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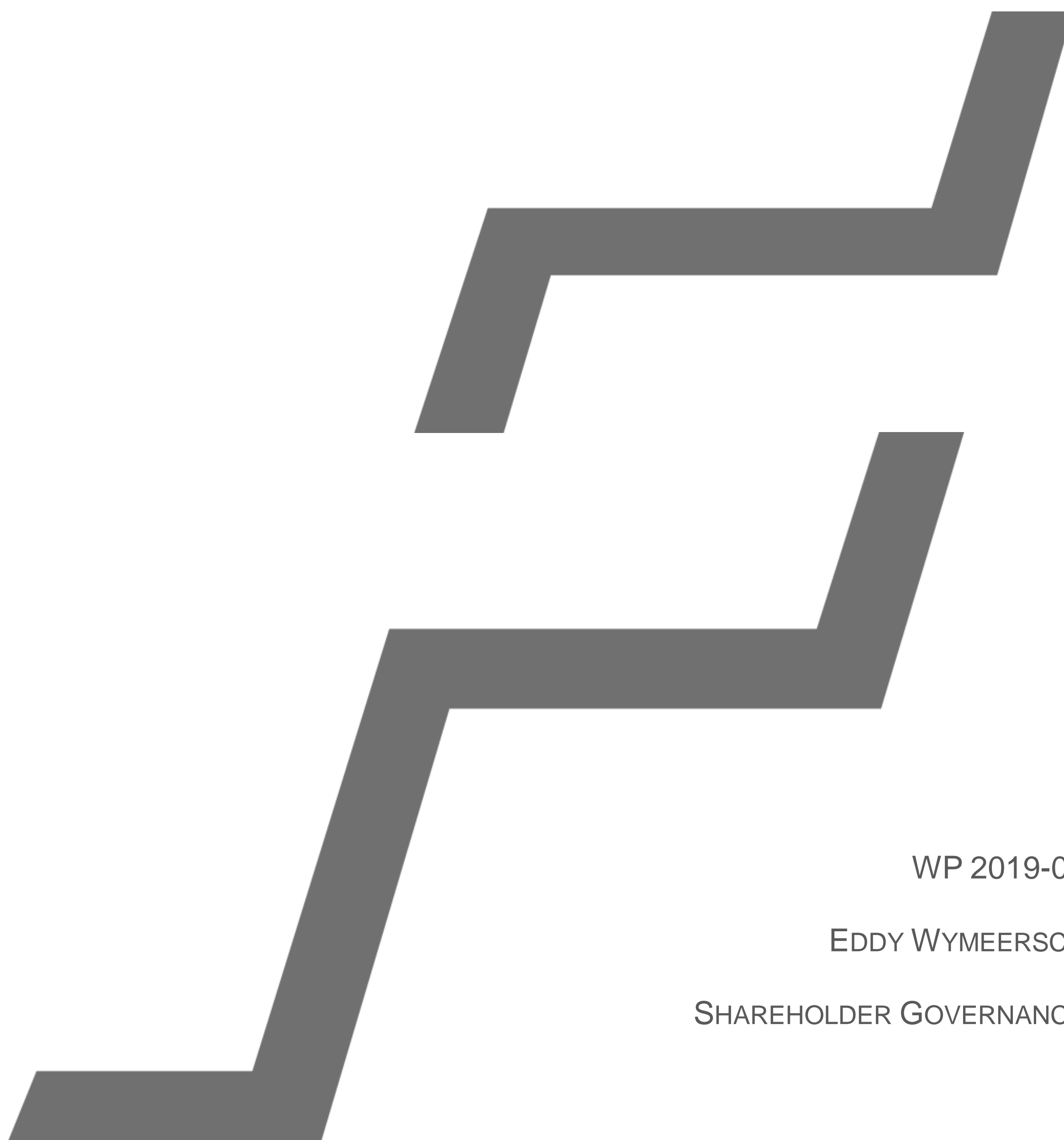

WP 2019-04

EDDY WYMEERSCH

SHAREHOLDER GOVERNANCE

GHENT UNIVERSITY

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Shareholder governance

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The Shareholder Rights Directive II, of 17 May 2017, which will enter into force on June 10, 2019[1], deals with matters that in many respects touch upon the governance of listed companies. The directive is entitled "the encouragement of long-term shareholder engagement", indicating that it intends to change the relationship of the shareholders towards the company boards, giving more power to shareholders to reduce the wide discretion of boards to deal with company affairs. This approach is reportedly related to the weaknesses in governance which led to dramatic consequences during the 2008 financial crisis and caused considerable damage to the citizens' confidence in company management. The intervention of the European legislator in matters such as "say on pay" to somewhat curb the remunerations of the company leaders by implicating the shareholders or the provision on "related party transactions" are also instruments for avoiding controlling shareholders, or powerful directors taking advantage of their position within the company to their personal benefit or that of the company they represent: shareholders should be considered as countervailing powers leading to better, especially stricter management and more responsible governance[2]. Restoring trust was often mentioned.

