

SRD II – Impact on UK Asset Managers

Implementation of SRD II in UK

The provisions of SRD II applying to institutional investors take effect based on separate implementing regulations in each member state.

The UK was one of the first countries to update regulations to implement SRD II. The final implementing regulations were published in May 2019 with key provisions taking effect from June 2019 as shown in the table below:

Requirement	Details		Deadline	Implementing Rule
Disclose an engagement policy	<i>Comply or explain?</i>	Yes	10 June 2019	Section 2.2B 5-6 of the FCA Conduct of Business Sourcebook
	<i>Public Disclosure?</i>	Yes		
	<i>Annual?</i>	No		
Disclose engagement and voting behaviour	<i>Comply or explain?</i>	Yes	Following first full annual reporting period after 10 June 2019	Section 2.2B.7 of the FCA Conduct of Business Sourcebook
	<i>Public Disclosure?</i>	Yes		
	<i>Annual?</i>	Yes		
Disclose investment strategy and implementation	<i>Comply or explain?</i>	No	Following first full annual reporting period after 10 June 2019	Section 2.2B.9 of the FCA Conduct of Business Sourcebook
	<i>Public Disclosure?</i>	No*		
	<i>Annual?</i>	Yes		

**However, public disclosure may be made in place of client-specific disclosure*

Other improvements to transparency under SRD II, including the facilitation of shareholder identification and the provision of vote confirmation, will be implemented directly by EU implementing regulations taking effect in September 2020.¹

In the UK, the Financial Conduct Authority (FCA) is responsible for overseeing the implementation of SRDII and has amended its rules to require that life insurers and asset managers publicly disclose an engagement policy—or explain why they have not published such a policy—by 10 June 2019.

Who is affected?

In the UK, the rules apply to FCA-regulated asset managers and life insurers and branches of non-EEA investment firms which the FCA authorise. The latter must operate under similar rules to UK investment firms when they provide investment services and activities under the scope of MiFID.

What are the key changes to the FCA rules?

The key changes affecting asset managers are:

- New requirements regarding the public disclosure of their shareholder engagement policies, and annual public disclosure of the implementation of such policies, including voting behaviour²; and
- New requirements regarding the disclosure to asset owners of the manager's shareholder engagement activities and investment strategy.³

An asset manager may choose not to comply with the requirements to disclose an engagement policy and annual report on engagement and voting activity if it publicly discloses a clear and reasoned explanation as to why it is not doing so.⁴

¹ Technical aspects of SRD II—particularly pertaining to the format for transmission of data—have been implemented directly in EU member states by Commission Implementing Regulation (EU) 2018/1212.

² FCA Conduct of Business Sourcebook, Section 2.2B.5(1) and 2.2B.1.

³ FCA Conduct of Business Sourcebook, Section 2.2B.9.

⁴ FCA Conduct of Business Sourcebook, Section 2.2B.5(2).

What Must be in an Engagement Policy per the FCA Rules?

The policy must describe how the investor integrates shareholder engagement in their investment strategy and how the policy was implemented.⁵

The policy must include a description of the following:

- How the asset manager monitors investee companies on relevant matters including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance;
- How the asset manager conducts dialogue with investee companies⁶;
- How the asset manager exercises voting rights and other rights attached to shares;
- How the asset manager cooperates with other shareholders;
- How the asset manager communicates with relevant stakeholders of the investee companies; and
- How the asset manager manages actual and potential conflicts of interest in relation to its engagements.⁷

Asset managers will have to decide at what level to disclose their engagement policy. The policy could, for example, disclose the firm's overall approach to engagement or that of the wider group to which the firm belongs. Alternatively, it could set out the approach for each product, if different products use different approaches, or for some grouping of products or service offerings. The FCA did not provide additional guidance or rules at this time, on the basis that firms will be able to decide the appropriate level at which to disclose, based on their individual circumstances.⁸

The FCA does not expect that firms apply uniform practices across different jurisdictions. Firms are also not expected to have a uniform way of engaging with investee companies in all markets.⁹ Given the comply or explain basis of the new requirements, firms could explain that they have a different engagement policy for non-EEA markets in line with local standards, or that they have no engagement policy for these markets.¹⁰

Where an asset manager implements the engagement policy, including voting, on behalf of an institutional investor, the institutional investor shall make a reference as to where such voting information has been published by the asset manager.¹¹

What Must be Disclosed with Regard to Engagement and Voting Behaviour?

