European Commission - Fact Sheet

Shareholders' rights directive Q&A

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Today, the European Parliament has voted its report on the revised Shareholders' rights directive. The final adoption step will take place in the European Council shortly. The directive will enter into force two years after its publication in the official journal.

Why did the Commission revise the Shareholders 'rights directive?

The financial crisis had shown that many shortcomings in corporate governance of listed companies contributed to the financial crisis. For example:

- important deficiencies in the engagement and control by shareholders impede good decision-making by companies;
- excessive directors' pay not justified by performance has led to mistrust among shareholders and the society at large;
- complicated access and costly procedures for exercise of shareholder rights.

The new rules aim to contribute to the long-term sustainability of the EU companies, enhance the efficiency of the chain of intermediaries and to encourage long-term shareholder engagement.

Is there evidence today that short-term strategies are driving corporate governance?

Yes. There is evidence today that there is often focus on short-term strategies.

This is in particular the case concerning institutional investors (pension funds, insurance companies) and asset managers which play a key role in the Europe economy. Indeed, institutional investors own the major part of the shares of listed EU companies and asset managers manage the assets on behalf of a majority of these institutional investors.

- The performance of asset managers, employed by institutional investors to manage their assets, are often evaluated on a quarterly basis or even on shorter periods, which doesn't allow them to take into account long-term performance and puts pressure on them to deliver short-term returns.
- The average share-holding period is 8 months.
- On average, fund managers turn their entire portfolio in every 1.7 years.

In addition, several recent cases where extremely high remuneration of CEOs perceived as unduein the light of the weak performance of the director or the difficult situation of the company, provoked the dissatisfaction of shareholders.

What are the main changes?

- **Stronger shareholders 'rights and facilitation of cross-border voting:** the new rules will make it easier for shareholders to exercise their rights. Intermediaries, such as banks, will have to ensure that they pass on the necessary information from the company to the shareholders, and vice versa. The new rules will ultimately make it easier for shareholders resident in another EU country than where the investee companies is based to participate in the general meetings of such companies and vote.
- **Long-term engagement of institutional investors and asset managers:** the new rules willrequire institutional investors and asset managers to be transparent about how they invest and how they engage with the investee companies. Through increased transparency requirements, the Directive encourages these investors to adopt more-long-term focus in the investment strategies and to consider social and environmental issues. These new rules will be based on a 'comply or explain' approach. This means that if the investor decides not to comply with the rules, he needs to provide explanations why this is the case. The approach is similar as in corporate governance codes and stewardship codes. There is no requirement to reveal any confidential information.
- **More transparency of proxy advisors:** the new rules will require proxy advisors to disclose certain key information about the preparation of their recommendation and advice and to report about the application of the code of conduct they apply.

- **Shareholders will have a "say on pay":** the new rules will encourage more transparency and accountability about directors' pay. Shareholders will have the right to know how much the company's directors are paid and they will be able to influence this. This will guarantee a stronger link between pay and performance.
- **Related party transactions**: the new rules will require companies to publicly disclose material related party transactions that are most likely to create risks for minority shareholders at the latest at the time of their conclusion. Companies will also have to submit these transactions for approval of the general meeting of shareholders or of the board.

What is the "say on pay"? How will it work in practice? What is the difference between the binding and advisory vote?

A say on pay is the ability of shareholders to vote on the remuneration awarded to company directors.

According to the new rules, shareholders will be able to express their view twice. First they will vote *ex ante* on the remuneration policy which lays down the framework within which remuneration can be awarded to directors. Second they will vote *ex post* on the remuneration report describing the remuneration granted in the past financial year.

The vote on the remuneration policy will in principle be **binding**, which means that companies are only able to pay remuneration on the basis of the policy approved by shareholders. Member States will however have the possibility to opt for an **advisory** vote. This means that companies are allowed to apply a remuneration policy which has been rejected by shareholders, but are required to submit a revised policy at the next general meeting.

The vote on the remuneration report will be advisory. Member States will also have the possibility to allow companies to replace this vote by a discussion at the general meeting.

