

Shareholders' Rights Directive II:

Luxembourg implementation

Contents

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Introduction

Requiring much greater transparency on shareholder engagement activities, asset management mandates, investment strategies and remuneration policies, asset managers, institutional investors, listed companies, intermediaries and proxy advisors are subject to additional regulatory requirements by the Second Shareholders' Rights Directive[1] ("**SRD II**").

On 20 August 2019, the law of 1 August 2019 amending the amended law of 24 May 2011 regarding the exercise of certain rights of shareholders in general meetings of listed companies and implementing SRD II was published in the Grand Duchy of Luxembourg (the "**Law**").

The Law entered into force on 24 August 2019.

Directors (i.e. all members of the administrative, management or supervisory body of a company as well as the *directeur général* and the *directeur général adjoint*) will be collectively responsible for all damages resulting from a breach of their obligations under the Law.

This note summarises who will be affected and the key impacts of these changes on asset managers, institutional investors, listed companies, intermediaries and proxy advisors.

[1] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement

New requirements for asset managers and institutional investors

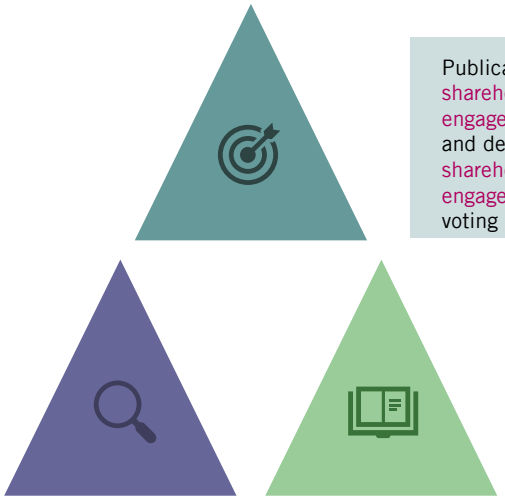
What does SRD II require asset managers and institutional investors to do?

SRD II aims to encourage long-term shareholder engagement in listed companies and to improve transparency on shareholder engagement. SRD II has specifically imposed additional obligations on asset managers (i.e. MiFID portfolio managers, AIFMs and UCITS management companies) and institutional investors (i.e. certain life insurance firms and pension funds) who invest in shares traded on regulated markets. Luxembourg has generally taken a "minimum harmonisation" approach to implementing SRD II, providing only for a few specificities.

Please read through the key SRD II requirements below for more details of the changes, analysis of where compliance may be difficult, and what firms should be doing to comply:

1. Publication of a shareholder engagement policy and details of shareholder engagement and voting behaviour;
2. Disclosures by institutional investors of (i) how their equity investment strategies are consistent with their liabilities and (ii) details of their asset management arrangements;
3. Disclosures by asset managers to institutional investors of how their investment strategy complies with the mandate agreed and contributes to medium to long-term performance.

Key SRD II requirements



Publication of a shareholder engagement policy and details of shareholder engagement and voting behaviour.

Disclosures by asset managers to institutional investors of how their investment strategy complies with the mandate agreed and contributes to medium- to long-term performance.

Disclosures by institutional investors of (i) how their equity investment strategies are consistent with their liabilities and (ii) details of their asset management arrangements.

Publication of a shareholder engagement policy and details of shareholder engagement and voting behaviour

SRD II requirements

Disclosure of engagement policy: SRD II requires all institutional investors and asset managers to develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement into their investment strategy. This should cover topics such as how the firm monitors and conducts dialogues with investee companies, exercises voting rights, cooperates with other shareholders and manages conflicts of interest.

Annual disclosure of implementation: Institutional investors and asset managers will also have to annually disclose how they have implemented their policy, including how they have cast votes in general meetings of investee companies. Firms may give explanations of the most "significant" votes and may exclude "insignificant" votes from this disclosure.

Comply or explain: SRD II allows firms to choose not to comply with one or more of the above requirements, but then the firm must publicly disclose a clear and reasoned explanation for that decision.

Place of disclosure: The information to be disclosed must be available free of charge on the institutional investors' or asset manager's website.

Difficulties for compliance

There is currently no indication to determine whether the details of shareholder engagement and voting behaviour may be disclosed on a group-wide (rather than firm specific) basis. There may also be difficulties for firms using delegation arrangements to non-EEA affiliates (who are not subject to SRD II) or firms outside their group. Firms may have to think carefully about which activities are in scope of their SRD II disclosures in relation to these arrangements.

