

# ALLEN & OVERY

## Second shareholder rights directive: impact on the Luxembourg banking sector

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On 1 August 2019, the Luxembourg legislator amended the act of 24 May 2011 relating to the exercise of certain shareholder rights at general meetings of listed companies (the **Act**), thereby implementing the second shareholder rights directive (**SRD II**)<sup>1</sup>.

The new rules have an impact not only on listed companies but also on intermediaries, institutional investors, asset managers and proxy advisors that are interacting with listed companies<sup>2</sup>.

In particular, a Luxembourg credit institution or investment firm offering (ancillary) custody services<sup>3</sup> to its clients in relation to shares<sup>4</sup> admitted to trading on a regulated market (within the meaning of MiFID II<sup>5</sup>) may have to comply with certain obligations under the Act as an intermediary (1.). Alike, a Luxembourg credit institution or investment firm offering portfolio management services to its clients (within the meaning of MiFID II) in relation to shares of companies based in the European Union (**EU**) admitted to trading on a regulated market will be considered as an asset manager and bound by certain obligations under the Act (2.).

This eAlert will focus on the new requirements applicable to these Luxembourg professionals of the financial sector (**PFS**).

### 1. *Obligations when providing custody services*

#### 1.1 Scenarios in which certain obligations under the Act apply to Luxembourg PFS

Luxembourg PFS are subject to the obligations set out in the Act for intermediaries when they provide custody services in relation to Luxembourg companies:

- whose shares are admitted to trading on a regulated market within the meaning of MiFID II established or operating in a Member State of the EU; or
- that have opted, on a voluntary basis, to comply with the rules set out in the Act when their shares are admitted to trading on a regulated market in a third country<sup>6</sup> that operates regularly and is recognised and open to the public;

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<sup>1</sup> 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.

<sup>2</sup> See our preceding eAlerts on the implementation of SRD II in Luxembourg for more detail: <https://bit.ly/34jGYcW> and <https://bit.ly/2YLRUil>.

<sup>3</sup> Custody services must be understood here as services consisting in the custody of financial instruments within the meaning of Annexes I and II to the act of 5 April 1993 on the financial sector, as amended. For the purpose of this eAlert, this includes services such as safekeeping or administration of shares or maintenance of securities accounts on behalf of investors (in line with the definition of the concept of intermediary in the Act). This concept does not include the provision of custody services to collective investment schemes.

<sup>4</sup> According to the Act, the concept of shares includes shares with or without voting rights and profit shares with voting rights.

<sup>5</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

<sup>6</sup> **Third country** means a country that is not a Member State of the EU.

(together, the **Listed Companies**)<sup>7</sup>.

Since the obligations in question derive from an EU directive, similar obligations may apply to Luxembourg PFS when they provide custody services in relation to shares of listed companies established in other EU jurisdictions. The obligations applicable in such cases should however be assessed in light of the relevant national legislation implementing SRD II in the EU jurisdictions concerned.

## 1.2 Key obligations

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

Intermediaries must take all necessary measures (including providing to shareholders all relevant information) to enable shareholders to participate in, and vote at, general meetings of shareholders and, more generally, to exercise all rights attaching to their shares, 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.

Information exchanges between Listed Companies and intermediaries must take place in accordance with the technical rules set out in the European Commission's Implementing Regulation 2018/1212<sup>8</sup>.

## 1.3 Actions to be taken by Luxembourg PFS to be compliant

In light of these new requirements, prudence commands that Luxembourg PFS review their contractual agreements governing the provision of custody services to their clients as well as their list of tariffs in order to ensure that they are in line with their new obligations under the Act.

In addition, while article 1bis (4) of the Act should be construed as an exemption to the professional secrecy obligation for transfers of client data made by intermediaries in accordance with the Act, Luxembourg PFS should nonetheless consider potential amendments in their contractual documentation to allow for the transfer of client data to a listed company (and potential intermediaries between the Luxembourg PFS and the listed company) in a cross-border scenario (that is not covered by the Act) without breach of professional secrecy.

# 2. *Obligations when providing portfolio management services*

## 2.1 Scenarios in which certain obligations under the Act apply to Luxembourg PFS

Luxembourg PFS are subject to the obligations set out in the Act for asset managers when they invest in any company whose shares are admitted to trading on a regulated market of a Member State of the EU within the meaning of MiFID II (**EU Listed Companies**).

## 2.2 Key obligations

Asset managers must develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. In particular, the engagement policy must describe how they monitor strategic, financial, environmental, social and governance matters at the level of EU Listed Companies and how they interact with EU Listed Companies, the other shareholders and the other stakeholders. According to the Act, asset managers must also ensure that their existing policy on conflicts of interest takes into account conflicts arising out of their engagement activities.

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<sup>7</sup> For the sake of completeness, note that while the terminology used in the Act is somehow confusing, it is arguable, in light of the provisions of SRD II, that the obligations set out in the Act for intermediaries will apply to all intermediaries in the chain, regardless of where they are established, but only to the extent that they provide services to Listed Companies having their registered office in Luxembourg.

<sup>8</sup> Commission Implementing Regulation (EU) 2018/1212 of 3 September 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.

Asset managers must also publicly report every year on how they implemented their engagement policy, specifically in terms of exercise of voting rights (i.e. description of voting behaviour, explanation on significant votes, report on votes cast and use of proxy advisors).

If they do not intend to comply with these requirements, they must publicly disclose a clear and reasoned explanation why they have chosen not to do so.

Publication takes place on the relevant asset manager's website and must be updated annually unless there is no material change.

### **2.3 Actions to be taken by Luxembourg PFS to be compliant**

Luxembourg PFS must develop and publicly disclose an engagement policy and also review their policy on conflicts of interest to ensure consistency with their engagement policy. Luxembourg PFS must further define the necessary procedures and processes (including internal control measures) to ensure the proper implementation and publication of their engagement policy.

In addition, Luxembourg PFS must define the necessary procedures and processes (including internal control measures) to ensure the timely publication of their annual report on engagement activities.

## *3. Potential sanctions*

Under SRD II, Member States of the EU have the ability to choose which sanctions will be appropriate in the case of infringement, provided that they are “*effective, proportionate and dissuasive*”. The Act retains the joint and several liability of the “executives”<sup>9</sup> of the Luxembourg PFS for any damage resulting from a breach of their obligations. Failure to comply will thus not automatically result in a sanction as damage must first be proven.

Should you wish to know more about your new obligations under the Act and the impact on your contractual documentation and internal policies, please contact the experts identified below.

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<sup>9</sup> 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 the vice managing officer (*directeur général adjoint*), if these functions exist.

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