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Taking a Helpful Step on Fund Proxy Reform

Authors:

Amy McDonald
Matt Thornton
James Duvall

Key Takeaways

- As many diversified indexes become increasingly concentrated (the S&P 500's top 10 holdings constituted 38% of the index in August 2026), many "diversified" funds must consider whether to (i) artificially cap their larger portfolio holdings, which may interfere with their stated investment strategies, or (ii) seek shareholder approval to become "non-diversified"—a costly and uncertain path.
- While comprehensive SEC-led fund proxy reform is desperately needed, the SEC staff can provide timely relief to diversified funds struggling to comply with their fundamental policies.
- Providing diversified funds with greater latitude to either change their policies or apply them less rigidly would aid efficiency and satisfy investor preferences.

Fund proxy campaigns are a costly burden. ICI demonstrated this in 2019 and again in 2026. Major reforms to fund proxy requirements to alleviate these burdens would fit perfectly within the SEC's 2026–2030 draft strategic plan, which seeks to "ensure that our regulations balance costs and benefits and do not add needless friction to the marketplace."

We have many fund proxy reform recommendations, most of which the SEC's Investor Advisory Committee (IAC) also recently put forward. As the IAC recognized, the SEC and staff can pursue near-term, medium-term, and long-term reforms. We agree. And a great

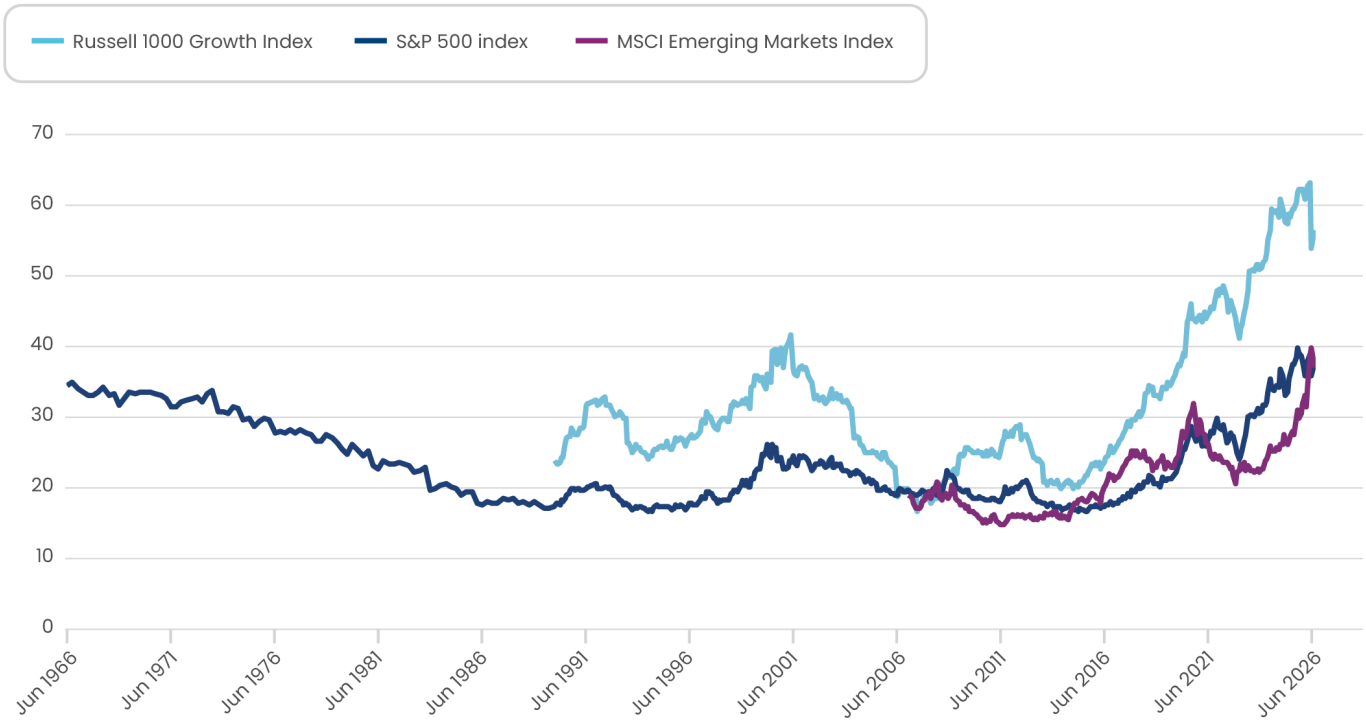
place to start is with funds' compliance with—and possible changes to—their fundamental policies.

Many Funds Struggle to Comply With Their "Diversified" Status

Funds registered under the Investment Company Act of 1940 (1940 Act) like mutual funds and ETFs are either diversified or non-diversified. Generally, a diversified fund has considerable flexibility in managing 25% of its portfolio; for the remaining 75%, investments in any one issuer must be limited to no more than 5% of the fund's total assets (or 10% of the voting shares of that issuer).

