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Transposition of Directive UE 2017/828 as regards the encouragement of long-term shareholder engagement in listed companies

On May 17, 2017, Directive EU 2017/828 of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement in listed companies ("Directive 2017/828") was adopted.

This revision of Directive 2007/36/EC ("Directive 2007/36") aims to change practices brought about by the 2008 financial crisis, which, by promoting short-term yields, lead to sub-optimal corporate governance and performance. Directive 2017/828 introduces new provisions allowing shareholders, made more easily identifiable, to decide on the remuneration of the company's directors. New transparency obligations are imposed on institutional investors – such as pension funds and life insurance companies – asset managers and proxy advisory firms. In addition, certain transactions, identified as potentially prejudicial to the company, will have to be published and approved through procedures that ensure the protection of the interests of the company and its shareholders. Directive 2017/828, which allows Member States to adopt or retain stricter provisions to further

facilitate the exercise of shareholders' rights, is supposed to be transposed into national law before June 10, 2019.

The needed intervention of the European Union institutions in the field of shareholders' rights: the "Shareholder Rights Directive I"

Early in the 2000's, the European Commission suggested initiatives to deal with dysfunctions related to cross-border shareholder voting, in particular the blocking of shares, insufficient or late access to information or the conditions regulating remote voting.

It is in this context that the European Parliament and the Council adopted on July 11, 2007 a Directive on the exercise of certain rights of shareholders in listed companies, known as the "Shareholder Rights I" Directive (Directive 2007/36), which introduced in particular:

- **equal treatment of shareholders**through (i) the 21-day notice period for convening shareholders of listed companies to general meetings, (ii) the publication on the issuer's website of all information necessary for the general meeting, (iii) the right of shareholders to include items on the agenda of the general meeting and to table draft resolutions, (iv) voting by electronic means or proxy, and finally (v) the right to ask questions[1];
- **identification of shareholders**, while leaving it to Member States to choose whether to provide that companies whose registered office is located within their territory shall be authorized to identify shareholders holding more than 0.5% of the share capital only. In this respect, financial intermediaries had to communicate to the company information concerning the identity of shareholders, notwithstanding the chain of intermediaries that might exist;
- **information to shareholders**, by requiring intermediaries to provide shareholders with all information necessary for them to exercise the rights attached to their shares; and
- **regulation of the activities carried out by intermediaries**, by requiring them to transmit to the company without delay the instructions received from shareholders concerning the exercise of the rights attached to their shares.

In France, the adaptation of the exercise of certain rights by shareholders in listed companies to comply with the provisions of Directive 2007/36/EC[2]has had *inter alia*the effect of enhancing the protection of shareholders represented by proxy at general meetings, since the choice of proxy became no longer limited[3].

Yet, while the very liberal approach of Directive 2007/36/EC has re-placed shareholders at the center of the corporate system, it has also had the effect of encouraging shareholders to reassess management strategies in order to pursue more lucrative short-term objectives.

Following the subprime crisis in 2008, the European Commission then considered the governance of financial institutions before broadening its reflection to corporate governance as a whole and more specifically to harmful practices such as short-termism and excessive risk-taking[4].

As a result, a Green Paper on corporate governance in the European Union was produced and works on the future of European corporate law were launched.

A revision of the law governing shareholders in listed companies with a view to promoting long-term engagement: the "Shareholder Rights Directive II"

In a communication dated December 12, 2012 called "*Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies*", the European Commission announced several initiatives aimed at promoting long-term shareholder engagement and improving transparency rules between companies and their investors.

These initiatives are reflected in EU Directive 2017/828 which seeks to address the insufficient commitment of shareholders and the lack of transparency both in corporate governance and among investors and their service providers by implementing measures, some of which will be transposed into French law through the so-called Law on business growth and transformation, known as the "PACTE Law"[5]in French.

Indeed, the PACTE law partially transposes EU Directive 2017/828 by supplementing existing provisions of French law to bring it in line with EU Directive 2017/828.

In this respect, the PACTE Law provides for:

- **the identification of shareholders in listed companies**[6]for companies that wish to identify shareholders who have interests exceeding 0.5% of the share capital. The objective is to be able to better communicate with them and understand their expectations. This shareholder identification system imposes communication obligations on intermediaries, including those whose registered office is not located within the European Union.

⇒As French law currently stands, the identification of shareholders already applies to shareholding interests exceeding 0.25% of the company's share capital and the PACTE Law[7]complements the measures in force under French law, and in particular the so called "identifiable bearer share"[8]. However, the PACTE Law does not provide the companies with the possibility to ask the intermediaries to collect information concerning the identity of shareholders.

