Voice *and* Exit:
Mutual Funds' Reactions to ESG Scandals

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Abstract

We study how mutual funds respond to ESG scandals of portfolio companies. We find that, after experiencing an ESG scandal in their portfolio, active mutual fund managers (but not passive ones) are both more likely to vote in favor of ESG proposals *and* to reduce their stakes (and hence their voting power) in high-ESG risk stocks compared to other funds holding the same stock at the same time. Our results suggest that scandal-shocked funds manage ESG risks in their portfolios, but fail to have much impact as exit undermines their engagement efforts precisely for those firms that have the biggest need for reform.

JEL classification: G11, G12, G14, G15

Keywords: ESG, mutual fund voting, voice vs. exit

1. Introduction

An increasing number of institutional investors claim to invest with environmental, social, and governance (ESG) criteria in mind. For example, the Global Sustainable Investment Alliance states that "sustainable" assets, which purportedly follow ESG standards, reached 35.3 trillion USD in 2020, up from 22.8 trillion USD in 2016. In a similar vein, signatories of the UN-backed Principles for Responsible Investment (PRI) now represent more than 50% of global public equity (Kim and Yoon, 2023; Gibson et al., 2022). Crucially, these commitments extend far beyond "ESG funds" in the narrow sense, i.e., funds that carry investment mandates with explicit ESG performance targets. How do these newly ESG-aware investors behave? Do they care about making companies more virtuous or do they simply want to avoid exposure to "sinful" companies? While we have some answers to these questions from experiments (Bonnefon et al., 2022; Heeb et al., 2023) and from surveys (Krueger et al., 2020), we still lack well-identified evidence from the field.

In this paper, we provide such evidence by *jointly* studying mutual funds' proxy voting and trading behavior in response to ESG scandals of (other) portfolio stocks. We posit that such scandals represent idiosyncratic shocks to mutual funds' awareness of ESG risks and their associated costs.[1] Moreover, since different funds are exposed to different scandals, we can saturate our regressions with high-dimensional fixed effects, allowing us to compare exposed and non-exposed fund managers' voting and trading behavior for the same (non-scandal) stock. We argue that, by identifying the causal effects of ESG scandals on voting and trading, our analysis sheds light on what mutual fund managers care about: reducing ESG risks in their portfolio (e.g., to avoid poor performance and/or outflows in the future) or impact (i.e., to improve companies' ESG performance).

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[1] With ESG risks, we mean the (uncertain) negative consequences for companies with poor ESG performance: e.g., more costly access to capital, loss in customers and/or key employees due to poor reputation, becoming the target of lawsuits or regulation. While funds may be broadly aware of ESG risks, they may underestimate the financial implications of these risks before experiencing them firsthand in one of their portfolio companies.

The literature discusses two channels for how an ESG-aware investor can respond to a high-ESG risk firm in her portfolio: she can engage with the stock's management with the aim of reducing ESG risks (*voice*), or she can divest from the stock (*exit*); see, e.g., Hirshman (1970) and Broccardo et al. (2022). Our contribution is to *jointly* describe mutual funds' voice and exit behavior after a (plausibly exogenous) shock to their ESG awareness. We document that, after experiencing ESG scandals for some of their portfolio stocks, mutual funds use both voice and exit simultaneously.[2] This creates a tension: by reducing their stakes in high-ESG risk stocks, mutual funds undermine their voting power for ESG-related shareholder proposals in precisely those firms that arguably have the biggest need of reform. Taken together, these findings hold important implications for how to model ESG preferences. Indeed, our evidence suggests that while mutual funds use voice and exit to manage ESG risks in their portfolios (i.e., to reduce exposure to future ESG scandals), this behavior comes at the cost of potentially reducing their impact on firms with poor ESG track records. As we explain below, this behavior is in line with funds having a "narrow mandate" (also referred to as value-alignment), while it is inconsistent with a "broad mandate" (also referred to as impact-seeking preferences).

To identify ESG scandals, we rely on the RepRisk database. RepRisk scans newspapers, news broadcasts, and social media sources worldwide for ESG incidents—i.e., news stories about environmental, social, or governance problems at public or private firms. Using a proprietary algorithm, RepRisk constructs a firm-level reputation risk index from this raw data. We rely on this *RepRisk Index* (RRI) and define ESG scandals as large jumps in this index. Our approach ensures that we pick up important ESG scandals that come as a surprise.[3] We identify 3,213 ESG scandals in our sample, confirming that such large increases in the RRI are relatively rare. On average, stocks with an ESG scandal exhibit negative abnormal returns and active

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[2] With exit we mean a reduction in portfolio weights (i.e., partial sell of a stock position). Indeed, the mutual funds in our sample rarely completely liquidate a stock position from one quarter to the next.

[3] We describe the data and our approach of identifying ESG scandals in detail in Section 2. In Appendix C, we give a few examples as well as an overview of the different types of ESG scandals that we have in our sample.

(but not passive) funds exposed to scandals experience outflows after controlling for the fund return. This shows that mutual funds are hurt by and ought to pay attention to these scandals.

We begin our empirical investigation with voice. Specifically, we look at the voting behavior of mutual funds for ESG-related shareholder proposals.[4] Such proposals allow investors to put pressure on management (Thomas and Cotter, 2007; Ertimur et al., 2010; Cunat et al., 2012). Our explanatory variable is *ESG scandal experience*, which we define as the average of the monthly fraction of a fund's portfolio holdings that experienced an ESG scandal over the prior year. A key advantage of our identification strategy is that different mutual fund managers are exposed to different ESG scandals. This allows us to include vote fixed effects. We thus test whether mutual funds whose portfolios were exposed to ESG scandals vote differently compared to other mutual funds taking part in the same vote, thereby controlling for all vote-specific and stock-time-specific factors that could influence mutual funds' voting behavior. Hence, factors like the proposal type, ISS and management recommendation, media coverage, public opinion, past performance etc. cannot explain our results.

Using this setup, we find that active mutual funds with higher *ESG scandal experience* are more likely to vote for ESG proposals in subsequent shareholders' meetings compared to other funds voting on the same proposals. In terms of magnitude, a 1 percentage point increase in ESG scandal experience (corresponding to 3-4 scandal months in the prior year for average-sized positions) increases the probability of voting in favor of an ESG proposal by 1.4 percentage points or 4% relative to the mean vote share in favor of ESG proposals. In contrast, passive funds do not change their voting behavior in response to ESG scandals in their portfolios. This no-result for passive funds is consistent with our earlier finding that passive funds do

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[4] Voting on shareholder proposals is only a part of mutual funds' overall engagement efforts. For instance, using data from a large UK asset manager, Becht et al. (2019) document that votes are often preceded by meetings between the asset manager's stewardship team and firm management. As such meetings are unobservable to us, we use voting behavior as a proxy for engagement.

not suffer outflows from holding a scandal stock; it also chimes with recent critique that, with respect to ESG, passive funds often do not *walk the talk*.[5]

In subsequent analyses, we verify that the effect on active funds' voting for ESG proposals is stronger when ESG scandals come from stocks with a larger portfolio weight, consistent with the idea that mutual funds pay more attention to ESG scandals that matter more for fund performance. We further find that the effect on voting is pronounced when the ESG scandal comes as a surprise (i.e., when it occurs for a company whose prior RepRisk rating indicates low ESG risks) and for funds who previously displayed a less extreme stance on ESG (i.e., for funds that in the past neither consistently voted for nor against ESG proposals). Hence, ESG scandals resonate more with funds that "have not yet made up their mind" on ESG.

We next ask *why* (active) mutual funds change their voting behavior after ESG scandals. One possibility is that mutual funds become aware that ESG scandals hurt performance and are disliked by fund investors, leading them to proactively manage ESG risks to protect their bottom line. Another possibility is that mutual fund managers become intrinsically averse to ESG scandals, perhaps because they personally feel guilt or shame of having invested in a "sinful" company (Hong and Kacperczyk, 2009; Riedl and Smeets, 2017). In line with the first explanation, we document that ESG scandals have a stronger effect on voting when the associated stock had a more negative return around the scandal; i.e., when the connection between ESG scandals and fund performance is presumably more salient. At the same time, performance considerations are not the full story, since we find that mutual funds are also more likely to support *pure ES* proposals, which are not known to improve shareholder value (Li et al., 2023). We also rule out that ESG scandals just make fund managers less management-friendly, as we find that they do not change their voting behavior for (non ESG-related) management proposals.

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[5] In his annual letter to CEOs, BlackRock's CEO Larry Fink repeatedly extolls the importance of ESG and particularly climate change for BlackRock's clients and, in turn, its investment strategy (https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter). According to Tariq Fancy (2021), BlackRock's former chief investment manager for sustainable investing, this is little more than "marketing hype, PR spin and disingenuous promises."

We then look at exit. Our tests proceed analogously to those for voice. Specifically, we compare the exit behavior in high-ESG risk stocks, i.e. stocks more prone to exhibit future scandals, for funds with different ESG scandal experiences. Through stock-quarter fixed effects, we control for all stock-time-specific reasons why any investor may want to sell a given stock at a given point in time. We find that, compared to other funds holding the same stock, active funds exposed to ESG scandals in their portfolios are more likely to (partially) sell their positions in high-ESG risk stocks. Consistent with our results for voice, this effect is more pronounced for scandals in stocks with a larger portfolio weight, for more surprising scandals, and for scandals accompanied by more negative stock returns. Next, given the obvious tension between exit and voice (as divestments reduce voting power), we study whether mutual funds are less likely to sell when they expect engagement to be more likely to succeed. Using three measures of the ex-ante probability of success for engagement, we indeed find that scandal exposed funds divest more from high-ESG risk stocks for which the ex-ante probability of a successful engagement is lower. This finding suggests that funds consider exit and voice as substitutes with the aim of reducing *portfolio-level* ESG risks. Moreover, we find them *not* to increase their portfolio weights in high-ESG risk stocks with a high probability of engagement success—i.e., stocks that should be attractive targets for impact-seeking investors. Hence, scandal-exposed mutual funds do not attempt to maximize their impact from voice.

Finally, we examine whether ESG scandal experiences affect portfolio-level ESG risks and the overall support for ESG proposals at the stock level. We find that—at the portfolio-level—funds with a higher ESG scandal exposure see an improvement in the average RepRisk rating and face fewer ESG scandals going forward, while—at the firm-level—ESG shareholder proposals do not receive higher aggregate support when firms are held by active funds with a higher average ESG scandal exposure. Only when we focus on stocks for which funds expect engagement to be more likely to succeed (and in which they, therefore, do not reduce their stakes), do we find weak evidence for an increase in the overall vote support for ESG proposals. These findings are again consistent with the view that scandal-exposed funds prioritize

mitigating portfolio-level ESG risks over impact: they succeed in reducing ESG risks in their portfolios, while only having a small impact on vote outcomes for ESG-related shareholder proposals.

Our paper contributes to the literature on ESG investing[6] by informing theorists how to model ESG preferences. Indeed, models of divestment typically assume that investors care about the ESG performance of stocks *in their portfolio only* (Heinkel et al., 2001; Pedersen et al., 2022; Pastor et al., 2022; referred to here as *narrow mandate*), while corporate finance models usually assume that investors care about their impact on ESG performance more broadly (Oehmke and Opp, 2023; Landier and Lovo, 2023; Green and Roth, 2024; referred to here as *broad mandate*). Knowing which type of preferences best describe investment behavior is crucial: indeed, while large-scale divestments can in theory raise the cost-of-capital of "bad" firms, recent evidence suggests this effect is quite small (Berk and van Binsbergen, 2022). Engagement may thus be more conducive for impact but requires a sufficiently large stake. In this regard our empirical evidence is sobering. While we find that shocked mutual funds are more likely to vote for ESG proposals, they also tilt their portfolios away from (and thus reduce their voting power in) in high-ESG risk stocks, for which the benefits of a successful engagement are presumably the greatest. This suggests that fund managers focus (narrowly) on managing ESG risks in their portfolios, inconsistent with the broad mandate assumption.

Our paper belongs to a recent strand of literature that studies ESG risks through ESG *incidents*, instead of relying on conventional ESG ratings.[7] Our data provider, RepRisk, provides the most comprehensive coverage of such incidents. Using the same data, Glossner (2021) finds that, in the cross-section of U.S. stocks, ESG incidents predict future ESG incidents and low stock returns, suggesting that U.S. investors are not paying sufficient attention to these events. Derrien et al. (2021) study how sell-side analysts adjust their earnings forecasts following ESG incidents. Gantchev et al. (2022) find that, after an ESG incident,

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[6] See Margolis et al. (2009) and Kitzmueller and Shimshack (2012) for literature reviews on ESG or Corporate Social Responsibility (CSR) more generally. See Dimson et al. (2015) and Dyck et al. (2019) for evidence of the impact of socially responsible investors on firms' CSR performance.

[7] As shown by Berg et al. (2021), ESG ratings from different data providers are often inconsistent and notoriously noisy.

firms exhibit mild divestitures and decrease their greenhouse gas emissions when they are held by more climate-conscious investors. In a related paper, He et al. (2023) show that firms are more likely to have ES incidents *after* failed ES proposals (which explains why ESG-aware funds want to vote for ESG-related shareholder proposals). Instead of focusing on scandal firms, we use (surprise) ESG scandals for portfolio firms to identify the causal effects of ESG awareness on mutual fund behavior (for non-scandal stocks).

Finally, we contribute to the literature on mutual fund voting (Davis and Kim, 2007; Iliev and Lowry, 2015; Bolton et al., 2020; Li et al., 2022). Contemporaneous work finds that mutual funds are more likely to vote for environmental shareholder proposals after experiencing natural disasters (Fich and Xu, 2021; Gustafson et al., 2023) or extreme temperatures (Di Guili et al., 2022). In these settings, mutual fund investors are reacting to salient cues about global warming that are orthogonal to the actual worth of a given environmental shareholder proposal. Instead, we focus on investment experiences—ESG scandals for portfolio stocks—that potentially bear on performance and the fund's reputation vis-à-vis investors. Moreover, we use our ESG-awareness shocks to jointly study voice and exit, allowing us to shed light on fund managers' motives. Overall, our results suggest that fund managers respond to ESG scandals for opportunistic reasons—i.e., they employ voice and exit to reduce their portfolio-level exposure to future scandals and to shore up their reputation vis-à-vis investors—and do not appear to care much for maximizing impact. Our paper thus complements recent work by Heath et al. (2023) and Atta-Darkua et al. (2023), who show that institutional investors that self-commit to SRI principles reallocate their portfolios toward more virtuous (e.g. low-emitting) firms without much evidence of engagement.[8] Moreover, by highlighting the tension between exit and voice, we add to recent papers questioning the usefulness of divestment campaigns as a strategy for impact (Berk and van Binsbergen, 2021; Edmans et al., 2022).

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[8] Another related paper is Saint-Jean (2023), who classifies mutual funds based on whether they mostly employ exit or voice strategies. He finds that voice funds—which are more likely to be true impact-seeking ESG funds—are more like to instigate a pro-social behavior change in target firms.

Our paper is organized as follows. In Section 2, we lay out our empirical hypotheses. In Section 3, we describe data sources, present summary statistics, and show that mutual funds are hurt by being exposed to ESG scandals. Section 4 presents our findings for voice (mutual fund voting); Section 5 those for exit. Section 6 studies the implications of the documented fund behavior on portfolio- and firm-level outcomes. Section 7 presents robustness checks. Section 8 concludes.