Institutional investors and asset managers will need to consider how they can track their shareholder engagement for the purposes of their annual disclosure. Similarly, institutional investors are required to reference information published by asset managers who implement the institutional investors engagement policy, which may require coordination.

There is limited guidance on what constitutes an "insignificant" vote that can be excluded from the disclosures, or what constitutes a "significant" vote requiring greater explanation.

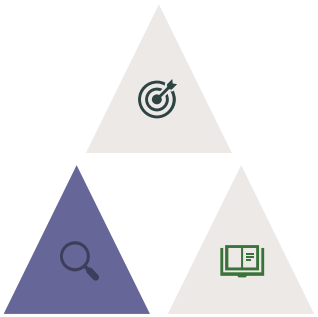
Compliance may also be particularly difficult for asset managers who only invest infrequently in listed shares, as establishing the necessary tracking mechanisms may be onerous.

Next steps for asset managers and institutional investors

Institutional investors and asset managers should review existing engagement policies to identify whether they comply with the new detailed SRD II rules and to consider the level at which to disclose their policy (e.g. at an entity or group level, setting out individual approaches for each product or taking a general approach etc.).

Institutional investors and asset managers should consider how they can track their voting behaviour for the purposes of their annual SRD II disclosure. In particular firms should consider how intra-group arrangements or interactions with other firms may impact their ability to make the required SRD II disclosures.

Disclosures by institutional investors of (i) how their equity investment strategies are consistent with their liabilities and (ii) details of their asset management arrangements



SRD II requirements

SRD II requires institutional investors to publicly disclose how their equity investment strategy is consistent with the profile and duration of their liabilities, with a particular focus on long-term liabilities.

Institutional investors will also be required to disclose detailed information where an asset manager invests on their behalf (either on a discretionary client-by-client basis or through a fund) or give a clear and reasoned explanation as to why they have omitted any elements.

Required details include:

- incentivisation of the asset manager to align with liabilities;
- incentivisation of the asset manager to make long term decisions and engage with investee companies;
- how performance evaluation and remuneration of the asset manager is in line with the liabilities of the institutional investor (particularly long-term liabilities);
- monitoring or portfolio turnover costs; and
- the duration of the arrangement.

Difficulties for compliance

The practical implementation of these disclosures may be difficult where an institutional investor uses a number of asset managers or invests in/via multiple funds.

Also, where an institutional investor invests via a fund that is not a bespoke arrangement for that investor some of the disclosures may be less meaningful, and in any event the institutional investor may not be in possession of all the relevant information necessary to make the required disclosures. They may also not be able to impose their own standards on the asset manager if they are just one of many clients.

SRD II is not intended for commercially sensitive information to be disclosed under this requirement, however, firms must still consider how the requirements can be satisfied without compromising key sensitive information.

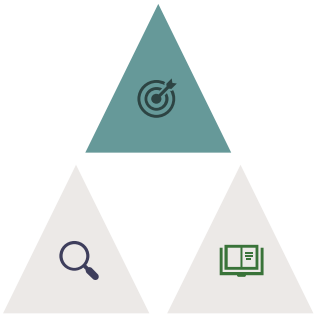
Next steps for institutional investors

Institutional investors should consider the level of detail they intend to provide in their disclosures on their investment strategy and arrangements with asset managers – particularly considering how commercially sensitive topics could be dealt with, bearing in mind any confidentiality agreements they may have entered into with asset managers and whether they require engagement with asset managers they use.

Institutional investors should also consider the SRD II requirements when entering into new arrangements with asset managers, both from the perspective of ensuring the arrangements are favourable from the perspective of the disclosures (e.g. the asset manager is incentivised to make long-term decisions and engage with investee companies) and ensuring that they can source the information required for the disclosures.

Institutional investors will particularly need to bear in mind the SRD II requirements when dealing with non-EEA asset managers who will not be subject to SRD II themselves, as those asset managers will not necessarily be providing their own disclosures which could assist the institutional investor.

Disclosures by asset managers to institutional investors of how their investment strategy complies with the mandate agreed and contributes to medium to long-term performance



SRD II requirements

Asset managers will be required to annually disclose to institutional investors how their investment strategy contributes to the medium to long-term performance of the assets of the institutional investor or fund. The disclosure should include details such as portfolio composition, turnover, use of proxy advisors and the manager's policy on securities lending.

