GSK Update

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Shareholders' Rights Directive II: What is new for Luxembourg issuers?

Executive Summary

> Luxembourg transposed Directive (EU) 2017/828 of 17 May 2017 ("SRD II") into national law on 1 August 2019, effective 24 August 2019.

> The key objective of SRD II is the encouragement of effective, sustainable and long-term shareholder engagement in listed companies and to tackle shortcomings of the first shareholders' rights directive.

> The new rules impact listed companies, intermediaries, institutional investors, asset managers and proxy advisors.

> Listed companies face new obligations in relation to shareholder identification, proxy voting, directors' remuneration and related party transactions.

1. Introduction

SRD II amended Directive (EU) 2007/36/EC of 11 July 2007 on the exercise of certain rights of shareholders in listed companies ("**SRD I**"). The reason for the revision of SRD I was the EU Commission's perception that shortcomings in the corporate governance of listed companies contributed to the 2008 financial crisis. In the Commission's view important deficiencies in the engagement and control by shareholders impeded good decision-making by companies and excessive, unjustified directors' remuneration led to mistrust among the society at large. Also procedures for exercise of shareholders' rights in listed companies were judged as complicated and costly. The main goal of SRD II is thus to reshape the corporate governance of listed companies in the EU towards sustainability, to encourage long-term shareholder engagement and to improve the issuer-shareholder dialogue.

The Luxembourg law of 1 August 2019 implemented SRD II and amended the existing law of 24 May 2011 on the exercise of certain rights of shareholders in general meetings of listed companies, as amended (the "**Law**"). The SRD II allows EU Member States a significant amount of leeway in terms of transposition and interpretation. Luxembourg completely abstained from any gold-plating and did not go beyond the guidelines of the SRD II. However, the SRD II rules themselves are supported by a level two implementing regulation laying down minimum requirements[1].

This GSK update focuses on the new rules applicable to listed companies in Luxembourg. The new transparency provisions applicable to institutional investors, asset managers and proxy advisors will be covered by a future GSK Update.

2. Scope

The SRD II applies to listed companies[2] intermediaries[3], institutional investors[4], asset managers[5] and

[1] Commission Implementing Regulation (EU) 2018/1212 of 3 September 2018 laying down minimum requirements implementing the provisions of SRD II, applicable as of 3 September 2020.

[2] Listed company: a company which has its registered office in an EU Member State and whose shares are admitted to trading on a regulated market within the meaning of art. 1(31) of the law of 30 May 2018 on markets in financial instruments established or operating in an EU Member State. Hence, companies incorporated outside the EU with shares listed on an EU regulated market as well as companies incorporated in an EU Member State with shares listed on a market which is not an EU regulated market are not subject to the SRD II rules.

[3] Intermediary: a person providing services of safekeeping or administration of shares or maintenance of securities accounts on behalf of shareholders or other persons, as set out in the definitions under art. 1(6) of the Law.

[4] Institutional investor: an undertaking carrying out activities of life insurance and an institution for occupational retirement provision.

[5] Asset manager: an investment firm providing portfolio management services to investors, an alternative invest-

proxy advisors[6]. UCITS and AIFs are out of the scope of the Law.

3. Overview Impact on Listed Companies

Listed companies are mainly affected by four new rules regarding:

- The listed companies' right to identify their shareholders;
- The listed companies' right to request intermediaries to transmit information to their shareholders;
- The general meeting's say on pay; and
- The obligation to get approval on related party transactions.

4. Shareholder Identification

a) Background

Due to complex cross-border chains of intermediaries holding the shares on behalf of shareholders, listed companies are often unable to identify their shareholders and to communicate with them. The SRD II therefore introduced the right for listed companies to identify their shareholders and to require the intermediaries, such as custodians, to cooperate in that identification process. While this new identification right for listed companies seems on the face of it as a one-sided advantage, one should not forget that the SRD II's ultimate goal is to first and foremost facilitate the effective exercise of shareholders' rights and shareholders' engagement vis-à-vis listed companies. It is therefore rather a mixed blessing paving the way for enhanced direct information exchange requirements between listed companies and their shareholders that may increase investor relations' costs.

b) 0.5% threshold not applicable in Luxembourg

The SRD II allowed EU Member States to exclude from the identification requirement those shareholders holding only a small number of shares, i.e. less than 0.5% of shares or voting rights. However, Luxembourg did not use this option and the identification requirement applies to all shareholders independently of the number of shares or voting rights held. Listed companies have thus an unrestricted right against intermediaries.

c) Which information?

Intermediaries, such as custodians, are now required to communicate without delay to the listed company, or to a nominated third party, information on the shareholders' identity, upon request. This includes:

- In the case of a natural person, at least the name and contact details of the shareholder;
- In the case of a legal person, its registration number or, if no registration number is available, a unique identifier, such as the Legal Entity Identifier (LEI code); and
- The number of shares held by the shareholder and, if requested by the listed company, the categories or classes of shares held as well as the date of their acquisition.

d) Who else must respond to the listed company?

