The reform that encourages long-term shareholder engagement at listed companies has been approved and it introduces amendments in terms of corporate governance and the functioning of capital markets

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The Spanish parliament has approved the Law amending the Companies Act (Legislative Royal Decree 1/2010, of July 2, 2010) and other pieces of financial legislation, as regards the encouragement of long-term shareholder engagement at listed companies.

The purpose of the law is the transposition into Spanish law of 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. The law also takes the opportunity to introduce other important amendments and changes into Spanish law, above all in relation to corporate governance and to encourage and enhance the functioning of capital markets.

Key changes:

- It sets out the **regime for related-party transactions** systematically, new rules are introduced for the approval of these transactions and transparency is enhanced. The approval of **intra-group transactions** is made easier, in line with the legislation in the main European countries.
- Listed companies are allowed to introduce **loyalty shares with double voting rights** in their bylaws.
- **Virtual-only shareholders' meetings** are allowed to be held for all capital companies including listed companies.
- The appointment of **legal persons as directors of listed companies is banned**.
- Rules are introduced on the right of listed companies to know **the identity of the ultimate beneficiary owners** and enabling them to exercise rights.
- The transparency of **institutional investors and asset managers** is enhanced.
- The role of **proxy advisor** is regulated for the first time.
- New rules are introduced to **speed up and add flexibility to processes for issuing shares and convertible bonds** at listed companies and companies that are in the process of making an IPO.
- The obligation for listed companies to publish **quarterly financial information** is removed.
- It lays down that new **remuneration policy** proposals have to be approved before the end of the last fiscal year in which the policy in force applies.
- In relation to takeover bids, the offeror is required to have reached, at least, 75% of the voting share capital of the target company for it to be able to **delist the company without having to make a delisting takeover bid**.
- A number of **corporate governance obligations** are streamlined and revised.

Special regime for related-party transactions

a) Regime applicable to listed companies

- **Definition of related-party transaction:** those performed by the company or its subsidiaries with (i) directors, (ii) shareholders owning 10% or more of the voting rights (until now the threshold was 3% due to referring to shareholders owning a "significant interest") or represented on the board of directors, or (iii) any other persons who must be considered related parties under IAS[1].

- **The following are not considered to be related-party transactions:**

  i. transactions performed between the company and its wholly owned subsidiaries[2],

  ii. the approval of contracts of executive directors and senior managers,

  iii. transactions concluded by credit institutions based on measures designed to safeguard their stability, adopted by the competent authority responsible for prudential supervision within the meaning of EU law, and

  iv. any transactions that a company carries out with its subsidiaries or participated entities, provided that no other party related to the company has interests in those subsidiaries or participated entities.

- **The authority to approve related-party transactions belongs**

  i. to the shareholders' meeting where they involve a sum equal to or above 10% of the assets, and

  ii. to the board of directors in all other cases, which cannot delegate that authority, except in relation to (a) intra-group transactions performed within the ordinary course of business and on arm's length terms or (b) standard contracts which are applied en masse to a high number of customers and do not involve sums exceeding 0.5% of net sales/revenues.

- **Audit committee's report:** the audit committee has to issue a report before the approval of any related-party transaction by the shareholders' meeting or the board. The report is not necessary where the authority to approve the transactions has been delegated, although the board of directors has to establish an internal control procedure, with intervention and supervision by the audit committee.

- **Voting by any shareholder with a conflict of interest:** if the shareholders' meeting has the authority to approve a related-party transaction, any shareholder affected by a conflict of interest will not be able to vote, **unless** the proposed resolution has been approved by the board **and a majority of the independent directors did not vote against it**. In the event of a challenge of the resolution, in qualifying cases the so-called "entire fairness test" is applicable, which shifts the burden of proving that the resolution is consistent with the company's corporate interest.

- **Flexibility added to the approval regime for intra-group transactions:** where the board is responsible for approving a related-party transaction, any director affected by a conflict of interest, or anyone representing a shareholder affected by a conflict of interest, will not be able to vote.

[1] International Accounting Standards adopted by Regulation (EC) 1606/2002, of July 19, 2002.