Difficulties for compliance

There are a number of practical questions to consider with this disclosure. The disclosure only has to be given to institutional investors (which has a restricted definition for the purposes of SRD II), so there is a question as to whether asset managers will seek to identify the relevant institutional investors within their client base and only make such disclosures to them, or whether they will make the disclosure more broadly (e.g. by including SRD II information in funds' annual reports). This may be the case for fund managers (e.g. managers of listed investment trusts) who are unable to readily identify whether their underlying investors are in-scope for SRD II purposes. Disclosure of the relevant information to all investors could help make the process of disclosure less burdensome and would also deal with any concerns that providing information only to certain investors could result in unequal treatment.

Similarly, where multiple asset managers are involved in an arrangement with an institutional investor (e.g. the institutional investor invests in an AIF, which is managed by an AIFM who delegates to a MiFID portfolio manager), there may be issues in determining and allocating responsibility for the disclosure.

Next steps for asset managers

Asset managers should consider how they intend to comply with their transparency obligations with institutional investors, including identifying the institutional investors that are in scope.

New requirements for listed companies, intermediaries and proxy advisors

Identification of shareholders by listed companies and transmission of information by intermediaries

Identification of shareholders by listed companies

Right for listed companies to identify their shareholders: In order to identify their shareholders, Luxembourg companies whose shares are admitted to trading on an EEA regulated market ("**listed companies**") may require, directly or through a third party, intermediaries to provide information regarding the identity of their shareholders. Intermediaries must communicate without delay to the company the information regarding shareholder identity.

Data protection: Listed companies accessing personal information are prevented from keeping the information on a shareholder for more than 12 months after they have become aware that the person has ceased to be a shareholder.

Request to central securities depository ("CSD"), intermediary or service provider: Listed companies may also request the CSD, an intermediary or a service provider to gather the information on the identity of its shareholders.

Chain of intermediaries: In case of multiple intermediaries between the listed company and its shareholder, the shareholder's identification request sent by the listed company or a third party nominated by the company must be transmitted without delay between intermediaries and information on the shareholder's identity must be transmitted directly to the company or a third party nominated by the company.

Definition of intermediary

An intermediary within the meaning of the Law is a person such as an investment firm, a credit institution or a CSD which provides services of safekeeping of shares, administration of shares or maintenance of securities accounts on behalf of shareholders or other persons.

Transmission of information by intermediaries

Information provided by listed companies: Intermediaries must provide without delay to the shareholder or a third party nominated by the shareholder (i) the information which the company is required to provide to the shareholder, to enable the shareholder to exercise rights flowing from its shares, and which is directed to all shareholders in shares of that class or (ii) a notice indicating where the information can be found on the company's website, (save when the information or notice is sent directly by the company to all their shareholders or a third party nominated by the shareholder).

Information provided by shareholders: Intermediaries must transmit, without delay, to the company the information related to the exercise of the rights flowing from their shares received from the shareholders, in accordance with their instructions.

Chain of intermediaries: The information provided by the listed company or by the shareholder, as the case may be, must be transmitted without delay between intermediaries unless the information can be transmitted directly by the intermediary to the company, the shareholder or a third party nominated by the shareholder.

Next steps for listed companies

Listed companies will now need to provide information to their shareholders ahead of general meetings in a standardised format in accordance with the provisions of the Commission Implementing Regulation (EU) 2018/1212.

Facilitation of exercise of shareholders' rights by intermediaries

Facilitation of exercise of shareholders' rights

Information given by shareholders: Information received from the shareholders related to the exercise of the rights flowing from their shares must be provided by intermediaries without delay. In case of a chain of intermediaries, such information must be transmitted without delay between intermediaries unless it can be transmitted directly by the intermediary to the company or the shareholder or the third party nominated by the shareholder.

Measures to be taken by intermediaries: Intermediaries (i) must take the necessary arrangements for the shareholder to be able to exercise themselves the rights and (ii) exercise the rights flowing from the shares upon explicit authorisation and instruction of the shareholder and for the shareholder's benefit.

