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Impact of the Second Rights Directive on Life Assurers

The second Shareholders Rights Directive (Directive (EU) 2017/828) (“**SRD II**”) imposes a number of obligations on:

- (i) life insurers and IORPs (“**institutional investors**”); and
- (ii) asset managers (which include MiFID firms providing portfolio management services to investors, AIFMs, UCITS management companies and UCITS SMICS) (“**asset managers**”).

The obligations imposed on institutional investors – including life insurers who invest in shares in EEA companies admitted to listing on EEA regulated market - which are set to apply from June 10 2019, are outlined below.

In Summary

The original Shareholders Rights Directive 2007/36/EC (Directive 2007/36/EC) (“**SRD I**”) was introduced to enhance shareholders rights and to facilitate and encourage effective shareholder control in companies whose shares were admitted to trading on a regulated EEA market. Its focus was on imposing rules on such companies regarding the operation of general meetings, including as to information, proxy voting, electronic participation and related matters.

The focus of SRD II is broader, as it imposes:

- requirements relating to the right of companies’ to identify their shareholders;
- requirements relating to intermediaries obligations

For further information on any of the issues discussed in this article please contact:



Andrew Bates
DD:+ 353 (0)1 673 1704
andrew.bates@dilloneustace.ie



Keith Waine
DD:+ 353 (0)1 673 1822
keith.waine@dilloneustace.ie



Rose McKillen
DD:+ 353 (0)1 673 1754
rose.mckillen@dilloneustace.ie

concerning communication with shareholders and the exercise of shareholder's rights where shareholders hold their shares through intermediaries;

- obligations on institutional investors (life insurers and IORPs) and on asset managers to publicly disclose their investment strategies, their shareholder engagement policy and the implementation thereof;
- obligations on institutional investors who use asset managers (either via discretionary mandate or through pooled funds) to publicly disclose certain key elements of their arrangement with the asset manager, including in particular how they incentivise the asset manager to align its investment strategy and decisions with the profile and duration of the liabilities of the institutional investor, in particular long-term liabilities, how they evaluate the asset manager's performance, including its remuneration; how they monitor portfolio turnover costs incurred by the asset manager and how they incentivise the asset manager to engage in the best medium to long-term interest of the institutional investor;
- obligations on asset managers to provide information to the institutional investor which is sufficient to allow the institutional investor to assess whether the asset manager pursues a strategy that provides for efficient shareholder engagement. The required disclosure includes how the investment strategy and its implementation contribute to the medium to long-term performance of the assets of the institutional investor or of the fund.

Asset managers must also disclose to institutional investors the composition, turnover and turnover costs of their portfolio as well as their policy on securities lending. They must also inform the institutional investor whether and, if so, how the asset manager makes investment decisions on the basis of an evaluation of the medium to long-term performance of the investee companies, including its non-financial performance. Proper information on conflicts of interest which have arisen in connection with the engagement should also be disclosed to the institutional investor by the asset manager and how it has dealt with such conflicts;

- obligations concerning proxy advisors;
- obligations relating to the remuneration of the directors of investee companies and the need for shareholders to have an effective say on the company's remuneration policy; and
- requirements relating to related party transactions.

This memorandum only focuses on the obligations imposed on institutional investors.

Which “institutional investors” and which “asset managers” are in scope?

An “institutional investor” is defined as follows:

- “(i) an undertaking carrying out activities of life assurance within the meaning of points (a), (b) and (c) of Article 2(3) of Directive 2009/138/EC of the European Parliament and of the Council (***) , and of reinsurance as defined in point (7) of Article 13 of that Directive provided that those activities cover life-insurance obligations, and which is not excluded pursuant to that Directive;*
- “(ii) an institution for occupational retirement provision falling within the scope of Directive (EU) 2016/2341 of the European Parliament and of the Council (****) in accordance with Article 2 thereof, unless a Member State has chosen not to apply that Directive in whole or in parts to that institution in accordance with Article 5 of that Directive;”*

“asset managers” are defined as: MiFID investment firms; AIFM (including any internally managed AIF but excluding small AIFM); UCITS management companies; and UCITS SMICS. Externally managed funds who have appointed a UCITS management company/AIFM will not constitute an “asset manager” under SRD II.

Life insurers are therefore subject to the institutional investor obligations set out below, and their asset managers must provide them with certain information.

When do the Transparency Obligations apply?

The transparency obligations under SRD II apply to institutional investors and asset managers who invest in a “company” where:

- (i) which has a registered office in an EEA member state; and
- (ii) whose shares are admitted to trading on a regulated market situated or operating within an EEA member state

This would appear to include UCITS or AIF type investment companies whose shares are listed on an EEA regulated market.

Shareholder Engagement Policy

In scope institutional investors must put in place a shareholder engagement policy and make it publicly available on their website or alternatively must publish a statement setting out why they have chosen not to do so on their website.

The shareholder engagement policy should address the following:

- (a) how the institutional investor integrates shareholder engagement in its investment strategy;
- (b) how the institutional investor

- monitors investee companies on relevant matters, including strategy, financial and non-financial performance, risk, capital structure, social and environmental impact and corporate governance;
- conducts dialogues with investee companies;
- exercises voting rights and other rights attached to shares;
- cooperates with other shareholders and other stakeholders of the investee companies; and
- manages actual and potential conflicts of interests in respect of their engagement.

Institutional investors may also want to consider setting down the criteria they apply for determining whether a vote is considered “insignificant” for the purposes of disclosing how voting rights were exercised.

