Shareholder Rights Directive II

BetaNXT

Introduction

In November of 2022, the European Market and Security Authorities published a call for evidence on the results of the active 2020 regulation. Findings published in July 2023 showed responses from stakeholders in the process—intermediaries, vendors and shareholders, which we will summarize in this whitepaper. The core themes were around the lack of uniformity of defining the end shareholder, lack of technology adoption and transparency around fees.

SRD II

In 2020, the updated Shareholder Rights Directive from the European Commission had a significant impact on brokers and banks in the U.S. and across the globe. As investors have sought to hold shares directly in local markets, this directive and related regulation have impacted all intermediaries who issued shares out of the European Economic Area (EEA), European Union (EU), Lichtenstein, Norway and Iceland.

The update to the 2007 SRD I mandate aimed to strengthen the shareholders role in the financial marketplace, promote long-term shareholder engagement and reduce excessive risk as an issuing company. Member states were allowed to transpose the directive into local law, using the regulation as a framework for implementation.

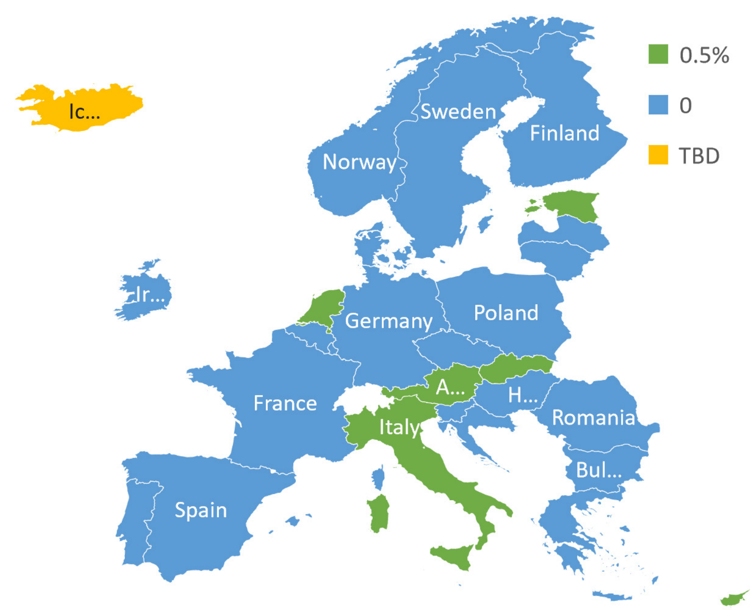
What is the focus of SRD II?

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. Issuers are now able to request shareholder details up to a threshold identified by the member state's transposition at anytime throughout the course of a year and not specifically around a general meeting event.
- Boost shareholder participation in corporate governance with a standardized, electronic method for voting in general meetings.
- Push asset managers and institutional investors to disclose policies on investment strategies and other information to increase transparency.
- Expand shareholder involvement in director compensation.

European Economic Area Disclosure Threshold by Member State



Source: https://www.esma.europa.eu/sites/default/files/library/esma32-380-143_national_thresholds_for_shareholder_identification_under_the_revised_srd.pdf

Who must comply?

SRD II not only impacts European issuers but also adds a new requirement to all intermediaries in the chain of custody: to inform shareholders of general meeting events, collect voting, and disclose shareholder details to the issuer.

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.

For example, this means U.S. brokers with U.S. account holders who hold shares of EEA issued events are responsible to comply with SRD II. As such, brokers must have an action plan to address the demands of this compliance initiative—notification of events, collection of votes, and ability to disclose shareholder details. Member states have started to publish fines or give the issuer rights to withhold dividend payments if SRD II regulations are not followed. According to media reports, Italian firms might be fined up to €5 million ($5.6 million USD) for a breach of shareholder identification protocols.

As is the case with previous EU mandates like MiFID II, the law is sweeping in scope but the details of how to implement the law are vague. Member states had to transpose their own legislation 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.

Impact of SRD II

As with other European Commission mandates, 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.