2. Empirical Hypotheses

Our aim is to study how mutual funds respond to ESG scandals. Key to our investigation is the idea that different types of ESG awareness should lead to different fund behavior. In Appendix B, we present a stylized model to guide our empirical hypotheses. Here, we discuss its intuition.

One possibility is that, after experiencing ESG scandals, fund managers genuinely care about mitigating ESG risks (e.g., carbon emissions) in the economy, as opposed to only caring about ESG risks in their portfolios. Following Oehmke and Opp (2023) we call funds with such preferences as having a "broad mandate." Another label for such preferences is "impact-seeking"; see e.g., Bonnefon et al. (2022), Landier and Lovo (2023), and Green and Roth (2024). Intuitively, investors that care about ESG risks regardless of their own portfolio holdings will vote for ESG shareholder proposals, but have little reason to divest from high-ESG risk stocks.[9] To the contrary, they may even want to overweigh some high-ESG risk stocks in order to increase their voting power and thus the likelihood of a successful engagement.

Another possibility is that, after experiencing ESG scandals, fund managers care about mitigating ESG risks in their portfolios only. In our model, we call funds with such preferences as having a "narrow mandate." Another label for such preferences is "value-alignment"; see e.g., Bonnefon et al. (2022), Landier and Lovo (2023), and Green and Roth (2024). Crucially, with such preferences, exit and voice become

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[9] In theory, divestments campaigns could have impact if they succeeded in raising the cost of capital of targeted firms. Empirical evidence suggests that this channel is unlikely to be effective (Teoh et al, 1999; Berk and von Binsbergen, 2022). In our setting, this motive is not likely to drive behavior as funds' scandal experiences, and hence any resulting portfolio reallocations, are largely idiosyncratic.

strategic substitutes as both actions help to reduce a fund's ESG risk profile. As such, we expect scandal-exposed funds to vote in favor of ESG proposals and to divest from high-ESG risk firms. Divestments should be particularly large for stocks in which engagement is unlikely to succeed.

As our model clarifies, not only do fund managers with broad and narrow mandates employ exit and voice strategies differently, but outcomes are expected to differ as well. If ESG scandals make fund managers care about ESG risks in their portfolios (narrow mandate), we should see their portfolio level ESG risks improve, while ESG shareholder proposals are not necessarily more likely to pass (because divestment undermines engagement). If, on the other hand, ESG scandals make fund managers care about ESG risks more broadly (broad mandate), ESG shareholder proposals should become more likely to pass, while the effect on portfolio level ESG risks is ambiguous (since such funds may overweigh engagement targets with high-ESG risks).

3. Data and Variable Construction

a. RepRisk Data

To identify ESG scandals, we use data from RepRisk on ESG incidents that spans the years 2007 to 2018.[10] RepRisk screens newspapers, news broadcasts, and social media sources worldwide to identify negative stories related to ESG issues that implicate firms.[11] RepRisk then uses a proprietary algorithm to construct the *RepRisk Index* (RRI) from this raw data. The RRI runs from 0 to 100 with higher values indicating a higher "reputational risk exposure to ESG issues" (RepRisk, 2020). When a new ESG incident occurs, the RRI is increased by an amount that relates to the reach, severity, novelty, and intensity of the incident. In months without an incident, the RRI slowly reverts back to zero. We define an ESG scandal event when the RRI for a given firm-month observation increases by more than 25 points, which corresponds to the

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[10] This dataset has been used in previous research such as Glossner (2019, 2021) and Akey et al. (2021).

[11] Firms are added to the dataset when they are mentioned for the first time in one of RepRisk's sources in relation to an ESG incident. We therefore treat firms that are not in the RepRisk data as having no ESG incident. Our results remain robust if we exclude stocks not in RepRisk before constructing our *ESG scandal experience* measure (see Table 11).

90th percentile among positive RRI changes.[12] Importantly, our approach ensures that we identify ESG incidents that are both *severe and unexpected*. Indeed, firms with a checkered history already have an elevated RRI, thus leaving less scope for further increases when a new ESG incident emerges. Our ESG scandals therefore constitute large shocks that are likely to draw fund managers' attention. Overall, we have 3213 ESG scandals in our sample.

In Appendix C, we give a few examples as well as an overview of the different related topics flagged by RepRisk for the ESG scandals in our sample. As the examples illustrate, most ESG scandals touch on more than one dimension and are therefore difficult to classify as either E, S, or G. We return to this point in Section 4.d below, where we attempt to study whether different scandals affect differently the voting on shareholder proposals.

RepRisk data is merged with CRSP using stock CUSIPs. In RepRisk, company identifiers map to several CUSIPs that do not change over time. We therefore use the historical 8-digit CUSIP ("NCUSIP") available in CRSP to merge between PERMNO and RepRisk ID. We match about 4000 PERMNOs in this way, which is in line with previous papers (see Akey et al., 2021).

b. CRSP Mutual Fund Data and creating the ESG scandal experience measure

We obtain quarterly mutual fund holdings data from the CRSP mutual funds data. Slightly below half of the funds in the sample have monthly holding data while the other half has quarterly data. To treat all funds equally, we reduce the monthly holdings data to quarterly frequency by keeping only the last monthly observation in the quarter.

To compute fund-level ESG scandal experience, we first compute the value-weighted fraction of the fund's stocks that experienced a scandal each month using the fund holdings at the end of the previous quarter.

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[12] In the robustness section, we verify that our results hold when we identify ESG scandals based on stricter or laxer thresholds (see Table 11).

Depending on whether we look at (annual) votes or quarterly holding changes, we then compute *ESG scandal experience* as the average of these monthly values for the fund over the previous 12 or 3 months:

$$ESG\ scandal\ experience_{f,T} = \sum_{t=T-h+1}^{T} \left(\sum_{i=1}^{N} weight_{f,i,t} * D(ESG\ scandal)_{i,t} \right) / h$$

where the subscript f denotes the fund, i denotes the stock, t denotes the month, $weight_{f,i,t}$ is stock i's portfolio weight at the end of the previous quarter, and $D(ESG\ scandal)_{i,t}$ is a dummy variable equal to one if stock i has a scandal in month t. For our (annual) voting analysis, T is the month prior to the vote and the lookback horizon h is 12 months. For our (quarterly) exit analysis, T is the quarter in question and h is 3 months, to account for the possibility that funds quickly reallocate their portfolios after being exposed to ESG scandals.

To distinguish between active and passive mutual funds, we obtain fund names and the "index_fund_flag" variable from the CRSP mutual fund data. Following Appel et al. (2016), we treat a mutual fund as passive if the index fund flag equals "D" ("Pure Index Fund") or if the fund name contains a string suggesting it is an index fund.[13]

c. Voting data

Since 2003, the U.S. Securities and Exchange Commission (SEC) requires all U.S. mutual funds to report their proxy votes in annual N-PX filings. We use the Institutional Shareholder Services (ISS) voting dataset that compiles information from N-PX filings as well as votes' results and ISS recommendations for both shareholder and management proposals of Russell 3000 companies. We follow Iliev and Lowry (2021) to match ISS to CRSP. Specifically, we determine the N-PX file id provided by ISS to download the actual file from EDGAR. We extract both the Central Index Key (CIK: EDGAR institution identifier) and the

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[13] Specifically, following Appel et al. (2016), we mark funds as index funds if their lower-case fund name contains one of the following strings: *Index, Idx, Indx, Ind_* (where_ indicates a space), *Russell, S & P, S and P, S&P, SandP, SP, DOW, Dow, DJ, MSCI, Bloomberg, KBW, NASDAQ, NYSE, STOXX, FTSE, Wilshire, Morningstar, 100, 400, 500, 600, 900, 1000, 1500, 2000* , and *5000*.

funds' tickers from the N-PX files' headers. Then for all funds with the same N-PX file id, we name-match the scraped EDGAR data with ISS to obtain a corresponding ticker to each ISS fund id. When we are unable to retrieve a fund ticker from the N-PX files, we manually match funds in ISS to CRSP by CIK and fund name. We are thus able to match around 80% of all funds in ISS.

We identify ESG-related shareholder proposals by looking at the proposal's description provided by ISS. We first remove routine shareholder proposals that are neither ES nor G (e.g., ISS description "reincorporate in another state" or "rotate annual meeting description"). To identify ES proposals, we follow He et al. (2022) but add a few items that we think also pertain to ES issues (e.g., ISS description "board diversity" or "report on pay disparity"). The remaining proposals are classified as G proposals and include items such as: proxy access, poison pills, or require a majority vote for directors' election. Our sample spans 9,155 ESG shareholders' proposals that were voted on between 2007 and 2018 and covers the votes of 8,406 funds, out of which 6,950 are actively managed.

d. Summary statistics

Table 1 presents summary statistics. In Panel A, we display summary statistics at the firm-month level for the RepRisk data. The average RRI is 7.5, which is due to more than half the observations having no prior ESG incidents and thus a RRI of zero. In 6.6% of the months, there is an ESG incident and the RRI increases. Of these increases, the average increase size is 9.7, while the median is 6. As mentioned above, our definition of an ESG scandal is an increase in the RRI of more than 25 points, which corresponds to the 90th percentile of RRI increases. These ESG scandals are rare events happening in 0.58% of firm-months observations.

In Table 1 Panel B, we display fund-level summary statistics. We use quarterly holdings data to compute ESG scandal experience on the fund level. For the median fund, the average portfolio weight (for positions with a valid PERMNO) is 1.7%, the median portfolio weight is 1.4% and the largest portfolio weight is 5.5%. This means that portfolio weights are large enough for the fund manager to pay close attention to

their position. Monthly fund returns have a standard deviation of 3.8%, while monthly fund flows have a standard deviation of 13.5%.

In Panel C, we display summary statistics for the proposal-level data used in our vote analysis. On average, funds vote in favor of ESG shareholder proposals 36.8% of the time. In Panel D, we display summary statistics for the fund-stock-quarter level data used in our exit analysis. On average, funds sell shares in 36.8% of their stock positions each quarter and about half of stock positions have a low RepRisk rating, which we define as a rating of A or worse.

e. Should funds care about ESG Scandals?

Here, we present evidence that mutual fund managers should care about ESG scandals. This evidence serves as a precursor for our main analyses in that it validates our choice of events (ESG scandals) and thus helps understand why mutual fund managers may react to them.

We start with reporting stock returns around ESG scandals. To get a sharper timing of when ESG scandal news might be incorporated in stock prices, we rely on daily media coverage data of ESG incidents. This data is also provided by RepRisk (and forms the raw data on which the RepRisk index is based). Specifically, we identify as events all media articles related to ESG incidents that are recorded during stock-months with an ESG scandal (i.e., when the RepRisk index jumps by 25 points). In Table 2 Panel A, we report cumulative market-adjusted returns for three different windows surrounding these media articles. When looking at the day of and the day following an article, we find a significantly negative return of 23 basis points (column (1)). When increasing the event window, cumulative returns become more negative. For example, starting 5 days prior to the article and ending 20 days after the article, the cumulative market-adjusted return is a highly significant negative 75 basis points (column (3)). In short, information pertaining to ESG scandals slowly trickles into prices (consistent with the findings in Glossner, 2021), and directly hurts the performance of exposed fund managers.

Next, we investigate whether funds suffer outflows after experiencing ESG scandals in their portfolios. The idea is that, if mutual funds' end-investors cared about ESG, they might withdraw their assets from mutual funds with large portfolio holdings in scandal stocks. Following standard practice in the literature (e.g., Sirri and Tufano, 1998), we compute monthly fund flows as a fraction of net asset value from the CRSP mutual fund database:

$$Fund\ flows_t = \frac{Net\ asset\ value_t - (Net\ asset\ value_{t-1} * Fund\ return_t)}{Net\ asset\ value_{t-1}}$$

We then regress monthly fund flows on our measure of *ESG scandal experience*, which captures funds' (position-weighted) average exposure to ESG scandals over the past year. We include fund returns—a common driver of fund flows (e.g., Chevalier and Ellison, 1997)—as well as month and fund fixed effects. Standard errors are two-way clustered by fund and month.

Table 2 Panel B presents the results. In the fund-month panel including all funds (columns (1) and (2)), the coefficient of *ESG scandal experience* is negative and statistically significant, implying that ESG scandals of portfolio firms trigger fund outflows. Importantly, these results are robust to controlling for fund returns over the current month and the previous year, suggesting that fund investors care about ESG scandals over and above their direct impact on fund performance. When splitting the sample into active and passive funds, we find that this result solely comes from the sample of active funds (columns (3) and (4)), while passive funds do not suffer outflows following ESG scandals in their portfolios (columns (5) and (6)).

In summary, exposure to ESG scandals especially hurts active funds: their performance suffers directly from the negative returns around scandals, and they experience additional outflows from their investors.

4. Results for Voice

a. Empirical Methodology

In this section we study voice. We ask whether, following exposure to ESG scandals, fund managers are more likely to vote in favor of ESG shareholder proposals. Specifically, we run the following linear probability model:[14]

$$D(Vote\ for\ ESG\ proposal)_{f,v} = \alpha_v + \alpha_f + \beta_1 * ESG\ scandal\ experience_{f,m-1} + \beta_2 * Controls + \varepsilon_{f,v},$$

where $D(Vote\ for\ ESG\ proposal)_{f,v}$ is a dummy variable equal to one if the fund votes in favor of the specific ESG shareholder proposal and $ESG\ scandal\ experience_{f,m-1}$ measures the average fraction of the fund's portfolio holdings that had an ESG scandal over the 12 months preceding the month m of the vote. Because the data is at the fund-vote level, we can include vote fixed effects (α_v) as well as fund fixed effects (α_f). The vote fixed effects are particularly important as they allow us to control for vote-specific omitted variables (such as the merit of the specific proposal) and any time-varying firm-level omitted variables (e.g., whether the firm recently had any ESG incidents itself).[15] Due to these fixed effects, the regression is relatively saturated even without adding other control variables (as evidenced by high adjusted R-squares). When displaying results below, we thus show first the specification without controls.

There are two types of omitted variables that our fixed effects cannot control for: fund-firm level and time-varying fund level variables. In our second specification, we add control variables along these dimensions. As fund-firm variables, we include position size and a dummy variable for whether the fund and the

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[14] We estimate a linear probability model (i.e., OLS) in order to avoid the incidental parameters problem that arises for nonlinear models with many fixed effects (Neyman and Scott, 1948).

[15] Hence, we identify a differential change in voting behavior for scandal-exposed funds that comes on top of a higher propensity to vote in favor of ESG shareholder proposals in scandal firms. In Table 11, we further confirm that our results are not driven by the votes in scandal firms by showing that our results remain unchanged when we remove stocks with scandals in the previous 12 months from the sample.

company's headquarter are located in the same state. As time-varying fund level variables, we include the fund return over the previous year and fund size (measured as total net assets). Including these control variables barely changes our results (see below), suggesting that omitted variable concerns are small.

We two-way cluster standard errors at the fund and shareholder meeting level. Clustering at the shareholder meeting level is more conservative than clustering at the vote level because it accounts for correlation between votes on different proposals voted at the same shareholder meeting.

b. Are funds exposed to ESG scandals more likely to vote for ESG proposals?