Confirmation of vote: When votes are cast electronically, an electronic confirmation of receipt of the votes must be sent to the person that casts the vote. A shareholder or a third part nominated by the shareholder is entitled to obtain, upon request and within up to two months from the date of the vote, a confirmation of receipt of the vote (unless the information is otherwise available). Intermediaries receiving such confirmation must transmit it without delay to the shareholder of the third party nominated by the shareholder. In case of a chain of intermediaries, such confirmation must be transmitted without delay between intermediaries unless it can be transmitted directly by the intermediary to the company or the shareholder or the third party nominated by the shareholder.

Costs charged by intermediaries

Disclosure: Intermediaries must disclose publicly any applicable charge for the services they provide in relation to the exercise of shareholders' rights.

No discrimination and proportionality: Any charges levied by an intermediary on shareholders, companies and other intermediaries shall be non-discriminatory and proportionate in relation to the actual costs incurred for delivering the services.

Differences between the charges levied between domestic and cross-border exercise of rights are permitted only when justified and where they reflect the variation in actual costs incurred for delivering the services.

Disclosure obligations for listed companies regarding related party transactions

Authorisation of material related party transactions

Prior approval: Material transactions between a listed company and a related party are subject to the prior approval of the board of directors. Luxembourg did not however opt in favour of the possibility contained in SRD II to create a right for shareholders in the general meeting to vote on material related party transactions.

Definition of material transactions: Material transactions are defined as all transactions (i) taking place between the listed company and a related party which, if published or disclosed, are likely to have a significant impact on the economic decisions of the shareholders of the company and (ii) which could create a risk for the company and its shareholders who are not a related party, including minority shareholders.

Related party: Definition of "related party" is aligned with the definition contained in the international accounting standards adopted pursuant to Regulation (EC) No 1606/2002.

Case by case analysis: Material related party transactions must be analysed on a case by case basis taking into account the nature of the transaction and the position of the related party.

Vote: Directors or shareholders involved in the related party transaction will not be entitled to participate in the approval or the vote.

Public disclosure of material related party transactions

Material transactions must be publicly disclosed by listed companies.

Timing for disclosure: Public disclosure must occur at the latest at the time of the conclusion of the transaction.

Content of disclosure: The disclosure must contain information on (i) the nature of the related party relationship, (ii) the name of the related party, (iii) the date, (iv) the value of the transaction, and (v) other information necessary to assess whether or not the transaction is fair or reasonable from the perspective of the listed company and of the shareholders who are not a related party, including minority shareholders. Luxembourg did not however opt in favour of imposing a fairness report accompanying the public announcement.

Subsidiaries: Material transactions with related parties of the listed company and the subsidiary must also be publicly disclosed, subject however to any applicable exemption (see next page for details on the specific exemptions available).

Exemption for transactions entered into in the ordinary course of business

Transactions entered into in the ordinary course of business and concluded on normal market terms shall be out of the scope of the authorisation and disclosure requirements applicable to material related party transactions.

Next steps for listed companies:

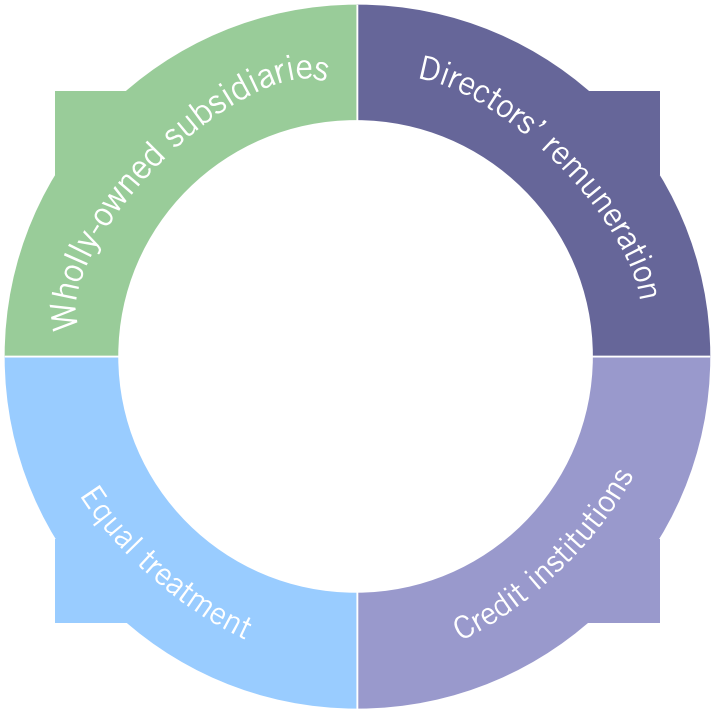
Listed companies must establish an internal procedure to periodically assess whether the conditions on the normal course of business are fulfilled.

