

SRD II Regulatory Update

October 2019



Shareholder Rights Directive II (SRD II) Regulatory Update

Summary

SRD II (the "Directive") is a revision of the original Shareholder Rights Directive (SRD I), which is an EU Directive that dates back to 2007. SRD II aims to improve long-term engagement between shareholders (asset owners and asset managers) and the companies in which they invest. The Directive's objective is to reduce risks associated with short termism and excessive risk taking by increasing transparency of decision making in companies. A key component in enabling this is the establishment of formal obligations on intermediaries in the custody chain to transmit information between Shareholders and Issuing Companies and to facilitate voting. The Directive is particularly noteworthy as it is part of a broader regulatory agenda to improve transparency and stewardship in capital markets, and is one of the first pieces of legislation that sets out detailed obligations around operational processes in the custody chain.

Why is this important?

The Directive requires additional obligations placed on intermediaries with respect to the services they provide to their clients. If you also act in the capacity of an "intermediary", you will be subject to the obligations set out in the Directive.

This document covers frequently asked questions relating to BNY Mellon in its role as an 'intermediary' in the custody chain. Since the Directive covers a broader range of activities, we recommend all clients review details of the Directive on our [SRD II Regulation Readiness page](#) to identify impacts or obligations. The webpage includes visual details on how SRD II-relevant information is transmitted in the chain of custody. There is also a link to the Implementing Regulation that outlines the different message requirements and brief explanations around the information required for each type of notification and response.

General Information

1. What securities are impacted by SRD II?

- SRD II applies principally to equity securities with voting rights that are admitted for trading on a regulated market within the EEA and whose issuer has a registered office within the EEA. In this respect, SRD II has a global impact on both intermediaries and shareholders holding in-scope equities.
- It should be noted that Member States do have some discretion with respect to the definition of which types of securities fall under the SRD II obligations, so that the full picture of exactly which securities fall under the obligations will not be known until all Member States have completed the transposition of SRD II into their national law.

2. What entities are impacted by SRD II?

- SRD II affects the following types of entities:
 - Companies / issuers that have a registered office in the EEA and whose shares that carry voting rights are listed on an EEA regulated market;
 - Intermediaries, including intermediaries located outside of the EEA, used by holders of in-scope securities; and
 - Institutional investors and asset managers who invest in in-scope securities.

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An “**intermediary**” is defined as an investment firm, credit institution or Central Securities Depository (CSD) that offers any of the following services in respect of in-scope securities (i.e., shares with voting rights that are listed for trading in an EEA regulated market and where the company has its registered office in the EEA):

- Safekeeping of shares;
- Administration of shares; or
- Maintenance of securities accounts on behalf of shareholders

The basic concept of an “**intermediary**” is that an intermediary holds securities on behalf of a client. Accordingly, the “intermediary” is not the beneficial owner of the securities and the “intermediary” has a contractual relationship with its clients to provide custody services.

3. Why is it important to know if I am an intermediary or final shareholder for SRD II?

- SRD II imposes obligations on intermediaries in the custody chain. The specific obligations placed on an intermediary depend on whether the client of an intermediary is, itself, an intermediary or is the final shareholder in the custody chain. Consequently, it is vital that an intermediary is able to identify where it sits within the custody chain.

4. How will my accounts be classified as an intermediary or final shareholder for SRD II?

- BNY Mellon is in the process of classifying impacted client accounts. If a client account is used to hold assets on behalf of a third party (i.e., the client's client), the account will be considered an intermediary account.

Alternatively, we will classify accounts as a final shareholder account where it is identified that the assets in that account are held for the client's own benefit. Examples of final shareholders include fund clients, natural/legal persons or institutional investors.

Where necessary, we will reach out to clients to confirm the categorisation that is to be applied to their account. We are currently finalising our timelines and anticipate this action to commence at the end of 2019 and continuing into 2020. We will inform you of the classification applied to your accounts.

Please take a moment to review our SRD II Expected Industry Information Transmission Flows on our [SRD II Regulation Readiness page](#).

5. What are the key operational impacts of SRD II for intermediaries?

- SRD II impacts three core processes relating to the transmission of information to the shareholders and facilitation of shareholder rights, as it requires intermediaries to:
 - Disclose shareholder identity upon an authenticated request and to forward that request to the next intermediary in the chain;
 - Notify shareholders of general meetings and facilitate the right of shareholders to participate in voting; and
 - Meet demanding deadlines with respect to the transmission of information for corporate events, as well as for general meetings. Intermediaries must transmit the information on the same day they receive it or, if received after 16:00, by 10:00 a.m. on the following day. SRD II also requires that there be a maximum of 3 days between the issuer deadline and the final intermediary response deadline.

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6. Are there similar operational impacts for final shareholders?

