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EuropeanIssuers' Position Paper on ESMA & EBA's Report on the Implementation of SRD2.

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EuropeanIssuers is a pan-European association representing the interests of companies listed on the stock exchanges in Europe. Our members include both national associations and companies from all sectors in 15 European countries, covering markets worth € 7.6 trillion market capitalisation with approximately 8000 companies. We aim to ensure that EU policy creates an environment in which companies can raise capital through the public markets and can deliver growth over the longer-term.

EuropeanIssuers welcomes ESMA & EBA's report on the implementation of SRD2 and, in this document, provides detailed comments and suggestions on the report.

1. Investment chain

In their joint report ESMA and the EBA take stock of stakeholder concerns and address various SRD2 provisions including those relating to the definition of "shareholder", shareholder identification, transmission of information, facilitation of shareholder rights, and intermediary practices.

1.1. Shareholder identification

Harmonisation of the shareholder definition

ESMA invites the Commission to propose amending the Shareholders Rights Directive (SRD 2) and its Implementing Regulation to provide a harmonised definition of 'shareholder'. Currently, the notion of shareholder is defined by the applicable corporate law, meaning that determination of the person entitled to receive and exercise shareholder rights depends on the Member state of issuance.

Shares of listed companies are largely held through increasingly longer daisy chains of intermediaries, often crossing multiple jurisdictions, through which shareholder rights need to be exercised. It is claimed that harmonization of the shareholder notion would help smoothen the differences between national shareholder identification processes and shareholder definitions, which are a prerequisite to direct communication between the shareholders and the company and therefore essential to facilitating the exercise of shareholder rights and encouraging shareholders to commit to long-term engagement.

ESMA recommends two alternative harmonisation options:

- Consider introducing a fully-fledged harmonised definition of shareholder, encompassing beneficial owner, or alternatively,
- Provide issuers with the right to identify beneficial owners in addition to nominee and/or provide an ad-how definition of the term "shareholder" only for the purpose of identification.

As a temporary measure, ESMA recommends publishing a list of shareholder definitions as applicable across MSs to improve market certainty.

EuropeanIssuers considers the first option of a fully-fledged harmonisation unnecessary and even counter-productive, given the potential of interaction with national corporate laws.

We understand that some intermediaries blame the difference in shareholder definitions across Member states for their failure to comply with their obligations under the directive, namely the requirement to pass on information to the shareholder and facilitate the exercise of their rights. This is an incorrect statement, for at least four reasons.

- First, while the definition of 'shareholder' may differ among Member states, it refers in most of them to the **end-investor** considered as the owner of the shares and having invested his own money directly into them. He has an in rem right in the shares, holds them on his own account and enjoys direct entitlements against the issuer, while intermediaries are mere agents and have no proprietary rights to the shares they maintain for their clients;
- Second, under European law, especially the Central Securities Depository regulation (CSDR) and the Transparency directive, all intermediaries have to separate shares they hold on their own account (for which they are shareholders) from shares they hold for someone else (including "securities" which they book into accounts of their clients even when they are considered "shareholders" under US or UK law). So, under these legal rules these intermediaries know perfectly well whether they are the "end investor" or not;
- Third, by design, the shareholder rights directive is based on the end-investor concept: though not explicitly mentioned, it may be inferred from the reference in the implementing regulation to the "last intermediary" who is the intermediary who provides the securities accounts in the chain of intermediaries for the shareholder" (article 1.6 IR 2018/1212);
- Fourth, the end-investor concept applies irrespective of the shares holding model, direct holding model based on the end-investor concept, or indirect holding model in common law Member states where the distinction between legal and beneficial ownership under trust law results in the upper-tier intermediary to be recognised as the legal shareholder vis-à-vis the issuer[1].

It follows that, under the existing EU legal framework, intermediaries are perfectly capable of identifying the end investor, and pressing for a fully-fledged harmonisation appears as a pretext by some of them for failing to comply with their obligation to pass down the information until the end investor and vice-versa. However, an exception on this, are countries applying a threshold of 0.5%. If shares are held via multiple accounts by the same investor, holding in aggregate 0.5%, such position is not identified. As explained further below, we would therefore suggest removing the 0.5% threshold as whole and leave the discretion of applying a threshold at the level of the issuer.

