	For
• Corporate Restructuring	CBC	N/A	CBC	N/A	CBC	For
• Liquidations	CBC	N/A	N/A	N/A	CBC	For
Management Proposals						
Capital:						
• Increase Common Stock	CBC	CBC (for)	CBC	CBC (for)	CBC	For
• Private Placements	N/A	N/A	N/A	CBC	CBC	N/A
• Reverse Stock Splits	CBC (for)	N/A	CBC	CBC	CBC	For
• Forward Stock Splits	CBC (for)	CBC	CBC	CBC	CBC (for)	For
• Share Repurchase Programs	N/A	CBC	N/A		For (open market only)	For
Compensation:						
• Approve Option Exchange	CBC	N/A	N/A	CBC	CBC	N/A
• Approve Incentive Plans	CBC	CBC	CBC	CBC	CBC	N/A
• Employee Purchase Plans	CBC (for)	CBC (for)	CBC (for)	N/A	CBC (for)	N/A
Takeover:						
• Adopt Classified Board	Against	CBC	Against	Against	Against	For
• Approve Poison Pill	CBC	CBC	CBC	CBC	CBC	CBC
• Allow Board to Amend Bylaws	N/A	Against	N/A	N/A	CBC	N/A
• Increase/Decrease Board Size	CBC (for)	N/A	N/A	N/A	Against (w/out SH Approval)	N/A

Note: CBC = Case-by-Case (comments in parentheses indicate a company's "general" or "default" position); N/A= Issue Not Addressed in Voting Guidelines

Table 2 (continued): A Comparison of Major ETF Voting Policies

Shareholder Proposals						
Board:						
• Adopt Majority Vote in Director Elections	CBC (for)	N/A	N/A (100% "for" company proposals)	For	For	N/A
• Appoint Separate/Independent Chair	For	N/A	Against	For	CBC (for)	Against
• Equal Access	CBC	N/A	N/A	N/A	N/A	Against
Capital:						
• Eliminate Dual-Class Common Stock	CBC	N/A	For	N/A	N/A	N/A
Compensation:						
• Allow Advisory Vote on Executive Compensation	Against	N/A	Against	CBC (for)	For	N/A
• Award Pay for Superior Performance	CBC (against)	N/A	CBC	CBC	For	CBC
• Limit Executive Compensation	N/A	N/A	CBC	CBC (against)	N/A	CBC
Social and Environmental:						
• Amend EEO Policy to Include Sexual Orientation	CBC	CBC	For	CBC	CBC (for)	Against
• Report on Greenhouse Gas Emissions	CBC	CBC	Abstain	CBC	CBC (for)	Against
• Report on Political Contributions	CBC	CBC	Abstain	CBC	CBC	Against
Takeover:						
• Eliminate Classified Board	For	CBC	For	For	For	Against
• Eliminate Supermajority Vote	CBC (for)	For	For	For	For	Against
• Allow Shareholders to Call Special Meeting	CBC (for)	For	CBC (for)	CBC (for)	For	N/A
• Submit Poison Pill For Shareholder Ratification	For	For	For	For	CBC (for)	CBC

Note: CBC = Case-by-Case (comments in parentheses indicate a company's "general" or "default" position); N/A= Issue Not Addressed in Voting Guidelines

III. ETF Votes on Key Issues at Selected Companies in 2008

The written proxy voting guidelines available from the major ETF sponsors illustrate some of the significant differences in policy approaches taken by these funds. Nevertheless, because most fund policy guidelines employ a case-by-case voting approach to many specific proposals and issues, it is useful to do an analysis of actual fund votes at specific companies to gain a better understanding of ETF voting practices. While anecdotal, a review of actual votes can provide some insight into whether ETFs are voting in a way that is consistent with their published voting guidelines and, in a particular circumstance, how they applied their case-by-case judgment.

Methodology

A review of specific votes by ETF sponsors is possible because they file annual Form N-PX reports with the SEC detailing their proxy votes, which are required of all mutual funds.

This study examined those filings for the period ending June 30, 2008, for at least one major fund (and in most cases for several funds) at each of the seven ETF sponsors included in this study. We searched these filings for the votes by each fund sponsor on 21 agenda items at 21 selected companies during the 2008 annual meeting season.

