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Groenland, I.C.P.

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Related Party Transactions in the Revised Shareholders' Rights Directive: The EU Perspective and Implementation in National Law

IRENE C. P. GROENLAND: UNIVERSITY OF AMSTERDAM*

1. INTRODUCTION

One of the main issues in corporate governance discussions is how to address and prevent expropriation by officers and more specifically controlling shareholders that is detrimental to the company, its minority shareholders and other stakeholders, a practice often referred to as 'tunnelling'.¹ Capital protection rules may apply to capital distributions, but the less transparent ways of expropriation, such as through RPTs, may be just as detrimental but more difficult to control. For RPTs, prevention is generally sought in procedural requirements. Illustrative of the worldwide attention for the regulation of RPTs may be the *G20/OECD Principles of Corporate Governance 2015*² that define specific governance guidelines on RPTs. The World Bank, in ranking 190 jurisdictions worldwide on their attractiveness for enterprises and investors,³ pays a high degree of attention to the strength of protection mechanisms on RPTs. Ranking European countries in this respect, the World Bank, in its *Ease of doing Business Report 2019*,⁴ places the UK and Ireland at the top of the list. Other European countries where corporate governance is a popular theme, such as Germany and the Netherlands, are somewhere in the middle.⁵ Ranking of the relevant jurisdictions by the World Bank is based on the criteria defined by S. Djankov et al. in 2004 for legal protection of minority shareholders against self-dealing.⁶ Safeguards against expropriation through RPTs can consist of provisions that focus on either prevention of self-dealing (*ex ante* provisions) or measures and penalties after the fact (*ex post* provisions), or a combination of both. The

criteria used by Djankov et al. strongly focus on statutory *ex ante* provisions. This may explain why countries which rely on a strong judiciary to rectify such actions are ranked much lower.

The abuse of self-dealing is by its nature a behavioural issue which cannot easily be controlled, and is not always easy to trace if covered up or simply not or not fully disclosed by the company. One way to address the risk of RPTs is to prohibit such transactions or prescribe procedural requirements such as notification to and approval of RPTs by corporate bodies or to have such transactions be reviewed by courts of law in light of all the circumstances of the case at hand. The challenge of any strategy to address RPTs is that rules and procedures may be either too easy to circumvent, for example by just structuring the transaction in another way, or too strict and therefore unnecessarily block or complicate transactions beneficial to the company, and as a result lead to unnecessary economic constraints as well as administrative burden.⁷

To date, each of the various jurisdictions in the EU has its own procedures and measures which aim to prevent self-dealing and 'tunnelling' by controlling shareholders. Differences occur not only along the lines of the distinction between shareholder model versus stakeholder model, but are also dependent on other elements, such as whether or not corporations in the specific jurisdiction historically have dealt with the presence of controlling shareholders, which is the case in, for example, France and Italy. On the other hand, other jurisdictions such as the Netherlands do not have a long-standing tradition of controlling shareholders in listed companies.

* Email: I.C.P.Groenland@uva.nl.

1 Inter alia: Eric Friedman et al., *Propping and Tunneling*, 31 J.Comp. Econ. 732–50 (2003), www.sciencedirect.com.

2 OECD (2015), *G20/OECD Principles of Corporate Governance* (OECD Publishing Paris), <http://www.oecd.org/corporate/principles-corporate-governance.htm> (last reviewed 11 Jan. 2019), see Principles II under F and G.

3 <http://www.doingbusiness.org/en/rankings> and <http://www.doingbusiness.org/en/methodology/protecting-minority-investors>.

4 <http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB19-Chapters/DB19-Score-and-DBRankings.pdf>.

5 The overall global ranking of the countries indicated in the full report *Ease of Doing Business*: UK no. 9, Ireland no. 23, Germany no. 24, The Netherlands no. 36. Denmark ranks highest amongst all European countries in position no. 3, but does not score particularly high on minority investor protection.