SRD II does not provide any guidance on the circumstances in which it may be appropriate for an institutional investor to publish a statement explaining why it has chosen not to prepare a shareholder engagement policy, save for requiring that such explanation be “clear and reasoned”. It would appear reasonable that institutional investors whose funds only invest to a very limited extent in EEA listed companies and/or EEA listed funds could avail of the flexibility to publish a statement stating that they do not consider it appropriate to prepare a shareholder engagement policy given the very limited exposure to such issuers.

Implementation of the Shareholder Engagement Policy

Where institutional investors do decide to publish a shareholder engagement policy, they must also publish on an annual basis a statement on their website setting out how they have implemented their policy. This should include a general description of voting behaviour, an explanation of the most significant votes and the use of the services of proxy advisors. They must also disclose how they have voted on matters relating to in-scope companies (with the exception of votes which are considered insignificant due to the subject matter of the vote or the size of the holding in the company).

This information must be available free of charge on the institutional investor’s website.

Where an asset manager implements the engagement policy, including voting, on behalf of an institutional investor, the institutional investor must make a reference as to where such voting information has been published by the asset manager.

Investment strategy of institutional investors

Institutional investors must also 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 to long-term performance of their assets.

Arrangements with Asset Managers

Where an asset manager invests on behalf of an institutional investor, whether on a discretionary client-by-client basis or through a collective investment undertaking, the institutional investor must publicly disclose the following information regarding its arrangement with the asset manager:

- how the arrangement with the asset manager incentivises the asset manager to align its investment strategy and decisions with the profile and duration of the liabilities of the institutional investor, in particular long-term liabilities;
- how that arrangement incentivises the asset manager to make investment decisions based on assessments about medium to long-term financial and non-financial performance of the investee company and to engage with investee companies in order to improve their performance in the medium to long-term;
- how the method and time horizon of the evaluation of the asset manager's performance and the remuneration for asset management services are in line with the profile and duration of the liabilities of the institutional investor, in particular long-term liabilities, and take absolute long-term performance into account;
- how the institutional investor monitors portfolio turnover costs incurred by the asset manager and how it defines and monitors a targeted portfolio turnover or turnover range;
- the duration of the arrangement with the asset manager.

Where the arrangement with the asset manager does not contain one or more of such elements, the institutional investor shall give a clear and reasoned explanation why this is the case. The above information must be available, free of charge, on the institutional investor's website and be updated annually unless there is no material change.

Institutional investors regulated by Solvency II can include this information in their solvency and financial condition report.

Asset manager must provide additional information to institutional investors

Asset managers must disclose, on an annual basis, to the institutional investor whose assets they manage via a discretionary mandate or pooled fund how their investment strategy and the implementation thereof complies with that arrangement and contributes to the medium to long-term

performance of the assets of the institutional investor or of the fund. Such disclosure must include reporting on:

- key material medium to long-term risks associated with the portfolio investments (including corporate governance matters);
- portfolio composition, turnover and turnover costs of their portfolio (turnover providing a good indicator as to whether the equities are held for a sufficient length of time to allow the asset manager to engage with the company in an effective way or whether they are being held for too long which may indicate inattention to risk management or a passive investment approach);
- whether the asset manager uses proxy advisors for the purposes of engagement activities;
- its policy on securities lending and how it fulfilled its engagement activities (as sold shares under a securities lending arrangement must be recalled for engagement purposes, including voting at the general meeting);
- whether, and if so, how the asset manager makes investment decisions based on an evaluation of the medium to long-term performance of the investee company;
- whether, and if so, how any conflicts of interest have arisen in connection with engagement activities and how it has dealt with same;

If the above information is already publicly available, the asset manager is not required to provide this information directly to its institutional investors.

Next Steps

- Review investment universe to determine whether you invest in EEA listed companies/EEA listed UCITS or AIF;
- Determine whether it is more appropriate to prepare a shareholder engagement policy or a statement explaining why it is not considered necessary to put in place a shareholder engagement policy;
- If relevant, consider the form that the shareholder engagement policy may take in light of any delegation arrangements in place with EU MiFID regulated investment firms or any existing group policy which addresses the area of stewardship.
- Gather the information on your arrangements with asset managers;
- Engage with your asset manager with regard to their obligations to provide certain information on engagement with investee companies to institutional investors.

- Draft your disclosures and get them ready to publish once the Irish implementing regulations issue.

Irish Implementing Measures

We await domestic implementing regulations.

FCA Proposed Approach

It is interesting to note that in its Consultation Paper 19.7 on the proposals to improve shareholder engagement (and transpose SRD II into UK law), the FCA suggested that for an initial period after 10 June next, in-scope firms could publish a statement on its website by 10 June advising interested parties that it is in the process of developing an engagement policy or is considering whether to have one.

We would highlight that the Irish authorities have not issued anything similar. However we will keep you updated should any such guidance emerge.

We would be happy to assist you further in your preparations to comply with SRD II.

Dillon Eustace
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DILLON EUSTACE

Dublin

33 Sir John Rogerson's Quay, Dublin 2, Ireland. Tel: +353 1 667 0022 Fax: +353 1 667 0042.

Cayman Islands

Landmark Square, West Bay Road, PO Box 775, Grand Cayman KY1-9006, Cayman Islands. Tel: +1 345 949 0022 Fax: +1 345 945 0042.

New York

245 Park Avenue, 39th Floor, New York, NY 10167, U.S.A. Tel: +1 212 792 4166 Fax: +1 212 792 4167.

Tokyo

12th Floor, Yurakucho Itocia Building, 2-7-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan. Tel: +813 6860 4885 Fax: +813 6860 4501.

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