

**ISS GOVERNANCE** 

**SRD II:**

Frequently Asked  
Questions

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## GENERAL QUESTIONS

### WHAT IS SRD II?

The Shareholder Rights Directive II (“SRD II”), which entered into force in June 2017, aims primarily to reinforce effective and long-term shareholder engagement and monitoring of company performance, which were perceived to be insufficient and inadequate during the global financial crisis when many companies were found to have assumed excessive risks in the pursuit of short-term returns.

SRD II builds on the original Shareholder Rights Directive (“SRD”), which aimed to facilitate the cross-border exercise of voting rights by correspondence and proxy and abolished share blocking. The SRD also provided new legislation to ensure that companies would provide shareholders with full and timely information regarding the issues to be decided at the general meeting.

### WHEN DID THE CHANGES COME INTO EFFECT?

Articles relating to the obligations of investors were transposed by most markets in 2019 with deadlines varying per market. Articles of SRD II relating to intermediaries came into effect on September 3<sup>rd</sup>, 2020.

### WHO IS REQUIRED TO COMPLY WITH SRD II?

The legal obligations (and penalties) reside within the transposition of SRD II into local law by each EU member state. As such, any answer to this question is not necessarily clearly defined for non-EU based asset managers/investors. For ISS Investor clients outside the EU, if they have EU-based entities or provide services in some manner from the EU or for EU-based funds, then they will likely be impacted as they would likely be impacted by local law.

As a large proportion of ISS’ Investor clients are global entities, many may be impacted with respect to their SRD II relevant holdings.

In terms of the UK and Brexit, as the UK did transpose into local law the articles of SRD II relating to asset managers and investors, the requirements still stand for UK clients unless those laws are subsequently overturned post-Brexit.

## HOW MIGHT THESE CHANGES AFFECT ISS – GENERAL QUERIES

### HOW WILL IT IMPACT US AS A RESEARCH AND VOTING CLIENT OF ISS?

Investor clients of ISS research and voting services that are required to comply are directly impacted by SRD II in that the minimum requirements call for investors to:

- Have an engagement policy or explain why they do not comply
- Disclose how their engagement policy is being implemented
- Disclose voting activity
  - o “Significant” votes are what is required to be disclosed

- Disclose this information on a website without charge

Investors may also see an impact in the manner in which they are serviced by their custodian banks for proxy voting. Intermediaries with clients holding SRD II relevant securities must observe the following minimum requirements:

- Facilitation of exercise of shareholder rights for clients holding SRD II securities
- Transmit information utilizing industry standard formats
- Adhere to stringent deadlines for the distribution of meeting announcements and vote instructions
- Provide a list of shareholders on record in their books if a company requests the information

## HOW WILL IT IMPACT ISS?

ISS is impacted by SRD II in the following manner:

### As a proxy advisor

Proxy advisors must:

- Maintain and disclose a code of conduct
- Explain any deviations from the code
- Ensure voting policies are of adequate quality and prepared by qualified staff
- Disclose voting policies
- Explain how conflicts of interest are managed

In addition to the requirements of ISS as a proxy advisor, the research policies of ISS could be impacted depending on transposition of the directive across each EU member state. Requirements of issuers relating to remuneration reporting, shareholder voting on remuneration and related party transactions may impact ISS' local market voting policies as well as lead to additional items on agendas at shareholder meetings and the availability of additional information for shareholders to consider.

### As a service provider to investors

ISS provides services to assist investor clients with their proxy voting responsibilities, including those under SRD II. This includes:

- Providing voting policies and recommendations
- Providing a voting platform and facilitating reporting for clients to identify "significant" votes
- Providing websites for clients to disclose voting activity and display their engagement and voting policies
- Providing an Engagement Module for the tracking and reporting of engagement activity with issuers

### As a service provider to intermediaries

ISS' Global Proxy Distribution ("GPD") services can assist intermediaries with their obligations set forth in the directive. As such, GPD is enhancing core services to include:

- Standardized Formats
  - o ISO 20022 SWIFT format development

- ISO 15022 SWIFT format update
- Meeting Notification
  - Distribution of preliminary meeting announcements
  - Updates to frequency of holdings file ingestion
- Vote Processing
  - Transmission of vote instructions “without delay” (as defined by the market or next intermediary)
- Status Updates
  - Post-meeting vote confirmation
- Shareholder Identification
  - Development of solution to receive and respond to issuer shareholder identification requests

## WHAT SERVICES CAN ISS OFFER TO ASSIST IN THE SRD II REQUIREMENTS?

ISS can offer investors the following services to assist them with their SRD II compliance efforts:

