

Second Shareholders' Rights Directive

AIFMs, UCITS ManCos, AIFs and SMICs

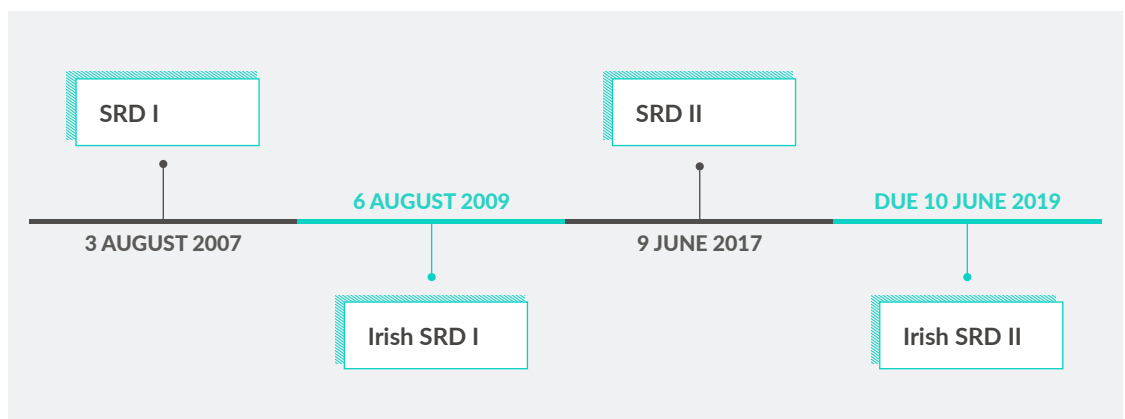
- The second Shareholders' Rights Directive (SRD II) is due to be implemented into national law by 10 June 2019.
- SRD II contains transparency provisions which are applicable specifically to AIFMs, UCITS ManCos and SMICs. One requirement is to have a shareholder engagement policy - or explain why one is not in place. Another is a requirement to disclose certain information annually to institutional investors with which a certain arrangement is in place. There is no member state discretion to exempt UCITS or AIFs from these requirements.
- The requirements of the first Shareholders' Rights Directives (SRD I) applied to listed companies having their registered office in a member state, including listed corporate UCITS and AIFs. Ireland exercised the member state discretion afforded in SRD I to exempt UCITS and AIFs from the provisions of the Irish implementing legislation.
- SRD II provides for a similar discretion with some of its requirements. Once the Irish implementing legislation for SRD II is available it will become clear if any exemptions provided for UCITS and AIFs under SRD II have been introduced into Irish law.

The Irish legislation implementing SRD I established requirements in relation to the exercise of certain rights of shareholders in listed companies. Irish UCITS and non-UCITS funds - today's equivalent are AIFs - were exempted from applying its requirements.

SRD II has an additional focus and aims to encourage long term shareholder engagement.

SRD II requirements apply in relation to:

- the identification of shareholders
- transmission of information
- facilitation of exercise of shareholders' rights
- transparency of institutional investors
- asset managers and proxy advisors
- remuneration of directors
- related party transactions



Exemptions and scope

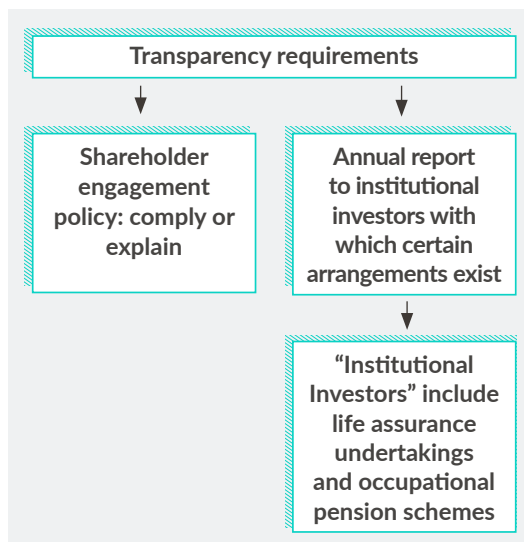
Member States may exempt UCITS and AIFs from certain provisions of SRD II, except the chapter on transparency of institutional investors, asset managers and proxy advisors.

The definition of asset manager in SRD II includes an authorized AIFM (AIFM), a UCITS management company (UCITS ManCo) and a self-managed UCITS investment company (SMIC). The SRD II definition will potentially put in scope non-EU AIFMs managing even a single AIF. The transparency requirements of SRD II apply to asset managers.

It is likely that any legal form, including an ICAV, of UCITS and AIFs will be in scope of the transparency requirements. This would be logical. However, SRD II states that “the companies” referred to in the definition of AIFs and SMICs cannot be exempted from the transparency provisions. Internally managed AIFs are not separately listed in the definition of asset manager. SRD II states elsewhere that AIFs may not be exempted from the transparency provisions. Therefore the analysis below of the transparency requirements can be read as if it applies to AIFs in the same way as it applies to SMICs. It would be welcome if these two points are clarified in the Irish implementing legislation.

