

2018

## The Corporate Governance Role of Retail Investors

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### Recommended Citation

Gaia Balp *The Corporate Governance Role of Retail Investors*, 31 Loy. Consumer L. Rev. 47 (2018).  
Available at: <https://lawcommons.luc.edu/lclr/vol31/iss1/4>

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# THE CORPORATE GOVERNANCE ROLE OF RETAIL INVESTORS

*Gaia Balp\**

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## I. INTRODUCTION

In the corporate governance debate, institutional investors' voting is a "hot topic" both in the U.S. and the European Union. To the contrary, "no one cares very much about retail investor voting".<sup>1</sup> Recent U.S. scholarship however, emphasizes the need to re-engage retail shareholders and explores a variety of possible means for retrieving lost shareholders.<sup>2</sup> The U.S. approach to retail investors' distance from the corporate governance scene is one step ahead of the EU, whose regulatory framework seems to focus on retail investors as capital suppliers rather than shareholders.

Since the enactment of the 2004 Markets in Financial Instruments Directive (MiFID),<sup>3</sup> the EU's long-standing regulatory policy aimed at fostering the development of stronger and efficient EU capital markets<sup>4</sup> has targeted retail investors as capital providers more closely than in the past. Based on a harmonized regulatory framework for financial services intended to ensure adequate investor protection on integrated markets, the unlocking of household savings to be channeled to the markets—directly or through intermediaries—is regarded as a driver of greater market depth and efficiency. Hence, promoting retail investor market participation ranks among the settled objectives

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<sup>1</sup> Jill. E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11, 12 (2017).

<sup>2</sup> See *infra* Part IV.

<sup>3</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, 2001 O.J. (L 145) 1. MiFID I was later replaced by Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), 2014 O.J. (L 173) 349 [MiFID II], that applies from Jan. 3, 2018.

<sup>4</sup> See *Communication from the Commission. Implementing the framework for financial markets: Action plan*, COM (1999) 232 final (May 11, 1999). Financial Services Action Plan (FSAP), aiming, as a general objective, to overcome financial market segmentation and allow business and consumers to directly access cross-border financial institutions, and setting the three "strategic objectives" of (i) developing a single European market in wholesale financial services; (ii) creating open and secure retail markets; (iii) ensuring financial stability through establishing adequate prudential rules and supervision. John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis*, 48 COMM'N MKT. L. REV. 125, 126 (2011) (noting that the implementation of the FSAP "has seen the emergence of a truly pan-European securities law").

of the EU regulatory policy. This objective is apparent from a consideration of some illustrative initiatives amongst the large number that have been taken in the field of financial regulation.

Similarly to the U.S. “Plain English” initiative,<sup>5</sup> the prospectus summary regime adopted under Article 5(2) of Directive 2003/71/EC<sup>6</sup> in the context of public offerings, which has been replaced by Article 7 of Regulation 2017/1129/EU—Prospectus Regulation,<sup>7</sup> is one very clear example of the willingness to facilitate access by retail investors to securities markets.<sup>8</sup> While not replacing the prospectus, the summary is intended to help unsophisticated investors when considering whether to make investment decisions. To aid unsophisticated investors, the summary provides key information concerning the offering in a clear and concise manner by using everyday language to avoid information overload.<sup>9</sup>

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<sup>5</sup> Presentation of Information in Prospectuses, 17 C.F.R. § 230.421 (2008).

<sup>6</sup> Directive 2003/71/EC of the European Parliament and of the Council of 4 Nov. 2003 on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and Amending; Directive 2001/34/EC, 2003 O.J. (L 345) 64 [Prospectus Directive], as amended by Directive 2010/73/EU of the European Parliament and of the Council of 24 Nov. 2010 amending Directives 2003/71/EC on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading; Directive 2004/109/EC on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market, 2010 O.J. (L 327) 1.

<sup>7</sup> Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, 2017 O.J. (L 168) 12.

<sup>8</sup> See Giovanni Strampelli, *The EU Issuers’ Accounting Disclosure Regime and Investors’ Information Needs. The Essential Role of Narrative Reporting*, 9 (Bocconi University Legal Studies Research Paper Series No. 3003743) (July 15, 2017), <https://ssrn.com/abstract=3003743>. See also Veerle Colaert, *Investor Protection in the Capital Markets Union*, in CAPITAL MARKETS UNION IN EUROPE, 345, No. 16.13 (Danny Busch at al. eds., 2018) (illustrating that the trend in the legislation to emphasize the need for short, comprehensible and comparable product information is explained by insights on consumer information overload, limits to investor rationality and the risk that information can lead to a shift in liability risk to the retail investors).

<sup>9</sup> See recitals 28, 30 and 32 to the Prospectus Regulation. Under Article 7 of the Prospectus Regulation, the length of the summary is set at seven A4 pages. Following public consultation, in July 2018, the European Securities and Markets Authority [hereinafter ESMA] issued regulatory technical standards (RTS) under the new Prospectus Regulation including content and format of the key financial information to be disclosed in the prospectus summary: see EUR. SEC. MKTS. AUT., DRAFT REGULATORY TECHNICAL STANDARDS UNDER THE

EU-wide regulation has massively supported retail investors' indirect access to securities. The composite framework put in place in stages through the enactment of and subsequent amendments to the Directives on Undertakings for Collective Investment in Transferable Securities (UCITS)<sup>10</sup>, Insurance Distribution (IDD)<sup>11</sup> and Institutions for Occupational Retirement Provision (IORPs)<sup>12</sup> has allowed intermediaries to offer an ever-widening range of mutual funds, insurance-based investment products, and pension schemes. Whilst varying in size and by type of institutional investor across different Member States, assets managed by investment funds, insurance companies and pension funds have significantly increased in the EU over the last fifteen years, both in absolute value and as a share of EU GDP.<sup>13</sup> Moreover, indirect investments through institutional investors are expected to further increase, in particular from pension funds.<sup>14</sup>

In its 2015 Action Plan on building a capital markets union (CMU), the European Commission (EC) further committed itself to improving cross-border access to retail investment products, noting that

Today, retail investors in Europe have significant savings in bank accounts, but are less directly involved in capital markets than in the past. Direct share ownership of European households has dropped from 28% in 1975 to 10-11% since 2007 and the proportion of retail investors among all shareholders is less than half the level it was in the

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NEW PROSPECTUS REGULATION (Final Report ESMA 31-62-1002), 10 *et seq.* (July 17, 2018).

<sup>10</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast), 2009 O.J. (L 302) 32, as last amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014, 2014 O.J. (L 257) 186 [UCITS V].

<sup>11</sup> Directive 2016/97/EU of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast), 2016 O.J. (L 26) 19, fully recasting Directive 2002/92/EC (Insurance Mediation Directive (IMD)).

<sup>12</sup> Directive 2016/2341/EU of the European Parliament and of the Council of 14 Dec. 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast) 2016 O.J. (L 354) 37 [IORP II].

<sup>13</sup> See Zsolt Darvas & Dirk Schoenmaker, *Institutional Investors and the Development of Europe's Capital Markets*, in CAPITAL MARKETS UNION IN EUROPE, 399-402 (Danny Busch et al. eds., 2018).

<sup>14</sup> *Id.* at 402.

1970s. Removing the barriers to retail investors saving via the capital markets requires competitive financial markets that can offer choice to allow customers to compare products and find the most suitable savings vehicles at competitive prices.<sup>15</sup>

As a consequence, in March 2017, the Commission published a wide-ranging Action Plan on retail financial services and insurance which sets out a strategy to strengthen the EU single market for retail financial services and harnesses the potential of digitalization and technological developments (so-called FinTech) in order to improve consumer access to financial services throughout the EU.<sup>16</sup> Since households are the ultimate providers of savings in the economy, the measures envisaged in the Action Plan should help mobilize retail investors towards market-based investment products by positively impacting their “relatively high degree of risk aversion, the lack of an “equity culture”, a low level of financial expertise, and a lack of trust in financial markets”.<sup>17</sup> Thus, “in an even more explicit way than previous investor protection initiatives, the CMU approaches investor protection as a tool to increase retail investor participation in the capital markets”.<sup>18</sup>

From the standpoint of EU policy, encouraging retail investors to participate in the financial markets more deeply and widely has certainly become ever more crucial, given that “[r]etail market investment is increasingly necessary to finance retirement,

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<sup>15</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *Action Plan on Building a Capital Markets Union*, 18, COM (2015) 468 final, (Sept. 30, 2015).

<sup>16</sup> Communication from the Commission to the European Parliament, the Council, the European Central Bank, European Economic and Social Committee and the Committee of the Regions, *Consumer Financial Services Action Plan: Better Products, More Choice*, COM (2017) 139 final (Mar. 23, 2017). The Plan comprises action aimed at: increasing consumer trust and empower consumers when buying services at home or from other Member States; reducing legal and regulatory obstacles affecting businesses when providing financial services abroad; supporting the development of an innovative digital world to overcome some of the existing barriers to the Single Market.

<sup>17</sup> See EUR. FUND AND ASSET MANAG’T ASS’N (EFAMA), *Asset Management in Europe. Facts and figures*, 16 (May 2017), <http://www.efama.org/statistics/sitepages/asset%20management%20report.asp> x.

<sup>18</sup> Colaert, *supra* note 8, at 314, n. 16.01.

education, and other social needs”<sup>19</sup> and “also remains an important source of stable capital for companies”.<sup>20</sup>

To support direct investments at listed companies, EU-wide regulation has focused on strengthening investors as shareholders. Based on the 2003 Commission’s communication on modernizing company law and enhancing corporate governance,<sup>21</sup> the Shareholders’ Rights Directive (SRD) was enacted in 2007 to enhance shareholders’ rights and address problems relating to cross-border voting.<sup>22</sup> As was acknowledged by the European lawmakers,

[h]olders of shares carrying voting rights should be able to exercise those rights given that they are reflected in the price that has to be paid at the acquisition of the shares. Furthermore, effective shareholder control is a prerequisite to sound corporate governance and should, therefore, be facilitated and encouraged.<sup>23</sup>

Several measures were introduced to accomplish that policy goal. In many Member States, share blocking during a certain period prior to the general meeting, and up to the end of the meeting, was a requirement for participation and voting. Share blocking was found to inhibit institutional shareholder voting since it overly restricted the ability to trade shares. Therefore, share blocking was prohibited and replaced by a system based on a “record date” (Article 7 of SRD). Under the record date scheme, only shareholders of record as of a specified cut-off date in advance of the general meeting are entitled to vote, irrespective of whether such shareholders will actually still hold their shares on the day of the meeting. New rules on transparency regarding the information provided prior to the meeting, timely and fast access to such information (Article 5), voting by proxy (Article 10), participation

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<sup>19</sup> Niamh Moloney, *Regulating the Retail Markets: Law, Policy, and the Financial Crisis*, 63 CURRENT LEGAL PROBLEMS 375, 388 (2010).

<sup>20</sup> *Id.* at 396.

<sup>21</sup> Communication from the Commission to the Council and the European Parliament, *Modernising Company Law and Enhancing Corporate Governance in the European Union. A Plan to Move Forward*, COM (2003) 284 final (May 21, 2003).

<sup>22</sup> Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, 2007 O.J. (L 184) 17 [hereinafter SRD].

<sup>23</sup> See recital 3 to SRD.

in general meetings at a distance via electronic means (Article 8), and voting by correspondence (Article 12) were also introduced. Shareholders were further granted the right to place items on the agenda and to table draft resolutions concerning agenda items, subject to a threshold (if any) not exceeding 5% of the company's share capital (Article 6), and to ask questions concerning agenda items, which the company is required to answer (Article 9).

When presenting its proposal for a SRD, the EC not only cautioned against the linkage between the rise of foreign (institutional) share ownership of EU listed companies and shareholder passivity, but also noted that "obstacles to cross-border voting may prevent small individual cross-border shareholders willing to exercise their voting rights from reaping the benefits expected in the near future from the technological advances of electronic voting."<sup>24</sup>

Hence, the removal of obstacles to cross-border voting has been regarded as a means to both increase cross-border voting records of institutional shareholders and to "make cross-border voting for small individual shareholders a real possibility in a near future."<sup>25</sup> At the same time, a reduction in the costs associated with cross-border voting by leveraging technology has been expected to allow small individual investors "to reap the benefits of the advances in information technology. Although electronic voting by distance is too costly for the moment, especially for individual shareholders, technological progress could allow for reducing such costs dramatically in the near future."<sup>26</sup>

On the whole, the sweeping European regulatory commitment to encourage individuals to participate in the capital markets is clear. However, despite all of the measures adopted to date, the role actually played by retail investors in direct corporate financing and governance remains weak. There still appears to be regulatory schemes which are somewhat inconsistent with that policy goal.

First, retail investors continue to play a role in corporate finance that is less significant than in the U.S. In the EU, retail

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<sup>24</sup> Commission Staff Working Document, *Annex to the Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC. Impact assessment*, at 1, COM (2005) 685 final, 2006 SEC 181 (Feb. 2, 2006) [hereinafter Eur. Comm'n Staff, Annex]

<sup>25</sup> *Id.* at 3.

<sup>26</sup> *Id.* at 38.



investors are more often than not offered packaged products instead of shares or other corporate securities, and agency ownership prevails: 78% of EU households' financial assets are held through life insurance, investment and pension funds.<sup>27</sup> In the U.S., retail shareholders own approximately one third of publicly traded shares,<sup>28</sup> and are a more substantial source of direct corporate financing.<sup>29</sup> In comparison, retail direct share ownership accounts for just about 10% of direct corporate financing in Europe.<sup>30</sup>

Second, although enhanced protection of shareholder rights is conceived as “a key precondition for economic growth in the EU”,<sup>31</sup> more than ten years after the enactment of the SRD, and six after completion of its transposition into national law, retail shareholder voting turnout at European general meetings remains low.<sup>32</sup> Although voting turnout has been generally increasing over the last decade, this seems to depend mainly on institutional

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<sup>27</sup> See BETTER FINANCE ASBL (THE EUROPEAN FEDERATION OF INVESTORS AND FINANCIAL SERVICES USERS), [http://betterfinance.eu/no\\_cache/home/other-investors/](http://betterfinance.eu/no_cache/home/other-investors/). See also Diego Valiante, *CMU and the Deepening of Financial Integration*, in CAPITAL MARKETS UNION IN EUROPE, 18, n. 2.22 (Danny Busch et al. eds., 2018) (noting that “[a]ccess to capital markets for European households often takes place through expensive intermediation, like insurance wrappers or pension funds”).

<sup>28</sup> See, e.g., Justin Fox & Jay W. Lorsch, *What Good are Shareholders?*, HARV. BUS. REV. 48, 51 (July-Aug. 2012) (illustrating that “[i]n 1950 households owned more than 90% of the shares of U.S. corporations. Now institutions hold approximately 50% of the domestically owned shares of public companies [. . .]. Add in institutional owners from overseas (foreign ownership of U.S. shares isn’t broken down between individuals and institutions) and hedge funds (which are counted mostly under households), and the true institutional share is probably closer to 65% or 70%.”). Hence, although ownership of U.S. publicly listed corporations is increasingly institutionalized, retail investors are still more important shareholders in the U.S. than they are in the EU. One reason for such difference also lies in that the European financial system has historically been, and still is, bank-based, as opposed to the market-based U.S. system: see EFAMA, *supra* note 17, at 13 (illustrating that “total assets of the banking sector averaged 316% of the GDP in the European Union in 2010-2014, compared to 115% in the United States. During this period, total EU stock market capitalization amounted to 64% of GDP, compared to 127% in the United States.”). Since European businesses remain too heavily reliant on banks for funding and not enough on capital markets, the CMU Action Plan intends to promote more diversified funding channels to the real economy and help reduce the reliance on bank lending and intermediation in the financial system.

<sup>29</sup> See *supra* note 15 and accompanying text.

<sup>30</sup> *Id.*

<sup>31</sup> Eur. Comm’n Staff, Annex, at 8.

<sup>32</sup> See *infra* Part II.B.

investors' increased engagement with investee companies, including voting. This outcome was driven to a significant degree by the adoption of the record date regime, and by enhanced regulatory and market pressures on institutional investors to take on stewardship responsibilities.<sup>33</sup> In contrast, voting has seemingly remained a costly and cumbersome issue for small individual investors.

In the U.S., retail voter turnout has been gradually decreasing over time. Despite holding the potential to increase turnout significantly, the retail base is weakly involved in engagement when compared to institutional shareholders. In fact, “[m]ore than 30% of the shareholdings of US public companies are held in retail hands, but only 29% of that segment voted in 2014, and retail participation hardly varies based on company size.”<sup>34</sup> The very same has been found to apply in relation to the U.S. 2017 proxy season.<sup>35</sup>

Nevertheless, individual share ownership and voting are as important in the European corporate landscape as in the U.S.<sup>36</sup> First, individual shareholders, who are by nature largely long-term investors, can be viewed as a source of long-term corporate financing. Second, retail investor votes can in some cases be decisive for the outcome at general meetings by either supporting, or contrasting, the board, “traditional” institutional investors (like actively managed mutual or pension funds), or activists (like hedge funds). Third, although ownership of publicly listed corporations is increasingly institutionalized, retail investors are not denied direct access to equity markets.<sup>37</sup> Therefore, the issue of retail shareholders' factual distance from participation in corporate governance should not be disregarded by the assertion that retail shareholders are motivated solely by the receipt of dividends.<sup>38</sup>

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<sup>33</sup> See *infra* Part II.A.

<sup>34</sup> See BROADRIDGE FINANCIAL SOLUTIONS, INC., RETAIL INVESTOR PROVIDES SILVER LINING (MKT 713 15, 2015), <http://go.broadridge1.com/ValueofRetailShareholderData>.

<sup>35</sup> See BROADRIDGE FINANCIAL SOLUTIONS & PRICEWATERHOUSECOOPERS, PROXY PULSE, 2017 PROXY SEASON REVIEW, 2 (Sept. 2017) (table featuring “Beneficial Share Ownership and Voting 2017 Proxy Season”), [https://www.broadridge.com/\\_assets/pdf/broadridge-2017-proxy-season-review.pdf](https://www.broadridge.com/_assets/pdf/broadridge-2017-proxy-season-review.pdf).

<sup>36</sup> See *infra* Part III.

<sup>37</sup> See *infra* Part III.A and note 249.

<sup>38</sup> See, e.g., UK INDIVIDUAL SHAREHOLDERS SOCIETY (SHARESOC), GUARANTEED VOTES FOR ALL. HOW TO REFORM THE UK SHARE OWNERSHIP, 14 (Sept. 2014), [https://www.sharesoc.org/Guaranteed\\_Votes.pdf](https://www.sharesoc.org/Guaranteed_Votes.pdf) (explaining

Of course, rational apathy<sup>39</sup> is crucial in explaining retail investors' largely passive behavior, especially within contexts of concentrated ownership which are typical for many European countries.<sup>40</sup> However, SRD shareholder empowerment notwithstanding, the persistence of rational apathy raises the question as to whether, and to what extent, retail investors' passivity might also be rooted in some regulatory shortcoming.