Of a more procedural nature are the directive's provisions on shareholder voting and engagement: here the objective consists of activating the shareholders[3] to be able to express their opinion on subjects proposed for company decision making, essentially by organizing and facilitating their participation in the general meeting. As a corollary, companies will be able to obtain the identity of their individual shareholders allowing them to communicate with them on company matters. Institutional investors will be the main transmission channels to pursue these policy objectives: as part of in their investment strategy, they will adopt active engagement with the investee companies and adapt their investing strategy to long-term value creation. These objectives are a response to the often-heard criticism about the short termism, one the root causes of the financial crisis[4]. Activating the voting rights of institutional investors and asset managers – possibly along with those of individual investors – with a view of influencing corporate behaviour is part of a wider drive, addressing behavioural objectives assigned to large companies in the context of ESG[5] and SDG [6] which is further developed in the EU's sustainable finance action plan[7]. Sustainability is one of the core concepts in this new approach to economic and environmental policies, while engagement is one of the instruments, supported by new disclosure requirements. The Union is driving towards a new social economic policy beyond the traditional objectives of shareholder value maximization. In the meantime, the Commission is proposing a series of measures which would have a much stronger effect on steering Europe's economic and financial systems toward long term sustainability[8] proposing to include sustainability criteria in the whole range of

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[1] Article 2 DIRECTIVE (EU) 2017/828 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 .05. 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement; but the provisions on shareholder identification and voting will only apply 24 months after the adoption of the implementing acts. See for the amended directive; DIRECTIVE 2007/36/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 11.07. 2007 on the exercise of certain rights of shareholders in listed companies. Referred to as SRD II and SRD I. See also: COMMISSION IMPLEMENTING REGULATION (EU) 2018/1212 of 03.11.2018 2018 laying down minimum requirements implementing the provisions of Directive 2007/36/EC of the European Parliament and of the Council as regards shareholder identification, the transmission of information and the facilitation of the exercise of shareholders rights

[2] http://europa.eu/rapid/press-release_MEMO-17-592_en.htm

[3] All shareholders may have to be identified, but States may introduce a minimum allowing only shareholders holding more than 0,5% of the capital to be subject to identification.

[4] The Commission press release mentions that on average their portfolio holding period is 8 mo. Portfolio are entirely turned over every 1,7 years.

[5] Environmental, Social and Governance (ESG) See: Principles of responsible investment (PRI)) developed by "investors for investors". See the six PRI, including the ESG, as developed by investors with a view of developing a more sustainable a global financial system, https://www.unpri.org.

[6] Sustainable Development Goals, As formulated by the United Nations in 2015, see: https://sustainabledevelopment.un.org/?menu=1300

[7] See: Communication from the Commission: Action Plan: Financing Sustainable Growth, 08.08. 2018, (Com92018) 97 final

[8] Among these, the Commission Communication mentions: standards for green financial products, sustainability in financial advice, sustainability in benchmarks, market research and credit ratings, clarifying investors' and asset managers'

financial regulatory requirements and company law provisions. In some fields proposals the Commission has already tabled proposals for regulations[9].

To what extent these objectives will be attained by this directive is a subject of discussion. Some of the obligations of the directive were already applicable in several Member states, often in a stricter, or less demanding format. This is especially the case for the provisions on Related party transactions[10], but also for the Say on pay rule. On shareholder voting and engagement by institutional investors, its practical effects will only become visible in the longer term.
All this activity supported by the public opinion, indicate that the interest for sustainability issues will continue to expand.

It is too early to assess this directive as to its contribution to the improvement of the governance of listed companies. The new regime the directive introduces is quite flexible, allowing Member states to derogate from its stricter requirements, while reducing the content of some of the obligations to a strict minimum or to an essentially formal procedure. For many of the EU member states, these requirements will constitute a considerable change in present practices[11]

The title of the directive refers to the encouragement of long-term shareholder engagement. "Greater involvement of the shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors, in particular as referred to in the Principles of Responsible Investment supported by the United nations" [12]. This overarching objective is translated in more specific provisions allowing investors to exercise their rights in a more effective way, and to engage with the company and its leadership. At present, most shareholders in listed companies are usually quite remote from the activities and developments of the company, while the latter has difficulty in establishing contact with them. Therefore, this directive aims at activating the relationship between listed companies and their shareholders from today's rather passive and financial approach, to some form of more active dialogue on the company's behaviour and management.

