Advancing to a state of readiness

All parties in the shareholder communication chain need to prepare for the enhanced requirements of the new Shareholder Rights Directive—and try to influence its local implementation to encourage a harmonised approach. Broadridge's Demi Derem and Elizabeth Maiellano highlight the key changes and challenges.

The new Shareholder Rights Directive (SRD), adopted by the European Council and approved by the European Parliament this spring, is a laudable initiative intended to encourage shareholder engagement in listed companies in Europe and improve the transparency of related processes—including proxy voting. The European Commission (EC) wants to see proof that companies understand their investors and communicate with them in a clear and transparent manner.

The new SRD updates its 2007 predecessor and introduces some new requirements related to remunerating directors, identifying shareholders, facilitating the exercise of shareholder rights, transmitting information and providing transparency for institutional investors, asset managers and proxy advisors. The majority of the SRD is required to be translated into national law by European member states by June 2019 (although some elements will not come into force until September 2020).

Given the complexities introduced by the new SRD, firms across the shareholder communication chain need to begin preparing now if they are to meet its requirements by 2019. These are expected to entail significant and potentially costly changes relating to process reforms and transparency requirements, impacting issuers, asset managers, custodians, central securities depositories (CSDs), and a range of other intermediaries and service providers.

The two-year member-state transposition process will involve adaptation of the SRD's requirements to reflect domestic market structures and local legal processes. We encourage all affected firms to engage with the EC and national regulators, and share their views on how the SRD should be implemented. This is vital for achieving outcomes that are equitable and commensurate with the corporate governance benefits of the SRD. If national regulators opt for significantly different interpretations of the SRD, this would be challenging for industry participants. For example, one global custodian has expressed concern about the risk of national divergence requiring compliance efforts to be tailored to each regulator's interpretation, thereby increasing the complexity and cost of SRD implementation for firms operating in more than one market.

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Another securities services firm believes that discrepancies in implementation dates in different jurisdictions will be problematic for global firms.

Institutional investor impact

Institutional investors and asset managers are likely to be affected by the SRD in a number of ways. For example, both will have to be more transparent about their engagement with investee companies and how they integrate shareholder engagement into their investment strategy. Under the SRD this information must be reported annually and made available on buy-side firms' websites. These firms must also disclose annually their voting behaviour and explain significant votes and their use of proxy advisor services. The SRD introduces these requirements on a comply-or-explain basis.

The SRD also grants shareholders the right to vote on companies' remuneration policies, which may increase the policy analysis and assessment required by the buy-side. Similarly, the SRD requires that any material transaction (as defined by national regulators) between a listed company and a related third party must be announced and approved by the shareholders and the board. Depending on national requirements, the announcement may also need to be accompanied by a report about the impact of the transaction from an independent third party, the board or a committee of independent directors.

These new requirements will result in the production of more data and more reporting before a vote, potentially creating a significant burden on asset managers and investors as they try to manage this information flow. This burden is likely to be particularly noticeable with related party transactions.

Intermediary implications

Intermediary firms will need to keep a close watch on national requirements for the adoption of specific identification standards and data items for shareholder transparency requirements. For instance, markets could set different minimum levels of holdings that must be disclosed.

In addition, the SRD refers to providing data in a standardised format but does not specify the standards, so these may be provided by the EC. However, if the disclosure of certain data items would breach some countries' data privacy laws, national regulators would have to alter the local requirements.

