
Briefing

SRD II – Implementation of new related party rules under Irish Law

April 2020

The Shareholder Rights Directive 2017/828 (“**SRD II**”), which amends the Shareholder Rights Directive 2007/36 (“**SRD I**”), has been transposed into Irish law by the EU (Shareholders’ Rights) Regulations 2020 (the “**SRD II Regulations**”)¹.

This briefing sets out a summary of the new rules for related party transactions for listed public limited companies (“**PLCs**”) under the SRD II Regulations. For a summary of other key areas introduced by the SRD II Regulations, please see [here](#).

The SRD II Regulations apply from 30 March 2020 with a number of transitional provisions.

1. Scope of the SRD II Regulations

As noted in our separate briefings on this topic, the changes introduced by the SRD II Regulations apply to PLCs incorporated and registered in Ireland whose shares are admitted to trading on a regulated market in an EU member state (“**Member State**”),² (a “**traded PLC**”) and so cover any Irish PLC whose shares are admitted to trading on Euronext Dublin and/or, for example, the main market of the London Stock Exchange.

¹ The SRD II Regulations amend and supplement the Companies Act 2014 (as amended) (the “**Act**”) by the inclusion of Chapters 8A, 8B, 8C and 8D in Part 17 of the Act and a new Schedule 21.

² The SRD II Regulations do not apply therefore to: (i) PLCs listed on Euronext Growth as it is not a regulated market within the meaning of SRD II; (ii) PLCs incorporated and registered elsewhere in the European Union (even if listed on Euronext Dublin) who fall within the remit of the Member State of its incorporation; or (iii) PLCs incorporated and registered outside the European Union. Corporate UCITS and AIFs are expressly excluded from the definition of a “traded PLC” in respect of the requirements for facilitating interaction between companies and shareholders.

2. New related party rules under the SRD II Regulations

Irish main market traded PLCs are used to complying with related party rules under the Euronext Dublin Listing Rules (“**Irish Listing Rules**”) which already require public disclosure and shareholder approval for material related party transactions. The new related party rules introduced under the SRD II Regulations are slightly broader in scope however, increasing the regulatory burden for traded PLCs where the transaction falls outside the requirements of the Irish Listing Rules but within the new regime.

What approvals and disclosures are required?

Under the SRD II Regulations, a material related party transaction must be:

- (a) approved by shareholders in general meeting prior to the conclusion of the transaction (and no related party on such transaction can take part in the relevant shareholder vote); and
 - (b) announced no later than the conclusion of the transaction.
- In practice, an announcement will be made by RIS at the same time as the shareholder meeting seeking approval of the transaction is convened.
 - Similar to the existing Irish Listing Rule regime, the announcement must contain the name of the related party, the nature of the related party relationship, the date and the value of the transaction. There is a new obligation to include any information which is necessary to assess whether or not the transaction is fair and reasonable from the perspective of the traded PLC and non-related shareholders including minorities.
 - The Irish Listing Rules already require a traded PLC to obtain confirmation from its sponsor that the terms of the proposed transaction with a related party are fair and reasonable. The new requirement that the announcement include any information which is necessary to assess whether this is the case clearly imposes a greater disclosure obligation than under the current regime. However, the alternative approach afforded to Member States under SRD II was to require a traded PLC to issue its announcement accompanied by a report of an independent third party, the board of directors or the audit committee which would include such an assessment. This alternative approach was not favoured as it was considered less compatible with the Irish Listing Rules.

In addition, when a related party of a traded PLC enters into a transaction with a subsidiary of that traded PLC, the traded PLC must publically announce the material transaction no later than at the conclusion of the transaction.

Traded PLCs must now comply with two related party regimes under the Irish Listing Rules and the SRD II Regulations

Who is a related party under the new rules?