The specific agenda items and companies used in this voting analysis were chosen to represent a broad cross-section of governance, compensation, environmental and social proposals that came to a vote in 2008. Six of these items are management proposals dealing with important governance and compensation questions, such as approving a poison pill or repricing employee stock options. Fifteen of the items are shareholder proposals – seven dealing with board and governance matters, three focused on compensation issues and five related to environmental or social issues. The sample votes were also selected, in part, based on the size of the companies involved and whether they were included in the broad-based indexes (such as the Russell 3000 index) on which many ETFs are based.

In addition to choosing proposals representing many salient issues, specific company votes were chosen where the authors believed that there was a strong likelihood that the funds in the study might have differing views on the proposals. In other words, the proposals chosen tended to involve controversial issues that might be seen as non-routine by many of the ETF sponsors. These votes should not necessarily be viewed as representative of how any fund typically votes on an issue, because some of the companies selected had particular circumstances that may not apply at other companies. For example, the case-by-case approaches at some funds could result in different votes on issues such as the adoption of poison pill takeover defenses or the approval of stock option exchanges based on whether a specific proposal contained certain shareholder-friendly features.

In addition to the question of which specific proposals and companies to choose for analysis, another methodological issue that arose was which specific fund or funds within each ETF family to use for the vote analysis. Whenever possible, we chose to use voting records from one or more broad market indices from each fund sponsor, since this would allow vote determination for the greatest number of our key issue votes. In a few cases, however, ETFs based on appropriate U.S. broad market indices were not available from a fund sponsor and our voting results are based on sector specific funds or smaller indices. The specific ETFs used in the voting analysis for each fund sponsor are mentioned in the summaries below.

Summary of Voting Patterns for each ETF Sponsor

There is significant variation between the disclosed 2008 proxy votes of the seven fund sponsors on the 21 proposals for which PROXY *Governance* examined Form N-PX filings. The voting patterns at each of the ETF sponsors are summarized below and shown in Table 5 on page 26.

Barclay's Global Investors: Our examination of votes for the iShares series of ETFs issued by BGI was based on BGI's on-line vote records for the iShares Russell 3000 Index Fund, which included votes on each of the key issue proposals in our sample. BGI's voting record for this fund indicated a relatively strong tendency to support management. BGI iShares voted with management on five of the six management proposals examined, with the exception being a vote against an option exchange at K-Swiss Inc. On the 15 shareholder proposals, BGI voted in favor of five – in each case on a shareholder rights or governance issue. It voted with management on all three of the compensation-related shareholder proposals as well as on all five of the environmental or social proposals. BGI's votes appear consistent with its voting guidelines, which generally stipulate a case-by-case approach to most votes.

While it supported management on the majority of the proposals in our sample, BGI's voting record also demonstrates a willingness to withhold votes from company directors. Based on a review of vote records for its iShares S&P 500 index fund, it withheld votes from at least one director at 16.8 percent of the companies in that fund during the one-year period ending June 30, 2008 – the second largest percentage of withhold votes among the seven funds in this study.

State Street Global Advisors: Our review of State Street Global Advisors' ETF voting record was based on a Form N-PX filing for the SPDR Series Trust, with votes utilized from the DJ Wilshire Total Market, Large Cap and Small Cap ETFs. SSgA shows a balanced overall voting record, with slightly more votes against management than the other two large ETF sponsors, but less than most of the smaller sponsors. SSgA voted against two of the six management proposals in our sample – a stock option exchange at K-Swiss Inc. and a proposal to approve a poison pill at Ameron International Corp. On the shareholder proposals, it voted in favor of five; four related to governance issues and one related to compensation matters. It did not support any of the proposals pertaining to environmental or social issues. SSgA withheld votes from at least one director at approximately 5% of the companies in The Select Sector SPDR Trust – near the middle of the withhold percentage range by the seven funds in this analysis.

SSgA's voting record appears generally consistent with its mostly case-by-case voting guidelines. One vote, on a proposal at Eaton Corp. to allow the board to amend the bylaws without shareholder approval, could potentially be at odds with the fund's voting policy, which states that it generally votes in favor of "mandates that amendments to bylaws or charters have shareholder approval."

