Shareholder Rights Directive II: Overview

Overview

The Shareholder Rights Directive II (EU 2017/828) (SRD II) amends the Shareholder Rights Directive to strengthen shareholder engagement and increase transparency.

SRD II came into force on 09 June 2017 and most provisions had to be implemented into national law by 10 June 2019. The remainder have to be implemented by 3 September 2020.

Key changes

The key changes include:

Identification of shareholders: new requirements allow companies to request information from intermediaries so that they can identify their shareholders but Member States can exclude very small shareholders (those holding less than 0.5%).

Transparency of institutional investors and asset managers: institutional investors and asset managers must develop a policy on shareholder engagement, make the policy available on their website and annually disclose how they have implemented the policy and disclose how they have cast votes at general meetings.

Institutional investors must disclose certain aspects of their equity investment strategy and the main elements of any arrangement with an asset manager which invests on its behalf.

The asset manager has to disclose to any institutional investor (with which it has any arrangement to invest on its behalf) how the asset manager's investment strategy and its implementation complies with that arrangement and contributes to the medium to long-term performance of the assets of the institutional investor or of the fund, unless that information is already publicly available.

Proxy advisers: proxy advisors must disclose any code of conduct they comply with and explain any derogations from that code or explain why they do not comply with any code. They also have to publish annually on their website certain information relating to the preparation of their research, advice and voting recommendations and must identify and disclose to their clients any actual or potential conflicts of interest that may influence the preparation of those recommendations and the actions they have taken to eliminate, mitigate or manage those conflicts.

Intermediaries' obligations: intermediaries must offer companies the right to have their shareholders identified; transmit information without delay between companies and shareholders; facilitate the exercise of shareholder rights and publicly disclose any charges for providing these services.

Directors' remuneration: listed companies must publish a remuneration policy and to give shareholders a vote on the remuneration policy. But, Member States can decide whether this should be a binding vote or an advisory one only. Directors' remuneration will have to be in accordance with an approved policy (or one that has been put to a vote). There continues to be a non- binding vote on the remuneration report.

Related party transactions: material related party transactions must be publicly announced when concluded. What is material will be decided by the Member States in accordance with certain specified criteria. Member States can require that the announcement is accompanied by a 'fair and reasonable' report.

Background

The Shareholder Rights Directive (2007/36/EC) was adopted on 11 July 2007. Its aim was to improve corporate governance in EU companies traded on regulated markets by enabling shareholders to exercise their voting rights and rights to information across borders. It was a minimum harmonisation directive: Member States were permitted to take further measures to facilitate the exercise by shareholders of the rights contained in the Directive. The Directive was implemented in the UK by the Companies (Shareholder Rights) Regulations 2009. See "UK implementation of EU Shareholder Rights Directive – effective from 03 August 2009".

See "SRD2 - are you ready?" for the new obligations on asset managers and life insurers and "SRD II: UK implementation: new related party transaction regime.

Directors' remuneration

The shortcomings identified by the EU Commission were that the information about directors' remuneration disclosed by companies was not comprehensive, clearly comparable and that shareholders often did not have sufficient means of expressing their opinion on directors' remuneration. As a result, there is, it is thought, currently an insufficient link between the pay and performance of directors of listed companies.

Directors

The definition of "director" has been expanded to include the chief executive officer and deputy chief executive officers, where they are not members of the administrative, management or supervisory bodies of the company.

Remuneration policy

Need to have one: Companies will have to establish a remuneration policy for directors which is clear and understandable and contributes to the company's business strategy, long term interests and sustainability and must explain how it does that. The policy will have to incorporate measures to avoid conflicts of interest.

Approval: Shareholders will have a vote on the directors' remuneration policy, which will have to be approved every four years but Member States can choose whether the vote is binding or advisory only. Any material changes to the policy will have to be voted on.

Payment in accordance with policy: If the vote is binding, directors' remuneration can only be paid if it is in accordance with an approved policy. Where a remuneration policy has not yet been approved and shareholders reject the proposed policy submitted for approval, the company can continue to pay remuneration to its directors in accordance with its existing practices but must put a revised policy for approval at the next general meeting.

Where there is an existing approved remuneration policy and shareholders do not approve a proposed new policy, the company must pay remuneration to its directors in accordance with the existing approved policy and must put a revised policy for approval at the next general meeting.

If the vote is advisory only, companies can only pay directors' remuneration in accordance with a remuneration policy that has been submitted for approval at a general meeting. If it has been rejected, the company has to submit one for approval at the next general meeting.

Derogations from policy: Member States can allow companies to derogate temporarily from the remuneration policy in certain exceptional circumstances.

Content of policy: The remuneration policy will have to:

- describe the different components of fixed and variable remuneration (including all bonuses and all benefits)
- indicate the relative proportion of the different components of fixed and variable remuneration, and
- explain how pay and employment conditions of the company's employees were taken into account when establishing the remuneration policy.

