LAW TO ENCOURAGE LONG-TERM SHAREHOLDER ENGAGEMENT IN LISTED COMPANIES: MAIN AMENDMENTS

29 MARCH 2021

KEY ISSUES

The Spanish Senate, sitting in full session (*pleno*), approved on 24 March 2021 the Draft Law (*Proyecto de Ley*) to amend the revised text of the Spanish Companies Law, approved by Royal Legislative Decree 1/2010 of 2 July, and other financial regulations, to encourage long-term shareholder engagement in listed companies (the "**Law**") without amending the text submitted by the House of Deputies (*Congreso de los Diputados*)[1]. The Law, further to transposing the so-called SRD II[2] Directive, includes other important amendments. We highlight the following:

- **Remote-only shareholders' meetings:** the L**aw introduces the possibility of holding shareholders'** meetings only remotely.
- **Related-party transactions:** the Law eases the regime for related-party transactions within a group of companies, and removes the mandatory abstention of proprietary directors who have a conflict of interest. Additional procedural and transparency duties are set out for listed companies and, under certain conditions, related-party transactions need not be approved by the board of directors.
- **Loyalty shares**: the Law introduces double voting shares for listed companies that decide to do so (**opt-in**), allowing significant shareholders who commit to the long term (two years) to strengthen their shareholding position (e.g. **a shareholder with a 17% stake could have voting rights representing up to 29%, if no other shareholders request double voting shares**). In addition, double voting may be retained if the shares are transferred through a structural modification (merger, spin-off, etc.). Companies going public can have loyalty shares upon listing.
- **Easing the regime for share capital increases and issue of convertible notes in listed companies**: the period for exercising pre-emptive subscription rights is reduced to 14 days and, where pre-emptive subscription rights are excluded and the amount issued does not exceed 20% of the share capital (and, in the case of share capital increases, if the discount is less than 10% of the trading price), an independent expert's report will no longer be required.
- **Encouraging shareholder engagement**: asset managers and other institutional investors are required to disclose their shareholder engagement policies and the manner in which they are implemented. The Law also develops the right of issuers and certain shareholders to know the identity of shareholders and ultimate beneficial owners.
- **Remuneration**: a greater level of detail in remuneration policies and the annual report on directors' remuneration is required. Reference is also made to the fact that **remuneration for executive functions** in listed companies should, not only be in accordance with the remuneration policy, but also with the articles of association. It cannot be ruled out that this unnecessary addition – given that the policy is already approved by the shareholders' meeting – could potentially end up being used to demand that the articles of association more precisely regulate the directors' remuneration for executive functions and that this lack of precision could be used to question its tax deductibility**.**

➢ The text submitted by the House of Deputies and approved by the Senate (unaltered) is available in Spanish at this link.

[1] The law is pending publication in the Official Gazette of the Spanish Parliament (*Boletín Oficial de las Cortes Generales*) and in the Spanish Official Gazette (*Boletín Oficial del Estado*) (BOE). The final version may correct some typographic errors.

[2] 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.

1. REMOTE-ONLY SHAREHOLDERS' MEETINGS

Companies may hold general meetings **only remotely**, without physical attendance of shareholders or proxy holders, if so provided by the articles of association and when approved by the management body upon calling the meeting. The amendment to the articles of association to provide for such possibility requires the favourable vote of two thirds of the share capital in attendance at the meeting, either in person or by proxy. This type of meeting requires that (i) the shareholders' and their proxies' identity and rights to attend are guaranteed; and (ii) that all the attendees can participate at the meeting through appropriate remote means of communication that enable them to exercise their rights in real time and follow other attendees' discussions.

In listed companies it will furthermore be required (i) that shareholders are able to vote or grant a proxy prior to the meeting by post, email or other form of distance communication that fulfils a set of requirements; and (ii) the minutes of the meeting are drawn up by a notary public.

