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Institutional Investors' Mandatory Voting Disclosure – European Plans and U.S. Experience

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Institutional Investors' Mandatory Voting Disclosure – European Plans and U.S. Experience

*KLAUS ULRICH SCHMOLKE**

ABSTRACT

The European Commission proposed in its action plan “Modernisation of company law and enhancing corporate governance in the European Union – a plan to move forward” of the year 2003 a mandatory disclosure of institutional investors’ voting behavior with regard to their portfolio companies as a medium-term measure. This proposal was evidently inspired by SEC rules mandating voting disclosure of investment companies and investment advisers adopted in the same year.

However, the realization of the Commission’s proposal is far from certain. It has not only met strong opposition by commentators when it was presented to the public in 2003. The Commission itself recently launched a consultation process to reassess the necessity and desirability of the medium- and long-term proposals of its action plan thereby indicating that it will take the principle of subsidiarity of EC law much more seriously than in the past. At the same time, the British government gets ready to adopt a disclosure rule at the national level.

This paper examines the U.S. debate on and experience with institutional investors’ mandatory voting disclosure. With the aid of the insights and arguments thereby gathered the paper argues that there was and still is a case for a mandatory voting disclosure rule at EC level.

* I thank Marcel Kahan for discussion and useful comments on earlier drafts. I also thank Claudia Royé for putting some useful data at my disposal.

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1. Introduction

Over the past decades the share of equities held by institutional investors has grown significantly, in the U.S. as well as in Europe. Among institutional ownership the growth of investment companies like mutual funds is disproportionately high.^{1/2} Nowadays, institutional investors play a major role not only in the U.S., but also in Europe. This is not only true for countries like the UK or Sweden³ with a high percentage of shares held by institutional investors. Their importance is also growing in countries with a relatively small percentage of institutional shareholding, like Germany.⁴

This noticeable growth of institutional ownership gave rise to the demand of more institutional shareholder activism,⁵ since the institutional investors are deemed able to overcome notorious

¹ According to data provided by the Federal Reserve Bank the percentage of holdings of U.S. equities by U.S. institutional investors grew in the time from 1995-2004 from 35.98% to 42.43%, while the share of mutual funds, Closed-end funds and Exchange-traded funds grew together from 13.89% to 26.87% (mutual funds alone: from 13.33% to 24.86%), see Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, Annual Flows and Outstandings, 1995-2004, table L.213, online: <http://www.federalreserve.gov/releases/z1/current/annuals/a1995-2004.pdf>. The U.S. equity holdings were computed by taking “Issues at market value” and deducting “Rest of the world – Holdings of foreign issues by U.S. residents”; institutional ownership was computed by deducting “Household Sector”, “State and local government” and “Rest of the World – Holdings of U.S. issues by foreign residents”.

According to Federation of European Securities Exchanges’ (FESE) data the weighted average of the participation of collective investment institutions, comprising pension funds, insurance companies, mutual funds and collective financial investment companies, in European bourses was 25% at the end of 2003. However, the differences between countries were large. While such institutions held 47.3% of the market capitalization in the UK and 26% in Sweden, the remaining markets in continental Europe are below the weighted average and 13 out of 17 countries for which data was gathered were below 15% [FESE, Share Ownership Structure in Europe 2004, Final Version, November 2004, online: http://www.fese.org/statistics/studies/share_ownership_2004.pdf]. Despite these figures for continental Europe are comparatively low, they indicate to a considerable growth in shareownership. For example, the share of equity held by German funds and insurance companies grew about twice as fast as the German equity market as a whole in the time from 1991 to 2004 [cf. DAI-Factbook, October 2005, table 08.3, online: http://www.dai.de/internet/dai/dai-2-0.nsf/dai_statistiken.htm (non-public)].

According to Investment Company Institute (ICI) data the total net assets of mutual funds have grown in the time from 1998 to 2004 from US\$ 5,525,209 million to 8,106,876 in the U.S. (= 46.73%) and from US\$ 2,743,228 to 5,628,152 million in Europe (= 105.17%), see ICI, 2005 Investment Company Fact Book, 45th ed., 2005, at Table 44, online: <http://www.ici.org/factbook/index.html>. U.S. Investment Companies, with the lion share held by mutual funds, held 24% of the outstanding stock of U.S. companies in 2004, see id., at p. 6 et seq. In 2005 the sales of equity fund shares in Europe doubled in comparison to the sales in the preceding year (to €109.7 billion), see Handelsblatt, *Nachzügler Deutschland* [Latecomer Germany], 23.02.2006, Nr. 39, at p. 28.

² As to the growth of holdings in U.S. equities by institutional investors and mutual funds, respectively, in the time period from 1985 to 2000 see the table provided by Palmiter, *Mutual Fund Voting of Portfolio Shares: Why Not Disclose?*, 23 Cardozo L. Rev. 1419 (2002), at p. 1426 and his references in fn. 6.

³ Cf. the impressive figures presented by Rolf Skog, *A Remarkable Decade: The Awakening of Swedish Institutional Investors*, [2005] EBLR 1016.

⁴ See Klaus J. Hopt, *Where Does the Action Plan of the European Commission Lead?*, ECGI Law Working Paper N° 52/2005, October 2005, online: <http://ssrn.com/abstract=863527>, giving an illustrating example.

⁵ For the U.S. see, for example, Bernard S. Black, *Shareholder Passivity Reexamined*, 89 Mich. L. Rev. 520 (1990); id., *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. Rev. 811 (1992); Edward B. Rock, *The Logic and (uncertain) Significance of Institutional Shareholder Activism*, 79 Geo. L.J. 445 (1991); cf. also the reference in Report of the High Level Group of Company Law Experts in a Modern Regulatory Framework for

collective action problems and other impediments, which had prevented significant shareholder activism so far⁶. Underlying those demands, being part of the general debate on corporate governance, is the assumption that shareholder activism disciplining corporate managers and preventing thereby selfish or otherwise deficient conduct enhances the value of the corporation.⁷

In the course of these long-time developments financial scandals occurring in the recent past gave momentum to the corporate governance debate and led to legislation in the U.S. in 2002 (catchword: Sarbanes-Oxley Act).

Against this background the European Commission proposed in its action plan “Modernisation of company law and enhancing corporate governance in the European Union – a plan to move forward” (“Action Plan”) adopted in May 2003⁸ in response to the Recommendations of the High Level Group of Company Law Experts (HLG)⁹ as a medium-term (2006-2008) measure that:

“Institutional investors should be obliged:

- a) to disclose [...] their policy with respect to the exercise of voting rights in companies in which they invest;
- b) to disclose to their beneficial holders at their request how these rights have been used in a particular case.”

Company Law in Europe, dated of November 4th, 2002, at p. 56, online: http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf, as to the respective debate in certain member states of the EU.

⁶ See, e.g., Black, *supra* note 5, 89 Mich. L. Rev. 520, *passim*.

⁷ See only Palmiter, *supra* note 2, at p. 1477 et seq., *passim*. As to recent research finding a positive correlation of good corporate governance and firm value see, e.g., Lawrence D. Brown and Marcus L. Caylor, *Corporate Governance and Firm Performance*, December 7, 2004, online: <http://www.issproxy.com/pdf/Corporate%20Governance%20Study%201.04.pdf>, Paul Gompers, Joy Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, Q. J. of Econ. 107 (2003), Lucien A. Bebchuk & Alma Cohen, *The costs of entrenched boards*, 78 J. of Fin. Econ. 409 (2005), and the summary of and reference to Corporate Governance Quotient 3.0 Research White Paper by ISS Researchers Daniel Cheng and Yi-Yen Wu in ISS, *Better Corporate Governance Results in Higher Profit and Lower Risk*, 2005, online: <http://www.issproxy.com/pdf/CGQSummary.pdf>. While Gompers, Ishii & Metrick at p. 145 as well as Bebchuk & Cohen at p. 426 point to the problem, that an empirically proven positive correlation does not conclusively establish the direction of causation, Bebchuk & Cohen tend to assume that good corporate governance is the cause and higher returns the consequence [*id.*, at p. 428]. The results of a recent study suggest the correctness of the latter view [*cf.* Reena Aggarwal & Rohan Williamson, *Did New Regulations Target the Relevant Corporate Governance Attributes?* (2006), at p. 24, online: <http://ssrn.com/abstract=859264>]. However, the assumption is not unquestioned, *cf.* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, Col L.R., 823, at p. 830 et seq. (2003) with regard to activism of public pension funds.

⁸ An English version of the Commission’s action plan can be found at [http://eur-](http://eur-lex.europa.eu/LexUriServ/site/en/com/2003/com2003_0284en01.pdf)

[lex.europa.eu/LexUriServ/site/en/com/2003/com2003_0284en01.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/com/2003/com2003_0284en01.pdf), further referred to as “Action Plan”.

⁹ HLG Report, *supra* note 5.

This proposal can be traced back to a similar recommendation of the HLG. The HLG, in turn, modeled this recommendation on the then SEC proposals on a Rule on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies and a Rule on Proxy Voting by Investment Advisers.¹⁰

However, meanwhile, the Commission seems to back-pedal when it comes to its mid-term and long-term proposals. At the end of 2005 the Commission launched a consultation process to reassess the priorities originally set in the Action Plan for 2006-2008 to find out whether those priorities still respond to market needs.¹¹ Even though the gathered opinions on introducing disclosure duties of institutional investors were split and the results of the consultation are, thus, not clear-cut, the process itself reflects the Commission's opinion that enhancing investors' confidence has ceased to be the main driver, but that now the main objectives are to improve the competitiveness of EU companies and EU's push towards better regulation.¹² In its consultation document the Commission stresses its intent to pursue legislation at EU level "only when that is the best level at which to act and where legislation is the only answer"¹³.

At the same time, the British Government gets ready to adopt a disclosure rule – again – inspired by the SEC Rules on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies and on Proxy Voting by Investment Advisers¹⁴ respectively within the framework of its Company Law Reform¹⁵, thus at the national level.

Also the U.S. seem to continue to deal with this topic more proactively, since the U.S. Government Accountability Office proposed to extend the SEC rules, i.e. an annual disclosure

¹⁰ See in greater detail 3.g) supra.

¹¹ Directorate General for Internal Market and Services, *Consultation on future priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union*, 20 December 2005, online: http://ec.europa.eu/internal_market/company/docs/consultation/consultation_en.pdf, and accompanying press release *Company law and corporate governance: consultation on future priorities for Action Plan*, 20 December 2005, IP/05/1639, online:<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/05/1639&format=HTML&aged=0&language=EN&guiLanguage=en>.

¹² See the speeches of the European Commissioner for Internal Market and Services Charlie McCreevy, *Company Law Action Plan: Setting Future Priorities*, London, 14 November 2005, Speech/05/683, online:<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/683&format=HTML&aged=0&language=EN&guiLanguage=en>, and id., *Future of the Company Law Action Plan*, Copenhagen, 17 November 2005, Speech/05/702, online:<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/702&format=HTML&aged=0&language=EN&guiLanguage=en>.

¹³ McCreevy, *Company Law Action Plan: Setting Future Priorities*, supra note 12, at p. 3.

¹⁴ Cf. DTI, *Transparency of Voting By Institutional Investors, explanatory material on draft clauses on the exercise of voting rights by institutional investors*, at p. 1 et seq. with fn. 1 (Background 6.), not available online any more.

¹⁵ Clauses 1241 to 1244 of the Companies Act (formerly Clause 866 of the Company Law Reform Bill), online: <http://www.publications.parliament.uk/pa/cm200506/cmbills/218/2006218c.pdf>.

requirement, to pension plans in August 2004.¹⁶ However, the Department of Labor has not seized the suggestion yet.¹⁷

Given these recent activities the question of sense or nonsense of a disclosure requirement with regard to voting portfolio companies' shares by institutional investors has gained momentum. This paper will focus on the desirability of the EU Commission's proposal being transformed into an actual directive. To answer this question it deems me worthwhile to particularly take into account the U.S. regulation including the preceding as well as the succeeding debate on that topic.

Therefore, the analysis proceeds as follows. After describing the European Commission's proposal, its genesis, the opposition met after its publication, and the recent reassessment conducted by the Commission (2.), I will examine institutional investors' mandatory voting disclosure in the U.S., in particular the developments having led to the U.S. regulation being the model for the Commission's proposal and the response to it (3.). Then I will briefly sketch the British Governments proposal for a national rule (4.), before I will come back to the European Commission's proposal in order to assess the desirability of its implementation against the background of the depicted U.S. experience (5.).

2. The European Commission's Proposal and the Responses thereupon

a) The Commission's Proposal

The European Commission adopted in May 2003 an action plan "Modernisation of company law and enhancing corporate governance in the European Union – a plan to move forward" ("Action Plan").¹⁸ Such plan aims at strengthening shareholder rights and third party protection, while fostering efficiency and competitiveness of business (key policy objectives). The action plan prioritizes the proposed measures and distinguishes three time periods in which these measures shall be put into action: short-term (2003-2005), medium-term (2006-2008) and long-term (2009 and onwards).

Under the heading of "Enhancing Corporate Governance disclosure" the Commission proposes that:

¹⁶ U.S. Government Accountability Office, *Report to the Ranking Minority Member, Committee on Health, Education, Labor, and Pensions, U.S. Senate: Pension Plans – Additional Transparency and Other Actions needed on Connection with Proxy Voting*, August 2004, GAO-04-749, online: <http://www.gao.gov/new.items/d04749.pdf>.

¹⁷ In 2005 the Canadian Securities Regulators have issued disclosure rules very similar to the SEC rules, see *supra* 3.g)(3).

¹⁸ Action Plan, *supra* note 8.

“Institutional investors should be obliged:

- c) to disclose [...] their policy with respect to the exercise of voting rights in companies in which they invest;
- d) to disclose to their beneficial holders at their request how these rights have been used in a particular case.”

By such proposal the Commission pursues two aims: on one hand the improvement of the internal governance of institutional investors and on the other the enhancement of institutional investors’ participation in the affairs of the companies in which they invest. In regard to the latter it is conceded that the proposed duties would deliver their full effect only once the problems related to EU-wide cross-border voting will be solved.¹⁹

As to clarify and specify its proposal the Commission adds in its explanatory remarks that a requirement for institutional investors to systematically exercise their voting rights is not considered desirable in view of its potential counterproductive effects. It is namely feared that due to lack of time or resources, institutional investors might simply vote in favor of any proposed resolution to fulfil this requirement.

The Commission suggests to implement these duties by legislative initiative (directive) in the medium term (2006-2008).²⁰

b) The preceding Recommendation of the High Level Group

Somewhat more information about the (likely) motives of the Commission’s proposal can be found in the preceding Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe²¹ (“HLG Report”), the preparatory work the Action Plan is based on. In its explanatory remarks regarding recommendation III.7, which is more or less coextensive to the Commission’s proposal,²² the High Level Group (“HLG”)

¹⁹ Action Plan, supra note 8, § 3.1.1 at p. 13.

²⁰ Action Plan, supra note 8, Annex 1 at p. 25.

²¹ HLG Report, supra note 5.

