

Corporate governance: long-term shareholder engagement

2014/0121(COD) - 09/04/2014 - Legislative proposal

PURPOSE: to revise Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies in order to contribute to their long-term sustainability.

PROPOSED ACT: Directive of the European Parliament and the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

BACKGROUND: Directive 2007/36/EC of the European Parliament and of the Council establishes requirements in relation to the exercise of certain shareholder rights attaching to voting shares in relation to general meetings of companies which have their registered office in a Member State and whose shares are admitted to trading on a regulated market situated or operating within a Member State.

The financial crisis has revealed that shareholders in many cases supported managers' excessive short-term risk taking. Moreover, there is clear evidence that institutional investors and their asset managers do not sufficiently focus on the real (long-term) performance of companies, but often on share-price movements and the structure of capital market indexes, which leads to suboptimal return for the end beneficiaries of institutional investors and puts short-term pressure on companies.

The past years have highlighted certain corporate governance shortcomings in European listed companies. These shortcomings relate to different actors: companies and their boards, shareholders (institutional investors and asset managers) and proxy advisors.

Five main issues have been identified:

- insufficient engagement of institutional investors and asset managers;
- insufficient link between pay and performance of directors;
- lack of shareholder oversight on related party transactions;
- inadequate transparency of proxy advisors;
- difficult and costly exercise of rights flowing from securities for investors.

Stakeholders were consulted on two Green Papers ("[Corporate governance in financial institution](#)" and "[The EU corporate governance framework](#)").

Based on these consultations and further analysis, the [Commission's Action Plan](#): European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies provides the Commission's roadmap in the area, based on the two objectives of enhancing transparency and engaging shareholders.

IMPACT ASSESSMENT: a range of options, including no policy change, have been considered to address each of the presented problems. The preferred option is the following:

- 1) mandatory transparency of institutional investors and asset managers on their voting and engagement and certain aspects of asset management arrangements;
- 2) disclosure of the remuneration policy and individual remunerations, combined with a shareholder vote;
- 3) additional transparency and an independent opinion on more important related party transactions and submission of the most substantial transactions to shareholder approval;
- 4) binding disclosure requirements on the methodology and conflicts of interests of proxy advisors;
- 5) creating a framework to allow listed companies to identify their shareholders and requiring intermediaries to rapidly transmit information related to shareholders and to facilitate the exercise of shareholder rights.

CONTENT: the main objectives of the proposal are as follows:

Improving engagement of institutional investors and asset managers: the proposal should increase the transparency of institutional investors and asset managers. They will be required to develop a policy on shareholder engagement, which should contribute to managing actual or potential conflicts of interests with regard to shareholder engagement. They should in principle disclose to the public their engagement policy, how it has been implemented and the results thereof. Where institutional investors or asset managers decide not to develop an engagement policy and/or decide not to disclose the implementation and results thereof, they shall give a clear and reasoned explanation as to why this is the case.

Strengthening the link between pay and performance of directors: the proposal aims at creating more transparency on remuneration policy and the actual remuneration awarded to directors and creating a better link between pay and performance of directors by improving shareholder oversight of directors remuneration.

Shareholders should have the right to approve the remuneration policy and to vote on the remuneration report. All benefits of directors in whatever form will be included in the remuneration policy and report. The proposal does not regulate the level of remuneration and leaves decisions on this to companies and their shareholders.

Improving shareholder oversight on related party transactions: the proposal requires listed companies that related party transactions representing more than 5% of the companies assets or transactions which can have a significant impact on profits or turnover to submit these transactions to the approval of shareholders and may not unconditionally conclude it without their approval.

For smaller related party transactions that represent more than 1% of their assets, listed companies shall publicly announce such transactions at the time of the conclusion of the transaction, and accompany the announcement by a report from an independent third party.

In order to target only transactions that could be most disadvantageous for minority shareholders and to keep administrative burden limited Member States should be allowed to exclude transactions entered into between the company and members of its group that are fully owned by the listed company.

Enhancing transparency of proxy advisors: the proposal will require proxy advisors to adopt and implement adequate measures to guarantee that their voting recommendations are accurate and reliable, based on a thorough analysis of all the information that is available to them and are not affected by any existing or potential conflict of interest or business relationship. Proxy advisors are required to publicly disclose certain key information related to the preparation of their voting recommendations.

Facilitating the exercise of rights flowing from securities for investors: it is estimated that non-national shareholders hold some 44% of the shares in EU listed companies. The proposal requires Member States to ensure that intermediaries offer to listed companies the possibility to have their shareholders identified. Intermediaries should, on the request of such a company communicate without undue delay the name and contact details of the shareholders.

The proposal also requires that intermediaries facilitate the exercise of the rights by the shareholder, including the right to participate and vote in general meetings and requires companies to confirm the votes cast in general meetings by or on behalf of shareholders.