ALLEN & OVERY

Asset managers, life insurance companies and pension funds: engage or explain

22 August 2019

"The financial crisis had shown that many shortcomings in corporate governance of listed companies contributed to the financial crisis. For example, important deficiencies in the engagement and control by shareholders impede good decision-making by companies." The European Commission[1]

New transparency requirements encourage asset managers, life insurance companies and pension funds to focus on the long-term sustainability of EU listed companies.

On 1 August 2019, the Luxembourg legislator implemented the second shareholder right directive (**SRD II**) by amending the law of 24 May 2011 relating to the exercise of certain shareholder rights at general meetings of listed companies through the adoption of Bill of Law N° 7402 (as amended, the **Shareholder Rights Law**).

Do not be misled by the title of the law, the new rules are not only about new rights for shareholders of listed companies but also about obligations for certain types of shareholders, in particular for institutional investors and asset managers (**SRD Investors**). Indeed, these investors own or manage the majority of shares in EU listed companies and their shareholding behaviour significantly impacts the governance of these entities.

SRD II aims at improving the long-term viability of European listed companies and at encouraging shareholder engagement, specifically the engagement of SRD Investors. With that in mind, SRD II introduces on the one hand requirements to ease the identification of shareholders, the transmission of information and the exercise of shareholders rights (in particular in cross-border situations) and on the other hand transparency requirements to foster the stewardship of SRD Investors.

This e-alert will focus on the new requirements applicable on the investors' side. In respect of obligations applying to listed companies, intermediaries and proxy advisors, please refer to our other e-alert "Second shareholder rights directive: an enhanced framework for shareholder rights in listed companies"

New obligations for SRD Investors investing in EU Listed Companies

The new rules apply to Luxembourg based SRD Investors investing in any company whose shares are admitted to trading on a regulated market of a Member State of the European Union (**EU Listed Companies**).

[1] https://europa.eu/rapid/press-release_MEMO-17-592_en.htm

The term "asset managers" encompasses MiFID firms providing portfolio management services, authorised AIFMs, UCITS management companies, self-managed UCITS and Part II UCIs, while "institutional investors" refers to life insurance and reinsurance undertakings as well as pension funds. All these entities fall within the scope of the Shareholders Rights Law to the extent they have their registered office in Luxembourg and invest in EU Listed Companies, including for the avoidance of doubt, listed Luxembourg UCITS and AIFs[2].

Engagement policy: comply or explain

SRD Investors should develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. In particular, the engagement policy must describe how they monitor strategic, financial, environmental, social, and governance matters at the level of the EU Listed Companies, how they interact with the EU Listed Companies, the other shareholders and the other stakeholders as well as how conflicts of interest are managed. In practice, asset managers will also have to review their existing policies on voting rights and conflicts of interest to ensure that these are consistent with their engagement policy.

SRD Investors must also publicly report every year on how they implemented their engagement policy, specifically in terms of exercise of voting rights (i.e. description of voting behaviour, explanation on significant[3] votes, report on votes cast and use of proxy advisors). If they do not intend to comply with these requirements, they must publicly disclose a clear and reasoned explanation why they have chosen not to do so.

Publication takes place on the relevant SRD Investor's website and must be updated annually unless there is no material change.

Disclosure of investment strategies and arrangements with asset managers

Institutional investors must further disclose on their website:

- certain elements of their equity investment strategies and of their arrangements with their delegated asset managers. Where an arrangement with an asset manager does not contain the information required, the institutional investor must explain why; and

- how these equity investment strategies and arrangements take into account and contribute to the medium to long-term performance of the relevant EU Listed Companies.

The above information must be updated annually in case of major change to it.

Unless the information is already public, asset managers must in turn report at least once a year to the relevant institutional investors how they have implemented their arrangement with them and contributed to the medium to long-term performance of the institutional investors' assets or of the fund managed. The Luxembourg legislator has not chosen to use the option given under SRD II to permit disclosure of this information in the annual reports or periodic information of these asset managers.

[2] However, the Shareholders Rights Law does not apply to UCITS and AIFs themselves.
[3] SRD Investors determine which votes are significant. For instance, votes cast on purely procedural matters or in companies where the asset manager or institutional investor has a very minor stake compared to its other holdings may be insignificant (Recital 18 of SRD II).

The above transparency requirements aim at increasing awareness along the investment chain on the positive impact that investment strategies and shareholding engagement can have on the sustainability of EU Listed Companies.

Effectiveness of the liability regime?