²² See HLG Report, Rock, supra note 5, at p. 11: “Regulation of *the relevant types* of institutional investors by Member States should include an obligation on those institutional investors to disclose their investment policy and their policy with respect to the exercise of voting rights in companies in which they invest, and to disclose to their

expresses “concerns about the potential for conflicts of interests of those who manage the investments on behalf [of the] beneficiaries, both in terms of their relationships with the companies they invest in and in terms of their internal reward schemes”.²³ In the view of the HLG this “potential of conflicts of interests justifies, as a matter of good governance of institutional investors, their beneficiaries being entitled to know what their policies are with respect to investment and the exercise of rights attached to their investments. Beneficiaries are also entitled to demand to see the voting records showing how these rights have been used in a particular case”.²⁴ In a terminal footnote the HLG refers to the then SEC proposals of a Rule on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies and a Rule on Proxy Voting by Investment Advisers.²⁵ Therefore the then proposed rules have obviously influenced the HLG’s recommendation and hence the Commission’s proposal, albeit a reference in the Action Plan itself is missing. Thus, the SEC rules will be of value when examining and assessing the underlying issues and motives of the Commission’s proposal. We will come back to them later.²⁶

c) Adverse Reactions and Doubts articulated as to the Disclosure Proposals within the Frame of the Consultation on the Action Plan in 2003

Already the responses to the consultation document provided by the HLG were by the majority negative as to the question whether to introduce new disclosure duties for institutional investors regarding the policy as to how they exercise their voting rights.²⁷ Those opponent respondents argued that confidentiality of business strategy from a competitive standpoint and equality of shareholders must prevail and that institutional investors should not be burdened with the extra costs.²⁸

The results of the Commission’s consultation of interested parties subsequent to the adoption of the Action Plan similarly show a sceptical perception of the Commission’s proposed legislative initiative. In the synthesis summarizing the responses the Commission concedes that

beneficial holders at their request how these rights have been used in a particular case.” Emphasis added. The proposal itself merely speaks of “institutional investors” without any qualification. See *infra* 5.b).

²³ HLG Report, *supra* note 5, 3.3 at p. 56.

²⁴ HLG Report, *supra* note 5, 3.3 at p. 56 et seq.

²⁵ HLG Report, *supra* note 5, 3.3 Fn. 17. To the respective SEC disclosure rules see *infra* 3.g).

²⁶ See *infra* 3.g).

²⁷ Summary of Comments submitted to the High Level Group of Company Law Experts in Response to its Consultation Document, HLG Report, *supra* note 5, Annex 3, 2.3 (p. 147). Cf. also *id.*, 3.3 at p. 56.

²⁸ *Id.*, Annex 3, 2.3 (p. 147).

the majority of respondents, among them not only investors' representatives, but also industry at large, "received" the proposal "more cautiously".²⁹ While the majority welcomed the request for disclosure of investment policy a minority of respondents were critical about the disclosure of voting policy and of how voting rights have been used in a concrete case. The main arguments put forward by those critical respondents are the following:

First, the positive impact on institutional investors' participation in the companies in which they invest was questioned. Second, the policy concerning the exercise of the voting rights could not be determined in advance by means of predetermined or theoretical methods. Rather, so the argument goes, this policy is by its nature very dynamic and it must be able to change very rapidly according to the circumstances. Third, these disclosure duties could constitute a distortion of competition vis-à-vis non-EU institutional investors. Forth, institutional investors should not have different rights or duties compared to other shareholders. This would conflict with the principle of equal treatment of shareholders. Fifth and last, it was noted that the terms "institutional investors" and "beneficial holders" were "rather broad and could be easily misinterpreted".³⁰

d) Consultation on Future Priorities for the Action Plan - The Commission's Reassessment of its mid- and long-term Proposals in 2005/2006

After the delivery of most short-term measures the European Commission announced under the UK Presidency in the midyear of 2005 that it would reassess the priorities originally set in the Action Plan for 2006-2008 to find out whether those priorities still respond to market needs.³¹ It reflects the Commission's opinion that the context in which the Action Plan was originally adopted was very different from the situation which the Commission faces now. While the short-term priority measures were fixed in the aftermath of the financial scandals at the beginning of the decade with the aim of restoring investors' confidence, now, the competent Commissioner

²⁹ Synthesis of the responses to the Communication of 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 of 21 May 2003, A Working Document of DG Internal Market of 15 November 2003 ("Synthesis"), online: http://ec.europa.eu/internal_market/company/docs/modern/governance-consult-responses_en.pdf.

³⁰ Id., 3.1.2 (p. 9 et seq.).

³¹ Cf. McCreevy, *Future of the Company Law Action Plan*, supra note 12.

McCreevy stated, the main driver is to improve the competitiveness of EU companies and EU's push towards better regulation.³²

This announcement is now put into action. The Commission published a consultation document which was followed by a three month period for comments which ended on March 31, 2006.³³ There it stressed its intent to pursue legislation at EU level “only when that is the best level at which to act and where legislation is the only answer”³⁴. As to the proposal at issue here the Commission asked “What would be the added value of addressing these questions at EU level?” and additionally stated “In recent years, institutional investors have been encouraged in a number of Member States to disclose their voting policies. Market pressures seem to be leading investors to disclose their policies; nonetheless, some Member States are considering adopting legislation to require disclosure. The OECD Principles on Corporate Governance provide for such disclosure”.³⁵ After the end of the period for comments the Commission organized a public hearing on May 3, 2006.³⁶

The consultation did not bring a clear result. While 44 percent of all 266 respondents addressed the issue of disclosure of institutional investors' voting policies, a short majority of those respondents did not expressly address the question whether there is need for intervention at EC level. Nevertheless, a “significant proportion” of commenters emphasized the need to impose transparency and disclosure obligations on institutional investors. The number of respondents opposing an intervention at EC level were in the same proportion as those supporting it. In addition to the already known arguments the opponents pointed to international as well as national initiatives which would let appear additional intervention at EC level unnecessary or, at least premature at this stage. The supporters, on the other hand, stressed the need to create a level playing field in the EU to foster cross-border investment. The views on the appropriate EC instrument to address the voting policies of institutional investors were likewise split (28,3% were in favor of a directive, 23,3% were in favor of a recommendation, while 10% were in favor of a regulation).³⁷

³² See the speeches of the European Commissioner for Internal Market and Services McCreevy, *supra* note 12.

³³ Directorate General for Internal Market and Services, *supra* note 11.

³⁴ McCreevy, *Company Law Action Plan: Setting Future Priorities*, *supra* note 12, at p. 3.

³⁵ Directorate General for Internal Market and Services, *supra* note 11, at p. 7 et seq.

³⁶ Its program and a webstream of the hearing is published at http://ec.europa.eu/internal_market/company/consultation/index_en.htm.

³⁷ Directorate General for Internal Market and Services, Consultation and Hearing on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union – Summary Report, at p. 2, 12-13, online: http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf.

3. Institutional Investors' Mandatory Voting Disclosure in the U.S.

As already stated, the Commission's proposal is inspired by SEC regulation mandating voting disclosure by investment companies and investment advisers. In the following, this regulation, the developments which led to it, and the associated debate shall be described in more detail.

a) Early SEC Activity – Promoting Institutional Investors' Voice

The SEC attempts to require mutual funds to disclose their voting policies and practices reach back to the 1970s. However, the two proposals launched in this time were “quietly abandoned”.³⁸ In 1971, the SEC proposed “to require investment companies registered under the [Investment Company] Act to disclose with greater specificity their policies or involvement in the affairs of their portfolio companies”³⁹. The rule, intended to be a first move in a broader campaign to promote institutional investors' voice,⁴⁰ would have mandated the disclosure of voting procedures and policies, but not of actual votes cast.⁴¹ Since the comments on the proposal were rather hesitant to support the rule,⁴² the SEC finally withdrew the proposal in 1976, because it had perceived that, as a general rule, investment companies did not develop general policies with regard to their activity in portfolio companies.⁴³

However, this set back did not prevent the SEC from introducing a second proposal just two years later in 1978. This rule, focussing on disclosure to shareholders of portfolio companies (!), would have required not only registered mutual funds, but also investment advisers, parent holding companies of banks, insurance companies and broker-dealers (1) to disclose their (and their affiliates') voting policies and procedures in the company's annual report to shareholders; (2) to describe any existing procedures for consulting beneficial owners; and (3) to disclose the number of times the institution (or affiliate) had voted for or against management on contested subject matters.⁴⁴ Though restrained, this proposal shared the fate of its predecessor primarily because of criticism that it left regulatory gaps, thus causing an uneven disclosure burden.⁴⁵

³⁸ Cf. Palmiter, *supra* note 2, at p. 1446. As to the following *id.*, at p. 1454 et seqq.

³⁹ Investment Company Act Release No. 6,853 Fed. Sec. L. Rep. (CCH) P 80,945, December 1, 1971..

⁴⁰ See SEC, Institutional Investor Study Report, H.R. Doc. No. 92-64 , Part.5.E., at p. 2749-2763, 1971.

⁴¹ *Id.*, as cited by Palmiter, *supra* note 2, in fn. 150.

⁴² As to the reactions see the references given by Palmiter, *supra* note 2, at p. 1455 et seq.

⁴³ Exchange Act Release No. 13,482 Fed. Sec. L. Rep. (CCH), p. 87,889, April 28, 1977.

⁴⁴ See Exchange Act Release No. 14,970, at 43-47 Fed. Sec. L. Rep. (CCH), p. 80,574, July 18, 1978, at p. 80,581 et seqq. (Proposed Rule 14a-3(b)(11)).

⁴⁵ See Exchange Act Release No. 15, 385, 16 SEC Docket 365, December 6, 1978.

Thereafter, the issue of mandatory proxy voting disclosure by institutional investors ceased to be a prominent issue on the SEC's agenda. Until the new proposal in 2002, which finally led to effective regulation, the issue only sporadically resurfaced in publicized discussions by the SEC and Congress.⁴⁶

b) Regulation of Pension Plans

As to private pension plans governed by Employee Retirement Income Security Act (ERISA)⁴⁷ the Department of Labor (DOL) began to scrutinize pension plan voting practices in 1988. In a series of advisory letters the DOL stated that under the prudent investor rule the named fiduciary has the duty to monitor the proxy voting activities of an investment manager. Therefore, the fiduciary must be able to review not only the investment manager's proxy voting procedure, but also the actions taken in individual situations. Thus, the investment managers or other fiduciaries are required to keep voting records.⁴⁸ In 1994 interpretive bulletins codified as § 2509.94-2 the DOL repeated these statements and clarified that plan fiduciaries "have a responsibility to vote proxies on issues that may affect the value of the shares in the plan's portfolio".⁴⁹ The DOL further encourages the maintenance of written statement of investment policy, including proxy voting policy guidelines, which investment managers are required to comply with.⁵⁰

As to public pension plans state legislation often requires funds to keep records of their voting and to make them available to their beneficiaries.⁵¹

c) The Rise of Institutional Shareholders and the Scholarly Debate about Institutional Investors' Voice and related Conflicts of Interest in the early 1990s

In the forty years from 1950 to 1989 the stock owned by institutional investors increased from less than one percent to more than forty-five percent of total equities in the United States.⁵² This

⁴⁶ See for further detail Palmiter, *supra* note 2, at p. 1459 et seqq. *Id.*, at p. 1441 for exceptional cases where the disclosure of voting/governance activities of mutual funds were already required by law before the SEC rule on mandatory disclosure of proxy voting came into force.

⁴⁷ Employee Retirement Income Security Act, Public Law No. 93-406, 88 Stat. 829, Sept. 2, 1974.

⁴⁸ See Letter from Deputy Assistant Secretary of Labor Alan Lebowitz to Helmuth Fandl, Avon Products Inc., 15 *Pens. Rep.* (BNA) 391 (Feb. 23, 1988); Letter from Alan Lebowitz to ISS President Robert Monks, 17 *Pens. Rep.* (BNA) 244 (Jan. 23, 1990).

⁴⁹ DOL, *Interpretive Bulletins Relating to the ERISA 1974*, 59 *Fed. Reg.* 38,860 (July 29, 1994).

⁵⁰ *Id.*

⁵¹ Cf. Palmiter, *supra* note 2, at p. 1443 pointing to the example of Cal. Corp. Code § 711 in fn. 101. For examples on ensuing institution of policies of voting transparency by private and public pension funds see *id.*, at p. 1443 et seqq.

⁵² Cf. Rock, *supra* note 5, at p. 447 et seqq. with Fn. 1 and 3. See also the data provided by Black, *supra* note 5, 89 *Mich. L. Rev.* 520, at p. 567 et seqq.

rise of the institutional investor changed the factual basis of the long prevailing passivity rule⁵³ and fueled the demand for more shareholder activism by institutions. Against the background of institutions' growth scholars like *Bernhard Black* and *Edward Rock* analyzed at the beginning of the 1990s the potential of institutional shareholder voice to overcome the notorious collective action problem and, thus, to keep corporate management in check.⁵⁴ In the course of their analyses both alluded to the instance that in the wake of growing institutional investor activism conflicts of interest with regard to institutional money managers will arise.

Black argues that the then observed passivity of institutional investors is due to – besides certain legal obstacles – these conflicts of interest rather than rational apathy.⁵⁵ Conflicts of interest will misalign the voting calculus to some extent away from maximizing share value. Institutional conflicts may have such an effect not only with regard to how institutions vote, but also whether they will make an antimanager proposal or not. The first conflict is less severe than the latter, so the argument goes, since once enough institutions vote antimanager, fiduciary duties combined with the example of what others are doing is an effective defense to pressure.⁵⁶ While – according to *Black* – all major institutions face significant conflicts, there are important differences among institutions.⁵⁷ *Black* argues that it is due to these differences that the “public funds are in the forefront of the nascent institutional shareholder movement, mutual funds are somewhere in the middle, and bank trust departments and insurers remain mostly promanager”.⁵⁸

As to corporate pension funds *Black* distinguishes three constellations: Investment and voting being assigned to an outside money manager, investment and voting in-house, investment by an outside money manager with in-house voting. As to the first, identified by *Black* as the most common pattern, conflicts of interest may arise when the plan's interests counsel an antimanager vote. In this case the pension managers face pressure from corporate officers to vote promanager, either in general or on a particular issue,⁵⁹ which DOL scrutiny of pension plan voting practices

⁵³ Among the most prominent advocates of the passivity rule are Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (1932), passim and Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983), at p. 402; for further details on the passivity rule see *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 526 et seqq. (sub II.A.).

⁵⁴ *Black*, supra note 5, 89 Mich. L. Rev. 520; id., supra note 5, 39 UCLA L. Rev. 811.

⁵⁵ *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 524 et seq., 595 et seqq.

⁵⁶ *Black*, supra note 5, 89 Mich.L.Rev. 520, at p. 606-7.

⁵⁷ *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 524 et seq., 595 et seqq. ; see also id., 39 UCLA L. Rev. 811, at p. 826 et seq.

⁵⁸ *Black*, supra note 5, 89 Mich. L. Rev. 520, 596.