[2] The reference to "*without prejudice to the provisions in article 231 bis*" is a technical error in the law: article 231 bis LSC contains the rule shifting the burden of proving that the resolution is consistent with the company's interests in relation to the approval of intra-group transactions subject to a conflict of interest. Moreover, the Preamble to the law makes it clear that the regime in article 231 bis LSC is not applicable to transactions between wholly owned companies because by definition they are not subject to a conflict of interest.

Directors representing or related to the parent company are able to vote at the board meetings of a listed subsidiary company. In the event of a challenge of the resolution, however, if their vote was decisive for adoption of the resolution the entire fairness test will apply, which shifts the burden of proving that the resolution is consistent with the company's corporate interests[3].

- **Transparency:** companies must give public notice (on their websites and through the CNMV), when they are concluded at the latest, of any related-party transactions that are equal to or exceed the following thresholds (i) 5% of total assets, or (ii) 2.5% of annual net sales/revenues. The notice must be accompanied by the audit committee's report.

- **Calculation rules:** for the purposes of calculating the thresholds determined for approval and publication, all transactions performed with the same counterparty in the previous twelve months must be added.

b) Rules applicable to all companies

- **Intra-group transactions subject to a conflict of interest** (transactions that the company performs with its parent company or other companies in the same group):

  - The authority for approval belongs

    i. to the shareholders' meeting where the transaction falls within its power and, in all cases, where it involves a sum equal to or above 10% of the company's assets, and

    ii. to the managing body in all other cases, which may delegate this authority in the case of transactions concluded in the ordinary course of business.

  - Flexibility added to the regime for approval subject to the entire fairness test: directors representing the parent company will be able to vote which will greatly simplify the running of Spanish groups of companies.

  - A reservation has been introduced, however, determining that in the event of a challenge of the resolution, if their vote had been decisive for its approval the entire fairness test is applicable, which shifts to the company and to the directors the burden of proving that the resolution is consistent with the company's corporate interest and that they acted with the required standard of care and loyalty.

  - The transactions performed by the company with its subsidiaries are not considered to be transactions subject to a conflict of interest, unless the subsidiary has a significant shareholder in relation to whom the regime for related-party transactions must be applied.

- **The spectrum of persons related to directors has been broadened**, to include

  i. companies in which the director owns an interest giving them significant influence (which is presumed to be 10% or higher) or holds a position on the managing body or in senior management (the LSC used to refer to this scenario as the existence of control), and

  ii. expressly for the first time, shareholders represented by the director on the managing body.

[3] The law determines that in this case the rule set out in article 190.3 LSC applies "*in analogous terms*". However, the correct article that it should have mentioned is the new article 231 bis.2 LSC.

Loyalty shares with double voting rights

- **Definition:** loyalty shares confer a double voting right to every share that has been owned uninterruptedly by the same shareholder for two consecutive years.

- **Requirements for obtaining double voting rights:** it is necessary (i) for the company to include the loyalty shares in its bylaws (opt-in system), (ii) for the shareholder to have first entered their shares on the special register that the company must create for this purpose, and (iii) for the shareholder to own the shares uninterruptedly for two consecutive years from the date of entry on the special register. The bylaws can lengthen, but they cannot shorten, the loyalty period required to obtain double voting rights.

- **Quorum and reinforced majorities for their inclusion in bylaws:** this requires the affirmative vote at a shareholders' meeting of at least (i) 60% of the capital present or represented, if the meeting is attended by shareholders representing 50% or more of the total subscribed share capital with voting rights, and (ii) the affirmative vote of 75% of the capital present or represented, if the meeting is attended by shareholders representing 25% or more of the capital up to 50%.

- **Term and removal:** the bylaws provision on loyalty double voting rights must be renewed every five years by the shareholders' meeting. After the end of ten years, it may be removed by the shareholders' meeting, in relation to which the double voting rights will not count for the purposes of quorums and majorities.

- **Transparency:** the company must report to the CNMV the number of shares with double voting rights existing from time to time, together with the registered shares for which the specified loyalty period has not yet been fulfilled, and publish this information on its corporate website (which must be kept updated at all times).

- **Encouragement of IPOs:** any companies applying for admission to listing of their shares on a regulated market may include loyalty shares in their bylaws with effects from the date of admission to listing, so that double voting rights may be granted to shareholders who evidence that they have owned their shares uninterruptedly for the immediately preceding two years.

