FINANCIAL CONDUCT AUTHORITY

# Consultation on proposals to improve shareholder engagement

**Consultation Paper**
CP19/7**

January 2019

# How to respond

We are asking for comments on this Consultation Paper (CP) by 27 March 2019.

You can send them to us using the form on our website at: www.fca.org.uk/cp19-07-response-form

**Or in writing to:**
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**Email:**
cp19-07@fca.org.uk

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# 1 Summary

## Why we are consulting

**1.1** In this Consultation Paper (CP) we set out how parts of the Revised Shareholder Rights Directive[1] (referred to here as SRD II or 'the Directive') will be implemented in the UK.

**1.2** SRD II aims to promote effective stewardship and long-term investment decision-making. Primarily, it aims to achieve this by enhancing transparency of engagement policies and investment strategies across the institutional investment community.

**1.3** Our consultation only relates to implementation of those parts of SRD II which apply directly to financial services firms that we regulate, and to issuers in respect of related party transactions.

**1.4** To ensure a coherent overall regulatory framework, in developing our proposed rules we have worked closely with other Government departments and regulators with an interest in stewardship – and, in some cases, with responsibility for implementing other elements of SRD II. These include the Department for Work and Pensions (DWP), the Department for Business, Energy and Industrial Strategy (BEIS) and Her Majesty's Treasury (the Treasury) and the Financial Reporting Council (FRC).

**1.5** The importance of effective stewardship, and how it is best achieved, has been much debated. It is clearly a topic that deserves consideration beyond the strict implementation of SRD II provisions. Most recently, the FRC Review recommended that the existing Stewardship Code be fundamentally revisited. To provide an appropriate platform for this broader debate on stewardship, we also publish today a joint Discussion Paper (DP) with the FRC, which builds on other initiatives in this area.

**1.6** The FRC is also today publishing a CP on revisions to the Stewardship Code.

**1.7** The FCA aims to ensure that regulated financial services firms, such as asset managers and life insurers, are delivering good outcomes for their customers. For many firms, the exercise of stewardship will be integral to the effective delivery of their services to clients and beneficiaries - for example, when an asset manager invests on behalf of asset owners over the long term. In other cases, however, stewardship may not be integral to a firm's acting effectively as an agent for its clients.

**1.8** Stewardship also has a role to play across a variety of investment strategies and approaches. To the extent that it improves market quality, stewardship can make markets function better for all users.

**1.9** The implementation of SRD II through our proposed new rules for asset owners and asset managers sets an important baseline in a continuum of measures to drive

1 Directive 2017/828 at eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L0828&from=EN

effective stewardship. The revised Stewardship Code aims to encourage higher standards beyond this baseline.

**1.10** Our DP gives stakeholders an opportunity to tell us their views on the right balance between minimum regulatory expectations and code-based measures such as the revised Stewardship Code. The proposals in the CP should be considered in this broader context.

## Who this applies to

**1.11** This consultation will be of interest mainly to asset owners (such as life insurers and pension funds), asset managers, and companies with shares admitted to trading on a regulated market, who may be directly affected by these proposals.

**1.12** Retail investors and consumers (the beneficiaries who are stakeholders in pension funds or policyholders of life insurers), may also have an interest, as they may be indirectly affected. However, they are not directly included in the scope of these proposals.

**The terms used in this paper**

SRD II uses the terminology 'institutional investors' to describe life insurers and occupational pension schemes. In this CP, we use the term 'asset owners' in place of institutional investors to ensure a common vocabulary with our joint Discussion Paper on stewardship with the FRC and the terminology the FRC used in its consultation on the revised Stewardship Code. Some asset owners are outside our regulatory perimeter. Where we describe proposed rules, we use the relevant regulatory term, for example 'life insurers'.

## How this consultation links with our objectives

**1.13** SRD II seeks to promote shareholder engagement and is part of a series of EU- wide measures intended to improve stewardship and corporate governance.

**1.14** The Directive aims to encourage effective stewardship, in part, by improving transparency about how stewardship is exercised across the institutional investment community. Underpinning it is an assumption that greater transparency will make effective stewardship a differentiating factor across firms, and that this will encourage higher standards.

**1.15** Implementing SRD II measures in the UK will contribute to our strategic objective to ensure that relevant markets function well, and to our three operational objectives: market integrity; consumer protection; and effective competition:

- Better transparency and greater disclosure would foster better information for stakeholders, helping markets work well.

- Market integrity would be supported through better engagement by asset owners. It would also improve transparency in how they, and asset managers, are taking an active interest in the decisions made by the governance bodies of the issuer companies in which they invest. Stewardship provides a challenge to companies to run themselves better and to ensure the interests of those investing and those they are investing for are better aligned. This, in turn, can contribute to the long-term efficiency and effectiveness of capital allocation, benefitting investors and society.
- Effective stewardship supports consumers by better aligning incentives across the institutional investment community with the long-term interests of consumers of financial services. Consumers should also benefit from better information flow across the institutional investment community about how firms engage with issuers to promote their interests.
- Developing a market for stewardship would also improve competition in consumers' interests by encouraging firms to compete to deliver high-quality investment decisions, oversight of assets and engagement with, and challenge of, companies' boards and management.

## The Revised Shareholder Rights Directive (SRD II)

**1.16** We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. In March 2018, the UK Government and the European Commission agreed the terms of an implementation period, which was included in the draft Withdrawal Agreement. In implementing relevant provisions of SRD II for FCA-regulated asset managers and life insurers, the FCA is catering for the scenario where an implementation period is in place after the UK's departure. During this period, set to start on 29 March 2019 and lasting until 31 December 2020, EU law will continue to apply in the UK. This would require the UK to implement SRD II by 10 June 2019.

**1.17** However, since the implementation period is part of the Withdrawal Agreement, it will need to be approved by the UK Parliament and the European Parliament in order to take effect on exit day. If the UK departs from the EU without an implementation period, we will not proceed with these proposals. We note, however, that SRD II would have some relevance to regulated firms and corporate issuers even in a scenario in which the provisions of the Directive were not implemented. We would expect to return with revised proposals once the Government has decided how to proceed, also having regard to feedback to the accompanying DP on stewardship more broadly.

**1.18** SRD II sets requirements relevant to FCA-regulated firms. These include:

- Article 3g. (of SRD II). This imposes requirements on asset owners and asset managers to develop and publicly disclose (on a comply or explain basis) an engagement policy. It also requires them to disclose annually how this policy has been implemented
- Article 3h. This imposes (on a comply or explain basis) requirements on asset owners to publicly disclose their investment strategies. They must also explain:
  - how they incentivise and monitor their asset managers so that their investment strategies are consistent with the profile and duration of their liabilities
  - how they monitor their portfolio costs and

  - the time horizon and method of their monitoring of the asset managers' performance and their remuneration

- Article 3i. This imposes requirements on asset managers to disclose to asset owners certain information about how their assets are being managed
- Article 9c. This imposes transparency requirements on companies with shares admitted to trading on a regulated market, in relation to related party transactions

**1.19** We set out how we propose to implement these measures in the UK in Chapters 3 and 4 of this document.

## What we are consulting on

**1.20** To implement SRD II, we propose to introduce rules that require:

- asset managers and certain life insurers to make disclosures relating to their shareholder engagement policies
- life insurers to:

  **a.** make disclosures about their arrangements with asset managers and
  **b.** publicly disclose how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities, long-term liabilities[2], and how these elements of their strategy contribute to the medium to long-term performance of their assets

- asset managers to make disclosures relating to their arrangements with asset owners and how their investment strategies are consistent with the medium and long-term performance of the assets of the asset owner or fund
- UK companies with shares admitted on a regulated market to disclose and seek board approval for related party transactions

**1.21** Our approach has generally been to align closely with the Directive's text where practicable.

**1.22** Where the Directive provides for alternative implementation options, our approach has been to select what we consider to be the most proportionate option, reflecting what can work well and be meaningful in a UK context.

**1.23** In doing so, we propose to make certain policy choices and additional interpretations in relation to a number of issues. In particular:

- Chapter 1b of SRD II's provisions applies to the shares of investee companies which are admitted to trading on a regulated market. We interpret 'shares traded on a regulated market' as meaning any share that has a primary or secondary listing on an EEA market. In practice, this applies to EEA companies as well as, for example, many overseas companies with secondary listings in the EEA. This scope is already quite broad, but we do not think that a distinction based on the domicile or the location of the trading market reflects how financial services in the UK generally provide services to their clients. In particular, it does not reflect how asset managers manage their portfolios in practice. So, we are consulting on a proposal

2 'Long-term liabilities' is used here to reflect the wording in SRD II

to expand the territorial scope of investments to which firms need to apply the SRD II requirements.

- Our Listing Rules (LRs) already have extensive related party requirements for premium listed companies. These requirements are often more stringent than the minimum requirements included in the Directive and have the support of market participants. We propose to implement the Directive in a way that leaves the existing premium listing regime intact. Premium listed companies will have some limited additional disclosure requirements. However, meeting existing premium listing related party disclosure and approval requirements should allow issuers to be compliant for the transactions which all within scope of both the Directive and LR regimes For all companies with shares traded on regulated markets, where the Directive has allowed us to make implementation choices, we have sought to take a proportionate approach. At the same time, we have applied the longstanding principle that any listed company in a given listing category should have to meet the same requirements, whatever its country of incorporation. This means that we have not limited the new obligations to UK-incorporated issuers. Overseas listed companies will have to make some additional disclosures to the market, if they are not already subject to a similar regime in their home jurisdiction.

**1.24** We are particularly interested in views about these policy choices on territorial scope. It is important to us that the territorial scope set out in the final rules is practicable and that it aligns with how asset managers manage their portfolios. At the same time, final rules will need to ensure that asset managers meet the expectations of asset owners, and that asset owners' expectations in turn meet those of beneficiaries.

**1.25** For issuers in a given listing category, we believe it is important that the same transparency standards apply to domestic and international issuers. At the same time, it is important that issuers can reasonably meet the obligations without incurring undue costs.

**1.26** We explore these issues further in Chapters 3 and 4.

## Equality and diversity considerations

**1.27** We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper.

**1.28** Overall, we do not consider that our proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules.

**1.29** In the meantime, we welcome your input on these issues.

## Next steps

### What do you need to do?

**1.30** We want to know what you think of our proposals and invite your responses to the questions in this paper, which are also included in Annex 1.

**1.31** Please send us your comments by 27 March 2019. The shortened consultation period is necessary because of the implementation deadline of the Directive.

## How to respond to this consultation?

**1.32** Use the online response form on our website, email us at cp19-07@fca.org.uk or write to us at the address on page 2.

## What will we do?

**1.33** We will consider feedback before finalising our rules. We will also take into account any other relevant developments.

# 2 The wider context

## Introduction

**2.1** The proposals in this CP are part of a continuum of legislative, regulatory and code-based actions to implement SRD II and to promote effective stewardship. For a full overview of how these actions fit together and how the various bodies with interests and responsibilities in this area are approaching stewardship, please read the joint FCA and FRC DP on stewardship, which is also published today. This chapter provides a brief overview and context for this CP.

## Asset managers' and asset owners' roles in stewardship

**2.2** In this CP, asset owners include life insurers and occupational pension schemes. These firms have sizeable funds to invest. Life insurers typically have long-term liabilities in relation for their life insurance business, which may include pension arrangements for end-consumers.

**2.3** According to data from the Investment Association (IA), the UK's asset management industry is the second largest in the world, managing around £8 trillion of assets. £2.4 trillion of that is invested by UK pension funds and £1 trillion by UK insurers (i.e. in scope asset owners). UK asset managers manage around £3.1 trillion for overseas clients. UK asset managers manage over one third of all assets managed in Europe.

**2.4** They are, therefore, among the largest investors in public companies. By exercising stewardship and challenging issuers' strategies and decisions, asset owners and their asset managers can improve issuers' understanding of their interests and influence corporate strategy to further those interests. This will contribute to the long-term efficiency and effectiveness of capital allocation, benefitting investors and society.

**2.5** Improved transparency of stewardship activities, in turn, should allow clients of asset managers and asset owners to take account of a firm's approach to stewardship when selecting their services.

**2.6** In its revised Stewardship Code, the FRC defines stewardship as the responsible allocation and management of capital across the institutional investment community, to create sustainable value for beneficiaries, the economy and society. Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities.

**2.7** Stewardship is about asset owners and asset managers properly taking an active interest in the decisions made by the governance bodies of the issuers of the assets they invest in. It is also about the institutional investment community taking constructive actions to promote clients' and beneficiaries' financial interests over their

investment time-horizon. Reflecting its importance to our objectives, stewardship will also be an area of focus for supervisory engagement going forward.

**2.8** SRD II imposes requirements on asset owners and asset managers. The DWP is responsible for implementing the requirements of the Directive affecting trustees of occupational pension schemes. We are making rules to implement SRD II provisions for asset owners that we regulate and for asset managers. This is intended to align with the DWP provisions to ensure consistency between requirements on occupational pensions schemes and the asset managers that they employ, and between requirements on occupational and personal pension schemes.