⁵⁹ See for evidence the survey quoted by *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 588, 597 Fn. 227.

was not able to extinguish⁶⁰. Money managers have a strong incentive not to make proposals, since they are highly visible to the disadvantage of corporate officers and – being at the expense of pension plan assets – the gains from activism go mostly to the pension plan’s beneficiaries, while the fiduciary faces the risk of personal liability for the losses.⁶¹ With regard to investment and voting in-house *Black* suggests that “[i]n-house money managers have only one client and will obviously do that client’s bidding”. While increasing returns and avoiding ERISA liability are incentives not to vote pro-manager, own proposals of in-house managers are deemed to be highly unlikely unless large stakes in the respective portfolio company are involved.⁶² The combination outside investment management with in-house voting *Black* finds “potentially the most conflict-ridden”, because the corporate pension officer is not constraint in his voting by the demand to create returns, which is up to the money manager.⁶³

With regard to public pension funds *Black* identifies their size and independence as the main characteristics different from corporate pension funds due to which those public funds have been the spearhead in the movement toward greater institutional activism in the late 1980s. Their independence is based on the fact that public fund managers do not solicit business from corporate managers. Nevertheless, public funds do also face conflicting incentives: Since public fund managers have to be not only good money managers but also good politicians, they may be influenced in their actions partly by the desire to generate good publicity for themselves. Thus, they may be inclined to support popular causes or use fund power for political goals.⁶⁴

Banks holding stock as fiduciaries through their trust business and as money managers for corporate pension plans, have been examined as being passive and routinely voting promanager.⁶⁵ As reasons for this passivity *Black* suggests, besides the aforementioned incentives of corporate pension fund managers when acting as such, the bank’s lending business and reputational motives.⁶⁶

⁶⁰ Cf. *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 588, 597.

⁶¹ *Id.*, at p. 597 et seq.

⁶² *Id.*, at p. 598.

⁶³ As a consequence of the DOL’s heightened scrutiny with regard to money managers’ voting this third constellation has become more popular since it avoids that scrutiny, see *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 598 and evidence in Fn. 230.

⁶⁴ *Id.*, at p. 598 et seqq.; see also Romano, supra note 7.

⁶⁵ For evidence see *id.*, at p. 600 Fn. 239.

⁶⁶ See for further details *id.*, at p. 600 et seq.

Even though owning huge amounts of stock for their own accounts also insurance companies face conflicts of interest. They may lose insurance business and as far as engaged in these activities lending, investment banking as well as fund management business if too active.⁶⁷

Black deems mutual funds to face less direct conflicts of interest because of their competition based on investment return.⁶⁸ Still, such conflicts occur if and when mutual funds are controlled by investment banks, who want to keep their clients well-tempered⁶⁹ or in case they are entrusted with the investment of employee savings plans or the like. Finally, fund managers might be afraid of being cut off soft information as a retaliation for not voting pro manager or even making an anti-manager proposal.⁷⁰

Investment banks holding many shares for clients have strong incentives to vote pro manager, from whom they receive underwriting and merger advisory business. Also their stock analysts have a strong interest in keeping the stream of information from corporate officials flowing.⁷¹

Foundations and Endowments, finally, may fear the ebbing of gifts from corporations and their wealthy senior management which may outweigh the possible increase in portfolio returns by voting anti-manager or making anti-manager proposal, respectively.⁷²

When it comes to the role of legal rules to diminish the aforementioned conflicts of interest *Black* discards the imposition of a legal duty to vote since that would alter little with regard to the conflict and could even backfire.⁷³ Alternatively, *Black* shows his sympathy towards confidential voting in order to shield the institutions from corporate pressure, while he finds voting disclosure worsening the problem of corporate pressure on institutional investors.⁷⁴ He deems a disclosure rule certainly unnecessary as an incentive to become informed since he finds large institutions to have significant incentives to become voters informed of corporate governance issues, because of ensuing trading benefits.⁷⁵ According to the difference in conflicts, he claims that “different institutions need different rules”⁷⁶.

⁶⁷ *Id.*, at p. 601. As to conflicts of interest faced by investment banks see *infra*.

⁶⁸ Cf. also Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* 102 (1994), at p. 268 et seq.

⁶⁹ Cf. below the Deutsche Bank example *infra* f).

⁷⁰ *Black*, *supra* note 5, 89 Mich. L. Rev. 520, at p. 601 et seqq.

⁷¹ *Id.*, at p. 603 et seq. with reference to NYSE rules restricting investment banks' power to vote clients' shares.

⁷² *Id.*, at p. 604.

⁷³ *Id.*, at p. 607.

⁷⁴ *Id.*, at p. 607 et seq.

⁷⁵ *Id.*, at p. 591.

⁷⁶ *Black*, *supra* note 5, 39 UCLA L.Rev. 811, at p. 851.

Rock also points to the abovementioned conflicts of interest under the heading of agency problems between money managers and shareholders.⁷⁷ He sees them as part of the costs inflicted upon money managers when acting in the interests of their beneficiaries (the other part being the costs of monitoring and organizing other shareholders). Since he finds “precious few [economic] incentives for money managers to act in the interests of their principles” by improving corporate governance,⁷⁸ the pressure from corporate managers has to be remedied by legal incentives. While considering confidential voting as such a legal remedy in order to ease the pressure by corporate management⁷⁹, he – like *Black* – implicitly rejects a duty to disclose proxy voting.

d) The Debate on Mutual Funds’ Voting Disclosure on the Eve of the SEC’s Adoption of a Mandatory Rule

The evolving debate on voting disclosure by institutional investors in general, and mutual funds in particular, has been concisely summarized by *Palmiter*, a supporter of mandatory disclosure, with regard to mutual funds in an article published on the eve of the adoption of the SEC’s mandatory disclosure rule in 2003^{80, 81}. Thus, I will refer to this article to paint a picture of the state of the debate just before the SEC introduced the mandatory disclosure rule discussed below.

Palmiter’s opening remarks on the factual background of mutual fund activism allude to three main findings. First, institutions having business relationships with portfolio companies (such as commercial banks, insurance companies, and corporate pension plans) have been relatively less active in exercising their governance rights than institutions (public pension funds, endowments/foundations) without such relationships.⁸² This negative correlation of business

⁷⁷ *Rock*, supra note 5, at p. 469 et seqq.

⁷⁸ *Rock*, supra note 5, at p. 472 et seqq. : He does not share Ronald J. Gilson’s and Reinier Kraakman’s point of view that money managers’ and their beneficials’ economic interests are aligned because their portfolio value will benefit from the corporate governance improvements of portfolio companies [see *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 *Stan. L. Rev.* 863 (1991)] because as far as money managers are evaluated in comparison to other managers and to market indices they have no selective incentive to engage in actions improving the performance of widely diversified funds across the board.

⁷⁹ Cf. *Rock*, supra note 5, at p. 489 et seq.

⁸⁰ See infra g).

⁸¹ *Palmiter*, supra note 2.

⁸² *Palmiter*, supra note 2, at p. 1424 et seq. referring to James E Heard & Howard D. Sherman, *Conflicts of Interest in the Proxy Voting System* (1987); James A. Brickley et al., *Ownership Structure and Voting on Antitakeover Amendments*, 20 *J. Fin. Econ.* 267 (1988); Rahul Kochhar & Parthiban David, *Institutional Investors and Firm Innovation: A Test of Competing Hypotheses*, 17 *Strategic Mgmt. J.* 73 (1996).

relationship and shareholder activism may be a hint at the actual impact of conflicts of interest on voting decisions, including decisions whether to make a proposal or not. Second, an increase in mutual fund activism could be observed (to remind: *before* the SEC disclosure rule was in force).⁸³ *Palmiter* suggests three reasons for this phenomenon: (1) funds cannot easily sell considerable blocks of poorly performing stock without significant losses, (2) investment policies compel many mutual funds to concentrate investments in giant multinational firms, making exit an untenable option, and (3) activism is the best way to distinguish fund performance, especially for indexed funds. Third, despite this increase in activism, mutual funds mostly endorse management proposals;⁸⁴ voluntary disclosure of voting practices and policies at that time, viz. 2002, have been nearly non-existent.⁸⁵

Against that background *Palmiter* introduces the main arguments of the debate on the possible merits and demerits of a mandatory disclosure rule by asking two main questions. First: Is mandatory disclosure warranted? Second: Will mandatory disclosure distort voting/governance behavior?⁸⁶ The first question he subdivides into four further questions: Are market forces sufficient to discipline mutual funds with regard to their voting behavior? Or non-market incentives? Would fund investors use the disclosure? Are the direct costs of disclosure justifiable?

As to the first subquestion some commentators argue that the entrance-exit option for investors – who generally act rational – makes fund managers sufficiently responsive to investor preferences, i.e. portfolio performance, thus making disclosure rules unnecessary.⁸⁷ Furthermore, funds which want to distinguish themselves may disclose their voting policies and practices voluntarily. *Palmiter* counters this argument by pointing to studies and investor behavior that suggest uni-directional sensitivity of investors to fund performance, i.e. they enter well performing funds, but do not leave badly performing ones, and regularly approval of an increase in fees. He infers that investors are insufficiently sensitive to inefficient fund governance

⁸³ *Palmiter*, supra note 2, at p. 1435 et seqq. referring to Gile R. Downes et al., *Institutional Investors and Corporate Behavior* 43 (1999).

⁸⁴ *Palmiter*, supra note 2, at p. 1439 et seq. citing John C. Bogle, *The Silence of the Funds: Mutual Fund Investment Policies and Corporate Governance*, Address Before the New York Society of Securities Analysts (Oct. 20, 1999), in Bogle on Investing (2000), at p. 197.

⁸⁵ *Palmiter*, supra note 2, at p. 1441.

⁸⁶ *Palmiter*, supra note 2, at p. 1468 et seqq.

⁸⁷ See, for example, Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, 57 *Brook. L. Rev.* 1 (1991), at p. 47; Mark J. Roe, supra note 68, at p. 268 et seq.

activities, thus leaving funds largely immune from market discipline.⁸⁸ As to non-market incentives *Palmiter* does not believe in the sufficiency of fiduciary duties and independent directors' monitoring against the background of risen expense ratios despite greater economies of scale and a positive correlation of director compensation and fund expense ratios.⁸⁹ With regard to doubts articulated whether investors would actually use disclosure to inform themselves or were rationally indifferent⁹⁰ *Palmiter* points to growing institutional ownership of mutual funds, intermediated information in the form of fund ratings and the potential value of the disclosed information in order to rebut these doubts.⁹¹ The fourth subquestion whether direct costs of a mandatory disclosure rule are unjustifiably high⁹², is answered in the negative by pointing to the existent voluntary disclosure and potential benefits of disclosure probably outweighing the direct costs.⁹³

The second main question – Will mandatory disclosure distort voting/governance behavior? – is also subdivided into further questions, namely the following: Will disclosure chill mutual fund activism? Will disclosure politicize or over-stimulate fund activism? Will mandatory disclosure invite heavy-handed oversight?⁹⁴ The first subquestion touches on the conflicts of interest described by *Black* and *Rock* and refers to the possibility of retaliation by corporate managers for anti-manager voting by means of denying access to corporate information and withdrawing business. Thus, mutual funds may become “pressure-sensitive” with regard to their voting because of the disclosure. Disadvantages with regard to access to information may affect fund performance and thus negatively affect investors who would eventually withdraw their money. *Palmiter* tries to mitigate this argument by alluding to mutual fund managers' unparalleled access to corporate information despite growing activism as well as constraints on retaliation because corporate managers fear to drive institutional investors away because of their stock options. And – so his further argument goes – even if investors made connection between voting activism and increased fund costs, they would not automatically conclude that costs are unjustified. Institutional investor ownership in funds and fund rating suggest that investors are capable of a

⁸⁸ *Palmiter*, supra note 2, at p. 1470 et seqq.

⁸⁹ For further details see *Palmiter*, supra note 2, at p. 1472 et seq.

⁹⁰ To this concern in the European context see infra 5.a)(2)(b).

⁹¹ *Palmiter*, supra note 2, at p. 1474 et seqq.

⁹² To this concern in the European context see infra 5.a)(2)(a).

⁹³ *Palmiter*, supra note 2, at p. 1478 et seqq.

⁹⁴ *Palmiter*, supra note 2, at p. 1480 et seqq.

rational benefit-cost analysis.⁹⁵ The second subquestion alludes to concerns that fund managers might feel compelled because of the higher visibility of their conduct to support political issues unrelated to investment returns or to exert more confrontational influence while non-confrontational efforts have been proven successful in the past.⁹⁶ *Palmiter* deems these possibilities to be unlikely because of the difference between mutual fund managers' incentives and culture and those of managers of politically activist institutions like labor union funds and state pension plans. Instead, he stresses the benefits of disclosure for the credibility of funds' activism (if any).⁹⁷ Finally, with regard to the third subquestion *Palmiter* identifies three types of possible liability: for not complying with disclosed policies, for not disclosing and for falsely disclosing. However, to *Palmiter* the "likelihood of liability seems minimal", thus, according to him, no overly extensive regulation has to be feared. To prevent liability in cases where disclosure may be sensitive, such as ongoing voting contests, he advocates disclosure exemptions.⁹⁸

After having countered all the arguments against a mandatory disclosure rule, he finally points to its benefits, such as the enhancement of accountability and transparency, the reminding effect on fund managers as to their responsibilities towards fund investors, and the enabling of monitoring managers by investors.⁹⁹

e) ISS Study on Mutual Fund Proxy Voting Disclosure

In December 2002, while the SEC rule proposals on mutual fund proxy voting disclosure were debated, Institutional Shareholder Services (ISS) conducted a study in December 2002 which is primarily based on the universe of mutual funds that are members of the Investment Company Institute (ICI) comprising 95 % of the total U.S. investment company industry's assets at that time.¹⁰⁰ The survey encompassed more than 400 fund families of which nearly all had Web sites accessible to the public. Of those only 11 fund complexes publicly disclosed their proxy policies, a major part of them socially responsible investor funds (SRI). Even less, namely 8 fund

⁹⁵ See *Palmiter*, supra note 2, at p. 1480 et seq. With further considerations with regard to indexed mutual funds.

⁹⁶ *Palmiter*, supra note 2, at p. 1484 et seq. referring to the "stealthy modus operandi" of the College Retirement Equities Fund ("CREF"). See further *id.*, at p. 1485 et seq. on possible impact of voting disclosure on mutual fund "herd mentality".

⁹⁷ *Palmiter*, supra note 2, at p. 1486 et seq.

⁹⁸ *Palmiter*, supra note 2, at p. 1488 et seq.

⁹⁹ *Palmiter*, supra note 2, at p. 1490 et seq.

¹⁰⁰ ISS, Mutual Fund Proxy Voting Disclosure: Baseline and Benchmarks, 2003 online: <http://www.issproxy.com/pdf/Proxy%20Voting%20Disclosure%20White%20Paper%20Document.pdf>.

complexes, all of them SRI funds, disclosed their vote records publicly, most of them two weeks in advance of the shareholder meeting. The disclosing fund complexes provided only scarce information on the decision-making processes by which they determine proxy voting policies and apply them in practice. There was almost no information in how funds address potential conflicts of interest with regard to proxy voting. The funds that disclosed proxy voting information identified six key policy topics, namely (1) executive and equity-based compensation, (2) anti-takeover defenses, (3) voting rights, (4) board of directors, (5) social policies, and (6) auditors.¹⁰¹

f) The Deutsche Bank vote on the Hewlett Packard/Compaq merger in 2003

Before addressing the SEC rules themselves the prominent case of the Deutsche Bank's vote with regard to the merger of Hewlett Packard (HP) and Compaq in 2003 shall in the following serve as an example to illustrate the possible conflicts of interests affecting institutional investors' vote as well as to show that such conflicts are not merely theoretical in nature.¹⁰²

In August 2003, the SEC imposed a fine of US\$ 750,000 on Deutsche Bank for failing to disclose to its mutual fund investors a material conflict of interest with regard to its vote on the proposed HP/Compaq merger.¹⁰³ The merger's success depended on a majority vote of HP shareholders, of whom 57% were institutional investors¹⁰⁴.

