

SHAREHOLDER RIGHTS DIRECTIVE II

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SRD II IS LIVE

The updated Shareholder Rights Directive from the European Commission will have a profound impact on U.S. broker-dealers and custodians trading securities in European Economic Area (EEA) and European Union (EU) markets.

As the global capital markets have faced a pandemic and an unstable American economy, U.S. broker-dealers have had to prepare for the implementation of the Shareholder Rights Directive II (SRD II) from the European Commission.

This update to 2007's EU-directed SRD I mandate aims to strengthen the shareholder's role in the financial marketplace, promote long-term shareholding and reduce excessive risk from companies that issue stocks. It also requires brokers and custodians to rely more on electronic data while respecting the EU's demand for shareholder privacy.

SRD II is one of the first pieces of legislation that sets out detailed obligations with respect to operational processes in the custody chain. Moreover, it's part of a broader regulatory agenda to improve transparency and stewardship in capital markets as well as the health of EEA and EU markets and economies.

WHAT IS THE FOCUS OF SRD II?

SRD II FOCUSES ON SEVERAL KEY OBLIGATIONS, to serve shareholders of stocks issued in the European markets.

In short, SRD II aims to:



Reduce short termism and instill the idea that shareholders are invested in the long-term health of listed companies and corporations. This will also strengthen the European markets and its overall economy.



Simplify how shareholders are identified, especially in cross-border situations. Intermediaries will communicate updates to shareholders via their name, contact information, registration number, and number of shares they own and oversee.



Boost shareholder participation in corporate governance with a standardized method for voting in general meetings.



Push asset managers and institutional investors to disclose policies on investment strategy and other information to boost transparency.



Expand shareholders' involvement in directors' compensation.

WHO MUST COMPLY

SRD II not only impacts European issuers of stocks, but also adds new requirements to all participants in the chain of custody of the company (aka the issuer) in an EEA or EU member state and those stocks that are traded on a regulated market in the EEA or EU. This can include U.S. brokers.

SRD II includes three sections that define each type of stakeholder in the investment industry and the responsibilities to achieve compliance: European listed companies, intermediaries (including institutional investors and asset managers), and proxy advisors.

Following are the specific requirements:

- European listed companies must show compliance to the retention period of shareholders' information, the dispersal of information that allows shareholders to cast an informed ballot, and the transparency of the voting process at general meetings.
- Intermediaries in the custody chain, such as credit institutions and central securities depositories, have new obligations regarding the identification of EEA or EU Listed companies' shareholders, and the transmission of their information. Institutional investors and asset managers must make public their engagement policies and investment strategies.
- Proxy advisors must be more transparent

regarding the code of conduct they follow, including voting recommendation policies and potential conflicts of interest.

This means that a U.S. broker with a U.S. account holder who owns shares of the EEA or EU issuer can be responsible to comply with SRD II. As such, this account holder must have an action plan to address the demands of the compliance initiative — or face fines or the withholding of dividends from the EU. Italian financial firms, for example, might be fined up to €5 million (\$5.6 million USD) for breach of the shareholder identification protocols, [according to media reports](#).

As is the case with previous EU mandates like MiFID II, the new law is sweeping in scope but the details of how to implement the law are vague. Right now, EEA & EU members must draft their own guidelines as to how they will meet the new compliance benchmarks. France, for example, may have a different method than Germany and Denmark and so on.

Financial services firms in the Europe and U.S. historically tend to take a “wait and see” approach to new mandates, especially those that originate from governmental agencies. In the past, financial firms submitted a proposed plan of action to regulators to determine the seriousness of the mandate and if this failed to appease regulators, they often had to pay a fine as details of the mandate became clear across the financial sector.

WHAT ELSE DOES SRD II SEEK TO ACCOMPLISH?

When implementing a solution to address the European mandate, U.S. brokers and intermediaries must realize that SRD II aims to respect shareholders' rights and strengthen their role in the financial marketplace.

In complex global capital markets, easily identifying shareholders can help issuers, asset managers and institutional investors boost engagement. For example, they can facilitate an easy way for proxy voting and conducting various corporate actions.

The crux of SRD II and its chief difference with SRD I is Article 3, which focuses on the identification of shareholders, the transmission of information, and protecting and serving shareholder rights.

Under Article 3, companies have the right to identify their shareholders and intermediaries and must transmit the necessary information to determine identities. Likewise, intermediaries are obligated to transmit relevant proxy information from the company to the shareholders to support their rights.

Further, the directive clearly highlights the importance of these communications to be electronic and recommends using the new ISO standard of messaging, ISO20022.

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THE DEVIL IN THE DETAILS

As with other EU mandates, EU member states rarely agree on how to approach the directive. Therefore, any U.S. broker looking for guidance will be challenged to find a single method for addressing this directive.

All EU member states had finalized or published their requirements or how they expect brokers to meet SRD II while most EEA countries are in the process of completing final transpositions into law. This creates another challenge for both U.S. and EU brokers: Although the European Commission passed this new regulation, each EU member state individually interprets the rules. To add more uncertainty, each member's interpretation may conflict with the way U.S. brokers interact with shareholders.

In certain European countries, for example, shareholders' identities will be known to the issuer, but this is not the case in the U.S. where we have registered shareholders and beneficial shareholders. Per the SEC, non-objecting beneficial owners (NOBOs) and objecting beneficial owners (OBOs) have the right to withhold their identify from the issuer.

