

Financial Regulatory Alert

Akin Gump
STRAUSS HAUER & FELD LLP

Changes to the FCA's Rules Implementing the Revised Shareholder Rights Directive – What Asset Managers Need to Know

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As part of the EU Sustainability Action Plan and the Sustainable Finance initiative¹, the revised Directive 2007/36/EC (the "Shareholder Rights Directive" or "SRD II") introduces new requirements on asset managers to establish a policy regarding its shareholder engagement, and to enhance the transparency available to certain institutional investors, and to the market more broadly.²

When will the new rules take effect?

In the UK, the implementation of the requirements under SRD II described above takes place through changes to the rules issued by the UK Financial Conduct Authority (FCA). After issuing a consultation paper earlier in the year, the FCA published a policy statement containing the final amendments to the rules on 31 May 2019.³ The changes to the rules will come into effect on 10 June 2019 to meet the transposition deadline for SRD II. However, the FCA has indicated that, because the rules will come into effect quickly after publication, for an initial period after 10 June 2019 it considers that a firm may be able to comply with the relevant requirements by explaining what it is doing to develop a shareholder engagement policy.

What do the new rules require asset managers to do?

Develop a shareholder engagement policy. FCA-authorized asset managers⁴ will need to develop and publicly disclose a policy on shareholder engagement with respect to shares traded on a regulated market,⁵ or explain why they have elected not to do so. This requirement builds on the current requirement on asset managers to explain the way in which they comply with the Financial Reporting Council's Stewardship Code, or their alternative strategies.

The shareholder engagement policy is required to set out how the asset manager communicates with investee companies, as well as how it monitors investee companies' strategies, performance, capital structure, social and environmental impact and corporate governance. In addition, the policy must state how the asset manager exercises voting rights and other rights attached to shares, cooperates with other

Contact Information

If you have any questions concerning this alert, please contact:

Ezra Zahabi

Partner
ezra.zahabi@akingump.com
London
+44 20.7661.5367

Helen Marshall

Partner
helen.marshall@akingump.com
London
+44 20.7661.5378

Ian Meade

Partner
imeade@akingump.com
London
+44 20.7012.9664

Tim Pearce

Partner
tpearce@akingump.com
London
+44 20.7012.9663

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shareholders, communicates with the relevant stakeholders in its investee companies and manages actual or potential conflicts of interest arising from its engagement.

Disclose annually information about its shareholder engagement. An asset manager must make an annual public disclosure stating how its shareholder engagement policy has been implemented. The annual disclosure must include a general description of the asset manager's voting behavior, an explanation of the most significant votes and reporting on the use of the services of proxy advisers. Specifically, an asset manager must disclose how it has cast votes in the general meetings of its relevant investee companies, save for votes that are insignificant due to the size of the shareholding or the subject matter of the vote. Where applicable, an asset manager may alternatively provide a "clear and reasoned explanation" why some or all of the information specified is not disclosed.

Provide information to certain institutional investors whose assets it manages (including through an investment in a fund managed by the asset manager). An asset manager will be obliged to disclose annually specified information to certain institutional investors (namely, life insurance companies and occupational pension funds) to which it provides portfolio management services, or who are investors in a fund managed by the asset manager. Such information includes how the asset manager's investment strategy and its implementation contributes to the medium to long-term performance of the assets. Further, asset managers must report on the key material medium to long-term risks associated with its investments, securities lending policy and how it is applied in relation to shareholder engagement, especially at the time of shareholder meetings; and whether, and if so, how, investment decisions are made based on the evaluation of medium to long-term performance (financial and otherwise) of investee companies.

In addition, the new rules require the disclosure of portfolio composition, turnover and turnover costs, the use of proxy advisors in relation to shareholder engagement activities; and whether any conflicts of interest have arisen in relation to shareholder engagement activities and, if so, what the conflicts are and how they have been addressed.

Institutional investors' disclosure obligations

The obligations imposed by SRD II on institutional investors echo those imposed on asset managers, in that they are also required to develop and publish a shareholder engagement policy and make annual public disclosure of its implementation. Relevant institutional investors are also required to publish information about the way in which votes have been cast (other than "insignificant" votes). In addition, an institutional investor subject to the SRD II disclosure obligations must reference the disclosures of any asset managers that "implement its policy" (e.g. exercise voting rights on its behalf) and disclose to the public specified information about its arrangements with the asset manager. Such disclosures must include, among other items, information about how the arrangements incentivise the asset manager to align its investment strategy with the liabilities, particularly the long-term liabilities, of the life insurer; and make investment decisions based on the assessments of medium- to long-term financial and nonfinancial performance of the investee company; and how the valuation and remuneration arrangements align with the long-term liabilities of the institutional investor and reflect the asset manager's absolute long-term performance.

The practical impact and commercial significance of these requirements will undoubtedly unfold in the medium term—and they may ultimately be reflected in the commercial and contractual arrangements between institutional investors and asset managers.

1 See also, among other things, the [technical advice](#) provided by the European Securities and Markets Authority to the European Commission on the integration of sustainability risks and factors, relating to environmental, social and good governance considerations with regards to investment firms and investment funds, into Markets in Financial Instruments Directive (MiFID) II, the Alternative Investment Fund Managers (AIFM) Directive (AIFMD) and the Undertakings for Collective Investments in Transferable Securities (UCITS) Directive.

2 The SRD II also introduces certain other requirements relating or applicable to certain companies admitted to trading on a regulated market, including new rules on related party transactions and shareholder consent to the directors' remuneration packages, and enhanced rights of companies to identify their shareholders.

3 The FCA's Consultation Paper [CP 19/7](#) and Policy Statement [PS 19/13](#) form part of a broader set of provisions dealing with the implementation of the revised Shareholder Rights Directive and enhancement of the stewardship framework. See also the [consultation paper of the Financial Reporting Council on revisions to the Stewardship Code](#).

4 Including MiFID portfolio management firms, AIFMs and UCITS management companies.

5 The term "regulated market" has an extended meaning for the purposes of these rules and includes certain non-European Economic Area (EEA) markets.

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