The shareholder vote became hotly contested when HP's Chief Executive Officer, Carly Fiorina, and Walter Hewlett, HP board member and son of HP's co-founder, publicly fought for shareholder support of their contrarious positions.¹⁰⁵ The two opponents both lobbied large shareholders, especially institutional investors, for support.¹⁰⁶ Ultimately, shareholders approved

¹⁰¹ See *id.*, at p. 1 for an executive summary of the survey.

¹⁰² See to the following also the summary by H. Anne Nicholson, *Securities Law: Proxies Pull Mutual Funds Into The Sunlight: Mandatory Disclosure Of Proxy Voting Records*, 57 Okla. L. Rev. 687 (2004), 687 et seqq.

¹⁰³ See SEC, *SEC Brings Settled Enforcement Action Against Deutsche Bank Investment Advisory Unit in Connection with Its Voting of Client Proxies for Merger Transaction; Imposes \$750,000 Penalty* (Aug. 19, 2003), at <http://www.sec.gov/news/press/2003-100.htm>.

¹⁰⁴ Louise Kehoe & Scott Morrison, *Fiorina Comes a Step Closer to Making the Connection: Shareholders Face Big Decision on Deal*, *Fin. Times*, March 7, 2002, at p. 26.

¹⁰⁵ Fiorina forecasted that the merger would be the key to HP's long-term growth. Hewlett opposed the merger, arguing that the move would reduce HP's stock price. Hewlett acted on behalf of the William and Flora Hewlett Foundation and the William R. Hewlett Revocable Trust, which together own more than 18% of HP's stock [see Kehoe & Morrison, *supra* note 104].

¹⁰⁶ Both Fiorina and Hewlett lobbied Institutional Shareholder Services (ISS), the third-party proxy research firm, for its recommendation; clients of ISS owned 23% of HP's stock [see *id.*]. One such client was Barclays Global Investors, which had pledged to vote its sixty million shares in accordance with the ISS recommendation [see *Hewlett v. Hewlett-Packard Co.*, No. 19513-NC, 2002 Del Ch. LEXIS 35, at *34 (Del Ch. Apr. 30, 2002)].

the merger, by a vote of 51% to 49%, with a margin of only forty-five million votes.¹⁰⁷ In this proxy contest Deutsche Bank had seventeen million proxies to vote on behalf of clients who had invested in its mutual funds.¹⁰⁸

The SEC started an investigation into Deutsche Bank's vote after a California newspaper had published a voicemail from Fiorina¹⁰⁹, in which she stated to HP Chief Financial Officer Bob Wayman that HP might "have to do something extraordinary" to gain the votes Deutsche Bank disposed of.¹¹⁰ Deutsche Bank investment banking arm was already working with HP on financing related to the merger and earning fees for this effort.¹¹¹ Additionally, Walter Hewlett filed a lawsuit immediately after the shareholder vote alleging that Deutsche Bank had already voted its shares against the merger when individuals from its commercial banking division intervened and initiated a meeting between HP management and the individuals responsible for voting the proxies.¹¹² Subsequently, Deutsche Bank changed its votes to support the merger.¹¹³

In the end, the SEC's investigation did not determine that Deutsche Bank's relationship with HP affected its vote for the merger.¹¹⁴ The Hewlett lawsuit was dismissed.¹¹⁵

g) The SEC Regulation on Disclosure of Proxy Voting by Registered Management Investment Companies and Investment Advisers of the Year 2003

¹⁰⁷ Ariana Eunjung Cha, *Deutsche Bank Pays \$750,000 in SEC Settlement*, Wash. Post, Aug. 20, 2003, at E1.

¹⁰⁸ SEC, *SEC Brings Settled Enforcement Action*, supra note 103.

¹⁰⁹ John Markoff, *U.S. Agencies Looking into Hewlett Vote*, N.Y. Times, Apr. 16, 2002, at C1.

¹¹⁰ *Id.*

¹¹¹ See Cha, supra note 107 (reporting that the SEC had found that Deutsche Bank received \$1 million for "market intelligence" relating to the merger, and was to receive an additional \$1 million if the HP-Compaq deal were to close).

¹¹² See *Hewlett v. Hewlett-Packard Co.*, 2002 Del. Ch. LEXIS 35, at **2-3.

¹¹³ See *id.* The SEC, in its administrative proceeding, found that after Deutsche Bank had voted its proxies, two members of the investment banking side of the bank had intervened on HP's behalf. The SEC stated that "[a] reasonable advisory client would want to know that its fiduciary, which was called upon to vote client proxies on a merger, had been contacted by officials of its affiliated investment bank in connection with an engagement directly related to the subject of the proxy vote." [see SEC, *Deutsche Asset Management, Investment Advisers Act of 1940*, Release No. 2160, 2003 SEC LEXIS 1977 (Aug. 19, 2003), at **10-11]. Based on Deutsche Bank's failure to disclose, the SEC found that Deutsche Bank had "willfully violated Section 206(2) of the Investment Advisers Act." [id. at *11].

¹¹⁴ *Id.*, at *11. The SEC found that Deutsche Bank should have disclosed its conflict on interest to shareholders on whose behalf Deutsche Bank voted by proxy, but stated that there was no requirement to show client harm to establish a violation of the Advisors Act [id. at *10]. Consequently, the SEC did not determine whether the votes were made in the best interest of Deutsche Bank's clients or not [id. at *11].

¹¹⁵ The Delaware Chancery Court was troubled by the fact that Deutsche's investment banking division initiated the meeting between the Proxy Working Group and HP management and found this to "raise [...] clear questions about the integrity of the internal ethical wall that purportedly separates Deutsche Bank's asset management division from its commercial division." *Hewlett v. Hewlett-Packard Co.*, 2002 Del. Ch. LEXIS 35, at **59-60]. Despite this concern, the court found that the evidence indicated the group's intent to vote in the best interest of individual investors [id.].

To address exactly the abovementioned kind of conflicts the SEC introduced new regulation. Two of these regulations adopted in 2003 deal with voting client proxies by investment advisers and mutual funds. While the first regulation imposes the duty on registered management investment companies, namely mutual funds, to disclose their proxy voting policies and procedures as well as the actual proxy votes they cast in shareholder meetings of issuers of portfolio securities,¹¹⁶ the second addressed the fiduciary duties of an investment adviser to its clients with regard to voting their proxies¹¹⁷.

(1) Content of the New Regulations – Outline¹¹⁸

(a) Regulation on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies

The SEC adopted the requirement that mutual funds which invest in voting securities disclose in their statements of additional information (“SAI”) the policies and procedures they use to determine how to vote proxies relating to their portfolio securities.^{119/120} The fund has to disclose in its shareholder reports that a description of those policies and procedures (or a copy of the policies and procedures themselves)¹²¹ is available (1) without charge, upon request, by calling a specified toll-free (or collect) phone number, (2) on the fund’s Web site, if existent, and (3) on

¹¹⁶ Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564 (Feb. 7, 2003).

¹¹⁷ Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585 (Feb. 5, 2003).

¹¹⁸ Cf. also Brian D. Stewart, *Disclosure of the Irrelevant? – Impact of the SEC’s Final Proxy Voting Disclosure Rules*, 9 Fordham J. Corp. & Fin. L. 233 (2003), at p. 238 et seqq. for a concise description of the content of the SEC rules in question.

¹¹⁹ Item 13(f) of Form N-1A; Item 18.16 of Form N-2; Item 20(o) of Form N-3. The SAI is part of a fund’s registration statement and contains information about the fund in addition to that contained in the prospectus. The SAI is required to be delivered to investors upon request and is available on the SEC’s Electronic Data Gathering, Analysis, and Retrieval System (“EDGAR”); closed-end funds disclose their policies and procedures annually on Form N-CSR. This disclosure requirement includes the procedures and policies when a vote presents a conflict of interest between the fund shareholders’ interests and the fund’s or its agents’ or affiliates’ interests. See id. at p. 6566 and note 26.

¹²⁰ Without mandating a specific content of the fund’s policies and procedures the SEC finds disclosure of the following examples of policies and procedures taken from some funds “appropriate” [while (1) - (3) describe general policies and procedures, (4)-(7) deal with specific types of issues]: (1) The extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party; (2) policies and procedures relating to matters that may affect substantially the rights of the holders of securities to be voted; (3) policies regarding the extent to which the fund will support or give weight to the views of management of a portfolio company; (4) corporate governance matters, including changes in the state of incorporation, mergers and other corporate restructurings, and anti-takeover provisions such as staggered boards, poison pills, and supermajority provisions; (5) changes to capital structure, including increases and decreases of capital and preferred stock issuance; (6) stock option plans and other management compensation issues; and (7) social and corporate responsibility issues; id. at p. 6567.

¹²¹ This latter alternative was added after concerns were expressed that funds with multiple sub-advisers, all having different procedures and policies, would add lengthy disclosure to the SAI, id. at p. 6567.

the SEC Web site. Upon request, the fund is obliged to send this description by mail to the shareholders.¹²²

Furthermore, the Commission adopted new rule 30b1-4 under the Investment Company Act. This rule requires a fund to file its complete proxy voting record on an annual basis, i.e. for a twelve-month period ending June 30, by not later than August 31 of each year.^{123/124} The form destined therefor has to be signed by the fund, and on behalf of the fund by its principal executive officer or officers.¹²⁵

Funds are obliged to disclose to the SEC for each matter relating to a portfolio security considered at any shareholder meeting held during the reporting period and with respect to which the fund was entitled to vote: (1) The name of the issuer of the portfolio security, (2) the exchange ticker symbol of the portfolio security, (3) the CUSIP¹²⁶ number for the portfolio security, (4) the shareholder meeting date, (5) a brief identification of the matter voted on, (6) whether the matter was proposed by the issuer or by a security holder, (7) whether the fund cast its vote on the matter, (8) how the fund cast its vote, and (9) whether the fund cast its vote for or against management.¹²⁷ Furthermore, the fund is required to make its proxy voting record available to shareholders either upon request or by an electronic version on or through the fund's Web site.¹²⁸ Finally, the fund has to allude in its annual and semi-annual reports to shareholders as well as in its SAI that information as to the fund's proxy voting is available (1) without charge, upon request, by calling a specified toll-free (or collect) telephone number, or on or through the fund's Web site at a specified Internet address, or both, and (2) on the SEC's Web site.¹²⁹

(b) Regulation on Proxy Voting by Investment Advisers

¹²² For further details, see *id.*, at p. 6566-67 and notes 29, 30.

¹²³ 17 CFR 270.30b1-4; General Instruction A and Item 1 to Form N-PX (17 CFR 274.129).

¹²⁴ This fixed date was introduced after commenters pointed to unnecessary costs for fund complexes that have funds with staggered fiscal year ends under the SEC proposal. For further detail see *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, 68 Fed. Reg. 6564 (Feb. 7, 2003), at p. 6569.

¹²⁵ General Instruction F.2.(a) to Form N-PX.

¹²⁶ CUSIP meaning The Council on Uniform Securities Identification Procedures.

¹²⁷ Information (2) and (3) may be omitted if it is not available through reasonably practicable means, see *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, 68 Fed. Reg. 6564 (Feb. 7, 2003), at note 43 on p. 6569.

¹²⁸ The latter way of disclosure again was inserted after concerns about the costs were raised by commenters, see *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, 68 Fed. Reg. 6564 (Feb. 7, 2003), at note 45/46 on p. 6569.

¹²⁹ If the fund got a request by phone it has to send the information included in the most recent report on proxy voting filed with the SEC within three business days of receipt of such request. If a fund discloses the availability of its proxy voting record on its Web site, the information disclosed must have the same content. See *id.*, at p. 6569/70.

Simultaneously to the regulation on management investment companies¹³⁰ the SEC adopted a new rule and rule amendments under the Investment Advisers Act of 1940 addressing investment advisers' fiduciary duties to its clients with regard to voting their proxies. The new rule requires an investment adviser authorized to vote proxies to adopt policies and procedures reasonably designed to ensure that the adviser votes in the best interest of his clients, to disclose those policies and procedures to clients, and to disclose how to obtain information about how the adviser actually voted the proxies. The rule amendments require the adviser to maintain certain records with regard to proxy voting.

New Rule 206(4)-6 provides that it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Investment Advisers Act of 1940, for an investment advisor to exercise voting authority with respect to client securities, unless (i) the adviser has adopted and implemented written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of its clients, (ii) the adviser describes its proxy voting procedures to its clients and provides copies on request, and (iii) the adviser discloses to clients how they may obtain information on how the adviser voted their proxies.¹³¹ The rule applies to all investment advisers registered with the SEC that exercise explicit as well as implied proxy voting authority over client securities. The required proxy voting policies and procedures must be in writing and have to describe how the adviser addresses material conflicts of interest between its interests and those of its clients with respect to proxy voting. Specific policies or procedures are not prescribed. But they should be designed to enable the adviser to resolve conflicts of interest before voting their proxies.¹³²

Under rule 204-2, as amended, advisers must preserve (i) their proxy voting policies and procedures; (ii) proxy statements received regarding client securities; (iii) records of votes they cast on behalf of clients; (iv) records of client requests for proxy voting information, and (v) any documents prepared by the adviser that were material to making a decision how to vote, or that memorialized the basis for that decision.

(2) Rationale and Genesis of the Regulation

¹³⁰ See 1.a) supra.

¹³¹ See Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585, at p. 6586 ("Discussion"). As to the following id., at p. 6586-88.

¹³² The SEC states that these requirement would be fulfilled by disclosing the conflict to clients and obtaining their consents before voting while simply abstaining from voting would not suffice. For further suggestions how to fulfill that obligation see id., at p. 6587.

(a) Rationale and Policy Considerations

The rationale of the regulation on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies is fourfold.¹³³ Besides addressing the abovementioned conflicts of interest by discouraging voting that is inconsistent with fund shareholders' best interests, the disclosure requirement shall recognize the "fundamental right" of investors in mutual funds to know how the fund casts proxy votes. Furthermore, disclosure shall incentivize the funds to make their voting decisions carefully¹³⁴. Finally, the SEC hopes to encourage funds to become more engaged in corporate governance of issuers held in their portfolios, "which may benefit all investors and not just fund shareholders".

The objective carrying the Regulation on Proxy Voting by Investment Advisers is – similar to the Regulation on Voting Policies and Proxy Voting Records by Registered Management Investment Companies – the protection of shareholder interests in situations of proxy voting by investment advisers by preventing material conflicts of interest from affecting the manner in which advisers vote clients' proxies.¹³⁵

(b) Genesis of the Regulations - Comments on the Proposals and SEC Reaction

(aa) Regulation on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies

The SEC composed a proposal on a Rule on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies September 20, 2002,¹³⁶ released soon thereafter. The proposing release generated significant comment,¹³⁷ which induced the SEC to moderate modifications of its proposal. The final rule was adopted on January 31, 2003. Its effective date was April 14, 2003.

The SEC proposal on the regulation on management investment companies' disclosure of proxy voting policies and procedures was generally supported by commenters. Suggestions to require more specific guidelines regarding the categories of disclosure were rejected by the SEC.

¹³³ See for the following id., at 6566 ("Introduction and Background").

¹³⁴ So I understand the statement that "Proxy voting decisions by funds can play an important role in maximizing the value of the funds' investments, thereby having an enormous impact on the financial livelihood of millions of Americans", id.

