

Group Briefing

May 2019

The Rules of Engagement - *The Revised Shareholder Rights Directive and its Impact on Asset Managers and Institutional Investors*

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This document contains a general summary of developments and is not a complete or definitive statement of the law. Specific legal advice should be obtained where appropriate.

Enhanced transparency requirements in relation to shareholder engagement and investment strategy to apply to asset managers and institutional investors from June 2019.

1. WHAT IS THE SHAREHOLDER RIGHTS DIRECTIVE ("SRD I")?

SRD I was implemented in 2009 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 EU regulated markets ("EU investee companies"). This has been amended by the Revised Shareholder Rights Directive ("SRD II"), which will apply from 10 June 2019.

SRD II will apply to asset managers and institutional investors, imposing certain disclosure requirements on their engagement as investors in EU investee companies.

2. WHICH ASSET MANAGERS / INSTITUTIONAL INVESTORS WILL BE CAPTURED BY SRD II?

"Asset managers" include MiFID firms, AIFMs¹, UCITS management companies and UCITS self-managed funds.

¹ SRD II applies to "AIFMs", which are defined as "legal persons whose regular business is managing one or more AIFs". While this definition does not exclude non-EU AIFMs, we think the proper interpretation of the Directive is that it is only intended to apply to EU authorised AIFMs. It is hoped that this will be clarified in the national implementing legislation.

"Institutional investors" include EU life assurance companies and pension funds.

3. WHAT NEW DUTIES ARE IMPOSED ON ASSET MANAGERS UNDER SRD II?

3.1 Obligation to put an engagement policy in place or explain non-compliance

Asset managers (and, for the avoidance of doubt, institutional investors) are required to adopt on a "comply or explain basis" an "engagement policy". The policy should describe how an asset manager integrates shareholder engagement into its investment strategy when it or its funds under management are shareholders in EU investee companies (including listed UCITS and AIFs). The policy should address how the asset manager:

- a. 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;
- b. interacts and cooperates with shareholders and other stakeholders in EU investee companies; and

- c. manages conflicts of interests with EU investee companies.

The engagement policy must be made available free of charge on the asset manager's website and an asset manager must disclose on an annual basis:

- a. how it has implemented the policy, including a general description of voting behaviour, an explanation of the most significant votes and the use of services of proxy advisors; and
- b. how it has cast votes in the general meetings of EU investee companies. Such a 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.

An asset manager may choose not to put this policy in place, as it is a "comply or explain" obligation. An asset manager would need to explain on its website why the decision not to have such a policy is appropriate, by reference to factors such as the nature, size and complexity of the asset manager and/or its funds under management and the investment strategies of those funds. For example, the relevant funds may not have a strategy of investing in EU investee companies. In other cases, the asset manager may already be subject to an existing group-level engagement policy. In any case, a clear and reasoned explanation for non-compliance with this requirement will have to be made available on the asset manager's website.

We have assisted asset managers in drafting an engagement policy that takes account of the existing regulatory regime they are subject to (e.g., the UCITS Directive or AIFMD) and leverages off existing policies adopted by the asset manager to comply with those regimes.

4. WHAT REQUIREMENTS APPLY WHERE ASSET MANAGERS INVEST ON BEHALF OF "INSTITUTIONAL INVESTORS"?

Where asset managers invest on behalf of institutional investors, whether through separately-managed accounts or through funds, certain additional

requirements apply:

4.1 the institutional investor will be obliged to disclose on its website certain aspects of its arrangements with asset managers including:

- a. how the asset manager is incentivised to align its investment strategy with the profile and duration of the institutional investor's liabilities;
- b. 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;
- c. how the institutional investor monitors portfolio turnover costs; and
- d. the duration of the arrangement with the asset manager.

Where the arrangement with the asset manager does not contain one or more of such elements, the institutional investor shall give a clear and reasoned explanation why this is the case.

4.2 the asset manager will be required to disclose to the institutional investor:

- a. how the asset manager's implementation of its investment strategy complies with the arrangements referred to above at section 4.1; and
- b. how the asset manager contributes to the medium to long term performance of the assets of the institutional investor or of the relevant fund.

This disclosure to the institutional investor shall include details on, among other things, medium to long-term investment risk, portfolio composition, turnover and turnover costs, the use of proxy advisors, its policy on securities lending and conflicts of interest. Where the information is already publicly available, the asset manager is not required to provide the information to the institutional investor directly.

5. WHAT IS NEXT?

SRD II must be transposed into Irish law by 10 June 2019.

While the Irish regulations to implement SRD II have not yet been published, SRD II has provided for each EU member state to have discretion to legislate for certain matters. For example, each member state has the discretion to allow for the information in section 4.2 above to be provided together with the relevant fund's annual report or in periodic communications. Each member state also has the discretion to decide that, where the assets of an institutional investor are not managed on an individual basis, but are instead pooled with assets of other investors and managed via a fund, information should also be provided to other investors, at least upon request, in order to allow all the other investors in the same fund to receive that information if they so wish.

SRD II imposes a number of other obligations relating to EU investee companies, such as reporting and approval of directors' remuneration. While listed UCITS and AIFs are clearly within scope of the engagement policy requirements outlined above, they can be exempted from the other obligations for listed companies at the member state's discretion. As this exemption was applied in Ireland under SRD I, we expect this position to continue under SRD II.

We will update you as and when the implementing regulations are published. In the meantime, asset managers should consider whether they wish to put an engagement policy in place to reflect the above requirements, or, if not, prepare to publish an explanation for not doing so. We are happy to provide support to you on this.

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