

Good Governance Code of Listed Companies

On February 24, 2015, the Spanish Securities Market Commission (the “**CNMV**”) published the new Good Governance Code of Listed Companies (the “**Code**”), prepared with the support of the Committee of Experts on corporate governance matters and approved in a resolution by the board of the CNMV on February 18.

The new Code has replaced the Unified Code of 2006, as revised in 2013 (the “**Unified Code**”), and completed the reform of the legislative framework for corporate governance in Spain, which started off with the recent reform of the Corporate Enterprises Law (*Ley de Sociedades de Capital*) in December, through Law 31/2014, of December 3, 2014, to enhance corporate governance.

The Committee of Experts began their task by drawing a distinction between the matters that should be proposed as enhancements to the legislative framework in force (which gave rise to Law 31/2014), from those more suited to taking the form of voluntary recommendations subject to the “*comply or explain*” principle, which are those set out in this Code.

The new Code contains 64 recommendations, whereas the June 2013 had 53. A total of 23 new recommendations have been added, 12 have been removed, after being included in the Corporate Enterprises Law, and 21 have been amended. The recommendations fall under three broad headings: general arrangements, shareholders’ meeting and board of directors.

The Code has been given a new format which is based on selecting and identifying 25 principles informing various concrete and specific recommendations.

Listed companies will be have to report, under the “*comply or explain*” principle, on their monitoring of the various elements included in the Code in the annual corporate governance reports they submit to the CNMV in 2016.

Shareholders, investors and the markets, in general, will be responsible for evaluating the explanations given by listed companies regarding not monitoring or only partially monitoring any of the recommendations that may apply to them.

1. Scope of application

The Corporate Governance Code is targeted at listed companies, meaning all those firms whose shares are traded on an official secondary market, regardless of their size and capitalization level.

Some recommendations expressly mention, however, they apply only to listed large cap companies.

2. Recommendations

2.1 *General arrangements*

The Code has kept in place without any changes the recommendations related to avoiding “anti-takeover bid” clauses in the bylaws (R1)¹ and the measures for cases where various listed companies belong to the same group (R2).

As new recommendations, the board chairperson should inform the shareholders’ meeting of all major changes concerning corporate governance that have occurred since the previous meeting and of the reasons for the company not implementing any of the recommendations (R3); and the company should define, promote and publish a policy for communication and contacts with shareholders, institutional investors and proxy advisors (R4).

Another new recommendation is that boards should make limited use of the delegated power to issue shares or convertible securities without pre-emptive subscription rights, in an amount not higher than 20% of the capital when the power was delegated (R5).

2.2 *Arrangements related to the shareholder’s meeting*

Various new proposals are made on this subject. The recommendations are to:

- Publish on their website, in advance of an annual shareholder’s meeting, the reports on auditor independence, on the operation of the audit committee and the nomination and remuneration committee, on transactions with related-parties and on the corporate social responsibility policy (R6).
- Broadcast its shareholders’ meetings live on the corporate website (R7).
- Display permanently on its website the requirements and procedures for admitting share ownership, the right to attend shareholders’ meetings, and the exercise or delegation of voting rights, and those requirements and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner (R9).
- Where a shareholder exercises the right to supplement the agenda or submit new proposals prior to the shareholders’ meeting, the company should immediately circulate the supplementary items and proposals, disclose the specimen attendance card or proxy appointment form duly modified, so that the new agenda items and alternative proposals can be voted on under the same rules as those submitted by the board of directors (R10).
- If a company plans to pay for attendance at the shareholder’s meeting it should first establish a general, long-term policy on attendance payments (R11).

¹ The initial R will be used to refer to the Recommendations throughout this paper: R1 = Recommendation 1^a

2.3 Board of Directors

On the subject of the board's responsibility, the new recommendations state, in line with the Unified Code, that the board should perform its duties with unity of purpose and be guided by the company's best interest, to be construed broadly, as the creation of a profitable and sustainable business in the long term that promotes continuity while maximizing the company's economic value, and striving to reconcile its own interests with the legitimate interests of its stakeholders, those of the boarder community and concerning the natural environment (R12).

There has been little alteration to the recommendations concerning the size and members of the board, and the removal and resignation of directors. Below are the most important changes that have been added:

- The board should approve a director selection policy that favors diversity of knowledge, experience and gender; it should inform the shareholders' meeting of this; and it should pursue the goal to have women in at least 30% of the places on the board (R14).
- At least half of all the board members should be independent directors; however, where the company does not have a large market capitalization, or where a large cap company has shareholders individually or concertedly controlling over 30 percent of capital, it is allowed for independent directors to occupy, at least, a third of all board places (R17).