One illustrative example concerns EU issuers' accounting information based on International Accounting Standards and International Financial Reporting Standards (IAS/IFRS) according to regulation 1606/2002/EC.<sup>41</sup> Due to their complexity, IAS/IFRS are not suited to meet the information needs of unsophisticated shareholders and therefore do not help promote retail investor voting. As has recently been suggested, simplified and plain language narrative information might complement the numerical sections of the financial statements and render financial reports more readable by private investors.<sup>42</sup> Given the lack of a harmonized EU regime of narrative reporting, the European Securities and Markets Authority might be motivated to promote the pursuit of proactive enforcement activities at the national level with a view to developing guidance and recommendations concerning the contents and format of narrative reporting, while

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how the existing UK system of share ownership, largely based on nominee accounts, "disenfranchises the vast majority of private retail shareholders.").

<sup>39</sup> ROBERT C. CLARK, CORPORATE LAW 390-92 (1986); FRANK H. EASTERBROOK & DANIEL R. FISCHER, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 91 (1991).

<sup>40</sup> For a general overview of the ownership structure of listed companies in OECD countries see ORG. FOR ECON. CO-OPERATION & DEV., OECD CORPORATE GOVERNANCE FACTBOOK 11-14 (2017), <http://www.oecd.org/daf/ca/corporate-governance-factbook.htm> [hereinafter OECD FACTBOOK].

<sup>41</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, 2002 O.J. (L243) 1 (IAS Regulation).

<sup>42</sup> See Strampelli, *supra* note 8. See also Bernhard Pellens & André Schmidt, *Verhalten und Präferenzen deutscher Aktionäre. Eine Befragung von privaten und institutionellen Anlegern zum Informationsverhalten, zur Dividendenpräferenz und zur Wahrnehmung von Stimmrechten*, 77-79 (Studien des Deutschen Aktieninstituts) (Feb. 2014), [https://www.dai.de/files/dai\\_usercontent/dokumente/studien/2014-11-02%20Studie%20Aktionaersverhalten.pdf](https://www.dai.de/files/dai_usercontent/dokumente/studien/2014-11-02%20Studie%20Aktionaersverhalten.pdf) (finding that retail investors make poor use of information included in issuers' accounting disclosures and rely more heavily on information from the press, which confirms that "many retail investors do not view themselves as addressees of IFRS financial statements": this is an argument in favor of simplified narratives and investor summaries).

also providing national enforcers with corresponding guidelines.<sup>43</sup>

Further, with respect to the SRD, shareholder-empowering provisions are largely conceived to facilitate and promote engagement with investee companies by institutional investors—rather than small individual investors.<sup>44</sup> For instance, from the retail investor standpoint, it may be argued that the non-binding nature of the provisions on voting at a distance could help in explaining why electronic voting has not actually evolved into an option generally available for small shareholders. At the same time, the mechanics of voting, either in person or by proxy, remain uneven, especially in cases involving cross-border relationships. This is also due to inefficiencies that characterize the investment chain with respect to the process for communicating with, and voting by, shareholders that hold their shares in the multi-leveled securities depositories and intermediaries system. Another factor is the absence of a reliable system for shareholder identification, especially where share ownership is mostly based on nominee accounts, as seen in the UK. The 2007 SRD failed to specifically engage with and resolve both the issues of the inefficiencies of the investment chain and that of shareholder identification.

Against this backdrop, retail investors at listed companies may deserve reconsideration. Whether their apathy is truly inevitable seems to be questionable. To begin with, regulatory shortcomings such as those pointed out above should be remedied. A number of new measures were adopted under the newly enacted directive (EU) 2017/828 of 17 May 2017 amending the 2007 SRD (SRD II),<sup>45</sup> aimed at facilitating shareholder identification, improving the transmission of information along the investment

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<sup>43</sup> Strampelli, *supra* note 8, para. 9.

<sup>44</sup> See Rebecca Strätling, *How to overcome shareholder apathy on corporate governance. The role of investor associations in Germany*, 83 ANNALS OF PUB. & COOPERATIVE ECON. 143, 145 (2012) (noting that “the participation of private retail investors in firms’ corporate governance has largely be ignored. Instead, attention has focused on how to incentivize blockholders or institutional investors to contribute to the supervision and control of the companies they invest in”); Marina B. Madsen, *Promoting the ‘Right’ Kind of Ownership: The Good, the Bad and the Passive*, EBLR 143, 149 (2018). See also Hanne S. Birkmose, *The Transformation of Passive Institutional Investors into Active Owners: ‘Mission Impossible’ ?*, 107, in THE EUROPEAN FINANCIAL MARKET IN TRANSITION (Hanne S. Birkmose et al. eds., 2012).

<sup>45</sup> Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, 2017 O.J. (L 132), 1 [hereinafter SRD II].

chain and facilitating the exercise of shareholders' rights.<sup>46</sup> Although the new rules clearly prioritize institutional investor and asset manager engagement, they can be beneficial also for retail investors willing to vote at general meetings, and can positively affect corporate communication programs that specifically target individual shareholders.<sup>47</sup>

However, the removal of these important hurdles still may not be enough to convince retail shareholders to participate more actively in the voting process. Even if the overall mechanics of voting were substantially improved in terms of their efficiency, this would not resolve the impact of decision-making costs in regards to how to vote and psychological shortfalls, which negatively impact upon retail shareholders' voting behavior.<sup>48</sup>

Interestingly, the issue of mobilizing retail votes is becoming increasingly supported in the U.S., where voting at a distance, whether electronically or by telephone, is widespread.<sup>49</sup> Moreover, a growing number of U.S. corporations hold electronic AGMs, in some cases as full substitutes for physical meetings. The fall in retail investor voting rates despite the relatively significant proportion of retail share ownership in U.S. publicly traded corporations has prompted some scholars to address the issue of disengaged retail shareholders. While the tools proposed for revitalizing individual shareholders differ, they all give consideration to decision-making costs and behavioral biases affecting participation.<sup>50</sup>

In order to explore whether, and if so how, retail investors might be induced to become more actively involved in EU investee companies, this Article proceeds as follows. Part II provides some evidence from various EU Member States as to how relevant retail shareholdings actually are in corporate ownership, as compared to institutional investors. Against this backdrop, Part III argues in favor of increased retail shareholder participation. Part IV illustrates the U.S. debate on mobilizing retail votes. Part V explores the potential constraints on retail shareholder engagement

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<sup>46</sup> See *infra* Part V.A.2.

<sup>47</sup> *Id.*

<sup>48</sup> See *infra* Part V.A.

<sup>49</sup> See Fisch, *supra* note 1, at 34 (reporting that "Broadridge's innovations offered retail investors the first modern alternatives to submitting their voting instructions by mail—initially enabling telephonic submission and then electronic submission through proxyvote.com. Of the retail shares that are currently voted, more than two-thirds are voted through proxyvote.com").

<sup>50</sup> See *infra* Part IV.

posed by the current European regulatory framework and comparatively assesses whether, and if so how, the U.S. proposals for activating passive retail investors might provide a blueprint for similar initiatives in Europe. Part VI sets out the conclusions.

## II. INSTITUTIONAL VS RETAIL SHAREHOLDINGS AND VOTING IN CONTEXT

The first step to be made when addressing the question as to whether small individual investors should be given more nuanced consideration within the corporate governance framework for EU listed companies is to examine more closely the factual economic context in which current regulation works. The examination of the distinctive features of institutional and retail investors as shareholders, their relative significance in terms of EU publicly traded share ownership, their voting behavior and its impact on listed companies will provide the background framework for the following analysis.

### *A. The rise of institutional shareholder ownership and engagement in Europe*

There is more than one reason for the rise in institutional shareholder engagement that all European jurisdictions have experienced over the last two decades.<sup>51</sup> This includes contexts where concentrated share ownership prevails.<sup>52</sup> Institutional share ownership at listed companies has increased dramatically in Europe, so much so that institutional investors have become the dominant owners of public equity.<sup>53</sup> Keeping this mind, the SRD

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<sup>51</sup> See, e.g., J.P. MORGAN, *KNOCKING AT THE DOOR. SHAREHOLDER ACTIVISM IN EUROPE* (Aug. 2014), [https://www.jpmorgan.com/cm/BlobServer/mabriefing\\_activism\\_july2014.pdf](https://www.jpmorgan.com/cm/BlobServer/mabriefing_activism_july2014.pdf). Referred to the US see PRICEWATERHOUSECOOPERS, *SHAREHOLDER ACTIVISM. WHO, WHAT, WHEN, AND HOW?* (Mar. 2015), <https://www.pwc.com/us/en/corporate-governance/publications/assets/pwc-shareholder-activism-full-report.pdf>.

<sup>52</sup> See, e.g., Massimo Belcredi & Luca Enriques, *Institutional Investor Activism in a Context of Concentrated Ownership and High Private Benefits of Control: the Case of Italy* (ECGI Law Working Paper No. 225/2013) (Mar. 2014), [http://ssrn.com/abstract\\_id=2325421](http://ssrn.com/abstract_id=2325421).

<sup>53</sup> See Serdar Çelik & Mats Isaksson, *Institutional investors and ownership engagement*, 95-193 (*OECD Journal: Fin. Market Trends* (2013), <http://dx.doi.org/10.1787/fmt-2013-5jz734pwtrkc>).

provisions strengthening shareholder rights<sup>54</sup> operate in conjunction with those set by stewardship and corporate governance codes that target institutional investors as shareholders in order to foster their constructive engagement with investee companies as a part of institutions' investment management activities.<sup>55</sup> Though non-binding in nature, self-regulation has exerted considerable pressure upon institutional investors to take on stewardship responsibilities, including voting and the disclosure of voting policies and votes actually cast.<sup>56</sup>

The trend towards responsible stewardship has been further enhanced by the SRD II, adopted following the EC's 2010 and 2011 Green Papers on corporate governance in financial institutions,<sup>57</sup> and the EU corporate governance framework,<sup>58</sup> which identified shareholder engagement as an aim of EU regulatory action. Based on "evidence that the majority of shareholders are passive and are often only focused on short-term profits", the Commission found that shareholders should be "encouraged to take an interest in sustainable returns and longer term performance and [...] to be more active on corporate governance issues".<sup>59</sup> Therefore, the SRD II introduced a set of provisions intended to promote "the level and quality of engagement of asset owners and asset managers with their investee companies,"<sup>60</sup> while also providing a broad definition of the notion of engagement. According to Article 3g (1)(a) of SRD II, engaging entails

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<sup>54</sup> See *infra* Part I.

<sup>55</sup> See, e.g., FIN. REPORTING COUNCIL, UK STEWARDSHIP CODE (2012), <https://www.frc.org.uk/investors/uk-stewardship-code>, and ORG. FOR ECON. CO-OPERATION & DEV., G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE (2015), [https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015\\_9789264236882-en](https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en).

<sup>56</sup> See, e.g., UK Dep't for Bus. Innov. & Skills, *Exploring the Intermediated Shareholding Model*, 136 (BIS Research Paper No. 261) (Jan. 2016), [http://www.uksa.org.uk/sites/default/files/BIS\\_RP261.pdf](http://www.uksa.org.uk/sites/default/files/BIS_RP261.pdf).

<sup>57</sup> Eur. Comm'n, *Green Paper. Corporate governance in financial institutions and remuneration policies*, COM (2010) 284 final (June 2, 2010).

<sup>58</sup> Eur. Comm'n, *Green Paper. The EU corporate governance framework*, COM (2011) 164 final (Apr. 5, 2011).

<sup>59</sup> *Id.* at 3.

<sup>60</sup> See Eur. Comm'n, *Proposal for a Directive of the European Parliament and the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement*, 2, COM (2014) 0213 final, (2014) 0121 (COD), (Apr. 9, 2014). [hereinafter Eur. Comm'n, Explanatory Memorandum].

monitor[ing] investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance, conduct[ing] dialogues with investee companies, exercis[ing] voting rights and other rights attached to shares, cooperat[ing] with other shareholders, communicat[ing] with relevant stakeholders of the investee companies and manag[ing] actual and potential conflicts of interests in relation to [. . .] engagement.

Accordingly, Article 3g of SRD II requires intermediaries—on a comply or explain basis—to develop an engagement policy, to publicly disclose the policy and report on its implementation on an annual basis. Disclosure of an engagement policy should include a general description of voting behavior, an explanation of the most significant votes cast and the use made of proxy advisory services. Intermediaries are further required to publicly disclose how they cast votes at the general meetings of each investee company, except for votes that are insignificant due to the subject matter or the size of the holding.

Based on the fundamental concept that intermediated investments must be managed in the best interest of those who bear the associated economic risk, the SRD II implicitly leverages the rationale of end-investor protection that underlies all investment manager duties as agents in order to enhance their duties as shareholders. As specifically regards voting, Article 3g of SRD II must in fact be read within the context of the broader regulatory framework governing discretionary portfolio and collective investment management,<sup>61</sup> which entitles intermediaries to vote on behalf of the shares owned by the funds they manage. Because of this entitlement, Article 21 of Directive 2010/43<sup>62</sup> and Article 37 of Regulation 231/2013<sup>63</sup> require mutual fund and

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<sup>61</sup> According to EFAMA, *supra* note 17, at the end of 2016, “Investment fund assets accounted for 51.8% of all AuM, totaling EUR 11,800 billion, whereas discretionary mandates represented 48.2% of total AuM, or EUR 11,000 billion”.

<sup>62</sup> Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company, 2010 O.J. (L 176) 42.

<sup>63</sup> Commission Delegated Regulation (EU) No 231/2013 of 19 Dec. 2012



alternative investment fund managers to establish a voting policy determining *when and how* voting rights are to be exercised, to the exclusive benefit of the funds concerned and their investors. The exercise of voting rights is thus conceived of as a duty that investment managers owe to end-investors wherever, based *inter alia* on a cost-benefit analysis, voting is in the best interest of the end-investor. Therefore, in a manner not very dissimilar to the U.S.,<sup>64</sup> a duty to vote *every share* is not mandated under European law. Still, investment managers are not allowed simply to remain passive and chose not to vote their shares. In effect, depending on the investment strategies adopted, voting passivity might be in conflict with institutions' duty to manage investments in the best interest of their clients.<sup>65</sup> Relying on the duty of intermediaries to vote the shares pertaining to the funds managed, the transparency provisions laid down by the SRD II as regards engagement strengthen investment managers' accountability to end-investors with respect to voting.

Alongside regulation and self-regulation, the rise of institutional investor engagement has also been supported by the growth of the proxy advisory industry. Proxy advisory services—particularly proxy analysis reports and voting recommendations—are a cost-effective solution for helping institutional investors, fund managers and investment advisers comply with stewardship and voting requirements, fill information and knowledge gaps, and provide relief from the cost and time-intensive work required to process the relevant information. Thus, proxy advisors have contributed to increasing the value of shareholders' voice, reducing investor apathy and providing a means for addressing collective action problems that are inherent within institutional shareholder action.

Finally, one of the reasons for the increase in institutional investor engagement is the ever-growing number of stakes held in issuers listed in Europe by foreign, international investors. According to the EC, non-national shareholders—most of which are institutional intermediaries—hold some 44% of the shares

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supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, 2013 O.J. (L 83) 1.

<sup>64</sup> See *infra* note 72.

<sup>65</sup> See, e.g., Christian Strenger & Dirk A. Zetzsche, *Corporate Governance, Cross-border Voting and the (draft) Principles of the European Securities Law Legislation—Enhancing Investor Engagement Through Standardisation*, 13 J. CORP. L. STUD., 503, 512-515 (2013).

issued by EU listed companies.<sup>66</sup> In Germany, for example, Blackrock, a U.S.-based institutional investment manager, became the largest investor in publicly listed companies by 2008 and grew quickly thereafter.<sup>67</sup> Further, other major institutional investors, such as Vanguard, Fidelity and Capital Group, saw similar growth with respect to investments in Germany's publicly listed companies.<sup>68</sup> By 2010, Norges Bank Investment Management, the world's largest sovereign wealth fund, had overtaken Allianz Group and Deutsche Asset Management, the two major German institutional investors.<sup>69</sup> Until 2007, both of these had been the major shareholders in publicly listed German companies with respect to overall value held as well as the number of block holdings.<sup>70</sup>

Given that a substantial proportion of shares in EU listed companies under foreign ownership is held by large U.S.-based investors,<sup>71</sup> there is no wonder that this factor has fueled

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<sup>66</sup> Eur. Comm'n, Explanatory Memorandum, at 3; OBSERVATOIRE DE L'ÉPARGNE EUROPÉENNE (OEE) & INSEAD OEE DATA SERVICE (IODS), *Who owns the European Economy? Evolution of the ownership of EU-listed companies between 1970 and 2012*, 20 (Aug. 2013), <https://publications.europa.eu/en/publication-detail/-/publication/db5b2604-e1d7-11e5-8a50-01aa75ed71a1/language-en> [hereinafter OEE & IODS, Who owns] (illustrating that over the last forty years, "the relative weight of foreign investors more than quadrupled, from 10% in 1975 to 45% in 2012, or 38% in 2012 if funds domiciled in Luxembourg or Ireland are considered as domestic investors rather than foreign ones"); ORG. FOR ECON. CO-OPERATION & DEV., *THE ROLE OF INSTITUTIONAL INVESTORS IN PROMOTING GOOD CORPORATE GOVERNANCE*, 26 (2011), <http://www.oecd.org/daf/ca/49081553.pdf>.

<sup>67</sup> See Jo Seldeslachts, Melissa Newham & Albert Banal-Estanol, *Changes in common ownership of German companies*, at 305 (DEUTSCHES INSTITUT FÜR WIRTSCHAFTSFORSCHUNG—DIW Econ. Bull. 30.201), [https://www.diw.de/documents/publikationen/73/diw\\_01.c.562467.de/diw\\_econ\\_bull\\_2017-30.pdf](https://www.diw.de/documents/publikationen/73/diw_01.c.562467.de/diw_econ_bull_2017-30.pdf). For the position in Italy see Nadia Linciano, Angela Ciavarella & Rossella Signoretti, *2016 Report on corporate governance of Italian listed companies*, 13-14 (CONSOB Statistics and Analyses) (Dec. 1, 2016), <https://ssrn.com/abstract=2947709> (reporting that, at the end of 2015, institutional investors were major shareholders in nearly 36% of the market, holding on average 6.9% of the share capital in 83 firms; foreign institutional investors owned major holdings especially in larger firms and in the financial sector).