## The flow of information in the institutional investment community

**2.9** Effective stewardship relies upon an appropriate flow of information between asset owners, asset managers and investee companies.

**2.10** In particular, it relies on asset owners having investment and engagement strategies that reflect beneficiaries' financial interests over their (often long-term) investment time-horizons. It also relies on asset owners explaining these strategies effectively to their asset managers to help ensure investment and stewardship objectives are aligned across the institutional investment community.

**2.11** In turn, asset managers need to communicate effectively with asset owners about how they are implementing their investment approach. They also need to engage effectively with the companies they invest in to deliver long-term, sustainable value that is consistent with asset owners' objectives.

**2.12** SRD II aims to address problems about a lack of transparency in how asset owners and asset managers set their long-term investment strategies and how they communicate these when working together. These 'information problems' may include insufficient dialogue between asset owners and asset managers about their investment strategies, and about how asset managers support asset owners' investment objectives when engaging with investee companies' boards and management. There may also be inadequate transparency about how shareholder rights, such as voting rights, are exercised.

**2.13** To implement SRD II requirements, we propose to introduce new rules for asset owners and asset managers to promote better engagement between them and greater disclosure of information about their investment strategies. DWP plans to implement SRD II requirements for better engagement and disclosure for occupational pension schemes, (whether defined benefit or defined contribution), largely through existing legislation.

## Related party transactions

**2.14** The Directive recognises that certain persons (related parties) may have an influence on investee companies, and that the nature of transactions with related parties may affect shareholders' evaluation and assessment of valuation. Its requirements build

on the accounting framework set under International Financial Reporting Standards (IFRS). It requires companies with shares admitted to trading on regulated markets to have safeguards in place applying to material transactions with related-parties.

**2.15** There are different views about what these appropriate safeguards should be and SRD II allows for a range of implementation choices, all with a common aim of providing shareholders at least with additional information.

**2.16** The Directive is conceptually aligned with the premium listing regime in the UK in identifying that additional controls should apply to related party transactions. The premium listing regime has always contained substantive related party requirements. Other companies with shares traded in the UK, such as standard listed companies, have not had to meet such stringent requirements Implementing SRD II requires us to consider what the appropriate measures should be, while balancing the needs of investors and issuers.

# 3 Our proposals for asset managers and life insurers

## Introduction

**3.1** This chapter sets out our proposed handbook changes for:

- engagement policies of life insurers and asset managers
- investment strategies of life insurers and arrangements with asset managers
- investment strategy of asset managers

**3.2** SRD II prescribes what is expected of firms. We propose to take a copy-out approach to transposing these requirements. Our approach follows the text of the Directive as closely as possible, whilst trying to ensure that rules and guidance are stated in clear language and presented in a way that links logically with other existing regulatory requirements.

### Overall scope – which firms the rules will apply to

**3.3** We propose to apply the rules to asset managers and life insurers for whom the UK is the home state, as envisaged by the Directive. We also propose to apply the requirements to branches of non-EEA investment firms which we authorise. These firms must operate under similar rules to UK investment firms when they provide MiFID investment services and activities. So, we have taken the view that applying the requirements to these firms is necessary to create a level playing field.

**3.4** Specifically, the proposed rules would apply to FCA-regulated life insurers subject to Solvency II requirements, and to asset managers. Where there are obligations on asset managers to provide information to asset owners (who are in this context directly or indirectly the client of the asset manager), the rules apply to all relevant clients. This includes occupational pension schemes that are regulated by the Pensions Regulator and asset owners in an EEA country.

**3.5** Asset managers are defined as:

- MiFID investment firms who provide portfolio management services
- alternative investment fund managers (AIFMs), excluding small AIFMs
- UCITS management companies
- UCITS funds without an external management company

**3.6** We consider that the clients of life insurers and asset managers will benefit from having clear and detailed disclosure, as intended by SRD II, including of engagement policies, equity investment strategies and voting records.

## Overall scope - Which investee companies the rules will apply to

**3.7** Chapter 1b of SRD II applies to 'shares traded on a regulated market'. This includes, at a minimum, any share that has a primary or secondary listing on an EEA market. This already brings into scope EEA companies as well as non-EEA companies with secondary listings in the EEA.

**3.8** SRD II already applies broadly. But consumers of UK asset management services could reasonably expect that UK asset managers would consider their approach to stewardship across all their investments in shares. Other parts of our rulebook do not typically differentiate between the standards expected of UK-based asset managers depending on which market they are investing in.

**3.9** Over the past 20 years, UK asset managers have significantly increased investment in companies listed in markets outside the UK. Because of this, stewardship of non-UK companies has become increasingly relevant to their consumers.

**3.10** So, we propose that the rules will apply to shares held by regulated firms in all investee companies admitted to trading on an EEA regulated market or on a comparable market outside the EEA.

**3.11** This does not mean that we expect firms to have a uniform way of engaging with investee companies in all different markets.

**Q1:** **Do you agree that the territorial scope of the rules framework should extend beyond that envisaged by the Directive?**

# Specific proposals - engagement policies

## Our proposals

**3.12** We propose to make rules that would implement the minimum requirements set out in Article 3g of the Directive. Under our proposed rules, life insurers and asset managers would be required to develop and publicly disclose a policy on shareholder engagement or to explain why they have chosen not to do so.

**3.13** We propose to set out in our rules the details of these requirements. This would require a firm to state in its engagement policy how it:

- monitors investee companies on relevant matters, which are further detailed as:
  - strategy
  - financial and non-financial performance and risk
  - capital structure
  - social and environmental impact
  - corporate governance
- engages in dialogue with companies it invests in
- exercises voting rights and other rights attached to shares
- cooperates with other shareholders
- communicates with relevant stakeholders of companies it invests in
- manages actual and potential conflicts of interest from its engagement

**3.14** Where a firm has chosen not to comply with any of these specific elements, it must publicly disclose a clear and reasoned explanation of why.

**3.15** We also propose a rule (on a comply or explain basis) to require life insurers and asset managers to publicly disclose, annually, how they have implemented any engagement policy, along with certain detailed information. They must explain the most significant shareholder votes that they have participated in, and how they use proxy advisors. They must also disclose how they have cast votes at general meetings. Firms have an option not to disclose insignificant votes.

**3.16** We propose to require that this information be available free on the asset manager's or life insurer's website, in line with the Directive.

**3.17** We also propose to require that a life insurer include, in its website disclosure, a reference to where voting information has been published by any asset manager who implements the engagement policy, including voting, on its behalf.

**3.18** The Directive sets out that conflicts of interest rules shall also apply to engagement activities. We propose to make a rule applying the relevant conflict of interest rules for asset managers.

## How this compares with our current requirements

**3.19** We currently require firms that manage investments for professional clients, which are not natural persons, to disclose the nature of their commitment to the FRC's Stewardship Code or, where they do not commit to the Code, their alternative investment strategy.[4] We introduced this requirement to encourage best practice at a time when there were no other FCA rules that explicitly covered stewardship.

**3.20** The FRC is proposing significant changes to the Code in a consultation published at the same time as this paper. As we do not wish to prejudge the outcome of that consultation, we are not currently proposing any change to this rule. We nevertheless welcome any views on the interaction between this rule and the proposals in this CP in the context of the broader question of the balance between regulatory rules and the FRC's Stewardship Code in the joint DP on stewardship (DP19/1) that is also published today. See Question 7 in DP19/1.

**3.21** Our rules on funds also require fund management firms to have strategies for the exercise of voting rights.[3] We believe these requirements complement our rules.

## Implications for firms

**3.22** We understand that many firms already have an engagement policy. These firms will need to review existing engagement policies to identify whether they comply with the full requirements of the new rules. Firms that do not have an engagement policy, and which are subject to COBS 2.2.3R, would have to set out an explanation of their alternative engagement strategy.

**3.23** Since the proposed new rules permit firms to explain why they have chosen not to comply with one or more of the detailed requirements around engagement policies,

3 COLL 6.6A.6R, AIFMD Delegated Regulation (EU No 231/2013) Article 37

firms would have the option of whether to comply with the new requirements for their engagement policy or to explain why they do not.

**3.24** Firms will have to decide at what level to disclose their engagement policy. The policy could, for example, disclose the firm's overall approach to engagement or that of the wider group to which the firm belongs. Alternatively, it could set out the approach for each product, if different products use different approaches, or for some grouping of products or service offerings. We do not intend to provide additional guidance or rules at this time, on the basis that firms will be able to decide the appropriate level at which to disclose, based on their individual circumstances.

**3.25** Firms will need to report publicly on their voting activity. There is no existing regulatory requirement to do this. We do not propose to give Handbook guidance on what might be the type of significant vote on which the firm would want to report. We also do not propose to give guidance on what constitutes an insignificant vote that does not need to be disclosed. Recital 18 of the Directive gives some examples of potentially insignificant votes, such as where a vote is on purely procedural matters, or where the investor has a very minor stake compared with their holdings in other companies. Firms will have to decide what constitutes an insignificant vote, and apply their chosen approach consistently.

**3.26** Where an asset manager implements the engagement policy, including voting, on behalf of a life insurer, the life insurer must publish a reference or link to where the asset manager publishes its voting information. We would welcome any feedback on how common such an arrangement is, and the practical consequences of this.

**3.27** The proposed rules will come into effect on 10 June to meet the transposition deadline for SRD II. For an initial period after they come into effect, we consider it would be possible for a firm to comply with the relevant rule by explaining what it is doing to develop an engagement policy. This may include, for example, explaining that it is in the process of developing one, or that it is considering whether to have one. This explanation would need to be added to a relevant webpage by 10 June.

**Q2:** **Do you agree with our proposed amendments to the Handbook to implement the Directive requirements around engagement policies? If not, please explain what alternative approach you would like us to take.**

# Specific proposals - life insurers' investment strategy and arrangements

## Our proposals

### *Public disclosure*

**3.28** We propose to make a rule which aligns with the provisions in Article 3h(1). Under our proposed rule, life insurers would be required to publicly disclose how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities long-term liabilities, and how they contribute to the medium to long-term performance of their assets.

**3.29** We are also proposing to make a rule which aligns with the provisions in Article 3h(2). Under our proposed rule, life insurers must (on a comply or explain basis) ensure that where an asset manager invests on their behalf, whether on a discretionary client-by-client basis or through a collective investment undertaking, that public disclosure is made regarding their arrangement with the asset manager. This public disclosure will include the following information:

- how the arrangement with the asset manager incentivises the asset manager to align its investment strategy and decisions with the profile and duration of the liabilities of the life insurer long-term liabilities
- how that arrangement incentivises the asset manager to make investment decisions based on assessments about medium to long-term financial and non-financial performance of the investee company and to engage with investee companies to improve their performance in the medium to long-term
- how the method and time-horizon of the evaluation of the asset manager's performance and the remuneration for asset management services are in line with the profile and duration of the liabilities of the life insurer, in particular, long-term liabilities, and take absolute long-term performance into account
- how the life insurer monitors portfolio turnover costs incurred by the asset manager and how it defines and monitors a targeted portfolio turnover or turnover range
- the duration of the arrangement with the asset manager

**3.30** Where the arrangement with the asset manager does not contain one or more of such elements, the life insurer shall give a clear and reasoned explanation why this is the case.

**3.31** In line with the Directive, we propose to create a requirement that this information be available free of charge on the life insurer's website. It should be updated on an annual basis unless there is no material change. We do not propose to require the information to be published anywhere else online as we do not believe there is a need for this. Under SRD II firms may include the required disclosures in their report on solvency and financial condition referred to in Article 51 of Solvency II (which is implemented through the rules of the Prudential Regulatory Authority).

## Implications for firms

**3.32** Life insurers will need to disclose specified information about the arrangements they have with asset managers. Where a life insurer appoints an asset manager to manage a segregated mandate, sufficient information about the arrangement should be readily available to the life insurer to support this disclosure. The Directive acknowledges in Recital 45 that there may be issues with the disclosure of certain information. We

consider that it is not the intention of the Directive to require disclosure of commercially sensitive information. We expect that firms will be able to provide high-level information about these topics without breaching commercial sensitivity.

**3.33** Firms will have to identify the arrangements which will require disclosure for the purposes of the rules we are proposing to implement Article 3h(2). The Directive envisages that an investment in a fund also constitutes an arrangement. These disclosure requirements would therefore also apply to such investments. Where an arrangement does not contain one or more of the elements specified, the life insurer must give a clear and reasoned explanation of why not. While some of the information may not be relevant or available in the case of an arrangement which involves investment in a fund, other information could still be disclosed in most circumstances for example, information about the time-horizon for the assessment of performance and portfolio turnover.