Besides being unnecessary, a fully-fledged harmonisation is certain to become a lengthy and complex process as it entails replacing 27 national definitions by a single, uniform one that will necessarily interact with existing national laws, including civil law, corporate law and tax law.

[1] By contrast, the US follow an approach by which the *in rem* right in the share is taken away from the end investor (called "disenfranchisement") and replaced by an instrument "securities entitlement" which only give a contractual right against a bank or other nominee and makes the nominee the shareholder. Large US custodians employ that approach even for shares in European companies and argue that European legal systems should adopt the US approach.

Instead, we favour the second option, providing for an ad-hoc definition only for the purpose of the directive. This alternative no longer requires replacing 27 national shareholder definitions by a single one and reflects a "functional approach" that underpins other European texts, including the Transparency directive. Under article 10 of this directive the notification of significant holdings also applies to the person who can exercise voting rights that are being held by a third party in its own name, but on that person's behalf (i.e., the nominee).

The consequence would be that national implementing legislation would ensure that information flows to the bottom of the chain, even when the formal legal shareholder is an entity higher in the holding chain.

Applying the functional approach to SRD 2 would consist in formally acknowledging the end-investor concept, which is implicit in the directive. and defining it as "*the person having invested his (own) money directly into the shares and holding them on own account".*

It would also imply clarifying that the "last intermediary" is "*the intermediary who provides the securities accounts in the chain of intermediaries for the [end-investor]".*

Consequently, the functional approach should not solely be considered for shareholder identification purposes, as ESMA's report suggests, but also when transmitting information to the end investor, exercising voting rights), hence referencing the whole Chapter 1a [2].

Other shareholder identification related issues

ESMA sets out several recommendations, the four following of which can be fully supported and even strengthened:

- Optional SRD2's shareholder identification threshold set by each Member State from 0% to 0.5% of issuer outstanding shares, and above which investors holding such amount are subject to being identified by issuers: ESMA and EBA do not propose any legislative changes. Instead, they encourage the Commission to further investigate how the thresholds affect shareholder engagement before considering any changes;

We consider that the best way forward would be to remove this option outright, insofar as it has given rise to inconsistent implementation across Member states and calls into question the very principle of shareholder identification. Large holders – holding in aggregate more than 0.5% - cannot be identified by issuers in case they are holding shares via multiple accounts or custodians. In fact, a 0.5% threshold caps the maximum number of identifiable holders to 200, but in practice tends to result in materially less. Especially for larger issuers, such number is too small to be useful. Therefore, these national 0.5% thresholds make the aspired identification ineffective;

- List of securities eligible to identification requests: the Commission should consider expanding the scope of eligible securities to securities other than shares, which would be a welcome move as some Member states already include bonds in the identification process. Furthermore the scope should be broadened to non-regulated markets as well.
- Despite we are three years further, we still see that intermediaries are not adhering to the standards as set by SRD II. One could think off not meeting the deadline or not using machine

[2] The functional approach could equally apply to elective corporate events (e.g., tender offers, rights issues or elective dividend options) which are currently referred to in Implementing Regulation 2018/1212 of 3rd September 2018.

readable format for communication. ESMA could consider applying penalties towards intermediaries not adhering to the standard;

- Confirmation of the discretion issuers retain, pursuant to IR 1212/ 2018 and its annexes, to determine, for obvious cost reasons, the scope of their identification request and customize it, for instance, in terms of percentage of shares held.

On a separate issue, the Report's proposal is to impose a fully harmonised obligation on the issuers to initiate a shareholder identification process by sending the CSD a "Golden operational record" ("GOR"). A simpler option would be to render all entries in the relevant IR 2018/1212 table mandatory, some of which are optional. In addition, as noted by ESMA, requiring a GOR means that shareholder identification can no longer be requested by issuers directly from intermediaries outside the intermediaries' chain. Indeed, the issuer's ability to communicate directly with any intermediary as well as through the holding chain is one of the founding principles of the directive that issuers wish to preserve.