<sup>68</sup> See Seldeslachts, Newham & Banal-Estanol, *supra* note 67, at 305, note 11.

<sup>69</sup> *Id.* at 305-306.

<sup>70</sup> *Id.* at 306.

<sup>71</sup> Referred to the UK see OFF. FOR NAT'L STAT., OWNERSHIP OF UK QUOTED SHARES: 2016, para. 3, 5, 11, <https://www.ons.gov.uk/economy/investmentpensionsandtrusts/bulletins/own>

engagement with European issuers. As is well known, U.S.-based institutional investors have a long-standing tradition of being more active shareholders: an attitude they tend to replicate internationally, supported by global and local proxy advisors.<sup>72</sup>

By and large, combined with the adoption of the record date system,<sup>73</sup> these factors account for the increased exercise of voting rights in European issuers. This phenomenon is remarkable; however, it is different from proactive activism experienced in the U.S., where some institutional shareholders show a more demanding, or even aggressive, attitude in exercising shareholder rights as a means of targeting investee companies in order to bring about a change in the boardroom or in the company's governance, business or strategy.<sup>74</sup> Notably, proactive

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ershipofukquotedshares/2016 [hereinafter OFF. FOR NAT'L STAT., OWNERSHIP] (noting that "North American investors have increasingly invested directly in the ordinary shares of UK companies listed on the London Stock Exchange". As at Dec. 31, 2016, the "rest of the world" sector held 53.9% of the value of listed UK companies' ordinary shares, 48.1% thereof being held by North American investors—mostly unit trusts, other financial institutions and pension funds).

<sup>72</sup> In the U.S., voting by mutual and public pension funds was fueled by regulatory action taken to heighten the fiduciary obligations applicable to voting proxies, most notably i) by two companion SEC releases of 2003 addressing voting disclosures for registered management investment companies and registered investment advisers exercising voting authority over fund portfolios (see Sec. & Exch. Comm'n, Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564 (Feb. 7, 2003); *Id.*, Proxy Voting by Investment Advisers, 68 Fed. Reg. 6586 (Feb. 7, 2003); and ii) by Department of Labor interpretative guidelines concerning the legal standards imposed by sections 402, 403 and 404 of Title I of the Employee Retirement Income Security Act (ERISA) (see Department of Labor, Interpretative Bulletin relating to the exercise of shareholder rights, 73 Fed. Reg. 61,732 (Oct. 17, 2008)). Those rulings were largely (mis-)interpreted as requiring addressees to vote on all matters, *i.e.* to vote *every* proxy.

<sup>73</sup> See, e.g., Christoph Van der Elst, *Shareholders as Stewards: Evidence of Belgian General Meetings*, 5 (Financial Law Institute Working Paper Series, WP 2013-05) (Jan. 2013), <https://ssrn.com/abstract=2270938> (assuming that the increase in attendance rates at Belgian listed companies' 2012 annual meetings "is due to the abolishment of the "blocking of shares").

<sup>74</sup> See Peter Cziraki, Luc Renneboog & Peter G. Szilagyi, *Shareholder Activism through Proxy Proposals: The European Perspective*, 16 EUR. FIN. MGMT., 738 (2010) (finding that proposal submissions remain infrequent in Europe compared to the U.S.; however, proposal sponsors are valuable monitors, since they typically target underperforming and low-leverage firms. Overall, the low voting support attracted by shareholder proposals and strongly adverse market reactions suggest that proposals are used at European companies as an emergency brake rather than a steering wheel). See also Angela Giovinco, *Activism. The Evolution of an Investor Strategy*, 9 (Jan. 13, 2015)

activism in Europe is still a long way behind the U.S., despite being on the rise.<sup>75</sup>

Although voting cannot be viewed as a measure of its quality, it is one measure of the level of shareholder engagement with investee companies. If measured with reference to voting, there is little doubt that institutional investors and asset managers have become more active shareholders.<sup>76</sup> On EU-average, the level of voter turnout—the proportion of a company’s issued shares that are voted at the general meeting—increased by 6.8 percentage points between 2008 to 2015, from 60.4% to 67.2%.<sup>77</sup> Although voter turnout data varies between different European countries,<sup>78</sup> this trend is Europe-wide, regardless of the lower or higher degree of share ownership concentration.<sup>79</sup>

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(unpublished manuscript), <https://ssrn.com/abstract=2549179> (noting that “Activist campaigns, which have grown in popularity in the United States, are less common in Europe”; further, European activism is described as “less noisily” as in the U.S.).

<sup>75</sup> See SKADDEN-ACTIVIST INSIGHT, *ACTIVIST INVESTING IN EUROPE. A SPECIAL REPORT* (Oct. 2017) (noting that increased activism in Europe is partly due “to a higher incidence of foreign activists looking for opportunities as the U.S. market has become increasingly picked over”), <https://www.skadden.com/insights/publications/2017/10/activist-investing-in-europe-a-special-report-2017>.

<sup>76</sup> See generally Chris Mallin, *Institutional investors: the vote as a tool of governance*, 16 J. MGMT. GOV. 177 (2012); Paul Hewitt, *The Exercise of Shareholder Rights: Country Comparison of Turnout and Dissent*, 15-17 (OECD Corporate Governance Working Papers, No. 3, 2011), <http://dx.doi.org/10.1787/5kg54d011lvf-en>.

<sup>77</sup> INSTITUTIONAL SHAREHOLDER SERVICES, INC., *EUROPEAN VOTING RESULTS REPORT. 2015 UPDATE*, 10, [http://www.agefi.fr/sites/agefi.fr/files/migrate/etudereference/QPZEUUZFN\\_European%2520Voting%2520Results%2520Report%25202015.pdf](http://www.agefi.fr/sites/agefi.fr/files/migrate/etudereference/QPZEUUZFN_European%2520Voting%2520Results%2520Report%25202015.pdf).

<sup>78</sup> See *id.*, at 10 (illustrating data ranging from 48.9% in Denmark up to 75.2% in the UK); SCHUTZGEMEINSCHAFT DER KAPITALANLEGER E.V., *SDK-PRÄSENZSTATISTIK DAX*, <http://www.sdk.org/assets/Statistiken/HV-Praesenzen/praesenz-dax15.pdf>, (reporting that mean voter turnout at German DAX 30 companies increased from 44.98% in 2005 to 54.95% in 2015).

<sup>79</sup> One illustrating example is Italy: see Linciano, Ciavarella & Signoretti, *supra* note 67, at 35 (noting that AGM attendance rates at top 100 Italian companies kept steadily around 70% of the companies’ shares since 2012, highlighting a gradual increase in the participation of institutional investors, currently amounting to approximately 19% of the companies’ shares, “ascribable to the attendance pattern of foreign institutional investors (from around 10% to 18% of the share capital over the last five years), while figures for Italian investors have continued swinging around 1% of the capital.” In 2016, foreign institutional represented on average more than one fourth of the capital represented at the meetings of the 100 largest companies). Similarly, using the

*B. What has become of the retail investor?*

Compared to institutional investors, retail investors seem to be turning into minor actors on the European direct corporate financing and the corporate governance scene. During the last forty years, the proportion of households within the share ownership structure of European listed companies has fallen by a factor of almost three:<sup>80</sup> “[h]ouseholds held 28% of the market capitalisation in 1975. Their stake dropped and stabilised at 10-11% since 2007.”<sup>81</sup>

Where indirect holdings of listed shares—through investment funds, life insurance policies and pension funds—are taken into consideration, “households are still major owners of listed companies.” However, such ownership “has become more and more intermediated in the last 30 years.”<sup>82</sup> Therefore,

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number of voting instructions submitted as a proxy for active ownership at Danish AGMs, “The number of voting instructions from foreign investors continues to increase” (plus 14 per cent in 2017, and plus 80 per cent during the period from 2014 to 2017): VP INVESTOR SERVICES, ANALYSIS AND ASSESSMENT OF THE DANISH ANNUAL GENERAL MEETINGS IN 2017, 7-8 (June 2017),

<http://ipaper.ipapercms.dk/VPSecurities/VPINVESTORSERVICES/Analyser/gf-analyse-2017/> (further illustrating that foreign investors’ ownership equals 53 per cent of the Danish equities market in 2017).

<sup>80</sup> OEE & IODS, *Who owns*, at 21.

<sup>81</sup> *Id.* at 24.; *see also* EUROSISTEM HOUSEHOLD FINANCE & CONSUMPTION NETWORK, *The Eurosystem Household Finance and Consumption Survey. Results from the first wave*, 41-43 (ECB Statistics Paper, No. 2, 2013), <https://www.econstor.eu/handle/10419/154637> [hereinafter Eurosystem Household Survey] (noting that, with only a small fraction of households—between 5% and 12%—owning bonds, publicly traded shares or mutual funds, participation in the stock market is “clearly below what is suggested by economic theory, namely that *all* households with positive net wealth should hold at least *some* publicly traded shares, for diversification reasons and because of the higher expected return on stocks compared to other investments”, and finding that stock market participation is very much related to i) income and net wealth (among households in the lowest quintile of the income distribution, only 2.2% own publicly traded shares, in contrast to 24.4% in the top quintile); ii) age (holdings of publicly traded shares increase with age and then decline, a pattern that is in line with a life-cycle behaviour of accumulating savings over working-life, while spending savings after retirement, and iii) education (only 4.2% of households with a reference person with primary or no completed education participate in stock markets, as opposed to 19.6% of households where the reference person has completed tertiary education).

<sup>82</sup> OEE & IODS, *Who owns*, at 55. Similarly, in the U.S., “over 66% of the Russell 1000 companies are owned by Main Street investors, either directly or

households still “play a critical role in allowing healthy financial intermediation,”<sup>83</sup> but their importance as shareholders has been steadily decreasing in significance. In the U.S., too, “institutionalization” (or “deretailization”) is a characteristic feature of equity markets.<sup>84</sup>

The fall in direct share ownership can most likely be viewed as a consequence of the shift towards indirect, managed shareholding.<sup>85</sup> In fact, indirect share ownership allowing for greater portfolio diversification and more efficient access to the markets has now become predominant for individuals. This was also as a consequence of the 1987, 2000 and 2008 crises, which “convinced many individuals that equity markets were too risky for them and that they were not at equality with professional market participants.”<sup>86</sup> Alongside the perception of increased market risk, lowered trust in equity markets, as well as punitive taxation of dividends and capital gains in several countries, entry costs, including information costs and the cost of financial literacy, income uncertainty, health risks and behavioral biases further impair households’ participation in the stock markets.<sup>87</sup> Moreover, banks may have an incentive to sell packaged retail and insurance-based investment products (so-called PRIIPs), that generate higher

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indirectly through mutual funds, pension or other employer-sponsored funds, or accounts with investment advisers. And, if foreign ownership is excluded, that percentage approaches approximately 79%”. Jay Clayton, *Governance and Transparency at the Commission and in Our Markets*. Remarks at the PLI 49th Annual Institute on Securities Regulation, New York, N.Y. (Nov. 8, 2017), <https://www.sec.gov/news/speech/speech-clayton-2017-11-08> (last visited Apr. 12, 2018).

<sup>83</sup> OEE & IODS, Who owns, at 9.

<sup>84</sup> See Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1026 (2009); Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 2038 (2010); Kathryn Judge, *Intermediary Influence*, 82 U. CHI. L. REV. 573, Part II C.1 (2015), (illustrating that, after removal of the fixed brokerage fees system in 1975, which was previously mandated in order to own and trade individual stocks, and due to subsequent price competition and technological advances, intermediary influence—specifically, stockbrokers enjoying positional advantages vis-à-vis their individual clients—has contributed to deretailization in favor of mutual funds basically out of a self-serving incentive at earning more profitable fees).

<sup>85</sup> Clayton, *supra* note 82, at 21.

<sup>86</sup> *Id.* at 9. According to EFAMA, *supra* note 17, at 3, at the end of 2015, European asset managers held 54% of the value of the free float market capitalization of euro area listed firms. Retail clients accounted for 27% of total assets under management in Europe.

<sup>87</sup> OEE & IODS, Who owns, at 25.

and more stable fees, or banking products that help ensure compliance with international liquidity ratios.<sup>88</sup>

As regards its effects on a company's corporate governance, indirect share ownership results in a concentration of retail investors' voting interests, and the management thereof, at the level of the investment manager. Given that beneficial owners of the assets under management are prevented from making any decision concerning the management of their investments, including voting, the end-investor-best-interest principle is the fundamental rule of conduct that is imposed upon investment managers in order to protect beneficial owners.

Therefore, from the standpoint of the retail investor, voting becomes an issue only where she directly owns a company's shares. But direct share ownership requires that shareholders willing to vote become involved in the complex voting machinery and incur high information and decision-making costs.

According to economic theory, due to the insignificant size of their stakes, small individual shareholders, who—unlike investment managers—have no responsibility to be active other than that owed to themselves, are likely to be rationally apathetic as regards gathering and processing the information needed to make informed voting decisions on a management proposal. Because, famously, “[w]hen many are entitled to vote, none expects his vote to decide the contest,” and “none of the voters has the appropriate incentives to study the firm's affairs and vote intelligently.”<sup>89</sup> Retail shareholders are therefore likely to trust the board or rely on larger investors' monitoring efforts and abstain from voting at all. After all, rational apathy can be an explanation for the preference of managed share ownership.<sup>90</sup> Similarly, shifting to intermediated share ownership can be regarded as a choice to eliminate the additional problem of individual inadequacy—meaning the inability to make “good” voting decisions due to inferior access to information, time, education, experience as well as business judgment constraints<sup>91</sup>—, which is

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<sup>88</sup> *Id.*

<sup>89</sup> EASTERBROOK & FISCHER, *supra* note 39, at 66.

<sup>90</sup> See Harry G. Hutchison & R. Sean Alley, *The High Costs of Shareholder Participation*, 11 U. PA. J. BUS. L. 941, 949 (2009) (noting “Why are mutual funds so widely held when they offer no participation in the underlying corporations at all? Why do people hire investment advisors to distance themselves from participating in their investments? One explanation is that the participatory experience is not worth its cost to a rational investor.”).

<sup>91</sup> See Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS

often used as an argument against shareholder empowerment.<sup>92</sup> Thus, shareholder apathy and inadequacy retain much intuitive appeal with respect to the small individual investor, whose reliance upon better-informed directors' voting proposals and other investors' monitoring is logical, at least as regards ordinary matters.<sup>93</sup>

These arguments are consistent with low retail shareholder turnout at general meetings.<sup>94</sup> While ample supporting empirical evidence is available in this respect for the U.S.,<sup>95</sup> the same does not apply to the European context, where empirical surveys focusing on retail investor participation at shareholder meetings are rare and usually refer to specific Member States. Thus, a clear EU-wide picture of retail shareholder voting is not easily gained, and uncertainty exists to some extent.

To assess large and small shareholders' attendance and voting behavior at AGMs, a recent study considers a wide sample of companies listed in seven representative EU Member States over the period from 2010 to 2014.<sup>96</sup> To determine small shareholder turnout rates, small shareholders are defined as all shareholders who are not block holders. Whereas a block holder is defined as a shareholder, or multiple shareholders that have collectively entered into a shareholder agreement subject to public disclosure according to Directive 2004/109/EC ("Transparency Directive"),<sup>97</sup> holding at least 5% of all voting rights (the lowest disclosure threshold in the Transparency Directive).<sup>98</sup> Assuming that all block holders attend the meeting, the study found that the mean voter turnout of small shareholders for the whole sample was

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L. REV. 605, 625 (2007).

<sup>92</sup> See Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1745-49 (2006).

<sup>93</sup> See Velasco, *supra* note 91, at 623.

<sup>94</sup> See, e.g., Madsen, *supra* note 44, at 149 (noting that "[t]he group of passive shareholders in European listed companies is a large fraction comprising of both professional and retail shareholders").

<sup>95</sup> See *supra* notes 34-35.

<sup>96</sup> ANNE LAFARRE, *THE AGM IN EUROPE: THEORY AND PRACTICE OF SHAREHOLDER BEHAVIOUR* (2017), Part III.

<sup>97</sup> Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, 2004 O.J. (L 390) 38, as amended by Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013, 2013 O.J. (L 294) 13 [hereinafter Transparency Directive]

<sup>98</sup> See Article 9 of Transparency Directive.



49.7% with a standard deviation of 18.1%.<sup>99</sup> Differences between Member States are remarkable. In the UK, mean small shareholder turnout rates are relatively high, with a rate around 60%, while they are substantially lower especially in Belgium and Austria, with rates of about 21% and 31% respectively.<sup>100</sup> Interestingly, in most countries analyzed, small shareholder turnout rates have increased over the years, suggesting that, in contrast to economic theory, “some small shareholders (although certainly not all) do vote, and that there is an increasing trend in small shareholder voter turnout.”<sup>101</sup>

However, due to the way in which the small shareholder is defined for the purposes of the study, these findings do not allow more precise conclusions to be drawn specifically in relation to “genuine” retail investors. Indeed, defining small shareholders as all those with holdings below the threshold of 5% of the voting rights remains too wide a definition to insulate the retail shareholder, whose stakes mostly remain largely underneath that threshold. At the very best, these findings enable it to be stated that, on average, the retail investor voter turnout rate at European AGMs certainly does not reach 50%. This means that, by an optimistic estimate, on average more than half of retail votes are not cast. Were data to be purged of the impact of the votes of “non-genuine” small individual investors, such as smaller funds, the actual retail investor voter average turnout rates would probably be even lower.

This assumption is consistent with national data. For example, according to a German survey based on questionnaires addressed at Deutsche Post DHL investors, 36% of all retail shareholders had not cast their votes during the previous two years, and did not plan to change their voting behavior in future, while only 11% personally cast their votes and 39% did so via a proxy agent.<sup>102</sup> According to a survey supported by the French Autorité des Marchés Financiers (AMF), only one retail shareholder out of three systematically, or frequently, votes her shares, due to a perceived irrelevance of retail votes, an

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<sup>99</sup> Lafarre, *supra* note 96, at 110.

<sup>100</sup> *Id.* at 112-113.

<sup>101</sup> *Id.* at 115.

<sup>102</sup> See Pellens & Schmidt, *supra* note 42, at 50, Table 18, and 51 (noting a negative trend of retail votes especially as regards unexperienced investors). In relation to Belgium, see van der Elst, *supra* note 73, at 11 (finding that “Only in Bel 20 companies the mean attendance of these shareholders exceeds the 25% threshold”).

unawareness of how to vote, or a poor understanding of the issues to be voted upon.<sup>103</sup>

### III. WHY DO RETAIL SHAREHOLDERS MATTER, AND WHY SUPPORTING RETAIL VOTING IS NOT TRIVIAL

When we consider shareholder general meetings in practice, to worry about retail investor absence might seem frivolous. Operations at general meetings are frequently described as standard and routine, and some particular portrait of attending individual shareholders might be disheartening: events like those at the 2016 Daimler AGM in Berlin, where the supervisory board chair had to call the police when retail shareholders quarreled over sausages at the buffet, make headlines.<sup>104</sup> There is reason to believe, however, that the absence of retail shareholders at issuers' general meetings is not a trivial concern.