¹³⁵ Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585 (Feb. 7, 2003), at p. 6586 ("Background").

¹³⁶ Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Investment Company Act Release No. 25739 (Sept. 20, 2002), 67 Fed. Reg. 60828 (Sept. 26, 2002).

¹³⁷ Cf. Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564 (Feb. 7, 2003), at p. 6566 ("Discussion").

The intent of the proposal, the commission argued, is to promote transparency with regard to proxy voting information, and not to mandate the content of a fund's policies or procedures.¹³⁸ Likewise, the approach of several commenters to exempt those funds from disclosure that have multiple sub-advisers, each of which using its own procedures and policies, was rebutted by the commission.¹³⁹ On the other hand, the SEC did not follow the proposal to require a distribution of proxy voting policies and procedures to all investors.¹⁴⁰

The SEC proposal to require funds to disclose their proxy voting records “generated strong and divergent views among commentators”¹⁴¹. While the vast majority of individual investors commenting on the proposal strongly supported the disclosure requirement as a means of monitoring as well as facilitating informed investment decisions¹⁴², a large number of fund industry participants vehemently opposed such a duty to disclose. Those commenters argued as follows:¹⁴³ First, there is no demand for such a disclosure requirement as they have received virtually no requests from shareholders for proxy voting information. Second, the disclosure duty would deny funds the ability to vote confidentially and thus subject funds to pressure from corporate management in order to influence their voting as well as to retaliatory actions after having voted in an unwanted way. Third, mandatory disclosure would undermine their ability to change corporate governance practices of their portfolio companies through “behind the scenes” private communications. Fourth, the disclosure requirement will subject the funds to campaigns by special interest groups detracting from the fund's ability to concentrate on portfolio management. Fifth, it would undermine the role of the fund's board in monitoring proxy voting and protecting fund shareholders against conflicts of interest. Sixth and last, the costs of the disclosure would exceed the benefit to shareholders.

Some of the opposing commenters suggested as a regulatory alternative to require the fund directors to approve proxy voting policies and procedures which also should address potential conflicts of interest and to oblige fund managers to provide the directors with reports on how actual proxy votes were cast.

¹³⁸ *Id.*, at p. 6567.

¹³⁹ *Id.*, at p. 6567.

¹⁴⁰ The SEC argued with the costs fund would have to bear, while the actual interest of each and every shareholder in the information is uncertain, *id.*

¹⁴¹ *Id.*, at p. 6567.

¹⁴² *Id.*

¹⁴³ See as to the following *id.*, at p. 6568.

“After careful consideration”¹⁴⁴ the SEC rejected the arguments of the opposition.¹⁴⁵ First, the SEC believes in a fundamental right of fund shareholders to know how the fund exercised its proxy votes on their behalf irrespective of any actual demand. Second, the danger of pressure on or retaliation against funds is not sufficient to outweigh the benefits of disclosure. Additionally, the confidentiality of the vote prior to a shareholder meeting is not endangered by disclosing the votes considerable time after such a meeting. Finally, a large majority of portfolio companies do not have confidential voting policies and that companies are often able to identify how a particularly large shareholder has cast its votes anyway. Third, disclosure requirement is not inconsistent with “behind the scenes” communications; it rather encourages such communications. Fourth, as to the danger of politicization of the proxy voting by non-shareholder interests the SEC refers to a monitoring procedure of the disclosure regulation, in which possible adverse effects will be assessed.¹⁴⁶ Fifth, the SEC rejects the suggested alternative of board supervision by pointing to already existing monitoring duties as to the voting of financial advisers. While the additional requirements with respect to fund boards are found to be unnecessary, the disclosure amendments are intended to “work in tandem” with the existing obligations of fund boards. Finally, as to the costs of the mandatory disclosure the SEC believes the costs to be reasonable. Furthermore, the proposal has been changed to further reduce costs.¹⁴⁷

As to the extend and form of disclosure the SEC has deliberately denied the adoption of the following proposals made by commenters:¹⁴⁸ (1) the requirement of additional disclosure with respect to situations where the fund’s investment adviser faces a conflict of interest¹⁴⁹, (2) the requirement to provide an executive summary of the fund’s votes, (3) the limitation of disclosure to situations where votes are cast against management, or where a conflict of interest exists, and (4) the limitation of disclosure to a summary of all proxy votes.

Proposals (1) and (2) were denied because they would impose undue costs on the funds. Proposals (3) and (4) were not adopted because such disclosure limitations would undercut the

¹⁴⁴ *Id.*, at p. 6568.

¹⁴⁵ As to the following see *id.*, at p. 6568 et seq.

¹⁴⁶ According to the SEC’s comments on its rule, this report was due on December 31, 2005, at the latest, cf. *id.*, at p. 6585. However, my inquiry in February 2006 resulted in the SEC’s answer that such a report does not exist.

¹⁴⁷ The investment companies are now required to disclose their voting records annually instead of semi-annually as initially proposed, *id.* at p. 6569.

¹⁴⁸ For the following see *id.* at p. 6570.

¹⁴⁹ For example disclosure of any business and financial relationship with the issuer and all fees received by the adviser or its affiliates from the issuer during a designated period of time.

objective to enable fund shareholders to determine how a fund voted with respect to any particular proxy vote.

On the other hand, the SEC dropped the proposal to require the disclosure of proxy votes that are inconsistent with fund's policies and procedures due to worries expressed by commenters. While proponents of proxy voting disclosure argued that such a requirement might lead funds to draft overly broad policies and procedures to avoid triggering the required disclosure, opponents argued that such a disclosure would be burdensome because it would require funds to analyze a large volume of proxy votes to determine (in)consistency with the policies and procedures and then to provide lengthy explanations to shareholders as to inconsistent votes.

(bb) Regulation on Proxy Voting by Financial Advisers

The proposal on the Regulation on Proxy Voting by Financial Advisers was composed and released simultaneously with its sister regulation on voting disclosure with regard to mutual funds.¹⁵⁰ Here again, the stakeholders concerned were invited to deliver their comments. Adopted on January 31, 2003, it came into effect on March 10, 2003.

As to the scope of application the SEC rejected the proposal of several commenters to create certain exceptions. With regard to smaller firms the agency argued that such firms are likely to have few or even no potential conflicts of interest relating to proxy voting, in which case their procedures would be much simpler and compliance with the rule would be commensurately less burdensome.¹⁵¹ The SEC did also not adopt suggestions to require specific policies or procedures, or provide a list of approved procedures. Such a "one-size-fits-all" approach was deemed to be inappropriate given the variety of investment advisers.¹⁵² Likewise, suggestions to require *public* disclosure of how advisers voted their proxies were not adopted because such a requirement was not only considered unnecessary, but also detrimental since such disclosure would reveal confidential client holdings.¹⁵³ The SEC, however, gave in as to concerns with the burdens of the proposed recordkeeping requirements and softened the rule in this regard.¹⁵⁴

(3) Reactions to the Final Rules

¹⁵⁰ See Proxy Voting by Investment Advisers, Investment Advisers Act Release No. 2059 (Sept. 20, 2002), 67 Fed. Reg. 60841 (Sept. 26, 2002).

¹⁵¹ Proxy Voting by Investment Advisers, 68 Fed. Reg. 6585 (Feb. 7, 2003), at p. 6586-87 at note 9.

¹⁵² *Id.*, at p. 6587.

¹⁵³ *Id.*

¹⁵⁴ See for further detail *id.*

There are some notable reactions to the SEC regulation described above by the U.S. Government as well as by the Canadian lawmakers recognizing it as being worth to be extended to other areas of law or other jurisdictions, respectively.

But before I will come to these reactions I will examine those of the scientific community. There are just a few articles dealing with the subject suggesting that the silent majority appreciates the rules as they are or resigns vis-à-vis this fait accompli.

Nicholson is part of the former fraction (though expressing her view in an article and not keeping silent). While conceding that the disclosure rules may not directly benefit retail investors, she states that the disclosure is able to overcome the threat of funds neglecting their beneficiaries' interests when conflicts of interests arise. While the market without such disclosure failed to address this problem, now financial intermediaries, the primary recipients for the raw data on proxy voting, were able to monitor the funds' behavior.¹⁵⁵ The publication of the funds' misbehavior should lead to economic loss on the part of the wrongdoing funds. Thus, the disclosure rules should deter such wrongdoing and realign the funds' interests with those of their clients.¹⁵⁶ *Stewart*, Vice-President of Merrill Lynch Investment Managers, in contrast, excoriates the new rules.¹⁵⁷ In his opinion, "while providing no practical benefit to investors in their investment decisions-making process, these new rules effectively impose onerous and costly obligations on funds and their advisers". Beyond the repetition of commenters' arguments against the draft rules and proposals already rejected by the SEC *Stewart* points to the lack of evidence demonstrating a positive impact of voting disclosure on shareholder value. Especially the proxy voting record disclosures would represent an inappropriate burden for mutual funds. Therefore *Stewart* proposes exemptions from the rule for certain funds, e.g. index funds or funds that invest 25 percent or less of its assets in voting securities, where voting is allegedly of no importance for investors, and certain *de minimis* exemptions. On the other hand, the one-sided imposition of disclosure duties on mutual funds and advisers of funds, while pension funds, hedge funds etc. do not face such duties, is deemed to be unfair. Finally, *Stewart* states that confidential voting is said

¹⁵⁵ Anecdotal evidence seems to prove that there is some truth in this argument, cf. Jennifer Levitz, *Do Mutual Funds Back CEO Pay?*, The Wall Street Journal, March 28, 2006, at C1 and C13 reporting on a study sponsored by the American Federation of State, County and Municipal Employees labor union in Washington and Corporate Library using the disclosed data to complain about mutual funds voting behavior not being in the interest of their beneficiaries.

¹⁵⁶ *Nicholson*, supra note 102, at p. 705 et seqq. *Nicholson* further adopts the argument that the costs for mandatory disclosure cannot be prohibitive given the fact that some funds disclosed their proxy voting voluntarily before the SEC Rule came into effect.

¹⁵⁷ *Stewart*, supra note 118.

to minimize conflicts of interest, therefore voting disclosure will not serve this purpose, but rather the opposite.

In an article published after the adoption of the SEC disclosure rules *Romano* addresses the very question whether confidential proxy voting minimizes institutional investors voting constraints caused by their conflicts of interest.¹⁵⁸ The empirical evidence she presents suggests that there is no impact of confidential voting on institutional investors' voting behavior. Given these findings *Stewart's* last argument borrowed from *Black* and others¹⁵⁹ lacks persuasiveness.

Albeit this scholarly debate the U.S. Government accountability office upon request of Senator Edward Kennedy composed a report, in which it recommends to amend ERISA in order to require that pension plan fiduciaries develop and maintain written proxy-voting guidelines, include language in voting guidelines on what actions the fiduciaries will take in the event of a conflict of interest, and given SEC's proxy voting disclosure requirements for mutual funds (sic!), annually disclose votes as well as voting guidelines to plan participants, beneficiaries, and possibly also to the public, "if the Congress wishes to better protect the interest of plan participants and increase the transparency of proxy voting practices by plan fiduciaries".¹⁶⁰ However, the Department of Labor having raised concerns with regard to the costs caused by the adoption of this recommendation¹⁶¹ has not seized the suggestion yet.

On March 11, 2005 the Canadian Securities Regulators (CSA) have issued Harmonized Rules for Continuous Disclosure by Investment Funds.¹⁶² These rules comprise the requirement for investment funds to establish voting policies and procedures, to maintain a proxy voting record, to post this record on an annual basis on the fund's Web site, and to promptly send the most recent copy of the fund's voting policies and procedures and proxy voting record, without charge, to any investor upon request. These rules which are clearly inspired by the prior SEC regulation apply for the first time for the annual period beginning July 1, 2005.¹⁶³

(4) Some Data indicating the actual Impact of the SEC Rules

¹⁵⁸ Roberta Romano, *Does Confidential Proxy Voting Matter?*, 32 J. Legal Stud. 465 (2003).

¹⁵⁹ See supra c).

¹⁶⁰ U.S. Government Accountability Office, supra note 16, at p. 29 et seq.

¹⁶¹ Cf. id., at p. 32.

¹⁶² See respective CSA News, online: http://www.csa-acvm.ca/html_CSA/news/05_07funds_disclosure.htm.

¹⁶³ See, e.g., Regulation 81-106 respecting investment fund continuous disclosure, Gazette Officielle du Québec, June 1, 2005, Vol. 137, No. 22, p. 1602, 1615 et seq. (Part 10).

Unfortunately, there are no studies on the actual impact of the SEC rules on investment companies' and investment advisors' behavior yet. Perhaps this is so because of the difficulties to isolate the impact of those rules, which is a condition to gain empirical proof of the disclosure rules' benefits. Nevertheless, there is some data, which, though far from being compelling evidence, may give some hints as to the effects of the SEC rules at issue.

For example, as to the prohibitiveness of costs of voting disclosure claimed by commenters on the SEC rules, the decline in total shareholder cost of stock mutual funds in the year 2003¹⁶⁴ and then again in 2004¹⁶⁵, while, for example, costs for bond mutual funds at the same time stayed the same or decreased less¹⁶⁶, make this argument less persuasive (not to speak of the fact that some funds voluntarily disclosed their voting prior to the SEC rules coming into effect).¹⁶⁷ Furthermore, streamlined proxy voting management products offered by service firms like ISS will likely reduce costs.¹⁶⁸

That leads to the related issue of alleged competitively disadvantageous effects of the disclosure rules. The fact that the total net assets of U.S. mutual funds grew in 2003 by 16% and in 2004 by another 9.3% does – of course – not show that there are no such effects, but at least suggest that those effects, if they exist, do not belong to the decisive competition drivers.¹⁶⁹ This is buttressed by the ICI's description of the market environment for mutual fund investment in 2004 as “very good”.¹⁷⁰ And again, the fact that there were funds voluntarily disclosing their voting behavior also suggests that the SEC rules do not distort competition.

As to the fear of an increase of politicizing campaigns there is indeed anecdotal evidence of such campaigns.¹⁷¹ But it remains unclear, whether there is an increase in such campaigns or

¹⁶⁴ See ICI, *supra* note 1, at p. 26 et seq.

¹⁶⁵ See ICI, *Fundamentals*, Investment Company Institute Research in Brief, Vol. 14, No. 6, October 2005, online: <http://www.ici.org/issues/fee/fm-v14n6.pdf>.

¹⁶⁶ See the references in notes 164 and 165.

¹⁶⁷ The cost estimates calculated by the SEC [see 68 Fed. Reg. 6564 (Feb. 7, 2003), at p. 6576 et seqq. and 68 Fed. Reg. 6585 (Feb. 7, 2003), at p. 6590 Fn. 35] were doubted by the fund industry, see, e.g., Henry Hopkins and Darell N. Braman, Letter to Nathan Knuffman and Jonathan G. Katz on Proxy Voting by Investment Companies; File No. S7-36-02, Practising Law Institute, PLI Order No. B0-01U8, May 12-13, 2003, at p. 4 et seq.

¹⁶⁸ Cf. the ISS brochure “Creating Effective Workflow Solutions to Proxy Voting Management”, online: www.issproxy.com/pdf/ISSVotingProcess.pdf.