6 Simeon Djankov et al., *The Law and Economics of Self-dealing*, 88 J. Fin. Econ. 430–65 (2008), www.sciencedirect.com.

7 See Alessio M. Paces, in *Rethinking Corporate Governance, the Law and Economics of Control Powers*, Chs 5 & 6 (Routledge 2012); and Alessio M. Paces, *Procedural and Substantive Review of Related Party Transactions (RPTs): The Case for Non-Controlling Shareholder-Dependent (NCS-Dependent) Directors*, ECGI Working Paper No. 3999/2018, May 2018, who refers to these risks as 'false negatives' and 'false positives' respectively.

The provisions on conflict of interests in statutory Dutch corporate law do not explicitly address transactions by controlling shareholders or close relatives of the board members or the senior management of the company. Conflict of interests provisions in the Netherlands focus on the members of the management board and the supervisory board. Any direct influence of a controlling shareholder, or any party closely related to the board members, on the businesses of a Dutch corporation is considered to be sufficiently constrained through the clearly defined fiduciary obligations of board members: the board and all its individual members are held to operate in the interests of the company and its various stakeholders (including its shareholders, but also the corporation's creditors, contract parties, employees and others who may be directly affected by actions of the company). Compliance with this principle and judicial review of how directors exercise their duties is with the courts, which are generally seen as accessible and effective in the measures they can take. Specifically the Amsterdam Enterprise Chamber (technically a branch of the Amsterdam Court of Appeal but which hears cases in first instance) may take a wide range of measures if minority shareholders feel their interests are neglected or adversely impacted by actions that favour majority shareholders. The Enterprise Chamber has in its case law proven it may intervene in contemplated transactions with related parties other than with only the board members themselves.⁸

It would seem fair to say that the jury is still out on whether jurisdictions (like the Netherlands) which rely on *ex post* protection by an active judiciary and not on *ex ante* protection through specific statutory rules and procedures as for example in the UK, provide less protection against RPTs. Yet the broader sentiment seems to be – and that sentiment seems to be reflected in the World Bank report and the underlying methodology – that the better approach is to enact specific rules and procedures in statutory law. This is reflected in the amended EU Shareholders' Rights Directive (AEU 2017/828⁹ (SHRD)) adopted in June 2017 which comes into force in June 2019. By that time the SHRD has to be implemented in the national laws of the EU Member States. I further analyse in this article the SHRD from the perspective of *ex ante* and *ex post* protection and how this may affect implementation in the respective national laws of the EU Member States.

2. ARTICLE 9C OF THE REVISED SHAREHOLDERS' RIGHTS DIRECTIVE

Although within the EU there is no explicit ambition to harmonize corporate governance rules for corporations in general, this certainly was the goal with regard to RPTs in listed companies at the time the discussions on the SHRD commenced. However, in its final

version the SHRD recognizes that EU Member States have diverging traditions in addressing RPTs, and therefore offers EU Member States a considerable number of options. Having said that, although the specifics in each Member State may differ, the SHRD provides for a relatively detailed framework that is to be adopted by all EU Member States.

The framework that the SHRD provides for, according to Article 9c of the SHRD, will require each EU Member State to implement legislation on (1) transparency and (2) approval of transactions by listed companies with 'related parties'. Such 'related parties' include board members, their closely related relatives, and controlling shareholders. The purpose of the framework is defined in order to safeguard the interests of the company and its stakeholders (including minority shareholders). Given the specific language of the SHRD, however, it seems fair to say that the main focus of the SHRD is the protection of the investment of in particular minority shareholders in listed companies with controlling shareholders.

The SHRD aims to achieve this protection of minority shareholders, in line with its focus on the reduction of agency costs for investors, by stipulating that EU Member States must provide for *ex ante* procedures on RPTs. The final date for implementation of the SHRD is 10 June 2019. In addition, EU Member States must provide for disclosure rules as well as rules on the decision-making process in relation to RPTs. The provisions apply to material transactions with related parties. Transactions that are within the scope of the ordinary business and on normal market terms are, in principle, exempted. Certain other exemptions are allowed, such as intra group transactions with subsidiaries of the relevant listed company. Circumvention of the criteria by breaking up a transaction into smaller pieces is restricted and transactions with the same related party within a twelve-month period or in the same financial year will be aggregated.