Another change introduced by the SRD is that intermediaries will have to store shareholder

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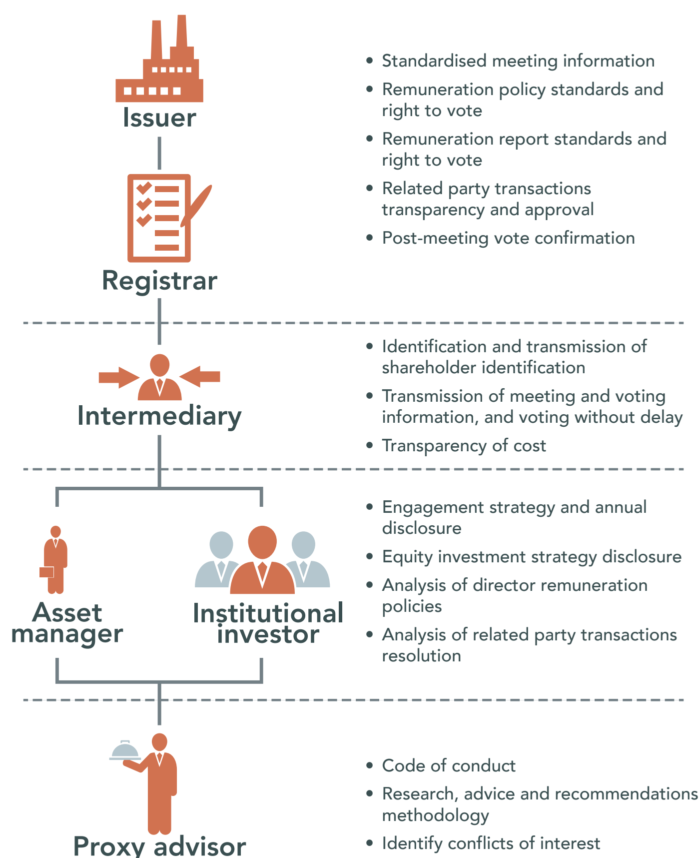

information for at least 12 months after they become aware that someone has ceased to be a shareholder. Data storage and retention requirements are therefore likely to increase.

A particular concern for intermediaries is that the SRD requires them to transmit general meeting agenda and voting information "without delay". National regulators could interpret this as a requirement for real-time or near-real-time reporting. If this means that vote information has to be transmitted immediately, intermediaries will need to introduce intraday processing support. Meanwhile, the need to use a standardised format could result in amendments to current SWIFT message formats, with associated costs. It is also likely that the volume of voting instructions and amendments will increase after implementation of the SRD.

One custodian has expressed concern about the lack of regulatory clarity on whether post-meeting announcements will also have to be transmitted immediately. The EC and national regulators will need to confirm the level of information that must be passed on to shareholders. Some intermediaries may face operational headaches if their current processes can support the transmission of voting information but not of other data items in the same standardised and immediate manner.

Intermediaries could face the brunt of the costs of SRD implementation, particularly because European member states can prohibit intermediaries from charging fees for the cost of changes related to disclosure. If regulators decide to mandate this, intermediaries will have to absorb all compliance costs rather than passing a percentage on to clients.

If regulators are more lenient, intermediaries may be able to pass on certain costs, but the SRD specifies that these must be proven to be proportionate to the cost of offering the service. Intermediaries could therefore have to pay for the full cost of transparency requirements in some jurisdictions, while providing an audit trail of operational costs (and facing questions about any inefficiencies) in others.

The bundling of proxy costs into custody fees may also need re-evaluating, because intermediaries will need to disclose their fees in relation to proxy services. The SRD stresses the need for "non-discriminatory and proportionate" fees and jurisdictions will also have the power to prohibit fees for proxy services. If some do prohibit fees, firms' business models will need to be revised.

Widespread impact

Issuers and registrars will also be affected by the SRD in relation to the standardisation of meeting announcements and the provision of vote confirmation. And proxy service providers will be impacted, although global firms that already comply with some jurisdictions' voluntary requirements in transparency and reporting will feel less short-term impact. They could face both opportunities and challenges—with the potential to deliver new services to help intermediaries to support requirements such as vote confirmation, but needing to invest to do so.

The SRD's transposition period presents market participants with an opportunity to review the impact on their operations, engage with regulators and assess their readiness. It is something that the industry should embrace and collaborate on to get right. ●

Find out more about preparing for the SRD at https://www.broadridge.com/_assets/pdf/broadridge-shareholder-rights-directive-wp.pdf

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Partnership
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