¹⁶⁹ See ICI, *supra* note 1, at p. 102 (table 44). The fact that the worldwide growth of total net assets of mutual funds amounted to 24.1% and 15%, and thus was higher than in the U.S. is probably explained by the more saturated U.S. market.

¹⁷⁰ *Id.*, at p. 11.

¹⁷¹ The Civil Society Institute, Ceres and Co-op America have started a survey-supported campaign in 2006 to urge U.S. mutual funds to start voting in favor of global warming proxy resolutions. For further details see online: <http://www.pnnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/01-26->

whether they affect fund performance negatively. On the other hand, the American Federation of State, County and Municipal Employees labor union in Washington and Corporate Library base their complaint about mutual funds' voting behavior on executive-pay plans not being in the interest of their beneficiaries on a study using the disclosed voting data of mutual funds.¹⁷² Thus, the argument seems to bear some truth that, even though retail investors may not use the disclosed voting information directly, intermediaries will monitor mutual funds on the basis of this data and present their findings to retail investors in a more digestible form, which in turn will adjust their investment behavior accordingly.¹⁷³

Finally, as to the assumption of the value enhancing nature of active corporate governance by shareholders, which is a premise for the SEC's argument that one benefit of the disclosure rules for the funds' clients is a more diligent exercise of funds' voting power, there are some recent studies buttressing the majority opinion that there is indeed such a positive correlation.¹⁷⁴

h) The Definition of the Institutional Investor and the Disclosure Rules' Scope of Application

An obvious difference between the EC Commission's proposal and the SEC rules is the scope of application with regard to the addressees of the rule. While the former encompasses "institutional investors" per se, the latter only address investment companies in terms of the Investment Company Act of 1940 and investment advisers in terms of the Investment Advisers Act of 1940. But this limitation must not be overestimated, since it is due to the limited regulation authority of the SEC.¹⁷⁵ It is not – to pick up the concerns raised with regard to the EC Commission's proposal – because the notion of the "institutional investor" is "rather broad and could easily be misinterpreted".¹⁷⁶ Rather conversely, critique was raised that institutions outside the SEC's jurisdiction like bank trust departments, pension plans and insurance companies face no obligation to disclose their votes.¹⁷⁷

2006/0004268526&EDATE=. See also Jennifer Levitz, *Funds Support Executive-Pay Plans*, The Wall Street Journal, March 28, 2006, at C 13.

¹⁷² Cf. Jennifer Levitz, *Do Mutual Funds Back CEO Pay?*, The Wall Street Journal, March 28, 2006, at C1 and C13.

¹⁷³ See supra (3).

¹⁷⁴ See the studies referred to in fn. 7. As mentioned there, authors tend to interpret this positive correlation in such a way that good governance causes better firm performance.

¹⁷⁵ But see also the complaints of Stewart, supra note 118, at p. 246 with regard to the non-application of the disclosure rules to advisers to pension plans, hedge funds or issuers.

¹⁷⁶ Cf. supra 2.c) and infra 5.b).

¹⁷⁷ Stewart, supra note 118, at p. 246.

As to the definition of institutional investor, this term is not yet settled in the U.S. either. For example, the definition of “institution” used by *Brancato*, which includes pension funds, open and closed end mutual funds, insurance companies, bank-managed trusts, and foundation and endowment trusts¹⁷⁸, is characterized by *Black* as an „incomplete definition of ‘institution’”.¹⁷⁹ *Chandler* states that “[d]efined broadly, [...] institutional investors are those stock and debt-holding groups or entities that actively invest on behalf of others. Among the entities that might [!] fall into this category are [...]” and thereby reveals a certain incertitude as well.¹⁸⁰ Others content themselves by stating that the term “institutional investor” typically refers to mutual funds or pension funds.¹⁸¹

While those general definitions of “institution” or “institutional investor” do not seem to be very helpful per se in determining the suitable scope of application of voting disclosure rules, it might be more promising to infer this scope from the purposes pursued by these rules. However, then the question has to be raised whether the differences in the kind of conflicts of interest faced by those institutions commonly named institutional investors, as described above¹⁸², are of such an importance that different disclosure rules are appropriate.¹⁸³ This has to be kept in mind, when analyzing the desirable scope of application of an EC voting disclosure rule.

4. The Proposal of the British Government – Clauses 1241 to 1244 of the Companies Bill

Not only the U.S. had a debate about voting disclosure rules for institutional investors (resulting in the discussed SEC rules), but also in the UK there are recent developments concerning that issue.

As early as 1998 the then DTI minister *Margaret Beckett* demanded in a speech before a conference sponsored by PIRC, a London-based governance consultancy, that institutional investors should vote all their shares and should annually disclose their voting policies and

¹⁷⁸ See Carolyn K. Brancato, *The Pivotal Role of Institutional Investors in Capital Markets: A Summary of Economic Research at the Columbia Institutional Investor Project*, in: Sametz et al. (eds.), *The Fiduciary Responsibilities of Institutional Investors* (1991).

¹⁷⁹ See *Black*, supra note 5, 89 Mich. L. Rev. 520, at p. 567 with Fn. 168.

¹⁸⁰ William B. Chandler III, *On the Instructiveness of Insiders, Independents, and Institutional Investors*, 67 U. Cin. L. Rev. 1083 (1999), in fn. 3.

¹⁸¹ *Nicholson*, supra note 102, at Fn. 3.

¹⁸² See supra c).

¹⁸³ This seems to be *Black*'s opinion; cf. *id.*, supra note 5, 89 Mich. L. Rev. 520, at p. 596: “[T]he single phrase ‘institutional investor’ obscures important differences between institutions”.

records so that they may be held accountable.¹⁸⁴ At the same time the DTI launched a long-term fundamental review of UK company law.¹⁸⁵

Three years later, in 2001, the Company Law Review being installed to make recommendations which should lead to a material reform of UK company law recommended mandatory disclosure of voting by institutional investors to the public. In its Modernising Company Law White Paper the government agreed in principle.¹⁸⁶

In 2003 the Institutional Shareholders' Committee (ISC) published a revised Statement of Principles as a response to Government pressure to increase shareholder activism. This code of best practice for institutional investors requires them to disclose their policies and some of their actions, including the voting of their shares.¹⁸⁷ Since the same time Trades Union Congress (TUC) conducts an annual Fund Manager Voting Survey "intended to give trustees information on how various fund managers exercise voting rights [...], and an insight into voting [...] processes"¹⁸⁸. The most recent one of 2006 provides the following key facts: The significant improvement of the response rate over the last years came to an end this year, when the number of respondents shrank for the first time.¹⁸⁹ A substantial part of institutions still declines to participate in the survey¹⁹⁰. More important, only seven organizations answered the question whether they already report any voting information publicly in the affirmative. Of those seven four reported their full voting records whereas three only provide a statistical breakdown of votes cast. Of those organizations that provide limited information, or none at all, only four reported that they hope to report publicly in the future.¹⁹¹ The TUC, thus, expresses its scepticism that a voluntary approach to voting disclosure will result in more reporting. It "believes [...] that [...]"

¹⁸⁴ *Beckett*, Speech held at the PIRC Annual Conference, London, March 4, 1998, online: <http://www.dti.gov.uk/ministers/archived/beckett040398.html>.

¹⁸⁵ Cf. DTI on the Company Law Review, online: <http://www.dti.gov.uk/bbf/co-law-reform-bill/clr-review/page22794.html>.

¹⁸⁶ Modernising Company Law Command Paper Cm 5553, Part II, 2.47, online: <http://www.dti.gov.uk/companiesbill/part2.pdf>; cf. also DTI, supra note 14, at p. 1 sub 5.

¹⁸⁷ ISC, *The Responsibilities of Institutional Shareholders and Agents – Statement of Principles*, online: http://www.napf.co.uk/publications/Downloads/PolicyPapers/sectionI/2005/ISC_Statement_of_Principles.pdf; cf. Richard Lamming et al., *The Effects of Financial Institutions and Investor Behaviour on Management Practice*, 2004, p. 31.

¹⁸⁸ TUC, *Fund Manager Voting Survey 2006*, July 2006, p. 5.

¹⁸⁹ *Id.*, at p. 5: 26 organizations provided full voting records (2005: 28; 2004: 17; 2003: 9), comprehensive voting data was delivered by 27 investors (2005: 32; 2004: 20; 2003: 12), and at least some voting data was received for 32 investors (2005: 37; 2004: 27; 2003: 21).

¹⁹⁰ *Id.*, at p. 5: Under 50% (2005: 50%) of the target group provided full responses, just over 61% (2005: 68%) of the target group provided some form of response. That leaves nearly 39% of the target group declining to respond.

¹⁹¹ *Id.*, at p. 43. As to the comparable results of the 2005 survey see TUC, *Fund Manager Voting Survey 2005*, June 2005, at p. 34.

many fund managers will not embrace transparency voluntarily”¹⁹², and, thus, favors a mandatory disclosure requirement for institutional investors to disclose voting records publicly.¹⁹³

On the other hand, a Report on “The Effects of Financial Institutions and Investor Behaviour on Management Practice“ delivered by *Lamming et al.* for the DTI suggests on the basis of literature review as well as on case study analysis comprising US, UK and German investors and portfolio companies that “investor activism is alive and well in the UK”.¹⁹⁴ However, the report itself qualifies its findings by pointing to the small number of case studies conducted and concludes that the “evidence presented [...] is insufficient for judging whether the UK is suffering because its investors are less activist in comparison to those in competitor nations”.¹⁹⁵ But also TUC concedes that “focusing on the exercise of voting rights provides only a partial picture of fund managers’ commitment to activism”.¹⁹⁶

On 1 November 2005 the British government introduced the Company Law Reform Bill (meanwhile changed to Companies Bill) in the House of Lords.¹⁹⁷ Under the heading “Information as to exercise of voting rights by institutional investors” this bill contains the Clauses 1241 to 1244 on institutional investors’ voting disclosure.¹⁹⁸ Clause 1241 provides in its first paragraph that “the [government] may make provision by regulations requiring institutions to which this section applies to provide specified information about the exercise of voting rights attached to shares to which this section applies”. In the following clause six types of institutions are mentioned to which Clause 1241 may apply, but this list is not exclusive. “Regulations under section 1241 may require the provision of specified information about [...] the exercise or non-exercise of voting rights [...] in respect of specified occasions or specified periods” (Clause 1244(1) and (2)). “Regulations under section 1241 may require the provision of regulations may

¹⁹² *Id.*, at p. 43.

¹⁹³ *Id.*, at p. 5, 49.

¹⁹⁴ *Lamming et al.*, *supra* note 187, at p. 36. The Report examined and interpreted case studies on 8 venture capital funds (4 UK, 1 UK/US, 2 US, 1 German), 8 Private Equity Fund Portfolio companies (5 UK, 1 UK/US, 1 US, 1 German), and 5 Institutional Funds (4 UK, 1 German).

¹⁹⁵ *Id.*, at p. 37.

¹⁹⁶ TUC, *supra* note 188, at p. 9.

¹⁹⁷ Company Law Reform Bill, online: <http://www.publications.parliament.uk/pa/ld200506/ldbills/034/2006034.htm>. For the latest version of the bill see Companies Bill, online: <http://www.publications.parliament.uk/pa/pabills/200506/companies.htm>.

¹⁹⁸ Companies Bill, Volume III, online:

<http://www.publications.parliament.uk/pa/cm200506/cmbills/218/2006218c.pdf>. When the bill was introduced in the House of Lords institutional investors’ voting disclosure was dealt with in the then Clause 866.

require the information to be provided [...] to such persons as may be specified, or to the public, or both” (Clause 1244(4)(b)).

The governments objective with regard to this provision is twofold: first, retail investors’ confidence in the governance exercised by institutional investors is expected to improve by entitling them to information on how assets owned on their behalf are voted.¹⁹⁹ “In addition”, voting transparency is expected to enhance the efficiency of institutional investment by (1) reducing the risk of conflicts of interest which institutional investors may face when voting shares from distorting voting decision and (2) increasing the accountability of institutional investors to retail investors, both for voting shares and for the signals being sent to company management by voting.²⁰⁰

The government denotes that, given the levels of voluntary disclosure already achieved, it may be possible to develop a voluntary disclosure regime. If the market fails to make progress in this regard it “could consider using the power” of Clause 1241.²⁰¹ Conducting a preliminary cost-benefit-analysis the governments concedes that the benefits are not easy to quantify but points to the example that, if better governance led to just 2% of companies increasing their rate of return to shareholders by 0.1% per annum, the annual benefit would be roughly £30 million p.a. The costs, on the other hand, are expected to be in the order of £6 to £9 million p.a.²⁰²

The government’s proposal met strong opposition from institutional investors representative groups. The Association of Investment Trust Companies (AITC), for example, expressed doubts about a real demand from retail investors. It is equally unconvinced as to the benefit analysis conducted by the government juxtaposing evident costs to unclear benefits. Furthermore, it raises concerns as to the practical feasibility of a disclosure requirement since the vast majority of trusts outsource their day-to-day fund management activities, including voting, to external fund managers.²⁰³ The Company Law Committee of the Law Society of England and Wales, the Company Law Sub-Committee of the City of London Law Society and the Law reform Committee of the General Council of the Bar back this criticism in their combined comment on

¹⁹⁹ DTI, supra note 14, at p. 1 sub 3 referring to the the Clause 866 of the Company Law Reform Bill.

²⁰⁰ Id., at p. 1 sub 4.

²⁰¹ Id., at p. 5 sub 19.

²⁰² Id., at p. 4 et seq. sub 17. and 18. The government points out that the cost estimates are “in line with the US estimates”, but “sensitive to underlying assumptions”, for details as to these assumption cf. id., at p. 6 et seq.

²⁰³ See AITC Comments on Company Law Reform Bill: Draft Clauses, online:

<http://www.aitc.co.uk/files/technical/draftclausescommentoct.pdf>. A summary of the objections can be found at http://www.aitc.co.uk/news_events/political.asp?id=4679.

the government's proposal and denounce the governments proposal as unclear with regard to its rationale and improper to achieve its aims while supporting a voluntary approach.²⁰⁴

5. Derivations for the European Commission's Proposal

After having portrayed the U.S. experience with institutional investors' mandatory voting disclosure rules and also having sketched recent developments in the UK the European Commission's proposal and the arguments of its opponents can now be assessed against the background of the depicted U.S. experience. In the following, it will be shown, that those arguments opposing a mandatory disclosure rule (and especially disclosure of how actual votes were cast)²⁰⁵ are not strong enough to outweigh the potential benefits of such a rule (a.). Before implementation of the proposal can take place, the rather cloudy term "institutional investors" has to be further concretized. Some brief remarks on that issue will round off the analysis (b.).

a) The Case for Mandatory Voting Disclosure

Armed with the insights and arguments gained from the U.S. experience supported by additional data and arguments from the European realms the concerns and arguments against the European Commission's proposal can be overcome. Indeed, there is a case for mandatory voting disclosure of institutional investors, because the benefits to be gained by a disclosure rule at EC level are probably higher than the potential drawbacks. This can be shown in a four-step analysis addressing the following questions: Do the proposed disclosure requirements further the objectives posed in justification of the rules (1)? Are the drawbacks of mandatory disclosure outweighing its benefits (2)? Is legislation necessary at all (3)? At EC level (4)?

While this subdivision may appear to be partly artificial and overlapping, it nevertheless seems helpful to structure the further train of thoughts.

(1) Is the Twofold Aim posed by the European Commission furthered by its Proposal?