We present the results for all funds in Table 3 Panel A. Column (1) shows the baseline without controls. We find that having a higher *ESG scandal experience* is statistically significantly related to voting more often in favor of a shareholder proposal. Next, we control for the position size, a dummy variable for whether the fund and the company are headquartered in the same state, fund size, and the fund return over the past 12 months. As shown in column (2), the result is robust to the inclusion of these control variables. In terms of economic magnitude, a 1 percentage point increase in *ESG scandal experience* increases the probability of voting for an ESG shareholder proposal by 1.1 percentage points, corresponding to 3% of the mean vote share in favor of ESG proposals.[16] While the effect may appear small, we note that it is obtained in a saturated model (with vote fixed effects) and for the sample of all funds, some of which may not pay attention to ESG scandals of individual portfolio stocks.

Environmental and social proposals are about externalities and may have an ambiguous or even detrimental effect on firm value (Bénabou and Tirole, 2010; Li et al., 2023). In contrast, governance proposals usually increase firm value (Cunat et al., 2012; Renneboog and Szilagyi, 2011). In columns (3)-(6), we therefore split our sample by environmental or social (ES) and governance (G) proposals, respectively. We find that

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[16] A 1 percentage point increase is roughly equivalent to having 3-4 scandal months for averaged-sized portfolio positions over the past year.

our results remain of similar magnitude and are statistically significant for both types of proposals, suggesting that fund managers' reaction to ESG scandals is not only about performance.

In Panels B and C, we run our tests separately for active and passive funds. Given our earlier finding that only active funds suffer from outflows following scandals in portfolio stocks, we expect our results for fund voting to be concentrated in active funds. As shown in Panel B, we indeed find that the coefficient estimate for active funds increases and becomes significant at the 1% significance level. A 1 percentage point increase in *ESG scandal experience* now translates into a 1.4 percentage points larger ESG proposal vote share, a meaningful increase of 4%. In contrast, the result disappears when we limit the sample to passive funds in Panel C. Since passive funds have no discretion to sell a particular position, one could have expected them to exert more voice (Appel et al., 2016). Our results suggest that—at least in response to ESG scandals—this is not the case.

Given that we find no effect on passive funds, we focus on active funds for the remainder of the paper.

c. When do ESG scandals matter the most?

We next examine which ESG scandals have the largest effect on fund voting behavior. We start with the idea that funds will pay more attention to their largest stock positions (Schmidt, 2019). Thus, we split fund holdings for each fund-quarter by size into above and below median and compute *ESG scandal experience* separately for each group. This gives us two scandal experience measures for each fund: *ESG scandal experience – large positions*, which is based only on above median holdings and *ESG scandal experience – small positions,* which is only based on below median holdings. For comparison, we standardize both measures to have a mean of zero and a variance of one. Fixed effects and control variables are the same as above.

The results are presented in Table 4 columns (1) and (2). We see that the coefficient of *ESG scandal experience – large positions* is highly significant, and the size of its coefficient is larger than in the baseline. In contrast, *ESG scandal experience – small positions* is not significant. This finding is consistent with the

idea that fund managers pay more attention to scandals occurring for large portfolio positions, implying that their subsequent voting behavior is more influenced by these scandals.

Next, we examine whether an ESG scandal will be particularly shocking if it occurs for a stock with an unblemished ESG track record (e.g., a firm with few prior ESG incidents). To do so, we rely on (ex-ante) ESG risk ratings provided by RepRisk, which take 10 different values from D (worst) to AAA (best) with AA being the median rating. We split fund holdings by whether the ex-ante RepRisk rating is at least AA or A and worse; i.e., by whether the ESG scandal comes as a large or small surprise. We then compute separate *ESG scandal experience measures* for these two groups, standardize them, and include both in the same regression.

We display the results in Table 4 columns (3) and (4). *ESG scandal experience* computed using (ex-ante) highly rated firms ("large surprise") strongly affects future ESG votes, while *ESG scandal experience* computed using (ex-ante) low rated firms ("small surprise") does not. Hence, mutual fund managers respond more strongly to surprise scandals, consistent with these scandals drawing more attention.

In the spirit of Bolton et al. (2020), we investigate next whether ESG scandals affect funds differently depending on whether they appear to have strong views on ESG as displayed by their prior voting behavior. Specifically, we hypothesize that funds that consistently vote in favor or against ESG shareholder proposals will be less influenced by ESG scandals. We therefore distinguish between two groups of funds: those which are in the top or bottom quartile in terms of support for ESG proposals over the previous year and thus have "strong ESG priors," and those which are in the middle two quartiles and thus have "weak ESG priors." We then compute *ESG scandal experience – funds with weak ESG prior* (which is set equal to zero for funds with strong ESG priors) and *ESG scandal experience – funds with strong ESG prior* (which is set equal to zero for funds with weak ESG priors). We standardize both variables and include them in the same regression.

The results in Table 4 columns (5) and (6) confirm that ESG scandals particularly affect funds with weak (ex-ante) ESG priors, while funds with strong ESG priors are not significantly affected. This finding suggests that funds that have already "made up their mind" on ESG do not change their opinion after being exposed to ESG scandals, while funds without strong views on ESG are more likely to be swayed by scandals. It is also consistent with unreported results in which we find no change in voting behavior for pure ES funds.[17]

d. Separating between ES and G

In an effort to study whether different types of scandals affect different types of shareholder proposals, we attempt to classify scandals along the ES and G dimensions.[18] Our classification is made difficult, however, by the fact that many scandals touch on multiple dimensions.[19] For example, when Acadia Healthcare agrees to a settlement payment for an alleged fraudulent overcharging of Medicaid in August 2015, RepRisk also classifies this as "human rights abuses and corporate complicity," even though it clearly pertains to the governance dimension.

As reported in Appendix D, we find that both ES and G scandals affect both ES and G proposals with similar magnitude. We think this reflects the difficulty of cleanly classifying scandals into ES and G scandals, as well as the difficulty of cleanly mapping different types of scandals to different proposals. For instance, by improving overall governance, G proposals may help more than S proposals in avoiding future scandals involving consumer protection, which are classified as S scandals. An alternative interpretation is

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[17] In unreported results, we find that scandals have no effect on the voting behavior of "pure" ES funds (defined as funds that carry an environmental or social mandate in their names following Michaely et al., 2022). This result is arguably not surprising as we expect such funds to be sensitive to ESG concerns regardless of whether they recently experienced an ESG scandal or not. Indeed, in our data ES funds on average vote almost twice as often in favor of shareholders' ESG proposals (61.1% vs 35.9% for non-ES funds). In short, ES funds already support ESG proposals and ESG scandals therefore have no incremental effect.

[18] To classify scandals into ES and G, we rely on the monthly RRI percentages coming from E, S, and G as provided by RepRisk. When this information is missing, we classify scandals based on, in that order, the UN Global Compact (UNGC) principles (https://www.unglobalcompact.org/what-is-gc/mission/principles) or the related issues list available in the daily ESG incidents data provided by RepRisk. For example, if an ESG incident pertains to UNGC Principles 7-9, it is classified as an E scandal. Scandals pertaining to UNGC Principle 10 (anti-corruption) are classified as G, even though they admittedly also have a social dimension.

[19] As documented in Appendix C Panel B, RepRisks tags a total of 7,497 related topics for the 3,213 ESG scandals in our sample, i.e., on average of 2.3 related topics per scandal.

that mutual fund managers—perhaps owing to the popularity of the ESG label—lump E, S, and G dimensions together so that different types of scandals affect their voting on different types of ESG shareholder proposals. After all, scandals identified by RepRisk reflect negative media coverage and thus pose the same reputation risk, perhaps explaining why they elicit the same voting response.

e. Why do funds change their voting behavior after ESG scandals in their portfolio?

In this section, we shed light on why funds change their voting behavior after ESG scandals. Recall that ESG scandals are accompanied by negative returns and lead to fund outflows (confer Table 2). One possibility is therefore that funds change their voting behavior out of concerns about performance.

To see whether performance considerations matter, we examine whether funds react more to ESG scandals that are accompanied by negative stock returns. To obtain the scandal return, we rely on the daily ESG media coverage data and compute, for each stock-month with an ESG scandal, the average stock return reaction to ESG media articles over the day of the article and the following trading day (we use two days because some incidents may be reported after markets have closed). We then compute *ESG scandal experience* variables using different subsamples based on the average scandal return. The results are presented in Table 5. In columns (1) and (2), we split ESG scandals by whether the ESG scandal return is above or below the median and compute *ESG scandal experience* for each subgroup. The coefficient of *ESG scandal experience – below median return* is economically larger and more statistically significant than the coefficient for scandals with above-median returns. When we compare the effect of scandals with top vs. bottom quartile returns (columns (3) and (4)), the difference in coefficients widens. Indeed, scandals with above-quartile returns do not significantly affect future support for ESG proposals.

While these results show that performance considerations matter, we argue they are unlikely to be the full story. To see this, recall our earlier finding that ESG scandals affect the voting for both ES and G proposals by similar magnitudes (see Table 3). Existing literature suggests, however, that only the passage of governance proposals increases shareholder value (Cunat et al., 2012), whereas support for ES proposals—

while more predictive of future ES incidents (He et al., 2023)—is if anything linked to future underperformance (Li et al., 2023). Thus, if scandal-exposed funds cared only about performance, we would have expected them to increase their support for G but not for ES proposals.

Finally, we address the possibility that funds blame management for ESG scandals thereby making them less "management-friendly" and explaining why they start voting for shareholder proposals (which are usually opposed by the management). To do so, we investigate whether ESG scandals also affect funds' voting behavior for management proposals. The idea is that, if ESG scandals make funds more hostile towards management, we would expect them to become less likely to vote in favor of management proposals. Instead, we find in Appendix E that ESG scandal experiences have no significant effect on funds' voting behavior for management proposals. Hence, funds respond to ESG scandals out of concerns for ESG performance and risk, instead of a changing attitude towards management.

5. Results for Exit

a. Empirical methodology

In this section, we study how mutual funds reallocate their portfolios following ESG scandals. As explained in Section 3 (see also Appendix B), mutual funds that care about their own portfolio-level ESG risk exposure ("narrow mandate") are expected to reduce their holdings in high-ESG risk stocks. In contrast, mutual funds that care about ESG risks outside their portfolios ("broad mandate") have no reason to reduce (and may even increase) their holdings in high-ESG risk stocks (which have a large potential benefit from engagement).

We start from the sample of quarterly portfolio holdings reported in the CRSP mutual fund holdings database for the 2006-2018 period. We create a dummy variable *D(Sell)*, which equals one if the fund reduces the number of shares held in a given stock over the quarter (and zero if the number of stocks

increased or remained constant).[20] We then run the following regression with *D(Sell)* as the dependent variable:

$$D(Sell)_{f,i,t} = \alpha_{i,t} + \alpha_f + \beta_1 * ESG\ scandal\ experience_{f,t}$$

$$+ \beta_2 * ESG\ scandal\ experience_{f,t} * D(RepRisk\ rating\ low)_{i,t-1} + \beta_3 * Controls + \varepsilon_{f,i,t},$$

where f indexes the fund, i indexes the stock, and t indexes the quarter. ESG scandal experience is now computed over the current quarter given that funds can immediately adjust their portfolios after a scandal (in contrast to the voice tests, as funds can only vote at the next annual meeting). *D(RepRisk rating low)* is a dummy variable equal to one if the firm's RepRisk rating was A or worse (i.e., below median) at the end of the previous quarter.[21] Stocks with a low RepRisk rating are prone to experience future ESG incidents, either because they have had ESG incidents in the past or because they belong to a sector with lots of ESG incidents.[22] Thus, stocks with a low RepRisk rating have high ESG risk. Our key variable of interest is β_2, which captures whether funds are more likely to sell high-ESG risk stocks after experiencing ESG scandals in their portfolios. We include stock-quarter fixed effects ($\alpha_{i,t}$), thereby controlling for all stock-time-specific reasons for why funds may want to sell a given stock in a given quarter.[23] Thus, analogous to our voting specification, we examine how different funds trade the same stock depending on ESG scandals in their portfolios. We also include fund fixed effects and the same controls as before (position size, same-state dummy, past fund return, and fund size). We two-way cluster standard errors by fund and quarter.

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[20] We make sure to also include complete selloffs, i.e., when a fund does not report holding any shares in a stock in which it had reported holdings at the end of the previous quarter. Such complete selloffs are relatively rare (18% of all sells).

[21] Firms that are not in the RepRisk data have not yet had any ESG incidents. We therefore set *D(RepRisk rating low)* to zero for these firms.

[22] See https://www.reprisk.com/lab/reprisk_rating.html for information on the calculation and interpretation of the RepRisk rating. In unreported results, we verify that firms with a low RepRisk rating experience more ESG incidents going forward.

[23] The level effect of *D(RepRisk rating low)* is subsumed by the stock-quarter fixed effects.

b. Do funds exit from high-ESG risk stocks following ESG scandals?

Table 6 presents our results. In columns (1) and (2), we focus on active funds. The coefficient of the interaction between *ESG scandal experience* and *D(RepRisk rating low)* is positive and significant at the 1 percent confidence level, suggesting that active funds are more likely to divest stocks with high ESG risks after they experience ESG scandals in their portfolios. In terms of economic magnitude, a one percentage point increase in scandal experience increases the probability to sell by 0.63 percentage points, corresponding to a 2% increase relative to the unconditional sell probability (of around 1/3). The result remains significant after adding our usual set of control variables in column (2). In columns (3) and (4), we show that, in contrast to active funds, scandal-exposed passive funds are not more likely sell high-ESG risk stocks. This result is expected as passive funds have much less discretion to reallocate their portfolios for reasons unrelated to index membership.

c. Which types of scandals affect exit the most?

In this subsection, we examine which ESG scandals most cause mutual funds to divest from high-ESG risk stocks. We examine the same characteristics that we examined for votes. First, we study if ESG scandals of larger positions have a larger effect. As before, we do this by computing two measures of *ESG scandal experience*: *ESG scandal experience – large positions* and *ESG scandal experience – small positions,* which are based, respectively, on fund positions that are either above or below median for a given fund-quarter. We then interact both of these variables with *D(RepRisk rating low)* and include them in the same regression.

The results are presented in columns (1) and (2) of Table 7. The coefficient for the interaction with ESG scandal experience based on large positions is large and statistically significant while that for small positions is not. Thus, as before, ESG scandals for above-median portfolio positions have a bigger effect. Next, in columns (3) and (4), we create two *ESG scandal experience* variables based on whether the scandal firm had a high or a low ex-ante RepRisk rating; i.e., based on whether the scandal comes as a large or small surprise. We find that the interaction including *ESG scandal experience – large surprise* is positive

and statistically significant while the one for *ESG scandal experience – small surprise* is not significant and even slightly negative. This finding suggests that, consistent with the results for voice, more surprising ESG scandals lead to larger divestment effects on firms with high ESG risk.

Finally, we construct two ESG scandal experience variables based on whether the scandals were accompanied by above or below median returns. We find that the interaction including *ESG scandal experience – below median return* is positive and statistically significant, while the one for *ESG scandal experience – above median return* is not significant and close to zero. Hence, funds react more to scandals accompanied by below-median returns. In short, our findings for exit closely dovetail those for voice.

d. How do funds decide between voice and exit?

Our results for exit suggest that scandal-exposed mutual funds follow a narrow mandate: they exit high-ESG risk positions to reduce ESG risks in their portfolios even if this comes at the cost of reducing their voting power. In contrast, funds following a broad mandate (i.e., if they were impact-seeking) should, if anything, increase their stakes in high-ESG risk stocks as engagement has a larger potential impact for those stocks.

In this subsection, we test the corollary that, for funds with a narrow mandate, exit and voice are substitute strategies to reduce portfolio-level ESG risks (see Appendix B). Specifically, we study whether funds are more likely to use exit when voice is less likely to succeed. To do so, we use our regression setup at the individual stock position level with *D(Sell)* as the dependent variable and run interaction tests based on three different proxies for the expected effectiveness of voice.