#### *A. Retail Share Ownership and Market Efficiency*

Enhancing the governance role of retail investors could not only incentivize retail share ownership of listed companies.<sup>105</sup> From a broader economic perspective, it also could help increase equity markets efficiency. The massive withdrawal of retail investors from listed stock ownership in the U.S. since the 1970s has been found to have negative implications for capital formation, investor protection, and market efficiency. Individual investors are often seen as irrational and uninformed noise traders,<sup>106</sup> who

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<sup>103</sup> See AUTORITE DES MARCHES FINANCIERS, *Lettre de l'Observatoire de l'épargne de l'AMF*, 3 (No. 9, June 2017), <http://www.amf-france.org/Publications/Lettres-et-cahiers/Lettre-de-l-observatoire-de-l-epargne/Archives?docId=workspace%3A%2F%2FSpacesStore%2F0729ba4a-a168-4d3e-9a8a-ff88ceda788> [hereinafter AMF, Lettre]. Similar data are referenced for the UK: see *supra* note 38, 24-25.

<sup>104</sup> See *Büfett auf Hauptversammlung. Daimler Aktionäre streiten über Würstchen*, SPIEGELONLINE (Apr. 7, 2016, 11:52 AM), <http://www.spiegel.de/wirtschaft/unternehmen/wuerstchen-streit-zwischen-daimler-aktionaeren-provoziert-polizeieinsatz-a-1085886.html>.

<sup>105</sup> See Arthur R. Pinto, *The European Union's Shareholder Voting Rights Directive from an American Perspective: Some Comparisons and Observations*, 32 FORDHAM INT'L L.J. 587, 620-621 (2009) (noting that "enhancing shareholder voting could encourage more share ownership, which could then provide additional support for improved corporate governance").

<sup>106</sup> See Werner F.M. De Bondt, *A portrait of the individual investor*, 42 EUR. EC. REV. 831 (1998) (finding that small individual investors who manage their own equity portfolios discover naive patterns in past price movements,

distort stock prices and harm market functioning.<sup>107</sup> This generalization ignores the fact that retail trading may increase share price accuracy and market allocative efficiency, and thus give “substantial reasons to lament retail investor flight”.<sup>108</sup> In fact, evidence suggests that retail investors play an important role in market functionality by showcasing the existence of causal relationships between the proportion of trading by individual investors, stock price informativeness, and the probability of informed trading.<sup>109</sup>

The market-efficiency-enhancing effect of retail trading ties in with findings which document that retail trading can add market liquidity.<sup>110</sup> This is particularly important in regards to the stocks of small firms, for which liquidity is often a significant problem. Retail investors provide liquidity to institutional investors who require immediacy in trade execution.<sup>111</sup> In fact, retail traders seem to have some ability to act as market makers, especially when institutional liquidity dries up in times of high uncertainty.<sup>112</sup> Additionally, individual investors may have private information and their trading can be informative, meaning that the information incorporated into stock prices through collective individual investors’ trading can be relatively precise and valuable.<sup>113</sup> The improvement in stock price informativeness

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share popular models of value, are not properly diversified and trade in suboptimal ways).

<sup>107</sup> See Brad M. Barber, Yi-Tsung Lee, Yu-Jane Liu & Terrance Odean, *Just how much do individual investors lose by trading?*, 22 REV. FIN. STUD. 609 (2009), and Bran M. Barber, Terrance Odean & Ning Zhu, *Do retail trades move markets?*, 22 REV. FIN. STUD. 151 (2009) (finding that individual investor trading results in systematic and economically large losses). See also Thierry Foucault, David Sraer & David J. Thesmar, *Individual investor and volatility*, 66 J. FIN. 1369 (2011) (finding that retail investor trading adds volatility to stock prices, which suggests they behave as noise traders).

<sup>108</sup> See Alicia J. Davis, *Market Efficiency and the Problem of Retail Flight*, 20 STAN. J.L. BUS. & FIN. 36 (2014).

<sup>109</sup> *Id.* at 45.

<sup>110</sup> See Rong Ding & Wenxuan Hou, *Retail investor attention and stock liquidity*, 37 INT’L FIN. MARKETS, INST. & MONEY 12 (2015) (finding that retail investor attention to stock significantly enlarges the shareholder base and improves stock liquidity).

<sup>111</sup> See Ron Kaniel, Gideon Saar & Sheridan Titman, *Individual Investor Trading and Stock Returns*, 63 J. FIN. 273 (2008) (documenting that risk-averse individuals provide liquidity to meet institutional demand for immediacy).

<sup>112</sup> See Jean-Noel Barrot, Ron Kaniel & David Sraer, *Are retail traders compensated for providing liquidity?*, 2 (CEPR Discussion Paper No. DP10820) (Sept. 2015), <https://ssrn.com/abstract=2661549>.

<sup>113</sup> See Ron Kaniel, Shuming Liu, Gideon Saar & Sheridan Titman,

determined by individual investor trading reduces information asymmetry and enhances firm value.<sup>114</sup> At the same time, reduced information asymmetry induced by individual investor trading improves stock liquidity.<sup>115</sup>

From an issuer standpoint, encouraging retail shareholder participation builds upon shareholder loyalty to stabilize the investor base, which in turn is expected to reduce stock volatility. Retail investors are reported to be the most patient shareholders with a long-term focus and little interest in speculative trading.<sup>116</sup> If retail shareholders were to become more active in voting, this would probably enhance the beneficial effects associated with a more stable investor base. In fact, owing to their past commitment in voting shares, active shareholders are likely to become more tightly tied to their shares and unwilling to sell up, even where exiting is actually the optimal choice.<sup>117</sup> This effect is referred to as the “sunk cost effect”: an effect explained as a behavior “manifested in a greater tendency to continue an endeavor once an investment in money, effort, or time has been made”.<sup>118</sup> Hence, exploiting retail investor sunk cost behavior by incentivizing

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*Individual Investor Trading and Return Patterns around Earnings Announcements*, 67 J. FIN. 639 (2012) (documenting evidence consistent with informed or skillful trading by individual investors); Ekkehart Boehmer, Charles M. Jones & Xiaoyan Zhang, *Tracking Retail Investor Activity* (Oct. 31, 2017) (unpublished manuscript), <https://ssrn.com/abstract=2822105> (finding that retail investors are contrarian on average and quite well-informed as a group, especially in smaller stocks with lower share prices, although do not exhibit any market timing ability).

<sup>114</sup> See Qin Wang & Jun Zhang, *Does individual investor trading impact firm valuation?*, 35 J. CORP. FIN. 120 (2015).

<sup>115</sup> See Qin Wang & Jun Zhang, *Individual investor trading and stock liquidity*, 45 REV. QUANT. FIN. ACCT. 485 (2015).

<sup>116</sup> See, e.g., AMF, *Lettre*, at 1-3; Brad M. Barber & Terrance Odean, *The Behavior of Individual Investors*, 1539 in 2/B HANDBOOK OF THE ECONOMICS OF FINANCE (George M. Constantinides et al. eds., 2013).

<sup>117</sup> Though often associated with economically irrational individuals' decisions, the sunk cost effect may still be rationally explained: R. Preston McAfee, Hufo M. Mialon & Sue H. Mialon, *Do Sunk Costs Matter?*, 48 EC. INQUIRY 323, 333-334 (2010) argue that ignoring sunk costs is rational “in situations in which past investments are not informative, reputation concerns are unimportant, and budget constraints are not salient.”

<sup>118</sup> See Hal R. Arkes & Catherine Blumer, *The Psychology of Sunk Cost*, 35 ORG. BEHAV. & HUM. DECISION PROCESSES, 124, 124 (1985) (explaining that “[t]he prior investment, which is motivating the present decision to continue, does so despite the fact that it objectively should not influence the decision. [. . .] the psychological justification for this maladaptive behavior is predicated on the desire not to appear wasteful.”).

voting and increasing the proportion of active share owners can be viewed as a possible issuer strategy for managing volatility risks.<sup>119</sup>

### *B. Retail (Non-)Voting and Corporate Governance*

From a corporate governance perspective, retail shareholder voting passivity means losing a significant proportion of the votes cast at shareholder meetings. Refraining from voting, and relying on other investors' voting to perform a monitoring function, can distance the board or the controlling shareholders from optimal monitoring. At companies with concentrated ownership, retail shareholders' apathy-driven reliance on controlling shareholders' or larger institutional investors' monitoring may enhance the risks associated with the lack of adequate controls over the controlling shareholders. At companies with a dispersed ownership structure, retail shareholder passivity may enhance the lack of adequate controls over the board.

Situations arise in which retail votes, were they exercised to a larger extent than they currently are, might make the difference in the outcome of the vote. For example, at contested elections, retail shareholders might choose to either support the board's proposal, or to back alternative proposals made by activists or major institutional shareholders. Therefore, increased retail participation can strengthen shareholder monitoring which ultimately fosters board and controlling shareholder accountability.

As has been illustrated in relation to director elections in the U.S., retail-investor voting can be regarded as a tool for accomplishing the policy goal of striking an efficient balance between board authority and accountability:

[i]t is estimated that retail investors hold approximately one-quarter of the common stock of U.S. public corporations. These retail investors could indeed make the difference in director elections if one could mobilize them. Their votes could bolster the presumption of authority or challenge it.<sup>120</sup>

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<sup>119</sup> See generally Roth Parayre, *The strategic implications of sunk costs: A behavioral perspective*, 28 J. EC. BEHAV. & ORG. 417 (1995).

<sup>120</sup> Christopher Gulino, *The Retail-Investor Vote: Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board's Presumption of Authority*, 2010 UTAH L. REV. 547, 571 (2010).

Just as any attempt to change the voting habits of retail investors might shift the balance either in favor of the board's accountability, and against its authority, or in favor of its authority, and against its accountability, in dispersed ownership scenarios, the very same might apply in relation to controlling shareholders at companies with concentrated ownership. As has been noted by Professor Pinto,

The fact that a controlling shareholder has the votes does not mean that shareholder voting is irrelevant. In some countries, minority shareholders have specific rights to protect themselves by voting on certain issues or there may be a super majority vote required for a particular action to be taken which requires the votes of the minority shareholders. The controlling shareholders may also consist of blocks of different shareholders who may not always act together and thus empower the minority in a given case to supply the needed votes. But even if the vote of the minority shareholders will not affect the decision directly because of the control, the fact that a vote needs to be taken could change the behavior of those in control. The increased use of independent directors on the boards of such companies may also serve as a means to have those views of the public shareholders taken seriously. Controlling shareholders may also consider the views of the public minority shareholders to enhance its ability to attract equity capital through good corporate governance.<sup>121</sup>

Enhanced institutional investor participation at shareholders' meetings renders voting outcomes more difficult to predict, even in contexts of concentrated ownership. This in turn increases the potential importance of retail investor votes. Also in countries with a reputation for high levels of ownership concentration, situations may arise in which voting outcomes cannot *ex ante* be taken for granted. At de facto controlled companies, where the controlling shareholder holds less than 50% of the voting rights, this might typically be the case where proxy fights occur, minority (institutional) shareholder slates are submitted to be voted on at director elections, or the general

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<sup>121</sup> Pinto, *supra* note 105, at 617-18.

meeting is to vote on material related-party transactions (see Article 9(c) of SRD II). Further examples of challenging shareholder meetings, where higher retail participation might be outcome determinative, include those that vote upon say on pay proposals (see Article 9(a) SRD II) or the approval of stock option plans. As the likelihood of highly uncertain voting outcomes increases, issuers will become more interested in reaching out for their shareholders, including retail investors. In fact, issuers might wish to gauge retail shareholders' orientations or possibly influence their votes. Importantly, active shareholders, or activists, might share the very same interest at trying to win retail shareholders to their cause.

In relation to the EU, one theoretically illustrative example reported is that of Deutsche Bank AG, the largest German publicly listed financial institution. Deutsche Bank AG's overall attendance rate at the 2015 AGM was only 33.4% of the voting capital.<sup>122</sup> Keeping in mind that retail investors were holding a significant 20% equity share in Deutsche Bank, and that, however, their attendance rate was low, "it becomes obvious that this group of investors "could indeed make the difference (. . .) if one could mobilize them"<sup>123</sup>. Deutsche Bank is not an isolated case. In Italy, too, many companies have a large number of individual investors. Almost 27% of the share capital of Assicurazioni Generali s.p.a., the major Italian insurance company, is currently held by retail shareholders.<sup>124</sup> Institutional investors hold some 42.25%, and major shareholders hold 20.14%.<sup>125</sup> Similarly, Crédit Agricole S.A., as a major bank, ranks second to date among CAC 40—the main capitalization-weighted French stock market index—companies in terms of the number of individual shareholders, with 1.7 million.<sup>126</sup> Given the remarkable proportion of retail shareholdings at such companies, it will come as no surprise that Generali's investor relations department has built up a dedicated section for dealing

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<sup>122</sup> André Schmidt, *Determinants of Corporate Voting. Evidence from a Large Survey of German Retail Investors*, 18 SCHMALENBACH BUS. REV. 71, 72 (2017).

<sup>123</sup> *Id.*

<sup>124</sup> See GENERALI, <https://www.generali.com/investors/Retail-shareholders> (last visited November 26, 2018).

<sup>125</sup> See GENERALI, <https://www.generali.com/investors/share-information-analysts/ownership-structure> (last visited April 10, 2018).

<sup>126</sup> See GROUP CRÉDIT AGRICOLE, <https://www.credit-agricole.com/en/finance/finance/financial-press-releases/credit-agricole-s.a.-named-best-cac40-company-for-retail-shareholder-services> (last visited Apr. 11, 2018).

with private shareholders<sup>127</sup>, and that, to establish a closer relationship with its individual shareholders, Crédit Agricole has developed a communications system, as a part of its “Shareholders’ Club”, offering dedicated tools and documents, as well as meetings on a variety of issues across France.<sup>128</sup>

Importantly, as is also the case in the U.S.,<sup>129</sup> significant retail share ownership not only applies to some major issuers or blue chips, but even more so to smaller listed companies. In France for example, individual shareholders own, on average, 8% of the capital of CAC 40 companies,

but among companies in the CAC PME index [which tracks SMEs’ stock performance] this share increases to an average of 28% [. . .]. The level of individual share ownership varied between 1.8% and 37% of share capital for the CAC 40 and between 1.3% and 70% for the CAC PME. While overall the average rate of individual share ownership was stable between 2013 and 2014 for the CAC 40, the CAC PME saw an average increase of 3.5%.<sup>130</sup>

In the UK too, “evidence suggests AIM companies are indeed owned to a greater extent by individual shareholders”.<sup>131</sup>

By and large, these data sets show with sufficient clarity that retail investors do, in some instances at least, yield significant potential voting power that issuers are well aware of. This is why,

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<sup>127</sup> See GENERALI, <https://www.general.com/investors/Retail-shareholders> (last visited Apr. 10, 2018).

<sup>128</sup> See *supra* note 126.

<sup>129</sup> See BROADRIDGE FINANCIAL SOLUTIONS INC., *supra* note 34 (noting that “Involving retail constituents is especially important for micro- and small-cap companies, for which individual investors represent 71% and 35% of the shareholdings, respectively”).

<sup>130</sup> See AUTORITÉ DES MARCHÉS FINANCIERS, *2015 AMF Study on Programmes Set Up by Listed Companies to Communicate with Individual Shareholders*, 5 and 7 (Nov. 2015), [http://www.amf-france.org/en\\_US/Publications/Rapports-etudes-et-analyses/Societes-cotees-et-operations-financieres?docId=workspace%3A%2F%2FSpacesStore%2Ff558b4a6-6b87-46c8-ab25-69aa9d6e4859](http://www.amf-france.org/en_US/Publications/Rapports-etudes-et-analyses/Societes-cotees-et-operations-financieres?docId=workspace%3A%2F%2FSpacesStore%2Ff558b4a6-6b87-46c8-ab25-69aa9d6e4859) [hereinafter AMF, 2015 Study].

<sup>131</sup> See OFF. FOR NAT’L STAT., OWNERSHIP, para. 2 (illustrating that, at the end of 2016, the “individuals” sector as a beneficial owner holds 9.5% of the FTSE 100, 29.7% of the Alternative Investment Market (AIM) and 19.4% other quoted companies).



as Professor Aggarwal noted as a panelist to the SEC's 2015 roundtable on proxy voting, retail investors' thinking of not voting because they believe their votes will not make a difference in influencing corporate policy is actually incorrect thinking<sup>132</sup>

At the aggregate level, deciding not to vote entails outsourcing voting decisions to those shareholders who do vote, which, generally speaking, might distort voting outcomes in favor either of the board or (in controlled companies) the controlling shareholder, or of activist shareholders, depending upon the side which non-voted shares would presumably have backed had the voting rights been exercised. Due to the scale of the phenomenon, retail non-participation in the voting process can make it easier to defeat shareholder proposals submitted by institutional investors or activists when voted on, even where they might have been beneficial for all shareholders, and make it more difficult to challenge the board or the controlling shareholder, or to resist aggressive, detrimental activist campaigns.<sup>133</sup>

Retail apathy in voting cannot be blamed from a legal perspective, since the small individual shareholder is under no regulatory obligation to vote her shares. However, the absence of retail investors within corporate governance weakens plural control in that—as it is all but evident that the interests of different classes of shareholders converge—the voice of shareholders will be selectively represented at the general meeting.<sup>134</sup> Assuming that retail investor voting preferences tend to be board-friendly—out of loyalty, inability to process information, information disadvantage, overconfidence etc.—,<sup>135</sup> the chances are that

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<sup>132</sup> Sec. & Exch. Comm'n, Proxy Voting Roundtable Proceedings (unofficial transcript), 91, <https://www.sec.gov/spotlight/proxy-voting-roundtable/proxy-voting-roundtable-transcript.txt> [hereinafter 2015 Proxy Voting Roundtable Unofficial Transcript]. See also Kobi Kastiel & Yaron Nili, *In Search of the Absent Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55, 66 (2016) (noting that mobilizing 10-15% of the eligible voters could have a substantial impact on the final voting results in contested elections, withhold campaigns, or when shareholder proposals are brought to a vote to bring about important governance changes).

<sup>133</sup> See Kastiel & Nili, *supra* note 132, at 70-74.