Given the differing national practices, we propose to ensure the dual approach whereby the required information is sent to the intermediaries directly by the issuer or to the CSD. A dual approach would remove the dependency of the CSD requiring for example issuers to pay extra costs or agree to certain terms.

1.2. Transmission of information

EuropeanIssuers opposes ESMA's harmonization recommendations, the first of which is for the reasons indicated above, the second one because Article 9 IR 2018/1212 scope of application does not overlap with MiFiR/MiFiD as claimed:

- The introduction of a "golden operational record" requirement for issuers, similar to the one proposed for shareholder identification purposes, would address the lack of standardization against Article 3b (transmission of information). This would entail further harmonizing the communication format and removing existing optional fields of the relevant tables, especially tables 3 and 8 of the Implementing regulation (respectively, meeting notice and notification of corporate events other than general meetings). We propose to implement a dual approach whereby the required information is sent to the intermediaries directly by the issuer or to the CSD. A dual approach would remove the dependency of the CSD requiring for example issuers to pay extra costs or agree to certain terms.,

The flexible application of the transmission deadlines under article 9 of the Implementing regulation 2018/1212 (transmission along the holding chain "*without delay and no later than by the close of the same business day as it (the intermediary) received the information")* to ensure intermediaries compliance with their specific duties under MiFiD, including the obligation on intermediaries to provide retail investors with information in a comprehensible form, which does not exclude communication in paper form. We consider any alleviation of Article 9 deadlines unnecessary as this provision relates to the transmission through the intermediaries holding, whereas MiFIR/ MIFID solely addresses the relationship between the relevant intermediary and the end-investor.

1.3. Facilitation of the exercise of shareholders rights

Most of ESMA's proposals can be endorsed, notably the following ones:

- Mandate the use of machine-readable formats allowing interoperability and STP to communicate the notice of participation in general meetings and, as applicable, voting instructions (also leveraging on European industry standards) or corporate action elections. In practice, we still see that voting instructions, corporate action elections are not submitted immediately to the issuer but saved up until the deadline;
- Explore gradually harmonizing the national record dates determining shareholders entitled both to notice of and to vote at the shareholders' meeting.
- Consider diversifying regulatory mechanisms for voting confirmation, including by explicitly recognising different strategies such as the publication of voting record. It should be clarified that these alternative strategies, which are deeply rooted in Member states specific circumstances and practices, remain optional.

We disagree on the other hand with the proposal providing that the confirmation of entitlement should also be accepted as the EU-wide form to allow shareholder participation in general meetings. In our view, the confirmation of entitlement should be either attached to or included in the notice of participation to avoid transmitting multiple documents to the issuer.

1.4. Non-discrimination, proportionality and transparency of costs

EI supports the call from EBA to reduce negative impacts of costs on investors' engagement, EBA's plea for more transparency from the side of the intermediaries, and the need for more disclosure and comparability of costs.

The EBA notes the limited level of disclosure and comparability across the EU of costs charged by intermediaries and recommends harmonizing first, the terminology of the types of fees or services charged by intermediaries and second, the terminology of the services for which such charges are levied. It also proposes a harmonised format through which this information should be disclosed by intermediaries to prospective investors and other relevant actors. The EBA is taking inspiration from the approach followed in the Payment Accounts Directive (PAD) of 2014, through which a standardized disclosure of charges for payment accounts was implemented across the EU.

Overall, we support the EBA three-pronged approach, which would contribute to increased transparency by bringing about, first, a harmonized terminology of the types of charges, second, a harmonized language of the services for which such payments are levied and third, a harmonized format for disclosing this information.

But to ensure that costs remain reasonable and proportionate for investors and issuers, we propose also to take inspiration from the "best-execution" and inducement rules under Mifid. Only focusing on more transparency might at first sight create a level playing field, but doesn't bring down the costs in the value chain, let alone rule out intransparent costs in the value chain and/or arbitrary differences in services and costs between Member States. To reduce negative impacts of costs on investors' engagement and issuers some basic rules/principles for intermediaries are needed to ensure the intermediaries act in the best interest of the investor and/or issuer.