**Q3:** **Do you agree with our proposed approach to implementing Article 3h of the Directive? If not, please explain what alternative approach you would like us to take.**

## Specific proposals - Transparency of asset managers' activities

### Our proposals

**3.34** We propose a new rule which would require asset managers to disclose certain information, at least on an annual basis, to the firms they provide services to. The aim of this increased transparency is to enable asset owners to assess whether and how the manager is acting in their best long-term interests and to assess whether the asset manager's strategy allows for effective shareholder engagement.[4]

**3.35** In line with the text in the Directive, we propose to require asset managers to disclose:

- how their investment strategy and its implementation contributes to the medium to long-term performance of the assets of the asset owner or the fund
- The following information:
  - the key material medium to long-term risks associated with the investments
  - portfolio composition
  - turnover
  - turnover costs
  - whether the asset manager uses proxy advisors for the purpose of their engagement activities
  - their policy on securities lending and how it is applied to fulfil engagement activities, if applicable, particularly at the time of general meetings of companies they invest in
- whether, and if so, how they make investment decisions based on an evaluation of medium to long-term performance, including the non-financial performance, of the companies they invest in
- whether any conflicts of interest have arisen in their engagement activities, and, if so, what they are and how the asset manager has dealt with them

4 Recital 20 of the Revised Shareholder Rights Directive

**3.36** We do not propose to define the terms listed above in our rules but would welcome views from market participants about whether further clarity is required to ensure consistency and comparability of disclosures.

## Implications for firms

**3.37** As noted earlier, the intention of the Directive is to require certain disclosures in relation to arrangements between asset owners and asset managers. These firms will need to consider arrangements of all kinds, including where an asset owner invests in a fund. We consider that this should lead to a better functioning market, and will provide all types of asset owner, regardless of size, with information to help them evaluate the performance of their assets and manager.

**3.38** We know that there may be some practical challenges for fund managers. However, our expectation is that, where there is no bilateral contractual relationship between a fund manager and an asset owner, if/when the asset manager receives a request for the Directive information from the asset owner, this makes them aware that they have an asset owner in scope of the Directive requirements.

**3.39** We consider this may be the most practical and efficient way for the flow of information envisaged by the Directive to work. Since the requirement is to provide information on an annual basis, we expect that the fund managers would continue to provide the information to the asset owner until they are told that the asset owner no longer has an investment in the fund. We propose to specify that, if the fund manager chooses to make the information publicly available, they would not have to provide it to the asset owner directly.

**3.40** We do not propose to require the information to be included in the fund's annual report. But we would be interested in feedback whether, in practice, it is easier for the industry to do this, as we can see that this would be a way of addressing practical issues. For clarity, we are not planning to require firms to disclose information to other investors in the same fund on request[5], although we would be interested to hear whether there would be any demand for this information from other investors.

**3.41** We know that asset managers already provide some of the information required under the proposed new rule to their institutional clients. For example, fund annual reports, and periodic reports to portfolio management clients, must include the portfolio composition. Where information is already required by other rules, we will not require it to be provided again to meet this rule. But, where information may currently be provided under contractual provisions, or through market practice, our proposed rules would require it to be provided to all relevant firms. We do not propose to set out a standard way in which firms must disclose the information, and will not require it to be provided in a single report. We believe this approach will provide flexibility. We welcome feedback from asset managers and relevant firms on any practical issues that are created through reporting in this way.

**Q4:** **Do you agree with our proposed amendments to implement the Directive requirements on asset managers reporting to asset owners? If not, please explain what alternative approach you would like us to take.**

5 This is permitted by Article 3i(3) of the Directive

**Q5:** **Are there any other points we should address in the Handbook in relation to SRD II, for example by adding clarificatory rules or providing further guidance?**

# 4 Our proposals for related party transactions

## Context

**4.1** SRD II sets rules about the disclosure and approval of transactions between companies with shares admitted to trading on a regulated market and their related parties. This is to increase transparency and to protect the company and its shareholders, including minority shareholders (who are not the related party), against the risk of the related party appropriating value belonging to the company.

**4.2** The related party provisions in SRD II allow a number of choices to be made as part of the Directive's implementation, meaning that the regimes in different jurisdictions can be expected to vary. This chapter sets out how we propose to implement SRD II related party provisions.

**4.3** In the UK, we already have extensive related party rules for premium listed companies in chapter 11 of the LRs. The premium listing regime is well-established and has the support of market participants. The existing premium listing requirements are often much more stringent than the minimum requirements set by the Directive.

**4.4** The existing premium listing regime also already contains many of the concepts covered by the Directive, such as a quantitative test based on financial measures to determine the materiality of a transaction (in the premium listing regime, these are referred to as class tests).

**4.5** By contrast, other companies to which the Directive applies, such as standard listed companies, are not currently subject to a related party transaction regime. These companies will be keeping track of related party transactions for financial reporting purposes, but do not have to comply with substantive requirements in relation to such transactions.

**4.6** One key difference between the premium listing regime and the SRD II regime is that the Directive uses the definition of related party for accounting purposes in international accounting standards (IAS 24), which is wider than the premium listing definition. As such, there are a small number of instances in which the existing premium listing requirements would not cover SRD II requirements.

**4.7** Underpinning the listing regime is also a principle that all companies in a given category must meet the same requirements, and that these standards are determined by the listing segment they chose rather than by their home domicile. When we have asked market participants about differentiating by domicile, most recently asking about proposals to create a standalone international segment, market participants did not support this suggestion.

**4.8** Investors value related party disclosures but, making disclosures – and more importantly having the systems in place to be able to make disclosures – imposes

costs on issuers. When we have previously sought market feedback about ways to improve the listing regime, we have not had strong calls for a related party regime for standard listed companies. On the other hand, we are aware that a number of UK market participants favoured the introduction of EU-wide related party votes.

**4.9** All companies to whom the Directive applies will also already be used to making announcements to the market of information under the Market Abuse Regulation (MAR). They will also be preparing annual reports under IFRS, or an equivalent standard, and half-yearly reports in accordance with the requirements under the Transparency Directive (TD). So, all UK issuers on regulated markets will already have certain systems and controls in place to be able to report to the market.

**4.10** Taking into account these factors, we have sought to design a regime that would allow us to implement the Directive minimum obligations in a proportionate manner for all companies within the scope of the Directive, but, at the same time, impose minimum change on issuers that already comply with the existing premium listing requirements. This approach seeks to ensure that shareholders and potential shareholders have the benefit of more timely additional disclosures where appropriate, while minimising the additional burden for issuers.

**4.11** In relation to any transactions for which a premium listed issuer has already complied with the announcement and approval requirements in LR 11.1.7R, no further action would need to be taken. There will be a small number of residual transactions where premium listed issuers will have to provide further transparency, for example, because the related party definition in SRD II differs from the related party definition in LR 11.

**4.12** SRD II includes provisions in relation to director remuneration, which will be implemented through BEIS legislation. SRD II allows for an exemption from the related party requirements for transactions regarding remuneration of directors, or certain elements of remuneration of directors, awarded or due in accordance with Article 9a of the Directive. These SRD II provisions interlink with the disclosures that can be exempted pursuant to Article 9c.

## Overall scope - Who the new rules will apply to

**4.13** The Directive requires us to make rules in relation to related party transactions that apply to all companies with their registered office in the UK who have shares admitted to trading on a regulated market in the UK or elsewhere in the EU. This includes both companies that are listed in the UK, and UK-incorporated issuers of non-listed shares admitted to a regulated market (such as the Specialist Fund Segment or the High Growth Segment in the UK, or a regulated market elsewhere in the EU). All these UK companies will therefore become subject to the new rules, which we are proposing to include as part of our corporate governance rules in the Disclosure Guidance and Transparency Rules sourcebook of our Handbook (DTR).

**4.14** The new rules would be located in DTR 1B and in a new section in chapter 7 of the DTRs (DTR 7.3). We are proposing to follow the existing definition of 'traded company' in section 360C of the Companies Act 2006, which is relevant for existing Companies Act provisions which implemented the original SRD requirements, as the basis for defining the scope of our new DTR provisions.

**4.15** Companies with a registered office in an EU Member State outside the UK which have shares admitted to a regulated market will be subject to the rules that transpose the Directive in the Member State where their registered office is located. The Directive does not prescribe rules for non-EU incorporated issuers (including those which have shares admitted to a regulated market in the EU).

**4.16** To reconcile the Directive scope with the principle that all issuers in a given listing category should have to meet the same requirements, we propose to amend the LRs to require all issuers with a premium listing (other than open-ended investment companies subject to LR 16) and all issuers with a standard listing of equity shares (LR 14) which are not already required to comply with the new requirements on related party transactions in DTR 7.3 to comply with those requirements as if they were an issuer to which DTR 7.3 applied. However, we propose to dis-apply these new LRs where a company is already subject to equivalent provisions in its country of incorporation – whether within the EU or elsewhere – to avoid duplicative obligations.

**4.17** This means that the new requirements in DTR 7.3 would apply to those premium listed issuers and standard listed equity issuers as well as the entities set out in paragraph 4.13.

**4.18** We propose that the new rules will not apply to standard-listed GDR issuers, as the Directive does prescribe requirements for GDR issuers.

**4.19** The premium listing category for sovereign-controlled companies permits issuers to apply for a listing of shares or GDRs under this category. To ensure consistent application of requirements within one category, we propose that the new DTR provisions will apply to all companies within this listing category. In practice, this means that these issuers would need to make some limited additional announcements and ensure board decisions are taken by directors that are not linked to the related party.

## Overall approach to the new requirements

**4.20** We propose that the new DTR provisions will set the minimum standards for related party transactions as required by the Directive.

**4.21** Where the Directive prescribes definitions of particular terms, we propose to copy these. In particular, we propose to copy the definition of related party from the Directive, which cross refers to the definition in IFRS. Applying this approach, the reference would be 'ambulatory'. This means, if the definition in IFRS were to change, then the scope of the transactions subject to the new requirements would change accordingly.

**4.22** Where the Directive allows us to make choices, we propose the implementation options that provide transparency, but at the same time minimise the impact on issuers.

- The Directive requires that material transactions with related parties are approved by the shareholders in a general meeting or by the administrative or supervisory body of the company. We would provide for board approval only. This means in effect that decisions for material transactions will have to be taken by those directly accountable to shareholders – the issuer's directors – and cannot be delegated. We do not propose to require additional shareholder approval.

- The Directive requires the public announcement of a material related party transaction. However, we do not propose that the announcement should include a report prepared by a third party assessing whether, or not, the transaction is fair and reasonable.
- We propose that firms should make disclosures no later than when the terms of the transaction are agreed, replicating the LR timing.. In some instances, disclosures required under MAR will need to be made at an earlier point in time and the requirements in the Directive are explicitly expressed to be without prejudice to the requirements on the disclosure of inside information in Article 17 of MAR.
- We propose to provide exemptions from the announcement and approval requirements for some of the transaction types permitted by the Directive. This will replicate in substance the exemptions available under the existing premium listing regime so far as possible. The proposed exemptions would cover:
  - transactions entered into in the ordinary course of business and concluded on normal market terms
  - certain transactions between the issuer and its subsidiary undertakings
  - transactions offered to all shareholders on the same terms
  - transactions in relation to remuneration that are awarded in line with the provisions we anticipate BEIS to propose in due course
- We do not propose to exempt transactions entered into by credit institutions. Where a credit institution is a related party, we believe that the same transparency requirements as for any other related party should apply. We note that the requirements only apply to transactions not entered into in the ordinary course of business and on normal market terms.
- We also do not propose rules to exempt transactions for which UK law requires approval in a general meeting (with protections for the fair treatment of all shareholders and the interests of the company and non-related party shareholders). This is because we could not identify a meaningful list of such requirements.
- We propose a relatively high threshold for materiality at 25% of any one of profits, assets, market capitalisation or gross capital tests.

**4.23** Where concepts in the Directive are the same, or substantially similar, to concepts in the existing premium listing regime, we propose to mirror the language and structure of the premium listing regime (to the extent that this this is appropriate). This regime is already familiar to many UK market participants and their advisers. For example:

- Where the Directive requires us to introduce tests to assess materiality, we propose to mirror in a new Annex to DTR 7 the existing class tests in Annex 1 to LR 10 so far as possible. The premium listing requirements include certain references to circumstances where we may modify requirements. These references are well understood by premium listed issuers and their sponsors. However, we propose to adjust the equivalent language in the new Annex to DTR 7 to give issuers comfort to avoid the risk of it appearing in the provisions to mean we may arbitrarily change the class test. We also recognise that issuers who are not subject to premium listing requirements may not have certain information readily available, and have, accordingly, made certain adjustments.
- We do not propose to include additional sector-specific materiality tests (recognised as specialist issuers under the Listing Rules).
- We propose to mirror language in relation to board approval and to directors linked to the related party abstaining from consideration of material transactions.

- The Directive requires transactions to be aggregated, and again we propose to reflect the existing aggregation provisions in LR 11 as far as possible.
- The aggregation provisions set out in Article 9c (8) of the Directive mean that even transactions that are not material need to be aggregated and, effectively, announced and approved by the board if materiality thresholds are reached (except where they are explicitly exempted by the Directive). As such, certain transactions that are seen as immaterial for LR purposes may still have to be announced under the new DTR provisions. Accordingly, we have not replicated certain exemptions currently contained in the Annex to LR 11.
- The Directive requires systems and controls to be established for transactions which are exempt because they are in the ordinary course of business and on normal market terms. We propose to reflect the language of Listing Principle 1 as far as possible in the new DTR provision which implements this requirement.