2. RELATED-PARTY TRANSACTIONS

Competent body for the approval of related-party transactions: the management body retains the general power with the following exceptions:

(i) **if the value of the transaction is equal to or greater than 10% of the assets**, according to the last balance sheet approved by the company, it must be approved by the **general shareholders' meeting**; and

(ii) the authorisation of certain ordinary related-party transactions or those that do not reach particular materiality thresholds may be delegated if there are control mechanisms for monitoring compliance.

The significant shareholder as a person related to the "proprietary" director in unlisted companies: in unlisted companies, the definition of individuals related to directors is extended to include, as in listed companies, shareholders who have a representative in the management body.

Transactions considered as related-party transactions in listed companies: in listed companies, related-party transactions are those carried out by the company or its affiliates with:

(i) directors;

(ii) shareholders who hold 10% or more of the voting rights or who are represented on the board of directors of the company; and

(iii) other individuals who must be considered as related-parties in accordance with IAS 24, which includes, in particular, senior managers.

In addition, it is clarified that the following shall **not be deemed to be related-party transactions**: (i) those carried out by the company and its **wholly-owned subsidiaries**; (ii) those carried out by the company and its **subsidiaries or affiliates**, provided that no other related-party of the former holds an interest in the subsidiaries or affiliates; (iii) the executive directors and senior managers' agreements; and (iv) those carried out by **credit institutions** on the grounds of being aimed at **safeguarding their stability**, adopted by the competent authority responsible for the prudential oversight under European Union law.

Proprietary directors of the group can vote even if they have a conflict of interest: in both listed and unlisted companies, directors who have a conflict of interest are allowed to vote on related-party transactions between companies of the same group. If their vote is decisive and the transaction is challenged, those directors and the company itself must prove that the transaction was in the company's best interest (thereby reversing the burden of proof).

Relevance of the vote of independent directors in listed companies on related-party transactions submitted to the general shareholders' meeting: with regard to listed companies and the related-party transactions that must be submitted to the general shareholders' meeting (those exceeding 10% of the assets), in order for the director who has a conflict of interest to be able to vote at the meeting, the transactions must first be approved by the board without the majority of independent directors voting against it.

Mandatory engagement of the audit committee in listed companies: before the board or the general shareholders' meeting approves the transaction, as appropriate, the audit committee must prepare a prior explanatory report in the case of listed companies, without the directors who have a conflict of interest being involved, to confirm that the transaction is fair and reasonable from the perspective of the company and external shareholders.

Additional disclosure requirements for listed companies: listed companies must disclose related-party transactions (of the company or the entities of its group) that reach or exceed 5% of the assets or 2.5% of the annual turnover, (i) as soon as

they are agreed; (ii) through the website of both the company and the Spanish National Securities Market Commission; and (iii) including the audit committee's report.

Entry into force of the rules for listed companies: the new rules on related party transactions for listed companies will enter into force two months and twenty days after the publication of the Law in the BOE.

3. LOYALTY SHARES

Shareholders of listed companies may have double voting rights for their shares if the following conditions are met:

(i) **Company's decision**: that the issuer, by means of a general shareholders' meeting resolution passed by a qualified majority, includes the concept of loyalty shares (opt-in) in its articles of association.

(ii) **Shareholder's decision**: that the shareholder concerned holds the shares uninterruptedly for a minimum of two years as from registration in a special register (the articles of association may require a longer holding period).

(iii) **Shareholder's prerogative**: the double vote will be limited to those shares that the shareholder expressly indicates and the minimum holding period will only begin when the shareholder requests their registration in the special share register for shares with double voting rights. The shareholder may waive the double voting right at any time. The aforementioned special register will be available to all shareholders.

Issuers that adopt the loyalty share regime must include **updated information** on their website on the number of shares with double voting rights existing from time to time, as well as those registered shares which loyalty period provided for in the articles of association is pending completion.

Double voting rights will generally terminate when the shares are transferred, except in the case of intra-group transfers, transfers between family members (except in the case of controlling shareholders, whose double-voting shareholder status will be put to a vote) or, under certain conditions, transfers through structural modifications.