As noted above, asset managers will be required to disclose annually how their engagement policies have been implemented. The annual disclosure must include a general description of voting behaviour, an explanation of the most significant votes and the use of the services of proxy advisors.¹² Asset managers must publicly disclose how they have cast votes in general meetings during the reporting period. Such disclosure may exclude votes that are insignificant due to the subject matter of the vote or the size of the holding in the company.¹³ Firms will have to decide what constitutes an insignificant vote and apply their chosen approach consistently. Separately, asset managers must disclose a description of the "most significant" votes they identified during the year. The FCA guidance provides some examples of potentially insignificant votes, such as where a vote is on purely procedural matters, or where the investor has a very minor stake compared with their holdings in other companies.¹⁴ However, the rules provide significant leeway for asset managers to define insignificant votes which are excluded from general reporting and the most significant votes which must be described in more detail.

What Must be Disclosed with Regard to Investment Strategy?

Asset managers are required to disclose certain information about their investment strategy, at least on an annual basis, to asset owners. The aim of this increased transparency is to enable asset owners to assess whether and how the manager is acting in their long-term interests and to assess whether the asset manager's strategy allows for effective shareholder engagement. Such disclosure must include the following:

⁵ FCA Conduct of Business Sourcebook, Section 2.2B5(1)(b).

⁶ These rules apply to shares held by regulated firms in all investee companies admitted to trading on an EEA regulated market (primary or secondary listing) or on a comparable market outside the EEA. Notably, these implementing regulations differ from SRD II requirements, which only specify requirements applying to investee companies *within* the EEA.

⁷ Section 2.2B.6 of the FCA Conduct of Business Sourcebook.

⁸ FCA Consultation Paper 19/7, Section 3.24.

⁹ FCA Consultation Paper 19/7, Section 3.11.

¹⁰ FCA Consultation Paper 19/7, Section 2.13.

¹¹ FCA Conduct of Business Sourcebook, Section 3.4.7.

¹² FCA Conduct of Business Sourcebook, Section 2.2B 7(1).

¹³ FCA Conduct of Business Sourcebook, Section 2.2B 7(2).

¹⁴ FCA Consultation Paper 19/7, Section 3.25.

- key material medium to long-term risks associated with the investments;
- portfolio composition;
- turnover and turnover costs;
- use of proxy advisors for the purpose of engagement activities;
- 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;
- how they make investment decisions based on evaluation of medium to long-term performance of the investee company, including non-financial performance; and
- which conflicts of interests have arisen in connection with engagements activities and how the asset managers have dealt with them.¹⁵

There is no proposed standard way in which firms must disclose the information, and this information is not required to be provided in a single report. Where information is already required to be disclosed in accordance with other rules, there is no requirement to disclose again to meet this rule. But, where information may currently be provided under contractual provisions, or through market practice, the rules require it to be provided to all relevant firms.¹⁶

Where information is already required under other legislation, it is not expected that firms devote significant resources to doing something different to meet the requirements of the rules, unless they think to do so will help market participants to better understand their approach.¹⁷

Does Glass Lewis need to do anything as a result of SRD II?

Yes. SRD II requires proxy advisors to report on certain key aspects of their business models and conflict of interest procedures in accordance with a best practice code. Glass Lewis is a founding member of the industry group that created the Best Practice Principles for Providers of Shareholder Voting Research & Analysis (“BPP”) in 2013 and has reported against the BPP since 2014. The BPP was updated in 2019 to take into account the reporting requirements of the BPP. Glass Lewis will report against the updated BPP for reporting year 2019 in full compliance with SRDII.

In the UK, Glass Lewis must register with the FCA to join the official list of Proxy Advisors.

What about data transmission?

Glass Lewis is engaging with relevant vote tabulators and custodians, who are responsible for transmitting voting information in accordance with the Commission Implementing Regulation, to understand and prepare for any new technical requirements for the receipt and transmission of data under the scope of SRD II, which would take effect in September 2020.

Stewardship Code

Unlike the requirements of SRD II, adherence to the UK Stewardship Code (“Stewardship Code”) is not mandatory. The Stewardship Code sets best practice standards for institutional investors and service providers with regard to stewardship activities and requires a certain level of compliance and public disclosure in order to be accepted as a signatory. UK asset managers should remain cognisant of the related, parallel developments to the Code.