Exemptions on disclosure obligations for listed companies regarding related party transactions

Specific exemptions available

Luxembourg decided to opt in favour of four of the proposed exemptions for related party transactions contained in SRD II. The below categories of transactions are exempt from prior authorisation and disclosure requirements:

Transactions between the company and (i) wholly-owned subsidiaries or (ii) subsidiaries in which the related party has no interest



Transactions regarding directors' remuneration or elements of such remuneration

Transactions offered to all shareholders on the same terms where equal treatment and protection of the interests of company is ensured.

Transactions entered into by credit institutions on the basis of measures, aiming at safeguarding their stability, adopted by the Luxembourg financial sector supervision authority (*Commission de Surveillance du Secteur Financier*) or "CSSF".

Introduction of a "say on pay" for listed companies – Remuneration policy and remuneration report

Establishment of a remuneration policy

Procedure: Listed companies must establish a remuneration policy as regards directors (as defined in the introduction section).
Aim of the policy: The remuneration policy shall contribute to the company's business strategy and long-term interests and sustainability and explain how it does so.
Content: It must clearly describe the different components of fixed and variable remunerations.

Shareholders' vote on remuneration policy

Shareholders' approval: The remuneration policy will be submitted to the vote of the annual general meeting. The company shall pay remuneration to its directors only in accordance with a remuneration policy that has been submitted to the general meeting.
Nature of vote: The vote of the shareholders on the remuneration policy is advisory only, except if the articles of association indicate that the vote will be binding. If the vote is advisory, the remuneration will be possible as soon as the shareholders have voted on it. However, if the shareholders reject the policy, the issuer must submit a revised policy at the next general meeting. In case of a binding vote, the new remuneration will only be possible when the shareholders have approved the remuneration policy.
Material change: A vote by the general meeting must occur at every material change and in any case at least every four years.
Exceptional circumstances: The company may temporarily derogate from the remuneration policy should exceptional circumstances arise (i.e. situation in which a derogation is necessary to serve the long-term interests and sustainability of the company as a whole or to serve its viability).

Issuance of a remuneration report

Content of the report: Listed companies must draw up a clear and understandable report which must contain a comprehensive overview of remuneration, including all benefits in whatever form, awarded or due during the most recent financial year to individual directors, including to newly recruited and to former directors. It must include specific information regarding the remuneration of each individual director.
Responsibility: The directors of the company, acting within the filed of competence assigned to them by the law, will have collective responsibility for ensuring that the report is drawn up and published.
Personal data: The report must not include special categories of personal data of individual directors or which refer to the family situation of individual directors.
Vote on report: The annual general meeting will have the right to hold an advisory vote on the report of the most recent financial year. The company will have to explain in the following remuneration report how the vote by the general meeting was taken into account.

Publicity of the remuneration policy and report

The report will be publicly available after the general meeting, free of charge, on the company's website for a period of ten years. Companies may choose to keep it available for a longer period provided it no longer contains the personal data of directors.

Next steps for listed companies

Listed companies must gather the relevant information on their remuneration policy and prepare the content of their remuneration policy and remuneration report in order to submit them to their next annual general meeting.

Disclosures by proxy advisors to ensure transparency – "Comply or explain"

Recognising the influence of proxy advisors on the voting behaviours of investors, SRD II imposes creates new obligations for proxy advisors to increase transparency.

Definition of proxy advisors

A proxy advisor, within the meaning of SRD II and the Law, is 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 of informing investors' voting decisions by providing research, advice or voting recommendations that relate to the exercise of voting rights.

Disclosure of code of conduct

Proxy advisors must disclose the code of conduct applied by said proxy advisor and establish a report on the application of such code of conduct.

"Comply or explain"

Proxy advisors who will not apply a code of conduct or will depart from any of its recommendations shall provide a clear and reasoned explanation why this is the case. If and when departing from the recommendations of the code of conduct, a proxy advisor must declare from which parts they depart, provide explanations for doing so and, where appropriate, indicate any alternative measures adopted. Information on the application of the code of conduct must be made publicly available by proxy advisors on their website and be updated annually.

