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Shareholder Rights Directive II is looming – what you need to know

The first Shareholder Rights Directive (SRD) was implemented in 2007 with the aim of encouraging better engagement with shareholders. However, the financial crisis of 2008 evidently made it clear that the ambitions of the directive had failed, with the European Commission highlighting several points. These included that shareholders were still supporting excessive risk taking by boards, shareholders lacked the ability to effectively monitor companies, director remuneration in some instances was out of line with a company's performance and exercising shareholder rights remained unduly complex, especially in cases of cross-border holdings.

With this in mind, regulators have been revising the rules in a bid to tackle these shortcomings. After much debate, this is finally due to be implemented on 3 September and even though the UK is now in the transition period as it departs from the EU, the FCA has elected to push ahead with parallel rules, with the aim of improving shareholder engagement – and ultimately corporate governance.

So, what has changed? In an ideal world, each shareholder's name would be recorded on the register. However, as we all know, it's far more complex than that, with beneficial owners often tucked behind broker nominee accounts or wrapped up in pensions or other funds. Whilst the ambition of SRDII may have been to try to drill down to the most granular level, the reality is that regulators had to accept that this isn't possible given the varying national legislation defining shareholders, but we are still on course to see some fundamental changes in investor relations this autumn.

One point of focus is that institutional investors, such as pension fund administrators and asset managers, will be obliged to develop and communicate their strategies as to how they intend to engage with issuers – or otherwise state why they're not doing so. Separately, to improve the transparency of the voting process, new demands on shareholder identification will be deployed to ensure that issuers can easily identify and communicate with investors, leaving intermediaries responsible for generating a suitable audit trail. And it's this proxy voting element that could prove the most pivotal.

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Shareholder Rights Directive II is looming – what you need to know (continued)

Proxy voting

When it comes to proxy voting, there will be some additional administrative overhead both to issuers, their agents and possibly their professional advisers. For thirty days following a meeting at which voting occurs, a recognised shareholder, directly on the register or otherwise, may well have the right to subsequently request evidence that their voting instructions were correctly included in the count. A response must be given within sixteen days. Such requests could be made directly to the issuer (most likely the company secretary) or its registrar, for holdings being directly entered on the register. Issuers will need to keep documentary evidence of the breakdown of voting for at least that period. When the shareholder is typically not on the register directly but contained within a structure along with other investors, they will need to engage with that structure's administrators and they will then contact the issuer for a confirmation of their group voting.

SRDII mandates that from September, electronic voting at meetings must be immediately confirmed as having been received. CREST has chosen to provide received message notification to voting within the system. As registrars, Avenir are fully compliant with handling CREST messaging traffic. This will be the case with proxy voting announcements, receiving in voting and will also be the case for confirmations to voting entities within the context of meeting any SRDII mandated new working methods. However, given the short time left, it does currently remain to be seen whether any additional CSD functionality enhancements in connection to proxy voting confirmation will be fully tested and live by September.

If the full impact of SRDII matches expectations, this new legislation should see a genuine improvement in shareholders' enfranchisement and a consequential improvement in the respect afforded to them by issuer boards. That in turn has the potential to see improvements in corporate governance including a move away from likely short-termism. SRDII also cannot be taken in isolation as it forms part of a broader agenda that also includes a shift in pre-emption rights constraints and the long running move to full dematerialisation of holdings, with all that means for investor recognition and engagement. The broad-based activism we saw in the shareholder springs of 2015 and 2017 could end up being rather more impactful as a result of initiatives like this.

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