Loyalty shares must be taken into account for the purposes of, among others: (i) calculating the **quorum of the general shareholders' meeting and the relevant majorities** for the approval of resolutions; (ii) complying with the **obligation to notify significant holdings**; and (iii) determining the existence of a controlling interest that triggers the obligation to launch a **takeover bid.**

The double vote provision must be renewed every five years as from its adoption.

Companies that are to go public may amend their articles of association to allow pre-existing shareholders to benefit from double voting shares from the moment the IPO takes place.

4. ISSUANCE OF SHARES AND CONVERTIBLE NOTES BY LISTED COMPANIES AND BME GROWTH COMPANIES AND EXTENSION OF RULES ON LISTED COMPANIES TO ISSUERS WHOSE SHARES ARE LISTED ON FOREIGN EXCHANGES

Easing requirements: the minimum term of the pre-emptive subscription period is reduced from 15 to 14 calendar days. Similarly, and provided that the incomplete subscription of shares has not been excluded, resolutions approving share capital increases may be filed with the Commercial Registry before they are executed (in which case, shares may be delivered and transferred upon granting the public deed of execution of the capital increase, which must be submitted for registration within five days of the public deed having been granted).

Fair value and expert reports regarding share capital increases and issuances of convertible notes excluding pre-emptive subscription rights ("DSP"): when listed companies exclude DSPs, **an independent expert report will be necessary**, except if the amount issued does not exceed 20% of the issuer's share capital and the discount over the listing price is less than 10% of the trading price. If the discount were to exceed 10% of the trading price, the expert report will address the dilution of the value of the shareholders' interests and the reasonableness of the justification for excluding DSP and the proposed issue rate.

No independent expert report is required to **issue convertible notes** if they do not amount to more than 20% of the company's share capital.

Authorised share capital excluding DSP: in line with what has been a good governance practice thus far (although without going as far as the recommendations resulting from the policies of some proxy advisors), delegations to increase share capital will be limited to 20% of the existing share capital when DSPs are excluded (currently 50%). The same rule applies to convertible notes issuances excluding DSPs in relation to the shares to be issued (except for issues by credit institutions where the requirements for the issued notes to qualify as additional Tier 1 capital instruments are met).

BME Growth: these regulations – together with those provided for in the Spanish Companies Law and which include, for example, the right to identify shareholders or the maximum treasury stock limit – will also apply to companies listed on multilateral trading facilities, such as BME Growth.

First admissions to listing: share capital increases made before the first admission of shares to listing on a regulated market or on a multilateral trading facility (BME Growth) may apply the provisions that allow for a shorter period in which the rights are traded, the exclusion of pre-emptive subscription rights by the management body and avoiding, if appropriate, the independent expert's report, unless there is no reason to presume that the issue price is aligned with the market value (e.g. because the number of subscribers is low).

Extending the application of Title XIV of the Spanish Companies Law to public limited companies listed on regulated markets in the European Economic Area or comparable markets in third countries: the Law acknowledges and confirms that the provisions under Title XIV of the Spanish Companies Law also apply to public limited companies listed on markets outside Spain albeit with the necessary adjustments pursuant to the general principles of private international law.

5. REMUNERATION OF LISTED COMPANIES' DIRECTORS

A reference has been introduced to the fact that remuneration for executive functions should, not only be in accordance with the remuneration policy, but also with the articles of association. It cannot be ruled out that this unnecessary addition – given that the policy has already been approved by the shareholders' meeting – could potentially end up being used to demand that the articles of association more precisely regulate executive remuneration and result in the Spanish Tax Authority questioning the tax deductibility of directors' remuneration for executive functions that are not expressly regulated in the articles of association.

Remuneration policies may include procedures for their temporary repeal under certain conditions.

A **greater level of detail** is required regarding remuneration policies and annual remuneration reports.