Why is there a need to regulate directors' remuneration?

Directors' remuneration plays a key role in aligning the interests of directors and shareholders and ensuring that the directors act in the best interest of the company. The way directors are paid influences their decision. If the pay incentives focus exclusively on short term, decisions may be taken by directors with too much focus on short term, with prejudice for the company in the long-term. There is need for proper oversight to ensure that the pay is in line with long-term interests and sustainability of the company.

Directors' pay, and in particular its relationship with performance, is a key concern for shareholders and other stakeholders. However, it is often difficult to identify the important information in the current directors' remuneration reports. The complexity of directors' pay makes it hard to disentangle what executives are actually earning and to judge whether this is appropriate. The quality of disclosure is insufficient. This makes it time consuming and costly to assess remuneration and to compare between companies, especially across borders.

How will the new rules increase the level and quality of engagement by institutional investors and asset managers?

The new rules will require institutional investors to disclose how they take the long-term interests of their beneficiaries into account in their investment strategies and how they incentivise their asset managers to take these long-term interests into account. Asset managers will be required to report to the institutional investors for whom they manage funds how they have performed in relation to their mandate.

The new rules will also require institutional investors and asset managers to disclose their engagement policies including their implementation. Through increased transparency requirements, the new rules will encourage these investors to adopt more-long-term focus in their investment strategies and to consider social and environmental issues.

Do the new rules result in an obligation to vote or to engage for institutional investors and asset managers?

There is no obligation to vote or to engage.

Institutional investors and asset managers will only be required to disclose an engagement policy and how it has been implemented, including how they have voted.

The requirement applies on a 'comply or explain' basis. This means that investors may choose not to disclose an engagement policy or its implementation, provided that they give an explanation why this is the case.

What is the benefit of an EU framework for shareholder identification?

The new rules will give companies the right to identify their shareholders. It will oblige the chain of intermediaries to pass on relevant information and to facilitate exercise of shareholder rights including voting. The shareholders' personal data will be protected throughout the chain. This will make communication and interaction between companies and investors possible and more efficient. Currently, in particular in cross-border situation, there are many layers of intermediaries between companies and investors and information is not always passed between companies and investors.

Communication between companies and shareholders will facilitate shareholder engagement with investee companies. However, shareholders will not be obliged to engage.

How will the new rules solve the problem of exercising rights (e.g. voting rights) by shareholders, in particular in cross-border situations?

The new rules will significantly improve the exercise of rights by all shareholders, including retail shareholders. Many problems arise when there is more than one intermediary between the listed company and the shareholder, especially in cross-border situation. The new rules will require intermediaries to transmit the voting information from the shareholder to the company. Companies will be required to confirm the votes cast at the request of the shareholder. Shareholders could therefore be certain that their votes have effectively been cast, including across borders.

What are proxy advisors? Why is there a need to regulate them?

Proxy advisors are companies specialised in analysing company disclosures and providing advice for investors on how they should vote at the general meeting of shareholders. As institutional investors and asset managers generally have a large number of companies in their portfolios, proxy advisors play a necessary and important role in providing useful voting recommendations, especially in case of cross-border shareholdings.

The important role of proxy advisors also gives them a key role in improving shareholder engagement. To ensure reliable and high quality recommendations and to enhance trust in such services, the proposal would require proxy advisors to disclose certain information about the ways in which they prepare voting recommendations.

Who do the new rules apply to?

More than 8000 listed companies on the EU regulated markets, whatever their sector of activity, capitalising around €8 trillion.

What is the relationship between the rules on remuneration in the Shareholder rights directive and in the Capital Requirements Directive IV?

The Capital Requirements Directive IV rules apply to financial institutions irrespective of whether listed or not. The logic of the rules is different, as the objective of the CRDIV rules is to preserve the financial stability of the financial institutions and it contains more detailed rules on the structure of the pay. The Shareholders Rights Directive on the other hand only deals with transparency and shareholder say on pay.

For further information

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