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The Rise of the Retail Investor

Regulation and the increased influence of Fintech in democratising corporate governance in Europe



Produced in collaboration with



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KEY TAKEAWAYS:

There are five key reasons causing banks, brokers and wealth managers to reappraise how they service the retail investor community in Europe:

1. Regulation will compel firms to transform how they service the voting requirements of the retail investor community. The European regulatory agenda and the continued introduction of the Capital Markets Union (CMU) have set the tone for a more engaged and empowered retail investor in the region. To this end, the second Markets in Financial Instruments Directive (MiFID II), the latest Undertakings for the Collective Investment in Transferable Securities (UCITS) directive and the Alternative Investment Fund Managers Directive (AIFMD) are all under review at the EU level and it is anticipated the updated versions will feature more requirements targeted at improving investor access to the various funds across Europe. Furthermore, the updated Shareholder Rights Directive (SRD II) granted retail investors with more voting rights, and the upcoming European Commission review and next iteration of the directive will likely close the remaining loopholes around the identification of the individual shareholder in each country. Once this has been addressed, it is likely that national regulators will be compelled to address noncompliance within their jurisdictions. Financial intermediaries must comply by offering these services or face financial penalties and related reputational damage.

2. Providers and platforms that fail to meet investor expectations can expect a public backlash. Financial institutions that don't currently offer voting capabilities have already been criticised by the shareholder community for failing to meet basic client expectations. These capabilities will need to be offered consistently across markets in order to meet these expectations in both a domestic and cross-border investment context.

3. Environmental, social and governance (ESG) investing will compel more activity from the retail investor community. Issues including board diversity and sustainability are a driving force for further investor engagement in the form of shareholder voting on these topics. The Sustainable Finance Disclosure Regulation (SFDR) and the UK's own version of these sustainability rules will memorialise in regulation the requirements to provide more transparency at the entity and instrument level for investors across Europe and beyond. This trend is also true of mutual and index funds where, with an eye to the US, the likes of Blackrock are now enabling their underlying mutual and index investors with the ability to vote – including on ESG themes important to them.

It should be noted that the US is not unique in the indirect investment space and there are, for example, initiatives in the UK that are also looking to empower investors – both institutional and retail - who hold via indirect instruments.

4. The next generation of investors have higher expectations for digital support from their financial institutions. E-voting and digital channels for investor engagement have become table stakes for firms servicing the retail investor community. Mobile device support is a key part of this as clients expect a seamless and consistent user experience across various devices.

5. Wider retail investor engagement is an integral part of Europe's future. The European Commission's Capital Markets Union (CMU) plan includes the wider engagement of the retail investor for the benefit of the growth of the region's capital markets. Financial institutions need to capitalise on these future opportunities by focusing on the retail investor community ahead of time.

THE APPETITE FOR CHANGE

The popularity of ESG investment strategies among the retail and institutional investor communities and the industry discourse around topics related to diversity and transparency of corporate governance signal that significant changes are afoot. Governance has long been a topic for discussion within the institutional investor community, but the retail investor community has increasingly begun to make its voice heard. This has been enabled by significant regulatory changes in Europe as part of SRD II, and the industry-wide push for increased transparency around shareholdings and greater accountability at the corporate level, which have combined with the increased desire of individual investors to influence change.

Significantly SRD II has mandated the provision of proxy voting services by intermediaries to both institutional and retail investors, paving the way for retail investors to have a greater say in the governance of the companies in which they hold shares and the democratisation of the markets overall. Social media has also played a pivotal role over the last few years in highlighting the voice of the retail investor.

The first half of 2021 saw the community on online forum Reddit demonstrating the appetite of retail investors to engage and influence markets via their trading activities. Although the aspects of engagement around Gamestop and the other meme stocks may not be typical of the whole retail investor community, these developments have influenced the way the



public at large (and the industry, regulators and politicians) views the position of the retail investor.