Luxembourg listed companies may request not only the direct intermediary, but also central securities depositories, other intermediaries in the chain of intermediaries and further service providers to collect the shareholders' information[7]. Intermediaries must for this purpose communicate to the Luxembourg listed company the details of the next intermediary in the chain of intermediaries, if requested. The Law implemented thus all optional request rights under the SRD II identification of shareholders' rules, which is positive for listed companies.

e) Processing personal data

In times of GDPR, the delivery of shareholder data immediately raises the concern about data storage and processing. The Law allows the listed companies to process and store personal data relating to shareholders until the date on which they have become aware of the fact that a person has ceased to be a shareholder and for a maximum period of twelve months after that date[8]. Intermediaries who disclose information in line with the Law cannot be

ment fund manager, or a management company, or an investment company which is authorised in accordance with the amended law of 17 December 2010 on collective investment undertakings, provided that it has not entrusted its management to a management company authorised under that law.

[6] Proxy advisor: a legal person that analyses, on a professional and commercial basis, the communication of firms and, where relevant, other information of listed companies with a view to informing investors for their voting decisions by carrying out research, providing advice or making voting recommendations that relate to the exercise of voting rights.

[7] Art. 1bis (2) of the Law.

[8] Art. 1bis (3) of the Law.

in breach of any legal or contractual provisions. In Luxembourg, all natural and legal persons have the right of rectification of incomplete or inaccurate information regarding their shareholder identity[9]. However, this right may be available only to legal, and not natural, persons in some EU Member States depending on the SRD II's implementation in that state. Luxembourg did not implement the SRD II's option to allow listed companies to process shareholders' personal data for other purposes than facilitating shareholder rights and shareholder engagement with the listed company.

f) Implementing Regulation

The Commission has already adopted the Commission Implementing Regulation (EU) 2018/1212 of 3 September 2018 (the "**CIR**"), which lays down minimum requirements regarding shareholder identification, the transmission of information and the facilitation of the exercise of shareholders rights. It will become effective as of 3 September 2020 and will then be directly binding in all Member States.

5. Transmission of Information to Shareholders

The SRD II strengthens the communication between a listed company and its shareholders through the chain of custodians.

a) Scope

The Law's provisions on the transmission of information from the listed companies to its shareholders are mainly addressed to the intermediaries. Intermediaries are obliged to transmit without delay to the shareholders the information that the listed company provides to the shareholders to enable the shareholders to exercise their rights attached to their shares. This information includes for example, the right to participate and vote in general meetings, to receive dividends or participate in other corporate events.

b) Language

According to the CIR, the information shall be provided by the listed company in the language in which it publishes its financial information and if that is not English, also in English.

c) Use of standardised forms by listed companies

In order to facilitate the procedure for the intermediaries, listed companies have to provide the information to intermediaries in a standardised manner. The CIR contains for this purpose standardised forms, such as meeting convening notices, confirmation of entitlement, notice of participation, voting receipt, confirmation of the recording and counting of votes and notification of corporate events that shall be used by the listed companies.

d) Exemptions

In case the information is already on the website of the listed company, the intermediary does not need to transmit the information, but only a notice indicating where on the website of the company the information can be found. Moreover, if the listed company sends the information or notice itself directly to the shareholders, the intermediary is completely exonerated to transmit.

e) Transmission of shareholder instructions

Intermediaries are not only obliged to transmit information from the listed company to the shareholders, but also instructions from the shareholders to the listed company. This relates for example to exercise of the rights stemming from the shares or the right to participate and vote in general meetings. Intermediaries must assist shareholders in either enabling them to exercise their voting rights themselves or exercising the voting rights on their behalf.

g) Voting at general meetings

An important new rule for listed companies is that shareholders or their proxies can now request a confirmation from the listed company that their votes were validly recorded and counted at a general meeting of shareholders. The latest deadline until when shareholders may request that confirmation was set to three months by the SRD II, but Luxembourg reduced this deadline to two months[10]. When votes are cast at a general meeting of a listed company electronically, which is notably until today not a legal requirement in Luxembourg, then shareholders shall receive an electronic confirmation of receipt of the votes. When intermediaries receive a voting confirmation from the listed com-

[9] Art. 1bis (5) of the Law.

[10] Art. 1quater (2) of the Law.

pany, they must transmit it to the shareholder or its proxy without delay.

f) General rules

All provisions applying to single intermediaries do also apply to third country intermediaries and in case of chain of intermediaries all information handled within the chain of intermediaries must still be transmitted without delay, except the information can be transmitted directly to the shareholder or its proxy.
The Law furthermore requires the intermediaries to publish separately the costs they charge for these services[11]. Levied charges must be non-discriminatory and proportionate in relation to actual costs[12]. Luxembourg did not implement the option under the SRD II to prohibit intermediaries to charge fees at all.

6. Directors' Remuneration

Shareholders of listed companies will now have a "say on pay" and will be able to express their view twice in relation to the directors' remuneration.