The SRD II Regulations adopt the meaning given to ‘related party’ under the International Financial Reporting Standards (IAS 24). The IAS 24 definition is wider in scope than that provided for under the Irish Listing Rules, as summarised below:

Related Party Definition	
SRD II (IAS 24)	Irish Listing Rules
<ul style="list-style-type: none"> • a person or a close member of that person’s family is related to a reporting entity if that person has control, joint control, or significant influence over the entity or is a member of its key management personnel • an entity is related to a reporting entity if, among other circumstances, it is a parent, subsidiary, fellow subsidiary, associate, or joint venture of the reporting entity, or it is controlled, jointly controlled, or significantly influenced or managed by a person who is a related party 	<ul style="list-style-type: none"> • a substantial shareholder (i.e. able to exercise 10% or more of the voting rights) • a director or shadow director of the company, its subsidiary undertaking of its parent undertaking • a person exercising significant influence • an associate (e.g. spouse, civil partner, child, trustee, certain associated companies and partnerships) of a related party

In practice, the meaning of “related party” in IAS 24 is complicated and judgement is required. While traded PLCs and their finance teams that report under EU IFRS will already be familiar with this definition for the purpose of related party disclosures in annual and half-yearly reports, the SRD II Regulations require another layer of compliance to ensure timely announcement and approval of material related party transactions.

What is a related party transaction under the new rules?

A related party transaction under the SRD II Regulations means a transaction between a traded PLC and its related party, excluding:

- any transaction or arrangement in the ordinary course of business and concluded on normal market terms;
- any transaction between a traded PLC and its subsidiary undertaking(s) if the subsidiary undertaking(s) is or are wholly owned or no related party of the traded PLC has an interest in the subsidiary undertaking(s);
- any transaction regarding a director’s remuneration awarded or due under a shareholder approved remuneration policy under the SRD II Regulations; and
- any transaction offered to all shareholders on the same terms where equal treatment of all shareholders and protection of the traded PLC’s interests are ensured.

New internal procedures required to assess “ordinary course” and on “normal market terms”

This definition excludes fewer transactions than under the Irish Listing Rules. For example, the insignificant subsidiary exemption, the grant of credit on normal commercial terms and certain joint investment arrangements are not excluded. Importantly, ordinary course transactions are only excluded under the SRD II Regulations if they are also concluded on normal market terms.

Are new internal systems and controls required?

The SRD II Regulations require directors to establish an internal procedure to assess whether or not transactions are entered into in the ordinary course of business and concluded on normal market terms and as such fall outside the new related party rules. This will require adoption of new or revised procedures, systems and controls by traded PLCs as soon as possible. A related party should not take part in any assessment of the relevant transaction under these internal procedures.

When is a related party transaction material?

Member States were given the option to set their own materiality thresholds and, helpfully, the Irish legislature has adopted class tests (being the gross asset, profits, consideration and gross capital tests) which are broadly similar (but not identical) to those adopted under the Irish Listing Rules to determine whether a transaction is material³. Under the SRD II Regulations, a transaction will be material where any of the percentage ratios calculated under the class tests is 5% or more. This contrasts with the position under the Irish Listing Rules where a transaction below 5% but above 0.25% in any of the class tests will still fall within the regime, although as a “smaller related party transaction” requiring announcement but no shareholder approval.

Should related party transactions be aggregated to determine materiality?

Traded PLCs are required to aggregate transactions with the same related party over the previous 12 months or in the same financial year (e.g. if a financial year were to exceed 12 months where a new financial year end has been adopted). Where any percentage ratio is 5 per cent or more for the aggregated transactions, the traded PLC must comply with the shareholder approval and announcement requirements under the SRD II Regulations (requiring approval “prior to the conclusion of the transaction” and announcement “no later than at the conclusion of the transaction”) in respect of each of the aggregated transactions or arrangements.

Where the aggregated transactions meet the materiality threshold, the shareholder approval and announcement requirements apply to all of the transactions included in the aggregation, and not just the one that crossed the materiality threshold. This diverges from the aggregation rules under Chapter 11 of the Irish Listing Rules which provide for the approval and disclosure of the transaction that triggers the materiality threshold and disclosure only of the earlier aggregated transaction(s).

