ALLEN & OVERY

Changes to the Shareholders' Rights Directive

The Council of the EU adopted several changes to the Shareholders' Rights Directive of 2007. The changes are relevant to listed companies in the EU.

The changes are aimed at encouraging shareholder engagement, in particular in the long term, and relate to identification of shareholders, transmission of information, facilitation of the exercise of shareholders rights, transparency of institutional investors, asset managers and proxy advisors, remuneration of directors and related party transactions. Rules on enhanced voting rights or dividend rights (loyalty rights), which were included in an earlier version of the proposal for the Directive, were rejected by the European Parliament in July 2015.

In this eAlert we briefly point out the most important changes from a Dutch perspective.

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SHAREHOLDERS 'SAY ON PAY'

Listed companies in the EU must establish a remuneration policy for their directors. Shareholders have the right to vote on the policy at the general meeting. Member states will have to choose between a binding vote and an advisory vote for the general meeting. Remuneration may only be paid in accordance with the remuneration policy approved by the general meeting.

In exceptional circumstances, member states may allow companies to temporarily derogate from the policy. This is only possible if the policy includes the procedural conditions under which the derogation can be applied and specifies the elements of the policy from which derogation is possible. Exceptional circumstances cover only situations in which the derogation is necessary to serve the long-term interests and sustainability of the company as a whole or to assure its viability.

The remuneration policy must be submitted to a vote on every material change and in any case at least every four years.

The remuneration policy must, among others:

– contribute to the company's business strategy and long-term interests and sustainability and must explain how it does so;

– describe the different components of fixed and variable remuneration, including all bonuses and other benefits, which can be awarded to directors and indicate their relative proportion;

– explain how the pay and employment conditions of employees of the company were taken into account when establishing the remuneration policy; and

– indicate the financial and non-financial performance criteria for variable remuneration, including corporate social responsibility criteria where appropriate.

Companies must draw up a remuneration report, which must contain the total remuneration for each individual director and an explanation how it complies with the remuneration policy, how it contributes to the long-term performance of the company and how the performance criteria were applied. The annual general meeting has the right to hold an advisory vote on the remuneration report for the most recent financial year.

Companies must explain in the following remuneration report how the advisory vote of the shareholders meeting has been taken into account. Member states may provide that for small and medium-sized listed companies the remuneration report is only a discussion item on the agenda of the general meeting.

The European Commission has yet to adopt guidelines to specify the standardised presentation of the information in the remuneration policy and report.

Consequences for the Netherlands

Dutch law already provides that listed companies must have a remuneration policy, which is presented to the general meeting for adoption. The topics to be included in the remuneration policy are set out in the Dutch Civil Code and in the Dutch Corporate Governance Code. If the company wishes to make changes to the remuneration policy, the revised policy must be approved or the new policy has to be adopted by the general meeting. Currently no obligation exists to require a shareholders vote on the policy once every four years, so this aspect of the Directive will have to be implemented.

Under Dutch law a remuneration report has to be drawn up, in which the supervisory board renders an account of the implementation of the remuneration policy in a transparent manner. The report should be posted on the company's website. The rendering of account for the implementation of the remuneration policy has been a discussion item on the agenda of the annual general meeting since 2014. Under the new Directive this will have to be an advisory vote on the remuneration report, at least for large companies. The Dutch government may opt to have the report as a discussion item on the agenda for small and medium-sized companies. Whether the Dutch government will do that, is unclear at the moment. A second new element is that the supervisory board will have to address in the next remuneration report how the advisory vote of the general meeting has been taken into account.

RELATED PARTY TRANSACTIONS

The European Parliament and the European Commission note that adequate safeguards for the protection of companies and shareholders' interests are of importance. For this reason member states must ensure that material related party transactions are submitted for approval by the shareholders or by the administrative or supervisory body, according to procedures that prevent the related party from taking advantage of its position and provide adequate protection for the interests of the company and of shareholders who are not a related party, including minority shareholders.

Where the related party involves a director or a shareholder, this director or shareholder should not take part in the approval or the vote. Member states have the possibility of allowing the shareholder who is a related party to take part in the vote, provided that appropriate safeguards are in place in relation to the voting process to protect the interests of the company and of the other shareholders, for example a higher majority threshold for the approval.

Member states must define 'material transactions' taking into account:

– the influence that the information about the transaction may have on the economic decisions of the shareholders; and

– the risk that the transaction creates for the company and its shareholders who are not related parties, including minority shareholders.

When defining material transactions, member states must set one or more quantitative ratios, based on the impact of the transaction on the financial position, revenues, assets, capitalisation, including equity, or turnover of the company or take into account the nature of transaction and the position of the related party. Member states may adopt diffrent materiality definitions according to the company size.

Companies will have to make a public announcement of a material transaction, at the latest at the conclusion of the transaction. Member states may provide for this announcement to be accompanied by a fairness opinion from an independent third party, the administrative body or supervisory body of the company or the audit committee or any other committee, the majority of which is composedof independent directors.

According to the new Directive, transactions with related parties entered into in the ordinary course of business and transactions concluded on normal market terms are exempted from the related party transactions requirements unless member states provide otherwise.