Vanguard Group: Our examination of ETF voting at Vanguard Group was based on a Form N-PX filing for the Vanguard Total Stock Market Index Fund. Vanguard's ETFs are separate share classes of its underlying index funds. Vanguard's voting record for our sample votes shows a strong tendency to support management. It supported management on five of the six management proposals in our sample, voting against management only on an option exchange proposal at K-Swiss Inc. On the shareholder proposals, it supported two and abstained on three proposals. The two shareholder proposals Vanguard voted for were a proposal at Ford Motor Co. to eliminate its dual-class common stock structure and a proposal at Boston Properties Inc. to declassify its board. The abstentions were on three environmental and social proposals – where Vanguard has a policy of generally abstaining on most issues.

Because Vanguard's voting policy describes a case-by-case approach on most of the management proposals where it voted in favor of management, we examined Vanguard's voting record on a larger sample of proxy votes on management proposals to determine whether it was actually utilizing a case-by-case approach. Our research concludes that it is. In fact, we found that while Vanguard votes with management or abstains on most shareholder proposals, it votes against management fairly regularly on a range of management-sponsored proposals – including approval of equity incentive and employee stock purchase plans, increases in authorized common shares, ratification of auditors and approval of the board's ability to transact other business without shareholder approval.

Vanguard is also relatively active in withholding votes against directors. It withheld votes for at least one director nominee at approximately 6.4% of the companies in its S&P 500 index portfolio for the period ending June 30, 2008.

Vanguard's voting record is generally consistent with its written voting policies, which often use a case-by-case voting approach. One vote, against a shareholder proposal at Murphy Oil to amend its EEO guidelines to include sexual orientation, appears to be potentially at odds with Vanguard's written voting policy. In a telephone conversation with a representative from Vanguard, the firm mentioned that it voted against this proposal because Murphy Oil already had in place a general policy prohibiting discrimination based on sexual orientation, although the policy was not as strong as that favored by the proponent. [12]

Invesco: Our analysis of votes by Invesco's PowerShares ETFs was based on a Form N-PX filing for the PowerShares Exchange-Traded Fund Trust. The specific funds utilized were the FTSE RAFI US 1000 Portfolio and the FTSE RAFI US 1500 Small-Mid Portfolio. PowerShares was among the funds most likely to vote against management in our sample votes. Of the six management proposals, it voted against four of them, the highest proportion of votes against management on these proposals of any of the ETFs examined. It voted for all ten governance or compensation-related shareholder initiatives, but against all five of the environmental and social proposals. PowerShares was also quite active in withholding votes against directors; a review of its voting for the FTSE RAFI 1000 Portfolio showed that it voted against at least one company director nominee at approximately 9.5 percent of the companies in the portfolio.

Invesco's voting record demonstrates a strong pattern of support for shareholder proposals that seek to increase shareholder rights or limit executive compensation as well as a pattern of voting against shareholder proposals addressing environmental or social issues. This voting pattern is no doubt linked to the firm's use of Glass Lewis' voting guidelines and recommendations, which fit this pattern.

The vote against each of the five environmental and social shareholder proposals in our sample vote raised the question of whether Invesco actually utilizes a case-by-case approach to these issues as its guidelines state, or it simply votes against all such proposals**.** To answer this question, we reviewed how Invesco voted on 30 additional votes on social and environmental matters. Invesco voted for a requested report on political contributions at Halliburton Co. and for a proposal requesting ExxonMobil Corp. to set quantitative goals regarding greenhouse gas emissions. Based on this, it appears that Invesco does utilize a case-by-case approach to social and environmental proposals, but that its votes in support of such proposals are relatively rare.

<u>ProFunds</u>: We analyzed the voting record of the ProShares ETF series from its Form N-PX filing by ProShares Trust for its Ultra S&P 500 fund, Ultra Russell 2000 fund and Ultra Mid-Cap 400 fund. It voted against two of the six management proposals – one involving an employee option exchange at footwear manufacturer K-Swiss and the other to approve a poison pill at Ameron International Group. More notably, ProFunds voted for 14 of the 15 shareholder proposals in our vote sample, the greatest overall level of support for these proposals of the seven funds in the study.

The only exception to its near-unanimous support of the shareholder proposals in our sample was opposition to a proposal at Murphy Oil Corp. requesting that the company amend its equal employment opportunity policy to include a prohibition against discrimination based on sexual orientation. The vote against the shareholder proposal at Murphy Oil could potentially be inconsistent with ProShares' voting policy, which utilizes guidelines provided by RiskMetrics. The RiskMetrics guideline on this issue states that it will "generally, vote FOR proposals seeking to amend a company's EEO statement in order to prohibit discrimination based on sexual orientation, unless the change would result in excessive costs for the company."