In October 2019, the UK Financial Reporting Counsel (“FRC”) issued a revised UK Stewardship Code elevating best practice standards for stewardship of institutional investors and service providers. The requirements of the Code are more demanding than SRD II, and it is the intention of the FRC that in reporting against the Code, signatories to the Code will already have regard to any relevant reporting requirements of the laws, rules, regulations and administrative provisions that transpose SRD II. Notably, the revised Code focuses on detailed disclosure of actions and outcomes of stewardship activities--rather than the policies required by SRD II--in the context of multiple asset classes and relevant stakeholders.

Note: This document is not intended as, and should not be relied upon, as legal advice. Investment advisers should consult legal counsel on any questions about their particular legal responsibilities.

¹⁵ FCA Conduct of Business Sourcebook, Section 2.2B.9.

¹⁶ FCA Consultation Paper 19/7, Section 3.41.

¹⁷ FCA Consultation Paper 19/7, Section 2.20

Summary of Key Provisions of SRD II

New Requirement Details	Explanation
<p><i>Requirement:</i> Vote Confirmation</p> <p><i>Applies to:</i> Issuers & intermediaries</p> <p><i>Deadline:</i> September 2020</p> <p><i>Implementing rule:</i> EU Commission Implementing Regulation 2018/1212</p>	<p>The EU Regulation defines the template for submitting and responding to a request. Per the EU Regulation, confirmation of receipt of votes must be provided immediately. Further, upon request, confirmation of how votes were recorded and counted must be provided within 15 days of the request or the date of the relevant general meeting, whichever is later.</p>
<p><i>Requirement:</i> Shareholder Identification</p> <p><i>Applies to:</i> Issuers & Intermediaries</p> <p><i>Deadline:</i> September 2020</p> <p><i>Implementing rule:</i> EU Commission Implementing Regulation 2018/1212</p>	<p>The UK Companies Act already allows issuers to request the identity of any shareholder with 1 share or “any interest” in the company. Technical standards and templates for requesting and transmitting information are determined by the EU Regulation. Shareholder identity must be provided by the intermediary on the business day following the record date or the receipt of the request, whichever is later.</p>
<p><i>Requirement:</i> Voting Data Transmission</p> <p><i>Applies to:</i> Issuers & Intermediaries</p> <p><i>Deadline:</i> September 2020</p> <p><i>Implementing rule:</i> EU Commission Implementing Regulation 2018/1212</p>	<p>The EU Regulation specifies how the electronic transmission of information regarding the notice of meeting, agenda items, deadlines, voting rights, shareholder participation in the general meeting and shareholder voting instructions will be standardised into tabular formats and that it must be transmitted “without delay”.</p>
<p><i>Requirement:</i> Proxy Advisor Code of Conduct</p> <p><i>Applies to:</i> Proxy Advisors</p> <p><i>Deadline:</i> 21 June 2019</p> <p><i>Implementing rule:</i> Part 2, The Proxy Advisors’ (Shareholders’ Rights) Regulations 2019</p>	<p>Proxy advisors are required to disclose (i) the code of conduct (“the code”) they apply, and where their practice is to depart from any of the recommendations contained in the code, (ii) a statement which specifies the recommendations concerned, explains the reason for departing from them, and indicates any measures adopted instead of them. Proxy Advisors are required to register with the FCA as a proxy advisor by April 2020.</p>
<p><i>Requirements:</i> Remuneration Reporting & Shareholder Vote on Remuneration</p> <p><i>Applies to:</i> Issuers</p> <p><i>Deadline:</i> N/A</p>	<p>No material changes to UK law are required to comply. However, some remuneration reporting requirements such as service contract lengths and average change in employee pay will be updated. Further, when a policy is not approved by shareholders the company must submit a new policy for approval at the next AGM.</p>
<p><i>Requirement:</i> Related Party Transactions</p> <p><i>Applies to:</i> Issuers</p> <p><i>Deadline:</i> 10 June 2019</p> <p><i>Implementing rule:</i> DTR 7.3</p>	<p>The new rules impose a standard requirement for board approval and public announcement of material related party transactions for both premium and standard listings, including GDRs. The materiality threshold is 5%, tested against profits, assets, market capitalisation or gross capital. Only the premium listing rules require shareholder approval and a third-party report of material transactions.</p>