- **Shareholder Disclosure Request** - There is no operational impact on final shareholders as BNY Mellon and other relevant intermediaries will respond with all necessary details.
- **General Meeting Notification and Participation in Voting** – If the final shareholder's accounts with BNY Mellon are already set up to receive notification and participate in voting for the impacted securities, there is no major operational impact. Final shareholders will see benefits such as faster notifications and response deadlines.

If the final shareholder's accounts with BNY Mellon are not already set up, we will arrange to set them up to receive notifications and participate in voting for the impacted securities by September 3, 2020. Therefore, such final shareholders will need to prepare for receiving this service or ask BNY Mellon to opt-out. We will share more details on this service and the opt-out via future communications.

- **Corporate Action Events** – There is no major operational impact on final shareholders. Final shareholders will see benefits such as faster notifications as well as better response deadlines (please see further details below).

7. Am I required to be SWIFT 2022 compliant?

- SRD II obliges all intermediaries to notify each other in straight through processing, machine-readable formats and sets out a new messaging structure.

The current ISO 15022 corporate action messages cannot be used for the new SRD II message flows. New messages are being created in ISO 2022 format only; as such, they are the only SWIFT messages that will support the disclosure process (notification and response).

BNY Mellon will continue to use existing ISO 15022 messages for other corporate events, and will use ISO 2022 for disclosures and general meetings. All notifications will continue to be available, including disclosure via the BNY Mellon online portals and the general meetings via ProxyEdge.

If you are an intermediary, while you can opt to receive your notifications in one of our formats, you will need to plan to provide responses to disclosure requests. As issuers are responsible for determining and communicating the manner in which they will accept responses (for example, and as per the regulatory text, sent by a BIC address, secured or certified e-mail address, or URL for a secure web portal), BNY Mellon cannot comment on what formats will be available and it will likely change on a case-by-case basis.

Final shareholders do not need to be ISO 2022 compliant for disclosure as BNY Mellon and other relevant intermediaries will respond with all the necessary details.

It is the responsibility of both the issuer and the intermediary to ensure information is transmitted using appropriate technical and secure channels.

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8. I am a shareholder located outside of the EU – does SRD II still impact me?

- The Directive, as implemented in national laws, expects all intermediaries, regardless of their location, to implement the changes.

All clients should be aware that when BNY Mellon receives an authenticated request, we will disclose the identity of all impacted clients holding the security, regardless of their location.

9. How will BREXIT impact UK securities and/or UK clients?

- At the moment, the impacts of BREXIT are unknown. For the purposes of this program, BNY Mellon is continuing to include UK securities and UK clients as being impacted. Once further information becomes available, we will update these pages.

10. When do these changes take effect?

- While some aspects of SRD II have gone live since June 10, 2019 (or later depending on national transposition), the SRD II changes we focus on in this document (and covered in the Implementing Regulation) will be effective from September 3, 2020. Practically, this means all the operational changes referred to in this document will be in place by then.

Identification of Shareholders

11. When must intermediaries forward the disclosure request?

- The issuer, when notifying the intermediary, can specify if the receiving intermediary just needs to respond or if the receiving intermediary must also pass the disclosure request through the chain.

In case the issuer asks to pass the disclosure request through the chain, the receiving intermediary must forward it to all of their intermediary clients on the same day it is received or, if received after 16:00, by 10:00 the following day.

12. How should the intermediary respond to a disclosure request?

- Intermediaries are required to respond to shareholder disclosure requests directly to the issuer (or their appointed third party agent). This differs to other events where responses are traditionally passed through the custody chain.

This means all intermediaries must be able to send shareholder disclosure responses to another party other than their account servicer (as mentioned, the shareholder disclosure request will outline the response methods available).

The response must include the total number of shares held by the responding intermediary as well as a breakdown by client, whether or not the client is an intermediary or the final shareholder.

13. What shareholder information is an intermediary required to disclose and why?

- Intermediaries are required to disclose specific information relating to their clients and the positions held on their behalf. This includes information such as final shareholder name and address, and includes unique identification data (e.g., Legal Entity Identifier (LEI) for legal entities).

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The Directive states each response must categorise the nature of the position being disclosed; for example intermediary or final shareholder.

Each intermediary will respond directly to the issuer, or the issuer's appointed third party, with their direct client's information. This means each position will be reported multiple times with details becoming more granular until reaching the final intermediary (who will respond on behalf of the final shareholder). All of this information will need to be reconciled by the issuer so it will have a complete picture of the company's shareholders.

14. When must the Intermediaries reply to a Disclosure request?

- If the Record Date is in the future, the intermediary must reply no later than Record Date + 1.
- If the Record Date is in the past, the intermediary must reply no later than:
 - Request Date + 1 if Record Date is less than 7 days in the past; or
 - Issuer Deadline if Record Date is more than 7 days in the past.

15. Is there a threshold limit for Disclosure?

- A mandatory threshold of up to 0.5% can be applied by each Member State. This means any individual client holding less than the mandatory threshold of shares does not need to disclose. Additionally, an issuer can impose any threshold on a case-by-case basis (within the restrictions imposed by the impacted Member State). All thresholds must be notified as a number and not a percentage.

