Acting Director-General for Justice and Consumers at the European Commission, Salla SAASTAMOINEN

Executive Director of ESMA, Verena ROSS

Brussels, 1 September 2020

Joint trade associations letter on a delay in the date of applicability of Shareholder Rights Directive II

Dear Ms Saastamoinen, Dear Ms Ross,

On behalf the European Banking Federation (EBF), the Association for Financial Markets in Europe (AFME), the International Securities Lending Association (ISLA), the Association of Global Custodians (AGC), the European Central Securities Depositories Association (ECSDA), the Securities Market Practice Group (SMPG), the European Savings and Retail Banking Group (ESBG), the Associazione Intermediari Mercati Finanziari (ASSOSIM), the Association française des Professionnels des Titres (AFTI) and the European Association of Co-operative Banks (EACB) (together, the "Associations"), we would like to thank you for

your letter dated 27 May 2020, in response to our letter dated 9 April asking for a delay in the date of applicability of the rules set out in Chapter 1a of Shareholder Rights Directive (SRD II).

We would also like to express our thanks and appreciation to Ms Maija Laurila and to Ms Katalin Koos-Huta, who in a phone conference on 26 June discussed with ourselves our letter and your response.

In this letter, we would like to respond more formally to your letter, and to give some additional information on two points with respect to which we believe that there is a misunderstanding.

We believe that the implementation of SRD II operational rules will be a key building block in the creation of a Capital Markets Union, and we are committed to delivering a successful implementation. Given the problems associated with the implementation that are outside of the control of market infrastructure entities and market participants, we believe that European and member state authorities should take action to facilitate the implementation of SRD II rules, and to remediate the gaps in SRD II.

In this letter, we shall also set out steps that can be taken by European public authorities in this respect.

Working towards compliance / risks of non-compliance

In your letter, you confirm that there will not be a delay from 3 September of the date of applicability of the SRD II requirements, and you also express confidence that our associations and member organisations will continue working on standardisation and on IT solutions so that all intermediaries and listed companies will be able to comply with the new requirements as from 3 September 2020.

We indeed confirm that our associations and member organisations are working, and have been working for several years, on drafting standards, and on building solutions, so that to the greatest extent possible the core SRD II operational processes (shareholder identification, general meetings, and financial corporate actions) will be effected in an SRD II-compliant manner from 3 September.

However, we do also believe that there is sufficient information in the public domain for us to be certain that as of 3 September not all SRD II operational processes will be effected in an SRD II manner and that many parties, who themselves have the technical ability to process in a compliant manner, will be forced to exchange information in a non-compliant

manner because one or more of their clients, counterparties or service providers will not be able to issue or to accept fully SRD II-compliant messaging.

We believe that the critical drivers behind these cases of non-compliance are (i) differences in national transposition and national applicability of SRD II rules, and (ii) timing of national transpositions, so that market infrastructure entities and market participants have had insufficient time to build fully SRD II-compliant processes. The impacts of the differences in national transpositions, and of the timing of national transpositions, have been exacerbated by the effects of the COVID-19 pandemic. We believe that the effects of COVID-19 on the delivery date of major public and private sector infrastructure and IT projects are well-recognised, and we are not aware of any reasons as to why, uniquely, the delivery of the SRD II project would remain unaffected. We believe that the risks inherent in different national transpositions were well-known, and were articulated in a presentation on SRD II that was given in a meeting on 20 September 2018 of the Consultative Working Group of ESMA's Post-Trading Standing Committee. It has, of course, been necessary to wait for the national transpositions in order to see if these risks would materialise.

Misunderstanding – national transposition as an add-on to the Implementing Regulation

There is a view, expressed in your letter, that the SRD II Implementing Regulation (IR), published in September 2018, sets out a core set of operational rules that apply uniformly across all member states, and that since September 2018 market infrastructure entities and market participants have had sufficient time to adapt their operational processes to these rules.

Under this view, the national transpositions of SRD II simply create additional ("add-on") rules. This view therefore suggests that national transpositions are not a source of problems because delays do not involve additional requirements.

We believe that this view is misconceived: the manner in which the requirements set out in the IR apply in each member state depends on how the member state has transposed the Directive, and, in particular, on how each member state has chosen to determine which entity is considered to be the "shareholder".

This continuing concern leads to two important conclusions. The first is that in order for market infrastructure entities and market participants to be able to build SRD II-compliant processes there was a need for national transpositions to have been completed by September 2018, or, at the latest, by 10 June 2019. The second is that differences in national transpositions, and in, for example, national definitions of shareholders, create

complexity, and make it for difficult for market infrastructure entities and market participants to build SRD II-compliant processes.