In addition to voting against management the most times on shareholder proposals, ProFunds was also the fund sponsor most likely to withhold votes from or vote against management's director nominees. It did so for at least one director nominee at approximately 19 percent of the companies at an S&P 500 ETF we reviewed.

Rydex Investments**:** We based our analysis of proxy votes by Rydex Investments on a Form N-PX filing by Rydex ETF Trust, utilizing votes from its 2x Russell 2000, 2x S&P 500 and 2x Mid-Cap 400 ETFs. Rydex was the ETF sponsor that voted most consistently in favor of management-sponsored proposals and against shareowner proposals. It was the only ETF to support management's position on all six of the management proposals chosen in our vote sample; it also supported management on all but two of the 15 shareholder proposals we examined. The two exceptions were a proposal at Boston Properties to declassify its board and a proposal at Mueller Industries Inc. requesting the company to prepare a report on board diversity. The strongly pro-management voting pattern demonstrated by Rydex appears generally consistent with its summary voting policy guidelines, which indicate that it votes with management on most issues. However, Rydex's vote in favor of the shareholder proposals at Boston Properties and at Mueller Industries appear to be potentially inconsistent with Rydex's summary guidelines.

In addition to being the least likely to vote against management on proposals sponsored by companies or shareholders, Rydex also was the least likely to withhold votes against directors. In fact, in reviewing its votes on its S&P 500 equal weight index ETF, we were unable to find any instances where it withheld votes against a director nominee supported by company management.

WisdomTree: Our analysis of voting at WisdomTree was based on its voting at five funds: Earnings 500, Small-Cap Earnings, Large-Cap Dividend, Mid-Cap Dividend and Small-Cap Dividend. Votes by these funds covered 19 of the 21 votes in our sample. WisdomTree voted in favor of three of the five management proposals for which it cast votes. Of the 14 shareholder proposals for which it cast votes among these funds, it voted in favor of six—all on proposals related to board governance or compensation matters. It voted against all of the social and environmental shareholder proposals. A determination of whether WisdomTree's votes were consistent with its written voting guidelines was not possible because WisdomTree did not provide PROXY *Governance* with its detailed voting guidelines, despite several written and telephonic requests to obtain them.

WisdomTree utilized withhold votes against directors somewhat less than most of the other ETF funds, with the exception of Rydex. It withheld votes from at least one director at approximately 3 percent of the companies in its Earnings 500 fund for the year ended June 30, 2008.

Comparison of ETF Sponsor Voting Trends on Key Proposals in 2008

A summary of the voting patterns of the ETFs in this study (at a sample of 21 votes that were chosen because PROXY *Governance* believed that they were controversial or non-routine issues that might display differences in how funds voted) is shown in Table 3 below. A complete listing of the fund votes on each of these proposals is shown in Table 5 on page 26.

Acknowledging that our sample votes are anecdotal, and do not represent a complete picture of the voting by these funds, several trends are apparent from this vote summary. First, in general terms, the largest fund sponsors – BGI, SSgA and Vanguard – tend to vote with management a greater percentage of the time than three of the smaller ETF fund sponsors – Invesco, ProFunds and WisdomTree. This was true for both management proposals and for shareholder proposals. Rydex Investments is the clear exception to this general statement as it had the most consistent record of voting with management of any of the funds in the study.

Table 3: Relative Propensity of ETF Funds to Vote Against Management

(at 21 selected non-routine 2008 proxy proposals at sample funds)

Fund	% votes against management proposals	% votes for shareholder proposals on governance	% votes for shareholder proposals on compensation	% votes for shareholder proposals on social issues
BGI	16.70%	71.40%	0%	0%
SSgA	33.30%	57.10%	50%	0%
Vanguard	16.70%	28.60%	0%	0%*
Invesco	66.70%	100%	100%	0%
ProFunds	33.30%	100%	100%	80%
Rydex	0%	14.30%	0%	20%
WisdomTree	40%	83.30%	33.30%	0%

* – Vanguard abstains on most social and environmental proposals

Among the three largest fund sponsors, there was also a greater tendency to vote in favor of certain shareholder-sponsored governance initiatives than to vote against management-sponsored proposals, at least within the sample of votes we reviewed. Two of the three largest ETFs, Barclays Global Investors and Vanguard had only one vote against management on the six management proposals in our sample.