Intermediaries, including U.S. brokers, have to be well-versed in each member state's SRD II transposition or work closely with a partner that is knowledgeable. The key deliverables that changed the shareholder experience are:

- **Notification of Events.** Shareholders are expected to receive general meeting notifications on all European securities in scope with SRD II, whereas in the past, it was typical for shareholders to have to contact their broker specifically about an event in which they wanted to participate.
- **Facilitation of Voting.** Along with the notification of voting, brokers must support a means to capture voting and pass the details back through the chain of custody or directly to the issuer.
- **Shareholder Disclosure Details.** Within a day upon request, custodians and brokers need to provide issuer shareholder details and systemically support passing the request to the next intermediary in the chain of custody.

The technology utilized in each country can differ as well. In some cases, the Central Securities Depositary (CSD) and sub-custodians are compliant with ISO20022 messaging; however, full adoption has been slow and still not achieved three years later. With CSD and custodians still using ISO150022, the regulations cause additional fees for intermediaries and excess manual work since ISO20022 messaging improved the ability to send multiple votes through SWIFT.

This is why brokers need to work with a shareholder communications provider who is familiar with the different countries and how they address SRD II.

What about the UK?

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 SRD II. So Brexit's impact on the UK eliminated the SRD II requirement for UK security intermediaries to notify the underlying shareholder.

Who is affected?

- Issuers with registered offices in an EU member state
- Beneficial owner of EEA and EU securities
- Intermediaries in the custody chain of these EEA and EU securities
- Institutional investors and asset managers

Is SRD II enforceable?

As expected, it remains difficult for national competent authorities (NCAs) to monitor cross-border processes in practice, even within the EU. At a cross-border level, this problem is reportedly exacerbated by the lack of clarity on how competence is allocated between the NCAs responsible for issuers and the ones in charge of intermediaries, welcoming guidance by the Commission on the matter.

How BetaNXT can help?

Brokers that use BetaNXT, through our Mediant solution, can comply with SRD II with minimal effort. Our solution covers SRD II's vote capture and tabulation mandates as well as the new EU rules, which add responsibilities to the shareholder disclosure requirements. 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.

As mentioned earlier, addressing this shareholder requirement will be technologically intensive, including supporting slow adoption to ISO20022 messaging. As a result, our solution assists with receiving the requests for shareholder disclosure through ISO20022, ISO15022 or whatever means the custodian is using. Then we will obtain the eligible shareholder information from the broker and respond on its behalf in the proper format requested from the issuer.

What does being prepared look like?

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 shareholders as they conduct proxy voting whereas the EU does not. SRD II is diverging from this to all electronic communications so choosing a provider who takes a digital-first approach can help solve for this challenge.

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, BetaNXT, through Mediant's platform, is ready to address the new mandate. If a broker is expanding and looking to use BetaNXT for issuer communications in other countries outside SRD II, our same platform is used — no new systems to learn or log-ins to remember. Our 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, BetaNXT 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, BetaNXT can help any broker stay ahead of the regulatory curve.

3 Years in... is it working?

Short answer, yes and no.

From BetaNXT's perspective, we are aligned with much of the feedback coming from this report.

- We've hit hurdles with ISO20022 messaging with some custodians and proxy vendors.
- We agree that defining the shareholder will streamline processing.
- We agree that outlining fees and responsibilities is needed to effectively implement this solution.

In navigating the complexities of SRD II, BetaNXT, through our Mediant business, stands as an optimal solution. With our comprehensive technology, operational excellence and regulatory expertise, we offer a streamlined path to address all your requirements.

About BetaNXT

BetaNXT powers the future of connected wealth management infrastructure software, leveraging real-time data capabilities to enhance the wealth advisor experience. Combining industry expertise with the power of our proven Beta, Maxit and Mediant businesses, we are focused on solving our customers most demanding integration challenges with flexible, efficient, connected solutions that anticipate their changing needs. Our comprehensive approach reduces enterprise cost, streamlines operations processes, increases advisor productivity, and enhances the investor experience.

Together with BetaNXT, wealth management firms are transforming their platforms into differentiating assets that enable enterprise scale and stimulate commercial growth.

For more information, visit betanxt.com