- **Loyalty double voting rights are taken into account** for the purposes of the **quorum and voting majorities** at shareholders' meetings. Also for the purposes of the obligation to report **significant interests** and of the legislation on **takeover bids**.

  Consistently with this last point, the law has introduced a **new scenario of unintentional takeover bid** in the Securities Market Act (added to those set out in article 7 of Royal Decree 1066/2007, of July 27, 2007 on takeover bids) as a result of the variation in the number of voting rights.

Virtual-only shareholders' meetings

- **Option to hold virtual-only shareholders' meetings for all companies, including listed companies:**

  - A provision in the bylaws is needed: the amendment must be approved by the shareholders' meeting with a reinforced majority of two-thirds of the capital, present or represented.

  - The meeting will be deemed to have been held at the registered office.

- Requirements: (i) appropriate assurance must be obtained of the identities of the shareholders and their representatives, and (ii) all those attending must actually be able to participate (to exercise in real time the rights to speak, propose and vote and to follow speeches). To that end, the directors must implement the necessary technical measures by reference to the state of the art and the company's circumstances, especially the number of shareholders.

- Listed companies: it is required (i) that shareholders must be able to delegate their vote or vote in advance, and (ii) that the meeting minutes must be issued by a notary.

- **Option for remote attendance at S.L. companies:** S.L. (i.e. Spanish limited liability companies) are also allowed to provide for remote attendance of shareholders' meetings in their bylaws.

Ban on appointing legal entity's as directors of listed companies

- **Legal entities will not be able to be directors of listed companies**, the only exception being companies belonging to the public sector.

Remuneration of executive directors at listed companies

- **Timing for approval of the remuneration policy:** proposals for new remuneration policies must be submitted for approval by the shareholders' meeting at the end of the last fiscal year in which the remuneration policy in force is applicable. The shareholders' meeting may determine that the new policy will become applicable on the date of its approval, and for the following three years, or from the beginning of the following fiscal year.

- **The consequence of rejection of the proposal of a new remuneration policy is expressly stated:** the company will continue remunerating its directors under the remuneration policy in force and must submit a new proposal for approval by the following annual shareholders' meeting.

- **Rejection by the shareholders' meeting of the annual directors' remuneration report (IARC):** if the IARC is rejected in the consultative vote at the annual shareholders' meeting, the company is only allowed to continue applying the remuneration policy in force until the following annual shareholders' meeting (under the previous regime, in the event of rejection, the applicable remuneration policy for the following year had to be submitted for approval by the shareholders' meeting before its approval, even if the three-year period had not elapsed).

- **Increased compulsory contents of the remuneration policy and of the IARC.** In particular, the IARC must include information on the total annual amount earned and the variation experienced in the year in the following categories: the remuneration of each director, the company's performance and the average remuneration on a full-time basis for workers other than directors for at least the most recent five years, presented jointly to enable comparison.

- **Executives remuneration within the bylaw framework:** changes are included to try to adapt the provisions relating to executives remuneration at listed companies to the Supreme Court judgment of February 26, 2018 (contrary to the predominant legal doctrine and the doctrine of the Directorate-General of Registries and the Notarial Profession), which concluded that any remuneration received by directors (including executive directors) must be subject to the bylaws reserve and therefore subject to the control of the shareholders' meeting.

Right to know the identity of shareholders and beneficial owners

- **Right to know the identity of ultimate beneficial owners:** a right is introduced for listed companies to know, in addition to the identity of its shareholders, the identity of its ultimate beneficial owners (i.e. person on behalf of whom the intermediary company authorized as shareholder as a result of the book entry acts, directly or through a chain of intermediaries), this can be requested directly from the intermediary entity or through the central securities depository.

  This right will also be held by associations of shareholders representing, at least, 1% of the share capital and any shareholders holding individually or jointly an interest of at least 3% of the share capital.

- A few practical elements are regulated to **enable the transfer of information and enable ultimate beneficial owners to exercise their rights**.

- **Electronic voting:** the electronic confirmation of receipt of their votes must be sent to shareholders. A shareholder and a beneficial owner may request confirmation that their votes have been correctly computed in the month following the shareholders' meeting date.