As with the interpretation of SRD II, each EEA and EU member differs in its approach to addressing the new mandate. Some member states require confirmation of the shareholders' birth dates to identify them for voting while others don't. Typically, this is not done by U.S. brokers either.

The technology utilized in each country can differ as well. In some cases, the Central Securities Depository and sub-custodians are compliant with ISO20022 messaging, however, some are only able to support ISO15022. Tracking countries preferred means of communications and processing both message types can prove time consuming and costly for many brokers.

This is why U.S. brokers need to work with a shareholder communications provider who is familiar with the different countries and how they address SRD II. Since Brexit took full effect on January 1, 2021, the United Kingdom (UK) is no longer in scope for the directive. The UK had already established rules about shareholder rights through the Companies Act 2006 with amendments made in 2020. Under this Act, the custodian (or any other intermediary) has no obligation to pass on details of the general meeting to the beneficial owner of the shares, unlike in SRDII. So Brexit's impact on the UK eliminated the SRD II requirement for UK security intermediaries to notify the underlying shareholder. In practice, however, the intermediary may be required under the contract between itself and its clients to pass on the notices of general meetings.

WHO IS IMPACTED BY SRD II?

Despite the wide-ranging mandate, not all U.S. brokers definitively need to prepare for SRD II. The updated rule only impacts issuers with registered offices in an EU member state who trade on an EU-regulated market, as well as intermediaries in the custody chain and institutional investors and asset managers of their shares.

Only U.S. brokers that trade on EEA and EU markets and hold these positions directly or through a custodian must address shareholder identification, information sharing and proxy capture. This last item requires shareholders to receive a “receipt of voting” for all electronic voting campaigns and after the meeting, issuers will confirm that the shareholder’s vote has been counted in an accurate and timely manner.

SRD II IMPACTS:



ISSUERS WITH REGISTERED OFFICES IN AN EU MEMBER STATE



ISSUERS WHO TRADE ON AN EU-REGULATED MARKET



INTERMEDIARIES IN THE CUSTODY CHAIN OF THESE EEA AND EU SECURITIES



INSTITUTIONAL INVESTORS & ASSET MANAGERS

HOW MEDIANT CAN HELP

Brokers that use the Mediant solution can face SRD II without much extra effort. For a broker's client using a custodian domiciled in and/or operating under EU regulations, their systems are capable of addressing the communication requirements.

While Mediant's solution covers SRD II's vote capture and tabulation mandates, the new EU rule adds responsibilities to the shareholder disclosure requirements such as brokers must provide the issuer with what they know regarding the shareholder information. For example, a global custodian needs to know that the broker

has 100 shares and that is what they will send back to the issuer. Under SRD II, the broker is obligated to send the issuer details of who owns those 100 shares.

Addressing this shareholder requirement will be technologically intensive. For starters, the Mediant solution assists with receiving the requests for shareholder disclosure through ISO 20022, ISO15022 or whatever means the custodian is using. Then Mediant will obtain the eligible shareholder information from the broker and respond on its behalf in the proper format requested from the issuer.

READY OR NOT

What does being prepared for SRD II mean exactly?

The SRD II mandate means having a provider who is handling your notifications for proxy votes, electronically notifying your clients, and responding to shareholder disclosure requests. It also means having a solutions provider who is familiar with the different rules within the EU and U.S.

One challenge for U.S. brokers may be print mail. U.S. brokers and custodians still rely on physical mailings via the U.S. Postal Service and private mail delivery systems to reach share-

holders as they conduct proxy voting whereas the EU does not. SRD II is diverging from this to all electronic communications. But in some cases, brokers do not have the proper technology in place.

Most brokers use shareholder communications solutions from financial services vendors, but may encounter difficulties with the siloed approach of those with aging and separately developed solutions. Some solution providers provide a split offering at global versus domestic operations — unfortunately, these solutions do not interact outside their “silos.” This back office technical reality creates extra work and

introduces the potential for error. Plus, when different solutions are added together in the enterprise, the cost of these duplicative solutions becomes onerous.

As other proxy solution providers push to purchase new wares for SRD II, Mediant's platform is ready to address the new mandate. If a broker is expanding and looking to use Mediant for issuer communications in other countries outside SRD II, our same platform is used — no new systems to learn or log-ins to remember. Mediant's MIC platform is all electronic and cloud-based with a sharp focus on shareholder compliance. All notifications such as capturing the electronic vote and passing it back to the

custodian is already done. Essentially, through API services, Mediant integrates the broker's EU custodians with its security processing system to meet the SRD II mandate. Mediant offers a single log-in solution that interacts and "speaks" with other systems, making it a one-stop solution that is less complex to manage and competitively priced.

In short, Mediant takes on the entire technological burden of SRD II. With its expertise in the EU marketplace as well as the regulations and how different member nations address compliance mandates, Mediant can help any broker stay ahead of the regulatory curve.

Mediant delivers investor communications solutions to banks, brokers, corporate issuers and funds. Our solutions are driven by leading technology and strict compliance with industry regulations, which allows clients to balance innovation with requirements. We enable banks and brokers to effectively manage all potential touchpoints within the investor communications lifecycle — from proxy statements and prospectuses to voluntary corporate actions. We provide corporate issuers with turnkey proxy processing, and we empower mutual funds, REITs and insurance companies with a full-service, end-to-end proxy solution.

For more information on Mediant's SRD II solution or to schedule a consultation, [contact us](#).