Our first proxy is based on whether the firm had, in the prior year, a vote on an ESG-related shareholder proposal that either passed or was close to passing (i.e., failed by less than ten percentage points). The idea is that the passage or near-passage of an ESG proposal is a strong signal that other like-minded investors are present and that, therefore, engagement through voting can succeed (again). We thus interact *ESG*

scandal experience with a dummy that takes the value one for high-ESG risk firms (i.e., RepRisk rating of A or worse) that had such a prior vote as well as with a dummy variable for high-ESG risk firms without such a vote. As shown in Table 8 columns (1) and (2), we find that scandal-exposed funds are significantly more likely to sell high-ESG risk stocks with no passed or almost passed ESG vote, while the interaction coefficient for high-ESG risk stocks with a passed or almost passed ESG vote is smaller and insignificant (but still positive).

The second proxy for engagement success is based on a predictive regression model. Specifically, we run a firm-year (pooled) regression with the fraction of passed ESG proposals as the dependent variable. As explanatory variables we use fixed effects for year, 48-Fama-French industries, 5 size quintiles, and 5 institutional ownership quintiles.[24] We use the coefficients from this regression to predict the likelihood of passing an ESG proposal for all firms in our sample (including those that never passed an ESG proposal). We then interact *ESG scandal experience* with dummies for high-ESG risk stocks with an above- or below-median predicted likelihood of passing an ESG proposal. As can be seen from the positive significant interaction coefficients shown in Table 8 columns (3) and (4), scandal-exposed funds are more likely to sell high-ESG risk stocks regardless of whether these stocks had an above or below-median likelihood of passing an ESG proposal, but the effect is slightly larger for stocks with a below-median likelihood of passing an ESG proposal.

As a third proxy for the effectiveness of voice, we use the fund's ownership stake measured as the fraction of the number of shares outstanding of a given stock that is held by the fund. The idea is that a fund owning a larger stake in the firm is more likely to effectively influence the firm's management. We thus interact *ESG scandal experience* with a dummy that takes the value one for high-ESG risk firms with above-median

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[24] Year dummies account for the fact that investors have become more sensitive of ESG over time. Industry fixed effects control for differences in ESG importance across industries. Size quintiles account for the fact that larger firms face more public scrutiny to adopt good ESG practices. Institutional ownership quintiles account for the fact that institutional owners are more likely to vote in favor of ESG shareholder proposals compared to individual investors (see Thomas and Cotter, 2007; Crane et al., 2016; and Chen et al., 2020).

ownership stakes and another dummy for high-ESG risk firms with below-median ownership stakes. As can be seen from the positive significant interaction coefficients shown in columns (5) and (6), scandal-exposed funds are more likely to sell high-ESG risk stocks in which they hold small ownership stakes. In contrast, scandal-exposed funds hold on to high-ESG risk stocks in which they have larger stakes, presumably because they expect to be better able to reduce ESG risk in these stocks through engagement.

Taken together, these results suggest that scandal-exposed funds choose exit when they expect voice to be more difficult, consistent with a narrow mandate. Moreover, the fact that funds are (if anything) also more likely to *sell* high-ESG risk stocks that are engageable suggests that they do not seek impact. Indeed, such stocks should be attractive targets for impact-seeking investors. Yet, the scandal-exposed funds in our sample do not increase their holdings (and thus their voting power) in these stocks, inconsistent with a broad mandate.[25]

6. Portfolio-level ESG risks and ESG proposal support

In this section, we study how funds' responses to portfolio scandals affect fund-level ESG risks and firm-level ESG proposal support. Our results so far indicate that funds prioritize mitigating ESG risks in their portfolios over impact (consistent with a narrow mandate). We therefore expect to find a reduction in fund portfolio-level ESG risks, while the effect on overall ESG proposal support may be weak.

a. Do fund-level ESG risks change?

We look at two measures to study how portfolio-level ESG risks change after scandal exposure: the change in the value-weighted average RepRisk rating of the fund's portfolio and the fund-level ESG scandal experience *next* quarter.[26] We then regress both measures on our usual fund-level ESG scandal experience

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[25] When we run the regressions with *D(Buy)* instead of *D(Sell)* as dependent variable (where *D(Buy)* also captures newly established positions), we find a negative coefficient on the interaction between ESG scandal experience and "easier-to-engage" high-ESG risk stocks (results available upon request). Hence, scandal-exposed funds are not more likely to buy these attractive engagement targets.

[26] To compute the average rating change, we assign numeric values to the RepRisk rating categories from 1 (D) to 10 (AAA). Importantly, when computing this change, we keep the RepRisk rating of the stocks constant at last quarter's values. This ensures

variable in a fund-quarter panel regression with fund return and fund size controls as well as fund and quarter fixed effects.

Table 9 presents our results. We find that funds experiencing more ESG scandals during a given quarter improve their average portfolio RepRisk rating more (columns (1) and (2)), leading them to experience fewer ESG scandals in the future (columns (3) and (4)). These findings confirm that (partial) exits of high-ESG risk stocks improve the future ESG risk profile of scandal-exposed funds (and are not offset by other sales or purchases). As explained before, such a behavior is more consistent with funds caring about portfolio-level ESG risks, and less consistent with them pursuing impact (by targeting high-ESG risk stocks).

b. Do ESG shareholder proposals receive more support?

Next, we study whether the change in fund behavior following ESG scandals has an impact on the firm-level vote support for ESG shareholder proposals. Given our earlier findings that scandal-exposed funds use both more voice and more exit (which reduces voting power), the overall effect on the support for ESG shareholder proposals is unclear (see also Appendix B). Only for high-ESG risk firms that are expected to be more engageable, which funds therefore do not exit (see Table 8 above), we expect a positive effect on ESG proposal support.

We regress *proposal support*, defined as the fraction of votes in favor of the proposal, on ESG scandal experience averaged at the firm level (i.e., active funds' ESG scandal experience averaged across funds weighted by position weights at the end of the quarter preceding the vote). We include standard control variables for vote-level regressions (see, e.g., Iliev and Lowry, 2015): a dummy whether ISS recommends voting in favor of the proposal, the (natural logarithm of) total assets, the market-adjusted stock return over the previous 12-months, ROA, leverage, and institutional ownership. We further include ISS proposal type

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that the observed portfolio-level rating changes are driven by fund-level portfolio reallocation decisions (instead of actual stock-level rating changes).

fixed effects, year fixed effects, and—in some specifications—firm fixed effects. As reported in Table 10 Panel A, when looking at all votes on ESG shareholder proposals, we do *not* find that active funds' average ESG scandal experiences correlate with a higher proposal support at the firm level, consistent with the idea that—for the average firm—exit undermines voice.

We then focus on votes for high-ESG risk firms that are expected to be engageable. To the extent that votes for these firms matter (as there is a large room for improvement of ESG risks) and are more likely to pass, scandal-exposed funds have no reason to sell them (as documented in Table 8), implying that average ESG scandal exposure may correlate positively with a higher proposal support. In Panel B, we proxy for engageability by whether the vote passes or is close to passing, based on the idea that, by talking to each other and/or by relying on public information, funds can (imperfectly) foresee which votes have a chance of passing (Cunat et al., 2012). In Panels C and D, we proxy for engageability using the (regression-based) predicted likelihood of ESG proposal passage and the size of funds' ownership stakes introduced in Section 5.d. In all cases, we find that, for votes in high-ESG risk firms that are engageable, ESG scandal experience predicts a marginally significantly higher vote support for ESG shareholder proposals, while it does not for the other votes.

Overall, the results in this section are again consistent with scandal-exposed funds following a narrow mandate: they prioritize reducing portfolio-level ESG risks through exit, instead of maximizing their impact through voice. As a consequence, they only seem to have an impact on a small subset of votes (for high-ESG risk firms that are engageable).

7. Robustness checks

In this section, we present several robustness checks for our voice and exit tests. We start by addressing the fact that our main regressions for voice and exit include scandal months. Note that this is *a priori* not a problem since our high-dimensional (e.g., vote or stock-quarter) fixed effects ensure we control for the

average effect of scandals on voting and exiting behavior. Indeed, due to these fixed effects, the coefficient on ESG scandal experience always reflects the incremental effect due to differences in scandal exposure across funds. Nevertheless, one may wonder whether this incremental effect is driven by scandal-month observations. We therefore repeat our main regression for voice (i.e., with *D(Vote for ESG proposal)* as the dependent variable) after excluding stocks that had an ESG scandal in the 12 months prior to the vote. As can be seen in Table 11 Panel A columns (1) and (2), our results remain statistically significant at the 1 percent level and the economic magnitude is close to unchanged. Similarly, in Panel B columns (1) and (2), we show that our exit results (i.e., with *D(Sell)* as the dependent variable) remain statistically significant and economically meaningful when we exclude stocks that experienced an ESG scandal in the current quarter.

Next, we present additional robustness checks specific to our voice analysis. Recall that our baseline tests measure ESG scandal experience at the *fund* level. However, several financial institutions—such as Blackrock (Dougherty et al., 2022)—have stewardship teams at the family level that oversee corporate governance of their portfolio firms and give voting recommendations for funds in the family. To see whether scandal exposure at the *family* level also matters for funds' voting behavior, we create *ESG scandal experience measure – family* as the average of all the family's ESG scandals in the past 12-months weighed by the family's stock positions after excluding the voting fund's positions. By construction, this measure accounts for family experience effects outside of the fund's own ESG scandal experience. We then re-run our vote level regression while including this family level experience variable alongside our usual (fund level) ESG scandal experience variable. As shown in columns (3) and (4) of Panel A, we find that only the fund level experience variable is strongly significant while the family-based experience variable is insignificant, suggesting that only a fund's own ESG scandal experience matters for its voting behavior. Motivated by the debate about whether mutual funds over-rely on proxy advisors (Iliev and Lowry, 2015), we then run our vote analysis separately for whether ISS is in favor or against the specific shareholder proposal. Results in columns (5) to (8) show that the ESG scandal experience measure affects funds' votes

for both ESG proposals for which ISS recommends voting in favor (columns (5) and (6)) and those for which it recommends voting against (columns (7) and (8)). If anything, the effect seems to be slightly stronger when ISS recommends voting against the proposal, perhaps because many funds vote in favor of ESG proposals irrespective of their scandal experience when the ISS recommendation is favorable.

We next address a concern specific to the exit analysis. Indeed, we find that ESG scandals lead to fund outflows (confer Table 2). If these outflows trigger sells that are concentrated in high-ESG risk stocks, this could potentially explain our exit result. To account for this issue, we define a flow-adjusted sell dummy that takes the value one if the fund is reducing its position in a given stock by more than what would be necessary to accommodate the fund's outflow.[27] As shown in Panel B columns (3) and (4), when we use this flow-adjusted sell dummy as the dependent variable for our exit test, our results remain highly significant and increase in economic magnitude. This finding suggests that our exit result is not driven by outflows following ESG scandals.

Finally, we show additional robustness checks regarding specific data assumptions and variable definitions—for voice in Panel C and for exit in Panel D. Recall that, when constructing our *ESG scandal experience* variable, we treat firms that are not in RepRisk as never having had an ESG scandal, i.e. we fill in zeros for them. We do this because RepRisk adds firms to RepRisk (and fills back zeros) once a company exhibits an ESG incident. Thus, if a company is not in RepRisk, this means that it never had a media-covered ESG scandal. In Panels C and D, we instead treat firms not in RepRisk as missing observations when creating the ESG scandal experience variable. As seen in columns (1) and (2), both our voice and exit results remain significant at the 1% level and of similar economic magnitude.

Next, we assess robustness with respect to the 25 points cutoff for the change in the RepRisk index that we use to define an ESG scandal. Our cutoff choice of 25 points was motivated by the fact that it corresponds

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[27] For example, if a fund has a 5% outflow, the flow-corrected sell dummy for that fund only flags position reductions by more than 5%. Hence, a fund that only scales up or down its portfolio in response to flows would not record any sells with this definition.

to the 90th percentile of monthly ESG increases and the RepRisk index decays at different speeds above and below 25 points. Nonetheless, we show that our results are robust to defining ESG scandals using a 30 or 20 points cutoff, respectively. These seemingly small changes to the definition produce a meaningful change to the number of scandals: using a cutoff of 30 points reduces the number of scandals by about a third, while using a cutoff of 20 points increases the number of scandals by about two-thirds. As shown in columns (3) to (6), using these alternative cutoffs to define ESG scandals does not meaningfully change our results. Finally, in columns (4) and (8), we show that our results are robust to changing the time window over which we compute ESG scandal experience to 6 months.

8. Conclusion

In this paper, we study how prior investment experiences shape mutual fund managers' perception of ESG risks and their subsequent behavior. Specifically, we show that, after being exposed to ESG scandals in their portfolios, active (but not passive) funds are more likely (1) to vote in favor of ESG-related shareholder proposals and (2) to reduce their stakes in high-ESG risk stocks. Both findings are more pronounced when scandal stocks have a larger portfolio weight, when scandals were less expected, and when they are accompanied by negative stock returns. Moreover, we find that managers are more likely to sell high-ESG risk stocks when they are expected to be less engageable, suggesting that they treat exit and voice as substitute strategies.

Our findings highlight a tension between exit and voice: by reducing their portfolio positions in high-ESG risk stocks, funds undermine their voting power in precisely those stocks that arguably have the biggest need of reform. This suggests that scandal-exposed mutual funds prioritize limiting exposure to ESG risks in their portfolios (consistent with a narrow mandate), instead of maximizing their impact through voice (as would be expected for a broad mandate). As a result, funds' portfolio-level ESG risk exposure decreases, while their overall impact on vote outcomes is limited.

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Table 1: Summary statistics

This table displays summary statistics. In Panel A, we display the summary statistics for the RepRisk data at the stock-month level. *RepRisk Index* (RRI) is an index, between 0 and 100, computed by RepRisk that increases when the company has an ESG incident and slowly decreases otherwise. *D(RepRisk Index increased)* is a dummy variable equal to one if the *RepRisk Index* increased in that month and *Size of RepRisk Index increase* shows the size of that increase in index points (for the cases where there is an increase). *D(RepRisk index increase>25)* is a dummy variable equal to 1 if the RepRisk Index increased over 25 points. In Panel B, we display summary statistics at the fund-quarter and fund-month level. We show the average, median, and maximum of portfolio weights as a fraction of fund assets including only positions with a PERMNO. We also show the number of positions with a PERMNO, *Fund Size*, which is the fund's total net assets in $ million, monthly fund returns, and fund flows. In Panel C, we display vote-level data. *ESG scandal experience* is the fraction of equity holdings of the funds over the past year that experienced an ESG scandal. *Position size* is the size of the equity position that the fund holds in the firm as a fraction of the firm's total shares outstanding. *D(same state)* is a dummy variable equal to one if the fund and the firm are headquartered in the same state. In Panel D, we show summary statistics for the fund-stock-quarter level data that we use for our divestment tests. *D(Sell)* equal to 1 if the fund decreases the number of shares of the firm it holds and equal to 0 if it keeps the number of shares constant or increases it. *D(RepRisk rating low)* is equal to one if the firm's RepRisk rating is A or worse. Details on variable constructions can be found in Appendix A.