**4.24** This approach adds more detail than is in the Directive. However, in some areas the Directive itself does not provide sufficient detail to give issuers certainty and to make the related party regime operational. We have taken the view that certainty is preferable for issuers. For example, if we only introduced a requirement to disclose material transactions, with material transactions defined as 25% of any one of profits, assets, market capitalisation and gross capital tests without further guidance, issuers would need to make difficult choices about how to apply this rule.

**4.25** So, if we had not chosen to replicate the premium listing requirements in these areas, we would have had to create an alternative parallel regime. On balance, we believe this would have been more burdensome for issuers overall. We would welcome feedback on whether this assumption is correct.

**4.26** We also propose to replicate certain 'anti-avoidance' provisions from the existing premium listing regime, for example, to ensure transactions cannot be structured artificially to evade disclosure requirements. While the Directive does not explicitly require these, they have been a useful component of the premium listing regime and so we believe they should be replicated in the new DTR provisions.

## Interaction with the current premium listing regime for related party transactions

**4.27** We propose to amend the premium listing continuing obligations to extend the new requirements in the DTRs to the relevant listing categories as described in paragraph 4.16.

**4.28** The new DTRs would also include a specific guidance provision to reassure issuers that where they have met certain disclosure and other requirements in the premium listing regime, this will also satisfy compliance with the disclosure and approval requirements in the new DTRs for the transactions in question.

## Interaction of the new rules with the requirements for standard listing and the LRs more generally

**4.29** The LRs are designed in a way that ensures that all issuers in a given category must meet the same requirements. So, we propose to include a new rule in LR 14. This will require overseas issuers with a standard listing of shares to comply with the DTRs on related party transactions, where they are not already required to comply with rules

implementing the Directive in another Member State. Otherwise, a proportion of issuers with a standard listing of shares may have lower standards to meet.

**4.30** We do not wish to impose duplicative requirements on overseas issuers. We also recognise that initiatives to promote transparency on related party transactions are not confined to SRD II. So, the proposed rules are designed also to allow listed companies subject to similar regimes outside the EU to benefit from an exemption from the new DTR requirements.

## Timing of the provisions

**4.31** We propose that issuers who are within scope of the new DTR regime, and listed companies already admitted to listing on 10 June 2019, would be required to comply with the new requirements from the start of the first financial year following the 10th June 2019.

**4.32** This would also apply to the aggregation requirements, which should be applied to transactions entered into on or after the start of the first financial year following the 10th June 2019.

**Q6:** **Do you agree with how we are proposing to implement SRD II requirements on related party transactions in the DTRs (including our proposal to replicate existing LR provisions so far as possible and choosing a threshold of 25%)? If not, please explain what alternative approach you would like us to take.**

**Q7:** **Do you agree with our proposed amendments to the LRs – in particular, that we should extend our rules for related party transactions to all issuers with a premium listing (except those subject to LR 16) or with a standard listing of shares that have their registered office outside of the UK or other EU Member State? Further, do you agree that we should give recognition to compliance with equivalent standards in non-EU jurisdictions and, if so, what are your views on how this could best be achieved?**

**Q8:** **Are there any other points we should address in our rules for related party transactions in relation to SRD II?**

**Q9:** **Do you agree with the conclusion and analysis set out in our cost benefit analysis?**

# Annex 1
# List of questions

**Q1:** Do you agree that the territorial scope of the rules framework should extend beyond that envisaged by the Directive?

**Q2:** Do you agree with our proposed amendments to the Handbook to implement the Directive requirements around engagement policies? If not, please explain what alternative approach you would like us to take.

**Q3:** Do you agree with our proposed approach to implementing article 3h of the Directive? If not, please explain what alternative approach you would like us to take?

**Q4:** Do you agree with our proposed amendments to implement the Directive requirements on asset managers reporting to asset owners? If not, please explain what alternative approach you would like us to take.

**Q5:** Are there any other points we should address in the Handbook in relation to the SRDII, for example by adding clarificatory rules or providing further guidance?

**Q6:** Do you agree with how we are proposing to implement SRD II requirements on related party transactions in the DTRs (including our proposal to replicate existing LR provisions so far as possible i and choosing a threshold of 25%)? If not, please explain what alternative approach you would like us to take.

**Q7:** Do you agree with our proposed amendment to the LRs – in particular that we should extend our rules for related party transactions to all issuers with a premium listing (except those subject to LR 16) or with a standard listing of shares that have their registered office outside of the UK or other EU Member State? Further, do you agree that we should give recognition to compliance with equivalent standards in non-EU jurisdictions and, if so, what are your views on how this could best be achieved?

**Q8:** Are there any other points we should address in our rules for related party transactions in relation to SRD II?

**Q9:** Do you agree with the conclusion and analysis set out in our cost benefit analysis?

# Annex 2
# Cost benefit analysis

## Introduction

1. The Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

2. Our proposed approach to implementing SRD II has generally been to align closely with Directive text where practicable.

3. Where the Directive provides for alternative implementation options, our approach has been to select what we consider to be the most proportionate options, reflecting what can work well and be meaningful in a UK context.

4. To assess the costs and benefits of our proposals for asset managers and life insurers we rely on our standardised cost figures. We provide a quantitative and qualitative cost benefit analysis for our additional proposals on related party transactions. These changes apply to overseas incorporated issuers with their registered office in a non-EU country with a premium or standard listing of shares. Although these issuers are admitted to a UK regulated market they are outside of the scope of SRD II because they do not have their registered office in an EU member state.

## Our proposals for asset managers and life insurers

5. SRD II seeks to ensure that asset owners have the information that they need to make effective long-term decisions. In particular, that they have sufficient information about how asset managers make decisions on a medium- to long-term basis, and how they conduct engagement and stewardship activities.

6. Requiring asset managers to demonstrate how they manage investments with a medium to long-term time horizon, should give asset owners access to better and more consistent information on whether asset managers are acting in their best long-term interests. For managers who are already considering some, or all, of the elements we set out in our new rules, the changes in behaviour will be smaller. For firms not considering these issues at all, we expect them to start doing so.

7. We estimate that a total of around 100 life insurance firms will be affected by the proposals in this consultation. These data are based on information supplied by the National Specific Template data return.[6]

8. Other firms affected include those in the alternative asset and fund management industry landscape. An estimate of the firms falling within this population was obtained through searching the FCA Register.

6 Firms which are regulated by the Prudential Regulatory Authority are required to complete National Specific Templates (NSTs). These templates address those areas which stem from specific national requirements or specificities of local markets, which are otherwise not addressed in the set of Solvency II harmonised templates. More information can be found on the Bank of England website.

**9.** Around 2,400 firms have the relevant asset management permissions. However, we are aware that many of these firms are parts of wider groups which share compliance functions, and many do not have relevant clients. We did not consider it proportionate to conduct a detailed granular analysis of how many entities will be in scope of these rules, but we estimate that around half (i.e. 1,200) of these firms are in scope.

### *Costs imposed by familiarisation and gap analysis*

**10.** We expect life insurers and asset managers to incur familiarisation costs related to reading the new rules and undertaking a gap analysis to determine to what extent their existing approach to engagement already complies with the new requirements.

**11.** We assume that there will be approximately 20 pages of policy documentation with the CP that life insurers and asset managers will need to familiarise themselves with. We assume that it would take around 1 hour to read the document. It is further assumed that 20 compliance staff at large providers, 5 compliance staff at medium providers and 2 compliance staff at small providers will read the document. Finally, using data on salaries from the Willis Towers Watson UK Financial Services survey, the hourly compliance staff salary, including 30% overheads, is assumed to be £60 at the larger providers and £43 at small providers.

**12.** Following familiarisation with the proposals, we expect firms to conduct a legal review of the proposals and an accompanying gap analysis to check their current practices against expectations. We estimate the cost to firms of reading around 10 pages of legal text to review. We assume this will take around 6 hours per employee for large firms, 4 hours per employee for medium firms, and 1 hour per employee for small firms. It is assumed that 4 legal staff at large providers, 2 legal staff at medium providers and 1 legal staff at small providers will review the legal instruments associated with our proposed rules. Finally, using the same source as above, the hourly legal staff salary, including 30% overheads, is assumed to be £66 at large and medium providers and £52 at small providers.

**13.** Using these assumptions, we estimate a total industry wide cost of around £360,000 for asset managers and £50,000 for life insurers for familiarisation and gap analysis.

### *Implementation costs*

**14.** Our proposals require firms to develop and publicly disclose a policy on shareholder engagement, or explain why they have chosen not to do so. We anticipate that most firms already have an existing engagement policy in place. These firms will incur the cost of conducting a review to identify whether their current policy complies with the full requirements of our new rules (as above), the cost of adding elements to their existing policy where required, and the cost of publishing the policy on their website. Firms that do not have a policy on stakeholder engagement will incur additional costs to develop this policy, or explain why they have chosen not to do so.

**15.** Our proposals will also require firms to report publicly on their voting activity. We anticipate that firms will incur a one-off cost to identify which votes will be reported, to the extent that they do not already disclose this information. In addition, we anticipate that firms may incur ongoing costs due to collating and disclosing their votes, and (where relevant) disclosing where asset managers implement the firm's engagement policy on their behalf.

**16.** Our proposals require life insurers to publicly disclose how the main elements of their equity investment strategy are consistent with the profile and duration of their liabilities, in particular, long-term liabilities, and how they contribute to the medium to long-term performance of their assets. We anticipate firms may incur ongoing costs in collating and disclosing this information on their website, and updating it on an annual basis.

**17.** Our proposals also place requirements on asset managers to make an annual disclosure to asset owners which they have an arrangement with, and subsequently for those asset owners within the scope of our rules life insurers to ensure this information is publicly disclosed.

**18.** Life insurers that do not routinely collate this information as part of their existing arrangements will incur one-off costs in implementing the necessary IT systems changes to ensure that an accurate record is maintained on an ongoing basis. They will also incur ongoing costs to collate this information on an annual basis and disclose it on their website.

**19.** SRD II envisages that an investment in a fund also constitutes an arrangement and would be subject to the same requirements. Where an arrangement does not contain one or more of the specific elements of information, the life insurer must give a clear and reasoned explanation why not. We, therefore, anticipate that life insurers which hold such arrangements will incur a cost to explain why one or more of these elements do not apply.

**20.** We anticipate that life insurers that appoint an asset manager to manage a segregated mandate will already hold this information, and as such will only incur a cost for the disclosure of this information on their website.

**21.** We also anticipate that firms which comply with Solvency II will already disclose information relating to their financial performance and long-term liabilities.[7] We therefore anticipate that these life insurers will therefore not have to collate these parts of the disclosure and will incur a lower overall collation cost. We would be interested in further feedback on this point.

**22.** Our proposed rules require asset managers to explain how their investment strategy, and its implementation, contributes to the medium to long-term performance of the assets of the asset owner or the fund. This includes providing the medium to long-term risks associated with the portfolio investments, including corporate governance matters. We anticipate that most firms will already have some of this information via existing reporting obligations in UCITS, AIFMD and MIFID and thus will incur one-off costs for assessing and communicating this disclosure to the asset owner.

**23.** We assume that firms will incur one-off costs as they prepare for the implementation of this new rule. We estimate that each firm will incur an average one-off cost of £4,400. This is based on estimated costs due to extra staff time and external legal advice. We estimate that each hour of compliance staff costs to firms will cost £60 including an allocation for overheads. We estimate that this sort of compliance work will take fifteen hours. This amounts to £900. Secondly, we estimate that each firm will incur one working day (7 hours) of external legal advice at an estimated average cost per hour of £500 (£3,500 per firm).

**24.** Taken across the 1,200 relevant firms we authorise, this equates to £5.3m in one-off costs.

**25.** Firms will need to provide asset owners in their funds with certain information on an ongoing basis. We consider that most of this information will already be available from existing sources, so we do not expect material costs from providing this information to clients where it is not already required to be disclosed.

**26.** Firms already disclose information about portfolio composition via UCITS, AIFMD and MIFID obligations so we assume the costs for firms to communicate this information to asset owners to be zero.

7 PRA Rulebook, Solvency II firms, Investments, Prudential Person Principle, 2.1

**27.** As for turnover and turnover costs, we expect firms to have the capability to compute this information already and thus assume the cost to firms of our disclosure requirement will not be material.

**28.** Firms will need to regularly review and update asset owners in their fund on the use of proxy advisors in their activities; their policy on security lending and how it is applied to fulfil its engagement activities, particularly at the time of the general meeting of the investee company. We expect that the costs to firms of these rules would be small, but not negligible. Because firms will have this information already, we do not assume additional costs for firms disclosing this breakdown of information.

**29.** Our proposals require asset managers to disclose how investment decisions are based on the evaluation of the medium to long-term performance of the investee company, including its non-financial performance. We anticipate most firms already provide asset owners with performance evaluation of the investee company, but that they may incur additional costs for assessing the medium to long-term performance.

**30.** Asset managers will also be required to provide information about any conflicts of interests that have arisen in connection with engagement activities and how the asset manager has dealt with them. We anticipate that most firms will already hold this information as part of their conflicts of interest policy, and, as such, will only incur a cost for communicating this information to the asset owner in their fund.

### *Benefits*

**31.** We anticipate that our proposals overall will strengthen investors' stewardship capability, improve market discipline and result in improved corporate governance for listed companies.