Proxy advisors

- **Rules are provided on proxy advisors:** certain transparency and disclosure obligations are imposed on them and it is specified that they are subject to the CNMV's supervision regime.

Prospectus

The Securities Market Act is amended to adapt its provisions to Regulation (EU) 2017/1129 (the "**Prospectus Regulation**") which, since July 21, 2019, has been directly applicable in Spain. Royal Decree 1310/2005 is not expressly repealed, so it may be interpreted that any of its provisions that do not contradict the provisions in the Prospectus Regulation and the Securities Market Act remain in force.

- **Definition of public offering:** the law moves on from the definition of "non public offering" under Royal Decree 1310/2005 to introduce that of a "public offering exempt from the obligation to publish a prospectus", in line with the provisions in the Prospectus Regulation.

- **Amount-based exemption from the obligation to publish a prospectus:** exercising the discretion conferred by the Prospectus Regulation, Spanish legislators have chosen to exempt from the obligation to publish a prospectus any offerings in which the total amount is below eight million euros, generally, and five million in cases involving credit institutions (until now the threshold was five million generally).

- **No prospectus will be needed for the issuance or admission to trading of promissory notes at under 365 days:** although in the Prospectus Regulation it is clear that a prospectus is not needed in relation to these instruments (they are not considered to be securities according to its provisions), the obligation continued to be contained in Royal Decree 1310/2005, so the clarification was necessary. In any event, a requirement is introduced for the intervention of an entity authorized to provide investment services to validate the information to be provided to investors and supervise the marketing process.

- **The CNMV is allowed to request a prospectus** in cases where the legal requirements for exemption are fulfilled, and in light of the complexity of the issuer or the financial instrument offered[4].

- **Liability regime:** the liability regime provided in the Securities Market Act before the Prospectus Regulation came into force has been retained in general terms. In particular, the liability of the lead arranger in respect of the verification tasks they perform, which is not contemplated in the Prospectus Regulation, is retained in the Securities Market Act.

Voluntary delisting of shares following the making of a takeover bid

- A **requirement** is introduced **involving the offeror having to have reached at least 75% of the voting rights** of the target company of the takeover bid in order to be able to apply for the option set forth in **article 11.d) of Royal Decree 1066/2007**, of July 27, 2007 on takeover bids, in other words, in order for the company to be able to decide to carry out a voluntary delisting of shares without having to make a delisting takeover bid.

Capital increases and issuance of convertible bonds by listed companies

- **Exercise period for preferential subscription rights:** the minimum period for exercising preferential subscription rights is shortened from 15 to 14 calendar days. It is not possible to establish a period shorter than 14 days as imposed by Directive (EU) 2017/1132[5].

- **Capital increase processes made quicker:** the capital increase resolution may be registered before it has been implemented (*ejecución*). Shares issued in a capital increase may be reported to Iberclear, and therefore transferred, once the capital increase resolution has been registered and the notarial deed for its performance (*ejecución*) has been executed (which is allowed not to include subscribers' identities), without needing prior registration of this deed at the Commercial Registry.

- **Incomplete subscription:** unless agreed otherwise, the capital increase will take effect, even if it was not complete.

- **Independent expert's report:** is necessary to be able to exclude preferential subscription rights in connection with share capital increases where (i) the total amount of the issue is above 20% of the share capital, or (ii) the 20% threshold is not reached, but the issue price is below fair value (listing value and up to 10% lower). The issuance of convertible bonds shall not require independent expert report if it does not reach 20% of the share capital.

- **Reduction of the limit for delegating the authority to exclude preferential subscription rights (authorized share capital):** the delegation of authority by the shareholders' meeting to the board for the issuance, jointly, of shares or convertible bonds with the exclusion of preferential subscription rights cannot relate to more than 20% of the share capital at the time of the delegation (in connection with convertible bonds, the limit relates to the maximum number of shares in which convertible bonds can be converted).

- **Issuance of CoCos**: the 20% limit[6] for delegating the power to exclude preferential subscription rights in issuances of CoCos (contingent convertible bonds) by financial institutions does not apply if they qualify as additional tier 1 capital instruments under the applicable prudential legislation.