Panel A: Rep Risk data (stock-month level)

Variable	Mean	10th Percentile	Median	90th Percentile	Standard Deviation
RepRisk Index (RRI)	7.53	0	0	24	11.8
D(RepRisk Index increased) (%)	6.57	0	0	0	24.8
Size of RepRisk Index increase (only increases)	9.70	2	6	25	9.44
D(RepRisk index increase>25) (%)	0.58	0	0	0	7.59
D(RepRisk index increase>30) (%)	0.39	0	0	0	6.22
D(RepRisk index increase>20) (%)	0.95	0	0	0	9.70
Observations	553960				

Panel B: Fund-time level data

Variable	Mean	10th Percentile	Median	90th Percentile	Standard Deviation
Average portfolio weight (%)	3.26	0.28	1.72	9.09	4.20
Median portfolio weight (%)	2.68	0.15	1.39	6.87	3.69
Largest portfolio weight (%)	9.61	2.11	5.47	23.8	10.7
Number of positions (with PERMNO)	146.0	11	58	356	304.3
Fund Size (m$)	412.5	0.40	35.9	882.4	1253.8
Monthly fund return (%)	0.46	-3.83	0.40	4.83	3.81
Monthly fund flow (%)	1.64	-4.78	-0.27	7.07	13.5
Observations	749351				

Panel C: Vote-level data

Variable	Mean	10th Percentile	Median	90th Percentile	Standard Deviation
D(Vote for ESG proposal) (%)	36.8	0	0	100	48.2
ESG scandal experience (%) – 12 months	0.35	0.04	0.28	0.73	0.30
Position size (%)	0.064	0.0002	0.005	0.11	0.28
D(same state) (%)	5.73	0	0	0	23.2
Observations	2051198				

Panel D: Fund-stock-quarter data

Variable	Mean	10th Percentile	Median	90th Percentile	Standard Deviation
D(Sell) (%)	36.8	0	0	100	48.2
D(RepRisk rating low) (%)	48.8	0	0	100	50.0
ESG scandal experience (%) – 3 months	0.39	0	0.30	0.89	0.41
Observations	38714631				

Table 2: Should mutual funds care about ESG scandals?

In this table, we show that even performance-driven mutual funds should care about ESG scandals. In Panel A, we show cumulative market-adjusted returns around ESG incidents recorded during ESG scandal-months (i.e., months where the RepRisk index increases by 25 points). Standard errors are two-way clustered by stock and month. In Panel B, we examine if funds experience outflows after having ESG scandals in their portfolio firms. For this purpose, we regress monthly fund flows on *ESG scandal experience*, which measures the fraction of funds' equity holdings over the previous 12 months that experienced an ESG scandal. Columns 1 and 2 show results for all funds, columns 3 and 4 show results for actively-managed funds, and columns 5 and 6 show results for passively-managed funds. In all regressions, we control for fund size, defined as funds' assets under management at the end of the previous month, fund returns over the previous 12 months, month fixed effects, and fund fixed effects. In columns 2, 4, and 6 we additionally control for the fund return in the current month. Standard errors are two-way clustered by fund and month. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Panel A: Stock returns around ESG scandals

Return window:	[0, 1]	[0, 20]	[-5, 20]
	(1)	(2)	(3)
Cumulative market-adjusted return (%)	-0.23***	-0.40***	-0.75***
	(-4.49)	(-2.72)	(-4.35)
N	4376	4376	4376

Panel B: Fund flows and ESG scandal experience

Dependent variable:	Fund flows (%)					
Sample:	All funds		Active funds		Passive funds	
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience (%)	-0.118**	-0.118**	-0.124***	-0.124***	-0.087	-0.083
	(-2.57)	(-2.60)	(-2.68)	(-2.68)	(-0.57)	(-0.58)
Fund Return$_t$ (%)		0.089***		0.058***		0.307***
		(5.68)		(3.82)		(9.59)
Fund Return$_{t-12,t-1}$ (%)	1.294***	1.306***	1.307***	1.314***	1.234***	1.274***
	(18.52)	(19.14)	(19.16)	(19.59)	(9.18)	(9.70)
Fund Size$_{t-1}$	-1.811***	-1.804***	-1.765***	-1.761***	-2.561***	-2.536***
	(-32.75)	(-32.89)	(-31.75)	(-31.83)	(-16.39)	(-16.40)
Observations	1809230	1809230	1617457	1617457	191773	191773
Adjusted R^2	0.113	0.114	0.115	0.115	0.113	0.117
Month fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Table 3: Funds with ESG scandal experience support ESG proposals

This table displays regressions examining if funds are more likely to vote for ESG shareholder proposals if they experienced more ESG scandals in their portfolio holdings in the previous year. The dependent variable is a dummy variable equal to one if the fund votes in favor of the proposal and equal to zero if it votes against or abstains. The explanatory variable of interest is *ESG scandal experience*, which measures the fraction of equity holdings of the funds over the past year that experienced an ESG scandal (in percent). In columns 2, 4, and 6, we include the following control variables: *Position size* is the size of the equity position that the fund holds in the firm as a fraction of the firm's total equity. *D(same state)* is a dummy variable equal to one if the fund and the firm are headquartered in the same state. $Fund\ Return_{t,t-12}$ is the cumulated fund return over the past year. $Fund\ Size_{t-1}$ is the natural logarithm of total net assets of the fund at the beginning of the quarter. In Panel A, we include all funds. In Panel B, we focus on active funds. In Panel C, we focus on passive funds. In all regressions, we include vote fixed effects and fund fixed effects. Standard errors are two-way clustered by fund and shareholder meeting. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Panel A: All funds

Dependent variable:	D(Vote for ESG proposal) (%)					
Sample:	All ESG proposals		ES proposals		G proposals	
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience (%)	1.156**	1.102**	1.001**	0.994*	1.449***	1.401***
	(2.52)	(2.36)	(2.03)	(1.96)	(2.73)	(2.58)
Position size (%)		-1.337***		-2.554***		-0.948**
		(-4.04)		(-6.71)		(-2.18)
D(same state)		-0.464		0.074		-0.636
		(-1.18)		(0.15)		(-1.35)
$Fund\ Return_{t-12,t-1}$ (%)		-0.304**		-0.117		-0.423**
		(-2.07)		(-0.72)		(-2.41)
$Fund\ Size_{t-1}$		-0.082		0.310*		-0.242
		(-0.53)		(1.87)		(-1.38)
Observations	2051198	1911836	724288	681261	1326910	1230575
Adjusted R^2	0.510	0.510	0.494	0.493	0.508	0.509
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Panel B: Active funds

Dependent variable:	D(Vote for ESG proposal) (%)					
Sample:	All ESG proposals		ES proposals		G proposals	
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience (%)	1.465***	1.403***	1.371***	1.362***	1.778***	1.723***
	(3.29)	(3.18)	(2.78)	(2.71)	(3.29)	(3.17)
Position size (%)		-1.273***		-2.642***		-0.633
		(-3.68)		(-6.58)		(-1.38)
D(same state)		-0.817*		-0.244		-0.793
		(-1.79)		(-0.42)		(-1.47)
$Fund\ Return_{t-12,t-1}$ (%)		-0.155		-0.063		-0.196
		(-0.96)		(-0.34)		(-1.00)
$Fund\ Size_{t-1}$		-0.045		0.172		-0.041
		(-0.23)		(0.87)		(-0.19)
Observations	1347695	1243352	487892	455037	859803	788315
Adjusted R^2	0.509	0.509	0.497	0.497	0.505	0.506
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Panel C: Passive funds

Dependent variable:	D(Vote for ESG proposal) (%)					
Sample:	All ESG proposals		ES proposals		G proposals	
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience (%)	-0.608	-0.581	-1.254	-1.378	-0.352	-0.286
	(-0.37)	(-0.33)	(-0.79)	(-0.81)	(-0.21)	(-0.16)
Position size (%)		0.009		-1.724		0.237
		(0.01)		(-1.26)		(0.16)
D(same state)		-0.428		0.303		-1.014
		(-0.65)		(0.41)		(-1.24)
Fund Return$_{t-12,t-1}$ (%)		-0.721**		-0.380		-1.015***
		(-2.17)		(-1.09)		(-2.69)
Fund Size$_{t-1}$		-0.430		0.131		-0.759**
		(-1.60)		(0.48)		(-2.41)
Observations	703503	668484	236396	226224	467107	442260
Adjusted R^2	0.533	0.532	0.507	0.504	0.536	0.536
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Table 4: Which ESG scandals affect fund voting the most?

In this table, we examine which types of ESG scandals affect funds' voting decisions the most. We split scandals by position size, ex-ante ESG rating of the scandal firm, and the funds' past voting pattern on ESG proposals. For the first test (columns (1) and (2)), we create two variables of *ESG scandal experience*, one based on ESG scandals for positions that are above the median by size and the other based on ESG scandals for below-median positions. For the second test (columns (3) and (4)), we create two variables of *ESG scandal experience*, one based on ESG scandals that come as a large surprise (i.e., for positions in firms with an ex-ante RepRisk rating of AA or better), and the other based on ESG scandals that come as a small surprise (i.e., in firms with an ex-ante RepRisk rating of A or worse). For the third test (columns (5) and (6)), we split the sample into funds that have strong ESG priors (i.e., are in the top or bottom quartiles by average support for ESG shareholders' proposals in the previous year) versus funds that have weak ESG priors (i.e., are in the two middle quartiles). For ease of comparison, we standardize all ESG scandal experience variables to have mean zero and variance one. Other variables are defined as above (and as explained in Appendix A). We limit our sample to actively-managed funds. In all regressions, we include vote fixed effects and fund fixed effects. Standard errors are two-way clustered by fund and shareholder meeting. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:	D(Vote for ESG proposal) (%)					
Sample:	All ESG proposals					
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience – large positions	0.473***	0.454***				
	(3.75)	(3.63)				
ESG scandal experience – small positions	0.007	-0.000				
	(0.06)	(-0.00)				
ESG scandal experience – large surprise			0.473***	0.515***		
			(3.43)	(3.85)		
ESG scandal experience – small surprise			0.060	0.002		
			(0.58)	(0.02)		
ESG scandal experience – weak ESG prior					0.713***	0.672***
					(3.99)	(3.82)
ESG scandal experience – strong ESG prior					0.157	0.166
					(0.94)	(0.99)
Position size (%)		-1.271***		-1.275***		-1.176***
		(-3.67)		(-3.69)		(-2.88)
D(same state)		-0.818*		-0.817*		-0.395
		(-1.79)		(-1.79)		(-0.72)
Fund Return$_{t-12,t-1}$ (%)		-0.156		-0.148		-0.334
		(-0.97)		(-0.91)		(-1.56)
Fund Size$_{t-1}$		-0.046		-0.045		-0.132
		(-0.23)		(-0.23)		(-0.54)
Observations	1347695	1243352	1347695	1243352	929335	865544
Adjusted R^2	0.509	0.509	0.509	0.509	0.517	0.516
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Table 5: Scandals with negative returns affect fund's voting more

In this table, we examine if ESG scandals that are accompanied by lower stock returns affect funds' voting behavior more. For this purpose, we create two pairs of ESG scandal experience variables based on ESG scandals with stock returns that are (1) above/below median or (2) in the top/bottom quartile, respectively. For ease of comparison, we standardize all ESG scandal experience variables to have mean zero and variance one. For more details on variable construction see Appendix A. We limit our sample to actively-managed funds. In all regressions, we include vote fixed effects and fund fixed effects. Standard errors are two-way clustered by fund and shareholder meeting. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:	D(Vote for ESG proposal) (%)			
Sample:	All ESG proposals			
	(1)	(2)	(3)	(4)
ESG scandal experience – below median return	0.319***	0.293***		
	(2.97)	(2.73)		
ESG scandal experience – above median return	0.274**	0.287**		
	(2.38)	(2.44)		
ESG scandal experience – bottom quartile return			0.244***	0.238**
			(2.64)	(2.54)
ESG scandal experience – top quartile return			0.105	0.136
			(1.04)	(1.34)
Position size (%)		-1.272***		-1.270***
		(-3.68)		(-3.67)
D(same state)		-0.817*		-0.814*
		(-1.79)		(-1.78)
$Fund\ Return_{t-12,t-1}$ (%)		-0.161		-0.138
		(-1.00)		(-0.85)
$Fund\ Size_{t-1}$		-0.046		-0.044
		(-0.24)		(-0.22)
Observations	1347695	1243352	1347695	1243352
Adjusted R^2	0.509	0.509	0.509	0.509
Vote fixed effects	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes

Table 6: Funds divest firms with low ESG-ratings after ESG scandals

In this table, we examine if funds divest firms with low ESG ratings after experiencing an ESG scandal in their portfolios. The dependent variable is *D(Sell)*, which is a dummy variable equal to 1 if the fund decreases the number of shares of the firm it holds and equal to 0 if it keeps the number of shares constant or increases it. The explanatory variable of interest is the interaction between *ESG scandal experience* and *D(RepRisk rating low)*. *ESG scandal experience* measures the fraction of equity holdings of the fund that experience an ESG scandal in the current quarter. *D(RepRisk rating low)* is a dummy variable equal to one if the firm's RepRisk rating is A or worse. We include stock-quarter and fund fixed effects in all regressions. We limit our sample to actively-managed funds in regressions 1 and 2, and to passively-managed funds in regressions 3 and 4. Standard errors are two-way clustered by fund and quarter. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:	D(Sell) (%)			
Sample:	Active Funds		Passive Funds	
	(1)	(2)	(3)	(4)
ESG scandal experience	0.630^{***}	0.607^{**}	-0.081	-0.047
* D(RepRisk rating low) (%)	(2.71)	(2.31)	(-0.09)	(-0.05)
ESG scandal experience (%)	-0.448^{*}	-0.362	-1.876	-1.657
	(-1.71)	(-1.32)	(-1.46)	(-1.26)
Position size (%)		3.852^{***}		4.318^{**}
		(8.09)		(2.08)
D(same state)		-0.297^{**}		-0.080
		(-2.48)		(-0.77)
$Fund\ Return_{t-12,t-1}$ (%)		-3.018^{***}		-2.631^{***}
		(-5.09)		(-3.09)
$Fund\ Size_{t-1}$		2.107^{***}		3.903^{***}
		(4.00)		(3.71)
Observations	19104765	17594105	12203259	11491024
Adjusted R^2	0.169	0.173	0.231	0.231
Stock-quarter fixed effects	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes

Table 7: Which ESG scandals affect exit the most?

In this table, we examine which type of ESG scandals lead to bigger divestments from stocks with high ESG risks. The dependent variable is *D(Sell)*, which is a dummy variable equal to 1 if the fund decreases the number of shares of the firm it holds and equal to 0 if it keeps the number of shares constant or increases it. The explanatory variable of interest is the interaction between *D(RepRisk rating low)* and *ESG scandal experience* based on three different splits: whether the position was above or below median in size for the fund (columns (1) and (2)), whether the scandal comes as a large surprise (scandal stock has an ex-ante RepRisk rating of AA or better) or small surprise (scandal stock has an ex-ante RepRisk rating of A or worse) (columns (3) and (4)), and whether the scandal return was above or below median (columns (5) and (6)). For example, *ESG scandal experience – large position* is the fraction of a fund positions (weighted by size) that are above median and had an ESG scandal during that quarter. For ease of comparison, we standardize all ESG scandal experience variables to have mean zero and variance one. Control variables are omitted for brevity. In all cases, we include the constituents of the interaction as control variables. In columns (2), (4), and (6), we also include the following control variables: *Position size, D(same state), Fund Return$_{t-12,t-1}$,* and *Fund Size$_{t-1}$*. We limit our sample to actively-managed funds. We include fund and stock-quarter fixed effects. Standard errors are two-way clustered by fund and quarter. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:			D(Sell) (%)			
Sample:			Active Funds			
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience – large position * D(RepRisk rating low)	0.303*** (3.26)	0.284** (2.67)				
ESG scandal experience – small position * D(RepRisk rating low)	0.007 (0.10)	0.024 (0.33)				
ESG scandal experience – large surprise * D(RepRisk rating low)			0.322*** (3.66)	0.303*** (3.03)		
ESG scandal experience – small surprise * D(RepRisk rating low)			-0.093 (-0.85)	-0.112 (-0.88)		
ESG scandal experience – below median return * D(RepRisk rating low)					0.264*** (2.70)	0.292*** (2.77)
ESG scandal experience – above median return * D(RepRisk rating low)					0.057 (0.54)	-0.009 (-0.08)
Observations	19104765	17594105	19104765	17594105	19104765	17594105
Adjusted R^2	0.169	0.173	0.169	0.173	0.169	0.173
Control variables	No	Yes	No	Yes	No	Yes
Stock-quarter fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Table 8: Are firms more likely to exit if voice is more difficult?