But market developments over the past decade have made continued operation as "diversified" difficult or impossible for many funds. For example, the weight of the 10 largest stocks in the S&P 500 index has grown substantially since the global financial crisis, totaling 38% in August 2026 (Figure 1). Similarly, the combined weight of the 10 largest stocks in the Russell 1000 Growth Index was 57%. And currently there are four and five issuers in these two respective indexes that have individual weights of more than 5% of the index. This isn't a US-specific phenomenon, either—the MSCI Emerging Markets Index and many other global or country-specific indexes are similarly concentrated, or worse.

Figure 1: Some Indexes Have Become Heavily Concentrated
Share of ten largest holdings in stated index, percent, June 1966–August 2026



Data between June 1966 and December 1989 are quarter-end, and data between January 1990 and August 2026 are month-end.
Note: Between June 1966 and December 1989, the weight of the ten largest stocks in the S&P 500 index are from S&P Global. Data for the Russell 1000 Growth Index begin in December 1989, and data for the MSCI Emerging Markets Index begin in January 2007.
Source: ICI calculations of Morningstar Direct and S&P Global data

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Go back far enough, and it's clear that high concentration is not novel. For example, the

weight of the top 10 stocks in the S&P 500 index was similarly concentrated in the late 1960s and early 1970s. But with just 361 mutual funds in existence in 1970, compared with 11,264 mutual funds and ETFs at year-end 2025, the problem now hits far more funds.

These market trends stress both diversified index funds *and* diversified active funds. As indexes become more concentrated, index funds that track them may be unable to fully track their returns. For active funds, portfolio managers may be unable to invest fully in those growing companies or sectors in which they have strong conviction, which can adversely affect performance relative to a benchmark or peer funds. In each case, these artificial caps distort or dilute the exposures that fund investors otherwise seek and expect. Given that nine out of 10 mutual fund investors review a fund's historical performance in comparison with its benchmark, these deviations, and their investor impact, matter.

Diversified to Non-Diversified Policy Changes Are Costly and Uncertain

But couldn't a fund facing these pressures just re-classify as "non-diversified?" Not easily, or with certainty. The 1940 Act requires shareholder approval for such a change. ICI's 2026 white paper identified 73 funds that sought to change their fundamental policies in this way between 2020 and 2025. These proxy campaigns collectively cost these funds $66 million (three of which individually cost more than $5 million), or over $900,000 on average per campaign. More than one-third of these required at least one adjournment to reach quorum, and six ultimately failed because they couldn't meet the quorum requirement.

Voting shareholders favor these proposals by wide margins (including those that failed). An average of 85% of shares represented at these shareholder meetings voted "for" these proposals—far greater than the statute's 67% approval threshold. Excluding abstentions and broker non-votes (that is, brokerage customer shares present at a shareholder meeting that the brokers have not voted), the average percentage of votes cast "for" these items jumps to 92%.

While some funds have sought and obtained shareholder approval to change their policies, the problem persists industrywide. And changing status to "non-diversified" isn't necessarily a permanent fix because a fund can effectively revert to "diversified" if it operates as such for a continuous three-year period. Further, the above figures do not capture the costs to investors of funds *not* seeking to re-classify as non-diversified, primarily due to the costs of doing so combined with the risks of not being successful. A substantial backlog of funds wishing to change their policies—or at least apply them more flexibly—remains.

The SEC Can Fix This

As we've recommended, SEC rulemaking could allow funds to change their fundamental policies—including diversification status—with board approval and advance shareholder notice. We believe that these steps, coupled with existing redemption and sales rights (investors dissatisfied with a pending change can vote with their feet), more than suffice to protect shareholders while ensuring their funds are investing as expected. Requiring shareholder approval on top of all of this provides little investor benefit at great cost.

The SEC staff could act much more quickly. While the rulemaking reform above would make fundamental policy *changes* much more efficient, the staff could permit funds *to interpret and apply* their existing diversification policies more flexibly. Rulemaking and staff action of this kind are not mutually exclusive—they would provide complementary short- and

medium-term relief.

In fact, the SEC staff took a step in this direction with its 2019 Stradley no-action letter. There, the staff stated that it would not recommend enforcement action to the SEC against certain index-based funds that continued to purchase shares of a portfolio company when the fund's holdings of the company exceeded the limits for a diversified fund. However, this letter did not extend to active funds or all index funds (the letter covers only index funds tracking broad-based indexes).

We would like to see a prudent expansion of this staff relief that benefits all funds—active and index—subject to appropriate investor protections. This would balance costs and benefits and remove needless frictions for funds seeking to pursue their stated investment objectives and strategies. At the same time, this framework could be expanded further to cover funds' compliance with their concentration policies, which can create fund management challenges similar to those discussed above.

Conclusion

Often, the best way to tackle a large or multi-faceted project—including fund proxy reform—is to break it down into manageable chunks. The SEC or its staff can do a great deal of good by quickly addressing the pain caused by fundamental investment policies to which funds can't easily adjust in today's dynamic markets.

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