The US market, both for equities and funds, can be viewed as a frontrunner to European markets in terms of retail investor engagement and governance activity. In 2020, retail trading hit a 10-year high in the United States, representing 19.5% of all order flow in the equities markets, according to Bloomberg Intelligence figures¹. Investor groups in the United States lobbied the Securities and Exchange Commission (SEC) to compel the regulator to repeal legislation that would impact their proxy voting rights and the SEC proposed rules in November 2021 to repeal the Trump-era regulation².

The European markets have never been more accessible to retail investors—traditional and online brokers have tailored their e-trading applications to attract a generation of new retail investors. Accounts are easy to open and manage, financial barriers to investing are lower than ever, and data is much more accessible and available via simplified user interfaces and faster connection speeds. In Europe, retail brokers indicate that client numbers have increased significantly during 2020 and 2021. For example, UK-based online trading platform Freetrade, which launched in late 2018, signed up around 160,000 new clients in January 2021 alone and hit the one million milestone in October 2021³. In Germany, retail brokers have benefited from the boom by increased share prices for their own stocks. German market maker Baader Bank saw accounts on its trading platform more than double in 2020 and retail trading firm Tradegate more than doubled its dividend after pre-tax profit increased by 568% in 2020⁴.

Prior to 2020, retail trading in Europe was much more subdued but there are further drivers for growth from the regulatory perspective—one of the key pillars of the European Union’s aspirational CMU is to increase retail investor activity in the region, including cross-border investment. MiFID II increased transparency requirements for retail brokers and financial advisors when it comes to their dealings with retail investors. MiFID II also created a new category of multilateral trading facility targeted at the small and medium-sized corporations that has proved increasingly popular with retail investors.

The upcoming regulatory reviews of MiFID, UCITS and AIFMD are also all expected to include more requirements for the funds industry to improve the transparency of and accessibility to the various funds regimes across the region. One of the likely priorities will be in creating a level playing field between alternative funds and UCITS funds and introducing a passporting regime for the distribution of retail AIFs. The regulations will be adapted to allow retail AIFs that have similar features to UCITS to be eligible as non-complex products under the MiFID II framework, which will reduce market fragmentation and improve access to these funds for investors within Europe and outside of the region.

These developments all reflect the European prioritisation of the goals of the CMU, which aims to reduce barriers to retail equity investment through various means, such as increasing retail investor access to market data, which will, in turn, increase the percentage of retail shareholders overall across the region in the future. It is also focused on reducing the administrative demands of including a retail segment in capital raisings and it aims to “facilitate direct investment without

high intermediation costs typically charged of retail investors⁵. Retail investors represent a major source of potential capital and liquidity for initial public offerings and follow-on share offerings, especially for the small and medium-sized enterprises across Europe.

While the United States has a much higher percentage of retail shareholder engagement, the EU is keen to gain competitive footing versus its transatlantic neighbour, as stated in the CMU documentation. At an individual country level, this will mean an increase from a very low base in markets such as the Netherlands, where retail investor holdings have been as low as 4% in recent years, but much higher in markets such as Austria⁶. The share of retail investor holdings at the country level is typically less than 30% in the EU member states, though some smaller financial centres such as Hungary and Malta are slightly higher. In the United Kingdom, the proportion of UK shares held by UK-resident individuals rose to 13.5% in 2018 from 10.6% in 2012, according to the Office for National Statistics⁷.

The engagement of these investors is likely to increase as a result of their appetite for sustainable and ESG investments. Figures from the Association of the Luxembourg Fund Industry indicate that European ESG mutual funds and exchange-traded funds hit the US\$1.4 trillion milestone in 2020 and now account for around 10% of the region's total funds assets⁸. The UK's Investment Association released research in March 2021 that indicates net retail sales into responsible investment funds in the UK reached £1.2 billion in January 2021⁹.