Consequences for the Netherlands

Pursuant to the Dutch Corporate Governance Code 2016, all transactions between the company and (i) legal or natural persons who hold at least 10% of the shares in the company, (ii) managing directors or (iii) supervisory directors, must be agreed on terms that are customary to the market. Decisions to enter into transactions with such persons, which are of material significance to the company and/or to such persons, require the approval of the supervisory board. Also, such transactions must be published in the management report. For the implementation of the Directive it seems not sufficient to have these rules in the Corporate Governance Code. These rules need to be included in Dutch legislation, together with a definition of 'material transactions'. Whether the Dutch government will make other changes as well with respect to related party transactions, is not yet known. The Dutch Civil Code prohibits a management director from taking part in the deliberation and decision-taking process within the management board regarding resolutions with which he has a conflict of interest. The same applies to supervisory directors. Following Dutch law regarding annual accounts, significant transactions entered into by the company with related parties (as referred to in the standards of the International Accounting Standards Board and approved by the EC) on terms other than normal market terms, the volume of such transactions, the nature of the relationship with the related party, and such further information as is necessary for providing a view of the financial conditions of the related person, shall be stated in the annual accounts.

COMMUNICATION WITH SHAREHOLDERS

Identification of shareholders

Listed companies should have the right to identify their shareholders in order to be able to communicate with them directly. This is deemed essential to facilitate the exercise of shareholders' rights and shareholder engagement. Therefore, member states must ensure that companies have the right to identify shareholders who hold more than 0.5% of the shares or voting rights. The information must include at least:

– name and contact details (including full address and, where available, email address), registration number (if the shareholder is a legal entity); and

– number of shares, categories or classes and date from which the shares are held.

Under the new Directive, companies must be able to obtain information from any intermediary in a chain of intermediaries.

Companies and intermediaries are allowed to store personal data until the date on which they become aware of the fact that a person has ceased to be a shareholder and for a maximum period of 12 months after becoming aware of that fact.

Consequences for the Netherlands

We already have a process for identification of shareholders, which has been in operation since 1 July 2013. Shareholder identification can only take place 60 days prior to a general meeting. We also have a threshold of 0.5%. Some minor changes to the Dutch process will be necessary to bring it in line with the Directive.

Transmission of information

In the preamble of the new Directive, it is noted that in a chain of many intermediaries, information is not always passed from the company to its shareholders and shareholders' votes are not always correctly transmitted to the company.

Following the new Directive, member states must ensure that the intermediaries are required to transmit the information which the company is required to provide to the shareholder to enable the shareholder to exercise its rights without delay.

If such information is published on the company's website, the intermediaries are required to transmit a notice indicating where on the website this information can be found. Companies must be required by the member states to provide the intermediaries with the information in a standardised and timely manner.

The European Commission will adopt implementing acts to specify the minimum requirements as regards the types and format of information to be transmitted, including their security and interoperability and the deadlines to be complied with.

Facilitation of exercise of shareholders rights

Under the new Directive, member states shall ensure that intermediaries facilitate the exercise of shareholder rights, including the right to participate and vote in general meetings, by a shareholder or by an intermediary upon explicit authorisation and instruction of the shareholder.

The new Directive also prescribes that member states must ensure that, when votes are cast electronically, after the general meeting of shareholders, the shareholder can verify whether his vote has been validly recorded and counted by the company.

Third-country intermediaries

As the chain of intermediaries may include intermediaries that have neither their registered office nor their head office in the EU, this could be an obstacle for achieving the objectives pursued by the new Directive, because the flow of information would risk being interrupted.

Therefore, it is stipulated that these third-country intermediaries which provide services with respect to shares of companies that have their registered office in the EU and the shares of which are admitted to trading on a regular market situated or operating within the EU, should be subject to the Directive's rules on shareholder identification, transmission of information and facilitation of exercise of shareholders rights as mentioned above.

The European Commission will monitor this aspect of compliance by third-country intermediaries and draft a report on the implementation within six years.

TRANSPARENCY OF INSTITUTIONAL INVESTORS, ASSET MANAGERS AND PROXY ADVISORS

Member states must ensure that institutional investors and asset managers either:

– develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy, and, on an annual basis publicly disclose how their engagement policy has been implemented; or

– publicly disclose a clear and reasoned explanation why they have chosen not to comply with one or more of the above requirements.

The engagement policy must describe how they:

– monitor companies in which they invest, on relevant matters;

– exercise voting rights and other rights attached to shares;

– cooperate with other shareholders;

– communicate with relevant stakeholders of the investee companies; and

– manage actual and potential conflicts of interests in relation to their management.

Member states must ensure that institutional investors publicly disclose how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities, in particular long-term liabilities and how they contribute to the medium- and long-term performance of their assets. Institutional investors and asset managers must publicly disclose how they have cast votes in the general meetings of companies in which they hold shares.

Institutional investors must also publicly disclose certain information regarding their arrangements with asset managers. The asset managers must disclose to the institutional investors on an annual basis how their investment strategy and implementation thereof complies with the arrangement between them and how it contributes to the medium- and long-term performance of the assets of the institutional investor or the fund.

Proxy advisors must publicly disclose reference to a code of conduct which they apply and report on the application of that code. If they do not apply a code of conduct, they must provide a clear and reasoned explanation why this is the case. They must also publicly disclose on an annual basis certain information in relation to the preparation of their research, advice and voting recommendations.

Consequences for the Netherlands

Currently there are no rules in Dutch law for institutional investors, asset managers and proxy advisors, as described above, so these will have to be fully implemented in new legislation. In 2011, Eumedion, which represents institutional investors' interests in the field of corporate governance and related sustainability performance in the Netherlands, published best practices for engaged share ownership. These best practices already cover several topics now included in the Directive. The institutional investors that are a participant in Eumedion in principle apply (part of) these best practices.

TERM OF INCORPORATION INTO DOMESTIC LAW

Member states will have up to two years to incorporate the new Directive into domestic law. The ultimate date of incorporation is 10 June 2019.