First, they can vote *ex ante* on the remuneration policy which lays down the framework within which remuneration can be awarded to directors. The vote on the remuneration policy will in principle be binding, which means that listed companies are only able to pay remuneration on the basis of the policy as approved by the shareholders. However, EU Member States had the possibility under the SRD II to implement an advisory vote instead, which Luxembourg took advantage of. This means that listed companies in Luxembourg are allowed to apply a remuneration policy even if rejected by shareholders, but are required to submit a revised policy at the next general meeting[13]. Remuneration policies must be submitted to the general meeting of shareholders at least every four years or whenever there is a material modification[14]. The Law also governs the remuneration policy's object and content[15].

Second, shareholders will also have the right to vote *ex post* on the remuneration report, which will have to describe in a clear and understandable way the remuneration granted in the past financial year to individual directors. The vote on the remuneration report is advisory, not binding. In Luxembourg, small and medium-sized listed companies have the possibility to replace this vote by a discussion at the general meeting[16]. Listed companies shall publish the remuneration report on their website for 10 years[17].

7. Related Party Transactions

Listed companies were already obliged to disclose related party transactions ("**RPT**") when publishing securities' prospectuses and their annual reports. Listed companies in Luxembourg must now also take into account the rules on RPT under the Law.

a) Definition

Each EU Member State was allowed to define in its own discretion what an RPT constitutes, but was obliged to take into account the high-level limits set by the SRD II. The Law defines an RPT as: "Any material transaction between the (listed) company and a related party, the publication or disclosure of which (i) would be likely to have a significant impact on the economic decisions of the shareholders of the (listed) company and (ii) which could create a risk for the (listed) company and its shareholders, who are not related parties, including minority shareholders. The nature of the transaction and the position of the related party must be taken into account[18]." Several RPT with the same related party over a 12-month period or in the same financial year shall be aggregated.

b) Approval

In Luxembourg, an RPT must be approved by the board of directors only. An RPT may therefore get approved in Luxembourg much quicker than in other EU Member States where, depending on the implementation of the SRD II, an RPT must be submitted to the prior approval of the general meeting of shareholders or additionally submitted to the general meeting after having received approval by an administrative or supervisory board.
Where the RPT involves a director or shareholder, the director or shareholder must of course not take part in the approval by the board of directors or the

[11] Art. 1quinquies (1) of the Law.
[12] Art. 1quinquies (2) of the Law.
[13] Art. 7bis (2) of the Law.
[14] Art. 7bis (5) of the Law.
[15] Art. 7bis (6) of the Law.
[16] Art. 7ter (4) of the Law.
[17] Art. 7ter (5) of the Law.
[18] Art. 7quater (1) and (2) of the Law.

vote of the general meeting of shareholders, if any[19].

c) Publication, but no report

An RPT must be publicly announced, i.e. on its website, by the listed company at the latest at the time of its conclusion[20]. An obligation to publish even earlier may still arise, if an RPT qualifies as inside information in accordance with the rules of Regulation (EU) No 596/2014 on market abuse[21]. Keeping the administrative burden for Luxembourg companies low, the Law does not require that the public announcement is accompanied by a report from an independent third party, the board of directors or the audit committee assessing whether or not the transaction is fair and reasonable, as it may be the case in other EU Member States.
Listed companies must also disclose on their website an RPT between a related party of the listed company and its subsidiaries.

d) Exemptions

Certain types of RTP are exempted from the board approval and the publication requirement[22]. Exemptions are in place, among others, if an RTP:

- is entered into between the listed company and its wholly owned subsidiaries provided that no other related party has an interest in the subsidiary;
- relates to directors' remuneration;
- is entered into during the ordinary course of business and concluded on normal market terms; or
- is offered to all shareholders on the same terms, where equal treatment and protection of the interests of the listed company is ensured.

To-dos for listed companies:

- In case shareholder identification is interesting for a listed company, it shall familiarize itself with the CIR rules;
- Listed companies must take into account that shareholders may request voting confirmations after general meetings;
- Listed companies must review their remuneration policy in the light of the rules of the Law and prepare for the voting on its remuneration report at the next annual general meeting, if that was not already part of it in the past; and
- Listed companies must implement the RPT rules in their board approval and publication processes.

8. Conclusion

The SRD II aims at enhancing the direct and reciprocal communication between listed companies and their shareholders in order to promote shareholder engagement and supervision. However, it remains to be seen whether the combination of new transparency obligations for institutional investors, asset managers and proxy advisers with additional disclosure requirements for listed companies will actually increase shareholder engagement. Listed companies nowadays face in particular the challenge to identify and manage the expectations of passive investors and investors represented by proxy advisers. Those investors' engagement with the management of the listed company or the lack of such may remain largely unchanged despite the new rules.

In summary, listed companies benefit from an increased toolbox in terms of shareholder identification and communication, but face in return the burden of additional disclosure obligations, especially regarding directors' remuneration.

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[19] Art. 7quater (4) of the Law.
[20] Art. 7quater (3) of the Law.
[21] Art. 17 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse, OJ L173/1, 12.6.2014.
[22] Art. 7quater (5) and (6) of the Law.

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