<sup>134</sup> See Fisch, *supra* note 1, at 15-16 (2017) (emphasizing that retail investor voting preferences seem to systematically differ from those of institutional investors and more often align with the board, and noting that "regardless of whether retail shareholders vote differently from institutional voters, voting results should convey the views of all shareholders.").

<sup>135</sup> See (referred to the U.S.) Choonsik Lee & Matthew E. Souther, *Managerial Reliance on the Retail Shareholder Vote: Evidence from Proxy Delivery Methods*, 5-6 (Oct. 23, 2017) (unpublished manuscript),

institutional investors, either traditional or activist, may lack support from retail shareholders if they attempt to challenge the board or the controlling shareholders.

Against this backdrop, it is no surprise that many companies voluntarily take organizational steps to make their investor relations departments better equipped to reach out to retail shareholders and offer programs specifically designed to involve them more actively.<sup>136</sup> In the U.S. too, directors seem to be engaging with retail investors to some extent: according to respondents to a 2013 public-company directors survey, some 44% of public company directors concerned were reported to engage with retail shareholders “in some form of communication outside the standard regulatory disclosures”.<sup>137</sup> In much the same way, service providers, like proxy solicitation firms, have developed strategies to engage retail investors in the proxy process for their clients. Such strategies include using reminder mailings, toll-free numbers for inbound calls, outbound calls offering the shareholder the opportunity to vote on a recorded line, robocalls to shareholders (*i.e.* recorded messages by a member of the senior management recalling the importance of the vote), town hall forums, blast emails and websites with links to the actual voting site.<sup>138</sup>

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<https://ssrn.com/abstract=2970650> (finding that retail shareholders are strong supporters of management; hence, reduced retail participation rates due to electronic proxy material delivery leads to lower voting support for management recommendations. Managers are found to be aware of this trend, and strategically reliant on retail shareholder support to ensure that their agenda passes. Thus, they try to garner retail support by changing the proxy material delivery method, “opting for full-set (mailed) delivery of proxy materials following periods of poor performance, high executive compensation, and when the ballot contains proposals related to compensation and shareholder rights”). However, anecdotal evidence to the contrary is mentioned in BRUNSWICK GROUP LLP, *RETAIL INVESTORS’ VIEWS OF SHAREHOLDER ACTIVISM AND WHY IT MATTERS* (July 2015), <https://www.slideshare.net/Brunswick/retail-investors-views-of-shareholder-activism-summary-of-results> (suggesting that “the often “pro-management” retail shareholder base is more susceptible to activist demands than originally thought”: retail investors are found to be aware of activism; they believe that activists add long-term value, want to be informed during activist campaigns, and are likely to vote if they care about the issue).

<sup>136</sup> See OFF. FOR NAT’L STAT., *OWNERSHIP*, at 7.

<sup>137</sup> PWC & WEIL GOTSHAL & MANGES LLP, *DIRECTOR DIALOGUE WITH SHAREHOLDERS—WHAT YOU NEED TO CONSIDER*, 5 (2013), [http://www.shareholderforum.com/access/Library/20131010\\_PwC-Weil.pdf](http://www.shareholderforum.com/access/Library/20131010_PwC-Weil.pdf).

<sup>138</sup> These tools were named by Donna Ackerly of proxy solicitor firm Geogeson, Inc., during the SEC 2015 proxy voting roundtable: see 2015 Proxy Voting Roundtable Unofficial Transcript, at 93-94.

Hence, wider participation by all shareholders appears to be in the interest of the issuers themselves. As former Deutsche Post DHL CFO Lawrence A. Rosen put it,

we have the impression that listed companies know much about the interests of their institutional investors, but this does not necessarily apply to the same extent to retail shareholders. A focus of our IR-work lays in communication with retail investors, who in the end are to date involved at Deutsche Post DHL with a € 3,3 bn investment.<sup>139</sup>

Indeed, retail shareholder relations strategies serve company-specific goals, building on a variety of not mutually exclusive factors such as the company's market history, its efforts to build up a loyal shareholder base, the quorum for the general meeting, making up for disinterest among institutional investors, and developing a corporate image.<sup>140</sup> The quality of companies' retail shareholder policies may not be the main factor driving the investment choice; still, it has been found to impact individual investors' behavior. For example, retail investors who are members of a shareholder club seem to be more active in attending general meetings, possibly as a consequence of being more and better informed.<sup>141</sup> Hence, shareholder policies seem to be a driver for enhancing retail investor engagement.<sup>142</sup>

Moreover, contrary to the received wisdom that considers retail shareholders at the general meeting to be little more than noise, some anecdotal evidence suggests that retail shareholders that attend the meeting might perform a valuable monitoring function. First, the right to ask questions is found to be important to small individual shareholders and their representatives, while institutional investors are offered other occasions for direct dialogue with the board. The general meeting "must be considered as the most important mean for private investors to challenge the management board and the supervisory board".<sup>143</sup> Second, the issues raised for discussion at general meetings by small individual investors are often the same as those raised by institutional investors during other occasions for dialogue with directors.<sup>144</sup>

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<sup>139</sup> See Pellens & Schmidt, *supra* note 42, at 9.

<sup>140</sup> AMF, 2015 Study, at 11.

<sup>141</sup> See AMF, *Lettre*, at 3.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at 59.

<sup>144</sup> See Van der Elst, *supra* note 73, at 21.

Finally, retail investors' voice matters from a theoretical corporate law perspective, given that voting rights provide the balance of power between the general meeting and the board of directors.<sup>145</sup> Irrespective of any utility it may or may not have on the practical level, "investor participation in a firm's decision-making process has intrinsic value"<sup>146</sup>, since

[c]orporate democracy and, specifically, minority shareholder suffrage, legitimizes the exercise of power by the public corporation's insiders: the controlling shareholder, directors, and managers. Indeed, the shareholder's right to vote is the foundation upon which the public corporation is constructed and sustained.<sup>147</sup>

#### IV. ACTIVATING RETAIL VOTES: THE U.S. DEBATE

Retail shareholder voting passivity has recently been a feature in the U.S. debate on corporate governance. With the drop in retail share ownership and voter turnout at publicly listed company meetings, regulatory changes and shareholder empowering measures that have evolved over the last two decades have fueled the debate surrounding the activation of small individual shareholder votes.

Specifically, the significant restrictions gradually imposed upon broker discretionary voting and sec. 957 of the 2010 Dodd-Frank Act have rendered retail shareholders' low participation

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<sup>145</sup> See ROGER M. BARKER & IRIS H.-Y. CHIU, CORPORATE GOVERNANCE AND INVESTMENT MANAGEMENT. THE PROMISES AND LIMITATIONS OF THE NEW FINANCIAL ECONOMY, 159, Edward Elgar Publishing, Cheltenham-Northampton, MA (2017).

<sup>146</sup> Dov Solomon, *The Voice: The Minority Shareholder's Perspective*, 17 NEV. L.J. 739, 759-763 (2017).

<sup>147</sup> *Id.* at 739 (further illustrating, at 744 and 756, that "Without the mechanisms of corporate democracy and, specifically, the shareholder's right to vote, the exercise of power and control by the corporation's insiders—its controlling shareholder, directors, and managers—is stripped of its legitimacy and ideological foundation", it being understood that, while ownership and control may be separated, "it is the implicit or explicit consent of the owners of the corporation—i.e., the shareholders -that legitimizes managers' exercise of control"); see also Lee Harris, *Missing in Activism: Retail Investor Absence in Corporate Elections*, 2010 COLUM. BUS. L. REV. 104, 113 (2010) (noting that "increased shareholder participation matches the generally shared Western ideals that the ultimate owners should have some discretion and authority over firm assets, regardless of whether their choices are value-enhancing").

rates at annual meetings more clearly visible than before. The previous regime that regulated brokers' authority to vote uninstructed shares on "routine" matters under New York Stock Exchange (NYSE) Rule 452 had been masking low retail voter turnouts, given that, as evidence widely showed, brokers did vote uninstructed shares, and tended to do so in line with board proposals.<sup>148</sup> This factor contributed to shoring up the board's authority, since, as a matter of fact, the board was authorized to rely on a certain proportion of votes that would almost automatically be cast for its proposals. The virtual elimination of discretionary broker voting that was achieved by classifying as "non-routine" a growing number of voting matters (such as uncontested director elections) resulted in lower retail voter turnout rates.<sup>149</sup> Hence, voting power shifted towards institutional investors, both traditional and activist. This outcome was further enhanced by the rise of institutional investors<sup>150</sup> and the regulatory changes that favored it, including most notably the strengthening, in 2010, of say-on-pay advisory votes on executive compensation, the stricter rules on mutual fund, investment adviser and pension fund fiduciary obligations in relation to voting proxies, and the proxy access Rule 14a-8, which has helped reduce plurality voting and staggered boards.

Focusing on the highly complex U.S. proxy voting system,<sup>151</sup> the Securities and Exchange Commission held a

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<sup>148</sup> See Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV., 520, 561 (1990); Gulinello, *supra* note 120, at 563-64; Jennifer E. Bethel & Stuart L. Gillan, *The impact of the institutional and regulatory environment on shareholder voting*, 31 FIN. MGMT., 29, 42 (2002) (finding that broker votes account for about 13% of outstanding shares; hence, broker votes are potentially outcome determinative at shareholders meetings); Jie Cai, Jacqueline L. Garner & Ralph A. Walking, *Electing Directors*, 64 J. OF FIN., 2389, 2415 (2009) (estimating that "excluding the broker votes reduces the percent of "for" votes by an average of 2.5%" in the sample analyzed); Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality*, 59 EMORY L.J. 869, 874 (2010) (noting that, "[u]nder the revised NYSE rules, companies will lose a sizeable block of automatic votes in favor of their nominees, shifting power to those shareholders who do vote").

<sup>149</sup> See Kastiel & Nili, *supra* note 132, at 62-63 (finding that "non-voting percentages have spiked in matters where brokers were no longer allowed to vote [uninstructed] shares. In uncontested elections the non-participation rate jumped from 14% to 24%". The significant increase in the prevalence of broker-non-votes has led to an overall increase in the ratio of shares that do not vote).

<sup>150</sup> See Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPECTIVES 89 (2017).

<sup>151</sup> The complexity of the system is illustrated by Marcel Kahan & Edward

roundtable on February 19, 2015 to explore possible improvements to the proxy voting process, including how to increase retail shareholder participation—whether through disclosure, education, technology or the voting mechanics.<sup>152</sup> As commissioner Luis Aguilar acknowledged,

[d]ismal retail investor participation numbers persist despite technological advances that should have made it easier and more efficient for a widely dispersed group of shareholders to engage with other investors and their companies.<sup>153</sup>

While no action has followed the SEC roundtable yet, on November 9, 2017 SEC Chair Jay Clayton announced his willingness to reconsider proxy voting and shareholder resolution processes for public company annual meetings.<sup>154</sup> Chair Clayton planned to start review by reopening the comments period for the SEC's 2010 concept release on the U.S. proxy system to solicit updated feedback from market participants concerning the strengths and weaknesses in the system.<sup>155</sup> Chair Clayton pointed out that low participation rates in the proxy process may express the need to update the proxy process.<sup>156</sup>

The drop in retail shareholder participation in the proxy process has also been addressed by scholars, and a variety of possible approaches to foster retail voting have been proposed.

The assumption upon which analysis builds is that retail investors' apathy toward corporate voting also has its roots in the information costs associated with voting; therefore, in addition to rendering the mechanics of voting smoother, promoting retail investor voting requires a reduction in information costs.<sup>157</sup> It is worth noting that the costs of voting are not limited to collecting and processing information; the cost of decision-making combines with psychological factors which can further enhance passivity.

The relevance of such behavioral tendencies is illustrated by experience with the U.S. proxy voting system. One such

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Rock, *The Hanging Chads of Corporate Voting*, 96 Geo. L.J. 1227 (2008).

<sup>152</sup> See *Proxy Voting Roundtable*, SEC. & EXCH. COMM'N, <https://www.sec.gov/spotlight/proxy-voting-roundtable.shtml>.

<sup>153</sup> 2015 Proxy Voting Roundtable Unofficial Transcript, at 11-12.

<sup>154</sup> See Clayton, *supra* note 82.

<sup>155</sup> Sec. & Exch. Comm'n, Concept Release on the U.S. Proxy System, Release No. 34-62495 (July 14, 2010) [75 Fed. Reg. 42982 (July 22, 2010)].

<sup>156</sup> Clayton, *supra* note 82.

<sup>157</sup> See Gulinello, *supra* note 120, at 579.

example concerns the “notice-only” (or “notice and access”) model introduced in 2007 as an option for electronic proxy material delivery by a company or another soliciting party,<sup>158</sup> which has apparently discouraged retail shareholder participation. Electronic proxy delivery has been found to significantly reduce the voting response rate as a primary result of the lower likelihood of response from retail shareholders.<sup>159</sup> The notice-only delivery of proxy materials, which merely informs shareholders of the online availability of proxy materials instead of mailing the “full set”, reduces the cost to issuers by avoiding the distribution of paper proxies and ballots. However, this method of delivery also lowers the voting participation rate of retail shareholders.<sup>160</sup> Arguably, the need to take proactive steps following a mailed notification to access proxy materials available on a website, which is inherent in the “pull” delivery model featuring the notice-only option, can inhibit voting from the shareholders who are unwilling to make the additional effort required.<sup>161</sup>

Further, the length and language of proxy statements can be confusing and also blur relevant information, negatively affecting participation and voting.<sup>162</sup> On average, the duration of retail investors’ electronic access to proxy statements is no longer than five minutes, which, compared to the average length of the material accessed,<sup>163</sup> and coupled with educational limits, can easily lead to a decision not to vote at all. Moreover, information contained in the proxy statements is often not truly illuminating.

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<sup>158</sup> Sec. & Exch. Comm’n, Internet Availability of Proxy Materials, Fed. Reg. 4148 (Jan. 29, 2007) (to be codified at 17 C.F.R. pt 240, 249, and 274, 72).

<sup>159</sup> Lee & Souther, *supra* note 135, at 16-17; *see also* Fabio Saccone, *E-Proxy Reform, Activism, and the Decline in Retail Shareholder Voting*, 4 (Dec. 26, 2010) (The Conference Board Director Notes No. DN-021), <https://ssrn.com/abstract=1731362>. Converging findings from previous research are referenced by Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1283 (2009).

<sup>160</sup> Lee & Souther, *supra* note 135, at 16-17.

<sup>161</sup> *See* Fisch, *supra* note 1, at 26.

<sup>162</sup> Even institutional investors consider proxy statements too long and difficult to read and only rely on a small fraction of the information comprised in them: *see* David F. Larcker, Ronald Schneider, Brian Tayan & Aaron Boyd, *2015 Investor Survey Deconstructing Proxy Statements—What Matters to Investors*, 1, [https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-surveyey-2015-deconstructing-proxy-statements\\_0.pdf](https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-surveyey-2015-deconstructing-proxy-statements_0.pdf) (illustrating that “Investors claim to read only 32 percent of a typical proxy, on average. They report that the ideal length of a proxy is 25 pages, compared to the actual average of 80 pages among companies in the Russell 3000.”).

<sup>163</sup> *See* Kastiel & Nili, *supra* note 132, at 69.

As has been noted with respect to director elections, after investing some time reading the proxy statement, “[t]he retail investor would learn very quickly that there was not much she could learn from a proxy statement that would influence her vote one way or another,”<sup>164</sup> it being unlikely she would find “information regarding whether the director-nominees performed their duties diligently and free of improper influence that might impair their independent judgment.”<sup>165</sup>

Significantly, unlike institutional investors, the average retail investor cannot normally take advantage of information shortcuts such as voting recommendations provided by proxy advisory firms, nor engage in direct director-shareholder dialogues.

Thus, when considering how possibly to activate retail votes, behavioral tendencies and psychological limitations associated with decision-making need to be kept in mind in addition to addressing shortcomings in the voting mechanics. In order to reduce such disincentives, inspiration from typical institutional investors’ voting patterns can be helpful.

Along these lines, Professor Fisch contends that, in order to increase the level of retail investor voting, retail investors that hold their shares in street name (representing the majority of retail shareholders in the U.S.) should be allowed—as institutional investors only currently are—to submit standing voting instructions (SVIs) to their intermediaries, on which basis nominee record holders would cast their votes. SVIs

are voting guidelines or policies provided by an investor to an intermediary in advance of a specific shareholder meeting, directing how the investor’s shares are to be voted. The intermediary then applies these instructions to each shareholder meeting, and casts the client’s vote in accordance with those instructions, unless the client directs otherwise.<sup>166</sup>

To implement this proposal, changes need to be made to current SEC proxy solicitation rules, given that nominees are required to obtain separate instructions from the beneficial owners on how to vote their shares at each company in which they own

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<sup>164</sup> See Gulinello, *supra* note 120, at 583.

<sup>165</sup> *Id.* at 581.

<sup>166</sup> Fisch, *supra* note 1, at 23.



stock. This prohibits intermediaries from soliciting SVIs from their customers.<sup>167</sup> Under the proposal, retail investors would be able to “designate a set of voting preferences in advance, save their prior voting preferences, or designate a set of guidance that will be applied automatically”<sup>168</sup> by the broker or the platform. To compel (and not just enable) brokers to accept SVIs, and overcome their limited interest at facilitating retail voting where no affirmative obligation or financial incentive exists, the SEC should “require custodial brokers to provide investors with access to an Internet-voting platform”<sup>169</sup> offering retail clients “with comparable functionality to that available to institutional investors, including the ability to submit voting instructions through the brokers’ website and the ability to provide SVI.”<sup>170</sup>

Building on behavioral economics tools and the theory of “libertarian paternalism,”<sup>171</sup> one further proposal from Kobi Kastiel and Yaron Nili suggests that retail investor participation in the proxy voting process be facilitated

by providing them with a little “nudge” in the form of highly-visible default arrangements that would dramatically reduce the economic and mental costs associated with voting. These default arrangements would allow (or force) retail investors to choose between several available voting short-cuts, such as

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<sup>167</sup> See *id.* at 40-41 (illustrating that the regulatory exception under Rule 14a-2(a) (1) for certain communications from the broker to its customers “limits a broker’s ability to obtain standing voting instructions because, for the exemption to apply, the broker must “furnish promptly” proxy materials to the person solicited. By definition, the submission of SVI takes place prior to the filing of proxy materials, making it impossible for the broker to satisfy this requirement” when transmitting third-party proxy solicitation material to its customers. Moreover, “Rule 14a-4(d) also limits a broker’s ability to ask for SVI”, since it “does not permit a proxy to confer voting authority “with respect to more than one meeting” or for “any annual meeting other than the next annual meeting . . . to be held after the date on which the proxy statement and form of proxy are first sent or given to security holders”).

<sup>168</sup> *Id.* at 24 (discussing the shortcomings of the mechanisms available for retail shareholders to use the internet to submit their voting instructions, as compared to those open to institutional investors).