If the policy is **rejected** by the general shareholders' meeting, **the existing approved policy may remain in force, but a new policy must be proposed at the following ordinary general shareholders' meeting**. Should the general shareholders' meeting **reject the annual remuneration report** (advisory vote), **the policy in force may only be applied until the following ordinary general shareholders' meeting**.

The new provisions on remuneration policies will enter into force **six months after publication of the Law** in the BOE; therefore at the first general shareholders' meeting held after that six-month period issuers must propose a remuneration policy that is in line with the new modifications. Furthermore, the additional content required by the Law for the remuneration report will apply to reports for financial years ending after 1 December 2020.

6. OTHER NOVELTIES

Identification of shareholders and ultimate beneficial owners: the right of the issuer (and, under certain conditions, of the significant shareholders or shareholder associations) to know the identity of both the shareholder and the ultimate beneficial owner (i.e., the person on whose behalf the intermediary institution acts as a shareholder by virtue of the accounting record) is regulated. It has been clarified that the company is not party to the relationships between the ultimate beneficial owner and the intermediary entity or entities and that, therefore, it is not bound vis-a-vis the ultimate beneficial owners.

In the case of **electronic voting, the issuer must send confirmation to the shareholder**. In addition, both the shareholder and the ultimate beneficial owner may request confirmation that their votes have been correctly accounted within one month of the meeting (unless they already have this information).

Statement of non-financial information: it must include information on the systems and procedures in place at the company to promote employee involvement in the company's management. This amendment will enter into force twelve months after publication of the Law in the BOE.

Proxy advisors: proxy advisors who (i) have their domicile in Spain; (ii) have their main place of business in Spain but their domicile is outside the European Union; or (iii) have an establishment in Spain, but their domicile and main place of business are outside the European Union, must comply with certain disclosure and transparency obligations; and be subject to the CNMV supervision regime.

Engagement of institutional investors: certain transparency and disclosure obligations are imposed on: (i) **collective investment scheme management companies** (*sociedades gestoras de instituciones de inversión colectiva*); (ii) **closed-end collective investment management companies** (*sociedades gestoras de entidades de tipo cerrado*); and (iii)

investment firms and credit institutions providing discretionary and individualised portfolio management services. Those obligations mainly consist of:

(a) developing and publicly disclosing an engagement policy that describes how they integrate shareholder engagement in their investment strategy; and

(b) publicly disclosing, on an annual basis, the application of their engagement policies, their voting behaviour and whether or not they have engaged the services of proxy advisors.

Prohibition of legal persons to serve on boards of listed companies: directors of listed companies cannot be legal persons, with the exception of public sector companies. This rule will apply to appointments, including renewals, that are approved as from the month following the publication of the Law in the BOE. Therefore, legal persons appointed as directors of listed companies before the entry into force of this provision can remain as directors until their term of office expires.

Removal of interim management statements (quarterly reports): the obligation for listed companies to disclose financial information on a quarterly basis is removed, without prejudice to the fact that (i) issuers may continue to disclose such reports on a voluntary basis; and (ii) the Spanish National Securities Market Commission may require this information to be published.

Removal of the obligation to prepare an annual corporate governance report for security issuers other than listed companies; they only need to include some corporate governance information in the management report.

Exemption from publication of a prospectus in connection with an offer of securities: in addition to adapting the Securities Market Law to Regulation (EU) 2017/1129, the threshold above which an offer of securities in the European Union will require the publication of a prospectus has been increased from EUR 5 million to EUR 8 million. This threshold is measured over a 12-month period.

Delisting takeover bid exemption: in cases of delisting, no takeover bid will need to be launched if a previous takeover bid for all the securities had been launched at a price equal to or higher than that required for a delisting bid, provided that, as a result of such prior takeover bid, the offeror attained at least 75% of the voting share capital of the target company.

Appointments and remuneration committee: companies issuing securities other than shares admitted to trading on regulated markets and obliged to have an audit committee must also have in place an appointments and remuneration committee.

Entry into force: except for some specific matters that have already been described in this publication, the new provisions will come into force twenty days after publication in the BOE.

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