Several tools are used to obtain these objectives: the first one relates to shareholder identification, the second to the obligation of institutional investors to take a more active part in the company's oversight. In both cases, company governance practice may be quite substantially affected.

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sustainability duties, also in prudential requirements, in disclosure and accounting rulemaking, sustainable corporate governance, etc.
In May 2018 the Commission proposed 5 proposals for regulations introducing sustainability perspectives in financial regulation:
Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the establishment of a framework to facilitate sustainable investment, 24.5.2018, COM (2018) 353 final
Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, Brussels, 24.5.2018 COM (2018) 354 final
Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the establishment of a framework to facilitate sustainable investment 24.5.2018, COM (2018) 353 final
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks 24.5.2018 COM (2018) 355 final
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, 24.5.2018 COM (2018) 354 final
COMMISSION DELEGATED REGULATION (EU) .../... of XXX amending Delegated Regulation (EU) 2017/2359 with regard to environmental, social and governance preferences in the distribution of insurance-based investment products 2018-275977V2
COMMISSION DELEGATED REGULATION (EU) .../... of XXX amending Regulation (EU) 2017/565 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that directive 2018 275991V3

[9] In May 2018, the Commission table 5 regulatory proposals

[10] See for an overview: see L. ENRIQUES and T. TROEGER The Law and (Some) Finance of Related Party Transactions: An Introduction, SSRN 3214101

[11] See ESMA, Report on shareholder identification and communication systems, 05.04 2017, ESMA 31-54-435, with a strong call for further harmonisation.

[12] Recital 14, see the six PRI, including the ESG, as developed by investors with a view of developing a more sustainable global financial system, https://www.unpri.org.

1. Shareholder identification

The first and quite conspicuous obligation relates to the right of the listed companies to request the identification of their shareholders: once shareholders are known to the company, the latter might start a dialogue with its shareholders and engage directly on company affairs, resulting in orienting the way shareholders will exercise their – voting and other - rights.

The identification of shareholders was already practiced in certain Member States and usually takes places through the securities holding chain involving at the apex the Central Securities Depositary (CSD) where the shares have originally been deposited and from there on are further transmitted through the chain of intermediaries where the shares have been booked[13]. This quite complex mechanism which is also adopted in the directive, is first intended to allow companies to inform their shareholders and activate their voting rights. But at the same time, it will allow the issuer company to determine which parties are holding shares, but - often more importantly- who is buying or selling shares, and so have a reliable view of its shareholder constituency. One could also analyse this provision as a device for identifying third parties building up a stake which may result in a controlling block or a change of control – in which case a takeover bid might become mandatory – or more common these days, start an activist campaign against the incumbent management. The purpose of the provision is not only to allow the company to communicate with the shareholder, but also to "facilitate shareholder engagement with the company"[14] alluding here to the two sides of communication. Issues of confidentiality have been eliminated: the communication will not breach any restriction on disclosure of information[15]. GDPR would therefore not apply.

This identification system is quite ambitious and will result in considerable costs. The question has therefore been raised whether the identification requirement should not be limited to companies where the shareholder population is very dispersed, as in most European companies, shares are often held in concentrated ownership which is perfectly known to the company's management[16]. The requirement can be limited by the Member states, provided all holdings above 0,5 % will have to be reported[17]. The rule applies to shares registered in a non-EU account: it is expected that the CSD will be able to request information from the foreign depository[18]. It should not further be possible to hold shares secretly, at least as far as the name of the account holder - different from the beneficiary[19] - is concerned.

The identification system constitutes the framework within which shareholder information will be circulated to and from shareholders. It is also the mechanism through which the voting will take place[20]. The pre-meeting information to be addressed to shareholders will be whether directly circulated by the issuer companies to the known shareholders, or through one of the intermediaries for shareholders which were identified in their

[13] The communication will follow the existing standards for Transparency of Holdings (ISO 20022) and Markets Standards for Corporate Actions processing, 2015 and for general meetings. Previously a regime for the notification of major holdings was already applicable: see article 9 of the COMMISSION DELEGATED REGULATION (EU) 2015/761 of 17.12.2014 with regard to certain regulatory technical standards on major holdings and supplementing Directive 2004/109/EC of the European Parliament and of the Council Directive 2004/109/EC of the European Parliament and of the Council of 15.12. 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

[14] Article 3a (4), SRD II

[15] Article 3a (6), SRD II

[16] See ECLE, Shareholder Engagement and Identification, 02.2015, https://europeancompanylawexperts.wordpress.com/shareholder-engagement-and-identification-february-2015/

[17] The decision is in the hands of the company. In many cases, a higher percentage might have reduced the administrative burden of this regime.