<sup>169</sup> *Id.* at 42.

<sup>170</sup> *Id.*

<sup>171</sup> See RICHARD R. THALER & CASS S. SUNSTEIN, *NUDGE. IMPROVING DECISIONS ABOUT HEALTH, WEALTH AND HAPPINESS*, 2<sup>nd</sup> Ed. (2009), at 5-6; Sunstein & Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003); Thaler & Sunstein, *Libertarian Paternalism*, 93 AM. ECON. REV. 175 (2003).

voting along with a specific large and sophisticated shareholder, in accordance with the majority vote of institutional investors not affiliated with management, or in accordance with the recommendation of a proxy advisor.<sup>172</sup>

The investor would always be allowed to opt out of those arrangements, but

if [she is] unlikely to invest time and resources in making an informed decision on the merits, case by case, [she] may now use a short-cut, choosing an agent to make the choice for [her]. Making a single choice regarding an agent rather than numerous decisions on the merits of each topic, would reduce the costs associated with voting, therefore making the expression of preferences by retail investors more likely.<sup>173</sup>

Similarly to some extent, as specifically regards director elections, Professor Gulinello envisages a coalition of private professional organizations and self-regulatory organizations—preferably comprising the American Bar Association Business Law Section, the NYSE, the NASDAQ exchange, the Financial Industry Regulatory Authority (FINRA) and groups representing directors of public companies—establishing and managing a cognitive-shortcut system designed to help small individual shareholders make informed voting decisions based on the release of voting recommendations (he calls “Retail Investor Voting Instructions—RIVI”) which will be delivered along with the company’s proxy materials.<sup>174</sup> Voting instructions would be based on information and statements provided by nominees by filling out specific questionnaires—differently designed depending on how aggressively the presumption of board authority is intended to be challenged or preserved—eliciting specific key information. The coalition would be able to gather the expertise required and “would likely have the gravitas needed to persuade many public companies to participate the system.”<sup>175</sup> To facilitate dissemination of voting instructions to retail investors, the cooperation of brokers

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<sup>172</sup> Kastiel & Nili, *supra* note 132, at 58-59.

<sup>173</sup> *Id.* at 59.

<sup>174</sup> See Gulinello, *supra* note 120, at 583-597.

<sup>175</sup> *Id.* at 594.

should be enlisted (ideally, through FINRA requirements).<sup>176</sup> The SEC should support the system externally by playing an active role “in issuing the no-action letters and rule changes necessary to accommodate the RIVI.”<sup>177</sup>

## V. THE EUROPEAN REGULATORY FRAMEWORK FOR PARTICIPATING IN THE VOTING PROCESS VIEWED THROUGH THE EYES OF A RETAIL INVESTOR

The central position occupied by voting within the SRD clearly reveals the assumption by European lawmakers that shareholder participation in the voting process, including small individual investors, is desirable. Promoting proxy voting by removing restrictions or requirements not explicitly allowed under Articles 10 and 11 of SRD is a tool for facilitating and encouraging shareholder participation at general meetings, as also are other tools considered under Articles 8 and 12. Notably, electronic real-time transmission of the meeting, real-time two-way communication enabling shareholders to address the meeting from a remote location, electronic voting and voting by correspondence allow cost-effective participation at a distance and *in absentia* or voting in advance of the meeting.

Against this backdrop, low retail voter turnout at general meetings of European issuers casts doubt on the efficacy of the measures adopted to achieve the policy goal established. It also makes a comparative analysis of the proposals put forward in the U.S. to activate retail votes all the more interesting in addressing the same issue within the European context.

### *A. The promises and possible constraints of the (revised) Shareholders' Rights Directive*

If the European regulatory framework relevant for voting is considered from the particular standpoint of a retail investor, two main obstacles may lower a shareholder's incentive to be active. First, as a matter of fact, retail investors, unlike institutional investors, are rarely offered the opportunity to participate at the meeting and vote the shares at a distance via electronic means, also due to the non-binding SRD provisions. Second, the extent to which the new SRD II provisions on

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<sup>176</sup> *Id.*

<sup>177</sup> *Id.* at 595.

shareholder identification and facilitating the exercise of shareholders' rights can actually help to foster retail engagement will primarily depend on their transposition into national law. Thus, despite the enabling stance adopted at the EU-wide level, enhanced retail shareholder empowerment appears to rely primarily on Member State choices and on the arrangements that individual companies may take in this respect.

1. Enabling vs mandatory rules on exploiting technological advance to facilitate retail participation in the voting process

One potential weakness of the current European framework with regard to retail investor participation may lie in the fact that addressee issuers are not compelled to use technology in order to allow their shareholders to choose, if they so wish, to participate the general meeting at a distance and vote electronically during, or in advance of, the meeting. While requiring Member States to empower companies to offer their shareholders the opportunity to participate in the meeting by electronic means, Article 8 of SRD vests discretion with the issuers to decide whether or not to adopt any, or all, of the tools listed in para. 1, namely (a) real-time transmission of the general meeting, (b) real-time two-way communication enabling shareholders to address the meeting from a remote location, and (c) electronic direct voting, defined as "a mechanism for casting votes, whether before or during the general meeting, without the need to appoint a proxy holder who is physically present at the meeting."<sup>178</sup> Similarly, under Article 12 of SRD, issuers may, but are not required to, allow voting in advance of the meeting by e-mail correspondence.<sup>179</sup>

Hence, as a matter of fact, a retail shareholder willing to vote her shares without appointing a proxy agent will, or will not, be enabled to do so remotely or in advance of the meeting depending, first, on the tools for casting votes that are permitted under national law, and, second, on whether her investee company actually offers her (one or more of) those tools.<sup>180</sup> Moreover, the tools listed under Articles 8 and 12 do not all harness technology to the same extent. Furthermore, a retail shareholder holding shares

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<sup>178</sup> Article 8(1)(c) of SRD.

<sup>179</sup> Article 12 of SRD (requiring Member States to "*permit* companies to offer their shareholders the possibility to vote by correspondence in advance of the general meeting") (emphasis added).

<sup>180</sup> *See supra*, notes 178, 179 and accompanying text.

in more than one company will likely find herself having to deal with both different participation and voting tools, as well as with different mechanics governing those options, depending on the details provided in investee companies' articles of association.

From the standpoint of an individual investor who is potentially willing to vote her shares, it might seem questionable as to whether such a flexible regime for the use of internet-based technology could actually operate as an incentive to participate in the voting process. Due to the variables left up to national law and the companies concerned, the resulting picture may well be disheartening and fragmentary. With the exception of Turkey (and a few other countries in the European Economic Area), where it is mandatory—and leaving aside the Nasdaq Tallinn pilot program for blockchain technology-driven voting for companies listed on the exchange<sup>181</sup>—, electronic proxy voting is reported as commonplace in Europe in regard to institutional investors.<sup>182</sup> Indeed, “global custodian banks typically bear the responsibility for organizing voting for their institutional shareholder clients, rather than the company itself, and it is overwhelmingly done via electronic proxy voting.”<sup>183</sup>

In contrast, particularly when considering the investor of the future, technology arguably ranks amongst the most promising tools for engaging retail shareholders.<sup>184</sup> There is anecdotal evidence in relation to the UK that there exists “a younger generation with a thirst for knowledge, the need to build wealth for retirement, an appetite to invest and an increasing ability to access online media resources” and that “nearly a quarter (23%) of retail investors would like to attend AGMs.”<sup>185</sup> This factor

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<sup>181</sup> See David Yermack, *Corporate Governance and Blockchains*, REV. FIN. 7, 23 (2017) (discussing the potential corporate governance implications of blockchain technology-driven changes).

<sup>182</sup> Melsa Ararat & Muzaffer Eroğlu, *Istanbul Stock Exchange Moves First on Mandatory Electronic Voting* Harvard Law School Forum on Corporate Governance and Financial Regulation, (Nov. 6, 2012), <https://corpgov.law.harvard.edu/2012/11/06/istanbul-stock-exchange-moves-first-on-mandatory-electronic-voting/>.

<sup>183</sup> *Id.*

<sup>184</sup> A view shared by Fisch, *supra* note 1, at 38-39 (illustrating that the model for harnessing technology to make retail voting more efficient “can be found in the voting platform that market forces currently provide to institutional investors” in the U.S.).

<sup>185</sup> EQUINITI, RETAIL INVESTORS: TECHNOLOGY LED CHANGE AND THE OPPORTUNITY (NEED) FOR INCREASED ENGAGEMENT, 4 and 6 (Dec. 2016), <https://equiniti.com/media/2754/1217-equiniti-white-paper-savings-and->

indicates “that companies who actively engage through online channels, will gain access to this growing retail investor base”, which is crucial for investor relation programs to build shareholder loyalty.<sup>186</sup> Whilst it is by no means obvious that the anecdotal evidence from the UK could apply to other Member States to a comparable degree,<sup>187</sup> it could still suggest that requiring issuers to set up electronic voting facilities that render participation in the process cost-effective might be particularly beneficial for retail shareholders.<sup>188</sup>

European lawmakers might therefore consider further investigating whether a strengthening of the current SRD provisions to compel issuers to adopt technology-driven participation tools is needed to increase retail shareholder voter turnout. This would not entail a shift towards a virtual, online-only model for general meetings—a model which, despite its potential advantages, would require regulatory changes in some European countries.<sup>189</sup> Under the hybrid regime, the shareholder would be allowed to choose to participate in the physical meeting, vote by e-mail, participate and vote electronically during the meeting, or provide a proxy holder with voting authority. Arguably, such an alternative-design approach to participation would encourage voting by shareholders less familiar with digitization.

Such an investigation would require, first, an in-depth analysis of the extent to which European issuers actually offer their shareholders access to participation-facilitating tools, the tools that they offer, and the differences throughout the EU. Indeed, most

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investments-survey.pdf. [hereinafter EQUINITY, RETAIL INVESTORS].

<sup>186</sup> *Id.*

<sup>187</sup> The SRD assumes national legislatures to “use their discretion to look out for the optimal level of digital involvement of shareholders in the decision making process”: Dirk Zetzsche, *Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive*, 8 J. CORP. L. STUD. 289, 331 (2008).

<sup>188</sup> See EQUINITY, RETAIL INVESTORS, at 5 (finding that “nearly a quarter (23%) of retail investors would like to attend AGMs, but only 6% do and 45% said they would be more likely to attend a digital AGM.”).

<sup>189</sup> See Christoph Van der Elst & Anne Lafarre, *Blockchain and the 21st Century Annual General Meeting*, 14 EUR. COMPANY L.J. 167 (2017) (arguing that “a decentralized system that makes use of blockchain solutions can strongly enhance the position of the AGM, adapting it to twenty-first century technology, and offering real solutions to the impediments of this nineteenth century static corporate organ”. However, allowing for a virtual-only AGM would require regulatory changes, since company law provisions in many Member States assume that a physical AGM takes place).

European jurisdictions allow for a combination of those tools;<sup>190</sup> but there is no clear EU-wide comparative evidence of the tools actually available at the company-specific level.<sup>191</sup>

Second, European lawmakers could investigate the continuing validity of the arguments upon which Articles 8 and 12 were originally adopted. In the impact assessment concerning its proposal for the SRD, the Commission acknowledged that any shareholder “would significantly benefit from the possibility of participating in General Meetings in absentia by electronic means.”<sup>192</sup> However, also due to cost considerations concerning the relevant technology, it contended that “imposing such a requirement on all listed companies may not seem appropriate as not all issuers have a significant number of cross-border investors.”<sup>193</sup> More than a decade after the enactment of the SRD, the Commission might consider assessing whether, and if so to what extent, technology costs—primarily meaning those for internet-based voting platform services—have decreased, taking account of different levels of digitization, both in terms of the infrastructure available at national level and the degree to which people make use of, and rely on, web-based technology.

Third, more comprehensive information would be needed concerning the true scale of retail shareholder willingness to participate in the voting process electronically, or, in other words, the scale of the disincentive effect attributable to the lack or insufficient availability of electronic participation means, or to burdensome operational schemes, taking account of the level of coordination with brokers’ infrastructures.

At the very least, investigation would provide a better and more current understanding of the factual background to the issue under discussion. However, it is likely that no conclusion will be reached in the near future as to whether it would be appropriate to mandate the adoption of electronic facilities for the general meeting at the European level.

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<sup>190</sup> See EUR. SEC’S MKT. AUTH., *Report on shareholder identification and communication systems*, 29 and table 56 (ESMA 31-54-435) (Apr. 5, 2017) [hereinafter ESMA, Report on shareholder identification]

<sup>191</sup> In Italy, *e.g.*, electronic meetings and direct electronic voting are an option in “very few, if any, companies” only: B. Espen Eckbo, Giulia Paone & Runa Urheim, *Efficiency of Share-Voting Systems: Report on Italy*, 115 (Tuck School of Business Working Paper No. 2009-64; ECGI - Law Working Paper No. 174/2011) (January 2011), <http://ssrn.com/abstract=1431733>.

<sup>192</sup> See Eur. Comm’n Staff, Annex, at 32.

<sup>193</sup> *Id.* at 32-33

It is likely to remain unclear whether the case for activating retail shareholder voting will justify the imposition of additional burdens on some Member States (those that are lagging behind in terms of adequate infrastructure) and on any European listed company, irrespective of the actual composition of its shareholder base, the significance of its retail component or voter turnout. It is not insignificant in this respect that, out of the 28 countries in the European Economic Area that responded to a query by the European Securities and Markets Authority, only Hungary and Iceland reported that they had mandated provision of electronic means to enable shareholders attend the meeting, including for voting.<sup>194</sup> It is also noteworthy that this issue was not reconsidered during the recently completed process for amending the SRD.

And it is true, indeed, that “[b]ecause shareholder participation is costly, at some point it makes financial and operational sense to stop promoting it.”<sup>195</sup> In the longer run, market forces might drive the transition towards electronic participation tools even without regulatory intervention. Although regulation can accelerate the process, one important point against switching towards mandatory EU regulation is that electronic tools to participate in the meeting cannot possibly increase voting rates from those shareholders who are absent due to decision-making costs as regards how to vote their shares. Even if they were provided user-friendly electronic tools to exercise their rights, these shareholders would likely still not vote. Moreover, to achieve a meaningful result, mandating electronic means of participating in the meeting and voting EU-wide would require parallel engagement with problematic issues arising out of the lack of interconnectivity and interoperability between intermediaries’ and proxy agents’ infrastructures, as well as cost allocation issues.

## 2. Moving forward towards a more efficient regime for shareholder identification and for communicating with the shareholder base

Issuers’ voluntary adoption of electronic means for participating in the voting process might be encouraged following the implementation of the SRD II. Article 3a of SRD II sets forth

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<sup>194</sup> See ESMA, *Report on shareholder identification*, 28-29. Note that the SRD does not prevent Member States from imposing, or keeping in place, further obligations on companies aimed at facilitating the exercise of shareholder rights: see Article 3.

<sup>195</sup> Hutchison & Alley, *supra* note 90, at 945.



provisions that allow listed companies to identify their shareholders within complex intermediated shareholding systems in a precise manner. This should allow companies to improve communication with their shareholder base, including retail investors, develop more targeted communication programs, promote shareholder usage of electronic means of participation, and ultimately support shareholder engagement.

SRD II also provides for minimum standards to apply throughout the UE as regards top-down and bottom-up transmission of information relevant to the exercise of shareholders' rights along the investment chain. The new rules on the transmission of information (Article 3b of SRD II) are aimed at remedying the failure of the 2007 SRD in addressing the reluctance of intermediaries to actively engage in the voting process. As has been noted,

Custodians and depositaries typically do not generate income by issuing voting entitlements or proxy cards to their customers. Further, nominees and custodians along the chain typically do not have an economic stake in the shares. Consequently, these intermediaries show no propensity to support the exercise of their customers' voting rights, and while the company-level is widely digitalized little money is invested in modernizing the technical infrastructure for voting at the intermediary level.<sup>196</sup>

As a consequence, "especially when the chain involves many intermediaries, information is not always passed from the company to its shareholders and shareholders' votes are not always correctly transmitted to the company."<sup>197</sup> Hence, according to Recital 12 to SRD II, intermediaries, including third-country intermediaries that have neither an office nor their head office in the EU,

should be obliged to facilitate the exercise of rights by shareholders, whether shareholders exercise those rights themselves or nominate a third person to do so. When shareholders do not want to exercise the rights themselves and have nominated the intermediary to do so, the latter should exercise those rights upon the explicit authorisation and instruction of the shareholders

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<sup>196</sup> Zetsche, *supra* note 187, at 327.

<sup>197</sup> Recital 8 to SRD II.

and for their benefit.<sup>198</sup>

As is apparent, the SRD II rules on shareholder identification and on the transmission of information are complimentary in promoting the exercise of shareholder rights as a policy goal. Shareholder identification encourages engagement between a company's investor relations department and its shareholders; transmission of information along the investment chain facilitates shareholders in exercising their rights—whether voting, convening a general meeting, putting a new item on a meeting's agenda, or asking questions according to Article 9 SRD.<sup>199</sup>

More precisely, Article 3a of SRD II entitles companies to request that intermediaries along the chain provide information regarding their shareholders' identity. Further, Article 3a imposes an obligation upon intermediaries to communicate information regarding shareholders' identities to the requesting company "without delay."

With respect to top-down information, Article 3b requires intermediaries to transmit to shareholders information that the company is required to disseminate concerning the exercise of shareholder rights, unless a company directly provides such information to all of its shareholders. However, intermediaries are allowed to restrict transmission to a notice when the required information is available on the company's website. An intermediary providing notice must only indicate the location of required information within a company's website. Conversely, as regards bottom-up information, Article 3b requires bottom-up information to be transmitted by intermediaries. When intermediaries transmit bottom-up information, they must transmit any information received from the shareholders that relates to the exercise of their rights, and the transmission of information must occur without delay and in accordance with instructions received. Following the adoption of implementing acts by the European Commission to set minimum requirements regarding the types and format of information to be transmitted, Article 3b should ensure that all shareholders receive participation and voting entitlements, including depositary certification of the investors' shareholdings. Article 3b should also ensure that companies receive participation notices from the shareholders and, where applicable, a proxy card entitling the investor to exercise

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<sup>198</sup> Recital 9 to SRD II.

<sup>199</sup> See *also* recital 4 to SRD II.

rights on behalf of the nominee.