To make a case for the European Commission's proposal on mandatory voting disclosure the first question to be answered in the affirmative is whether the objective pursued by that proposal are

²⁰⁴ The Law Society, Company Law Reform Bill, Draft Clauses issued for comment by the DTI on 14 October 2005, Comments of the Law Society's Company Law Committee, the Company Law Sub-Committee of the City of London Law Society and the Law reform Committee of the General Council of the Bar, 1 November 2005, online: <http://www.lawsociety.org.uk/documents/downloads/dynamic/complawreformbilldraftclausesoct05.pdf>.

²⁰⁵ Cf. infra a)(1)(b).

actually furthered by the proposed rules. Those objectives are two: the improvement of the internal governance of institutional investors and the enhancement of institutional investors' participation in the affairs of the companies in which they invest.²⁰⁶

(a) Improvement of Internal Governance – Conflicts of Interest

The general objective of improving the internal governance of institutional investors mentioned in the Commission's proposal is somewhat cryptic. Elucidation can be found in the HLG Report. The disclosure rules, like their U.S. pendant²⁰⁷, shall remedy the "the potential for conflicts of interests of those who manage the investments on behalf [of the] beneficiaries".²⁰⁸ For this potential for conflicts of interest, broadly described above with regard to U.S. institutions²⁰⁹, is a general phenomenon not confined to the U.S.²¹⁰ Given that institutions' business relationships with portfolio companies seem to be a main source of conflicts of interest, financial conglomerates offering multiple financial services (insurance, lending, investment banking, asset management etc.) seem to be strongly exposed to such conflicts. Since in Europe these financial conglomerates – some of the biggest coming from the UK, France or Germany²¹¹ – play a major role on their domestic financial markets as well as Europe-wide, the potential for the abovementioned conflicts of interest is real. To pick Germany as an illustrative example, the most important German mutual fund management companies like DWS Investments, Union Investment, DIT Allianz Dresdner Asset Management etc. are all owned by banks which are engaged in the lending business and/or investment banking.²¹² Furthermore, a vast majority of the 24 accredited German pension funds are raised and managed by companies owned by banks, insurance companies and/or financial conglomerates.²¹³

²⁰⁶ See supra 1.a).

²⁰⁷ Cf. supra 3.g)(2)(a).

²⁰⁸ See supra 1.b).

²⁰⁹ See supra 3.c) and the illustrative example supra 3.f).

²¹⁰ Cf., e.g., for conflicts of interest affecting German institutional investors Christian Fraune, *Der Einfluss institutioneller Anleger in der Hauptversammlung* [The influence of institutional shareholders at the shareholders' meeting], 1996, and the reference in DTI, supra note 14, at p. 1 sub 4..

²¹¹ Cf. the list of European groups identified as financial conglomerates in terms of the Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002, OJ No. L 35 of 11 Feb. 2003, p. 1 et seqq., online: http://ec.europa.eu/comm/internal_market/financial-conglomerates/docs/20060322_conglomerates_by_country_en.pdf.

²¹² The situation in Greece seems to be quite similar, cf. Phoebus Athanassiou, *Recent Developments in Greek Capital Markets Law*, [2005] EBLR 893, at p. 907 et seq.

²¹³ A list of the 24 accredited German pension funds can be found on the Web site of the German Federal Financial Supervisory Authority (BAFin) at http://www.bafin.de/cgi-bin/vu_liste.pl (in German). However, on the basis of data of 2004, none of the pension funds invested in equity directly [cf. BAFin, Annual Report 2004, Part B table 6,

And even though those conflicts differ among the different kinds of institutional investors²¹⁴, the voting disclosure seems to be an appropriate remedy for all of these conflicts to secure the investment managers' voting in accordance with their fiduciary duties.

However, the argument has been made by the proponents of confidential voting that voting disclosure may have the opposite effect, namely worsen the conflicts of interest by exposing the institutional investors to the retaliation of corporate management.²¹⁵ But this argument loses its persuasive power against the background of *Romano's* findings, that there is no impact of confidential voting on institutional investors' voting behavior.²¹⁶ Furthermore, retaliation by corporate managers is checked by the threat to withdraw the investment and the consequent decline in the value of managers' stock options, a means of compensation getting more and more common in Europe as well. Moreover, corporate management will gain nothing by taking business from the inconvenient investor, since his competitors will also be under close scrutiny due to their own duty to disclose. Finally, it can be assumed that the publication of the institutions' voting will intensify the pressure on corporate management to comply with the institutions' requests.²¹⁷

(b) Enhancement of Institutional Investors' Participation

Unlike the aforementioned objective the enhancement of institutional investors' participation is only briefly mentioned in the HLG report. The HLG believes that such a rule "would also contribute to a *considered* participation by institutional investors".²¹⁸ The "also" indicates that the enhancement of institutional investors' participation in the affairs of the portfolio companies is only considered as an ancillary objective, while the wording "considered participation" points to a qualitative improvement of participation rather than a quantitative.²¹⁹ This interpretation is buttressed by the fact that the HLG itself states that institutional investors are "increasingly inclined actively to engage in internal control within the company".

online: <http://www.bafin.de/jahresbericht/2004/TeilB-tab6.pdf> (in German)], albeit pension funds are allowed to invest in international equities markets [cf. § 2(1) No. 13, 14 *Verordnung über die Anlage des gebundenen Vermögens von Pensionsfonds gemäß § 115 Abs. 2 des Versicherungsaufsichtsgesetzes (Pensionsfonds-KapitalanlagenVO)* [Regulation on Pensionfund investments].

²¹⁴ Cf. supra 3.d) and Fraune, supra note 210.

²¹⁵ Cf. as to the U.S. debate supra at 3.c), d) and g)(3). As to the European / German debate cf. Handelsblatt, 17.02.2005, Nr. 34, at p. 18.

²¹⁶ See supra at 3.g)(3) at footnote 156.

²¹⁷ See Ulrich Hommel, Professor at the European Business School, Oestrich-Winkel, Handelsblatt, 17.02.2005, Nr. 34, at p. 18.

²¹⁸ HLG Report, supra note 5, at p. 56 et seq. Emphasis supplied.

²¹⁹ The SEC distinguishes between these two aspects of participation improvement, cf. supra 3.g)(2)(a).

Hence, the increase in institutional investors' activism which can presently be observed²²⁰ cannot be used as an argument to demonstrate the needlessness of a mandatory disclosure rule, since it does not convey any information as to the care and deliberation with which such activism is exerted. This aim of "considered" participation can very well be enhanced by voting disclosure requirements. By this means institutional investors' clients can better monitor the investment managers' voting behavior and hold them accountable for their stewardship.²²¹ In return, investment managers being aware of their voting behavior's visibility will most likely make their voting decisions more deliberately.

(2) Are the Drawbacks of Mandatory Disclosure outweighing its Benefits?

After finding the proposed disclosure rules furthering their intended objectives, the next step is to analyze whether the intended benefits are outweighing the (potential) drawbacks. As to the latter it is noticeable that the concerns raised by opponents of the European Commission's proposal are very similar to those raised with regard to the SEC's disclosure rules. The former can therefore be countered by the same arguments the latter were countered at that time.²²²

(a) The Arguments of the Opposing Commenters

The arguments and concerns expressed by the opponents of the Commission's proposal are not convincing.²²³

As to the perhaps most fundamental argument, the questioning of the positive impact of institutional shareholder activism,²²⁴ there is evidence that companies with better corporate governance have lower risk, better profitability and higher valuation.²²⁵ Thus, shareholder activism, especially activism of influential institutional investors, aiming at a better corporate governance will most likely have the described positive effect.²²⁶

The argument put forward that voting policies are not predeterminable and must be adaptable to a rapid change is not very convincing either. To mandate the adoption of voting policies which

²²⁰ Cf., e.g., the Lamming Report stating that in the UK "investor activism is alive and well", supra 4; for the institutional shareholders' activism in Sweden cf. Rolf Skog, supra note 3.

²²¹ Cf. DTI, supra note 14, at p. 1 sub 2.

²²² Cf. supra 3.d) and 3.g)(3).

²²³ See the summary of those concerns supra 2.c).

²²⁴ Cf. also the criticism of the UK government's proposal by AITC as to the uncertainty of benefits, supra 4.

²²⁵ See references in note 7. As mentioned there, authors tend to interpret this positive correlation in such a way that good governance causes better firm performance.

²²⁶ Cf. also Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 Yale J. on Reg. 174 (2001), passim.

are to be disclosed does not mean that the institutional investors will be held liable merely because they deviate from those policies in a concrete case. Rather, they are urged to be able to explain this deviation, which will have a positive disciplinary effect to the extent that they will be less able to deviate in their voting behavior from their beneficiaries interests.

A further concern raised are the costs of a disclosure rule and, closely related, the (possible) distortion of competition vis-à-vis non-EU institutional investors. As to the costs, also in the EU examples of voluntary disclosure can be found which indicates that costs are not prohibitive.²²⁷ The calculations of the SEC²²⁸ as well as of the DTI²²⁹ concerning the cost/benefit ratio of mandatory disclosure rules – though not unchallenged²³⁰ – suggest that the benefits most likely outweigh the costs.²³¹ The fear of distortion of competition vis-à-vis non-EU institutional investors seems equally unfounded. First of all, in relation to U.S. mutual funds there is no competitive disadvantage, since they already face mandatory disclosure rules. Furthermore, as reported, the market environment for U.S. mutual funds in 2004 was “very good”,²³² no sharp decline in demand could be observed after the adoption of the SEC rules. Comparing the growth rates in net assets of U.S. mutual funds and mutual funds worldwide for the time period of 1998 to 2004 the figures do not indicate any kind of competitive distortion caused by the SEC disclosure rules.²³³ So, why should there be such distortion with regard to EU institutional investors?

²²⁷ In Germany Allianz Global Investors and its affiliate Deutsche Investment-Trust (DIT), one of the major players in fund business, decided to disclose its voting behavior voluntarily in 2005, the information is made publicly available at http://www.dit.de/ueber_uns/treuhaenderfunktion/treuhaenderfunktion.html; see also FAZ, *Allianz veröffentlicht Abstimmungsverhalten ihrer Fonds* [Allianz publishes the voting behavior of its funds], 15.02.2005, Nr. 38, at p. 19; Handelsblatt, *Fondsbranche streitet um mehr Transparenz* [The fund industry argues about more transparency], 17.2.2005, Nr. 34, at p. 18. For the UK see the TUC survey data summarized supra 4. For the U.S. debate see Palmiter, supra note 2, at p. 1478 et seq. and Nicholson, supra note 102.

²²⁸ See SEC, *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, 68 Fed. Reg. 6564 (Feb. 7, 2003), at p. 6576 et seq. and the criticism supra 3.g)(3).

²²⁹ See supra 4.

²³⁰ See, e.g., the criticism put forward by the AITC as to the benefits/costs-ratio of mandatory disclosure, supra 4.

²³¹ Cf. also Palmiter, supra note 2, at 1478 et seq. as to the U.S. debate.

²³² See supra 3.h).

²³³ The growth rates are more or less parallel. The U.S. mutual funds' growth is far from being disconnected from worldwide growth. While in the time from 1998 to 2001 the U.S. funds grew faster than the funds grew on a worldwide basis (23.9%, 1.7% and 0.1% in comparison to 22.6%, 0.9% and -1.8%), the worldwide growth rate exceeded the U.S. growth rate in the following years (-2.8%, 24.1% and 15% in comparison to -8.4%, 16% and 9.3%). Since this change started in 2002 a direct causal relation to the SEC disclosure rules seems unlikely. Furthermore, the fact that the considerable growth rates in 2003 and 2004 are below the worldwide growth is most possibly due to the stronger saturation of the U.S. market (which in 2004 amounted to more than 48.4% of the worldwide net assets held in mutual funds). The computations were made with data taken from ICI, supra note 1, Table 44.

The allegation of an impairment of shareholder equality by imposing voting disclosure duties on institutional investors (and not on non-institutional investors), another argument against such duties, is beside the point. First, the principle of equal treatment only applies to subjects in equal circumstances. Thus, if there is an appropriate reason to differentiate, no discrimination is taking place.²³⁴ Institutional investors are the only intended addressees of the disclosure rule, since in their case – in contrast to (most) other shareholders – the deviation of economic ownership and voting control is typical. They are subject to fiduciary duties towards their clients and typically face the sort of conflicts of interest the disclosure rule intends to address. Hence, there is good reason to impose mandatory voting disclosure duties on institutional investors, while other shareholders do not face such duties.

The impairment of “confidentiality of business strategy from a competitive standpoint” is an argument not so easily overcome. While one may suggest to limit the disclosure to the clients and not extend it to the public, this barrier may be easily circumvented by competitors. Furthermore, financial intermediaries which are necessary to transmit the disclosed information to present and future clients of the institutional investors in a digestible form may face difficulties in getting the information needed. However, the voting in shareholder meetings is principally non-confidential. Thus, no institutional investor can rely on his voting behavior to stay a “trade secret”. It seems indicative that no objection in this regard has been raised by U.S. mutual funds against the abovementioned SEC rules.

Finally, those who point to the vagueness of the notion “institutional investors” and the possibility of its misinterpretation are undoubtedly right. However, while this term is used in the European Commission’s proposal, the wording of the final rule will – also without doubt – be more specific. Defining the target group of the rule in more detail is without question a task still to be performed²³⁵, but the fact that it has not been done yet does not question the rule as such.

(b) More Arguments against Mandatory Voting Disclosure

In addition to those arguments made by the opposing commenters of the European Commission’s proposal other concerns and arguments to be addressed in the following were put forward against an mandatory disclosure rule in the context of the U.S. debate on the SEC’s rules²³⁶, in response

²³⁴ Majority shareholders, for example, are subject to fiduciary duties minority shareholders are not.

²³⁵ See *infra* c).

²³⁶ See *supra* at 3.

to the UK Government's proposal of a national disclosure rule²³⁷, and in the wake of the announcement of one of the biggest German fund groups to voluntarily disclose its voting behavior²³⁸. The latter gave rise to a discussion among investment companies, shareholder protection groups and other stakeholders about the sensibility of voting disclosure. While most of the major German investment companies as well as the umbrella organization European Fund and Asset Management Association (EFAMA)²³⁹ were inclined to give voting policies disclosure a second thought²⁴⁰, they showed reluctance or even outright opposition as to the disclosure of their actual voting.²⁴¹

Among those arguments is the concern about the securing of access to information, the preference of behind-the-scenes negotiations and the worry about the institutions becoming "pressure-sensitive" by revealing their voting behavior.²⁴² That the latter argument is unconvincing has already been revealed above.²⁴³ As to the former arguments one has to remind *Palmiter's* analysis that despite growing shareholder activism in the U.S. fund managers' have extensive access to corporate information.²⁴⁴ And again, it can be assumed that the publication of the institutions' voting will intensify the pressure on corporate management to comply with the institutions' requests.²⁴⁵

The opponents of mandatory disclosure of actual voting also fear that a public discussion about funds' voting behavior may induce fund managers not to vote in the interest of their clients.²⁴⁶ This fear seems to be unfounded as well, since just the disclosure will secure that fund managers' do not deviate in their voting behavior from their clients interests. Potential liability and the threat of the withdrawal of assets should be sufficient incentives for the fund manager to stay unimpressed by public discussions of the aforementioned kind.

²³⁷ See supra at 4.