[18] This seems the meaning of article 3e SRD II relating to "third-country intermediaries". This notion would include UK intermediaries after Brexit.

[19] Unless under the regime of the Ultimate beneficial owner. Indirectly financial techniques, e.g. options might allow the build-up of long or short positions without individual disclosures.

[20] See article 3c, directive 2017/828 SRD II which refers to the participation of shareholder in the AGM, implying the developing of a multiparty simultaneous communication system.

accounts[21]. Companies may also limit themselves to posting the information on their website. This information mainly relates to the pre-AGM documentation. Conversely intermediaries will transmit information to the issuer but only if it relates to the exercise of the investor's rights, in practice mainly for the exercise of his voting rights. The shareholder is entitled to receive a confirmation of his vote, and that these have been recorded by the company. The same applies to votes cast electronically. Electronic voting was still not widely practised in the mid 2010s but would not be contrary to the directive. The technical modalities of these communications, including their standardised format and content have been detailed in the implementing regulation[22]

These mechanisms may allow companies to enter into discussions with their shareholders but is no to do so.[23] There is no mention of voting platforms organised by the issuers or third parties.

2. The engagement by institutional investors and asset managers.

The second layer of obligations introduces the engagement obligation for different categories of professional investors[24] and asset managers. These investors or advisory organisations are considered important monitors of the company action which is part of investor engagement. The directive states that these investors should develop an "engagement policy" and report annually how the policy has been implemented, mainly by informing the public on how they have exercised the voting rights attached to the shares in their portfolios. What this "engagement policy" contains is described in very broad terms in the directive:

> " the policy shall describe how [these institutional investors or asset managers] monitor investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance, conduct dialogues with investee companies, 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 engagement"' [25].

The directive is more modest as to reporting on actual voting by these investors, as this only relates to the voting behaviour in general and to the most significant votes which have been cast by or on behalf of the investor. In principle, by publishing how votes have been cast, investors could assess how much the asset manager has been able or willing to influence the investee 's behaviour. The disappointed investors have few instruments to influence the company's behaviour: he could sell his portfolio in whole or in part, or the asset manager may have to face a negative rating.

From the governance point of view, the development of an active engagement action may significantly influence the way the investee company is managed. These large investors have to publish how the engagement policy has been implemented, especially by indicating that they have voted according to their policy. This would include disclosure e.g. of how their investment strategy supports the long-term nature of their investments, how they have engaged to improve the performance of the investees, and on which elements investment decisions – including non-financial performance- have been based. Similar obligations

[21] The directive also mentions the hypothesis that the information is directly sent to the shareholder, or to a third party nominated by the shareholder which will receive the information on his behalf: article 3 b (3). This would allow to centralise the information.

[22] Implementing regulation 2018/121 of 03.09. 2018

[23] Article 3b (4) SRD II. Shareholder democracy remains limited to the participation in the AGM. But article 3a (4) SRD II seems to open the door to a broader interaction by shareholders with the company: the system will "facilitate shareholder engagement with the company"

[24] The 'institutional investors' have been defined in a limitative way as: pension funds, insurance companies Are also included Collective investment undertakings (UCITS, AIFs) and proxy advisors (article 1 (6) (c) of Directive 2007/ 36 (SRD I), as modified by Dir 2017/828. (SRD II)

[25] Engagement Policy: investors would have to describe, *inter alia*, how they integrate shareholder engagement in their investment strategy, how they intend to vote in general and to what extent they intend to retain the services of proxy advisers. The Engagement Policy must also include detailed conflict of interest rules. Once a year, institutional investors and asset managers must publish a document on their website detailing how they have implemented such policy. Pursuant to the principle of "comply or explain", investors may also refrain from such annual publication if they give a reasoned explanation as to why this is the case.

apply to asset managers. Information on the use of proxy advisors in the context of their engagement activities will also be relevant. A specific provision addresses conflicts of interests as applicable in these parties' respective regulatory instruments[26]: the conflicts of interest regime would also apply to engagement activities, in other words the engagement - including the related activity of proxy advisors - has to take place on an objective basis.
Disclosure serves as a potent tool: the relevant information will be available on the investor's or asset manager's website and specialized organisations may compare and rate the engagement intensity. The UK FRC has undertaken engagement actions for several years, based on its "stewardship code" published in 2010, on the basis of which these institutional investors would develop their responsibilities as owners of the companies[27].

These requirements apply on a "comply-or-explain" basis[28]. Competition for reputation may be a strong incentive for developing some engagement policy. Up to now the ESAs have not intervened actively in this field.