The idea of harmonization of the rules on RPTs seems to a great extent to have got lost in the negotiations on the SHRD. The SHRD in its final form includes many options for Member States to tailor the rules to their own governance principles. These tailoring options especially serve the needs of the more stakeholder-oriented countries, the framework of the provisions still echoing the spirit of its Anglo-US roots: the UK Listing Rules seem to have been the model for the preliminary drafts of the relevant provisions.¹⁰

Most significant in that respect is that EU Member States, albeit within parameters set by the SHRD (see Article 9c(1)) may each specify their own definition of a material transaction related to the transaction value or the position of the related party.

8 Illustrative examples in recent case law are the decisions of the Amsterdam Enterprise Court EC 24 Apr. 2017, ECLI:NL:GHAMS:2017:1626, (*Fortuna Forbet*) and EC 22 Dec. 2017, ECLI:NL:GHAMS:2017:5354, (*Intergamma*).

9 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

10 FCA Listing Rules 11.1 Related Party Transactions, <https://www.handbook.fca.org.uk/handbook/LR/11/1.html>.

3. THE DEFINITION OF MATERIAL TRANSACTIONS ACCORDING TO THE SHRD

The scope of Article 9c of the SHRD is restricted to ‘material transactions’, the specific definition of which is left to the member states themselves, albeit within certain parameters that are provided by the SHRD. The term ‘material transactions’ in the context of RPTs already is known in EU Member States, because of the disclosure obligation on RPTs in the annual accounts, based on IAS 24 standards. Since IAS 24 is relatively detailed in a number of countries, including the Netherlands, what is ‘material’ is not specified further.¹¹ This is potentially confusing as the term ‘material’ as denoted in the SHRD is not defined by IAS 24. On the contrary, in implementing the SHRD, EU Member States are free, although within the parameters mentioned, to define which transactions will qualify as ‘material’ within the scope of the SHRD, a definition that may be more restrictive or broader than anticipated in IAS 24.

Article 9c(1) provides:

- (1) *Member States shall define material transactions for the purposes of this Article, taking into account:*
- (a) *the influence that the information about the transaction may have on the economic decisions of shareholders of the company;*
 - (b) *the risk that the transaction creates for the company and its shareholders who are not a related party, including minority shareholders.*

When defining material transactions Member States shall set one or more quantitative ratios based on the impact of the transaction on the financial position, revenues, assets, capitalisation, including equity, or turnover of the company or take into account the nature of transaction and the position of the related party.

Member States may adopt different materiality definitions for the application of paragraph 4 than those for the application of paragraphs 2 and 3 and may differentiate the definitions according to the company size.

For a number of reasons this is a very interesting as well as intriguing method to attain a certain level of harmonization within the EU. The SHRD aims to achieve this not by prescribing a legal formula, but by mandating that EU Member States must devise specific legal rules on the basis of economic notions that the SHRD wants the Member States to consider. To that end paragraph 1(a) refers to the influence an RPT might have on the ‘economic decisions of the shareholders’. Such economic decisions are likely to be investment or divestment decisions of the investors, i.e. decisions to buy or sell the shares in a listed company. The criterion therefore

seems to refer to an effect of the transaction on the stock market price. Paragraph 1(b), broadens this approach and mandates Member States to also take into account ‘the risk that the transaction creates for the company and its shareholders’. The combination of these economic factors seem to imply a certain threshold for the application of the RPT provisions i.e. transactions that may have or are expected to have, at least some negative effect on the share price or value of the shares. On the basis of paragraph 1(b) legislators may further specify transactions which are believed to have such influence, although they may not necessarily always have that effect.