Regarding shareholder proposals, the voting record by the three dominant ETF providers confirms the use of a case-by-case approach on many governance and compensation issues, while also showing essentially no support for social or environmental shareholder proposals. Of the five social and environmental shareholder votes we reviewed, there were no votes in favor of these proposals by the largest funds, although Vanguard abstained on three votes, which is consistent with its policy.

Among the smaller fund sponsors, with the exception of Rydex, there was a much greater propensity to vote against management proposals and a general willingness to support shareholder proposals. Two funds, ProFunds and Invesco PowerShares, showed universal support for the shareholder proposals in our sample dealing with board governance and compensation issues, although they differed markedly in their support levels for the social and environmental proposals. This voting pattern likely reflects the heavy reliance of these two funds on voting guidelines and recommendations from proxy advisory firms which advocate strong shareholder rights perspectives on governance issues but take different policy approaches on social policy questions. Overall, support levels for shareholder proposals dealing with governance and compensation issues were much higher on our sample votes than they were for social and environmental proposals, with Profunds being the only fund to vote in favor of a significant number of the social and environmental proposals in our sample.

Directionally, the seven ETFs in our sample tended to vote with the majority of all proxy voters on more than 80 percent of the twenty-one specific proposals we reviewed – in other words they tended to be on the "winning side" of most votes. For example, among the six management-sponsored proposals in our sample, five of these proposals were approved by shareholders, with the majority of ETFs in our study supporting all of these proposals with the exception of an employee stock option exchange proposal at K-Swiss – where six of the 7 ETFs voted against the proposal. On the one management proposal that was not approved by shareholders – a poison pill proposal at Ameron International Corp. – a slim majority of four of the ETFs in the study also voted against the proposal.

Of the 15 shareholder proposals among our sample votes, the majority of the ETFs ended up on the "winning side" of the vote in all but three cases. The three votes where they tended to differ from the majority vote were a proposal to eliminate a dual-class stock structure at Ford Motor Co., a proposal to limit executive compensation by restricting tax gross-ups at CVS-Caremark, and a proposal requesting Mueller Industries to issue a report on its board diversity. In the case of the vote at Ford Motor Co., four of the six ETFs that voted on this issue supported the shareholder proposal, but it received the support of only 27.2 percent of the shares voted. This variance with the majority vote is easily explained, however, by the fact that the founding Ford family controls 40 percent of the voting power at the company – and no doubt voted against the proposal to eliminate its special voting status. On the other two votes where the majority of ETFs were at variance with the majority of votes by all shareholders, the ETFs were nearly evenly split on these issues and the actual vote totals were within a few percentage points either way of the 50 percent level – again suggesting that the ETFs were fairly closely aligned with the votes by the majority of shareholders.

One of the most prominent differences between the voting practices of ETFs examined in this study relates to the frequency with which they withheld votes from incumbent director nominees seeking re-election. Such "withhold" votes are increasingly seen as one of the strongest methods for shareholders to express disapproval with company practices, such as excessive CEO compensation, or with particular aspects of a director's performance, such as a poor meeting attendance record. Decisions to oppose directors have become more meaningful as more companies have adopted majority voting and/or director resignation policies, where a failure to garner more than 50 percent of the votes cast can lead to a director being unseated from the board.

Table 4: Frequency of Use of Withhold Votes in Director Elections

Fund	Percentage of companies in S&P 500 where ETF withheld votes from or voted against some directors
BGI	16.8%
SSgA	5.0%
Vanguard	6.4%
Invesco	9.5%
ProFunds	19.0%
Rydex	0.0%
WisdomTree	3.0%

As shown in Table 4, the percentage of "withhold" or "against" votes for directors running on management's slate among the funds in the study ranged from 19 percent at ProFunds to none at Rydex, with the average for the seven funds being 8.5 percent. On this measure, there was a slightly higher average frequency of withhold votes at the three largest funds (9.4 percent) than that at the four smaller funds (7.9 percent). Since the largest ETF sponsors were generally *less* likely to vote against management on all classes of proposals in our sample than were the smaller funds, this suggests that the larger funds are placing greater relative reliance on holding directors accountable for their actions as opposed to trying to prescribe specific governance practices or rules through their votes on shareholder and management proposals.