- **The preparation and annual publication of a shareholder engagement policy**[9]describing how "institutional investors" and "asset managers", in particular management companies of collective investment schemes or alternative investment funds, integrate their role as shareholders into their investment strategy. In addition, EU Directive 2017/828 specifies that this engagement policy must describe in particular how these market players monitor companies, engage in dialogue with the relevant actors within the companies, exercise the voting rights and other rights attached to the shares and prevent conflicts of interest in relation to their engagement.

⇒Regarding voting policy within management companies, Article L. 533-22 of the French Monetary and Financial Code already provides for transparency obligations in accordance with the terms of the General

Regulation of the *Autorité des MarchésFinanciers* (French Financial Markets Regulator) which goes well beyond what is required under the Directive.

- **Approval of the remuneration policy for directors by shareholders and preparation of an annual remuneration report.**EU Directive 2017/828 requires Member States to introduce into their legislation the "*say on pay*" procedure[10], which until now was only a mere recommendation by the European Commission[11]. As such, Directive UE 2017/828[12]provides that the shareholders must have the right to vote on the remuneration policy for directors at every material change and in any case at least every four years. Yet, Member States are free to choose whether to make this vote binding or merely consultative. In addition, the Directive requires companies to provide shareholders with clear and understandable information, through a report, on remuneration, including all benefits, granted or due during the previous financial year[13].

⇒In this respect, the PACTE Law empowers the Government to set up by way of Ordinances a "*unified and binding framework for the remuneration of directors of listed companies*"[14]in order to adapt the French Commercial Code to meet the requirements introduced by the Directive.

- **Information on transactions between the company and a "related party",**which must be approved by the company's executive or supervisory board. The proposal for a Directive included a prior authorization requirement in this respect, a clarification which is no longer set forth in the adopted Directive. In addition, Member States are given the possibility to require a fairness opinion on transactions concluded between the company and a related party.

⇒The PACTE Law provides for an amendment to the French Commercial Code in this respect, it being specified that French law provides that the person concerned by the transaction may not take part in the vote of the general meeting or the board which must approve the transaction. Finally, as far as the fairness opinion is concerned, since it is merely an option, the PACTE bill does not include this measure.

- **The transparency of proxy advisory services**by regulating for the first time the activity of proxy advisory firms and by imposing various obligations on them, including: (i) the publication of the code of conduct they apply and the drafting of a report on how this code is applied, (ii) the publication on their website of information relating to their advice, voting recommendations and researches carried out in this respect, (iii) the communication to their clients of any conflict of interest likely to influence the advice given and recommendations made to shareholders.

⇒The PACTE Law incorporates these provisions into the French Monetary and Financial Code, in a section dedicated to proxy advisory services for shareholders of companies listed in the European Union. The PACTE Law also specifies the scope of application of these provisions by including advisory firms whose registered office is located outside France but who operate on the French territory through an entity.

As mentioned above, this is a partial transposition of the provisions of EU Directive 2017/828 through the PACTE Law. For the rest, the PACTE Law *inter alia*empowers the Government to take measures by way of

Ordinances to transpose some provisions of EU Directive 2017/828, which is theoretically to be fully transposed before June 10, 2019.

To conclude, when we analyze the developments brought about by EU Directive 2017/828, we note that some key proposals made during the debates have not been endorsed. In addition, Member States have a wide margin of discretion to implement the measures and decide on sanctions applicable in case of breach of national provisions adopted to ensure the transposition of the requirements of EU Directive 2017/828. In addition, certain obligations may be waived by interested parties by providing an explanation on the reasons for such waiver, in accordance with the governance principle "*comply or explain*".

Finally, we observe a continuation of the shareholder approach to corporate governance. The results are therefore mixed.

[1]Articles 5, 6, 8, 9 and 10 of Directive 2007/36

[2]Through Ordinance n°2010-1511 dated December 9, 2010 and Decree n°2010-1619 dated December 23, 2010

[3]Article Art L225-105 *et seq*.and R.225-71 *et seq*.of the French Commercial Code

[4]Comment Lextenso, Bulletin Joly "*Révision de la directive Droit des actionnaires*"

[5]The PACTE Law has been definitively adopted by the French Parliament on April 11, 2019 but it has not yet come into effect. It has been referred to the Constitutional Council to ensure the constitutionality of some of its provisions.

[6]Article 3 bis of Directive 2017/828

[7]Article 66 III of the PACTE Law

[8]Articles L228-2 *et seq*of the French Commercial Code

[9]Article 3g of Directive 2017/828

[10]Procedure allowing the shareholders of a company to vote on the remuneration of the corporate officers.

[11]Recommendation 2004/913/CE of the European Commission of December 14, 2004 fostering an appropriate regime for the remuneration of directors of listed companies

[12]Art 9 bis de la Directive UE 2017/828

[13]Art 9 ter de la Directive UE 2017/828

[14]Article 66 V de loi « PACTE »

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