The remuneration policy will have to show the following for variable remuneration:

- clear, comprehensive and varied criteria for its award
- financial and non-financial performance criteria including, where appropriate, criteria relating to corporate social responsibility
- explain how they contribute to the company's business strategy, long term interests and sustainability, and
- the company's ability to reclaim variable remuneration.

For share–based remuneration it must show vesting periods and, where applicable, the retention of shares after vesting, and explain how the share-based remuneration contributes to the company's business strategy, long term interests and sustainability.

The remuneration policy must indicate the duration of the directors' service contracts (or arrangements) and the applicable notice periods, termination terms, payments linked to termination of contract and the main characteristics of supplementary pension or early retirement schemes.

The policy will also have to explain the decision-making process followed for its determination, review and implementation, including measures to avoid or manage conflicts of interests and the role of the remuneration committee. Any revised policy will have to include an explanation of all significant changes and how it takes into account shareholders' votes and views on the policy and reports since the most recent vote on the remuneration policy.

Public disclosure: After any vote on a remuneration policy, the policy and the results of the vote have to be made public without delay on the company's website and the policy has to remain available, free of charge, on the company's website for so long as it is the company's policy.

Remuneration report

Need to have one: Companies will have to prepare an annual remuneration report which is clear and understandable and provides a comprehensive overview of all remuneration (including all benefits) awarded or due, in accordance with the remuneration policy, to the individual directors in the previous financial year.

Content: The report will have to include, where applicable:

- the total remuneration split out by component, the relative proportion of fixed and variable remuneration, an explanation of how the total remuneration complies with the adopted remuneration policy, including how it contributes to the long-term performance of the company and information on how the performance criteria were applied

- the annual change of remuneration, the general performance of the company and of the average remuneration of employees of the company other than directors over at least the five most recent financial years, presented in a way which allows a comparison
- any remuneration from any undertaking in the same group
- the number of shares and share options granted or offered, and the main conditions for the exercise of the rights, including the exercise price and date and any change to them
- information on whether the ability to reclaim variable remuneration was used; and
- information on any deviations from the procedure for implementing the remuneration policy and any derogations.

SDR II includes certain safeguards to protect directors' personal data.

Approval: Shareholders have the right to an advisory vote on the remuneration report at the annual general meeting. The company will have to explain, in its next remuneration report, how the shareholders' vote has been taken into account.

Member States can, however, allow small and medium-sized companies to only put the remuneration report up for discussion at the annual general meeting.

Public disclosure: Companies have to make the remuneration report publicly available on their website, free of charge, for at least ten years.

Related party transactions

The shortcomings identified were that shareholders did not have access to sufficient information ahead of a planned transaction and did not have adequate tools to oppose abusive transactions.

Shareholder approval: there is a new requirement for companies to seek prior approval for material transactions with related parties either from the shareholders or the administrative or supervisory body of the company.

Member States have to ensure that related parties are not involved in preparing the report (see below) and cannot vote on the transaction or take part in any approval of the transaction. Member States can, however, allow a shareholder who is a related party to take part in a vote provided that the national law provides safeguards to protect the interests of shareholders who are not related parties.

Announcement: where a company enters into a material related party transaction, the company must publicly announce the transaction at the latest when it is concluded. Certain information has to be included in the announcement.

Fair and reasonable report: Member States can require that the announcement is accompanied by a report assessing whether or not the transaction is fair and reasonable from the company's and shareholders' (other than a related party) perspective and explaining the assumptions it is based on.

The report has to be provided by an independent third party; the company's administrative or supervising body or the audit committee or a committee of independent directors.

Aggregation: transactions with the same related party that have been concluded in any 12 month period or in the same financial year and have not been approved must be aggregated.

'Material transactions with related parties': will be defined by each Member State taking into account:

- the influence that the information about the transaction may have on the economic decisions of shareholders of the company, and
- the risk that the transaction creates for the company and its shareholders who are not related parties, including minority shareholders.

Member States must set one or more quantitative ratios based on the impact of the transaction on the financial position, revenues, assets, capitalisation or turnover of the company or take into account the nature of the transaction and the position of the related party.

Excluded transactions: the rules do not apply to transactions in the ordinary course of business and concluded on normal market terms unless the Member States decide they should.

Exceptions: Member States may exclude or allow companies to exclude certain transactions including transactions entered into between a company and its subsidiaries provided that they are wholly owned or no other related party of the company has an interest in them.

Identification of shareholders

The shortcomings identified are that it is difficult and costly for shareholders to exercise their rights.

There is a new requirement for Member States to ensure that companies have the right to identify their shareholders but Member States can exclude very small shareholders (those holding less than 0.5%).

If requested by the company (or a third party nominated by a company), an intermediary will have to provide the company, without delay, with information regarding shareholder identity. This is defined as any information to establish a shareholder's identity (including certain specified minimum information, such as the name and contact details of the shareholder and, where the shareholder is a legal person, its unique identifier if available).

Where there is more than one intermediary in a chain, the request must be transmitted between the intermediaries without delay and the intermediary who holds the requested information must give it directly to the company (or the third party) without delay.