- **ISS ProxyExchange Engagement Suite** and **Pooled Engagement Services** to facilitate and improve investor-issuer dialogue
- **ISS Benchmark Voting Policy Service**: research and recommendations including data, analysis, and recommendations based on ISS' benchmark policy
- **ISS Range of Specialty Voting Policies plus full Custom Policy Service** to reflect an investor’s unique governance views; can cover sustainability and socially responsible investment themes
- **ISS Vote Disclosure Services** to publicly disclose voting and engagement policies as well as voting activity

ISS can offer intermediaries engaged in global proxy distribution with services to assist with compliance to SRD II, including:

- **Full end-to-end outsourcing of proxy voting** to distribute meeting notifications and facilitate the exercise of shareholder rights
- **Meeting announcement and agenda data** proactively sourced and distributed to clients “without delay”
- **Adherence to deadlines** to ensure information is disseminated in accordance with the deadlines established by SRD II
- **Adherence to standardized formats** ensuring information is transmitted along the chain of intermediaries in electronic and machine-readable formats
- **Vote confirmation** to be provided if received from the issuer through the chain of intermediaries
- **Identification of shareholders** to be communicated to a company upon request

## PROCESS RELATED QUESTIONS

### HOW MIGHT THINGS VARY ACROSS DIFFERENT MARKETS FOR INVESTORS

Each EU market was required to transpose SRD II into local law by June 2019. Some markets have made clear their interpretation and transposition of SRD II, while others may have utilized the wording of SRD II in their local transposition, meaning there is still room for interpretation. The following items are where ISS has seen the largest difference in interpretation or transposition:

#### Proxy Voting

- Threshold of minimum shareholding for shareholder identification
- Adherence to deadlines and definition of “without delay” for processing of voting instructions

#### Proxy Research

The research process will remain unchanged with ISS well placed to incorporate the increased number of remuneration proposals that will require analysis.

### DOES ISS HAVE ANY INTELLIGENCE AS TO HOW OTHER INVESTORS MIGHT BE DEFINING “SIGNIFICANT VOTES”?

Many ISS Research and Voting clients disclose their full voting activity and thus believe they are already compliant with this requirement. Those who may choose to only disclose specific votes may consider defining “significant” through filters such as:

- Threshold of share ownership
- Any agenda items voted Against or Abstain
- Any agenda items voted against the Management’s recommendation
- Meetings containing a shareholder proposal
- Any agenda item pertaining to a specific topic (diversity, climate change, etc....)
- Defined list of markets or issuers

### HOW AND WHEN WILL ISS IMPLEMENT SRD II REQUIREMENTS SUCH AS TRANSPARENCY REQUIREMENTS INCLUDING REPORTING ON AN ANNUAL BASIS:

ISS provides proxy advisory services in accordance with and by reference to the Best Practice Principles for Shareholder Voting Research & Analysis (the “Principles”).

By way of background, the Principles were first launched in March 2014 by the Best Practice Principles Group (the “BPPG”), a group formed in February 2013 to promote greater understanding of the corporate governance and environmental, social and governance research and support services provided to institutional investors and other capital market participants. ISS is pleased to have been a founding member of the BPPG and to have participated in the development and publication of the Principles.

The Principles, along with associated guidance on their application, can be found on the BPPG's public website at: <https://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf>.

#### Report on the Application of the Code of Conduct

Consistent with the BPPG's expectations and in accordance with the requirements, ISS publishes a Principles Compliance Statement which reports on the manner in which ISS applies the Principles. ISS' most recent Principles Compliance Statement is dated 19 April 2017 and remains a current statement of ISS' approach to the application of the Principles. ISS' Principles Compliance Statement can be found on ISS' website at: <https://www.issgovernance.com/file/duediligence/best-practices-principles-iss-compliance-statement-april-2017-update.pdf>. It is also available on the BPPG's public website.

## HOW WILL ISS COMPLY WITH THE DIFFERENT OBLIGATIONS UNDER ARTICLE 3J: TRANSPARENCY OF PROXY ADVISORS?

In addition to affirming its commitment to the Principles, ISS' Principles Compliance Statement provides extensive information about the manner in which ISS conducts its business, including steps it takes to ensure the accuracy and reliability of its offerings.

These extensive disclosures include information about (a) ISS' proxy voting policy frameworks and methodologies for assessing issues and issuing vote recommendations; (b) the sources of information ISS relies upon to conduct its work; (c) the procedures ISS has implemented to ensure the quality of its work product and the suitability of the staff that perform this work; (d) the manner in which ISS' proxy voting policy frameworks account for local market and company specific conditions with respect to the companies it covers; (e) ISS' protocols for engaging with the companies it covers as well as other stakeholders; and (f) ISS' extensive policies and procedures regarding the prevention, management and mitigation of potential conflicts of interest.

