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Second shareholder rights directive: an enhanced framework for shareholder rights in listed companies

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"*Shareholders rights are being reinforced and new transparency measures will facilitate the exercise of voting rights in Luxembourg listed companies. All the chain of intermediaries, whether or not located in the EU, will be impacted by these requirements*."

In the context of the implementation of the second shareholder rights directive (**SRD II**),[1] the Luxembourg legislator has amended the law of 24 May 2011 relating to the exercise of certain shareholder rights at general meetings of listed companies through the adoption of the law of Bill of Law N°7402. Do not be misled by the title of the law, the new rules will have an impact not only on listed companies but also on intermediaries, institutional investors, asset managers and proxy advisors that are interacting with them.

The new rules aim at improving the long-term viability of European companies and creating a more attractive environment for shareholders of listed companies, which in turn means facilitating the exercise of shareholders' rights and enhancing transparency around the investment chain, the remuneration of executives and transactions with related parties.

This e-Alert focuses on the changes having an impact on listed companies, intermediaries and proxy advisors. With respect to new rules applying to institutional investors and asset managers, please refer to our other e-Alert "Asset managers, life insurance companies and pension funds: engage or explain"

The new rules apply to Luxembourg listed companies, related intermediaries and proxy advisors

One area of particular attention is the scope of the new rules.

They apply to Luxembourg companies whose shares are admitted to trading on a regulated market established or operating in a Member State of the European Union. There is also an option for Luxembourg companies to, on a voluntary basis, comply with the rules when their shares are admitted to trading on a regulated market in a non-Member State that operates regularly and is recognised and open to the public.

They also apply to intermediaries and proxy advisors who, in a nutshell, provide services in relation to the abovementioned companies (the **Listed Companies**), regardless of where these intermediaries or proxy advisors are established.[2]

Shareholders now have a "say on pay"

[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.
[2] Proxy advisors must, however, have a presence in the European Union to fall within the scope of the new rules.

Listed Companies will have a hard legal obligation to establish a remuneration policy of their executives to be published on their website (as opposed to the "soft law" approach that many Listed Companies have already adopted). Such remuneration policy must be submitted to the non-binding advisory vote of the shareholders at the time of any significant change and at least every four years. If the remuneration policy is not approved by the shareholders, executives may still continue to be remunerated in accordance with such policy provided that a revised policy is submitted for a vote at the next general meeting. Listed Companies may provide in their articles of association that the shareholders' vote on the remuneration policy is binding.

To help shareholders monitor the application of the remuneration policy, Listed Companies have to produce an annual remuneration report (to be published on their website) describing how the remuneration policy has been implemented and giving an overview of the remuneration granted to each individual executive. This report must likewise be submitted to the non-binding advisory vote of the shareholders. Listed Companies must also explain in their next remuneration report how such vote was taken into consideration.

Material transactions with related parties must be disclosed

Transactions with related parties are "material" if their publication and disclosure are likely to have a material impact on the economic decisions of the Listed Company's shareholders and if they could create a risk for the company and its shareholders who are not related parties, including minority shareholders. The question as to what is material or not will have to be carefully analysed on a case-by-case basis by the relevant corporate bodies in light of the specific factual setup of the relevant company and transaction.

These material transactions must now be submitted for approval to the management body of the Listed Company. Besides being reported in the annual financial statements, material transactions with related parties will also have to be publicly disclosed no later than the time of the conclusion of the transaction. The information must include the identity of the related party, the date and value of the transaction and any other information necessary to assess the fairness of the transaction.

The new requirements do not apply to transactions carried out in the ordinary course of business and made under ordinary market conditions. Other transactions (including in particular any remuneration related matters) are also explicitly excluded from the scope of these new provisions.

Communications between Listed Companies and their shareholders are facilitated

Listed Companies now have the right to ask any intermediary in a chain of intermediaries to provide information on the identity of their shareholders.

Intermediaries also have to take all necessary measures (including providing to shareholders all relevant information) to enable shareholders to participate in and vote at general meetings either by themselves or by instructing intermediaries to do so on their behalf. Listed Companies must upon request confirm to their shareholders that their vote has been recorded and taken into account at the relevant general meeting.

The new rules should be read in conjunction with the European Commission's Implementing Regulation 2018/1212 of 3 September 2018. This regulation contains a list of obligations for issuers and intermediaries that will come into force on 3 September 2020.

Compliance with the new rules falls upon the "executives" of the Listed Companies and related intermediaries

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, if such a function exists within the company, the vice managing officer (*directeur général adjoint*)). The executives will be jointly and severally liable for any damage resulting from a breach of their obligations under the law. The law does not specify the circumstances under which an executive may be released from such liability.

Proxy advisors to provide explanations regarding their voting recommendations

Proxy advisors are for the first time required to make available on their website their code of conduct (or explain why they do not have one) and if applicable, report on its implementation each year. Additionally, they must disclose at least once a year certain information in connection with the preparation of their researches, advices and recommendation of votes. They also must remain alert in relation to actual or potential conflicts of interests or business relationships that may influence their work.

The new rules will enter into force on 24 August 2019.

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