Table 5: Comparison of ETF Votes on Selected Proposals in 2008

Issue Proposal	Company	BGI	SSgA	Vanguard	Invesco	ProFunds	Rydex	Wisdom Tree	Total % of Votes in Favor
Management Proposals									
Approve Employee Option Exchange	K-Swiss	A	A	A	A	A	F	A	81.4%
Approve Equity Incentive Plan	Ryland Group	F	F	F	F	F	F	F	88.9%
Adopt Advance Notice Requirement	American Greetings	F	F	F	A	F	F	F	96.4%
Approve Poison Pill	Ameron Int'l Corp.	F	A	F	A	A	F	A	35.3%
Allow Board to Amend Bylaws	Eaton Corp.	F	F	F	A	F	F	F	92.4%
Approve Reverse Stock Split	Conexant Systems	F	F	F	F	F	F	NA	86.9%
Shareholder Proposals									
Adopt Majority Voting in Company Bylaws	Kellogg Co.	A	A	A	F	F	A	F	27.4%
Adopt Majority Voting in Governance Documents	Southwest Airlines	F	A	A	F	F	A	F	68.8%
Appoint Separate/Independent Board Chair	Exxon-Mobil	F	A	A	F	F	A	A	39.5%
Eliminate Dual-Class Common Stock	Ford Motor	A	F	F	F	F	A	NA	27.2%
Eliminate Classified Board	Boston Properties	F	F	F	F	F	F	F	86.9%
Eliminate/Reduce Supermajority Vote	Lowe's Companies	F	F	A	F	F	A	F	70.5%
Allow Shareholders to Call Special Meeting	IBM	F	F	A	F	F	A	F	56.8%
Allow Advisory Vote on Executive Compensation	Comcast	A	A	A	F	F	A	F	20.7%
Award Pay for Superior Performance	Nabors Industries	A	NV	A	F	F	A	A	30.8%
Limit Executive Compensation – Tax Gross Ups	CVS-Caremark	A	F	A	F	F	A	A	52.3%
Amend EEO Policy to Include Sexual Orientation	Murphy Oil	A	A	A	A	A	A	A	8.9%
Report on Sustainability	Dover Corp.	A	A	A	A	F	A	A	39.5%
Adopt Goals on Greenhouse Gas Emissions	General Motors	A	A	AB	A	F	A	A	15.0%
Report on Political Contributions	Wal-Mart	A	A	AB	A	F	A	A	11.7%
Report on Board Diversity	Mueller Industries	A	A	AB	A	F	F	A	47.5%

ETF Funds Used for Sample	Legend
BGI -- Russell 3000 Index	F = For
SSgA -- SPDR DJ Wilshire Total Market	A = Against
Vanguard -- Total Stock Market Index	AB = Abstain
Invesco -- FTSE RAFI US 1000 Portfolio, 1500 Small-Mid Portfolio	NV = Not Voted
ProFunds -- Ultra S&P 500, Ultra Russell 2000, Ultra Mid-Cap 400	NA = Company not in ETF Fund used for sample
Rydex -- 2 x S&P 500, 2 x Russell 2000 or 2 x S&P 400 Mid-Cap	
WisdomTree -- Earnings 500, Small-Cap Earnings, Mid-Cap Dividend, Small-Cap Dividend	