In this table, we examine if scandal-exposed active funds are more likely to divest from high-ESG risk stocks in which a successful engagement (i.e., voice) is expected to be more difficult. The dependent variable is *D(Sell)*, which is a dummy variable equal to 1 if the fund decreases the number of shares of the firm it holds and equal to 0 if it keeps the number of shares constant or increases it. In columns (1) and (2), the explanatory variables of interest are the interactions between *ESG scandal experience* and, respectively, *D(RepRisk rating low & no close or passed ESG proposal)* and *D(RepRisk rating low & close or passed ESG proposal)*. *ESG scandal experience* measures the fraction of equity holdings of the fund that experience an ESG scandal in the current quarter, standardized to have mean zero and variance one. *D(RepRisk rating low & no close or passed ESG proposal)* is a dummy variable equal to one if the firm's RepRisk rating is A or worse and if the firm did not have a prior ESG proposal that either passed or was close to passing (i.e., failed by less than 10 percentage points). *D(RepRisk rating low & close or passed ESG proposal)* is a dummy variable equal to one if the firm's RepRisk rating is A or worse and if the firm had a prior ESG proposal that either passed or was close to passing (i.e., failed by less than 10 percentage points). In columns (3) and (4), the explanatory variables of interest are the interactions between *ESG scandal experience* and, respectively, *D(RepRisk rating low & low likelihood to pass ESG proposal)* and *D(RepRisk rating low & high likelihood to pass ESG proposal)*, which are based on whether the firm has a predicted likelihood of passing an ESG proposal that is below or above median. The likelihood of passing an ESG proposal is the predicted value of a regression of ESG proposal passage on dummy variables for year, Fama-French 48 industry, firm size quintiles, and institutional ownership quintiles. In columns (5) and (6), the explanatory variables of interest are the interactions between *ESG scandal experience* and, respectively, *D(RepRisk rating low & small stake in firm)* and *D(RepRisk rating low & large stake in firm)*, which are based on whether the size of the fund's ownership stake in the firm at the end of the previous quarter is below or above median. In all cases, we include the constituents of the interaction as control variables (not shown for brevity). In columns (2), (4), and (6) we also include the following control variables: *Position size, D(same state), Fund Return$_{t-12,t-1}$*, and *Fund Size$_{t-1}$*. We limit our sample to actively-managed funds. We include fund and stock-quarter fixed effects. Standard errors are two-way clustered by fund and quarter. We report *t*-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:	D(Sell) (%)					
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience *	0.279**	0.269**				
D(RepRisk rating low & no close or passed ESG prop.)	(2.64)	(2.28)				
ESG scandal experience *	0.172	0.159				
D(RepRisk rating low & close or passed ESG prop.)	(1.17)	(0.92)				
ESG scandal experience *			0.240***	0.218**		
D(RepRisk rating low & low likelihood to pass ESG prop.)			(2.88)	(2.34)		
ESG scandal experience *			0.200**	0.176*		
D(RepRisk rating low & high likelihood to pass ESG prop.)			(2.13)	(1.69)		
ESG scandal experience *					0.421**	0.386*
D(RepRisk rating low & small stake in firm)					(2.30)	(1.85)
ESG scandal experience *					0.005	-0.016
D(RepRisk rating low & large stake in firm)					(0.04)	(-0.14)
Observations	16270655	15173328	16467290	15349590	18924911	17594105
Adjusted R²	0.166	0.171	0.164	0.169	0.168	0.173
Interaction constituents	Yes	Yes	Yes	Yes	Yes	Yes
Control variables	No	Yes	No	Yes	No	Yes
Stock-quarter fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Table 9: Funds' ESG risk exposure improves after scandals

In this table, we examine if active funds improve their ESG risk exposure after being exposed to scandals in their portfolios. In columns (1) and (2), the dependent variable is the change in the value-weighted average RepRisk rating of the fund (using previous quarter's RepRisk rating). For this purpose, we assign numeric values to the rating categories from 1 (D) to 10 (AAA). In columns (3) and (4), the dependent variable is the fund's *ESG scandal experience* in the *next* quarter. The explanatory variable of interest is *ESG scandal experience*, which measures the fraction of equity holdings of the fund that experience an ESG scandal in the current quarter. We only include active funds. In all regressions, we include fund and quarter fixed effects. Standard errors are two-way clustered by fund and quarter. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:	Change in funds' average RepRisk rating		ESG scandal experience next quarter	
	(1)	(2)	(3)	(4)
ESG scandal experience	0.639**	0.633**	-0.044**	-0.047**
	(2.52)	(2.44)	(-2.64)	(-2.64)
$Fund\ Return_{t-12,t-1}$		-0.227		0.004
		(-0.85)		(0.21)
$Fund\ Size_{t-1}$		-0.003*		0.000
		(-1.78)		(1.21)
Observations	193483	180054	195022	180176
Adjusted R^2	-0.007	-0.004	0.157	0.153
Fund fixed effects	Yes	Yes	Yes	Yes
Quarter fixed effects	Yes	Yes	Yes	Yes

Table 10: Vote support increases after scandals only in engageable firms

In this table, we examine whether the overall support for ESG shareholder proposals is affected by the average ESG scandal experience of active funds holding the stock. The dependent variable is *Proposal Support*, which is defined as the fraction of votes in favor of the proposal. The explanatory variable of interest is *ESG scandal experience – Firm*, which is constructed as the weighted average of scandal experiences of all active funds holding the firm at the end of the quarter preceding the vote. Panel A shows results for all votes. Panel B shows results after splitting the sample between votes for firms with a low RepRisk rating and a close or passed ESG proposal (columns (1) and (2)) and votes for other firms (columns (3) and (4)). Panel C shows results after splitting the sample between votes for firms with a low RepRisk rating and an above-median predicted likelihood of passing an ESG proposal (columns (1) and (2)) and votes for other firms (columns (3) and (4)). Panel D shows results after splitting the sample between votes for firms with a low RepRisk rating and an above-median (weighted) average of the *large stake in firm* dummy used in Table 8 (columns (1) and (2)) and votes for other firms (columns (3) and (4)). We include the following control variables in all regressions: a dummy for whether ISS recommends supporting the proposal, log(total assets), the market-adjusted stock return over the previous 12-months, ROA, leverage, and institutional ownership. Control variables are omitted for brevity. We include year and proposal fixed effects in all regressions. Even columns further include firm fixed effects. Standard errors are clustered by firm. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Panel A: All votes

Dependent variable:	Proposal Support	
	(1)	(2)
ESG scandal experience – Firm	0.011	0.303
	(0.01)	(0.21)
Observations	6362	5998
Adjusted R^2	0.632	0.740
Control variables	Yes	Yes
Firm fixed effects	No	Yes
Year fixed effects	Yes	Yes
Proposal type fixed effects	Yes	Yes

Panel B: Split by close or passed vote

Dependent variable:	Proposal Support			
Sample	RepRisk rating low & close or passed ESG proposal		Other	
	(1)	(2)	(3)	(4)
ESG scandal experience – Firm	9.633**	10.666*	-0.371	-0.938
	(1.98)	(1.87)	(-0.23)	(-0.78)
Observations	1191	1041	5151	4783
Adjusted R^2	0.358	0.520	0.681	0.804
Control variables	Yes	Yes	Yes	Yes
Firm fixed effects	No	Yes	No	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Proposal type fixed effects	Yes	Yes	Yes	Yes

Panel C: Split by likelihood of passing ESG proposal

Dependent variable:	Proposal Support			
Sample	RepRisk rating low & high likelihood to pass ESG proposal		Other	
	(1)	(2)	(3)	(4)
ESG scandal experience – Firm	8.462*	9.296*	0.763	-1.272
	(1.77)	(1.74)	(0.40)	(-0.78)
Observations	1477	1332	4597	4257
Adjusted R^2	0.725	0.808	0.619	0.730
Control variables	Yes	Yes	Yes	Yes
Firm fixed effects	No	Yes	No	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Proposal type fixed effects	Yes	Yes	Yes	Yes

Panel D: Split by concentration of large stakeholders

Dependent variable:	Proposal Support			
Sample	RepRisk rating low & large ownership stakes		Other	
	(1)	(2)	(3)	(4)
ESG scandal experience – Firm	4.784	9.148*	0.553	0.263
	(1.04)	(1.80)	(0.32)	(0.18)
Observations	1167	1042	5175	4801
Adjusted R^2	0.611	0.691	0.647	0.760
Control variables	Yes	Yes	Yes	Yes
Firm fixed effects	No	Yes	No	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Proposal type fixed effects	Yes	Yes	Yes	Yes

Table 11: Robustness checks

This table displays robustness checks for our main specifications. In Panel A, we show robustness checks for our main result on voice (Table 3). In regressions 1 and 2, we exclude any stock that had an ESG scandal in the 12 months prior to the vote. In regressions 3 and 4, we add a variable capturing the ESG scandal experience of other funds in the fund's family. In regressions 5 and 6, we show the results for the subset of proposals for which ISS recommended voting in favor; regressions 7 and 8 show the results for proposals for which ISS recommended voting against. In Panel B, we show robustness checks for our main result on exit (Table 6). In regressions 1 and 2, we exclude any stock that had an ESG scandal in the current quarter. In regressions 3 and 4, we use the dependent variable *D(Sell flow-adjusted)*, which is equal to 1 if the fund divests the stock relatively more than what would be expected based on fund flows. In Panel C, we display additional results for the vote test in which we do not fill in zeros for stocks not covered in RepRisk. We also compute *ESG scandal experience* using cutoffs of 30 and 20 respectively (instead of 25) and computing it over the previous 6 months instead of 12 months. In Panel D, we conduct the same robustness checks as in Panel C for our exit test. In Panels A and C, we include vote fixed effects and fund fixed effects and standard errors are two-way clustered by fund and shareholder meeting. In Panels B and D, we include stock-quarter fixed effects and fund fixed effects and standard errors are two-way clustered by fund and quarter. In all panels, even columns include the following control variables: *Position size, D(same state)*, $Fund\ Return_{t-12,t-1}$, and $Fund\ Size_{t-1}$. For more details on variable construction see Appendix A. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Panel A: Robustness tests for vote results

Dependent variable:	D(Vote for ESG proposal) (%)							
Sample:	Exclude scandal stocks		All ESG proposals		ISS for proposal		ISS against proposal	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ESG scandal experience	1.443***	1.330***	1.209**	0.956*	0.809**	0.862**	1.739***	1.568***
	(3.21)	(2.97)	(2.42)	(1.92)	(2.41)	(2.51)	(2.94)	(2.66)
ESG scandal experience – family			-0.555	-0.066				
			(-0.69)	(-0.08)				
Observations	1298562	1199776	999335	919099	395396	368344	911019	837165
Adjusted R²	0.509	0.509	0.513	0.513	0.313	0.313	0.522	0.524
Controls	No	Yes	No	Yes	No	Yes	No	Yes
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Panel B: Robustness tests for exit results

Dependent variable:	D(Sell) (%)		D(Sell flow-adjusted) (%)	
Sample:	Exclude scandal stocks		All ESG proposals	
	(1)	(2)	(3)	(4)
ESG scandal experience * D(RepRisk rating low) (%)	0.506**	0.475*	0.638**	0.620**
	(2.13)	(1.77)	(2.25)	(2.10)
Observations	18859600	17372015	17845546	17407512
Adjusted R²	0.169	0.173	0.088	0.088
Controls	No	Yes	No	Yes
Stock-quarter fixed effects	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes

Panel C: Additional robustness checks for vote result

Dependent variable:	D(Vote for ESG proposal) (%)							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ESG scandal experience no fill-in zeros – 25 cutoff	1.184***	1.142***						
	(3.14)	(3.04)						
ESG scandal experience no fill-in zeros – 30 cutoff			1.381***	1.238**				
			(2.86)	(2.52)				
ESG scandal experience no fill-in zeros – 20 cutoff					0.546**	0.461*		
					(2.28)	(1.96)		
ESG scandal experience no fill-in zeros – 6 months							0.887***	0.824***
							(2.90)	(2.73)
Observations	1347607	1243341	1347607	1243341	1347607	1243341	1347695	1243352
Adjusted R^2	0.509	0.509	0.509	0.509	0.509	0.509	0.509	0.509
Controls	No	Yes	No	Yes	No	Yes	No	Yes
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Panel D: Additional robustness checks for exit result

Dependent variable:	D(Sell) (%)							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ESG scandal experience no fill-in zeros – 25 cutoff * D(RepRisk rating low) (%)	0.633***	0.636***						
	(3.39)	(3.05)						
ESG scandal experience no fill-in zeros – 30 cutoff * D(RepRisk rating low) (%)			0.861***	0.807***				
			(4.06)	(3.32)				
ESG scandal experience no fill-in zeros – 20 cutoff * D(RepRisk rating low) (%)					0.218*	0.255*		
					(1.69)	(1.81)		
ESG scandal experience no fill-in zeros – 6 months * D(RepRisk rating low) (%)							0.695**	0.710**
							(2.63)	(2.41)
Observations	19085248	17579188	19085248	17579188	19085248	17579188	19105625	17595234
Adjusted R^2	0.169	0.172	0.169	0.172	0.169	0.172	0.169	0.173
Controls	No	Yes	No	Yes	No	Yes	No	Yes
Stock-quarter fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Appendix A: Variable definitions

This table displays the variable definitions for all variables used in the regressions. All continuous variables are winsorized at the 1% level on both sides.