**32.** The increased transparency will enable some investors to engage and to adopt a longer-term focus in their investment strategies. Over time, we expect investors to benefit from improved financial of companies, to increase their returns, and contribute to the long-term value creation for all stakeholders. These benefits are not, however, easily quantified.

**33.** Improved stewardship should encourage companies to take greater responsibility for the environmental and social aspects of their businesses. This should lead to a more sustainable allocation of capital and resources across the real economy.

## Our proposals for related party transactions

**34.** SRD II provides a framework for setting procedures on the approval and notification of transactions with related parties.

**35.** The issuers that will have to follow the new regime as transposed into the DTRs are UK incorporated with shares admitted to a regulated market in the UK or another EU Member State. Those admitted to a UK regulated market include around 710 issuers with a premium listing, 60 issuers with a standard listing (data extracted from the FCA's Official List), issuers admitted to the non-listed s segments of the Main Market (the Specialist Fund segment (18 issuers) and the High Growth segment - data extracted from the LSE's website) and UK incorporated issuers admitted to other EU regulated markets.

**36.** Overseas issuers that are admitted to a UK regulated market are not in scope of our transposition of the related party regime into the new DTRs. However, overseas issuers of premium or standard listed shares admitted to a UK regulated market but with their registered office in a non-EU member state will be subject to our proposed new Listing Rules which require them to follow the new DTRs regime. There are circa 110 such premium listed issuers and 66 such standard listed issuers (data extracted from the FCA's Official List). Overseas issuers with their registered office in another EU member state will be subject to the related party regime as transposed by that member state.

### *Costs imposed by familiarisation and gap analysis*

**37.** We expect all impacted issuers (those directly subject to the new DTRs and those that are required to follow them by the LRs) to incur upfront familiarisation costs in reading the new rules. They will also need to assess and, where necessary, change their internal procedures to ensure they meet the new requirements for approving and announcing related party transactions.

**38.** To indicate the likely scale of the cost for overseas issuers that are subject to the new LRs, we have considered what costs might be involved at an upper limit of the work that may be undertaken. We have based our calculations on the assumption that all impacted issuers are already required to identify their related parties in accordance with the IFRS definition of such (which is used in the SRD II related party regime). We have also assumed that they already have procedures in place to manage conflicts of interest at board level. However, there will be a variance in these costs given that firms with a standard listing vary in size and nature and not all will prepare their accounts to IFRS standards.

**39.** We estimate that this sort of work will cost £355 per person per day. This is based on an average annual staff cost to the firm of £78,000 per person, inclusive of 30% overheads, divided by 220 working days.

**40.** Assuming 66 such overseas standard listed issuers affected by the proposed new DTRs with up to one day's familiarisation work and average of 10 days implementation of any changes to processes then an upper limit may be considered as 66 multiplied by £355 x 11) is a one-off cost of £257,730. Allowing for a 20% margin either side of the £355 daily cost rate, the aggregate costs would range between £206,184 and £308,550.

**41.** Similar costs and a similar calculation can be extrapolated to relevant overseas premium listed issuers, multiplied by the larger cohort, i.e. 110 multiplied by (£355 X 11) is a one-off cost of £405,350. Again, allowing for a 20% margin either side of the £355 daily cost rate, the aggregate costs would range between £324,280 and £486,420.

**42.** Sponsor firms are also impacted and we would extrapolate similar costs per firm and time spent. Issuers with a premium listing must obtain sponsor guidance on the application of the LRs and DTRs to transactions that may be related party transactions. There are currently 42 sponsor firms we approved that may provide this advice. We expect sponsors to incur familiarisation costs in reading the new rules and updating their internal knowhow for guiding issuers on the application of the LRs and DTRs to related party transactions.

### *Ongoing implementation costs*

**43.** We expect ongoing monitoring costs to be incurred by issuers in ensuring that they know, at all times, who their related parties are under the IFRS definition used in SRD II, and assessing whether the new rules apply to transactions with those parties.

**44.** To take into account that the monitoring exercise would depend on the issuer, a range of costs is considered. Between 1 and 5 days would cost between £23,430 (66 x £355) and £117,150 (66 x £1,775). Whilst we understand that monitoring costs incurred by issuers will vary, we assume here an average of 2 days per year for the 66 standard-listed issuers. Using the same cost figures as above, this will lead to aggregate annual costs of £46,860 (66 x 2 days' work at the daily staff rate of £355). Over a 10-year horizon (discounted by 3.5% to net present value) based on 2 days of work, this would amount to a cumulative cost of £373,681. The respective NPVs over a 10-year horizon for 1 and 5 days of work are £23,430 and £117,150.

**45.** Applying the same costs and calculation method for the 110 premium-listed issuers produces an aggregate annual cost of £78,100 (110 X£710) and costs of £54,700 set in a ten-year time frame (discounted by 3.5% to Net Present Value (NPV)) The respective NPVs for 1 and 5 days' work are £39,050 and £195,250.

**46.** Issuers may also incur costs if they need to change their approval procedures for transactions that they determine to be within scope of the related party rules. Further costs will accrue when announcing those transactions to the market or changing their behaviours with respect to not entering into such transactions.

**47.** Whilst we cannot forecast how many transactions with related-parties will be undertaken by standard-listed issuers impacted by the new rules, we can extrapolate an indicative figure from recent data held by the FCA on how many circulars that we approved for related party transactions by premium listed issuers. This is likely to be at the top end given that the premium listed cohort is much larger than standard listed. Also, the requirement to publish a circular is triggered when a percentage ratio on the class tests is at least 5% (our proposals in the DTRs apply when the class tests produce a 25% ratio) and the cost of publishing a circular is likely to be higher than for a notification.

**48.** There were 27 related party circulars in 2018 for over 700 premium-listed issuers. This low frequency would suggest that only one or two overseas non-EU premium or standard-listed issuers would incur the costs associated with approving and notifying a related party transaction in any one year. We estimate three full days' work for each transaction at £2,130 (2 x 3 days' work at the daily rate of £355). Over a 10-year horizon (similarly discounted) this would be a cumulative cost of £17,714.

**49.** Similar costs may again be extrapolated to the wider category premium-listed issuers but multiplied by the larger cohort (i.e. circa 710 premium listed issuers carrying out 2 day's work at the £355 daily rate) and other standard listed issuers. However, these additional costs are likely to be lower in practice for premium listed issuers because they will only accrue to the transactions that are caught by the new DTRs but are outside the existing Listing Rules for related party transactions (if any such transactions are contemplated). They are also likely to be mitigated by the fact that such premium- listed issuers should already have processes in place to comply with our rules on the approval and notification of related party transactions.

### *Benefits*

**50.** Investors in companies admitted to regulated markets, including minority shareholders in such companies, will benefit from increased transparency of the governance requirements for approving the entry (or otherwise) into transactions with related-parties. These changes may lead to improved corporate governance in issuers that need to alter their behaviours to comply with the rules. Investors should also benefit from timely and detailed notifications of the transactions which may be relevant to their investment decisions. The cumulative effect of these changes is that investors (including minority shareholders) should benefit from greater protection against the risk of appropriation of value from the issuer by the related party.

**51.** Our LRs proposals for non-EU incorporated issuers will ensure that, once Member States have transposed the Directive, there will be a level playing field in the UK on the minimum requirements for board approval and notification of related party transactions for all issuers with a standard listing of shares. Otherwise there is a risk that overseas, non-EU incorporated standard-listed issuers will be subject to lower standards than the minimum required by the Directive, or no similar standards. There would be a discrepancy in the UK listing regime that could create uncertainty for investors as to which standards (if any) standard listed issuers should adhere to and uneven safeguarding of investors interests. This could undermine confidence in the standard listing regime.

**52.** These issuers should also benefit from a reduction in the risk of value appropriation by the related party. Our proposals set robust standards for board approval of material transactions with related parties, and the opportunity for more timely public scrutiny of these transactions through notifications. This may lead to better decision-making at board level and retention of value to the benefit of the issuer and ultimately its shareholders. To estimate the size of this benefit to overseas, non-EU incorporated issuers, we would again consider the value of the transactions noted in related party circulars for premium listed commercial company issuers during 2018 (such as fundraisings, acquisitions and disposals, and other commercial agreements). These transactions were mainly in the range of £10m to £50m. Therefore, if these changes were to impact a single transaction in a year over a 10-year period, taking a mid-range transaction size of £25m, we could estimate the benefits to overseas, non-EU incorporated issuers as£177,230,000 in aggregate for those with a standard or premium listing (£25m per annum, discounted by 3.5% to NPV).

**53.** We would therefore summarise the aggregate costs and benefits to the standard and premium listed, overseas non-EU incorporated issuer cohort as:

### *Standard listed*

- One-off costs for the familiarisation and gap analysis work - £257,730
- Ongoing monitoring costs (assuming five days' work annually over 10 years discounted by 3.5% to NPV) - £117,150
- Ongoing implementation costs (assuming three days' work annually over 10 years discounted by 3.5% to NPV) - £17,714
- Total costs (as above) - £392,594
- Benefits (over 10 years discounted by 3.5% to NPV) - £177,330,000

### Premium listed

- One-off costs for the familiarisation and gap analysis work - £405,350

- Ongoing monitoring costs (assuming five days' work annually over 10 years discounted by 3.5% to NPV) - £195,250
- Ongoing implementation costs (assuming three days' work annually over 10 years discounted by 3.5% to NPV) - £17,714
- Total costs (as above) - £618,314
- Benefits (over 10 years discounted by 3.5% to NPV) - £177,330,000

**54.** Our package of proposals for the transparency of related party transactions and the robustness of approval processes should further enhance the functioning of primary markets. Where confidence in markets is increased, the availability and costs of capital to participants in those markets is also improved. Given that the anticipated costs of our proposals are low, even a small positive impact on primary markets will outweigh the costs considered in this analysis.

# Annex 3
# Compatibility statement

## Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

## The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals set out in this consultation are primarily intended to advance our operational objective of market integrity.

**8.** They are also relevant to the FCA's consumer protection and effective competition objectives.

**9.** We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because additional transparency in the market will provide better information for asset owners and asset managers in their exercise of stewardship. Our proposals in relation to related party transactions will also add to transparency assisting investor confidence the market working well.

**10.** Better transparency and greater disclosure would foster better information for stakeholders, helping markets work well.

**11.** Market integrity would be supported through better engagement by asset owners. It would also improve transparency in how they, and asset managers, are taking an active interest in the decisions made by the governance bodies of the issuer companies in which they invest. Stewardship provides a challenge to companies to run themselves better and to ensure the interests of those investing and those they are investing for are better aligned. This, in turn, can contribute to the long-term efficiency and effectiveness of capital allocation, benefitting investors and society. Market integrity will also be supported by our measures in relation to related party transactions which will provide greater transparency for investors.

**12.** Effective stewardship supports consumers by better aligning incentives across the institutional investment community with the long-term interests of consumers of financial services. Consumers should also benefit from better information flow across the institutional investment community about how firms engage with issuers to promote their interests.

**13.** Developing a market for stewardship would also improve competition in consumers' interests by encouraging firms to compete to deliver high-quality investment decisions, oversight of assets and engagement with, and challenge of, companies' boards and management.

**14.** In preparing the proposals set out in this consultation, we have had regard to the regulatory principles set out in Schedule 3B FSMA.

**The need to use our resources in the most efficient and economic way**

**15.** A largely copy out approach to implement SRD II requirements represents the most efficient and economic way to ensure UK compliance with the Community acquis.

**The principle that a burden or restriction should be proportionate to the benefits**

**16.** Copy out of SRD II requirements represents the most economic way of ensuring UK compliance.

**The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term**

**17.** The promotion of better stewardship will help contribute towards markets working well and sustainable growth.

**The general principle that consumers should take responsibility for their decisions**

**18.** SRD II measures will promote greater transparency which should help consumers better understand how asset owners exercise oversight of their assets. Where consumers are beneficiaries (for example as pension holders) this may help them to exercise some choice in relation to pension providers.

## Expected effect on mutual societies

**19.** We do not expect the proposals in this paper to have a significantly different impact on mutual societies.

## Equality and diversity

**20.** We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

**21.** The outcome of the assessment in this case is stated in paragraph 1.24 of the Consultation Paper.

## Legislative and Regulatory Reform Act 2006 (LRRA)

**22.** We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that our proposals are consistent with LRRA principles. We have clearly set out our proposed rules in a transparent way. Our proposals are proportionate in providing for a largely copy out implementation of SRD II and follow are consistent regulatory approach.

