

Say on Pay and Focus on Sustainability of Companies: A Revised Shareholders' Rights Directive

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The financial crisis revealed that shortcomings in corporate governance of listed companies were a contributory cause. The European legislature means to remedy this. Increased engagement and control by shareholders could contribute to good decision-making by companies. On 14 March 2017 the European Parliament voted on the revised Shareholders' Rights Directive (SRD). The Council adopted the amended SRD on 22 March 2017. Article 1 of Directive 2007/36/EC is amended to 'establish (...) specific requirements in order to encourage shareholder engagement, in particular in the long term'. In short, long-term commitment to companies instead of short-termism.

1. CONTRIBUTING TO LONG-TERM SUSTAINABILITY OF EU COMPANIES

The new rules aim to contribute to the long-term sustainability of EU companies by establishing rules for the 'identification of shareholders, transmission of information, facilitation of exercise of shareholders rights, transparency of institutional investors, asset managers and proxy advisors, remuneration of directors and related party transactions'. The SRD will facilitate cross-border voting rules which will make it easier for shareholders to exercise their rights. This will contribute to stronger shareholders' rights. The company on the other

hand gains insight into their identity thanks to Article 3a: 'Member States shall ensure that companies have the right to identify their shareholders'.

2. SHAREHOLDERS' 'SAY ON PAY'

The SRD also lays down certain requirements with regard to directors' remuneration. In short, we could say that the provisions concerning remuneration serve two goals: enhancing the pay governance of listed companies, and increasing transparency and accountability of directors. To align the interests of the company and its directors, shareholders should have an effective say on pay. Therefore, the SRD requires Member States to ensure that shareholders have a binding vote on remuneration policy so that companies are obliged to award their directors remuneration in accordance with the approved policy. This enhanced position of shareholders is somewhat weakened by the following derogations. Member States may provide for the shareholders' vote to be advisory. If the General Meeting rejects a proposed remuneration policy, the company will have to submit a revised policy to a vote at the following General Meeting. Furthermore, Member States may allow companies, in exceptional circumstances and under specific conditions, to temporarily derogate from the remuneration policy if this 'is necessary to serve the long-term interests and sustainability of the company as a whole or to assure its viability'. In order to make sure that the implementation of the remuneration policy is in line with the approved policy, Member States should ensure that shareholders have the right to vote on the remuneration report. In the event the shareholders vote against this report, companies should explain, in a subsequent report, in what manner this vote was taken into account.

Besides these provisions focused on enhancing the pay governance of listed companies, the SRD provides for provisions concerning the content of the remuneration policy and report. These requirements

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should enable shareholders to perform their monitoring tasks and increase the accountability of directors towards shareholders and stakeholders. Companies, for instance, are required to come up with a clear and understandable remuneration policy that describes the different components of directors' pay. The remuneration policy shall also explain in what manner the pay and employment conditions of employees of the company were taken into account when establishing the aforementioned policy. The remuneration report should, *mutatis mutandis*, provide a comprehensive overview of the remuneration awarded, including all benefits in whatever form. This increased transparency on (awarded) remuneration should enhance shareholder monitoring on the link between remuneration and performance.

3. ENCOURAGING LONG-TERM SHAREHOLDER ENGAGEMENT

To solve the problem that shareholders today often focus on short-term strategies, the amended Directive additionally creates transparency on the engagement policies of institutional investors and asset managers and on the activities of proxy advisors. The requirements focus on institutional investors (pension funds,

insurance companies) and asset managers because they play a key role in the European economy and their business models do not 'allow them to take into account long-term performance and put (...) pressure on them to deliver short-term returns'.

4. TRANSPARENCY REQUIREMENTS

Institutional investors and asset managers will also have to be transparent about how they invest and how they engage with the investee companies. These transparency requirements will encourage these investors to adopt more-long-term focus on the investment strategies and to consider social and environmental issues. The 'comply or explain' approach to this requirement which is also used in corporate governance codes, applies. The revised Dutch Corporate Governance code entails similar requirements for directors to encourage long-term value creation. However, the implementation of the Directive will result in statutory requirements instead of soft law.

Since the revised SRD was adopted on 22 March 2017, Member States will have 24 months from this date to implement the new rules.