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SHAREHOLDERS' RIGHTS DIRECTIVE II BECOMES IRISH LAW

On 20 March 2020, the provisions of the Shareholders' Rights Directive II **(SRD II)** became law in Ireland with the publication of the European Union (Shareholders' Rights) Regulations 2020 **(SRD II Regulations)**. The SRD II Regulations will apply with effect from 30 March 2020.

What is SRD II?

SRD II amends the first Shareholder Rights Directive **(SRD I)** which was published in 2007. The objective of SRD I was to enhance corporate governance in EU companies listed on a regulated market by facilitating, particularly on a cross-border basis, the exercise of voting rights of company shareholders. SRD II builds on the SRD I premise that "effective shareholder control is a pre-requisite to sound corporate governance" through the removal of barriers to shareholder engagement and further aligning the interests of shareholders and the investee company.

To whom do the SRD II Regulations apply?

The SRD II Regulations (which transpose SRD II into Irish law) include obligations for:

- **public limited companies** whose shares are traded on an EU regulated market (Traded PLCs). UCITS and AIF PLCs listed on a regulated market are specifically excluded from the term "Traded PLCs" (this reflects the exercise by Ireland of a discretion available to Member States under SRD II);
- **asset managers** being MiFID investment firms, AIFMs, UCITS management companies (including self-managed UCITS) that invest in

SRD II: THE HEADLINES

- SRD II transposed into Irish law and is effective from 30 March 2020.
- SRD I & II are aimed at enhancing the governance of companies listed on a regulated market.
- SRD II was published in 2017 and significantly reforms the first Directive of 2007 (SRD I).
- SRD II aims to tackle issues arising from a lack of engagement by shareholders of listed companies which persisted following the introduction of SRD I.
- UCITS management companies and AIFMs are exempted under Irish law from the listed company provisions of SRD I & II but are subject to SRD II shareholder transparency provisions where they invest in listed companies.
- Transparency provisions oblige (on a "comply or explain" basis) in-scope entities to put in place a shareholder engagement policy and they may be obliged to comply with additional transparency requirements.
- Compliance impact of new requirements may be reduced due to overlaps with existing UCITS and AIFM regimes and the application of proportionality.

shares traded on an EU regulated market on behalf of investors;

- **service providers** to Traded PLCs that provide safekeeping and/or administration of shares or maintenance of securities accounts including investment firms, credit institutions and central securities depositaries;
- **institutional investors** being life assurance companies and occupational pension schemes that invest in shares traded on an EU regulated market; and
- **proxy advisors**.

In this briefing, we focus on the obligations for asset managers, in particular AIFMs and UCITS management companies **(Fund Managers)**. While MiFID investment firms are also in-scope asset managers, they are not dealt with in this briefing as such firms may have additional obligations, as well as differing approaches to compliance, due to their structure, operation and governing regime.

Fund Managers' Obligations under SRD II Regulations

With effect from 30 March 2020, Fund Managers are subject to the relevant transparency provisions contained in Chapter 8b of the SRD II Regulations.

These are:

1. a requirement to adopt and publicly disclose, or explain any failure to adopt and publicly disclose, an engagement policy that describes how the Fund Manager engages with the listed companies in which it invests on behalf of investors; and
2. to make prescribed disclosures to life assurance companies and occupational pension schemes (Institutional Investors) where a Fund Manager enters into an arrangement to invest the assets of the Institutional Investor or the assets of a fund managed by the Institutional Investor.

1. Engagement policy – 'comply or explain' requirement

Fund Managers are required to either:

A.

i) develop and publicly disclose on their websites free of charge, an engagement policy describing how they incorporate engagement with investee companies into their investment strategies. The engagement policy should also describe how:

- investee companies are monitored on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance;
- dialogues are conducted with investee companies;
- voting rights and other rights attached to shares are exercised;
- they co-operate with other shareholders;
- they communicate with relevant stakeholders of the investee companies; and
- they manage actual and potential conflicts of interests in relation to their engagement, and

ii) publicly disclose on their websites, on an annual basis, how their engagement policy has been implemented, including:

- a general description of voting behaviour;
- an explanation of the most significant votes taken;
- information on any use of the services of proxy[1] advisors ; and
- information on how they have cast votes in general meetings of companies in which they hold shares (unless such disclosure may be excluded on the basis that "the votes are insignificant due to the subject matter of the vote or the size of the holding in the company"), or

B. publicly disclose on their websites a clear and reasoned explanation for their failure to do A(i) and/or (ii) above.

Compliance considerations for Fund Managers

> *'comply or explain'*

SRD II obliges a Fund Manager to disclose why it has chosen not to comply with the above requirements; however, in transposing this requirement into Irish law, the SRD II Regulations refer to a Fund Manager's obligation to disclose why it has failed to comply. Whilst the difference highlighted could arguably call into question a Fund Manager's ability to choose not to comply on an initial or ongoing basis, the better view is that as the legislator nonetheless has effectively drafted the provision as a " comply or explain" measure, compliance remains optional.