The effectiveness of these instruments deserves to be further analysed and this in the context of the different ownership structures as exist in the EU. From a legal point of view, the very wide and specific formulation, as copied above, may raise questions as to the nature of the possible intervention of these investors which if pushed too far, may be qualified as "de facto directors", possibly triggering their possible liability for not having paid sufficient attention to e.g. the financial position of the company. On the other hand, from the side of the company directors, these rules may increase their liability if they have not paid attention to critical remarks published by some of these investors.

The possible disciplining action developed by these large investors is best illustrated by referring to the case of the activist investors[29] who have several times obliged companies to modify their policy, their governance or leadership or the structure of the investee group, leading corporate boards to develop best practices for responding to shareholder activism. Similar but less structured action relate to companies put under pressure for respecting gender equality, human rights and other sustainability objectives[30]. Until further notice, action in these fields remains outside the scope of the engagement definition as formulated in the directive.

3. Proxy advisors

The role of the proxy advisors is generally considered an important bridge in the shareholders' governance as they generally represent a large fraction of the shareholders and usually determine the way the votes – especially the institutional votes - are cast at the general meeting. They fulfil an essential function in making the voting system work, as shareholders – including institutional investors and assets managers – are very dispersed, and in the past have shown not to be able to cast their votes, or were not willing to be involved in this aspect of the governance system[31]. The soliciting of proxies was originally the American approach to solve this issue, both for supporting the position of individual shareholders, e.g. candidates for board seats, as for supporting contested votes especially by activists. The advisory function was added later, as the proxy advisors have developed procedures to vote in accordance with the shareholder's views, and this in line with the characteristics of the company and the specific agenda for each meeting. Up the now, the action of proxy advisors was not subject to regulation, although a voluntary code of conduct called 'Best Practice Principles for Providers of Shareholder Voting Research and Analysis' has been developed by the proxy advisors in

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[26] Article 3 g (3) SRD II
[27] See https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf. The FRC has announced a revision of its 2010 code, with i.a. attention to ESG, see Press release 30 January 2019.
[28] Article 3g (1) SRD II
[29] Depending on their legal structure, activist investors would probably be qualified as Alternative Investment Funds.
[30] See about these: Commission Action Plan: Financing sustainable growth, 08.03.2018. Comm (2018) 97 Final Report 2018, and the Commission proposed delegated regulation amending Delegated regulation 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.; Report by the High-Level Expert Group on Sustainable Finance, 180131-sustainable-finance-final-report_en.pdf
[31] See for data C.VAN DER ELST, *Shareholder Engagement and Shareholder Voting Modes: Two of a Different Kind,* 2019, /ssrn.3323848

2014[32].The directive further builds on this practice, formally requesting that they adhere to a code of conduct and report on its application. The code will apply on a "comply-and- explain" basis.

The directive's provision should be situated in the context of the recognition of this advisory business with a view of activating this part of shareholder governance. In the past, there have been concerns about proxy advisors exercising too strong influence on boards, acting without sufficient knowledge of the company's business, not adapting to the specific agenda of the AGM, and more delicate, to offer their services to the companies. ESMA analysed their action and concluded that although there is no clear evidence of market failure, concerns were raised with regard to their independence, the accuracy and reliability of their advice" [33]. It is unclear why the EU did not develop a stronger policy on this topic, the more as proxy advisor develop a significant influence on many aspects of company decision making, such as appointment of directors, setting the level or structure of remuneration level, etc. In 2013, ESMA advised to regulate this activity, especially as far as their code of conduct is concerned[34]. In the 2017 directive, ESMA it has been charged to advise the Commission, which has delivered a report to the Council and Parliament. In a 2016 publication, it concluded that it was still too early to draw conclusions[35] The US congress has introduced regulation and supervision for proxy advisors[36]. In the meantime, a debate has sprung up in the US, leading to strong criticism of the proxy advisor industry[37] and to an initiative in Congress.

It is important to note that the EU requirement also applies to non-EU proxy advisors, the two lead internationally active firms being based in the US.

4. The remuneration policy: "Say-on-pay"

The remuneration of directors and managers has been the subject of quite some controversy. Increasing attention and criticism is being formulated to very high remunerations, and this from the angle of fairness and relative contribution to the company's management[38]. Gender discrimination in remuneration has become one of the most controversial items in the gender debate. Procedures such as involving the employees in determining remuneration have been considered[39]. Remuneration has also become a decisive factor in the relocation context.

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[32] See D. ZETZSCHE, *Best Practice Principles for Proxy Advisors and Chairman's Repor*t, 23 .08.2014, (article 1(5)

[33] Follow-up on the development of the Best Practice Principles for Providers of Shareholder Voting Research and Analysis, 18.12. 2015, ESMA 2015/1887 https://www.esma.europa.eu/press-news/esma-news/esma-publishes-report-proxy-advisors'-best-practice-principles

[34] Feedback statement on the consultation regarding the role of the proxy advisory industry, ESMA 19.02 2013, 2013/84, including guidance for a Code of Conduct.