# Annex 4
# Abbreviations used in this paper

| | |
|---|---|
| **AIFM** | Alternative investment fund manager |
| **BEIS** | Department of Business, Energy and Industrial Strategy |
| **COBS** | Conduct of Business Sourcebook. The section of the FCA's Handbook that deals with business standards |
| **CP** | Consultation Paper |
| **DTRs** | Disclosure and Transparency Rules |
| **DP** | Discussion Paper |
| **DWP** | Department of Work and Pensions |
| **EU** | European Union |
| **EEA** | European Economic Area |
| **FCA** | Financial Conduct Authority |
| **FRC** | Financial Reporting Council |
| **GDR** | Global Depository Receipt |
| **IAS** | International Accounting Standards |
| **IFRS** | International Financial Reporting Standards |
| **LRs** | Listing Rules |
| **MAR** | Market Abuse Regulation |
| **MiFID** | Markets in Financial Instruments Directive |
| **SRD II** | Revised Shareholder Rights Directive |
| **TD** | Transparency Directive |
| **UCITS** | Undertakings for Collective Investment in Transferable Securities. |
| **UK** | United Kingdom |

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN

# Appendix 1
# Draft Handbook text

# SHAREHOLDER RIGHTS DIRECTIVE (ASSET MANAGERS AND INSURERS) INSTRUMENT 2019

## Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in or under:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers);
(c) section 139A (Power of the FCA to give guidance);
(d) section 247 (Trust scheme rules);
(e) section 248 (Scheme particulars rules);
(f) section 261I (Contractual scheme rules);
(g) section 261J (Contractual scheme particulars rules); and

(2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

## Commencement

C. This instrument comes into force on 10 June 2019.

## Amendments to the Handbook

D. The modules of the FCA Handbook listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

| (1) | (2) |
|---|---|
| Glossary of definitions | Annex A |
| Senior Management Arrangements, Systems and Controls sourcebook (SYSC) | Annex B |
| Conduct of Business sourcebook (COBS) | Annex C |

## Citation

E. This instrument may be cited as the Shareholder Rights Directive (Asset Managers and Insurers) Instrument 2019.

By order of the Board
[*date*] 2019

[*Editor's note*: The text in this draft instrument takes no account of the amendments proposed in CP18/28 (Brexit: proposed changes to the Handbook and Binding Technical Standards – first consultation), CP18/29 (Temporary permissions regime for inbound firms and funds), CP18/36 (Brexit: Proposed changes to the Handbook and Binding Technical Standards – second consultation) or CP19/2 (Brexit and contractual continuity).]

## Annex A

## Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

| | | |
|---|---|---|
| *engagement policy* | (1) | (in *SYSC* 3.4) as defined in *SYSC* 3.4.4R(1)(a). |
| | (2) | (in *COBS* 2.2B) as defined in *COBS* 2.2B.5R(1)(a). |
| *proxy advisor* | a legal person that analyses, on a professional and commercial basis, the corporate disclosure and, where relevant, other information of listed companies, with a view to informing investors' voting decisions by providing research, advice or voting recommendations that relate to the exercise of voting rights. | |
| *SRD* | the *Shareholder Rights Directive*. | |
| *SRD asset manager* | (1) | an *investment firm* that provides *portfolio management* services to investors; |
| | (2) | an *AIFM* that is not a *small AIFM*; or |
| | (3) | the *operator* of a *UCITS*. |
| | [Note: article 1(2)(f) of the *SRD*] | |
| *SRD institutional investor* | (1) | an undertaking carrying out activities of life assurance within the meaning of points (a), (b) and (c) of Article 2(3) of Directive 2009/138/EC of the European Parliament and of the Council, and of reinsurance as defined in point (7) of Article 13 of that Directive, provided that those activities cover life-insurance obligations, and which is not excluded pursuant to that Directive; or |
| | (2) | an institution for occupational retirement provision falling within the scope of Directive (EU) 2016/2341 of the European Parliament and of the Council, in accordance with Article 2 thereof, unless a Member State has chosen |

not to apply that Directive in whole or in parts to that institution in accordance with Article 5 of that Directive.

Amend the following definition as shown. Underlining indicates new text and striking through indicates deleted text.

| | | |
|---|---|---|
| *regulated market* | (1) | a multilateral system operated and/or managed by a *market operator*, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in *financial instruments* - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the *financial instruments* admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of *MiFID*. |
| | | [Note: article 4(1)(21) *MiFID*] |
| | (2) | (in addition, in ~~*INSPRU* and *IPRU(INS)* only~~ *INSPRU*, *IPRU(INS)*, *SYSC* 3.4 and *COBS* 2.2B only) a market situated outside the *EEA States* which is characterised by the fact that: |
| | | (a) it meets comparable requirements to those set out in (1); and |
| | | (b) the *financial instruments* dealt in are of a quality comparable to those in a regulated market in the United Kingdom. |

## Annex B

## Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

Insert the following new section after SYSC 3.3 (Additional requirements for insurance distribution). The text is not underlined.

### 3.4 SRD requirements

Application

3.4.1 R This section applies to:

(a) a *UK insurer*; and

(b) a *UK pure reinsurer*,

doing *long-term insurance business*.

3.4.2 R The *rules* in this section apply to the extent that a *firm* is investing (or has invested) in *shares* traded on a *regulated market*.

3.4.3 G The defined term *regulated market* has an extended meaning for the purposes of this section. The definition includes certain markets situated outside the *EEA*.

Engagement policy and disclosure of information

3.4.4 R A *firm* must either:

(1) (a) develop and publicly disclose an engagement policy that meets the requirements of *SYSC* 3.4.5R (an "engagement policy"); and

(b) publicly disclose on an annual basis how its *engagement policy* has been implemented, in a way that meets the requirements of *SYSC* 3.4.6R; or

(2) publicly disclose a clear and reasoned explanation of why it has chosen not to comply with any of the requirements imposed by (1).

[**Note:** article 3g(1) and (1)(a) of the *SRD*]

3.4.5 R The *engagement policy* must describe how the *firm*:

(1) integrates shareholder engagement in its investment strategy;

(2) monitors investee companies on relevant matters, including:

(a) strategy;

(b) financial and non-financial performance and risk;

(c) capital structure; and

(d) social and environmental impact and corporate governance;

(3) conducts dialogues with investee companies;

(4) exercises voting rights and other rights attached to *shares*;

(5) cooperates with other shareholders;

(6) communicates with relevant stakeholders of the investee companies; and

(7) manages actual and potential conflicts of interests in relation to the firm's engagement.

[**Note:** article 3g(1)(a) of the *SRD*]

3.4.6 R (1) The annual disclosure must include a general description of voting behaviour, an explanation of the most significant votes and the use of the services of *proxy advisors*.

(2) (a) Subject to (b), a *firm* must publicly disclose how it has cast votes in the general meetings of companies in which it holds *shares*.

(b) A *firm* is not required to disclose votes that are insignificant due to the subject matter of the vote or the size of the holding in the company.

[**Note:** article 3g(1)(b) of the *SRD*]

3.4.7 R (1) The applicable disclosures or information specified in *SYSC* 3.4.5R and *SYSC* 3.4.6R must be made available free of charge on the *firm's* website.

(2) Where an *SRD asset manager* implements the engagement policy, including voting, on behalf of a *firm*, the *firm* must make a reference as to where such voting information has been published by the *SRD asset manager*.

[**Note:** article 3g(2) of the *SRD*]

Investment strategy and arrangements with SRD asset managers

3.4.8 R A *firm* must disclose publicly how the main elements of its equity investment strategy are consistent with the profile and duration of its

liabilities, in particular long-term liabilities, and how they contribute to the medium- to long-term performance of its assets.

[**Note:** article 3h(1) of the *SRD*]

3.4.9 R (1) Where an *SRD asset manager* invests on behalf of a *firm*, whether on a discretionary client-by-client basis or through a collective investment undertaking, the *firm* must publicly disclose the following information regarding its arrangement with the asset manager:

(a) how the arrangement with the *SRD asset manager* incentivises the *SRD asset manager* to align its investment strategy and decisions with the profile and duration of the liabilities of the *firm*, in particular long-term liabilities;

(b) how that arrangement incentivises the *SRD asset manager* to make investment decisions based on assessments of medium- to long-term financial and non-financial performance of the investee company, and to engage with investee companies in order to improve their performance in the medium- to long-term;

(c) how the method and time horizon of the evaluation of the *SRD asset manager's* performance and the remuneration for asset management services are in line with the profile and duration of the liabilities of the *firm*, in particular its long-term liabilities, taking into account its absolute long-term performance;

(d) how the *firm* monitors portfolio turnover costs incurred by the *SRD asset manager* and how it defines and monitors a targeted portfolio turnover or turnover range; and

(e) the duration of the arrangement with the *SRD asset manager*.

(2) Where the arrangement with the *SRD asset manager* does not contain one or more such elements, the *firm* must give a clear and reasoned explanation why this is the case.

[**Note:** article 3h(2) of the *SRD*]

3.4.10 R The information referred to in *SYSC* 3.4.8R and *SYSC* 3.4.9R must:

(1) be made available, free of charge, on the *firm's* website; and

(2) be updated annually, unless there is no material change.

[**Note:** article 3h(3), first paragraph of the *SRD*]

Amend the following as shown. Underlining indicates new text.

…

## 10 Conflicts of interest

…

### 10.1 Application

…

Requirements only apply if a service is provided

10.1.2 …

SRD requirements

10.1.2A R The requirements in this section apply to an *SRD asset manager* with regard to its engagement activities covered by the *SRD*.

[**Note:** article 3g(3) of the *SRD*]

…

## Annex C

## Amendments to the Conduct of Business sourcebook (COBS)

Amend the following as shown. Underlining indicates new text.

**1 Application and purpose**

…

**1 Application (see COBS 1.1.2R)**

**Annex 1**

…

Part 3: Guidance

| | | |
|---|---|---|
| … | | |
| **10.** | **AIFMD: effect on territorial scope** | |
| … | | |
| **11.** | **SRD: effect on territorial scope** | |
| 11.1 | G | The *SRD* includes a number of requirements on *SRD asset managers*. These requirements are implemented in *COBS* 2.2B. |
| 11.2 | G | The *SRD* provides that the *EEA State* competent to regulate these requirements is the *Home State* as defined in the applicable sector-specific legislation. *COBS* 2.2B therefore applies where a *UK firm* carries on activities from an establishment in the *UK* or another *EEA State*, as set out in *COBS* 2.2B.4R. |
| | [**Note:** article 1(2)(a) of the *SRD*] | |

Insert the following new section after COBS 2.2A (Information disclosure before providing services (MiFID and insurance distribution provisions)). The text is not underlined.

**2.2B SRD requirements**

Application: Who?

2.2B.1 R This section applies to:

(1) a *UK MiFID investment firm* that provides *portfolio management* services to investors;

(2) a *third country investment firm* that provides *portfolio management* services to investors;

(3) a *UK UCITS management company*;

(4) an *ICVC* that is a *UCITS scheme* without a separate *management company*; and

(5) a *full-scope UK AIFM*.

[**Note:** article 2(f) of the *SRD*]

Application: What?

2.2B.2 R This section applies to the extent that the *firm* is investing (or has invested) in *shares* traded on a *regulated market*.

2.2B.3 G The defined term *regulated market* has an extended meaning for the purposes of this section. The definition includes certain markets situated outside the *EEA*.

Application: Where?

2.2B.4 R (1) This section applies in relation to activities carried on by a *firm* from an establishment in the *United Kingdom*.

(2) This section also applies in relation to activities carried on by a *UK firm* from an establishment in another *EEA State*.

Engagement policy and disclosure of information

2.2B.5 R A *firm* must either:

(1) (a) develop and publicly disclose an engagement policy that meets the requirements of *COBS* 2.2B.6R (an "engagement policy"); and

(b) publicly disclose on an annual basis how its engagement policy has been implemented in a way that meets the requirements of *COBS* 2.2B.7R; or

(2) publicly disclose a clear and reasoned explanation of why it has chosen not to comply with any of the requirements imposed by (1).

[**Note:** article 3g(1) and (1)(a) of the *SRD*]

2.2B.6 R The *engagement policy* must describe how the *firm*:

(1) integrates shareholder engagement in its investment strategy:

(2) monitors investee companies on relevant matters, including:

(a) strategy;

(b) financial and non-financial performance and risk;

(c) capital structure; and

(d) social and environmental impact and corporate governance;

(3) conducts dialogues with investee companies;

(4) exercises voting rights and other rights attached to *shares*;

(5) cooperates with other shareholders;

(6) communicates with relevant stakeholders of the investee companies; and

(7) manages actual and potential conflicts of interests in relation to the *firm's* engagement.

[**Note:** article 3g(1)(a) of the *SRD*]

2.2B.7 R (1) The annual disclosure must include a general description of voting behaviour, an explanation of the most significant votes and reporting on the use of the services of *proxy advisors*.

(2) (a) Subject to (b), a *firm* must publicly disclose how it has cast votes in the general meetings of companies in which it holds *shares*.

(b) A *firm* is not required to disclose votes that are insignificant due to the subject matter of the vote or the size of the holding in the company.

[**Note:** article 3g(1)(b) of the *SRD*]

2.2B.8 R The applicable disclosures or information specified in *COBS* 2.2B.6R and *COBS* 2.2B.7R must be made available free of charge on the *firm*'s website.

[**Note:** article 3g(2) of the *SRD*]

Transparency of asset managers

2.2B.9 R (1) This *rule* applies where a *firm* invests on behalf of an *SRD institutional investor*, whether on a discretionary client-by-client basis or through a collective investment undertaking.