The definition of asset manager also includes MiFID entities. SRD II uses the term “asset manager” only, and this should be borne in mind when interpreting whether and how the transparency requirements might apply to AIFMs, UCITS ManCos, AIFs and SMICs.

Transparency requirements



Shareholder engagement policy

The SRD II requirements which apply to AIFMs, UCITS ManCos, SMICs and AIFs apply to the extent they invest on behalf of investors in shares of companies traded on a regulated market.

It's worth noting that elsewhere in SRD II, the trigger for application of the transparency requirements is investment in “shares of companies which have their registered office in a Member State and the shares of which are admitted to trading on a regulated market situated or operating within a Member State”. However a logical interpretation suggests that the potentially broader trigger of “shares of companies traded on a regulated market” is the one which applies to asset managers.

AIFMs, UCITS ManCos and SMICs will be required to either:

- Develop and disclose a shareholder engagement policy, as well as disclosing annually how they implement the policy and disclosing how they have voted in general meetings of companies of which they hold shares; or
- Disclose a clear and reasoned explanation of why they have not complied with any of these requirements.

The engagement policy must describe how AIFMs, UCITS ManCos and SMICs integrate shareholder engagement in their investment strategy, monitor investee companies on relevant matters, conduct dialogues with investee companies, exercise voting and other rights, co-operate with shareholders, communicate with investee company stakeholders, and manage actual and potential conflicts of interest.

The annual disclosure of the policy's implementation must include a description of voting behaviour, an explanation of the most significant votes and the use of proxy adviser services.

All this information must be freely available on the AIFM's, UCITS ManCo's or SMIC's website or by other means easily accessible online.

Disclosure to institutional investors

An **arrangement** is 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.

Some analysis will be needed to establish if a particular AIFM, UCITS ManCo or SMIC has entered into an arrangement as defined in SRD II. It is clear how a MiFID authorized investment manager could enter into an arrangement. It should also be straightforward in the case of AIFMs and UCITS ManCos authorized for and engaging in individual portfolio management. For AIFMs and UCITS ManCos managing AIFs and UCITS and for SMICs and internally managed AIFs it will be worth analysing each arrangement.

If an AIFM, UCITS ManCo or SMIC invests on behalf of an institutional investor by way of an arrangement, the AIFM, UCITS ManCo or SMIC will be required to disclose, on an annual basis, to the institutional investor with which they have entered into the arrangement:

- how their investment strategy and 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.
- reporting on the key material medium to long-term risks associated with the investments, on portfolio composition, turnover and turnover costs, on the use of proxy advisors for the purpose of engagement activities and their policy on securities lending and how it is applied to fulfil its engagement activities if applicable, particularly at the time of the general meeting of the investee companies.
- whether investment decisions have been made based on evaluation of medium to long-term performance of the investee company, including non- financial performance
- whether conflicts of interests have arisen in connection with engagements activities and how the AIFM, UCITS ManCo or SMIC has dealt with them.

SRD II allows member states the discretion to disclose the above information in the annual report or by periodic communications to investors. Where the information described

above is already publicly available, the AIFM, UCITS ManCo or SMIC is not required to provide information to the institutional investor directly.

Member states also have discretion to require the information above to be provided to other investors of the same fund on request only where the AIFM, UCITS ManCo or SMIC does not manage the assets on a discretionary client-by-client basis. We will see how the Irish implementing legislation deals with this point.

Institutional investor disclosure of arrangement

Where an institutional investor has an arrangement with an AIFM, UCITS ManCo or SMIC, that institutional investor will be required to make certain disclosures publicly. This is not an obligation of the AIFM, UCITS ManCo or SMIC. It is worth being aware that the information prescribed in SRD II about the arrangement will be in the public domain.

Existing regulatory obligations

When establishing how Irish AIFMs, UCITS ManCos, AIFs and SMICs comply with the requirements of SRD II that apply to them, it will be worth examining if there is any crossover with existing statutory and regulatory obligations, such as conduct requirements, which already apply. One example is the requirement for UCITS and AIFMs to have strategies for exercising voting rights.

Conclusions

- The SRD II requirements affecting Irish AIFMs, UCITS ManCos, AIFs and SMICs can be analysed with more certainty when the Irish legislation implementing SRD II, due by 10 June 2019, is enacted.
- It is possible that Ireland will exempt UCITS and AIFs from the SRD II obligations relating to identification of shareholders, transmission of information, facilitation of exercise of shareholders' rights, remuneration of directors and related party transactions. This would be a similar approach to that taken for SRD I.
- The SRD II transparency requirements that apply to AIFMs, UCITS ManCos, AIFs and SMICs apply to the extent they invest on behalf of investors in shares of companies traded on a regulated market. A "regulated market" is that defined in MiFID II.

- No provision is made to allow member states to exempt UCITS or AIFs from the SRD II transparency requirements. The transparency requirements apply to asset managers which will include Irish AIFMs, UCITS ManCos, AIFs and SMICs. This means that for these entities there will be (a) a requirement to put in place a shareholder engagement policy or explain why this has not been done and (b) a need to analyse how the annual disclosure requirements to institutional investors may apply.

You can contact a member of the **A&L Goodbody Asset Management & Investment Funds team** for advice and assistance with compliance with the requirements discussed above.

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