Several of the recommendations in the Unified Code regarding the operation of the board have also been reproduced, and the main new additions concern the following:

- At least eight board meetings should be held in a year (R26).
- The agenda should indicate clearly on which points the directors must adopt a resolution, so that they can study the matter beforehand and gather together the material they need; where, however, for reasons of urgency the chairperson submits decisions for board approval that were not on the meeting agenda the prior and express consent of the majority of the directors present should be obtained (R31).
- Directors should be informed of movements in share ownership and of the views of the major shareholders, investors and rating agencies on the company and its group (R32).

In relation to positions on the board, the recommendations concerning the chairman and secretary have been redrafted (since a large part of the previous recommendations on this subject have been moved to the Corporate Enterprises Law) and, basically, the recommendation concerning the lead director has been amended to add additional powers to those envisaged in the law, such as to: chair board meetings in the absence of the chairman or vice chairmen (if any); voice the concerns of non-executive directors; contact investors and shareholders to hear their views so as to form an opinion on their concerns, especially those to do with the company's corporate governance; and coordinate the chairman's succession plan (R34).

In relation to the evaluations conducted by the board, the recommendations in the Unified Code have been implemented, notably that at least every three years the board should engage an independent external consultant to assist with its evaluations (R36).

Concerning the evaluation of board committees, the recommendations in the Unified Code have largely been kept, with the following main changes:

- Most of the members of the audit committee and the nomination and remuneration committee should be independent directors (R39 and R47).
- Under the supervision of the audit committee, the unit in charge of the internal audit function should report functionally to board's non-executive chairman or the chairman of the audit committee (R40).
- Some new functions have been added in relation to the audit committee, such as ensuring that the external auditor has a yearly meeting with the board to inform it of the work undertaken and developments in the company's risk and accounting positions; or that the audit committee should be informed on any structural changes and corporate transactions that the company plans to perform (R42 and R44).
- Further details are given on the recommendations for the internal risk control and management tasks and their powers of those in charge (R46).
- Large cap companies should operate separately formed nomination and remuneration committees (R48).
- Additional functions have been included to those conferred in the law for the nomination and remuneration committee, such as to review the remuneration policy for directors and senior officers, ensure that any potential conflicts of interest do not undermine the independence of any external advisors the committee engages and verify the information on directors' and senior officers' pay contained in corporate documents (R50).
- Recommendations have been included on the rules on the members and operations of other supervision committees which may be formed in line with those governing legally mandatory board committees (R 52).

One of the most notable new features of the Code is the inclusion of specific recommendations on corporate social responsibility ("**CSR**")². The recommendations are basically:

- The CSR policy together with the rules on corporate governance and in the internal codes of conduct should be included as a matter to be supervised by any of the committees, including a list of the functions that committee must deal with in those areas (R53).
- There should be a CSR policy with the recommended minimum contents (R54).
- Information should be given in a separate document, or in the directors' report, on CSR-related matters, for which some of the internationally accepted methods and systems should be used (R55).

² In its report of May 19, 2006, the special working group on good corporate governance excluded matters relating to corporate social responsibility from its remit in relation to the Unified Code.

Lastly, the Code contains nine recommendations on directors' remuneration, based on the general principle that remuneration must be in the necessary amount to attract and retain directors with the desired profiles, but not so high as to compromise the independent judgment of non-executive directors and the necessary mechanisms should be adopted to avoid excessive risk-taking. This principle is implemented in nine recommendations which further and supplement those set out in the Unified Code. Most notably, the following:

- Guidelines and standards in relation to variable remuneration items have been included (R58).
- The payment of a portion of the variable remuneration items should be deferred for the length of time required to confirm that the predetermined performance criteria have been fulfilled (R59).
- A major part of executive directors' variable remuneration should be linked to the award of shares of financial instruments having a value is linked to the share price (R61).
- Except in specific scenarios, it is proposed that following the award of shares, stock options or other rights in shares, directors should not be allowed to transfer a number of shares equivalent to twice their annual fixed remuneration, or to exercise the stock options or other rights in shares for at least three years after their award (R62).
- Clauses should be added that allow the company to reclaim variable remuneration items where payment was out of step with the director's actual performance based on data later found to be misstated (R63).
- It is recommended to place a limit on termination payments so that they cannot exceed an amount equivalent to two years of the directors' total annual remuneration (R64).

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