Subsequently, this raises the question how a definition of a ‘material transaction’ would relate to what is defined as ‘price sensitive information’ in Article 17 of the Market Abuse Regulation (MAR). This question may arise also if such a definition would not specifically refer to any effect on the stock price, and in that sense would deviate from the approach in the Netherlands (see below). Even then it may very well be the case that the disclosure of material RPT’s is price sensitive and therefore also required on the basis of Article 17 of the MAR. This interplay between the SHRD and the MAR is in general an interesting topic.^{12,13}

The second sentence of paragraph 1 allows EU Member States to relate the materiality criterion to the value of the transaction, the nature of the transaction, or the position of the related party. Also in this respect specific rules in the various EU Member States may differ. Basically what the SHRD allows for is that Member States may choose either strictly quantitative criteria or rather qualitative criteria. If the latter approach is preferred, a definition of a ‘material transaction’ within the meaning of the SHRD may not be fundamentally different from a definition of what a transaction that has to be disclosed under the MAR is. This is illustrated by the Dutch bill on implementation of the SHRD.

4. TRANSPARENCY ACCORDING TO THE SHRD

Once an RPT has been defined, a second important element is its disclosure to the relevant corporate bodies and shareholders, or investors, in general. Transparency on the existence of any RPTs seems to be vital to successfully prevent ‘tunnelling’. To that end the SHRD supplements the current rules on disclosure of RPTs in annual accounts of listed companies and requires that such RPTs be made public immediately after having been concluded. Obviously, this goes considerably beyond publication in the annual accounts, as publication in the annual accounts will only occur after the end of the financial year in which the transaction has taken place. If the transaction has caused harm to the company, this transaction can no longer be undone.

¹¹ See s. 2:381(3) Dutch Civil Code (DCC).

¹² Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 Apr. 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

¹³ Although the MAR is not explicitly mentioned in paras 1 and 2 of Art. 9c, the MAR is referred to in para. 9: ‘This Article is without prejudice to the rules on public disclosure of inside information as referred to in Article 17 of Regulation (EU) No 596/2014 of the European Parliament and of the Council’.

For this reason the SHRD requires that an intended transaction be disclosed no later than on the date of conclusion of the transaction.¹⁴ The SHRD does not, however, prescribe the formalities of the disclosure. According to the preambles to the SHRD (no. 44), public disclosure via the company's website could be sufficient. EU Member States may set additional requirements on the formalities of disclosure. Insofar as definitions adopted by Member States of 'material transactions' will have some overlap with transactions that need to be disclosed under Article 17 of the MAR, the administrative burden may be kept limited by not imposing other formalities than those required by the MAR. It must be noted, however, that the MAR allows for exemptions and delay of the disclosure in certain circumstances.¹⁵ Obviously, this option to delay the publication offered by the MAR will not be available in the case of an RPT after the SHRD is implemented in national law. As a result, if the intended RPT were to qualify as a transaction having a significant effect on the share price, the disclosures under the SHRD may be required at an earlier stage than required by the MAR.

According to Article 9c(2) of the SHRD, the disclosure must include further details on the transaction. The information to be disclosed must at least contain: *'the nature of the related party relationship, the name of the related party, the date and the value of the transaction and other information necessary to assess whether or not the transaction is fair and reasonable from the perspective of the company and of the shareholders who are not a related party, including minority shareholders.'*

One of the Member State options is that Member States may stipulate that the information to be disclosed include a report on the transaction.¹⁶ Such report must assess: *'whether or not the transaction is fair and reasonable from the perspective of the company and of the shareholders who are not a related party, including minority shareholders, and explaining the assumptions it is based upon together with the methods used.'*

According to Article 9c(3), the report may, but is not required to, be drawn up by an independent third party. Countries may prescribe that it may be produced by the management or the supervisory board, provided that if the related party is a member of the relevant board, the relevant party may not take part in the preparation of the report. The preparation of the report may also be entrusted to the audit committee or any committee the majority of which is composed of independent directors, provided of course that if the related party is a member of the relevant committee, such member does not participate in the preparation.

14 Art. 9c(2) SHRD.

15 Art. 17(5) MAR.

16 Art. 9c(3) SHRD.

17 See case law of the Dutch Supreme Court on this subject: SC 13 July 2007, NJ 2007, 434 (*ABN Amro*).

18 *Kamerstukken* 35058 no. 2, <https://zoek.officielebekendmakingen.nl/dossier/35058> <https://zoek.officielebekendmakingen.nl/dossier/35058>.