[4] It is questionable whether a prospectus may be required in cases that have been expressly exempted by the Prospectus Regulation.

[5] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law.

[6] This appears incorrectly in the law as 25%.

- **IPOs**: the new rules and, broadly speaking, the regime applicable to capital increases at listed companies will be applicable to capital increases at listed companies that increase capital before the first listing of their shares on a regulated market or on BME Growth.

Obligation to file the issuance document with the CNMV removed

- **Quicker listing and issuance procedure for securities:** the obligation to file the issuance document (*documento de la emisión*) for securities represented by book entries with the CNMV has been removed (it will only need to be filed with Iberclear and the market governing board). This was done to make the Spanish market more competitive (it was a peculiar feature to Spain) and reduce issuance costs.

Quarterly reports

- **The obligation to publish quarterly financial information has been removed for listed companies**. However, (i) issuers may continue publishing quarterly information voluntarily and (ii) the CNMV is allowed to request publication of this information in exercising its function of verifying periodical information.

Increased transparency required of asset managers and institutional investors

- **Engagement policies of asset managers:** asset managers (collective investment undertaking management companies -SGIICs- and closed-end type collective investment undertaking management companies -SGEICs-) and investment services firms and credit institutions providing discretionary portfolio management services[7] must (i) prepare and publish an engagement policy describing how their engagement as shareholders of the listed companies in which they invest is integrated in their investment policies, and (ii) report annually on how they have applied their engagement policies, how they have exercised their voting rights at the shareholders' meetings of listed companies and whether they have engaged proxy advisors.

- **Investment strategy of institutional investors:** any collective investment undertaking management companies (SGIICs) and closed-end type collective investment undertaking management companies (SGEICs) that invest in listed shares on behalf of insurers or employee pension plans or funds under asset management agreements must report annually to them on how their investment strategy and the way in which it is applied are consistent with the management agreement and contribute to medium and long term performance of the assets of those companies.

Amendment to directors' duty of care

- It is added that directors must **put the "interests of the business" before their own personal interests**[8].

[7] The obligations contained in the Directive in relation to the insurance industry were transposed in Royal Decree-Law 3/2020, of February 4, 2020, amending, among other pieces of legislation, Law 20/2015, of July 14, 2015, on the regulation, supervision and solvency of insurers and reinsurers and Legislative Royal Decree 1/2002, of November 29, 2002, approving the revised Pension Plan and Fund Act.

[8] The provision has mistakenly been included in their duty of care instead of their duty of loyalty.

Other key amendments in the field of corporate governance

- The corporate governance obligations of Spanish corporations (*sociedades anónimas)* whose shares are not listed on a Spanish regulated market, but only on a regulated market in the EU or EEA or on equivalent markets in a third country are streamlined.

- The information to be included in the annual corporate governance report (**IAGC**) has been increased. In particular, it must contain a list of the director/senior manager positions held at other entities and information on other remunerated activities of directors.

- The obligation to prepare the IAGC has been removed for securities issuers who are not listed companies, in an attempt to attract fixed-income issuers.

- Companies issuing securities which are not listed companies must have a nomination and remuneration committee, except when they are exempt from the requirement to set up an audit committee.

- Listed companies must include the IARC, in addition to the IAGC, in the management report.

- The exemptions from the obligation to set up an audit committee are toughened for public interest entities that are subsidiaries of another public interest entity.

Entry into force of the law and transitional regime

The law will enter into force twenty days after its publication in the Official State Gazette (BOE). However:

- The amendments relating to the **remuneration policy** will come into force after the end of six months from its publication in the Official State Gazette (BOE). Companies will have to submit their remuneration policies adapted to those amendments for approval by the first shareholders' meeting to be held after that date.

- The **additional mandatory contents of the IARC** will be applicable to annual directors' remuneration reports for fiscal years that ended on or after December 1, 2020[9].

- The new **regime for related-party transactions** applicable to listed companies will come into force at the end of two months following the entry into force of the law.

- The requirements for the **directors of listed companies to be individuals** will be applicable for appointments, including renewals, taking place after the end of a month following its publication in the Official State Gazette (BOE).

[9] This appears to be an error and should be on or after December 31, 2020.