³ The class tests under the SRD II Regulations are inserted into the Act through the inclusion of a new Schedule 21.

In the UK, the Financial Conduct Authority (“FCA”) has recognised the challenge for issuers in complying with the approval and announcement provisions (requiring approval “prior to the conclusion of the transaction” and announcement “no later than at the conclusion of the transaction”) for completed transactions included in the aggregation. However, it notes that these provisions flow from SRD II which does not provide an opt-out. The FCA highlights that where an issuer is proposing to enter into a sequence of smaller transactions with the same related party, it will need to take into account and plan for how it will be able to meet its future obligations for those individual transactions under the aggregation rules. Save where a traded PLC knows that it will be entering into a series of transactions which in aggregate will breach the materiality threshold, traded PLCs can presumably only make notification of the historic transactions at the time the aggregation threshold is crossed and seek approval of / ratify the earlier transactions as part of the approval of the aggregated material transaction. If approval is not forthcoming, the final transaction in the aggregation cannot be concluded and presumably the historic transactions then fall outside of the definition of a material transaction.

Transactions with the same related party must be aggregated over the previous 12 months or in the same financial year to determine if the materiality test is triggered

How do the new rules interact with existing provisions of the Irish Listing Rules?

Traded PLCs must continue to comply with the related party rules under the Irish Listing Rules in parallel to the new regime under the SRD II Regulations. While there is a large degree of overlap, differences apply.

Given the wider related party definition under IAS 24 and the different *de minimis* thresholds under each regime, there may be certain instances where a related party transaction will not fall within the scope of the Irish Listing Rules but will fall within the SRD II Regulations, or vice versa, so that going forward, traded PLCs will have to carefully consider all related party transactions under both regimes.

Where a traded PLC regularly relies on a particular exemption or each time a new exemption is considered under the Irish Listing Rules, it should be considered whether an equivalent is available under the SRD II Regulations and its related party rules and if not, the implications of complying with such new rules going forward.

When do the new rules come into effect?

The measures requiring traded PLCs to publicly announce and obtain shareholder approval for any material transactions with related parties under the new rules apply from 30 March 2020.

Internal related party policies and procedures should be adopted or existing policies and procedures updated for compliance with the new rules

3. Practical Considerations

- Existing procedures in place for compliance with the related party rules under the Irish Listing Rules will need to be revisited in light of the new regime. Board members and finance, legal and company secretarial teams will all need to be aware of the new rules and any new processes put in place to comply with them.
- Two separate “related party” lists may be required given the different definitions under the two regimes. Related party disclosures in the latest financial statements should be considered. Finance teams, accountants and sponsor(s) should be consulted and these lists periodically reviewed and updated.
- All transactions with related parties regardless of size should continue to be recorded, save for those in the ordinary course of business and on normal market terms. Before entering into a new related party transaction, all other transactions with the relevant related party over the last twelve months must be aggregated and considered when applying the materiality test.
- Advisers should be engaged in order to establish procedures for assessing whether transactions involving related parties are in the “ordinary course” and concluded on “normal market” terms. Evidence supporting a determination that a related party transaction falls within this exemption should be maintained.
- Disclosure obligations under the Market Abuse Regulation (“MAR”) will apply regardless of the analysis under the related party rules and where a transaction amounts to inside information, subject to the ability to delay disclosure under MAR, it must be announced.

4. Enforcement and Penalties

Where a person fails to comply with any of the provisions under SRD II Regulations set out above, that person and, where that person is a company, the company and any officer who is in default will be guilty of a category 3 offence, punishable on summary conviction by a fine of up to €5,000 and/or a term of imprisonment of up to six months.

Contacts

McCann FitzGerald has been closely monitoring the development of SRD II, as well as being experienced in advising our clients on the existing shareholder rights and related party transactions regime. For more information or general advice as to what the new SRD II Regulations mean for your business, please contact:



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