5. CORPORATE APPROVALS IN THE SHRD

An essential element of the SHRD is that 'material transactions' have to be approved by a relevant corporate body. In this respect Article 9c(4) of the SHRD requires that EU Member States:

shall ensure that material transactions with related parties are approved (...) according to procedures which prevent the related party from taking advantage of its position and provide adequate protection for the interests of the company and of the shareholders who are not a related party, including minority shareholders.

The SHRD does not require that RPTs be subject to approval by the general meeting; they may be subject to the approval of only the management or the supervisory board, provided that if the related party is a member of the relevant board, this party does not take part in the approval or the vote. If EU Member States prescribe that RPTs are subject to the approval of the general meeting, they must therefore either provide that the shareholder that is the related party in the relevant RPT may not take part in the approval or vote, or otherwise ensure the existence of appropriate safeguards against *'the related party from approving the transaction despite the opposing opinion of the majority of the shareholders who are not a related party or despite the opposing opinion of the majority of the independent directors.'* Such safeguard could, for example, consist of the requirement of a 'majority of minority vote', or the general meeting only has the right to veto a board resolution that has already been adopted, and does not have the authority to actually enforce it. An example of the latter is the approval of the general meeting that the management board of a Dutch public company (NV) may request a resolution to dispose of a subsidiary that is of such significant value that such disposal would change the identity or character of the company (section 2:107a Dutch Civil Code (DCC)). The shareholders' meeting does have a say, but entering into the transaction requires the affirmative resolution of the management board.¹⁷

6. DRAFT IMPLEMENTATION LEGISLATION IN THE NETHERLANDS

A bill was submitted to the Second Chamber of the Dutch parliament (*Tweede Kamer*) in October 2018¹⁸ on the implementation of the SHRD (the Bill). With respect to RPTs, the Bill may be qualified as quite efficient in addressing the formal requirements of the SHRD within the framework of the existing governance model and guiding principles prevalent in the Netherlands. The provisions in the Bill only apply to listed companies. Certain principles, like transparency towards shareholders, may however be more generally considered to reflect what is good governance for all companies including non-listed companies.

The Bill proposes to implement new rules required by the SHRD on RPTs in the Dutch Companies Act (a part of the DCC). The key subjects, as discussed below, include: (1) definition of material transactions, (2) transparency, and (3) corporate approvals of material transactions.

7. MATERIAL TRANSACTIONS IN THE NETHERLANDS

The Bill proposes¹⁹ that the provisions will only apply when two criteria are met: firstly, the transaction qualifies as inside information according to the MAR and secondly, it concerns a transaction that is concluded between the company and a related party (as meant in the IAS 24 standards²⁰), which in any case includes: (1) one or more holders of shares in the company that represent at least 10% of the issued share capital, and (2) members of the management or supervisory board of the company. The MAR requires that upon disclosure of certain facts or decisions, in this case the RPT, a *significant* effect on the stock exchange price is reasonably to be expected. The choice to align the definition with the MAR seems quite pragmatic: if both the RPT provisions and the MAR are applicable, the relevant disclosures may be combined in one.

In line with the SHRD, the proposed rules will not apply to the extent that material transactions are entered into in the ordinary course of business and at arm's length conditions. The supervisory board (or the board, in the case of a one-tier board structure) must establish internal procedures to assess whether this condition is met.

8. TRANSPARENCY IN THE NETHERLANDS

The Bill keeps the provisions on the disclosure obligations of RPTs by Dutch companies fairly simple. It introduces the obligation to disclose the information required according to Article 9c(2) of the SHRD. The Bill does not use the EU Member State option to prescribe that the disclosure must include a report on the transaction. The Explanatory Memorandum to the Bill explains that this is specifically intended to minimize additional administrative burdens. At the same time it is noted that of course a supervisory board should feel free to voluntarily draw up and publish a report if considered appropriate.²¹ The Bill does not prescribe any formalities applicable to the disclosure. The Explanatory Memorandum suggests that this can be done on the company's website, or by any other means that enables fast access, presumably making a reference to the requirements of Article 17 MAR which would require a press release. The transaction must be disclosed if and when the transaction has been concluded.