[35] ESMA Proxy advisors – an overview of the EU market, SMA Report on Trends, Risks and Vulnerabilities, 02 .11. 2016. P. 38. The analysis mainly dealt with the process the leading proxy advisors had followed to draw up their code of conduct.

[36] The Corporate Governance Reform and Transparency Act 2017 providing for registration with the Securities and Exchange Commission (SEC), disclosure of potential conflicts of interest and application of the codes of ethics, and make publicly available their methodologies for formulating proxy recommendations and analyses. See T.M. Doyle, The conflicted role of proxy advisors, Harvard Mat 22, 2018. See CNBC, A Congressman call these Wall Street proxy advisory firms "Vinny down the street" for their power to pressure companies, 28 June 2018,

[37] See e.g. T.M. DOYLE, *The Conflicted Role of Proxy Advisor*s, https://corpgov.law.harvard.edu/2018/05/22/the-conflicted-role-of-proxy-advisors/ May 22, 2018m, with 5 recommendations, referring to them as "shadow regulators"; for the Report, http://accfcorpgov.org/the-conflicted-role-of-proxy-advisors-report/; F.M. Placenti, *Are Proxy Advisors Really a Problem*?, https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-really-a-problem/; S. SEELIG and P. ARORA *The Regulation of Proxy Advisor*s, referring to H.R. 4015, https://corpgov.law.harvard.edu/2018/08/03/the-regulation-of-proxy-advisors/

[38] Comparative studies are important in this context: see *Executive Directors' Remuneration in Comparative Corporate Perspective*, *Edited by* C.VAN DER ELST , 2015, Kluwer L.I. ; for the banking sector; see: AFME, Review of the Reward Environment in the Banking Industry – May 2017, by McLagan Aon Hewitt https://www.afme.eu/en/reports/publications/afme-prd-review-of-the-reward-environment-in-the-banking-industry--may-2017/; see also the Swiss Minder initiative on executive pay, 2013, adopted by referendum.: P.FORSTMOSER, *Die "Lex Minder" Ein Schuss in den Ofen*? FS von der CRONE,2017; AMF, French and European "say on pay" regimes, 03.05.2017; C. C.VAN DER ELST, A. LAFARRE *Shareholder Voice on Executive Pay: A Decade of Dutch Say on Pay*, EBOR, 2017, 51.

[39] See on the position of the Trade Unions: A. JOHNSTON, A. and P. MORROW, The *Revised Shareholder Rights Directive 2017: Policy Implications for Workers,* ETUI Research Paper - 2/2018. SSRN: https://ssrn.com/abstract=3179973

In the banking sector, the remuneration of directors and senior management is subject to restrictions, several of which are risk related[40]. In the non-banking sector, the remuneration of directors and senior managers is not regulated, being freely determined by the general meeting. In some jurisdictions, the remuneration should conform to the generally formulated remuneration policy as approved by the general meeting.

The shareholder rights directive, which is only applicable to listed companies, builds further on a double approach, on the one hand by requiring companies to establish a remuneration policy, which is approved by the AGM, on the other by mandating elaborate disclosures which are subject to an advisory vote by the AGM. The first step requires companies to develop an effective, stable management, to be applied year after year.

The policy statement shall i.a. indicate how it supports the long-term business strategy, interests and sustainability of the company. It should also explain how the pay and labour conditions of the employees in general have been considered[41]. This provision would not mandate a formal pay ratio to be set, nor require that this specific information would have to be published[42] . Special conditions apply to variable remuneration, among the criteria for which "corporate social responsibility" is mentioned.

This policy as approved in the AGM is binding, although national law can provide that the vote is advisory, leaving the previously adopted policy in place[43].

However, the directive provides for quite some flexibility: on the one hand, Member States may derogate by declaring that the general meeting may declare the policy to be "advisory", while temporary derogations may be adopted by companies in certain exceptionally "procedural" circumstances[44], which are needed in a perspective of serving temporarily the company's long-term interests, the sustainability of the company or insure its viability.

For listed SMEs, the Member state may provide for a discussion in the AGM, rather than a formal vote[45].

The application of the remuneration policy will state for each director – and former director - how the policy has been applied, with details of the components of the remuneration, its variance over time, the split over the group companies, etc. The evolution of the remuneration over time – also in comparison with the employee remuneration – may be a subject for active discussion in the AGM[46] .This remuneration report, having been checked by the auditor[47], will be submitted for an advisory vote of the AGM., and be made publicly available.