Disclosure of key Information

Proxy advisors must disclose key information relating to (i) preparation of research, advice and voting recommendations, and (ii) actual or potential conflicts of interest or business relationships that may influence such preparation as well as the actions undertaken to eliminate, mitigate or manage the actual or potential conflicts of interest.

The information must be made publicly available on the proxy advisor's website, free of charge, for at least three years from the date of publication.

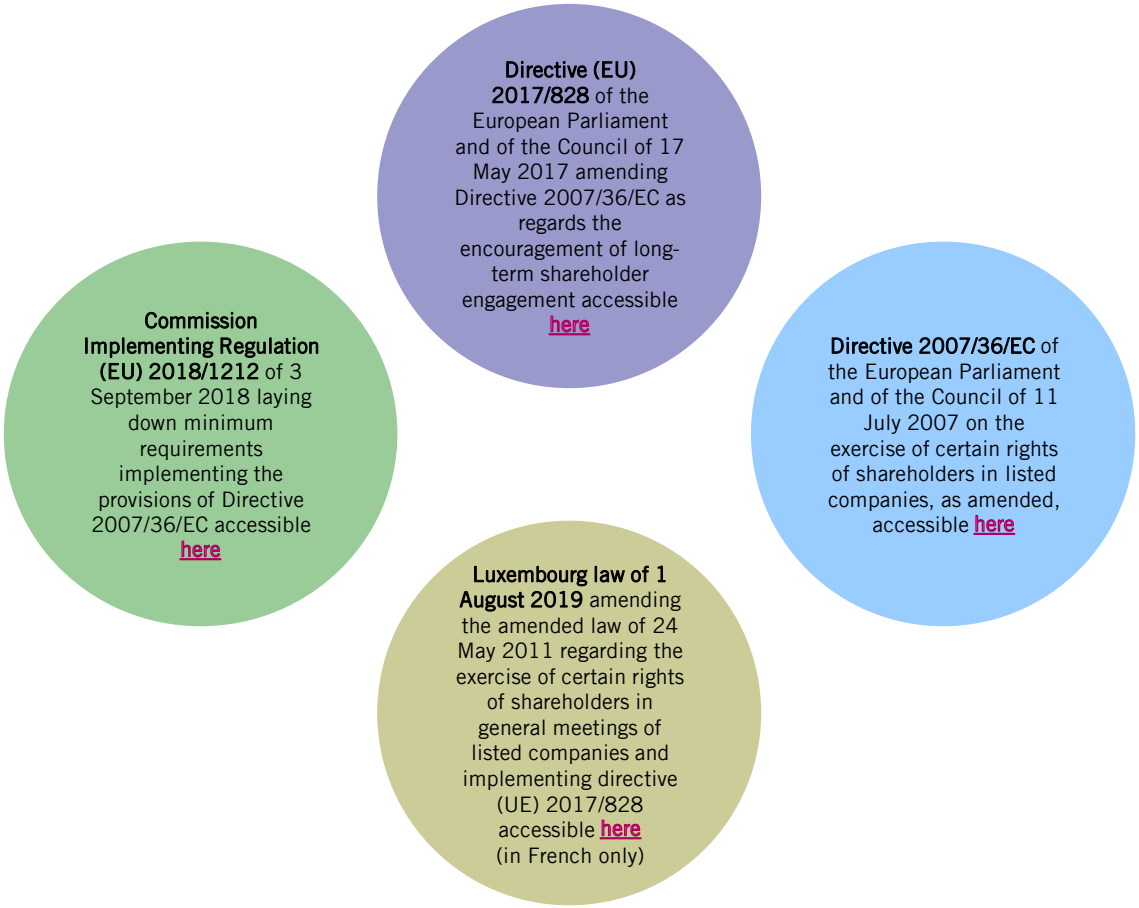
Non-EU proxy advisors

Obligations supported by proxy advisors under the Law also apply to proxy advisors that have neither their registered office nor their head office in the European Union and which carry out their activities through an establishment located in the European Union.

Next steps for proxy advisors

The obligations supported by proxy advisors will complement those of institutional investors and asset managers who must disclose the use of the services of proxy advisors as part of their engagement policy disclosure obligations.

Useful links



Contact us

We hope this note has helped you stay up to date with developments in this area. If you would like to discuss anything addressed here, or find out how we could assist you, please contact your usual Linklaters contact or anyone shown below.

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