By reducing inconsistencies along the chain, Article 3b can be beneficial for retail shareholders. In fact, in the absence of a compelling information-transmission regime, retail shareholders are faced with exceedingly burdensome and practically insurmountable obstacles and costs associated with negotiating individual voting support agreements with intermediaries.<sup>200</sup> Currently, the regulatory framework across Europe is uneven. Certain jurisdictions, such as France and Germany, mandate a combined system of public dissemination and individual transmission of information relevant to the exercise of shareholder rights. However, other jurisdictions, such as Italy, rely only on the public dissemination of such information via the company's website; it is very unusual for retail investors to negotiate any information transmission agreement along the chain. Hence, inconsistent national regimes do not contribute to combatting retail investor apathy.

In addition, Article 3c of SRD II stipulates that intermediaries are obliged to positively facilitate the exercise of shareholder rights, which can be done in one of two ways. First, an intermediary can make arrangements for the shareholder or shareholders' nominees to exercise their rights themselves. Alternatively, an intermediary can exercise a shareholder's rights "upon the explicit authorization and instruction of the shareholder and for the shareholder's benefit."

Finally, Article 3c(2) and 3c(3) require dissemination of an electronic confirmation upon the submission of an electronic vote in order to ensure that shareholders oversee the exercise of their voting rights. Further, shareholders must be given the right to obtain confirmation that votes have been validly recorded and counted by the company.

Against this background, several aspects need to be considered from the particular standpoint of the retail investor. First, as far as retail shareholder identification is concerned, the effectiveness of an issuer's ability to request and obtain insights into its retail shareholder base might be curtailed to some extent following the transposition of SRD II. This is because Article 3a(1) allows Member States to restrict a company's request to shareholders holding more than a certain percentage of shares or voting rights, not exceeding 0.5%. Thus, presumably due to cost-saving considerations, a Member State may refrain from ensuring

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<sup>200</sup> See Zetzsche, *supra* note 187, at 332-33.

that issuers obtain information concerning the identity of shareholders whose holdings or voting rights do not reach the minimum 0.5% threshold. As a result, an issuer's interest in reaching out to its retail shareholders may diminish.<sup>201</sup>

Second, SRD II refrains from granting access to information regarding shareholder identity to any individual or entity other than the company. Currently, shareholders are allowed to initiate the identification process in five jurisdictions upon meeting a certain threshold in terms of share ownership or voting rights. The threshold of share ownership or voting rights varies between 3% and 10%.<sup>202</sup> Member States retain the ability to extend the scope of national law in terms of individuals entitled to access such information; however, there is no incentive to do so under SRD II. It remains uncertain whether Member States will adopt a more enabling approach unless they are compelled to do so. This factor might prove to be problematic in situations concerning the engagement of votes by silent retail investors. If retail participation is to be taken seriously, companies will obtain an advantage by permitting the issuer alone to identify retail investors to contact and share views or gauge retail investor preferences in view of an important and uncertain vote and attempt to win them over.

Similarly, granting access to shareholder identification only to the company will lead to a corresponding disadvantage for the shareholders that are challenging the board or controlling shareholders, which will not be easily justifiable under a regulatory framework with the stated aim of facilitating shareholder engagement as a monitoring tool. Allowing shareholders to initiate the identification process is a means of sharing views on agenda items, corporate action and governance, and reducing agency problems between institutional and retail shareholders.<sup>203</sup> For example, Italy adopted a fair approach, which might be a model for other jurisdictions. Under the Italian law, the threshold

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<sup>201</sup> One further issue to be dealt with when a threshold for the process of shareholder identification is set forth arises where a shareholder's overall holding is split into different accounts, some or any of which reaching the threshold.

<sup>202</sup> See, ESMA, Report on shareholder identification, at 21-22, note 30 (illustrating that a 3% minimum threshold applies in Spain; 5% applies in the Slovak Republic; 10% applies in the UK and the Netherlands).

<sup>203</sup> See Ellis Ferran, *The Role of the Shareholder in Internal Corporate Governance: Shareholder Information, Communication and Decision-Making*, 347, in REFORMING COMPANY AND TAKEOVER LAW IN EUROPE (Guido Ferrarini et al. eds., 2004); ESMA, Report on shareholder identification, at 24.

shareholders are required to meet for initiating the process typically varies between 0.5% and 4.5% of the share capital depending on the size of the company and its ownership structure.<sup>204</sup> Another retail-friendly model to be taken into consideration is that adopted in Spain. Under Article 497 of Spain's *Ley de Sociedades de Capital*, the entitlement to initiate the identification process is extended to an issuer's shareholder associations provided they represent at least 1% of the company's share capital.

Third, the degree to which shareholder identification and communication processes may effectively support both a company's interest in engaging their shareholder base and shareholders' interest in exercising their rights is dependent upon the allocation of costs associated with the processes. Specifically, the inquiry becomes whether those costs are imposed upon the company or shared between the company and its shareholders. Where a case is made for enhancing retail shareholder participation, support may obviously result from the adoption of a regime under which those costs are borne by the company, even where the process is not initiated by the issuer. Such a regime ultimately entails that all shareholders collectively bear the costs. However, Article 3d of SRD II only provides that any charges levied by an intermediary on shareholders, companies, and other intermediaries "be non-discriminatory and proportionate in relation to the actual costs incurred for delivering the services." Further, Article 3d of SRD II allows Member States to "prohibit intermediaries from charging fees for the services provided for" under Articles 3a, 3b and 3c. Thus, cost allocation is basically left up to national law. As a result, national provisions may operate as a driver of retail shareholder participation to a higher or lower degree depending on the country's cost-allocation regime or whether the negotiation of a cost-allocation regime it is left up to a company.

Finally, as far as top-down transmission of information relevant for exercising shareholder rights is concerned, one point of potential concern draws on a comparison with the U.S. notice-only model for electronic delivery of proxy materials within the proxy process. There appears to be some degree of negative causal

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<sup>204</sup> See jointly: Articles 83-duodecies and 147-ter of Legislative Decree No. 58 of February 24, 1998 (Consolidated Law on Financial Intermediation [hereinafter CLFI]), and Article 144-quarter of implementing regulation No. 11971 of May 14, 1999 issued by the Italian supervisory authority for financial markets (Consob).

correlation between the pull electronic delivery model for proxy materials and retail voting response rate.<sup>205</sup> In contrast to a system that facilitates the exercise of shareholder rights by requiring intermediaries to coordinate the transmission of top-down information according to a push delivery method, the SRD II allows an issuer to disseminate information due prior to a general meeting based on the pull model.<sup>206</sup> Under the pull model, a company is only required to make top-down information available on its website. Hence, it remains to be seen whether the adoption of the notice-only model may be counter-productive as regards retail voting response.

According to the draft implementing regulation of the SRD II in relation to Articles 3a-3c,<sup>207</sup> a meeting notice must only contain a URL hyperlink to the website on which full information may be found, a specification of the message providing notice of an upcoming meeting and of the issuer's name and International Securities Identification Number (ISIN).<sup>208</sup> Thus, basic information concerning the specification of the meeting and the agenda are omitted. As a result, the visibility and salience of voting is reduced and negative drawbacks for retail participation emerge.<sup>209</sup> To avoid discouraging voting through the implementation of a minimum standard for notice, the EC should reconsider its draft implementing regulation and require that the notice include references to the items on the agenda.

*B. Tagging along with third-parties' voting preferences as a possible way out of decision-making cost-driven inertia: a comparative approach to the U.S. proposals for re-engaging*

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<sup>205</sup> See *infra* Part IV.

<sup>206</sup> See Article 3b(1)(b) of SRD II.

<sup>207</sup> See Annex to the Draft Commission implementing Regulation (EU) . . . laying down minimum requirements implementing the provisions of Directive 2007/36/EC of the European Parliament and of the Council as regards shareholder identification, the transmission of information and the facilitation of the exercise of shareholders rights, table 3, Ares (2018) 1944240 (Apr. 11, 2018), [https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-1944240\\_en](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-1944240_en).

<sup>208</sup> The ISIN code is a 12-character alpha-numerical code identifying a security for trading and settlement purposes. The ISIN code is the only common denominator securities identification number that is universally recognized.

<sup>209</sup> See Fisch, *supra* note 1, at 25-26 (discussing the drop in retail voter turnout at U.S. listed companies that followed introduction of the notice and access model for proxy delivery).

*retail investors*

As shown in Part V.A above, the European framework emerging from the amended SRD vests Member States and addressee companies with wide discretion with respect to arrangements that may be made for the purpose of encouraging retail shareholder participation in the voting process. When transposing the SRD II into national law, Member States should carefully consider adopting provisions that adequately meet the need to activate retail shareholders and take advantage of the possibilities allowed under European law to that end.

In spite of the above analysis, regulation scarcely impacts decision-making costs shareholders incur when faced with voting. U.S. scholars make it very clear that reducing retail investor apathy arguably requires the decision-making barrier to be addressed by taking account of the psychological tendencies that affect retail shareholder behavior. Thus, the U.S. debate on mobilizing retail votes builds on general premises that are also shared by Europe. Alongside the costs associated with collecting information, educational boundaries and information-processing costs associated with making an informed voting decision may typically impair retail shareholder willingness to participate the voting process. While those limitations do not affect all retail investors equally, they can have a decisive negative impact for those who are not willing to bear the burden of voting.

One German study has found that “investors with better resources, i.e., particularly well-educated or rather sophisticated and more experienced retail investors, are more likely to use their corporate voting right.”<sup>210</sup> This suggests that an increasing level of cognitive resources should reduce voting-related information costs and increase the likelihood of active corporate voting.<sup>211</sup> If this is true, keeping in mind that investors with higher education are the most likely to participate stock markets,<sup>212</sup> an incentive exists to encourage retail investors to exercise their voting rights. Minimizing the cognitive costs of informed voting could support retail investors’ voting. Offering retail investors some kind of short-cut with respect to informed voting could provide retail investors a convincing incentive to decide participate in the voting process.

An effective method of activating retail votes might,

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<sup>210</sup> Schmidt, *supra* note 122, at 71.

<sup>211</sup> *Id.* at 95.

<sup>212</sup> See Eurosystem Household Survey, at 43.

arguably, be based on shifting decision-making costs to other interested parties with more expertise, who are more educationally and organizationally equipped to process information and make voting decisions. The approach to voting shares generally adopted by institutional investors is essentially quite similar to this. Excessive information-processing costs are the very reason why institutional investors retain proxy advisors. Proxy advisors' voting recommendations actually provide a short-cut to help client investors make informed voting decisions and to support them in complying with the regulatory requirements that enhance their stewardship and engagement role with investee companies. Similarly, retail shareholders too should be allowed, if they so choose, to rely on third parties' voting preferences to be relieved from excessive decision-making costs.

Allowing retail shareholders to tag along with more expert investors, either institutional investors or the controlling shareholders, or the board, could be viewed as an arbitrage technique. Under this view, a reallocation of voting power into the hands of those with superior information, processing skills, and appropriate incentives would result. Reallocating voting power to shareholders in a superior position should increase the efficiency of voting.<sup>213</sup> By reducing the information asymmetry, "arbitrage increases the probability that a majority of the shares will be voted in favor of the correct option."<sup>214</sup> Arbitrage techniques as a means of increasing voting efficiency have been illustrated in relation to proxy solicitations and vote buying. Contrary to retail shareholders tagging along with third party voting, proxy solicitations and voting buying drag other shareholders along with an individual's own voting preferences. While cost considerations and legal constraints might reduce the effectiveness of proxy solicitations and vote buying as arbitrage strategies to leverage superior information,<sup>215</sup> tagging along in principle should not entail comparable downsides because the process of arbitrage is freely initiated by shareholders. Shareholders would choose which better informed third party voting preferences most closely match their own views. Thus, helping retail shareholders overcome decision-making costs by widening the range of tools available to choose an agent to direct their voting decisions might usefully broaden the reach of existing regulation with respect to accomplishing the

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<sup>213</sup> See Michael C. Schouten, *The Mechanisms of Voting Efficiency*, COLUM. BUS. L. REV. 763, 809 (2010).

<sup>214</sup> *Id.*

<sup>215</sup> *Id.* at 813-18.



policy goal of increasing shareholder participation.

Returning to the U.S. debate, all of the proposals mentioned above for winning back retail shareholder votes in a feasible manner are grounded upon finding cost-effective cognitive short-cuts to reduce disincentives related to decision-making. Where small, unsophisticated individual shareholders are involved, “heuristics are inevitable.”<sup>216</sup> Gulinello attributes retail shareholder reliance on more well-informed third parties to retail investor voting recommendations (“instructions”) which are provided by a private association of professional market participants. In contrast, Nili and Kastiel envisage cognitive short-cuts in the form of default voting arrangements to be offered to the shareholder when accessing an electronic voting platform. Fisch frames a somewhat different model.

Under Fisch’s model, the substance of voting decisions within the proxy voting process rests with the shareholder. However, the proxy voting process must occur according to permanent voting instructions submitted by the shareholder after establishing a sort of individual voting policy, which should be automatically applied unless the shareholder decides to vote differently. Here, cost-saving results from overcoming the need to submit voting instructions for each individual matter at each individual meeting. In addition, the decision-making shortcut results from the fact that, when addressing her voting policy, the shareholder may possibly tag along with the voting policies adopted by institutional investors whose preferences more closely resemble her own or in proxy advisors’ house voting guidelines.

#### 1. Enhancing the role of retail shareholders’ associations

Under the model proposed by Gulinello, retail investors are supposed to overcome their inability to make informed voting decisions by means of voting instructions advising on how to vote their shares in director elections. Decision-making is delegated to the private association of market participants tasked with disseminating the voting instructions. Unlike proxy advisors’ voting recommendations, here voting instructions seem to be conceived of as a public good, given that participating organizations are supposed to deliver instructions, and bear the associated costs, without being compensated by those whom the program is intended to benefit.

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<sup>216</sup> Gulinello, *supra* note 120, at 591.

Due to special features that are peculiar to the U.S. system of financial supervision, such a model for retrieving the passive retail investor is unlikely to work in the European setting. In fact, there is no FINRA-like private organization under European law that holds EU-wide regulatory authority over broker-dealers and exchanges and is subject to oversight by an SEC-like public organization, which might run the program as a part of its investor-education policy and have authority to actually require cooperation from both the exchanges and intermediaries. The program could not be run by the European Securities and Markets Authority (ESMA), since the ESMA lacks the authority to enlist the cooperation of individual financial market participants. According to Regulation (EU) No. 1095/2010,<sup>217</sup> the regulatory and enforcement authority of nationally based supervisory models is not overridden by the ESMA. This is because (aside from credit rating agencies and trade repositories) the ESMA is only granted the power: to issue guidelines and recommendations concerning the application of Union law in the relevant areas within the practice of the national supervisory authorities; to require those authorities to take specific action to remedy an emergency situation; to foster supervisory convergence across the EU; to actively promote a coordinated supervisory response; and to develop draft regulatory technical standards to be submitted to the EC for endorsement.<sup>218</sup> Even if the ESMA could be entrusted with the program, it would lack the desirable political independence, given that the ESMA is “a Union body with legal personality”<sup>219</sup> accountable to the European Parliament and the Council.<sup>220</sup>

Still, the proposal evokes the enhanced role that may be played by private shareholder associations in advising retail investors on to how to vote their shares. The relevance of shareholder associations is actually not the same in every European country as regards the manner in which and the intensity with which they contribute to retail shareholder engagement with investee companies. Notably, while in some

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<sup>217</sup> Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC, 2010 O.J. (L 331) 84 (Dec. 15, 2010).

<sup>218</sup> See Articles 8-10 of Regulation (EU) No. 1095/2010 (regulating the tasks and powers of the Authority).

<sup>219</sup> See Article 5(1) of Regulation (EU) No. 1095/2010 (defining the Authority’s legal status).

<sup>220</sup> See Article 3 of Regulation (EU) No. 1095/2010.

European jurisdictions, such as Italy, shareholder associations do not play a significant role (if not, in some cases, at issuer-specific level), in Germany investor associations have gradually become stronger based on the long-standing proxy voting regime established under § 135 of the *Aktiengesetz*.<sup>221</sup> Retail investor associations such as the ‘*Schutzgemeinschaft der Kapitalanleger e.V. (SdK)*’, the ‘*Dachverband der kritischen Aktionärinnen und Aktionäre*’ and the ‘*Deutsche Schutzgemeinschaft für Wertpapierbesitz e.V. (DSW)*’ are reported to be traditionally active at providing legal and proxy voting advice and voting services, where voting advice is often offered for free irrespective of membership requirements<sup>222</sup> Shareholder associations are also active at tabling corporate governance-related counter motions at general meetings, typically opposing the approval of the management board, the supervisory board, or both.<sup>223</sup>

One further example is Sweden, where the Swedish Shareholders’ Association, comprising private individual shareholders, has been remarkably successful in promoting its members’ interests. The Swedish Shareholders’ Association has been assisted by a unique regulatory tool that facilitates shareholder participation, involving the creation of a nomination committee independent from the board and made up entirely of shareholders, who are elected at the annual meeting and charged with assessing the board and making proposals to the shareholders’ meeting concerning board election and remuneration, auditor election and fees, and proposals for appointments to the nomination committee itself.<sup>224</sup>

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<sup>221</sup> See Strätling, *supra* note 44, para. 3 (2012) (illustrating how investor association and their influence evolved along with regulatory changes).

<sup>222</sup> *Id.* at 152 (explaining that associations “have an interest to provide a collective good to benefit their members as well as non-members”, given that they become the more influential, the more shares are voted in line with their recommendations”, and further illustrating that the funding of the proxy advisory and voting services offered for free rests on associations’ “ability to attract members who are either intrinsically motivated or who also have an interest in the opportunity to benefit from their legal advice, only offered to members”).

<sup>223</sup> See Henry Schaefer & Christian Hertrich, *Shareholder Activism in Germany: An Empirical Study*, 12 IUP J. CORP. GOV., 28, 29 (2013) (illustrating that retail investors and their associations are the main users of engagement tools such as the submission of counter motions for the agenda, while institutional investors are less involved).

<sup>224</sup> See Thomas Poulsen, Therese Strand & Steen Thomsen, *Voting Power and Shareholder Activism: A Study of Swedish Shareholder Meetings*, 18 CORP. GOV. INT’L REV., 329, 331-332 (2010) (explaining that small shareholders have

Despite the current practical differences between European countries, the German model shows that investor associations might indeed play an enhanced role in providing retail shareholders with cognitive short-cuts to decision-making in the form of voting advice. It is noteworthy in this respect that SRD II encourages associations to take on such a role, in that shareholder associations are exempt from the transparency requirements imposed upon commercial proxy advisors under Article 3j.<sup>225</sup> SRD II defines a proxy advisor as “a legal person that analyses, *on a professional and commercial basis*, the corporate disclosure and, where relevant, other information of listed companies with a view to informing investors’ voting decisions by providing research, advice or voting recommendations that relate to the exercise of voting rights”.<sup>226</sup> Hence, services provided by non-profit associations, such as shareholders associations, which are not offered on a commercial basis, fall outside the scope of SRD II.