Beyond the Principles Compliance Statement, ISS provides a variety of information on these topics which is made available on its public website, particularly within the "Policy Gateway" and "Compliance" sections. ISS' website can be accessed at [www.issgovernance.com](http://www.issgovernance.com).

Amongst other items, the Policy Gateway section of the website includes copies of current and historical proxy voting guidelines, an overview of the process ISS undertakes to develop and apply those policies and a discussion of policies and practices for engaging with companies and other relevant stakeholders.

The Compliance section also supplements ISS' Principles Compliance Statement with links its internal Code of Ethics, General Code of Conduct, and a Due Diligence Compliance Package.

## IF WE (ISS) ARE TO PROVIDE PRELIMINARY NOTIFICATION, WHAT WILL THIS LOOK LIKE ON PROXYEXCHANGE?

The preliminary meeting announcements will include at a minimum:

- Name of issuer
- Date of shareholder meeting
- Location of shareholder meeting

- Time of shareholder meeting
- Type of shareholder meeting
- ISIN

ISS intends to make this information available on ProxyExchange (“PX”) in a dedicated silo and not within the existing Meeting List view.

## CAN WE (THE CLIENT) REQUEST VOTE CONFIRMATIONS ON ANY MEETING?

There will be no need to request confirmation of vote instructions for a custodian bank utilizing either ISS’ Global Proxy Distribution service (GPD) services or for custodians who have outsourced proxy voting to other intermediaries.

GPD will be proactively requesting confirmation from the issuer when processing vote instructions submitted by ISS clients. Once the confirmation is obtained, the information will be displayed to clients in PX.

ISS anticipates that other proxy distributors will follow this same approach and will pass on the confirmation from the issuer for each vote to be displayed in PX.

## HOW WILL FAX CUSTODIANS BE IMPACTED BY SRD II OR SHOULD THE CLIENT BE REACHING OUT TO THEM DIRECTLY?

ISS has no direct connection to, or relationship with, custodian banks who do not utilize a vendor. ISS would recommend clients contact their custodians directly to confirm any changes to their existing practices in light of SRD II.

## DO WE KNOW WHAT CHANGES OTHER INTERMEDIARIES ARE MAKING AND WILL THERE BE DEVELOPMENT WORK AT ISS TO THIS EFFECT?

ISS has been liaising closely with global ballot distributors regarding SRD II and the various disclosure requirements.

ISS will be receiving pre-meeting notification and confirmation files from some intermediaries as a result of SRD II regulations; however, the fundamental voting flow will remain the same. From a user perspective, ISS’ governance research and voting clients will ultimately receive additional insight into confirmation and meeting notifications.



## GLOBAL PROXY DISTRIBUTION (GPD) SPECIFIC

### WHAT CHANGES ARE ISS MAKING TO ACCOMMODATE SRD II ON THE GPD BUSINESS?

ISS has invested heavily in the GPD solutions provided to intermediary clients to assist with preparation and compliance with SRD II in advance of the September 2020 deadline. This includes, but is not limited to, the following development items:

- Operational Workflow
  - o Communication and processing to and from markets and between ISS systems in line SRD II standards and timelines
- SWIFT Standard Updates
  - o Adherence to SRD II timelines and ISO 20022 message creation/updates/ingestion processing
- Preliminary Meeting Notifications
  - o Procurement and distribution of preliminary meeting announcements
- Holdings Processing
  - o Updates to frequency of processing and additional data points
- Shareholder Identification
  - o Storage, acceptance and delivery of data to accommodate requests received from issuers
- Vote Confirmation
  - o Updates to ProxyExchange to display confirmation received as well as alerting and reporting for clients

ISS expects that the GPD product strategy over the next two to three years will lean heavily on continued development based upon SRD II and the feedback from clients and EU markets. As clients and market constituents evolve their practices post implementation of SRD II, ISS will remain flexible to ensure development of any new solutions or amended business practices is tailored to accommodate new developments or standards.

### HOW WILL SRD II CHANGES AFFECT THE MANNER IN WHICH PROCESSING INSTRUCTIONS PLACED IN PX ARE UNDERTAKEN? (GPD)

For intermediaries utilizing ISS as a vendor for proxy distribution, ISS will process vote instructions in PX based upon the frequency stipulated by the intermediary client or their sub-custodian. This could be:

- As soon as the instruction is submitted on the platform (not recommended by ISS and not seen as a common request)
- Upon record date if prior to vote deadline
- Upon vote deadline if prior to record date
  - o Positions changes occurring after vote deadline will be sent to the next intermediary

## INTERMEDIARY CLIENTS AND BENEFICIAL OWNER INFORMATION

For beneficial owner disclosure, ISS, from a voting perspective (i.e. non-GPD), is not an intermediary and is not required to pass beneficial ownership information to proxy distributors in place of, or in addition to, the obligations the custodians have to pass that information down the chain.