VOTE EMPOWERMENT

Trading behaviour isn't the only way that retail investors can make their voices heard at the corporate level. The ability of shareholders to vote on key issues such as director remuneration and ESG policies has increased in Europe, in particular as part of SRD II. However, there are some challenges for retail investors in specific European countries because of the national divergences on the definition of a shareholder. The lack of harmonisation at the EU level around this key definition must be addressed by regulators in order for there to be a level playing field for individual retail investor access to proxy voting services in every country.

In the meantime, the pandemic has led more corporations and their issuer agents to support electronic voting to accommodate the remote working environment. The provision of these online portals has largely benefitted the institutional investor community, which has traditionally been much more engaged than retail investors in governance processes. The lack of individual investor engagement is partially due to the majority of European retail brokers and retail investment platforms not currently supporting shareholder voting processes. In 2021, these platforms have faced direct public criticism by retail shareholders on social media for their lack of proxy voting capabilities with one individual describing them as "prehistoric" for failing to provide these basic services.

The ability to influence corporations via voting on important issues such as board diversity, climate change and sustainability is likely to become increasingly appealing to this community as these issues continue to dominate the public consciousness.



THE NEED FOR GREATER ENGAGEMENT

The demand from retail investors for access to the basic services provided to their institutional counterparts is only likely to grow over time as digital and social channels increase their influence on this community. Social channels are frequently used by the public to provide feedback to companies and to air complaints, and these channels have become increasingly influential on capital markets due to the introduction of sentiment analytics that feed into trading strategies. Share prices can rise and fall based on a single tweet. Discussions within an online community such as Reddit can also cause retail investors to buy certain shares en masse.

Retail investors need better access to shareholder communications, corporate management and share offering information, and digital channels are the perfect way to supplement traditional methods of information delivery in a cost-efficient manner. The European Commission is also keen to improve financial literacy across the EU as part of the CMU, and investor engagement is a key part of this strategy.

THE IMPACT OF FINTECH ON GOVERNANCE

If retail investors are to become a larger part of the European market as companies build a more diversified investor base against the tide of passive investment strategies, these individuals need to have access to the voting capabilities of their institutional counterparts. Online annual general meetings (AGMs) throughout the pandemic have enabled a greater number of investors to participate in governance processes than ever before. The good news is that the technology is now available and proven to support both communication and voting processes for the retail investor community.

Regularly engaged shareholders tend to have more loyalty and feel less disenfranchised than those that have limited contact with the issuer. By offering voting capabilities—as mandated under SRD II—brokers, banks, wealth managers and other intermediaries will no longer represent a barrier to these retail investors. Given that the pandemic has also fostered a “work from anywhere” approach in many industries, mobile enablement is a key factor in the deployment of this technology, especially for younger investors.

Retail investors should be able to access a baseline of information on the company and be able to vote from anywhere. A seamless user experience across various devices is table stakes for financial institutions offering retail investor support, including consistent and frictionless support for shareholder voting across the markets in Europe and beyond.

These capabilities necessitate a secure and reliable technology platform that provides easy access to data from multiple sources to the end investor. The use of application programming interfaces (APIs) to deliver this data in an on-demand manner will allow issuers and intermediaries to provide the required information transparency. Bear in mind that the way in which retail investors receive information prior to their voting can have a significant impact on their engagement—keep it simple and electronically delivered.

WHY LEADING FIRMS ARE TARGETING THE RETAIL INVESTOR SPACE

The benefits to intermediaries such as banks, brokers and wealth managers, of focusing on these services include:

- **The ability to build brand reputation and trust:** As more retail investors come into the market across Europe, firms offering these services can demonstrate that they are ahead of the curve when it comes to ESG leadership and digital adoption. Brand visibility can increase further if using a white-labelled service from a vendor that enables the voting platform to have the same look and feel as all of the firm’s other offerings.
- **To achieve best in class compliance:** Regulators are increasingly keen to see retail investor engagement and transparency across the European markets. The advent of SRD II and MiFID II have placed emphasis on firms to better support governance processes and investor education. Financial institutions need to ensure that they are meeting their regulatory compliance obligations, including those that are aimed at protecting and servicing the retail investor community.
- **To increase client service and retain market share:** Retail investors have already criticised laggards in the market for not offering these services. Firms can avoid exposure to service weaknesses arising from legacy platforms by investing in their technology, and partnering with an established managed service provider.