(2) The *firm* must disclose to the relevant *SRD institutional investor*, on an annual basis, how its investment strategy and the implementation of it:

(a) complies with the arrangement referred to in (1); and

(b) contributes to the medium- to long-term performance of the assets of the *SRD institutional investor* or of the *fund*.

(3) The disclosure must include reporting on:

(a) the key material medium- to long-term risks associated with the investments;

(b) portfolio composition;

(c) turnover and turnover costs;

(d) the use of *proxy advisors* for the purpose of engagement activities;

(e) the *firm*'s policy on securities lending and how that policy is applied to supports the *firm's* engagement activities if applicable, particularly at the time of the general meeting of the investee companies;

(f) whether and, if so, how, the *firm* makes investment decisions based on evaluation of medium- to long-term performance of an investee company, including non-financial performance; and

(g) whether and, if so, which conflicts of interests have arisen in connection with engagement activities and how the *firm* has dealt with these conflicts.

[**Note:** article 3i(1) of the *SRD*]

2.2B.10 G A *firm* may provide the disclosure in *COBS* 2.2B.9R by making the relevant information publicly available.

Amend the following as shown. Underlining indicates new text.

**18 Specialist regimes**

…

**18.5A Full-scope UK AIFMs and incoming EEA AIFM branches**

…

Application or modification of general COBS rules

18.5A.3 R A *firm* when it is carrying on *AIFM investment management functions*:

(1) must comply with the *COBS rules* specified in the table, as modified by this section; and

(2) need not comply with any other *rule* in *COBS*.

Table: Application of conduct of business rules

| **Chapter, section, rule** | **Full-scope UK AIFM** | **Incoming EEA AIFM branch** |
|---|---|---|
| … | | |
| 2.1.4R (AIFMs best interest rule) | … | … |
| 2.2B (SRD requirements) | Applies | Does not apply |
| … | | |

…

**18.5B UCITS management companies**

…

Application or modification of general COBS rules

18.5B.2 R A *firm* when it is carrying on *scheme management activity*:

(1) must comply with the *COBS rules* specified in the table, as modified by this section; and

(2) need not comply with any other *rule* in *COBS*.

Table: Application of conduct of business rules

| **Chapter, section, rule** | **UCITS management company** |
|---|---|
| … | |
| 2.1.1 (The client's best interests rule) | Applies |
| 2.2B (SRD requirements) | Applies |
| … | |

…

**18.9 ICVCs**

18.9.1 R …

(3) *COBS* 2.2B (SRD requirements) applies to an *ICVC* that is a *UCITS scheme* without a separate *management company*.

…

# LISTING AND DISCLOSURE SOURCEBOOKS (SHAREHOLDER RIGHTS DIRECTIVE) INSTRUMENT 2019

## Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 73A (Part 6 Rules);
(2) section 89O (Corporate governance rules);
(3) section 96 (Obligations of issuers of listed securities);
(4) section 137A (The FCA's general rules);
(5) section 137T (General supplementary powers); and
(6) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

## Commencement

C. This instrument comes into force on [*date*].

## Amendments to the Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes in this instrument listed in column (2) below.

| (1) | (2) |
|---|---|
| Glossary of definitions | Annex A |
| Listing Rules sourcebook (LR) | Annex B |
| Disclosure Guidance and Transparency Rules sourcebook (DTR) | Annex C |

## Notes

E. In Annex C to this instrument, the notes (indicated by "**Note:**") are included for the convenience of readers but do not form part of the legislative text.

## Citation

F. This instrument may be cited as the Listing and Disclosure Sourcebooks (Shareholder Rights Directive) Instrument 2019.

By order of the Board
[*date*]

## Annex A

## Amendments to the Glossary

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

| | |
|---|---|
| *material related party transaction* | (in *DTR*) a *related party transaction* where any *percentage ratio* is 25% or more. |
| *related party tests* | (in *DTR*) the tests set out in *DTR* 7 Annex 1, which are used to determine whether a transaction or arrangement is a *material related party transaction*. |
| *Shareholder Rights Directive* | Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies. |

Amend the following definitions as shown.

| | | |
|---|---|---|
| *associate* | (1) | (in *LR*~~,~~) ~~(~~in relation to a *director*, *substantial shareholder*, or *person exercising significant influence*~~,~~ who is an individual) and (in *DTR*, in relation to a *related party* who is an individual): |
| | | … |
| | (2) | (in *LR*~~,~~) ~~(~~in relation to a *substantial shareholder*, or *person exercising significant influence* which is a *company*) and (in *DTR*, in relation to a *related party* which is a *company*): |
| | | … |
| | … | |
| *debt security* | (1) | (in *LR* and *DTR* 7) *debentures*, *alternative debentures*, debenture stock, loan stock, bonds, certificates of deposit or any other instrument creating or acknowledging indebtedness. |

| | | | |
|---|---|---|---|
| | … | | |
| *percentage ratio* | (1) | (in *LR*) (in relation to a transaction) the figure, expressed as a percentage, that results from applying a calculation under a *class test* to the transaction~~.~~; | |
| | (2) | (in *DTR*) (in relation to a transaction or arrangement) the figure, expressed as a percentage, that results from applying a calculation under a *related party test* to the transaction or arrangement. | |
| *related party* | … | | |
| | (2) | … | |
| | | (c) | that *person's* parent, brother, sister, child, grandparent or grandchild~~.~~; |
| | (3) | (in *DTR*) as defined in *DTR* 7.3.2R. | |
| *related party transaction* | (1) | (in *LR*) as defined in *LR* 11.1.5R~~.~~; | |
| | (2) | (in *DTR*) as defined in *DTR* 7.3.3R. | |

## Annex B

## Amendments to the Listing Rules sourcebook (LR)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

**9 Continuing obligations**

…

**9.2 Requirements with continuing application**

…

Compliance with the disclosure requirements, ~~and~~ transparency rules and corporate governance rules

…

9.2.6C R A *listed company* that is not already required to comply with:

(1) *DTR* 7.3 (Related party transactions);

(2) requirements imposed by another *EEA State* that correspond to *DTR* 7.3; or

(3) related party measures imposed by a *non-EEA state* under equivalent legislation having similar effect to the requirements set out in *DTR* 7.3;

must comply with *DTR* 7.3 as if it were an *issuer* to which *DTR* 7.3 applies.

…

**14 Standard listing (shares)**

…

**14.3 Continuing obligations**

…

Compliance with the transparency rules and corporate governance rules

…

14.3.25 R A *listed company* that is not already required to comply with:

(1) *DTR* 7.3 (Related party transactions);

(2) requirements imposed by another *EEA State* that correspond to *DTR* 7.3; or

(3) related party measures imposed by a *non-EEA state* under equivalent legislation having similar effect to the requirements set out in *DTR* 7.3;

must comply with *DTR* 7.3 as if it were an *issuer* to which *DTR* 7.3 applies.

…

## 16 Open-ended investment companies: Premium listing

…

### 16.4 Requirements with continuing application

16.4.1 R An *open-ended investment company* must comply with:

(1) *LR* 9 (Continuing obligations) except *LR* 9.2.2AR to *LR* 9.2.2GR, *LR* 9.2.6BR, *LR* 9.2.6CR, *LR* 9.2.15R, *LR* 9.2.20R, *LR* 9.2.21R, *LR* 9.2.23R, *LR* 9.2.24R, *LR* 9.2.25R, *LR* 9.3.11R and *LR* 9.8.4R(14);

…

…

## 21 Sovereign Controlled Commercial Companies: Premium listing

…

### 21.8 Continuing obligations: Certificates representing shares

Compliance with LR 9 (Continuing obligations)

21.8.1 R A *listed company* must comply with *LR* 9 (Continuing obligations) except:

…

(2) *LR* 9.2.5G to ~~*LR* 9.2.6BR~~ *LR* 9.2.6CR;

…

…

Additional requirements: compliance with the disclosure requirements, ~~and~~ transparency rules and corporate governance rules

…

21.8.17A R A *listed company* that is not already required to comply with:

(1) *DTR* 7.3 (Related party transactions);

(2) requirements imposed by another *EEA State* that correspond to *DTR* 7.3; or

(3) related party measures imposed by a *non-EEA state* under equivalent legislation having similar effect to the requirements set out in *DTR* 7.3;

must comply with *DTR* 7.3 as if it were an *issuer* to which *DTR* 7.3 applies.

…

After TR 13 (Transitional Provisions for the UK Corporate Governance Code) insert the following new TR 14. The text is not underlined.

**TR 14**

**Transitional Provisions in relation to DTR 7.3 (Related party transactions)**

| (1) | (2) Material to which the Transitional Provision applies | (3) | (4) Transitional Provision | (5) Transitional Provision: dates in force | (6) Handbook Provision: coming into force |
|---|---|---|---|---|---|
| 1. | *LR* 9.2.6CR | R | A commercial company, *closed-ended investment fund* or *sovereign controlled commercial company* with *equity shares* that have a *premium listing* on 10 June 2019 is only required to comply with *LR* 9.2.6CR | From [ ] to [ ] | [ ] |

| | | | | | |
|---|---|---|---|---|---|
| | | | from the start of the financial year beginning on or after 10 June 2019. | | |
| 2. | *LR* 14.3.25R | R | A *company* with *shares* that have a *standard listing* on 10 June 2019 is only required to comply with *LR* 14.3.25R from the start of the financial year beginning on or after 10 June 2019. | From [ ] to [ ] | [ ] |
| 3. | *LR* 21.8.17AR | R | A *sovereign controlled commercial company* with *certificates representing shares* that have a *premium listing* on 10 June 2019 is only required to comply with *LR* 21.8.17AR from the start of the financial year beginning on or after 10 June 2019. | From [ ] to [ ] | [ ] |

## Annex C

## Amendments to the Disclosure Guidance and Transparency Rules sourcebook (DTR)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

### 1B Introduction (Corporate governance)

…

### 1B.1 Application and purpose (Corporate governance)

…

Purpose: Related party transactions

1B.1.9 G The purpose of the requirements in *DTR* 7.3 is to implement parts of the *Shareholder Rights Directive* which require companies to have safeguards that apply to material transactions with related parties.

Application: Related party transactions

1B.1.10 R *DTR* 7.3 applies to an *issuer*:

(1) any *shares* of which:

(a) carry rights to vote at general meetings; and

(b) are *admitted to trading*; and

(2) which is a company within the meaning of section 1(1) of the Companies Act 2006.

[**Note:** article 1(1) of the *Shareholder Rights Directive*]

1B.1.11 G *LR* 9.2.6CR, *LR* 14.3.25R, *LR* 15.4.1R, *LR* 21.4.1R and *LR* 21.8.17AR extend the application of *DTR* 7.3 (Related party transactions) for certain *listed companies* which have *shares* or *certificates representing shares* admitted to the *official list* maintained by the *FCA* in accordance with section 74 (The official list) of the *Act*.

…

After DTR 7.2 (Corporate Governance Statements) insert the following new section 7.3 (Related party transactions). The text is not underlined.

## 7 Corporate governance

…

### 7.3 Related party transactions

Transaction

7.3.1 R A reference in this section:

(1) to a transaction or arrangement by an *issuer* includes a transaction or arrangement by its *subsidiary undertaking*; and

(2) to a transaction is, unless the contrary intention appears, a reference to the entering into of the agreement for the transaction.

[**Note:** article 9c(7) of the *Shareholder Rights Directive*]

Definition of related party

7.3.2 R In *DTR*, a "*related party*" has the meaning in *IFRS.*

[**Note:** article 2(h) of the *Shareholder Rights Directive*]

Definition of related party transaction

7.3.3 R In *DTR*, a "*related party transaction*" means:

(1) a transaction (other than a transaction in the ordinary course of business and concluded on normal market terms) between an *issuer* and a *related party*;

(2) an arrangement (other than an arrangement in the ordinary course of business and concluded on normal market terms) pursuant to which an *issuer* and a *related party* each invests in, or provides finance to, another undertaking or asset; or

(3) any other similar transaction or arrangement (other than a transaction or arrangement in the ordinary course of business and concluded on normal market terms) between an *issuer* and any other *person* the purpose and effect of which is to benefit a *related party*.

[**Note:** article 9c(5) of the *Shareholder Rights Directive*]

7.3.4 R An *issuer* must establish and maintain adequate procedures, systems and controls to enable it to assess whether a transaction or arrangement with a *related party* is in the ordinary course of business and has been concluded on normal market terms. An *issuer* must ensure that the *related party* and any

person who is an *associate*, *director* or *employee* of the *related party* does not take part in any such assessment.

[**Note:** article 9c(5) of the *Shareholder Rights Directive*]

Transactions to which this section does not apply

7.3.5 R *DTR* 7.3.8R does not apply to any *related party transaction* which is:

(1) a transaction or arrangement between the *issuer* and its *subsidiary undertaking* provided that:

(a) the *subsidiary undertaking* is wholly owned; or

(b) no other *related party* of the *issuer* has an interest in the *subsidiary undertaking*;

(2) a transaction or arrangement regarding remuneration, or certain elements of remuneration, of a *director* of the *issuer* (or any of its *subsidiary undertakings*), where the remuneration to be awarded or due to the *director* is in accordance with the *issuer's* directors' remuneration policy as approved by the shareholders of the *issuer* in accordance with [section 439A of the Companies Act 2006 and paid in accordance with section 226B of the Companies Act 2006]; or

(3) a transaction offered to all shareholders of the *issuer* on the same terms where equal treatment of all shareholders and protection of the interests of the *issuer* is ensured.