Variable Name	Definition
Fund flow	We compute monthly fund flows from the CRSP mutual fund database as: $$Fund\ flows_t = \frac{Net\ asset\ value_t - (Net\ asset\ value_{t-1} * Fund\ return_t)}{Net\ asset\ value_{t-1}}$$
D(ESG scandal)	Dummy variable equal to one if the RepRisk index of the firm increases by more than 25 points within a months and zero otherwise.
ESG scandal experience	To compute fund-level ESG scandal experience, we start by computing each month the value-weighted average of D(ESG scandal), where the weights are based on the market value of the fund's holdings at the beginning of the quarter. We then compute ESG scandal experience at the fund level as the average of these monthly values over the previous 12 months in our (annual) voting analysis, or over the previous 3 months in our (quarterly) divestment analysis. We treat stocks that have a PERMNO but are not in the RepRisk data as not having had a scandal because RepRisk states that stocks are added to their data as soon as they are mentioned in their sources in relation to an ESG incident. This implies that stocks not in RepRisk have not had a reported ESG incident.
$Fund\ return_t$	Monthly fund return from CRSP mutual fund data in the current month.
$Fund\ Return_{t-12,t-1}$	Monthly fund return from CRSP mutual fund data in the previous year.
$Fund\ Size_{t-1}$	Logarithm of the net asset value of the fund at the end of the previous quarter.
D(Vote for ESG proposal)	Dummy variable equal to one if the fund votes in favor of the ESG proposal and equal to zero if the fund votes against or abstains from voting.
Position size	The size of the equity position that the fund holds in a given stock at the beginning of the quarter as a fraction of shares outstanding of the firm as reported in CRSP.
D(same state)	A dummy variable equal to one if the fund and the firm are headquartered in the same state according to CRSP and zero if they are located in different states or we do not have information about their location.
ESG scandal experience – large positions	This variable is constructed like ESG scandal experience with the exception that only ESG scandals for above-median positions by size are included when computing the average. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – small positions	This variable is constructed like ESG scandal experience with the exception that only ESG scandals for below-median positions by size are included when computing the average. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – large surprise	This variable is constructed like ESG scandal experience with the exception that only ESG scandals for firms with an ex-ante RepRisk rating of AA or better are included when computing the average. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – small surprise	This variable is constructed like ESG scandal experience with the exception that only ESG scandals for firms with an ex-ante RepRisk rating of AA or better worse are included when computing the average. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – weak ESG prior	Same as *ESG scandal experience* but set to zero if the fund is in the top or bottom quartile by average support for ESG shareholders' proposals in the previous year. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – strong ESG prior	Same as *ESG scandal experience* but set to zero if the fund is **not** in the top or bottom quartiles by average support for ESG shareholders' proposals in the previous year. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – below median return	This variable is constructed like *ESG scandal experience* with the exception that only ESG scandals for firms with below median return are included when computing the average. Scandal returns are computed as the average two-trading day (t,t+1) return over all days with ESG incidents for the firm in that month reported in the daily incidents data provided by RepRisk. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – above median return	Same as *ESG scandal experience – below median return* but using ESG scandals with above-median returns. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – bottom quartile return	Same as *ESG scandal experience – below median return* but using ESG scandals with bottom-quartile returns. For comparison, the variable is standardized to have mean 0 and variance of 1.
ESG scandal experience – top quartile return	Same as *ESG scandal experience – below median return* but using ESG scandals with top-quartile returns. For comparison, the variable is standardized to have mean 0 and variance of 1.
D(RepRisk rating low)	Dummy variable equal to one if the firm's RepRisk rating is A or worse.
D(Sell)	Dummy variable equal to one if the fund decreases the number of shares of the stock and equal to 0 if it keeps the number of shares constant or increases it.
D(RepRisk rating low & no close or passed ESG proposal)	Dummy variable equal to one if the firm's RepRisk rating is A or worse and the firm did not have an ESG proposal that either passed or was close to passing (i.e., failed by less than 10 percentage points) in the previous year.

D(RepRisk rating low & close or passed ESG proposal)	Dummy variable equal to one if the firm's RepRisk rating is A or worse and the firm had an ESG proposal that either passed or was close to passing (i.e., failed by less than 10 percentage points) in the previous year.
D(RepRisk rating low & low likelihood to pass ESG proposal)	Dummy variable equal to one if the firm's RepRisk rating is A or worse and the firm had below median likelihood to pass an ESG proposal as predicted using a regression of yearly pass fraction of ESG proposals on fixed effects for year, Fama-French 48 industry, 5 quintiles for firm maket capitalization and 5 quintiles for fraction of institutional ownership.
D(RepRisk rating low & high likelihood to pass ESG proposal)	Dummy variable equal to one if the firm's RepRisk rating is A or worse and the firm had above median likelihood to pass an ESG proposal as predicted using a regression of yearly pass fraction of ESG proposals on fixed effects for year, Fama-French 48 industry, 5 quintiles for firm maket capitalization and 5 quintiles for fraction of institutional ownership.
D(RepRisk rating low & small stake in firm)	Dummy variable equal to one if the firm's RepRisk rating is A or worse and the size of the fund's ownership stake in the firm is below median at the beginning of the quarter.
D(RepRisk rating low & large stake in firm)	Dummy variable equal to one if the firm's RepRisk rating is A or worse and the size of the fund's ownership stake in the firm is above median at the beginning of the quarter.
Change in fund's average RepRisk rating	The change in the value-weighted average RepRisk rating of the fund (using previous quarter's RepRisk rating). For this purpose, we assign numeric values to the rating categories from 1 (D) to 10 (AAA).
Proposal Support	Fraction of votes in favor of the proposal
ESG scandal experience – Firm	The weighted average of scandal experiences of all active funds holding the firm at the end of the quarter preceding the vote, where the weight is the fund's position in the firm.
ESG scandal experience – family	Computed analogous to ESG scandal experience but at the fund family level and excluding the positions of the fund itself.
D(Sell flow adjusted)	Dummy variable equal to 1 if the fund divests the stock relative to what would be expected due to fund flows. Specifically, it is equal to 1 if $\frac{Shares_t - Shares_{t-1}}{Shares_{t-1}} - Fund\ flow$ is negative and zero otherwise. Thus, for a fund with a, say, 5% outflow, the sell dummy is one only for position reductions of more than 5%.
ESG scandal experience no fill-in zeros – 25 cut-off	This variable is constructed like ESG scandal experience, but we do not fill in zeros for stocks that are not in RepRisk.
ESG scandal experience no fill-in zeros – 30 cut-off	Same as ESG scandal experience but using a cut-off of 30 instead of 25 for the increase in the RepRisk rating to define an ESG scandal and we do not fill in zeros for stocks that are not in RepRisk.
ESG scandal experience no fill-in zeros – 20 cut-off	Same as ESG scandal experience but using a cut-off of 20 instead of 25 for the increase in the RepRisk rating to define an ESG scandal and we do not fill in zeros for stocks that are not in RepRisk.
ESG scandal experience no fill-in zeros – 6 months	This variable is computed in the same way as ESG scandal experience but only uses the average over the previous 6 months and we do not fill in zeros for stocks that are not in RepRisk.

Appendix B: A simple model of engagement and divestment

1. Model overview

We present a stylized model of how ESG preferences affect engagement and divestment. There is one stock in unit supply and a risk-free asset in infinitely elastic supply with gross return normalized to one. The stock pays out a single cash flow D at $t = 1$. We denote $E(D) = \bar{D}$, $\sigma(D) = \sigma_D$. Let P be the equilibrium price of the stock at $t = 0$.

Without engagement, the stock causes (per-share) negative externalities of E at $t = 1$. Examples of externalities are emissions, child-labor scandals, sexual harassment in the company etc. E can be thought of as the risk that such negative externalities (e.g., scandals) materialize; we thus refer to E as the level of ESG risk.

There is a unit-mass of risk-averse investors, indexed by i, with mean-variance preferences and risk aversion parameter γ. All investors start out with initial wealth $W_{i0} = W_0$. Let X_i denote the number of shares that investor i buys of the stock.

Fraction $\lambda \in [0,1]$ of investors are **ESG-conscious**, the remaining fraction $1 - \lambda$ of investors do not care about ESG risk and are referred to as "financial investors." Financial investors just care about financial performance; they maximize expected utility of terminal wealth:

$$E(W_{i1}) - \frac{\gamma}{2} Var(W_{i1})$$

ESG-conscious investors also care about E. We consider two ways of modeling ESG preferences and contrast the resulting predictions.

Our first way of modelling ESG preferences assumes that ESG-conscious investors only care about **ESG risks in their portfolios**. That is, they maximize expected utility of terminal wealth minus a penalty for the portfolio's ESG risk exposure:

$$E(W_{i1}) - \frac{\gamma}{2} Var(W_{i1}) - \theta X_i E,$$

where $\theta > 0$ captures how much these investors dislike ESG risk exposure. This way of modeling ESG preferences is consistent with experimental evidence showing that investors seek to align their portfolios with their social values (see Bonnefon et al., 2022). In the context here, the assumption implies that investors derive disutility from the risk of ESG scandals affecting their portfolios, but not from ESG scandals outside of their portfolios. One can think of these investors as socially responsible investors **with a narrow mandate**.

Alternatively, we assume that ESG-conscious investors care about ESG risks **in the economy**. That is, they maximize expected utility of terminal wealth minus a penalty for the economy's ESG risk exposure:

$$E(W_{i1}) - \frac{\gamma}{2} Var(W_{i1}) - \theta E,$$

where $\theta > 0$ again captures how much these investors dislike economy-wide ESG risks. This way of modeling ESG preferences is more consequentialist in that investors also care about, and thus have an interest in mitigating, ESG risks (e.g., emissions) outside of their portfolios. One can think of these investors as socially responsible investors **with a broad mandate** (Oehmke and Opp, 2023).

2. Solution for ESG-conscious investors with a narrow mandate

We first present and solve the model for ESG-conscious investors with a narrow mandate (i.e., ESG-conscious investors only care about ESG risks in their portfolios). Such preferences are also called value-alignment (Bonnefon et al., 2022) and are consistent with warm glow (Andreoni, 1989).

2.1 Portfolio allocation and market clearing

Let subscript f denote financial investors and subscript r denote responsible investors. The first-order conditions for financial and responsible investors, respectively, yield

$$X_f = \frac{\bar{D} - P}{\gamma \sigma_D^2} \quad \text{and} \quad X_r = \frac{\bar{D} - \theta E - P}{\gamma \sigma_D^2}.$$

Market clearing implies the equilibrium price:

$$P = \bar{D} - \lambda \theta E - \gamma \sigma_D^2$$

The equilibrium return (cost of capital) for the stock is $E(D - P) = \lambda\theta E + \gamma\sigma_D^2$. Intuitively, the higher a stock's ESG risk, the higher the fraction of responsible investors (λ), and the higher responsible investors' weight on ESG risk exposure (θ), the larger is the cost of capital. This is in line with the stated goal of divestment campaigns: by increasing their cost of capital, "bad" firms face higher costs for expanding their business and thus may have incentives to reduce emissions.[28] Recent empirical work argues, however, that this channel is unlikely to be impactful (Berk and van Binsbergen, 2022; Edmans et al., 2022).

The fraction held by responsible investors is given by

$$\lambda X_r = \lambda\left(1 - \frac{(1-\lambda)\theta E}{\gamma\sigma_D^2}\right).$$

This fraction is decreasing in the level of ESG risk and responsible investors' weight on their portfolios' ESG risk exposure. If $\frac{\theta E}{\gamma\sigma_D^2} \leq 1$, an increase in λ increases the fraction held by responsible investors. If $\frac{\theta E}{\gamma\sigma_D^2} > 1$, an increase in λ first decreases and then increases the fraction held by responsible investors. This happens because, for low levels of λ, responsible investors dislike the stock's ESG risk so much that they take a short position in it. Yet, because of λ being low, responsible investors' total short position is small and financial investors (who are numerous) take on the extra shares without requiring a large compensation in the form of higher returns. As λ goes up, financial investors (who become fewer) have to hold more shares and require a higher return compensation. The higher return also makes it more costly for responsible investors to short, eventually pushing them to go long. As λ approaches one, market clearing increasingly forces responsible investors to hold the stock.

Importantly, the model predicts that responsible investors tilt their portfolios away from high-ESG risk stocks, implying that a larger fraction is held by financial investors.

2.2 Engagement

We now suppose that responsible investors, in addition to tilting their portfolios, can also affect ESG risk by **engaging** with the stock at $t = 0$ (but after choosing their portfolios). For simplicity, we assume that engagement takes the form of a binding vote on a shareholder proposal. If the proposal passes, which occurs when the fraction of shares voting in favor exceeds 50%, then the stock's level of ESG risk is instantaneously reduced by a fraction $\pi \in (0,1]$. For simplicity, we assume that engagement is costless.

Note that in our model financial investors do not have the incentive to engage.[29] That is, financial investors will always vote against any ESG risk-reducing shareholder proposal. It follows that engagement for a given stock succeeds if and only if the fraction of shares controlled by responsible investors exceeds 50%,

$$FR \equiv \lambda\left(1 - \frac{(1-\lambda)\theta(1-\pi)E}{\gamma\sigma_D^2}\right) \geq 0.5.$$

E is now replaced by $(1 - \pi)E$. This is because, if responsible investors expect the engagement to succeed, they expect ESG risk to be $(1 - \pi)E$ and will choose their holdings accordingly.

In summary, when responsible investors care about ESG risks in their portfolios, they tilt their portfolios away from high-ESG risk stocks. This behavior undermines the probability of success of an engagement campaign exactly in the high-ESG risk stocks that stand to benefit the most from the engagement. Indeed, FR is decreasing in θ and E.

3. Solution for ESG-conscious investors with a broad mandate

We now solve the model under the alternative assumption that ESG-conscious investors have a broad mandate (Oehmke and Opp, 2023)—i.e., they care about ESG risks in the entire economy (as opposed to only about ESG risks in their portfolios). This is akin to assuming that investors have "impact-seeking preferences" in the sense of Bonnefon et al. (2022) or Broccardo et al. (2022).

3.1 Portfolio allocation and market clearing

Since responsible investors' disutility from ESG risk no longer depends on their portfolio allocation, responsible and financial investors now hold the same portfolios, $X_r = X_f = 1$. Thus, responsible investors with a broad mandate do not tilt their portfolios away from high-ESG risk stocks.

Given this, the equilibrium return is no longer affected by ESG risk:

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[28] See, e.g., Heinkel et al. (2001) for a model that includes the firm's choice of the level of ESG risk (e.g., emissions) in the presence of responsible investors.

[29] This can be seen by computing financial investors' expected utility at the equilibrium, $\frac{1}{2\gamma\sigma_D^2}(\lambda\theta E + \gamma\sigma_D^2)^2$, and noting that this expected utility is increasing in E.

$$E(D - P) = \gamma \sigma_D^2$$

3.2 Engagement

The fraction controlled by responsible investors is $FR = \lambda$. When $\lambda \geq 0.5$, responsible investors successfully engage the stock and are thereby able to reduce economy-wide carbon emissions by πE.

The result that responsible investors with a broad mandate do not adjust their portfolios follows from the assumption that they are infinitesimal and competitive, meaning that they cannot coordinate their engagement efforts. We now relax this assumption.[30]

Suppose there is one representative responsible investor with a broad mandate. This representative investor has mass λ and decides collective holdings and the engagement strategy.

Intuitively, for $\lambda < 0.5$, the representative investor may want to tilt its portfolio toward a high-ESG stock (i.e., choose $X_r > 1$) in order to allow the engagement to succeed.[31]

The benefit of a successful engagement is $\theta E \pi$. The cost of the engagement is the expected utility loss of holding a suboptimally large position in the stock. More specifically, instead of holding $X_r = 1$, the responsible representative investor needs to hold $X_r = \frac{1}{2\lambda} > 1$ (for $\lambda < 0.5$) in order to secure majority. For the market to clear, financial investors need to hold the rest, $X_f = \frac{1}{2(1-\lambda)}$, which implies an equilibrium price of $P = \overline{D} - \frac{1}{2(1-\lambda)} \gamma \sigma_D^2$. The responsible investor's expected utility from holding the stock is $\frac{1}{8} \frac{3\lambda-1}{\lambda^2(1-\lambda)} \gamma \sigma_D^2$. Expected utility from the stock at the optimal portfolio allocation, $X_r = 1$, is $\frac{1}{2} \gamma \sigma_D^2$. Hence, the representative responsible investor prefers overweighing the stock to make engagement succeed if and only if:

$$\theta E \pi \geq \left(\frac{1}{2} - \frac{1}{8} \frac{3\lambda - 1}{\lambda^2(1-\lambda)} \right) \gamma \sigma_D^2$$

Note that the right-hand-side becomes zero for $\lambda = 0.5$ (as in this case overweighing is not required). In general, for any $0 < \lambda < 0.5$, overweighing the stock becomes optimal if the benefits ($\theta E \pi$) are large enough.

