The EU’s revised Shareholder Rights Directive (SRD2) comes into effect from 10 June 2019 and imposes new obligations on, among others, MiFID firms, AIFMs, UCITS ManCos and self-managed UCITS. This note looks at the key issues of SRD2, including its scope, requirements and implementation.

Introduction

Perhaps unsurprisingly, the revised Shareholder Rights Directive (SRD2) has not been at the top of people’s agendas in recent months, including those of the regulators (more details on this below).

However, the first implementation deadline of 10 June 2019 will soon be upon us and we have noticed a recent uptick in incoming queries on SRD2. The FCA’s Policy Statement PS19/13, Proposals to promote shareholder engagement: Feedback to CP19/7 and final rules, was published on Friday 31 May and, as its title suggests, contains the final UK rules for implementing SRD2.

What is SRD2 and who does it affect?

SRD2 aims to tackle a perceived lack of shareholder engagement in the market by requiring asset managers and institutional investors to put in place a shareholder engagement policy and to increase the transparency of their investment strategies.

Proxy advisors, ‘intermediaries’ (firms that provide the services of safekeeping of shares, administration of shares or maintenance of securities accounts on behalf of shareholders or other persons) and issuers themselves are also affected by SRD2.

This note focuses on the provisions relating to asset managers and institutional investors but please contact us to learn more about the other categories of firm affected.
Types of asset manager (SRD asset managers) that are caught are:

- MiFID firms providing portfolio management
- AIFMs (excluding small AIFMs)
- UCITS ManCos
- UCITS funds without an external management company

SRD asset managers are caught by the Directive if they invest in shares traded on an EEA regulated market on behalf of their investors. The FCA is goldplating this so that the SRD2 rules apply to shares in companies admitted to trading on an EEA regulated market or on a comparable market outside the EEA. This expands the territorial scope of the rules beyond EEA listings, to cover all listed shares.

### Institutional investors

Types of institutional investor (SRD institutional investors) caught are:

- FCA-regulated life insurers subject to Solvency II (life insurers), and
- Occupational pension schemes (IORPs).

SRD institutional investors are caught by the Directive if they invest directly or through an SRD asset manager in shares traded on a regulated market. Again, the FCAs goldplating applies and this applies to all listed shares, not just EEA listings.

### What does SRD2 require?

Life insurers and SRD asset managers are required to either:

- draft an engagement policy that describes how they integrate shareholder engagement into their investment strategy, or
- provide an explanation as to why they do not need an engagement policy.

This must be done on a public website and the life insurer/SRD asset manager must disclose on an annual basis how it is implementing the engagement policy.

The FCA sets out that the engagement policy must cover how the firm:

1. integrates shareholder engagement in its investment strategy
2. monitors investee companies on relevant matters
3. conducts dialogues with investee companies
4. exercises voting rights and other rights attached to shares
5. cooperates with other shareholders
6. communicates with relevant stakeholders of the investee companies, and
7. manages actual and potential conflicts of interests in relation to the firm’s engagement.

The annual disclosure that SRD asset managers and life insurers are required to make as to how they are implementing their engagement policies must include a public disclosure of voting behaviour. This should be an explanation of the most significant votes and a report on the use of the services of proxy advisors.
In particular:

- the firm must disclose how it has cast votes in the general meetings of companies in which it holds shares
- the firm does not need to disclose ‘insignificant’ votes. Firms will have to decide what constitutes an insignificant vote and apply their chosen approach consistently
- Recital 18 of the Directive gives an example: “Such insignificant votes may include votes cast on purely procedural matters or votes cast in companies where the investor has a very minor stake compared to the investor’s holdings in other investee companies.”
- where an SRD asset manager implements the engagement policy, including voting, on behalf of a life insurer, the life insurer must make a reference as to where such voting information has been published by the SRD asset manager.

A life insurer must also make certain public disclosures about how its investment strategy is consistent with the profile and duration of its liabilities and how it contributes to the medium to long term performance of its assets. Where an SRD asset manager invests on behalf of the life insurer, the life insurer must publicly disclose certain information about the arrangements between them or publicly explain why it is not appropriate to do so. This disclosure must be updated annually.

An SRD asset manager must also disclose (on an annual basis) to its relevant SRD institutional investors, how its investment strategy complies with the arrangements between them, and how it contributes to the medium to long-term performance of the fund. This can be done publicly but it can be done directly instead. The FCA envisages that requests for this information will come to SRD asset managers from SRD institutional investors and this is the most practical and efficient way for the information to flow.

**When does SRD2 come into force?**

SRD2 set an implementation deadline for Member States of 10 June 2019 with regards to the asset manager, institutional investor, proxy advisor and issuer requirements.

The FCA rules are due to come into force on 10 June 2019. The FCA PS states that, for an initial period after the rules come into effect, the FCA considers it would be possible for a firm to comply with the requirement to have an engagement policy (or to explain why it does not need one) by publishing a statement explaining that it is in the process of developing an engagement policy, or that it is considering whether to have one. This explanation would need to be added to a relevant webpage by 10 June 2019.

Please contact us for the standard wording which we are suggesting asset managers use in this respect.

**What about other Member States?**

As SRD2 is a Directive, Member States need to implement SRD2 into their national law and have some discretion on how to do so. However, as we note above, there seems to have been a lack of regulator engagement on this Directive. In Ireland and Belgium, for example, no draft implementing regulations have yet been published.

**I have a MiFID hub in another Member State with a branch in the UK - which Member State rules do I look at?**

You should apply your home state rules (ie if your hub is in Ireland, the Irish rules) to both your hub and your UK branch.
If you have a branch of a non-EEA investment firm in the UK, the UK rules will apply to that branch.

We have an AIFM/MiFID investment firm/UCITS ManCo that delegates all of its management responsibilities to a non-EEA delegate - who is required to comply with the obligations?

On a literal, technical interpretation, we can see arguments for the delegate being the firm who is actually undertaking the investing activity, if it has taken on all of the portfolio management responsibilities and it selects the investments.

However, the AIFM/MiFID firm is the entity that will be caught by the SRD asset manager definition in new Glossary/COBS rules and is the entity that is, in fact, contractually providing portfolio management services to its clients (albeit performance is delegated to another party).

The FCA could take the view that it is, therefore, the AIFM/MiFID firm to which the obligations attach and that the AIFM/MiFID firm should agree the engagement policy with its delegate and source the relevant information from the delegate (under the terms of its sub-advisory agreement) to provide to its clients.

One could see how, with the introduction of SRD2, there may be a heightened level of client engagement on this issue, both from institutional investors that are covered by SRD2 and have a right to receive their disclosure under the new COBs rules, and also from investors that are not specifically covered by SRD2 but are nonetheless interested in understanding the value of their asset manager’s shareholder engagement.

In scenarios where the delegation is within the UK the analysis would be different (for example where an AIFM delegates to a UK MiFID firm) as both entities would be caught by the SRD asset manager definition. Practically, those entities would need to decide between themselves who would be making the required disclosures - or, indeed, whether both of them will - in which case they would want to be sure that they were being consistent.

How can I find out more?

If you are a member of the Alternative Investment Management Association (AIMA), Simmons & Simmons will be co-hosting an AIMA panel event on SRD2 at our offices on the morning of Friday 21 June 2019. An invitation from AIMA has been circulated.