[**Note:** article 9c(6) of the *Shareholder Rights Directive*]

Material related party transactions

7.3.6 G Whether a *related party transaction* is a *material related party transaction* is determined by assessing its size relative to that of the *issuer* proposing to make it. The comparison of size is made by using the *percentage ratios* resulting from applying the *related party test* calculations to a transaction or arrangement. The *related party tests* are set out in *DTR* 7 Annex 1.

7.3.7 R In *DTR*:

(1) "*percentage ratio*" means (in relation to a transaction or arrangement) the figure, expressed as a percentage, that results from applying a calculation under a *related party test* to the transaction or arrangement;

(2) "*related party tests*" means the tests set out in *DTR* 7 Annex 1, which are used to determine whether a transaction or arrangement is a *material related party transaction*;

(3) "*material related party transaction*" means a *related party transaction* where any *percentage ratio* is 25% or more.

Requirements for material related party transactions

7.3.8 R If an *issuer* enters into a *material related party transaction*, the *issuer* must:

(1) no later than the time when the terms of the transaction or arrangement are agreed, publish an announcement on a *RIS* which sets out:

(a) the nature of the *related party* relationship;

(b) the name of the *related party*;

(c) the date and the value of the transaction or arrangement; and

(d) any other information necessary to assess whether the transaction or arrangement is fair and reasonable from the perspective of the *issuer* and of the shareholders who are not a *related party*, including minority shareholders;

(2) obtain the approval of its board for the transaction or arrangement before it is entered into; and

(3) ensure that any *director* who is, or an *associate* of whom is, the *related party*, or who is a *director* of the *related party*, does not take part in the board's consideration of the transaction or arrangement and does not vote on the relevant board resolution.

[**Note:** article 9c(2) and 9c(4) of the *Shareholder Rights Directive*]

7.3.9 R If, after obtaining board approval but before the completion of a *material related party transaction*, there is a material change to the terms of the transaction or arrangement, the *issuer* must comply again separately with *DTR* 7.3.8R in relation to the transaction or arrangement.

7.3.10 G The *FCA* would (amongst other things) generally consider an increase of 10% or more in the consideration payable to be a material change to the terms of the transaction.

7.3.11 G (1) An *issuer* which complies with *LR* 11.1.7R (Requirements for related party transactions) in relation to a *material related party transaction* will satisfy the requirements of *DTR* 7.3.8R in respect of that transaction or arrangement.

(2) An *issuer* which complies with *LR* 11.1.10R (Modified requirements for smaller related party transactions) in relation to a *material related party transaction* will satisfy the requirements of *DTR* 7.3.8R(1) in respect of that transaction or arrangement.

(3) An *issuer* which complies with *LR* 11.1.7R as modified by *LR* 21.5.2R (Transactions with related parties: Equity shares) or *LR* 21.10.4R (Transactions with related parties: certificates representing

shares) in relation to a *material related party transaction* will satisfy the requirements of *DTR* 7.3.8R(1) in respect of that transaction or arrangement.

(4) An *issuer* which complies with *LR* 11.1.10R as modified by *LR* 21.5.2R or *LR* 21.10.4R in relation to a *material related party transaction* will satisfy the requirements of *DTR* 7.3.8R(1) in respect of that transaction or arrangement.

7.3.12 G *DTR* 7.3.8R applies to the variation or novation of an existing agreement between the *issuer* and a *related party* whether or not, at the time the original agreement was entered into, that party was a *related party*.

Aggregation of transactions in any 12-month period

7.3.13 R (1) If an *issuer* enters into transactions or arrangements with the same *related party* (and any of its *associates*) in any 12-month period, and the *issuer* has not been required to comply with *DTR* 7.3.8R in respect of the transactions or arrangements, the transactions or arrangements must be aggregated.

(2) If any *percentage ratio* is 25% or more for the aggregated transactions or arrangements, the *issuer* must comply with *DTR* 7.3.8R in respect of each of the aggregated transactions or arrangements.

[**Note:** article 9c(8) of the *Shareholder Rights Directive*]

Compliance with the disclosure requirements

7.3.14 G An *issuer* should consider its obligations under the *disclosure requirements* in relation to a *related party transaction*.

Insert the following new Annex after the new DTR 7.3 (Related party transactions). The text is not underlined.

**7 Annex 1 The related party tests**

**Related party tests**

1G This Annex sets out the following *related party tests*:

(1) the gross assets test;

(2) the profits test;

(3) the consideration test; and

(4) the gross capital test.

**The gross assets test**

2R (1) The gross assets test is calculated by dividing the gross assets the subject of the transaction by the gross assets of the *issuer*.

(2) The "gross assets" of the *issuer* means the total non-current assets, plus the total current assets, of the *issuer*.

(3) For:

(a) an acquisition of an interest in an undertaking which will result in consolidation of the assets of that undertaking in the accounts of the *issuer*; or

(b) a disposal of an interest in an undertaking which will result in the assets of that undertaking no longer being consolidated in the accounts of the *issuer*,

the "gross assets the subject of the transaction" means the value of 100% of that undertaking's assets irrespective of what interest is acquired or disposed of.

(4) For an acquisition or disposal of an interest in an undertaking which does not fall within paragraph (3), the "gross assets the subject of the transaction" means:

(a) for an acquisition, the consideration together with liabilities assumed (if any); and

(b) for a disposal, the assets attributed to that interest in the *issuer's* accounts.

(5) If there is an acquisition of assets other than an interest in an undertaking, the "assets the subject of the transaction" means the consideration or, if greater, the book value of those assets as they will be included in the *issuer's* balance sheet.

(6) If there is a disposal of assets other than an interest in an undertaking, the assets the subject of the transaction means the book value of the assets in the *issuer's* balance sheet.

3G The *issuer* should consider, when calculating the assets the subject of the transaction, whether further amounts, such as contingent assets or arrangements referred to in *LR* 10.2.4R (indemnities and similar arrangements), should be included to ensure that the size of the transaction is properly reflected in the calculation.

**The profits test**

4R (1) The profits test is calculated by dividing the profits attributable to the assets the subject of the transaction by the profits of the *issuer*.

(2) For the purposes of paragraph (1), "profits" means:

(a) profits after deducting all charges except taxation; and

(b) for an acquisition or disposal of an interest in an undertaking referred to in paragraph 2R(3)(a) or (b), 100% of the profits of the undertaking (irrespective of what interest is acquired or disposed of).

(3) If the acquisition or disposal of the interest will not result in consolidation or deconsolidation of the target then the profits test is not applicable.

5G The amount of loss is relevant in calculating the impact of a proposed transaction under the profits test. An *issuer* should include the amount of the losses of the *issuer* or target, i.e. the *issuer* should disregard the negative when calculating the test.

**The consideration test**

6R (1) The consideration test is calculated by taking the consideration for the transaction as a percentage of the aggregate market value of all the ordinary shares (excluding *treasury shares*) of the *issuer*.

(2) For the purposes of paragraph (1):

(a) the consideration is the amount paid to the contracting party;

(b) if all or part of the consideration is in the form of *securities* to be traded on a market, the consideration attributable to those *securities* is the aggregate market value of those *securities*; and

(c) if deferred consideration is or may be payable or receivable by the *issuer* in the future, the consideration is the maximum total consideration payable or receivable under the agreement.

(3) If the total consideration is not subject to any maximum (and the other *related party tests* indicate the transaction to be a transaction where all the *percentage ratios* are less than 25%) the transaction is to be treated as a *material related party transaction*.

(4) For the purposes of sub-paragraph (2)(b), the figures used to determine consideration consisting of:

(a) *securities* of a class already *admitted to trading*, must be the aggregate market value of all those *securities* on the last *business day* before the announcement; and

(b) a new class of *securities* for which an application for *admission to trading* will be made, must be the expected aggregate market value of all those *securities*.

(5) For the purposes of paragraph (1), the figure used to determine market capitalisation is the aggregate market value of all the ordinary *shares* (excluding *treasury shares*) of the *issuer* at the close of business on the last *business day* before the announcement.

7G The issuer should consider whether further amounts should be included in the calculation of the consideration to ensure that the size of the transaction is properly reflected in the calculation. For example, if the purchaser agrees to discharge any liabilities, including the repayment of inter-company or third party debt, whether actual or contingent, as part of the terms of the transaction.

**The gross capital test**

8R (1) The gross capital test is calculated by dividing the gross capital of the company or business being acquired by the gross capital of the *issuer*.

(2) The test in paragraph (1) is only to be applied for an acquisition of a *company* or business.

(3) For the purposes of paragraph (1), the "gross capital of the *company* or business being acquired" means the aggregate of:

(a) the consideration (as calculated under paragraph 6R);

(b) If a *company*, any of its *shares* and *debt securities* which are not being acquired;

(c) all other liabilities (other than current liabilities) including for this purpose minority interests and deferred taxation; and

(d) any excess of current liabilities over current assets.

(4) For the purposes of paragraph (1), the "gross capital of the *issuer*" means the aggregate of:

(a) the market value of its *shares* (excluding *treasury shares*) and the issue amount of the *debt security*;

(b) all other liabilities (other than current liabilities), including for this purpose minority interests and deferred taxation; and

(c) any excess of current liabilities over current assets.

(5) For the purposes of paragraph (1):

(a) figures used must be, for *shares* and *debt security* aggregated for the purposes of the gross capital percentage ratio, the aggregate market value of all those *shares* (or if not available before the

announcement, their nominal value) and the issue amount of the *debt security*; and

(b) for *shares* and *debt security* aggregated for the purposes of paragraph (3)(b), any *treasury shares* held by the *company* are not to be taken into account.

**Figures used to classify assets and profits**

9R (1) For the purposes of calculating the tests in this Annex, except as otherwise stated in paragraphs (2) to (7), the figures used to classify assets and profits must be the figures shown in the latest published audited consolidated accounts or, if an *issuer* has, or will have, published a preliminary statement of later annual results at the time the terms of a transaction are agreed, the figures shown in that preliminary statement.

(2) If a balance sheet has been published in a subsequently published interim statement then gross assets and gross capital should be taken from the balance sheet published in the interim statement.

(3) (a) The figures of the *issuer* must be adjusted to take account of transactions completed during the period to which the figures referred to in (1) or (2) relate, and subsequent completed transactions which the *issuer* would have been required to notify to a *RIS* under *LR* 10.4 or *LR* 10.5 if the *issuer* had a *premium listing*, provided that for such subsequent completed transactions the figures for the transactions are reasonably available to the *issuer*.

(b) The figures of the target company or business must be adjusted to take account of transactions completed during the period to which the figures referred to in (1) or (2) relate, and subsequent completed transactions which would have been a class 2 transaction or greater for the purposes of the *listing rules* when classified against the target as a whole, provided that for such subsequent completed transactions the figures for the transactions are reasonably available to the target.

(4) Figures on which the auditors are unable to report without modification must be disregarded.

(5) When applying the *percentage ratios* to an acquisition by a *company* whose assets consist wholly or predominantly of cash or short-dated *securities*, the cash and short-dated *securities* must be excluded in calculating its assets and market capitalisation.

(6) The principles in this paragraph also apply (to the extent relevant) to calculating the assets and profits of the target company or business.

10G The *FCA* may modify paragraph 9R(4) in appropriate cases to permit figures to be taken into account.

**Anomalous results**

11G If a calculation under any of the *related party tests* produces an anomalous result, or if a calculation is inappropriate to the activities of the *issuer*, the *FCA* may modify the relevant *rule* to substitute other relevant indicators of size, including industry-specific tests.

**Adjustments to figures**

12G Where an *issuer* wishes to make adjustments to the figures used in calculating the *related party tests* pursuant to 11G they should discuss this with the *FCA* before the *related party tests* crystallise.

**The profits test: anomalous results**

13R Paragraph 14R applies to an *issuer* where the calculation under the profits test produces a *percentage ratio* of 25% or more and this result is anomalous.

14R An *issuer* may, where each of the other applicable *percentage ratios* are less than 25%, disregard the profits test for the purposes of classifying the transaction.

## TP 1 Disclosure and transparency rules

Transitional Provisions

| (1) | (2) Material to which the Transitional Provision applies | (3) | (4) Transitional Provision | (5) Transitional Provision: dates in force | (6) Handbook Provision: coming into force |
|---|---|---|---|---|---|
| … | | | | | |
| 31 | *DTR* 7.3 and *DTR* 7 Annex 1R | R | An *issuer* is only required to comply with *DTR* 7.3 and *DTR* 7 Annex 1R from the start of the financial year beginning on or after 10 June 2019.<br>For the purposes of *DTR* 7.3.13R, only transactions or arrangements which are entered into on or after the start of the financial year beginning on or after 10 | From [ ] to [ ] | [ ] |

| | | | | | |
|---|---|---|---|---|---|
| | | | June 2019 must be aggregated. | | |

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