A remuneration report will have to be drawn up containing detailed information individually on each director's remuneration and its components or conditions. It will be submitted to an advisory vote at the annual AGM. This report will allow to verify whether the agreed remuneration respects the conditions of the policy[48]. In practice this may lead to criticism of the overall remuneration structure, and more precisely of the remuneration of individual directors. In this debate, the proxy advisors often play a decisive role[49] indicating that disclosure may open the door to more substantive criticism.
The report will be posted on the company's website for a period of 10 years[50].

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[40] See article 92 e.s. CRD IV
[41] Article 9a (6) SRD II; "pay ratios "are calculated in US and UK companies.
[42] See e.g. https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/ceo-pay-ratio-prep.aspx. But the remuneration report should inform "about the change .. of average remuneration on a full- time equivalent basis of employees… over the last 5 years. ", and related to company performance. Article 9 b (1)
[43] Article 9a (3) SRD II
[44] I.e. the circumstances in which this exception may come into play and the elements of the policy which are open for adaptation.
[45] Article 9 (b)((4) SRD II
[46] Article 9 b (1) (b) SRD II
[47] Or by the audit firm, separate from the auditor, which is a new approach to this activity.
[48] A clawback provision is also to be provided.
[49] Impact on Say-on-Pay and Influence of Proxy Advisors , Willis Towers Watson: *Shareholders rights directive*, Autumn 2017 https://www.willistowerswatson.com/en/insights/2017/12/implications-of-the-eu-shareholders-rights-directive-autumn-2017
[50] Article 9b (3) SRD II

5. Related Party Transactions (RPTs)

Another very much debated subject relates to the "related party transactions"[51]: it refers to material [52] transactions with "related parties"[53], creating conflicts of interest. The simple case is the one of a director entering into a contract with the company, whether personally or through a separate legal entity. More complicated cases are met in the field of groups of companies where transactions between affiliated companies may raise concerns about the fairness of the transaction, or the business interests for the group companies. Controlling shareholders, or powerful directors may also direct benefits from the company to themselves or to a company in which they own an important stake.

Many countries have adopted more or less elaborate regulation dealing with RPTs: these are often based on ex ante notification to the board which will request a report on the fairness of the transaction from the position of the company and possible prejudice to its future development and that of its shareholders. An independent expert or third party, but also the supervisory board, or the audit committee[54] may be in charge of drawing up this report. The approval of the transaction may take place – depending on national law – whether by the supervisory board or - if provided - also by general meeting, the conflicted party not take part in the decision.[55] The decision will be announced upon its conclusion, at the latest.

The special committee will report to the full board, where the transaction may be approved, or not. In some jurisdictions the approval of the general meeting is also required. The conditions of the transactions will be publicly disclosed.

The directive follows by and large this approach: main differences are the provision that the expert may be the supervisory body of the company, if any, or its audit committee, or a committee of independent directors[56]. Depending on the national legislator's choice, the transaction itself will have to be approved by the board of the company, by its AGM or by both, excluding the related party. In principle the related party should not take part in the vote: however, the law may allow that party to vote if there are sufficient safeguards and provided there is no opposition from the other shareholders of from the majority of independent directors.

In addition, national legislation may exclude from this regime certain transactions which typically contain little to no specific risk of being unfair: these are the transactions between a company and its fully owned subsidiaries, specified transactions for which fair treatment and adequate protection of the company or its shareholders are guaranteed, but also agreements relating to the remuneration of directors, adopted in applying the above provisions on remuneration approval. The same applies to transactions at normal market conditions[57].

The level of safeguards provided by the directive's provision are not very restrictive: in Member states where no regime on RPT was in force, they may lay down the basic minimal arrangement for these transactions in

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[51] L.ENRIQUES, *Related Party Transactions: Policy Options and Real-World Challenges* (with a Critique of the European Commission Proposal), European Business Organization Law Review, 16, 27-31 (2015); M. BIANCHI, L. ENRIQUES and M. MILIC. *Enforcing Rules on Related Party Transactions in Italy: One Securities Regulator's Challenge*, SSRN 3188063; M. Roth, *Related party transactions: board members and shareholders The European Commission proposal and beyond,* working paper, January 2016, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2710128 ; ICLEG, Report on the Recognition of the Interest of the Group, SSRN 2888863; see L.ENRIQUES and T.TROEGER., *The Law and (Some) Finance of Related Party Transactions: An Introduction*, SSRN 3214101; See on the widely diverse, actual practice in OECD countries; Corporate Governance Factbook, 2017, 3.4 , 65.

[52] Materiality will be defined by the Member state on the basis of quantitative ratio's, determining 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" (article 9c (1). For transactions in the ordinary course of business, another regime applies, based on an internal procedure and with periodic assessment.

[53] Defined as stated in the accounting standard IAS 24 on related party disclosures.

