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The Second Shareholders' Rights Directive: An Overview

by

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The second Shareholders' Rights Directive (EU) 2017/828 (SRD II) was due to be implemented into Irish law by 10 June 2019, but that has not yet happened. Implementing legislation in the form of a Statutory Instrument is expected.

SRD II in brief

- It implements transparency provisions which are applicable specifically to AIFMs, UCITS ManCos and SMICs.
- It introduces a new requirement to have a shareholder engagement policy -- or explain why one is not in place.
- It introduces a new requirement to disclose certain information annually to institutional investors with which a certain arrangement is in place.
- The Shareholders' Rights Directive (SRD I) applied to listed companies having their registered office in a member state, including listed corporate UCITS and AIFs. Ireland exercised the member state discretion afforded in SRD I to exempt UCITS and AIFs. There are some similar discretions afforded to member states under SRD II, but we won't know which of those that Ireland will take advantage of until the Irish implementing legislation for SRD II is available.
- It introduces enhanced transparency requirements in relation to shareholder engagement and investment strategy that apply to asset managers and institutional investors from June 2019.

Shareholders' Rights Directive (SRD I)

SRD I, which came into force in 2009, aimed to enhance the rights of shareholders by imposing certain minimum standards on the exercise of voting rights attaching to shares in companies that have a registered office in the EU and are listed on an EU regulated market (EU investee companies). SRD II amends SRD I. It is likely that SRD II will allow some exemptions for listed UCITS and AIFs.

Who falls to be regulated under SRD II?

Asset managers;

- MiFID firms
- AIFMs (it is unclear whether internally managed AIFs will be included)
- UCITS management companies
- UCITS self-managed funds

Institutional investors;

- EU life assurance companies
- Pension funds

New duty for asset managers to implement engagement policy or explain non-compliance

Asset managers and institutional investors are required to adopt on a “comply or explain basis” an “engagement policy”. The policy should describe how they integrate shareholder engagement into their investment strategy when they or the fund they manage are shareholders in EU investee companies (including listed UCITS and AIFs).

The policy should address how the asset manager:

- Monitors EU investee companies in respect of the EU investee company’s business strategy, financial and non-financial performance and risk, capital structure, and social and environmental impact and corporate governance.
- Interacts and cooperates with shareholders and other stakeholders in EU investee companies.
- Manages conflicts of interests with EU investee companies.

This policy must be made available free of charge on the asset manager’s website. The asset manager must also disclose on an annual basis how it has:

- implemented the policy, including a general description of voting behaviour
- voted in significant votes
- used the services of proxy advisors
- how it has cast votes in the general meetings of EU investee companies – this disclosure may exclude votes that are insignificant due to the subject matter of the vote or the size of the holdings in the EU investee company

Asset managers don’t have to put this policy in place, as it is a “comply or explain” obligation.

However, if it is decided not to have a policy, then there should be an explanation on its website setting out why the decision not to have such a policy is appropriate. Relevant factors might include:

- the nature, size and complexity of the asset manager and/or its funds under management
- the investment strategies of the funds (i.e. no investment in EU investee companies)
- the existence of another pre-existing group-level engagement policy

To be clear: an explanation for non-compliance with this requirement will have to be made available on the asset manager’s website.

Arrangements with “institutional investors”

Where asset managers invest on behalf of institutional investors, whether through separately-managed accounts or through funds, there will be obligations imposed on institutional investors that will oblige the institutional investor to disclose on its website certain aspects of its arrangements with asset managers including:

- how the asset manager is incentivised to align its investment strategy with the profile and duration of the institutional investor’s liabilities;
- how the asset manager is incentivised to make investment decisions based on the medium to long-term financial and non-financial performance of the EU investee company;
- how the institutional investor monitors portfolio turnover costs; and
- the duration of the arrangement with the asset manager.

If the arrangement with the asset manager does not contain one or more of the features listed above, the institutional investor must explain why not.

As a result of the requirements imposed on institutional investors, asset managers will be required to disclose to them how the asset manager:

- implements its investment strategy in a way that complies with the arrangements referred to above; and
- contributes to the medium to long term performance of the assets of the institutional investor or of the relevant fund.

This disclosure must focus on:

- medium to long-term investment risk
- portfolio composition
- turnover and turnover costs
- the use of proxy advisers
- policies on securities lending and conflicts of interest.

If the above information is already publicly available, there won't be a requirement to provide the information to the institutional investor directly.

Due to equal treatment concerns the Irish legislation may require that this information be made available to all investors and not just institutional investors.

About the Author