²³⁸ See supra in note 215.

²³⁹ Also known under its French name Fédération Européenne des Fonds et Sociétés d'Investissement (Fefsi).

²⁴⁰ See, for example, the disclosure of the major German fund group Union Investment's quite detailed voting policies for its retail clients on the company's Web site: [http://privatkunden.union-investment.de/-snm-0000565340-1148377715-0000021353-0000000000-1156956031-enm-\[in German\]](http://privatkunden.union-investment.de/-snm-0000565340-1148377715-0000021353-0000000000-1156956031-enm-[in German].).

²⁴¹ See the references supra in note 215.

²⁴² Cf. as to the U.S. debate supra at 3.c), d) and g) (3). As to the European / German debate cf. Handelsblatt, 17.02.2005, Nr. 34, at p. 18.

²⁴³ See supra (1)(a).

²⁴⁴ Cf. to those arguments of Palmiter, supra note 2, supra 3.d).

²⁴⁵ See Ulrich Hommel, Professor at the European Business School, Oestrich-Winkel, Handelsblatt, 17.02.2005, Nr. 34, at p. 18.

²⁴⁶ This concern was raised by Wolfgang Mansfeld, director of Union Investment; see Handelsblatt, 17.02.2005, Nr. 34 at p. 18.

A major argument against mandatory disclosure of the institutions' voting records, not only in the U.S. debate²⁴⁷, but also in the European context²⁴⁸, is the allegation that retail investors would not use the information provided by publication of the institutions' voting behavior. Consequently, Union Investment, a major German fund group, suggested to publish only voting results of "public interest", while the DWS, another major German fund group, intends to "substantively justify" their actual voting only in "special cases".²⁴⁹ This argument does not take into account two important considerations. First, as already pointed out in the U.S. debate, this vast information can be transformed by intermediaries into fund ratings more easily digestible by retail investors.²⁵⁰ Admittedly, the intermediaries have to become nominal retail investors of the institutions or obtain the information from other retail investors to get the respective voting data, if the Commission's proposal as to the voting record disclosure will not be changed in order to make the respective data available to the public. Secondly, not only retail investors, but also institutional investors hold shares in equity funds.²⁵¹ Those institutions are sufficiently sophisticated and have sufficient resources to evaluate the disclosed information and, consequently, to exert pressure on equity fund managers if their interests have not been pursued adequately.

(3) Is mandating disclosure warranted at all?

To make a case for mandatory voting disclosure rules it needs more than showing that such rules further beneficial aims²⁵² and do not face severe drawbacks²⁵³. Furthermore, such rules have to be necessary, because the market fails to sufficiently incentivize such behavior. Those opposing mandatory disclosure rules therefore point to voluntary solutions or other alternatives, allegedly making mandatory rules superfluous.²⁵⁴

But it seems doubtful that market forces, viz. the entrance-exit option of investors, make investment managers sufficiently responsive to investor preferences. *Palmiter* already alluded to

²⁴⁷ See supra 3.d) and 3.g)(3).

²⁴⁸ For the UK see supra 4. For Germany see Handelsblatt, 17.02.2005, Nr. 34 at p. 18.

²⁴⁹ Handelsblatt, 17.02.2005, Nr. 34, at p. 18.

²⁵⁰ For the U.S. debate cf. the arguments made by Palmiter and Nicholson, supra 3.d) and 3.g)(3). As an example of European fund rating companies I only want to mention the German fund rating companies FERI Rating & Research GmbH [online: fir.feri.de] and MorningStar Deutschland GmbH [online: www.morningstarfonds.de].

²⁵¹ Cf. again supra 3.d).

²⁵² See supra (1).

²⁵³ See supra (2).

²⁵⁴ Cf. supra 4 as to the UK debate and Handelsblatt, 17.02.2005, Nr. 34, at p. 18 as to the debate in Germany; further Karel Lannoo & Arman Khachatryan, *Reform of Corporate Governance in the EU*, 5 EBOR 37 (2004), at p. 48.

the problem of uni-directorial investor sensitivity in the U.S. context²⁵⁵, and there is no reason to believe that European investors act differently in this regard.²⁵⁶ Also the belief in the alignment of institutions' internal reward schemes being tied to the performance of portfolios they hold²⁵⁷ seems too roseate, since performance can also be improved by cutting costs rather than by being active, a strategy evading the risk of competitors' free riding.²⁵⁸

To hope for voluntary implementation of actual voting disclosure seems to be unwarranted either, given the obvious reluctance shown by most of the institutions, for example, in the UK and Germany.²⁵⁹

Thus, one can easily argue that "legislation is the only answer" to further the aims pursued by the mandatory disclosure rule proposal.²⁶⁰

(4) Is Legislation at EC Level warranted?

Whether mandatory disclosure legislation is warranted at EC level rather than at national level is a question more difficult to answer. The Company Law Committee of the Law Society of England and Wales, the Company Law Sub-Committee of the City of London Law Society and the Law reform Committee of the General Council of the Bar are "unconvinced that a directive is necessary or desirable"²⁶¹. Some scholars even doubt the desirability of harmonization of company law at EC level categorically.²⁶² The recent consultation document on future priorities for the action plan suggests that the European Commission is taking the principle of subsidiarity rooted in Art. 5 EC more seriously than in the past.²⁶³ However, this very general formula still provides considerable political leeway²⁶⁴, which should be used, if it leads to an advantageous result.

²⁵⁵ See supra 3.d) at note 86.

²⁵⁶ Cf. also Luigi Zingales, *The Costs and Benefits of Financial Market Regulation*, ECGI Law Working Paper N° 21/2004, April 2004, online: ecgi.org/wp, at p. 47.

²⁵⁷ Karel Lannoo & Arman Khachatryan, supra note 254.

²⁵⁸ Cf. Rock, supra note 5, at p. 474 et seq. as to passive (indexed) portfolio managers.

²⁵⁹ See for UK supra 4 and for Germany Handelsblatt, 17.2.2005, Nr. 34, at p. 18. This reluctance is in accordance with the situation in the U.S. prior to the SEC's adoption of mandatory disclosure rules, cf. supra 3.e).

²⁶⁰ Cf. the quote taken from the European Commission's recent consultation document supra 1.d).

²⁶¹ Comments of the Law Society's Company Law Committee, the Company Law Sub-Committee of the City of London Law Society and the Law reform Committee of the General Council of the Bar, supra note 204, at p. 10.

²⁶² Cf., e.g., Luca Enriques, *Company Law Harmonization Reconsidered: What Role for the EC?*, ECGI Law Working Paper N° 53/2005, November 2005, online: www.ecgi.org/wp.

²⁶³ See supra 1.d).

²⁶⁴ Cf. Hopt, supra note 4, at p. 21.

And advantages of a harmonized voting disclosure rule at the European level do exist. A pan-European disclosure standard may help investment groups having affiliates in different European member states to save costs by implementing a group-wide standard procedure, which may be insufficient to comply with different national disclosure standards. To put it differently: a harmonized rule will help to exploit economies of scale.²⁶⁵ The British DTI's explanatory material on its draft voting disclosure clauses reveals another argument in favor of a regulation at EC-level. As the Government rightly pointed out it would not "be permitted to impose a similar disclosure obligation on EU collective investment schemes passported-in to the UK retail market under the UCITS Directive. [...] The passported-in fund would be seen by potential clients as having a less transparent structure".²⁶⁶ Thus, by admitting national disclosure rules in lieu of adopting EC rules the objective of the UCITS directive, namely to promote the sale of units of certain collective investment undertakings to the public of the Community²⁶⁷, might be endangered as long as similar disclosure requirements are not adopted for the investment undertakings covered by the directive.

On the other hand, EC legislation faces the danger of petrification. This danger may become substantial and lead to undesirable results with regard to the scope of institutions covered by a mandatory disclosure rule: The market may produce new investment products not covered by the wording of the respective directive, while its rationale demands application. An appropriate remedy to deal with this concern would be the application of the flexible *Lamfalussy* procedure, which is especially aimed at dealing with legislative matter subject to rapid changes.²⁶⁸ However, even though the suggestion has been made to extend the *Lamfalussy* process to legislation in the

²⁶⁵ Cf. Also the related „level playing field“-argument put forward by supporters of an intervention at EC level within the frame of the consultation on future priorities for the action plan, supra 2.d).

²⁶⁶ Cf. DTI, supra note 14, at p. 9.

²⁶⁷ Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (85/611/EEC), OJ L 375, 31.12.1985, p. 3, online: http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31985L0611&model=guichett (consolidated version, lastly amended on 13 April 2005).

²⁶⁸ Cf. also the comment by Mr. Becht at the public hearing on future priorities for the action plan, Directorate General for Internal Market and Services, supra fn. 37, at p. 30. The *Lamfalussy* process was established in order to speed up the legislation with regard to the law of financial markets. Its main feature is the delegation of legislation on questions of detail to expert committees. For further details on the *Lamfalussy* process see, e.g., Klaus Ulrich Schmolke, *Der Lamfalussy-Prozess im Europäischen Kapitalmarktrecht – eine Zwischenbilanz*. [The *Lamfalussy* Process in European Law on Capital Markets – Interim Results], *Neue Zeitschrift für Gesellschaftsrecht* 2005, 912.

field of company law, the European Parliament has shown its unwillingness to accept this suggestion.²⁶⁹

Ultimately, it will be a matter of political determination and assertiveness whether the mandatory disclosure rule will be introduced at EC level or left to the member state legislation. However, as shown, there are good reasons to justify an EC rule.

b) The Definition of Institutional Investors – The Disclosure Rules’ Scope of Application

One main question still unanswered is which institutions the European Commission wants to address when talking about disclosure requirements for “institutional investors”. This has of course to be clarified before a mandatory disclosure rule can be adopted. As stated in the synopsis of the responses to the Commission’s Action Plan a significant number of respondents noted that the term “institutional investors” – as well as the one of “beneficial holders” – were “rather broad and could be easily misinterpreted”²⁷⁰.

The Commission itself gave a hint in § 3.1.1. of the Action Plan as to which institutions should be covered by the proposed rule. The explanatory text to the proposal states that fostering the role of institutional investors in regard to the governance of the companies in which they invest will “require amendments to a series of existing legal texts (relating to *insurance companies, pension funds, mutual or other investment funds, ...*)”²⁷¹. Thus, the Commission while speaking of institutional investors had in mind namely insurance companies, pension funds, and investment funds. But as the three points at the end of the quote also indicate, this enumeration was not meant to be exclusive.

It would go beyond the scope of this article to analyze in detail which institutions should be covered by the mandatory rule and which not, if any. Thus, even though the issue is highly important, I will have to confine myself to some brief remarks.

As already indicated above, the objective pursued by the disclosure rule determines its scope of application. Taking *Chandler*’s broad definition of institutional investors “as those stock and debt-holding groups or entities that actively invest on behalf of others” as a starting point²⁷²,

²⁶⁹ *Id.*, at p. 915; Klaus Ulrich Schmolke, *Die Einbeziehung des Komitologieverfahrens in den Lamfalussy-Prozess – Zur Forderung des Europäischen Parlaments nach mehr Entscheidungsteilhabe* [The Inclusion of the Comitology Procedure in the Lamfalussy Process – An Evaluation of the European Parliament’s Demand for more Decision-Making Power], *Europarecht* 2006, 432.

²⁷⁰ Synthesis, *supra* note 29, § 3.1.2. at p. 10.

²⁷¹ Emphasis supplied.

²⁷² See *supra* 3.h).

debt-holding entities without voting rights can evidently be ignored in the present context²⁷³. On the other hand, while the characteristic “investment on behalf of others” describes a basic prerequisite for conflicts of interest, namely the divergence of the authority to dispose and economic ownership, it does not reveal much about the quality and probability of (potential) conflicts of interest affecting these institutions. Since these features are difficult to measure, it seems indicated to draw the circle of covered institutions rather broader than narrower in order to minimize the negative impact of competitive distortion²⁷⁴ and to avoid legislative arbitrariness as far as possible. Therefore, it seems advisable to exclude a priori only those institutions where the actual realization of conflicts of interest seem purely theoretical.

Given these still very broad guidelines the Commission’s non-exclusive enumeration of “insurance companies, pension funds, mutual or other investment funds” is backed by *Black*’s elaboration on their respective structural potential for conflicts of interest²⁷⁵ and – partly – by *Palmiter*’s findings on the correlation of business relationships with portfolio companies and shareholder activism²⁷⁶, while the significance of the potential for conflicts of interest can be doubted with regard to foundations and endowments²⁷⁷.

Having recognized the significance of the potential for conflicts of interest as (the) one decisive characteristic to determine which institutions should be covered by the Commission’s proposed disclosure rule and which should not, one may give a second thought to a *de minimis* exemption for institutions with regard to holdings in portfolio companies below a certain percentage. For the significance of conflicts of interest can be doubted in cases where institutions only have an infinitesimal share of votes and, thus, influence.

In practice however, there are not only simple tripolar structures consisting of the institution, its clients and the portfolio company. In fact, more complex investment chain structures and the employment of independent investment managers and/or advisers by institutions are quite common.²⁷⁸ Clause 1243 of the UK Companies Bill provides an example of how regulation of such investment chains could look like without burdening institutions with too much bureaucratic

²⁷³ Cf. also the proposal made by Stewart, supra note 118, at p. 244, with regard to the SEC disclosure rule for investment companies to exempt funds which only hold voting securities as a minor portion of their assets.

²⁷⁴ Cf. the complaint put forward by Stewart, supra note 118, at p. 245 et seq.

²⁷⁵ See supra 3.c); cf. also the enumeration in Clause 1242(1) of the UK Companies Bill.

²⁷⁶ Cf. supra 3.d).

²⁷⁷ Cf. again supra 3.c).

²⁷⁸ Cf. for the UK Daniela Weber-Rey, *Institutionelles Investment in Großbritannien* [Institutional Investment in Great Britain], AG-Report 2005, 47 et seq.

expenses.²⁷⁹ As to disclosure duties of independent investment managers and/or advisers being employed by institutions it does not seem to be necessary to adopt special regulation in this regard as being done by the SEC. Since the employing institutions account for the voting disclosure, they have sufficient incentives to contractually ensure that the employed advisers/managers deliver the data to be disclosed to the institutions' clients (and otherwise act in accordance with the clients interests).

6. Conclusions

Despite the opposition displayed by stakeholders a case could be made for the adoption of the European Commissions' proposal of a mandatory voting disclosure rule for institutional investors. The examination of the U.S. experience with a similar rule provided valuable insights and arguments to overcome the concerns of the sceptics. Similar to the U.S. situation prior to the implementation of mandatory disclosure rules, the success of voluntary solutions as well as the reliance on market forces are not adequate substitutes for a mandatory rule in order to achieve disclosure to the extent intended by the proposal. There are also good reasons not to leave the adoption of a disclosure rule to the member states, but to realize the proposed EC legislation.

Therefor, the concretion of the cloudy term "institutional investor" has yet to be accomplished. The rule's objectives, above all the prevention of institutions deviating from their fiduciary duties towards their clients while facing conflicts of interest, may provide valuable guidance in this regard.

²⁷⁹ See §§ 2 to 4 of Clause 1243 (former §§ 6 and 7 of Clause 866). As a compromise between disclosure benefits and costs disclosure is only required up to second-tier vehicles, but not by vehicles of a higher level, see DTI, *supra* note 14, at p. 3, §§ 11, 12.