THE BENEFITS OF PARTNERING WITH A FINTECH

Fintech innovations in technology and digital communications are already supporting the empowerment of retail shareholders in Europe through the provision of efficient, cost-effective solutions that are delivered through a mutualised, shared cost service for the industry.

Broadridge, for example, is working with its financial intermediary clients to offer a seamless and white-labelled service to their own retail investor clients. The user experience is consistent for clients across the various portals and mobile

applications to allow voting from anywhere, and using the financial institutions' own branding and front ends where that is a preference.

Building from the requirements of SRD II, firms will need to support voting processes across all of the impacted European markets in a consistent manner. They will need to make the experience as frictionless and seamless as possible for their investor client base. This means working with partners such as Broadridge to provide mobile-enabled portals and e-delivery investor communications for online voting—let us worry about the back-end and the APIs, and enable a simple and easy-to-use client experience.

This fits into our focus on digital transformation. Broadridge continues to invest in next-generation technology capabilities to enable our clients to offer the best service possible to their own client communities. Digital channels and mobile enablement are all part of our focus on supporting digital transformation across the industry.

For more information visit www.broadridge.com/SRD or email global@broadridge.com

FOOTNOTES

1. [Trade Volume Explodes as Retail Traders Make Their Mark](#), 28 January 2021, Bloomberg.
2. [SEC eases path to votes on shareholder petitions at US companies](#), 3 November 2021, Financial Times.
3. [Freetrade reaches one million users](#), 14 October 2021, Freetrade.
4. [Retail trading boom sparks 500%-plus rally in small German brokers](#), 18 February 2021, Reuters.
5. [Capital markets union – reboot: a policy discussion on the future of the capital markets union](#), 9 September 2019, ECOFIN.
6. [Untapped Capital: Understanding the retail investor pool](#), 2020, Economist Intelligence Unit.
7. [Ownership of UK quoted shares: 2018](#), 14 January 2020, ONS.
8. [ESG Fund Assets Hit Record \\$1.4 Trillion in Europe Last Year](#), 16 June 2021, Bloomberg.
9. [Responsible investment funds under management up 66% over 12 months](#), 4 March 2021, Investment Association.

FRANCE: A MARKET-LEVEL CASE STUDY - BROADRIDGE COLLABORATES WITH SLIB

Broadridge and SLIB have collaborated to offer a fully automated, end-to-end cross-border proxy voting solution for SRD II compliance, covering European shareholder meetings. The solution enables French retail intermediaries to offer proactive proxy voting services to shareholders where they can be notified of shareholder meetings for European companies and exercise voting rights seamlessly. Unique to the French market, the solution leverages Broadridge's industry-leading Global Proxy solution and includes an STP connection to SLIB's Votaccess®, the leading electronic voting platform in France, which manages in excess of 80% of CAC 40 companies' General Meetings.

“This is a landmark initiative and brings together the leading provider of global proxy solutions in Broadridge, with our unique Votaccess platform, the electronic voting solution leader in the French market”

PHILIPPE COGNET, CEO, SLIB

CONTACT BROADRIDGE

To engage in further industry dialogue relating to retail voting in Europe, the Shareholder Rights Directive or for more information about Broadridge's proxy management, shareholder disclosure and corporate governance services, please contact:

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ABOUT BROADRIDGE'S RESEARCH PARTNER FOR THIS REPORT, FIREBRAND RESEARCH

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