# ESMA Final Report on the application and effectiveness of the provisions in the second directive regarding proxy advisors and the investment chain

**March 2024**

Directive 2007/36/EC was published in 2007 regarding the exercise of certain rights of the shareholders of listed companies with the main objective of promoting the exercise of rights of shareholders at the general meetings of those companies that have established their registered office in the European Union (EU) and whose shares have been listed on regulated markets in this same territory.

Subsequently, this Directive was modified by Directive 2017/828 (Second Directive) in order to encourage the long-term shareholder engagement. Specifically, this modification introduced specific requirements regarding the identification of shareholders, the transmission of information, the facilitation for shareholders to exercise their rights, the transparency of institutional investors, asset managers and proxy advisors, the remuneration of directors and operations with related parties. Furthermore, in 2018 the Commission adopted Implementing Regulation 2018/1212 which specifies some of these requirements. September 2020 was the date for implementation of this revised framework.

ESMA and EBA received a mandate from the European Commission in October 2022 requesting their collaboration in the preparation of the two reports this institution was to submit to the European Parliament and the Council, before 10 June 2023, on the following two aspects of the Second Directive: (1) Chapter Ia in relation to identification of shareholders, transmission of information, facilitation of exercise of shareholders rights – investment chain – (in particular, application, effectiveness and appropriateness of the scope of application in relation to third-country intermediaries); and (2) Article 3j in relation to proxy advisors (in particular, scope of application, effectiveness and appropriateness of the need for establishing regulatory requirements).

The Report, published by the European Securities and Markets Authority (ESMA) in June 2023 together with the European Banking Authority (EBA), after identifying and assessing the main obstacles detected for the application of the aforementioned provisions, proposes a series of recommendations to the European Commission (EC) which are described below.

**What methodology was used to prepare this Report?**

To prepare this Report, ESMA launched a Call for Evidence on 11 October 2022 – to which it received 73 responses – and requested the advice of the Securities Markets Stakeholder Group. On its part, EBA took part in some of ESMA's initiatives, launched its own calls for evidence and also received advice from its Banking Stakeholder Group. In turn, they both collected information from the National Competent Authorities (NCAs) regarding its practical application.

**Which observations stood out the most from the responses received?**

The observations that most stood out regarding proxy advisors were the following:

The regulatory framework included in the Second Directive is solid, although there is room for improvement in some areas.

Regarding the subjective scope, it would be appropriate to point out more precisely the subjects operating as proxy advisors.

In relation to reporting obligations, it would be appropriate to provide more/better information regarding potential conflicts of interest proxy advisors may incur when providing their services to issuers, while also considering the specific nature of local markets.

In relation to services provided regarding environmental, social or governance factors, the improvement of the sources of such data and of the relevant methodology would be convenient.

With regard to the scope of application of the revised Directive, it could be interesting to consider in the regulation other possible conflicts of interest deriving from additional services provided by proxy advisors.

The observations that most stood out regarding the investment chain were the following:

There is room for greater harmonisation.

The Second Directive has made the identification of shareholders easier. However, a harmonised definition of the shareholder concept would improve this process.

The Second Directive has led to improvements in the transmission of information, not so much regarding the exercise of the right to vote.

The level of satisfaction observed regarding proportionality, transparency and non-discrimination of costs related to voting is limited.

In relation to third-country intermediaries, the appropriateness of paying more attention to certain practices performed by non-EU intermediaries has become apparent.

**What recommendations have been included in the Report on proxy advisors?**

Regarding proxy advisors, the Report considers that the framework in force is solid but, however, recommends the EC should consider the introduction of the following measures:

In regard to the proxy advisor concept, firstly a clarification of its definition – included in Article 2(g) of the Directive – is proposed. In particular, the clarification of the following aspects is recommended: (1) the role of professionals not considered to be legal persons, and of nonprofit organisations, when providing advice on a commercial basis; and (2) if the activity of the proxy advisors also covers the provision of services related to data on environmental, social and governance (ESG) factors, or their analysis, when provided on a professional and commercial basis together with the advice on the exercise of voting rights. Likewise, an EU-wide basic proxy advisor registration system is proposed.

Regarding codes of conduct, the definition of certain minimum standards is proposed, even establishing an independent monitoring system on their application.