4. Empirical hypotheses

We now explain how our model can be mapped to our empirical analysis. An ESG scandal for a fund can be considered a (quasi-exogenous) shock to ESG preferences. Specifically, suppose that, after experiencing an ESG scandal, a previously performance-driven fund (financial investor) becomes ESG-conscious. Put differently, the ESG scandal increases the θ of an individual fund from $\theta = 0$ to $\theta > 0$. We derive the empirical predictions with regards to voice and exit depending on whether the ESG scandal makes the investor care about ESG risks in its portfolio (narrow mandate) or in the broader economy (broad mandate).

Our first hypothesis summarizes how ESG-conscious mutual funds respond to ESG scandals.

Hypothesis 1:

If, after being exposed to ESG scandals, the fund begins caring about ESG risks in its portfolio (narrow mandate), the fund will be more likely to start voting in favor of ESG-related shareholder proposals and will reduce its portfolio holdings in high-ESG risk stocks.

If, after being exposed to ESG scandals, the fund begins caring about ESG risks in the economy (broad mandate), the fund will be more likely to start voting in favor of ESG-related shareholder proposals and will either leave unchanged or even increase its portfolio holdings in high-ESG risk stocks (depending on whether coordination of engagement is possible).

The prediction for voice follows from the fact that, in our model, financial investors never vote in favor of ESG-related shareholder proposals, while ESG-conscious investors always do. The prediction for exit helps distinguish between the two different types of ESG preferences: ESG-conscious funds with a narrow mandate will tilt their portfolio away from high-ESG risk stocks, while ESG-conscious funds with a broad mandate will not (and might even tilt toward high-ESG risk stocks if they can coordinate engagement).

Our second hypothesis concerns the interplay between voting and portfolio reallocation as a function of the likelihood of a successful engagement.

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[30] In the model of Oehmke and Opp (2023), the ability to coordinate is a necessary condition (together with a broad mandate) for responsible investors to have impact.

[31] Note that, because they can avoid the disutility by tilting away their portfolios, responsible investors with a narrow mandate have less incentives to coordinate, especially if there is a risk that coordination can fail.

Hypothesis 2:

An ESG-conscious fund with a narrow mandate will divest less from a high-ESG risk stock for which engagement is more likely to be successful.

An ESG-conscious fund with a broad mandate will leave unchanged or may even increase the portfolio weight of a high-ESG risk stock for which engagement is more likely to be successful.

Intuitively, for a fund with a narrow mandate, portfolio tilting and voting are substitutes as both help reduce the portfolio's ESG risk exposure. When engagement is more likely to be successful, less portfolio tilting is needed. In our model, this can be seen by noting that a successful engagement reduces E and thereby increases X_r. For a fund with a broad mandate, in contrast, a higher likelihood of engagement success can increase the fund's incentives to overweigh the stock in order to secure the engagement success.

The third hypothesis concerns funds' portfolio-level ESG risk exposure.

Hypothesis 3:

If, after being exposed to ESG scandals, the fund begins caring about ESG risks in its portfolio (narrow mandate), the fund reduces its portfolio level ESG-risk exposure (by tilting away from high ESG-risk stocks and, if possible, through successful engagement).

If, after being exposed to ESG scandals, the fund begins caring about ESG risks in its portfolio (broad mandate), the fund only reduces its portfolio level ESG-risk exposure via successful engagement and may even increase its portfolio level ESG-risk exposure by actively tilting towards high-ESG risk engagement targets.

Intuitively, for a fund with a narrow mandate, portfolio tilting away from high-ESG risk stocks helps reduce the portfolio's overall ESG risk exposure even when engagement is not successful. If engagement is successful, this further reduces the fund's ESG risk exposure. In contrast, for a fund with a broad mandate, portfolio ESG risk exposure can only decrease when engagement is successful. Moreover, a broad mandate fund may even tilt its portfolio towards high-ESG risk stocks, thereby increasing its ESG risk exposure, in order to improve the chance of a successful engagement.

Our last hypothesis relates to the impact of ESG scandals on the probability of passing an ESG shareholder proposal. Here, we can think of ESG scandals as an increase in λ (i.e., some formerly financial investors now become responsible investors).

Hypothesis 4:

If, after being exposed to ESG scandals, funds begin caring about ESG risks in their portfolios (narrow mandate), the effect on the overall fraction of votes in favor of ESG-related shareholder proposals is ambiguous (can be positive or negative) and likely small.

If, after being exposed to ESG scandals, fund begin caring about ESG risks in the economy (broad mandate), the effect on the overall fraction of votes in favor of ESG-related shareholder proposals increases.

The ambiguity for funds with a narrow mandate follows from the fact that the fraction of responsible investors FR holding the stock is not necessarily increasing in λ (the fraction of ESG-conscious investors) and can at times become decreasing in λ. The latter occurs when the disutility from portfolio ESG risk exposure is so large and therefore portfolio tilting so strong that the equilibrium ownership by ESG-conscious investors goes down despite there being more of them. In contrast, for funds with a broad mandate, an increase in λ always increases the overall fraction of votes in favor of ESG shareholder proposals. Indeed, funds with a broad mandate never tilt away (and may even tilt toward) high-ESG risk stocks. Hence, with a broad mandate, voice and portfolio tilting work hand in hand to increase the overall support for ESG shareholder proposals.

Appendix C: Description of ESG scandals in our data

In this table, we give a few examples as well as an overview of different ESG scandals contained in our data. As described in Section 3, we define an ESG scandal as an event where the RepRisk Index for a given firm-month observation increases by more than 25 points. Importantly, our approach ensures that we identify ESG incidents that are both *severe and unexpected*. Indeed, firms with a checkered history already have an elevated RRI, thus leaving less scope for further increases when a new ESG incident emerges. With 3213 occurrences in our sample, such large increases are relatively rare, thus ensuring that we pick up important ESG scandals. In Panel A, we list several examples of ESG scandals together with a short description. In Panel B, we tabulate distinct "related issues" identified in RepRisk for the news days within an ESG scandal month (i.e., a stock-month in which the RepRisk index jumps by 25 points or more). We obtain this information from RepRisk's daily incidents data. Note that "related issues" are not mutually exclusive. Thus, a given scandal can relate to multiple issues.

Panel A: Three examples of ESG scandals in our data

Company	Month	Short description
Cabot Oil & Gas	01/2009	Cabot Oil & Gas, the best performer last year in the Standard & Poor's 500 Index, was cited by Pennsylvania officials in September for "improper" well construction after natural gas polluted drinking water, a report said. Inspectors found defects in the liner intended to prevent oil or gas from leaking into groundwater. [Related issues: Local pollution; Violation of national legislation]
SkyWest Airlines	07/2015	The U.S. Federal Aviation Administration has proposed a $1.23 million fine against SkyWest Airlines for allegedly failing to comply with safety regulations. [Related issue: Violation of national legislation; Products (health and environmental issues)]
Acadia Healthcare Inc.	08/2015	Acadia Healthcare agreed to dole out $17 million to settle accusations of fraud, alleging that Acadia Healthcare had over-charged West Virigina's Medicaid program for blood and urine tests. [Related issue: Human rights abuses and corporate complicity]
J&J Snack Foods Corp.	10/2015	J&J Snack Foods Corp. has agreed to pay more than $2.1 million in back wages and liquidated damages after federal investigators found temporary production line workers were denied wages by the company. The U.S. Department of Labor found J&J denied minimum wage and overtime pay to workers as required under the Fair Labor Standards Act. [Related issue: Violation of national legislation; Poor employment conditions]
Spirit Airlines Inc.	11/2015	Seven African-American passengers were kicked off a Spirit Airlines flight from Los Angeles to Dallas Monday, raising allegations of racial discrimination. [Related issue: Social discrimination]
Tesoro Logistics Corp.	07/2016	Justice department and U.S. Environmental Protection Agency announce settlement with Tesoro Corp. to reduce air pollution at several petroleum refineries. [Related issues: Impacts on communities; Impacts on landscapes, ecosystems and biodiversity]
NiSource Inc.	09/2018	On September 13, 2018, excessive pressure in natural gas lines owned by Columbia Gas of Massachusetts [owned by NiSource Inc.] caused a series of explosions and fires to occur in as many as 40 homes. One person was killed and 30,000 were forced to evacuate their homes immediately. [Related issue: Impacts on communities]

Panel B: Overview of "related issues" identified with ESG scandals

Related issues	Frequency	Percent
Animal mistreatment	31	0.41
Anti-competitive practices	267	3.56
Child labor	34	0.45
Climate change, GHG emissions, and global pollution	151	2.01
Controversial products and services	231	3.08
Corruption, bribery, extortion and money laundering	347	4.63
Discrimination in employment	121	1.61
Executive compensation issues	123	1.64
Forced labor	63	0.84
Fraud	744	9.92
Freedom of association and collective bargaining	67	0.89
Human rights abuses and corporate complicity	439	5.86
Impacts on communities	528	7.04
Impacts on landscapes, ecosystems and biodiversity	478	6.38
Local participation issues	63	0.84
Local pollution	453	6.04
Misleading communication	105	1.40
Occupational health and safety issues	265	3.53
Other environmental issues	2	0.03
Other issues	1	0.01
Other social issues	1	0.01
Overuse and wasting of resources	34	0.45
Poor employment conditions	340	4.54
Products (health and environmental issues)	357	4.76
Social discrimination	41	0.55
Supply chain issues	313	4.18
Tax evasion	32	0.43
Tax optimization	20	0.27
Violation of international standards	69	0.92
Violation of national legislation	1602	21.37
Waste issues	157	2.09
Total	7,497	100

Appendix D: Split by ES vs. G scandals

In this table, we examine if fund managers react differently to environmental and social (ES) or governance (G) scandals. For this purpose, we create *ES scandal experience* and *G scandal experience*, which are computed in the same way as *ESG scandal experience* but only include ES or G scandals, respectively. The classification into ES and G scandals is based on the monthly RepRisk index percentages coming from E, S, and G as provided by RepRisk. When this information is missing, we classify scandals based on, in that order, the UN Global Compact (UNGC) principles or the related issues list available in the daily ESG incidents data provided by RepRisk. As many scandals have simultaneously a social and an environmental dimension, we focus on classifying into ES and G, instead of also trying to subdivide between E and S. In this way, we identify 2,199 ES and 1,854 G scandals (our classification is not mutually exclusive). In Panel A, we present results for *ES scandal experience*; in Panel B, we present results for *G scandal experience*. Other variables are defined as above (and as explained in Appendix A). We limit our sample to actively-managed funds. In all regressions, we include proposal fixed effects and fund fixed effects. Standard errors are two-way clustered by fund and shareholder meeting. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Panel A: ES scandal experience

Dependent variable:	D(Vote for ESG proposal) (%)					
Sample:	All ESG proposals		ES proposals		G proposals	
	(1)	(2)	(3)	(4)	(5)	(6)
ES scandal experience (%)	1.550***	1.503***	1.282**	1.244**	1.948***	1.958***
	(2.99)	(2.93)	(2.23)	(2.11)	(3.12)	(3.11)
Position size		-127.037***		-264.120***		-62.944
		(-3.67)		(-6.57)		(-1.38)
D(same state)		-0.818*		-0.243		-0.795
		(-1.79)		(-0.42)		(-1.48)
Fund Return$_{t-12,t-1}$		-15.896		-6.686		-20.082
		(-0.98)		(-0.36)		(-1.02)
Fund Size$_{t-1}$		-0.045		0.172		-0.041
		(-0.23)		(0.87)		(-0.19)
Observations	1347695	1243352	487892	455037	859803	788315
Adjusted R^2	0.509	0.509	0.497	0.497	0.505	0.506
Proposal fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Panel B: G scandal experience

Dependent variable:	D(Vote for ESG proposal) (%)					
Sample:	All ESG proposals		ES proposals		G proposals	
	(1)	(2)	(3)	(4)	(5)	(6)
G scandal experience (%)	1.564***	1.406**	1.553**	1.611**	1.806**	1.543**
	(2.66)	(2.39)	(2.26)	(2.29)	(2.57)	(2.18)
Position size		-127.314***		-264.374***		-63.272
		(-3.68)		(-6.58)		(-1.38)
D(same state)		-0.816*		-0.243		-0.791
		(-1.78)		(-0.42)		(-1.47)
Fund Return$_{t-12,t-1}$		-13.630		-4.669		-17.056
		(-0.84)		(-0.25)		(-0.87)
Fund Size$_{t-1}$		-0.044		0.173		-0.039
		(-0.22)		(0.88)		(-0.18)
Observations	1347695	1243352	487892	455037	859803	788315
Adjusted R^2	0.509	0.509	0.497	0.497	0.505	0.506
Proposal fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes

Appendix E: ESG scandal experience and management proposals

This table displays regressions examining if funds are more likely to vote for management proposals if they experienced more ESG scandals in their portfolio holdings in the previous year. The dependent variable is a dummy variable equal to one if the fund votes in favor of the proposal and equal to zero if it votes against or abstains. The explanatory variable of interest is *ESG scandal experience*, which measures the fraction of equity holdings of the funds over the past year that experienced an ESG scandal (in percent). In columns 2, 4, and 6, we include the following control variables: *Position size* is the size of the equity position that the fund holds in the firm as a fraction of the firm's total equity. *D(same state)* is a dummy variable equal to one if the fund and the firm are headquartered in the same state. $Fund\ Return_{t,t-12}$ is the cumulated fund return over the past year. $Fund\ Size_{t-1}$ is the natural logarithm of total net assets of the fund at the beginning of the quarter. In columns (1) and (2) we include all funds, in (3) and (4), we focus on active funds, and in (5) and (6), we focus on passive funds. In all regressions, we include vote fixed effects and fund fixed effects. Standard errors are two-way clustered by fund and shareholder meeting. We report t-statistics below the coefficients in parenthesis. ***, **, * indicate significance at the 1%, 5% and 10% level.

Dependent variable:	D(Vote for management proposal) (%)					
Sample:	All funds		Active funds		Passive funds	
	(1)	(2)	(3)	(4)	(5)	(6)
ESG scandal experience (%)	0.013	-0.230	0.073	-0.235	-0.449	-0.767
	(0.03)	(-0.59)	(0.16)	(-0.52)	(-0.66)	(-1.10)
Position size		26.316***		36.359***		9.547
		(2.90)		(5.29)		(0.14)
D(same state)		0.070		0.148		0.047
		(0.50)		(0.96)		(0.22)
$Fund\ Return_{t-12,t-1}$		-5.584		-18.775		8.176
		(-0.52)		(-1.11)		(0.54)
$Fund\ Size_{t-1}$		-0.188		0.020		-0.449*
		(-1.39)		(0.26)		(-1.68)
Observations	3531925	3126657	1784386	1538947	1743769	1585262
Adjusted R^2	0.456	0.453	0.535	0.532	0.424	0.424
Vote fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Fund fixed effects	Yes	Yes	Yes	Yes	Yes	Yes