[54] Or a committee majority composed of independent directors.

[55] In the AGM, the approval may take place with the conflicted shareholder attending, if the is no opposition from other shareholders or of independent directors. "Safeguards" have to be provided.

[56] Being "fair and reasonable' from the perspective of the company and its not conflicted shareholders.

[57] Article 9 c (5) and (6) a and b. SRD II

accordance with the directive. But in most EU jurisdictions, a higher level of protections already applies, especially as to their fairness and these conditions should remain applicable to the extent that they guarantee a fair treatment and adequate protection[58]. This does however not mean that the protection of investors in these jurisdictions is very much superior, as these national regimes often are applied in a purely formal way. The ultimate guarantee will be found in the judicial protection in case of unfair or prejudicial transactions. Also, the national laws may declare the directive's requirements not applicable for "specific type of transactions which are protected without a shareholders' vote, subject to a fairness test, adequately protecting the interests of the company and the shareholders[59].

The directive does not explicitly deal with issues of groups of companies: frequently transactions between group entities are criticised from the angle of their financial fairness. Not only the financial conditions of the transaction, but the transaction may be questioned whether it serves the interest of the group, above the interest of the individual party concerned[60].

The directive limits the range of exceptions: Member States may exclude transactions with a wholly owned subsidiary if there are no other related party interests involved, or where the interests of the subsidiary or its stakeholders have been adequately protected[61]. Another exemption may be allowed in the national law, if the interests of the company and of the non-group shareholders are adequately protected: this might be the case for a transaction provided the parties have agreed to an adequate quid pro quo, - even if the balance between the two sides will only be determined in the long term -, and have secured that the transaction would not lead the subsidiary into insolvency[62]. However, the directive limits this exemption to "clearly defined types of transactions", for which a decision of the general meeting is requested.

Others exceptions apply to transactions necessitated by financial stability concerns, as adopted by the prudential authorities. Also exempted are decisions on the remuneration of directors, adopted in accordance with the directive and the applicable national provisions.

Conclusion

Shareholder governance is part of general corporate governance: it introduces rules to ensure that shareholders can effectively participate in company decision making and development. It is presumed that by doing so, company boards will adopt a more long-term vision, and will better oversee their risks. Identification of shareholders, supporting their participation in the AGM and engagement by institutional investors are the tools to achieve this objective. The proposed directive was opposed by the business organisations especially it sections on say on pay and on related party as being too strictly regulatory[63]. The final version of the directive has followed a different path: in many of its provisions, a "comply-or-explain" faculty has been opened, making the requirement optional. Also, the enforcement of the provisions is generally based on a disclosure process, leaving their enforcement largely to the appreciation of the markets.

In addition, the directive contains some contriving rules in two fields where shareholders should fear to be confronted by damaging conflicts of interest: remuneration of directors and related party transactions. Here the safeguards are process and disclosure bound. On remuneration, the objective is to moderate its amount,

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[58] See for these conditions: article 9c (6) (a) and (b) SRD II, " fair treatment of all shareholders"

[59] Article 9c (6) SRD II

[6060] See the reference to this criterion in article 9) (c) (6) (e) SRD II

[61] E.g. that the creditors have been fully secured. Would German group law – with compensation duty "Ausgleich" – meet this condition?

[62] These are the conditions of the so-called Rozenblum doctrine in which the French Cour de cassation stated: "the financial aid consented by the managers of the company which is part of a group in which they are directly or indirectly interested, should be motivated by the common economic interest in relation with the global policy of the group, should not be devoid of counterpart and should not provoke imbalance of the mutual obligations, nor exceed the financial capacity of the solicited company". Criminal Chamber, 04. O2. 1985, Rozenblum and Allouche, D. 1985, p. 478, n. D. Ohl, I-639, JCP 1986, II-20585, n. W. JEANDIDIER, Rev. soc. 1985, p. 648, n. B. Bouloc.

[63] See Business Europe, *Comments to the Shareholder Rights Directive;* https://www.businesseurope.eu/sites/buseur/files/media/imported/2014-00889-E.pdf, 03.10. 2014, i.a. as to its regulatory formulation, and its one size fits all approach. Also, it considered that it amounts to a blurring of the role of the board and the AGM.

or at least keep it within the boundaries of the agreed policy.   On related party transactions, the safeguards have to be found in an explicit procedure, calling for ex ante disclosure, expert advice, and approval by the AGM.

The directive introduces these objectives without making explicit reference to supervisory instruments, but relies on ex-ante policy statements, disclosure, internal procedures, but especially allowing shareholders to adopt decisions that the companies consider being in the interest of their companies. It will be interesting to see how the securities supervisory authorities will deal with these provisions.

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