For further information regarding beneficial ownership disclosure under SRD II, please see the below primer.

### **What is the problem?**

Certain markets require beneficial owner information to be included with vote instructions when sent to the sub-custodian or issuer. Custodian banks will collect and maintain the beneficial owner information of their clients and provide this with a vote instruction whenever their clients vote in a market which requires it. In the event an intermediary has an aggregated account through their custodian bank, there could be many underlying shareholders/beneficial owners represented within the aggregated account. If the intermediary votes upon the aggregated account in a market which requires beneficial owner disclosure, the custodian bank may not know which beneficial owners are represented within the vote instruction. In these instances, the intermediary must provide this information to the custodian or their service provider directly. As a result of SRD II, most EU countries will now require beneficial owner information to be included with vote instructions when sent to the sub-custodian or issuer. This will increase the possibility that intermediaries may need to provide beneficial owner information on a per-vote basis to custodian banks or their service providers.

Many custodian banks are currently performing outreach to their client base to inform them of the overall impact of SRD II to the voting process as well as to determine which of their clients are themselves intermediaries.

### **What is the solution?**

#### *Proxy Distributors:*

Intermediaries using a custodian who outsources to proxy distributors other than ISS will need to provide the beneficial owner information to them directly. ISS does not provide beneficial owner information to proxy distributors, nor do they expect this information from ISS.

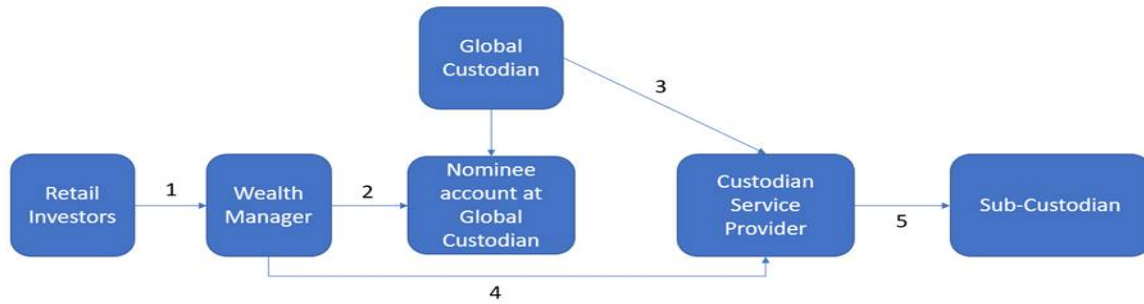
#### *ISS Global Proxy Distribution (GPD):*

Intermediaries using a custodian who outsources proxy distribution to ISS will need to provide the beneficial owner information to ISS directly. This can be done via SWIFT. GPD is developing functionality on PX to allow GPD users to upload beneficial owner information on a per meeting/ballot basis. This information is intended to then be automatically included on the vote instruction when sent out to the market. Development is targeted for Q1 2021, but the official timeline has not yet been determined.

### **Do you have an example?**

SRD II defines an “intermediary” to be any person who provides the services of safekeeping of shares, administration of shares or maintenance of securities accounts on behalf of shareholders or other persons.

Institutional clients of ISS are typically asset managers or asset owners. In many cases, these types of institutions do not meet the definition of intermediary; however, ISS could, and most likely does, have institutional clients who do classify as intermediaries under SRD II. A typical example would be a wealth manager. If your client has determined they are an intermediary, they will need to follow the steps in order to provide their custodian's service provider with beneficial owner information when they vote in markets where it is required. Please see the below example:



1. Retail/Private shareholders utilize a Wealth Manager who, as part of their service, provide their clients with proxy voting.
2. The Wealth Manager employs a global Custodian to handle custody of their clients' shares within an aggregated nominee account.
3. The Global Custodian utilizes a vendor for proxy distribution. As part of this service, the vendor will require the Global Custodian to provide them with beneficial owner information per custody account. This ensures the vendor can provide the information alongside vote instructions in markets where it is required.
4. As a nominee account is used by the Wealth Manager, the Global Custodian will not know which beneficial owners are represented behind a vote instruction for a shareholder meeting of a company held by the account. This information must then be passed along to the custodian or their service provider on a per-meeting basis.
5. Once received, the service provider can include the beneficial owner information alongside the vote instruction to the sub-custodian responsible for processing votes in the local market.

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All statistics referenced in this document are updated on an annual basis and, unless otherwise noted, relate to the year ending December 31, 2019.

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