Intermediaries must be able to receive and apply these thresholds when responding to the issuer or appointed third party. This topic is currently under discussion in various industry forums and it is anticipated that to ensure the issuer can fully reconcile the responses:

- If there are clients whose holdings are less than the notified threshold, the intermediary must aggregate and include the total number of shares under the limit, but is not required to provide information on the underlying clients; and
- If there are clients whose holdings exceed the threshold, then the intermediary must respond with the breakdown for those clients.

Any threshold will be imposed as per the Member State legislation in which the issuer is incorporated.

Please note that not all Member State transpositions are yet finalised; therefore, the final picture of which Member States will impose this threshold is unknown at the time.

16. Does the Disclosure process place obligations on final shareholders?

- As mentioned earlier, the shareholder disclosure process does not impose any operational requirements on clients that are final shareholders. We will ensure the data needed to respond to requests is available in our systems, and we will process accordingly.

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17. How does BNY Mellon keep personal information secure?

- We have a comprehensive information security program in place, which is subject to internal and external benchmarking and audit. The program is designed to protect, detect, and react to threats based on industry best practices, written processes, policies and procedures to maintain the confidentiality, integrity and availability of non-public personal information and customer data. BNY Mellon's Information Security Management System is ISO 27001 certified. You can learn more about how we keep information secure in our Cyber Security Brochure.

Proxy Voting Services

18. How will General Meeting notification and voting services be impacted under SRD II?

- As an intermediary, BNY Mellon is obliged to notify clients of general meetings (within the set time-frames) and facilitate the exercise of the rights associated with the meeting. We will provide these services through our existing external global proxy provider who will assist us in delivering a fully SRD II-compliant voting service utilising a portal based or SWIFT messaging service.

SRD II introduces a number of new message types, intended for standardised use across the industry, which include:

- Confirmation of Shareholder Entitlement - a confirmation of the client's entitlement to vote;
- Voting Receipt - confirmation that the vote has been received by the entity it was sent to; and
- Confirmation of the recording and counting of votes – confirmation from the issuer that the individual vote was received and subsequently counted and cast in the meeting.

Final shareholders will be able to 'opt out' from receiving notifications from BNY Mellon, and from participating in the BNY Mellon proxy service.

Further details will be provided as and when all Member State have transposed the Directive and Industry Standards are finalised.

19. Will there be any changes to notification timeframes and deadlines for general meetings and corporate events?

- Yes, the Directive mandates that intermediaries must forward the notifications to all of their clients the same day it is received or, if received after 16:00, then by 10:00 the following day.

Additionally, there should be a maximum of 3 days between the issuer deadline and the final intermediary response deadline.

20. Are there other operational impacts for general meetings?

- Yes, the name and unique identifier of the shareholder will become mandatory information when casting a vote. The Directive also requests the identity of the Proxy Advisor and their unique identifier, if applicable. BNY Mellon is working with our Proxy Voting provider to determine how these changes can be incorporated into the product for our final shareholder clients. More information will follow.

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21. What will be the impact if I am not currently registered for BNY Mellon's Proxy Voting service?

- We will be reaching out to all impacted clients to discuss their options and impacts. We anticipate this action to commence at the end of 2019 and continuing into 2020.

22. Will there be any impact if I am currently registered for BNY Mellon's Proxy Voting service?

- For clients already registered for the BNY Mellon's proxy voting product, the service will continue as normal; however, there will be some enhancements made to cover all SRD II requirements. More information will follow as the changes to this Product become clearer.

Other changes

23. How is BNY Mellon monitoring the various market changes?

- As with all Directives, there is a degree of latitude for Member States in how they implement the changes. As a global custodian, BNY Mellon may be impacted by these differences, and we are carefully monitoring the different transpositions to see what specificities are being considered. A harmonised approach makes it easier not just for us to manage, but also for our clients to understand what is required and when.

Within the industry, various task forces have been set-up to discuss these changes and BNY Mellon is an active participant. Market standards are currently being drafted which will outline the operational expectations.

We are also actively involved in the local market discussions where we have local presence and we are working with our sub-custodians to understand the changes for the remaining markets. Using these channels, we are pushing for consistency across all the markets and escalating matters, if required. We are also actively participating in a cross-industry endeavour to track national transpositions.

24. Will there be additional cost or charges following SRD II implementation in 2020?

- We are currently reviewing the impact of SRD II on client fee schedules.

25. When are intermediaries required to publicly disclose in-scope costs and charges?

- Intermediaries must publically disclose their costs and charges associated with services under SRD II and ensure these are non-discriminatory and proportionate. We will publish our pricing disclosure on our corporate SRD II web page in due course and no later than September 3, 2020. The precise date of publication is dependent on confirmation of the legal requirement in Member State transpositions.

For further information on SRD II, please visit BNY Mellon's [SRD II Regulation Readiness page](#), or contact your BNY Mellon Relationship Manager.