Misunderstanding – SRD II as a regulatory compliance project, and not as a market infrastructure project

There is a view, which we believe is expressed in your letter, that SRD II is fundamentally a regulatory compliance project, such as a project relating to prudential requirements, or conduct of business rules. Under this view, late compliance by an individual market participant is a well-circumscribed problem with limited impacts, and will be a subject of discussion between a regulated entity and its regulator/supervisor.

We believe that this view is too limited. From our perspective, SRD II is fundamentally a market infrastructure project. For a market infrastructure project, lack of readiness by any market participant has major knock-on effects on other market participants, and is the source of systemic risk. Market infrastructure projects have a major sensitivity to market readiness. We note, for example, that the European Central Bank has recently postponed from November 2021 to November 2022 the launch of the T2/T2S consolidation project precisely because of a concern about market readiness. We also note that with respect to the CSDR settlement discipline rules, which are another example of a market infrastructure project, the European Commission has recently asked ESMA to propose a delay in the date of applicability from February 2021 to February 2022 and that ESMA has published new amending draft RTS following this proposal.

We do not believe that late compliance with SRD II requirements will generate systemic risk. This is because market infrastructure entities and market participants will continue to process shareholder identification requests, general meetings, and financial corporate actions, even though the processing may not be fully in line with the SRD II requirements.

But we believe that SRD II should be treated as a market infrastructure project because the successful implementation of the SRD II processes, and full compliance by any individual entity, are dependent on full compliance by all market entities.

Expression of concern / next steps

We have three major areas of concern.

A first area of concern is that, as regulated entities, we have an obligation to report to our regulatory and supervisory authorities cases of non-compliance with applicable rules. But as yet, we have no clear understanding of to whom, and how, we should make these

reports. We believe that it is possible that many regulated entities will be under an obligation to report to twenty-seven separate national competent authorities.

A second area of concern relates to the consequences of non-compliance beyond any reporting obligations. National transpositions have varied widely with respect to potential penalties and fines that could be assessed. Potential repercussions range from criminal sanctions and extremely high penalties to no provision at all being made in national transposition. In view of concerns expressed in this letter, and resulting uncertainty that the industry must contend with, we believe urgent discussion is necessary to manage in view of the possibility of these sanctions, penalties and fines being applied.

Considering this, one way to address the current regulatory uncertainty with respect to penalties and fines would be to ensure a de facto transition period based on possible forms of supervisory forbearance. Given the circumstances, we believe that such period - limited to a reasonable time horizon - would contribute significantly to ensuring the best conditions for all intermediaries and market participants to fully implement SRD II requirements effectively.

A third area of concern is the fact that – as a result of differing national transpositions – SRD II has the effect of creating up to twenty-seven separate versions of each SRD II operational process. This is a major source of complexity, and creates barriers to market access, to the capital markets of each member state, and to EU-wide capital markets.

In this context, the IR also needs to be integrated into twenty-seven different regimes of national company law. In many cases, this poses great difficulties as the necessary connection can only be achieved by creative interpretation of the existing company law and the IR, which is likely to result in further differences between Member States. This in turn affects both the legal interpretation and the operational processes.

With regard to the mentioned concerns and given the seriousness of the situation, we believe that it is urgent that European and member state authorities take action. We kindly suggest that the European and member state authorities confirm that:

1. A single regulated entity has to report non-compliance with SRD II requirements only to one single national competent authority, and not to twenty-seven national competent authorities. On this point, we are also intending in the coming few weeks to engage with national competent authorities from all member states.
2. Sanctions, penalties and fines will not apply, at least until 3 September 2021.
3. With respect to the barriers to market access created by SRD II, the European Commission will implement as soon as possible Recommendation 9 of the Final Report of the Capital Markets Union High Level Forum.

Conclusion

In conclusion, we would like to reconfirm our commitment to building a Capital Markets Union, and to creating common, pan-European, SRD II-compliant operational processes.

We stand ready to engage with your teams with respect to any of the topics covered in this letter, and to assist your considerations in any way.

Your sincerely,

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Chief Executive Officer
European Banking Federation – EBF

Adam Farkas,
Chief Executive Officer
Association for Financial Markets in Europe – AFME

Andrew Dyson,
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John Siena,
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cc:

Ms Maija LAURILA, Head of Company Law Unit, European Commission

Ms Katalin KOOS-HUTAS, Company Law Unit, European Commission

Mr John BERRIGAN, Director General for Financial Stability, Financial Services and Capital Markets Union, European Commission

Mr Carmine DI NOIA, Chair of the ESMA Post Trading Standing Committee