Member States can allow a company to ask the central security depository (CSD) or another intermediary or service provider to collect the information regarding shareholder identity and to provide it to the company.

As shareholders' personal data will be processed to enable the company to identify its shareholders, Member States must ensure that shareholders can rectify any incomplete or inaccurate information about their shareholder identity. Intermediaries and companies may not keep the information for more than 12 months after they have become aware that the person concerned has ceased to be a shareholder.

‘Intermediaries’ obligations

Transmission of information

Intermediaries have to transmit the following information, without delay, from the company to any shareholder (or a third person nominated by the shareholder) if the company does not send it direct to the shareholder (or third party):

- information which the company has to provide to the shareholder to enable the shareholder to exercise rights attaching to its shares; or
- if that information is available on the company’s website, a notice indicating where that information can be found on the website.

The company has to provide the intermediary with the relevant information or notice to enable the intermediary to do this.

The intermediary must, without delay, transmit to the company information it receives from shareholders relating to the exercise of the rights attaching to their shares.

Where there is more than one intermediary in a chain, the information must be transmitted between the intermediaries without delay unless the information can be transmitted directly by an intermediary to the company.

Facilitating the exercise of shareholder rights

Intermediaries must facilitate the exercise of shareholders’ rights, including the right to participate and vote in general meetings.

After a general meeting, the shareholder (or nominated third party) must be able to obtain confirmation that their votes have been validly recorded and counted by the company. When votes are cast electronically, an electronic confirmation of receipt of votes must be sent to the person that casts the vote.

Where the intermediary receives the confirmation, it will have to send it to the shareholder (or third party) without delay. Where there is more than one intermediary in the chain, the confirmation must be transmitted between them without delay unless it can be transmitted direct to the shareholder (or third party).

Transparency on costs

Any charges levied by intermediaries for the services described above must be non-discriminatory and proportionate to the actual costs incurred and any differences in charges between the domestic and cross-border exercise of rights are only allowed if they can be justified and must reflect the variation in actual costs incurred for delivering the services.

Member States can provide that intermediaries are not allowed to charge for these services.

Intermediaries will have to disclose publicly any charges levied for each service provided.

Third country intermediaries

Third country intermediaries with no registered or head office in the EU which provide these services also have to comply with these rules.

Transparency of institutional investors and asset managers

Engagement policy

Institutional investors and asset managers have to:

- develop a policy on shareholder engagement ("engagement policy") which includes certain specified information including how they manage actual and potential conflicts of interests with regard to their engagement
- make that policy available free of charge, on the institutional investor's or asset manager's website:
- disclose annually how this policy has been implemented, and
- disclose how they cast their votes at the general meetings of the companies in which they hold shares,

or give a clear and reasoned explanation why they have decided not to comply with any of these requirements.

Where an asset manager implements the engagement policy on behalf of an institutional investor, the institutional investor will have to refer to where that voting information has been published by the asset manager.

Investment strategy of institutional investors and arrangements with asset managers

Institutional investors have to disclose publicly how the main elements of their equity investment strategy ("investment strategy") are consistent with the profile and duration of their liabilities (in particular long-term liabilities) and how they contribute to the medium to long-term performance of their assets.

Where an asset manager invests on behalf of an institutional investor, the institutional investor must disclose publicly the main elements of the arrangement with the asset manager (asset manager arrangement) in relation to certain specified matters. Where the asset manager arrangement does not contain any of the specified matters, the institutional investor will have to give a clear and reasoned explanation why not.

All of this information must be available on the institutional investor's website (free of charge) and must be updated annually until there is no material change.

Transparency of asset managers

Asset managers must disclose annually to the institutional investors with which they have an asset management arrangement how their investment strategy and its implementation complies with that arrangement and contributes to the medium to long-term performance of the assets of the institutional investor or of the fund unless that information is already publicly available.

Where the asset manager does not manage the assets on a discretionary client-by-client basis, it has to provide that information to other investors of the same fund on request.

Transparency of proxy advisors

Proxy advisors have to publish on their website, free of charge, and update annually:

- details of any code of conduct which they apply and how it has been applied or provide a clear and reasoned explanation why they do not apply a code, and
- if they apply a code, explain the reasons for departing from any of its recommendations and indicate any alternative measures adopted.

Proxy advisors also have to publish annually on their website certain information relating to the preparation of their research, advice and voting recommendations. This information will have to remain available for at least three years from the date of publication.

Proxy advisors will have to identify and disclose without delay to their clients any actual or potential conflicts of interest or business relationships that may influence the preparation of their research, advice or voting recommendations and the actions they have taken to eliminate, mitigate or manage those conflicts.

These rules apply to proxy advisers that do not have their registered or head office in the EU which carry out their activities through an establishment located in the EU.

For more information, please contact:

Charles Mayo

Senior Adviser

T +44 20 7825 4410

E charles.mayo@simmons-simmons.com

Or your usual contact at Simmons & Simmons.