The recently enacted legislation might therefore encourage associations to offer their members free voting advice and provide retail shareholders with a cost-effective “alternative to voting abstention or voting according to the executive board’s recommendations. This is an attractive option as, unlike supervisory and executive boards, investor associations are bound by their statutes to pursue the interests of private retail investors.”<sup>227</sup> Moreover, shareholder associations do not have business relationships with the companies they advise on, and—unlike major proxy advisory firms—are less subject to biased judgement due to conflicting interests.<sup>228</sup>

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a say in the committee, where in several cases they are represented by the Swedish Shareholders’ Association. The committee works therefore “as a forum for shareholders to employ the consensus principle”).

<sup>225</sup> Article 3j of SRD II (setting out transparency of proxy advisors ) requires proxy advisors to publicly disclose reference to a code of conduct which they apply and to report on the application thereof on an annual basis, or to explain why they do not apply a code of conduct. To inform their clients about the accuracy and reliability of their activities, proxy advisors are further required to publicly disclose information concerning the preparation of their research, advice and voting recommendations. Finally, proxy advisors are required to identify and disclose to their clients any actual or potential conflicts of interests or business relationships that may influence the preparation of their research, advice or voting recommendations and the actions they have undertaken to eliminate, mitigate or manage the actual or potential conflicts of interests.

<sup>226</sup> Article 2g of SRD II (providing the definitions relevant for the purposes of the SRD II) (emphasis added).

<sup>227</sup> Strätling, *supra* note 44, at 151-52.

<sup>228</sup> *Id.* at 153.

2. Enabling (or promoting) the submission of standing voting instructions

Relevant SRD provisions seem to take an enabling stance as regards standing voting instructions submitted by the retail shareholder. Article 10(3)(b) of SRD allows, but does not compel, Member States to restrict or exclude the exercise of shareholder rights through proxy holders where specific voting instructions for each resolution are lacking.<sup>229</sup> Furthermore, while requiring the proxy holder to cast votes according to the instructions received by the appointing shareholder, Article 10(4) of SRD does not assume that those voting instructions must be submitted for each resolution at each general meeting, and therefore does not prevent the shareholder from submitting standing instructions to be executed by the proxy holder unless revoked by the shareholder.<sup>230</sup>

At the national level, the German proxy voting regime based upon § 135 *Aktiengesetz* seems to be based on the same enabling approach. In its current version, § 135(1) assumes that the proxy holder—be it the custodian, a shareholder association or another person (see para. 8 and 10)—has been provided with explicit voting instructions concerning each item on the agenda.<sup>231</sup> This does not, however, mean that instructions need to be submitted separately for a specific item each time it appears on the agenda for an upcoming meeting. Shareholders are allowed to submit voting instructions even long before a general meeting is convened and the agenda is set, provided that the instructions refer to individual items.<sup>232</sup> Hence, as long as they are sufficiently detailed, voting policies can work as standing voting instructions submitted in advance of future general meetings, to be executed by the proxy holder each and any time an item appears on the agenda, unless the shareholder directs otherwise.<sup>233</sup> The practice of

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<sup>229</sup> Under Article 10(3)(b) of SRD, which regulates proxy voting, Member States “*may* restrict or exclude the exercise of shareholder rights through proxy holders without specific voting instructions for each resolution in respect of which the proxy holder is to vote on behalf of the shareholder” (emphasis added).

<sup>230</sup> Article 10(4) of SRD only provides that “[t]he proxy holder shall cast votes in accordance with the instructions issued by the appointing shareholder”, without any specification as to the characteristics of such instructions.

<sup>231</sup> § 135(1) of the *Aktiengesetz* refers to “explicit instructions” (*ausdrückliche Weisungen*) provided by the shareholder as a requisite for the proxy holder to be entitled to vote the shares.

<sup>232</sup> See Dirk Zetzsche, § 135 *AktG*, in 3/6 *KÖLNER KOMMENTAR ZUM AKTIENGESETZ* 69-70 (n. 185) (Wolfgang Zöllner & Ulrich Noack eds., 3rd ed., 2016).

<sup>233</sup> See *id.* at 73 (n. 199-202).

submitting voting policies to operate as standing voting instructions within the scope of § 135 is well-known in relation to institutional investors and their relationship with custodian banks.<sup>234</sup> Thus, there appears to be no reason why the same should not apply to retail shareholders as well, even more so upon consideration that the SRD II requires intermediaries to positively facilitate the exercise of shareholders' rights.

Arguably, small individual investors may examine some major institutional investor's voting policies, which are usually available on the internet, and establish their own standing voting instructions following the lead set by those institutional investors whose voting policies come closer to their own views, or that they consider reasonable and are therefore willing to share. The very same applies in relation to commercial proxy advisors' proprietary voting guidelines and those prepared by shareholder associations. Major proxy advisors' yearly updated national or regional house voting guidelines are available on the firms' websites, either voluntarily, having signed up to the industry's 2014 "Best Practice Principles for Shareholder Voting Research",<sup>235</sup> or according to Article 3j(2)(e) of SRD II, which requires proxy advisory firms to publicly disclose "the essential features of the voting policies they apply for each market" on an annual basis.<sup>236</sup>

Nonetheless, national provisions on proxy voting currently in place in other European jurisdictions set out a stricter regime that constrains a retail shareholder's ability to submit standing voting instructions. Under Italian law for instance, only intermediaries that provide collective investment management services are allowed to appoint a proxy for more than one individual general meeting.<sup>237</sup> Unlike investment managers, retail

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<sup>234</sup> *Id.*

<sup>235</sup> See BEST PRACTICE PRINCIPLES FOR PROVIDERS OF SHAREHOLDER VOTING RESEARCH & ANALYSIS, Guidance to Principle One, para. 5(b)(ii) (March 2014), <https://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf>.

<sup>236</sup> Article 3j(2)(e) of SRD II. Article 3j(2) of SRD II requires information subject to public disclosure to be "made publicly available on the websites of proxy advisors and [to] remain available free of charge for at least three years from the date of publication".

<sup>237</sup> See Articles 135-novies (8) of CLFI [allowing that, as an exception to the general rule set forth by Article 2372 (2) of the Italian Civil Code, intermediaries mentioned in the above text "may grant a proxy for more than one shareholders' meeting"], and 142 (1) of CLFI [stating that proxies to soliciting shareholders' associations "may be given only for one shareholders' meeting that has already been called, remaining effective for subsequent calls where applicable"].

shareholders are therefore not permitted to appoint a proxy that has authority to vote on their behalf on an ideally permanent basis, which in turn frustrates their potential willingness to submit standing voting instructions. For, even if the shareholder were to frame her own voting policy, she still would find herself compelled to nominate a proxy holder separately for each upcoming meeting. This brings out once again the potential relevance of psychological constraints that, due to the additional effort required, may eventually lead the shareholder to abandon proxy voting.

Thus, despite the enabling SRD provisions, national regimes appear to be anything but uniform. Concerns about retail voters' awareness and the potential for establishing standing authority by means of permanent proxies underlie the constraints imposed upon proxy voting under some national regimes. However, the existence of somewhat retail-unfriendly provisions does not help increase retail voter turnout. Again, in line with the European policy goal, the Member States concerned should consider amending national provisions in a way more favorable to retail shareholders.

Significantly, the facilitating of retail votes by allowing for the submission of standing voting instructions is not in tension with SRD II's policy goal of encouraging informed voting. Retail uninformed voting has risen concern in the U.S. too.<sup>238</sup> However, as has been argued by Fisch, the risk of encouraging uninformed voting is sufficiently narrow as to not justify the SEC's refusal to level the playing field between institutional and retail shareholders as regards SVIs.<sup>239</sup> Similarly, the issue of uninformed retail voting cannot be made under the European regulatory framework. The enabling SRD and SRD II regimes clearly show that concerns on this score are misplaced, as also does the German regime.<sup>240</sup>

In fact, the submission of voting instructions in advance of a meeting, and hence prior to dissemination of the relevant mandatory disclosures, does not contradict the relevance of such disclosures. This is because, as is also the case where voting

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<sup>238</sup> See comments from panelist Reena Aggarwal 2015 in Proxy Voting Roundtable Unofficial Transcript, at 90-91 (emphasizing the need to focus on "how to increase informed retail participation, not just increasing retail participation for the sake of increasing the numbers", and conceding that if retail investors could access, e.g., mutual fund voting reporting, they at least would "have some benchmark as to how others are voting and that might serve as useful information.").

<sup>239</sup> See Fisch, *supra* note 1, 43.

<sup>240</sup> See *supra* notes 229-32 and accompanying text.

instructions are submitted separately for each issue and each meeting, the shareholder always retains authority to revoke her standing instructions, either permanently or with regard to one single upcoming meeting.<sup>241</sup> As a consequence, where, upon disclosure of the relevant information by the issuer, the shareholder reaches a decision and directs her proxy holder otherwise, she would not be prevented from doing so. Even more importantly, the retail shareholder—unlike institutional investors managing other people’s money—is under no obligation (either to vote or) to make informed voting decisions.<sup>242</sup> Informed voting is an issue to be carefully reckoned with where investment managers are concerned, who are legally entitled to make voting decisions in lieu of, but also in the interest of, the end-investors whose economic interests are at stake. By contrast, since they are directly entitled to decide (whether and) how to vote and have a stake in the game, retail investors may be encouraged by the law, but not compelled, to be informed shareholders. As Professor Fisch notes in relation to federally-mandated issuer disclosures, “the principle behind the federal disclosure system is to require that the mandated disclosure be sent to each investor, not that each investor read it, acknowledge that they have read it, or demonstrate his or her familiarity with its contents prior to investing or voting.”<sup>243</sup> Moreover, if—as some data show<sup>244</sup>—shares are directly owned largely by educated (though non-expert) individuals, the issue of uniformed voting might lose some appeal with respect to establishing standing voting instructions.

However, given that framing one’s own voting policy requires a special, *ex ante* effort at decision-making (albeit reduced by the potential to tag along with better informed third parties), this factor might give rise to a chilling effect for uncommitted retail shareholders. This kind of constraint seems, instead, to be reduced under the model proposed by Kastiel and Nili, where, upon access to her brokerage account, the shareholder would be offered default arrangements allowing her to choose, unless she opts out, between

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<sup>241</sup> Article 11(3) of SRD (regulating the formalities for proxy holder appointment and notification) makes explicit reference to the “revocation of the appointment of a proxy holder”; although it does not explicitly mention the revocation of voting instructions, the power to revoke such instructions is inherent in that to revoke the proxy holder.

<sup>242</sup> Fisch, *supra* note 1, at 47-49 (referred to U.S. State law).

<sup>243</sup> *Id.* at 49-50.

<sup>244</sup> See Eurosystem Household Survey, at 43; Maarten van Rooij, Annamaria Lusardi & Rob Alessie, *Financial literacy and Stock Market Participation*, 101 J. FIN. ECON. 449-472 (2011).



a number of short-cuts available, “such as voting along with a specific large and sophisticated shareholder, in accordance with the majority of institutional investors not affiliated with management, or in accordance with the recommendation of a proxy advisor.”<sup>245</sup> Tagging along with the board should also be offered as an option, as well as withholding votes or choosing not to choose at all. In short, allowing the shareholder to choose an agent for decision-making is supposed to render the voting process more accessible and make “the expression of preferences by retail investors more likely.”<sup>246</sup>

If considered from a European perspective, it seems that, under the current regulatory and practical arrangements, a similar model could only be established through regulatory changes. Even if retail shareholders actually voted electronically upon accessing their broker accounts, it would be necessary to regulate the specific contents of the short-cuts to be offered the shareholders. This is because, arguably, in order to allow for an independent choice, the framing of those shortcuts should not be left up to the company or the intermediaries. Moreover, some of the shortcuts proposed appear to be difficult to implement, such as voting in line with a proxy advisor voting recommendations. In fact, voting recommendations are not public goods; hence, even though the recommended direction of the votes is usually publicly known prior to the meeting, this cannot be automatically be taken for granted in relation to any issue being voted upon.

### 3. Summarizing issuers’ disclosures

Despite the above conclusions, one further model that might possibly be replicated to facilitate retail investors’ voting decisions is that based on the prospectus summary.<sup>247</sup> Given that information overload associated with the length and language of issuers’ information materials prior to a shareholders’ meeting is likely to discourage the processing of that information,<sup>248</sup> one way

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<sup>245</sup> Kastiel & Nili, *supra* note 132, at 59.

<sup>246</sup> *Id.*

<sup>247</sup> *See infra* Part I.

<sup>248</sup> *See infra* Part IV. As discussed in more detail by Jeffrey Cohen, Lori Holder-Webb, Leda Nath & David Wood, *Retail Investors’ Perceptions of the Decision-Usefulness of Economic Performance, Governance, and Corporate Social Responsibility Disclosures*, 23 BEHAV’L RES. ACCT. 109, 111 (2011), “With the rise of behavioral finance, it has become apparent that the content and format of disclosures influences retail investment decisions.” Arguably, the same might apply as regards retail investor voting.

to provide the retail shareholder with an incentive to keep pace with relevant information is to offer a shortened, simplified version of the information.

Summarized AGM information might be helpful irrespective of how the shareholder chooses to cast her votes, i.e. both where she is unwilling to delegate voting decisions to better informed third parties, and where those decisions are instead delegated, whether formally (by appointing a proxy holder), substantially (as is the case, e.g., under the Nili and Kastiel model), or by means of standing voting instructions inspired by third party voting policies. Summarized information can help the shareholder maintain control over the proxy process where standing voting instructions have been previously submitted by her; the availability for each upcoming meeting of short information in ordinary language would at least make it less unlikely that the retail shareholder might check for any new information that could potentially lead her to deviate from her previous instructions and direct her proxy holder to vote otherwise. This would be especially helpful where important and contested issues are to be voted at the shareholder meeting.

From the legal standpoint, it is indeed unclear why retail investors should be offered summarized information in the context of private offerings, where corporate funding is at stake and retail shareholders act as capital providers, but not when their role as shareholders is under consideration. If retail investors are a target of wide-ranging EU regulatory policies aiming at strengthening EU financial markets by fostering their investments, unless they are prevented from directly accessing the equity markets and compelled to rely on investment managers only—which is not the case either in Europe or the U.S.—<sup>249</sup> it is unclear why, looking beyond their capital supply role, they should not deserve more nuanced consideration also as shareholders and be offered

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<sup>249</sup> See Luigi Zingales, *The Future of Securities Regulation*, 47 J. ACC'T RES. (2009), at 417-418 (arguing that, to protect uneducated and unsophisticated investors from risky financial decisions, “the goal of preventing unsophisticated households from investing directly in securities markets is a laudable one”, but that “it is probably not achievable”); Langevoort, *supra* note 84, at 1065-67 (hypothesizing that an institutions-only market, although politically infeasible, would be more efficient than one that includes retail investors and would lead to better corporate governance); *but see* Alicia Davis Evans, *A Requiem for the Retail Investor*, 95 VA. L. REV. 1105, 1116-25 (2009) (contending that eliminating the participation of individual investors could lower market efficiency, and noting that many institutional investors fail to serve as effective corporate monitors).

summarized information in the same way as they are in relation to public offerings.

## VI. CONCLUSION

Retail investors' absence from the corporate voting scene comes at a price in terms of the potential effectiveness of board and controlling shareholder accountability. When considering how possibly to activate retail shareholder votes at general meetings, behavioral tendencies and psychological limitations associated with decision-making need to be addressed alongside the voting mechanics. To lessen the reach of those disincentives, inspiration from voting patterns usually followed by institutional investors can be helpful. Allowing retail shareholders, if they so wish, to tag along with better informed third-party voting preferences may be a possible way out of decision-making cost-driven apathy.

The relevant European regulatory framework vests Member States and addressee companies with wide discretion as regards the provisions and arrangements that may be taken to encourage retail shareholder participation in the voting process.<sup>250</sup> Despite the potential shortcomings of the European framework, Member States should be wise to consider carefully the issue of activating retail shareholders when transposing the SRD II into national law, and to shape national provisions accordingly by taking advantage of the possibilities allowed under the European regulation.

The voting process should evolve towards digitization, and shareholders throughout the EU should not be charged for participating in the meeting and voting electronically. Importantly, the right to initiate the identification process should be granted the shareholders and shareholder associations as well; the related costs should be borne by the company. Restricting identification to shareholders whose holdings reach a minimum threshold might prevent initiating parties from reaching out to a significant part of a company's retail shareholder base; identification should therefore preferably be constrained only upon objection from individual shareholders.

To reduce decision-making costs associated with voting, retail investors should be allowed to submit standing voting instructions based on a policy that might tag along with voting guidelines established by institutional investors, proxy advisors or

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<sup>250</sup> See *supra* Part V.A.

shareholder associations. Investor associations might play an enhanced role in providing retail shareholders with cognitive short-cuts to decision-making in the form of voting advice, given that transparency requirements imposed upon commercial proxy advisors do not apply. Mandating summarized AGM information might also help reducing decision-making costs for retail shareholders.

Individual companies might further encourage retail participation by means of incentivizing tools: upon consideration of constraints possibly deriving from European rules on shareholder equal treatment and shareholder distributions, an attendance bonus for participating the meeting (as experimented in Spain at some general meetings)<sup>251</sup> might incentivize retail voting. Experiments such as Bank of America's campaign to donate \$1 to the Special Olympics on behalf of every individual investor who returned a voted proxy might also be helpful to support retail voting.<sup>252</sup>

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<sup>251</sup> See, e.g., Iberdrola S.A.'s 2018 attendance bonus scheme, offering an attendance bonus of € 0.005 per share (€1 gross) for every 200 shares for attending, delegating or voting remotely at the general meeting: <https://www.iberdrola.com/corporate-governance/general-shareholders-meeting/2018-gsm/attendance-bonus>. Although Spanish law does not regulate the practice of granting attendance premiums, the Spanish Corporate Governance Code approved by the Stock Market National Commission (CNMV) on Feb. 18, 2015 ([https://www.cnmv.es/DocPortal/Publicaciones/CodigoGov/Good\\_Governance\\_en.pdf](https://www.cnmv.es/DocPortal/Publicaciones/CodigoGov/Good_Governance_en.pdf)) considers attendance premiums as a measure for "encouraging shareholders to participate in general meetings and combating absenteeism": see Recommendation 11 (recommending, in order to promote transparency, that "[i]n the event that a company plans to pay for attendance at the general meeting, it should first establish a general, long-term policy in this respect").

<sup>252</sup> See Carl Hagberg, *BofA'S Donations to Special Olympics produced Big New-Voter Turnout*, The Shareholder Service Optimizer Online, <http://www.optimizeronline.com/article/103330/more-news-from-the-2017-meeting-front-the-best-worst>.