Furthermore strengthening the proposed standardization by restricting chargeable services to those bringing added value and excluding others, which do not carry specific costs, on the understanding that issuers, intermediaries and investors agree beforehand to what will be charged, could be helpful. Similarly, the allocation of intermediaries' charges should disallow for double charging and locate the

charges to their respective clients (either investors or an issuer) that benefit from the value added of the intermediaries' service and contract intermediaries for this purpose. We reserve the right to revert in due course to suggest selection criteria for establishing such a list together with a tentative list of chargeable services.

An additional avenue, together with the suggestions above, the EU indeed might explore, as suggested by ESMA and EBA[3], is akin to the Payment Accounts directive requiring Member states to develop national databases collecting costs and charges connected to GM-related processes. Such databases enabling users to compare charges would be the forerunner to an EU single database that, realistically, could be created later. The Payment Accounts directive also provides for ways to establish a sound & crisp allocation of costs and charges between payers and payees.

2. Proxy advisors

The report's recommendations include that: (1) the EC should consider clarifying the definition of the term "proxy advisor"; (2) the EC should consider defining minimum standards for codes of conduct for proxy advisors; (3) the creation of an exceptional recourse mechanism in case of blatant violation to the code of conduct; (4) in relation to conflicts of interest, disclosure obligations by proxy advisors, especially vis-à-vis their clients, could be enhanced in cases where proxy advisors render consultancy services to issuers and advise investors on those same entities; and (5) a basic registration mechanism for proxy advisors should be introduced at the EU level.

While supportive of the proposed recommendations that are heading in the right direction, we remain concerned that the report falls short of making any suggestion in two areas that are vital to issuers, namely the dialogue between proxies and issuers and the need for proxy advisors to better account for local, specific circumstances when issuing their recommendations to investors.

2.1 Definition of proxy advisors

ESMA calls on the Commission to clarify the SRD2 definition of proxy advisors to ensure that all market players exercising a similar economic function are captured. This would cover professionals that are not established as legal persons or non-profit organisations that provide advice on a commercial basis.

This would also encompass the provision of ESG data services, governance and/ or ESG analysis and rating services, when related to advice on the exercise of voting rights.

We welcome ESMA recommendations, including, among others, the incorporation of ancillary services (e.g. overlay services) into the scope of the definition, which until now have yet to be referenced in the industry Best Practices Principles (BPP). For the sake of consistency of European legislation, we recall the importance of taking into consideration other existing legislative instruments which may affect the same issue, such as – for instance - the Proposal for a Regulation on ESG Rating Providers (i.e. Art. 15 on the separation of business activities stating that ESG rating providers shall not provide consulting activities to investors undertakings), **Application of the Code of conduct**

[3] ESMA & EBA, "Implementation of SRD2 provisions on proxy advisors and the investment chain" Thursday 27 July 2023: paragraph 132 on page 51 and limb v on page 59,

ESMA calls on the Commission to consider defining minimum standards for codes of conduct, including, in particular, an independent monitoring mechanism, which may help provide further clarity to the market. We also suggest to include the adoption of a communication policy with issuer (see more specific comments above §2.7).

We can only encourage such an initiative. We have already asked to have issuers' representation within the BPP Oversight Committee strengthened.

2.2 Recourse mechanism

ESMA calls for the creation, within ESMA, of an exceptional recourse mechanism in case of blatant violation of the code of conduct, after exhausting the grievance procedures established by the industry, it being understood that ESMA's recommendations would not be binding.

We would welcome such an initiative, bearing in mind that the critical areas of concern to which the mechanism should apply are, in order of decreasing priority, the communication with issuers and the prevention and management of conflicts of interest.

2.3 Conflicts of interest

ESMA notes that conflicts of interest are the issuers' and investors' primary concern and recommends considering whether more detailed disclosure obligations on conflicts of interest to their clients might improve investors' understanding of possible conflicts of interest especially in instances where proxy advisors render consultancy services to issuers and advise investors on those same entities.