9. CORPORATE APPROVALS IN THE NETHERLANDS

The SHRD does not require that RPTs be subject to approval by the shareholders' meeting. According to the Bill, an RPT will have to be approved by the supervisory board of the relevant company. From a stakeholder perspective, the analysis under Dutch law is that a specific role for the shareholders' meeting is not justified. Directors of Dutch companies have to act in the interests of both the company and all its stakeholders, including minority shareholders, and the board is therefore obligated to take their legitimate interests into account when making its decisions, including whether or not to approve an RPT. From that perspective, passing on the authority to resolve on RPTs to minority shareholders may have a potentially adverse effect. The minority shareholders, not being subject to the principle that they must act in the corporate interests, could abuse an approval right to veto transactions just to frustrate the position of the controlling shareholder. The strengthening of their position by introducing shareholders' approval therefore is not deemed in the corporate interest. This may only be different if all board members were themselves to have a conflict of interest and should therefore not be allowed to resolve on whether or not to approve the RPT. Board members having a conflict of interest with respect to the RPT for which approval is sought, of course²² may not participate in the decision-making process and may not vote. If all board members were to have a conflict of interest, under Dutch law the authority to make a decision will transfer to the shareholders' meeting. In practice, it would seem very unlikely that such a situation would arise also in light of the provisions of the applicable *Dutch Corporate Governance Code 2016*,²³ which requires that a substantial number of the directors will need to be independent. The foregoing does not mean that the shareholders' meeting could not have a role to play. Under Dutch corporate law, substantial transactions (basically transactions with a value exceeding one-third of the total assets of the company) do need the approval of the shareholders' meeting. However, such rights of approval, and basically a right of veto, clearly are independent from and not affected by the SHRD.

10. CONCLUSION: IMPLEMENTATION OF THE SHRD AND HARMONIZATION

The Bill shows that the EU Member State options do serve the needs of the Netherlands as a stakeholder-oriented jurisdiction. The Bill does not interfere with the existing governance model, and adds certain additional procedural safeguards. It subjects RPTs that could have a significant negative effect on the share price to specific disclosure on the company's website at an early stage, and secures

¹⁹ Art. 167 Bill.

²⁰ <https://www.iasplus.com/en/standards/ias/ias24>; On the definition of 'related parties' in IAS 24: F. Leijten, *Transacties met verbonden partijen (a.k.a. 'transwakkies'): een proeve van richtlijnimplementatie*, in *Kort Juridisch, Liber amicorum Peter Wakke* 105–12 (H. J. de Kluiver, S. Perrick & I. Spinath eds, Red., Kluwer 2018).

²¹ *Kamerstukken* 35058, no 3, <https://zoek.officielebekendmakingen.nl/dossier/35058>.

²² S. 2:129(6) and (2) and s. 2:140(5) DCC.

²³ <https://www.mccg.nl/de-code>.

that such transactions are subject to approval by independent directors only. As both the management board and the supervisory board have to take into account the legitimate interests of the minority shareholders, the minority shareholders may be considered to be adequately protected against expropriation through RPTs.

One may therefore conclude that the structure of the SHRD, and the options it contains, is well designed and serves its purpose of preventing RPTs from adversely affecting minority shareholders while at the same time respecting the specifics of the corporate laws of EU Member States and tailoring the SHRD to their respective legal systems.

However, one may also take the opposite view and argue that the options in the SHRD undermine the underlying goal of

harmonization of procedures on protection of minority shareholders. Insofar as the initial intention of the SHRD was to further promote the attractiveness of investments in the EU by offering a clear and unified level of minority investor protection, this may not be achieved by the current SHRD. What ultimately will be the outcome of the process that the SHRD has initiated will probably also depend on the extent to which EU Member States in practice coordinate the implementation in the various Member States and in practice potentially achieve a level of harmonization that the SHRD itself cannot necessarily impose on the Member States. It will therefore be very interesting to monitor what the outcome of the implementation of the SHRD in the various Member States will be and how that evolves over time.