> *non-disclosure of insignificant votes*

The SRD II Regulations do not include guidance on what constitutes an insignificant vote which is not required to be disclosed per the requirement in paragraph (b) (last bullet) above. The recitals to SRD II provide that insignificant votes may include votes cast on purely procedural matters or votes cast in respect of companies in which the Fund Manager makes a minor investment when compared to the Fund Manager's investment in other companies. Fund Managers are permitted to set their own criteria regarding which votes are insignificant on the basis of the subject matter of the vote or the size of the holding in the company once they apply them consistently.

> *overlapping requirements*

Fund Managers should be aware of the significant levels of overlap between the requirements under the SRD II Regulations and those applied under the governing regimes of UCITS management companies and AIFMs. Both are required, under their respective regimes, to develop 'adequate and effective strategies for determining when and how voting rights [will be] exercised' and to make available to investors, free of charge, 'a summary description of the [voting right] strategies [and] details of the action taken on the basis of those strategies'. Such voting rights strategies must include measures and procedures for 'monitoring relevant corporate actions; ensuring the exercise of voting rights is in accordance with the investment objectives and policy of the relevant [fund]; and preventing or managing any conflicts of interest arising from the exercise of voting rights'.

[1]'Proxy advisor' means a legal person that analyses, on a professional and commercial basis, the corporate disclosure and, where relevant, other information of listed companies with a view to informing investors' voting decisions, by providing research, advice or voting recommendations that relate to the exercise of voting rights.

2. Transparency requirements

Where a Fund Manager has entered into an arrangement with an Institutional Investor to invest the assets of the Institutional Investor or the assets of a fund managed by the Institutional Investor, SRD II requires the Fund Manager to make certain annual disclosures to such Institutional Investors (either directly or publicly).

Fund Managers authorised to carry out collective portfolio management only are unlikely to be impacted by the transparency requirements as the provision of services under any such arrangement would likely (depending on the structure of the arrangement) require the Fund Manager to have in place a top-up licence for the provision of individual portfolio management services as provided for under the UCITS Directive or AIFMD.

Fund Managers subject to this requirement are required to disclose to Institutional Investors:

- how the investment strategy, and its implementation, complies with arrangements with the Institutional Investor and contributes to the medium to long-term performance of the assets of the Institutional Investor or a fund managed by the Institutional Investor;
- the key material medium to long-term risks associated with investments made;
- portfolio composition, turnover and turnover costs;
- the use of proxy advisors for the purpose of engagement activities;
- securities lending policy and its impact on engagement with investee companies, particularly at the time of the general meeting of the investee companies;
- whether, and, if so, how investment decisions are made on the basis of evaluation of the medium to long-term performance of the investee company, including non-financial performance; and
- whether and, if so, which conflicts of interest have arisen, the nature of those conflicts and the manner of dealing with them.

Next Steps

The publication of the SRD II Regulations on 23 March 2020 with an effective date of 30 March 2020 means that Fund Managers have only days in which to publish their engagement policy, or explain why they have not done so and, if applicable, address the above transparency requirements.

Although this is an extremely tight timeframe, it is likely that Fund Managers began their SRD II compliance planning well in advance of this week's publication of the SRD II Regulations transposing SRD II (the EU Directive) into Irish law. As highlighted in previous briefings by us, SRD II (the EU Directive) was first published in 2017 but Ireland, along with several other Member States, failed to meet the deadline of 10 June 2019 for publication of the necessary legislation to bring SRD II into national law. As such, the SRD II Regulations have been anticipated for some time. In addition, the requirements of the SRD II Regulations outlined above materially reflect the SRD II provisions which they transpose. As such, Fund Managers may, notwithstanding the limited timeframe afforded by the effective date, be well placed to ensure compliance ahead of the 30 March deadline.

Fund Managers should now:

- consider the impact on any existing SRD II compliance planning as a result of the publication of the transposing SRD II Regulations;
- where the engagement policy of the Fund Manager proposes reliance on the policies of a delegate, ensure compliance with the Central Bank's Guidance Note on Fund Management Companies, relating to reliance substance of its delegates' policies and procedures on delegate policies;
- if applicable, adopt and publish the engagement policy and address any additional disclosures under the transparency requirements.

A Fund Manager that fails to comply with the website publication requirements under 1. and/or 2. above, is guilty of a category 3 offence and liable, on summary conviction, to a class A fine or imprisonment for a term not exceeding 6 months or both.

How William Fry can help

If you have any queries in relation to these matters or require assistance in determining the appropriateness of having an engagement policy, developing an engagement policy if appropriate, and any related disclosures, please contact any of our Asset Management and Investment Funds partners below or your usual contact at William Fry.

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