This is one of the major potential or existing conflicts of interest that may arise and it is not expressly mentioned in the Best Practices Principles, which therefore did not prevent signatory parties from developing advisory services in parallel with their voting advisory activities.

Such case of conflicts of interest is explicitly mentioned by the ESMA Securities and Markets Stakeholder Group (SMSG) in its response to ESMA's Call for evidence on the implementation of SHRD2 in which it concludes that "chinese walls" between the team/company dealing with voting recommendations and the team/company offering advisory services are not an effective measure to address the distortions caused by conflicts of interest (see paragraphs 43 and 47 of the Stakeholder Group's contribution).

In this respect, it is therefore important to avoid an overly restrictive interpretation of who is subject to the disclosure obligations, thus inviting the Commission to also consider subsidiaries and/or companies belonging to the same group as the proxy advisors as in-scope.

On another ground, we welcome ESMA proposal to improve investor's understanding regarding conflicts interest through annotations on the first page of the voting advice, showing individual conflicts that have emerged and their nature, such as consultancy services.

ESMA also proposes to mandate transparency on the type of revenues a proxy advisor has generated by providing services to different clients and their relative weight. This would prove a helpful development, bearing in mind that the most significant area where conflicts of interest materialize, relates to consultancy services rendered both to issuers and investors.

2.4 Proxy advisors operating via establishments.

ESMA recommends that the Commission envisages that proxy advisors with at least an establishment in the EU be registered with their relevant competent authorities to "*provide better clarity to market participants and NCAs on the players operating under the SRD2 framework".* The registration mechanism could be associated with the publication of a list of such proxy advisors, specifying whether or not they apply a code of conduct.

Both recommendations are welcome. We suggest complementing them by strengthening NCAs 'oversight modelled on the practice followed in certain Member States requiring the competent local authority to monitor proxy advisory activities and issue annual reports. This approach would permit assessing how proxies apply the BPPs, giving guidelines, whenever required, to improve how they operate and identifying best practices to prepare for BPP's future developments.

2.5 Requesting more specific disclosure of information sources, including ESG data

We welcome the ESMA proposal to request more specific disclosure of information sources, including ESG data as proxy advisors includes ESG data provisions in their voting report without giving information on the methodologies and criteria used. Even if it does not necessarily give rise to voting recommendations, it may nevertheless influence investors' votes.

2.6 What is missing in the report: communication with issuers

Surprisingly, the report fails to address one of the issuers' critical concerns relating to the communication policy between proxy advisors and issuers. While making progress, there is still room for improving it.

We first note that certain proxy advisors now constrictively engage with issuers and seek to provide them with draft reports in due course. Feedback from issuers indicates that this has led, in some cases, to the proxy advisor changing his voting recommendations. In some instances, however, the proxy expects comments within a few hours, then in marked-up form, owing to lack of time or late communication. But this is no substitute for an honest dialogue, especially on essential matters requiring a subtle understanding of the issues on hand/

Another proxy advisors requires issuers to review within 48 hours the critical data points (Issuers Data Report -IDR) it uses for preparing the final Proxy Paper. The IDR does not contain the proxy's analysis or voting recommendations. Typically, this proxy does not t engage with issuers during the solicitation period, beginning when the meeting notice is released and ending on the meeting date.

Despite the improvement, there is still a need for strengthening the code of conduct with additional recommendations subject to the comply or explain principle.

. Therefore, proxy advisors should:

- disclose the main features of their engagement policy, which is currently not always the case.
- inform investors about their dialogue with issuers and the nature of that dialogue. This dialogue and its extent should be mentioned in the voting report provided to the investor client.

- promptly provide issuers with the draft voting recommendations and give them sufficient time to comment; in this respect, it is important to clarify that such provision should not be should not be bound to the publication of all pre-meeting documents within a definite time, i.e. 30-day period prior to the date of the meeting
- formally acknowledge issuers right to be heard and have factual errors rectified.

This would empower the Best Practice Principles Oversight Committee to monitor more closely these key issues.

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