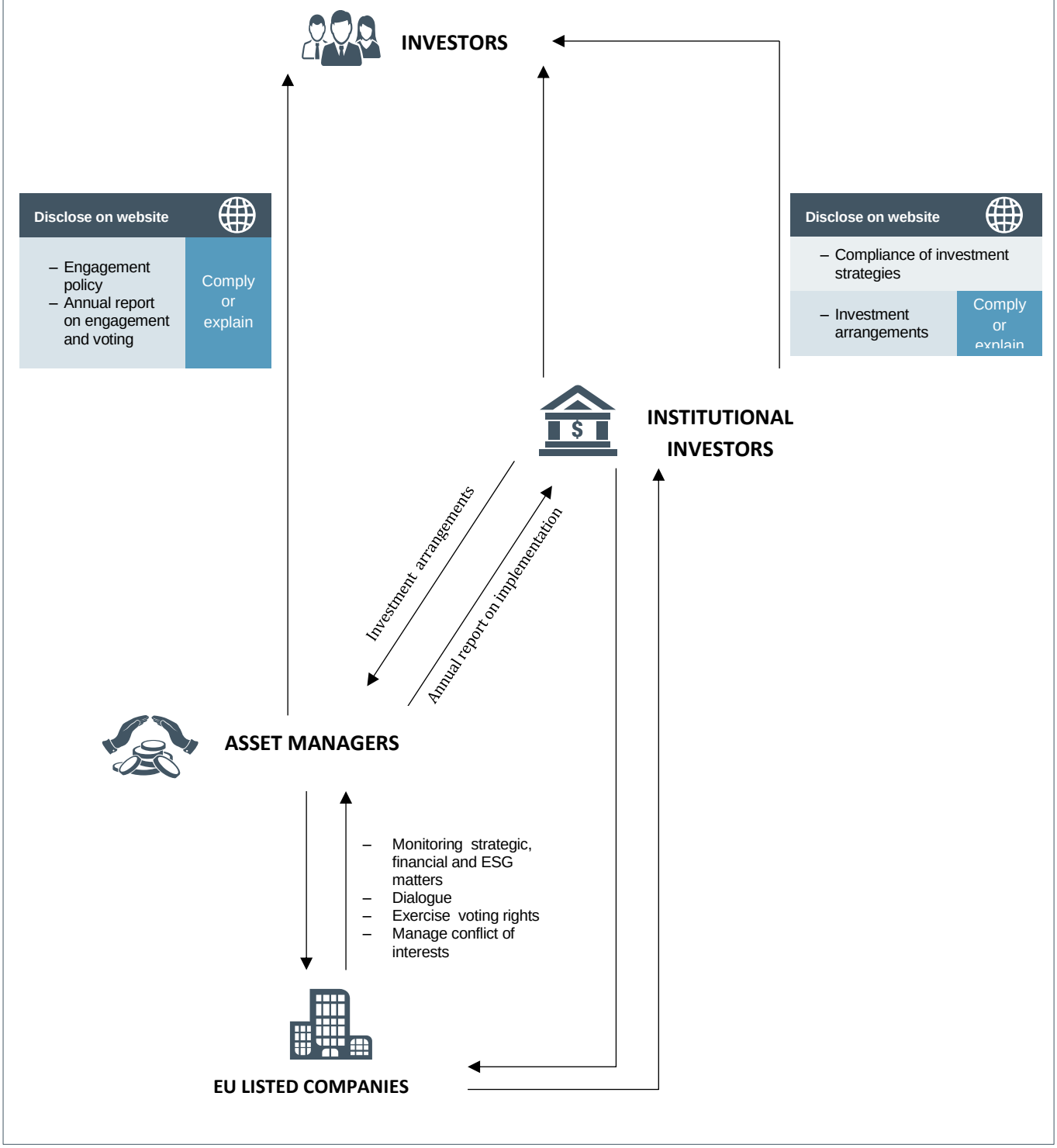
Member States have been left with the ability to choose which sanctions will be appropriate in case of infringement, provided that they are "effective, proportionate and dissuasive". Luxembourg law retains the joint and several liability of the "executives"[4] of the SRD Investors for any damage resulting from a breach of their obligations. Failure to comply will thus not automatically result in a sanction as damage must first be proven. Evidencing damage could be challenging in the context of a breach to a transparency obligation. In the absence of pre-determined fines but also of authority of control, will it be enough to induce shareholders' engagement?

Immediate application

The new rules will enter in force on 24 August 2019, leaving a very short period of time for SRD Investors to understand and implement the changes.

[4] The term "executive" (*dirigeant*) is defined as any member of a management or supervisory body of the company as well as the managing officer (*directeur général*) and the vice managing officer (*directeur général adjoint*), if these functions exist.

Asset managers and institutional investors: new disclosure requirements



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