Regarding reporting obligations, the possibility is proposed that issuers and clients may resort to ESMA in the case of controversial issues or alleged breaches of the code of conduct, enabling the latter to facilitate a dialogue between all the parties involved, without its recommendations being binding and ensuring the option

to take legal action. Providing more information on the sources, including ESG data, is also proposed.

Regarding conflicts of interest, the provision of more detailed information on conflicts between proxy advisors and clients is proposed, in particular when the advisors provide consultancy services to the issuers. Similarly, the publication of the income from the services provided, in terms of the type of client and their relative importance, is proposed.

Finally, regarding third-country proxy advisors which carry out their activities through an establishment, assessing the creation of an EU-wide basic registration system – mentioned above – is proposed, one in which to register not only those with a registered address in this territory, but also those which, without having this, have an establishment from which they carry out their activities. Similarly, the publication of a list with the proxy advisors operating in the EU is proposed, indicating whether or not they follow a code of conduct, while also providing the link to the annual report they are to publish on the preparation of their research, advice and voting recommendations.

**What recommendations have been included in the Report on the investment chain?**

The Report recommends the EC assesses the introduction of the following improvements:

Regarding the identification of shareholders, firstly it proposes considering the possibility of introducing in the regulation a harmonised definition of the shareholder concept applicable throughout the EU. Meanwhile, as a transitional measure, it recommends the EC publishes a list with the different existing definitions.

Secondly, it proposes allowing for the identification, by issuers, of not only nominee shareholders but also of beneficial owners. In addition, the Report recommends awarding issuers certain flexibility so they may customize the requests for identification of shareholders in terms of their specific needs.

In third place, it proposes to the EC a clarification on the securities included within the scope of application of Chapter Ia of the Second Directive and even the consideration of their possible extension, together with the publication of a list of the securities that are subject to this Chapter in each of the Member States.

In fourth place, it proposes considering a modification of the Second Directive and its Implementing Regulation, demanding the issuer fulfils certain additional requirements related to the shareholder identification process, such as sending the so called “golden operational record” – i.e., all the operational information – to the Central Securities Depository (or first intermediary).

In fifth place and regarding intermediaries, it proposes standardising the responses in relation to the shareholder identification process, together with clarifying in the regulation the obligation to inform on whether they keep securities in their own account or in the name of third parties.

Lastly, it proposes reinforcing the competence of the National Competent Authorities (NCAs) with regard to the follow-up they must perform during the shareholder identification process, particularly in the case they are of a cross-border nature.

Regarding the transmission of information, firstly it proposes modifying the Implementing Regulation in order to impose on the issuer the previously stated “golden operational record” requirement, only this time in relation to the transmission of information obligations along the chain of intermediaries.

In second place, it proposes forcing the issuer to submit to the Central Securities Depository all the information necessary to start a corporate event in a machine-readable format.

In third place, it proposes aligning the deadlines mentioned in Article 9 of the Implementing Regulation on the periods to be complied with by issuers and intermediaries in the corporate events and shareholder identification processes with the deadlines for other obligations (e.g., the compliance duties deriving from the

Markets in Financial Instruments Directive) to which these intermediaries are subject.

Regarding the facilitation of the exercise of voting rights, it proposes making an effort to harmonise: (1) the supporting documentation in relation to the ownership allowing for the rights to be exercised, also demanding that it is in a machine-readable format; (2) the documentation available for the meetings (even extending the number days between its publication and the meeting); and (3) the record date. It also proposes to improve the vote confirmation mechanism (e.g., by means of the publication of the recording and counting of votes).

Regarding the transverse considerations in relation to the identification of shareholders, the transmission of information and the facilitation of the exercise of voting rights, it proposes the specification of the more technical requirements relating to these aspects in a Regulation, in such a manner that this is supplementary to the Directive and the Implementing Regulation. Likewise, it proposes a review of the competence of the NCAs in this matter, particularly whenever there is a cross-border component.

Regarding the transparency, proportionality and non-discrimination of costs, it proposes the harmonisation of the terminology employed regarding costs and the different types of service provided in respect to those applied. It also recommends establishing a single format for their disclosure.

Finally, with regard to third-country intermediaries, it proposes solving the uncertainties caused by the differences between the various Member States in the application of the Second Directive, particularly regarding the shareholder concept, together with the preparation of guides on the requirements to be complied with intermediaries from third countries.

**Link of interest:**
Report on the Implementation of SRD2 provisions on proxy advisors and the investment chain