Findings and Conclusions

- There is significant variation in the voting philosophies and patterns of the largest ETF sponsors, with some funds much more likely to vote against management on both shareholder and management-sponsored proposals than other funds.
- There is evidence that the three largest ETF sponsors are somewhat less likely to vote against management on shareholder and management proposals than are most of the smaller fund sponsors examined in this study. This is particularly true with regard to management-sponsored proposals. On the other hand, on average, the three largest ETFs appear to withhold votes from incumbent director nominees at a greater number of companies than the smaller funds. On some issues, this appears to be their preferred means of expressing dissatisfaction with management or board governance, rather than voting against management on specific proposals.
- Funds that rely heavily on a proxy advisory firm for voting guidelines or to make their vote decisions tend to vote against management proposals, and in favor shareowner proposals, more frequently than do those that rely on their own guidelines. This fact probably accounts for much of the propensity we found for smaller funds to vote against management more often, because two of the smaller ETFs we examined vote primarily based on the guidelines and recommendations of their proxy advisors.
- There appear to be significant differences in the level of detail of proxy voting guidelines utilized by ETF sponsors. The ETF sponsors in the study that relied on guidelines provided by proxy advisory firms appear to have the most detailed and comprehensive, but also the most prescriptive, guidelines. At the other end of the spectrum, one smaller fund sponsor has very summary guidelines that stipulate voting with management on virtually all issues.
- The votes by the specific funds at selected 2008 annual meetings examined in this study appear to be generally consistent with the written voting policies of those funds. Case-by-case voting policies by many funds on most issues explain much of this consistency. In a few cases, however, specific votes were cast that appear to be potentially contrary to the fund's written voting guidelines.

End Notes

[1] See SEC website at http://www.sec.gov/answers/etf.htm

[2] Joseph F. Keenan, "A Modern Day Galapagos," 2008 Global ETF Update, June 2008, p. 15.

[3] Keenan, p. 12.

[4] "Mutual Fund Assets and Flows in 2000," Perspective – Vol. 7, No. 2, Investment Company Institute, February 2001.

[5] "ETF Snapshot: December 2008," State Street Global Advisors, p. 2.

[6] "Boom in ETFs loses steam," WSJ.com, Aug. 27, 2008, and Morgan Stanley 2007 Year-End ETF Global Industry Review.

[7] David Hoffman, "Boom in ETFs seems to have ended," Investment News, Aug. 25, 2008.

[8] "ETF Net Inflows Hit $26 billion in November," IndexUniverse.com, Dec. 4, 2008.

[9] "Matt Turner, "ETF Assets to Pass $1 Trillion," efinancialnews.com, Nov. 6, 2008.

[10] Email communication from Kenneth W. Pegher, Compliance Manager, ProFunds, Jan. 23, 2008.

[11] PROXY *Governance's* attempts to obtain WisdomTree's detailed voting guidelines included two phone calls and three email exchanges with a WisdomTree employee between the dates of Jan. 20, 2009, and Feb. 27, 2009, as well as a written communication sent by U.S. mail to Judy Manion, the designated contact person at BNY Mellon for inquiries about proxy voting policies found in WisdomTree's Dec.1, 2008, Statement of Additional Information for the WisdomTree Trust.. In several of these communications, PROXY *Governance* was told that its requests had been forwarded to the appropriate person, but was not given that person's name.

[12] Telephone conversation with Christopher Wightman, March 18, 2009.

Appendix: Links to ETF Voting Policies and Guidelines

Access to documents containing the proxy voting policies and/or guidelines for the ETF sponsors discussed in this study is available at the following internet addresses:

Barclays Global Investors (iShares):

http://us.ishares.com/content/stream.jsp?url=/content/repository/material/us_proxy_voting_guidelines.pdf&mimeType=application/pdf

State Street Global Advisers (SPDRs):

https://www.spdrs.com/library-content/public/SIS%20SAI_1.31.09.pdf?WT.z_sai_download=BIK&WT.z_sai_ordered=1

Vanguard Group (Vanguard ETFs):

https://personal.vanguard.com/us/content/Home/WhyVanguard/AboutVanguardProxyVotingGuidelinesContent.jsp

Invesco (PowerShares):

http://www.glasslewis.com/downloads/policies/USPolicyGuidelinesSummary2008.pdf

ProFunds (ProShares):

www.proshares.com/help/proxy
http://www.riskmetrics.com/node/135722

Rydex Investments (RydexShares):

http://www.rydexinvestments.com/service/prospectuses_reports.shtml

WisdomTree (WisdomTree ETFs):

Not Available

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About PROXY *Governance,* Inc.

PROXY *Governance*, Inc., (PGI) is an independent and conflict-free proxy advisory firm that helps build long-term shareholder value by providing various proxy research and voting services to institutional investors, including mutual funds, public and private pension funds, the investment arms of insurance companies and investment banks. PGI's services include high-quality research, independent voting recommendations and a state-of-the-art proxy voting platform, known as PROXY *Advantage*. For further information, see www.proxygovernance.com.

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