Chapter XX

SPAIN

Carlos Paredes[1]

I OVERVIEW OF GOVERNANCE REGIME

i Introduction

Corporate governance of listed companies in Spain is primarily regulated by the standard corporate legislation of a compulsory nature and by a corporate governance code, the recommendations of which are generally addressed to listed companies and may be followed voluntarily. Although these two sets of rules and recommendations follow different structures, there is no strict separation between them, as legal rules have been enacted following recommendations on corporate governance given by the prevailing corporate governance codes and, in turn, the latter use concepts and structures provided for by the legislation.

The applicable corporate legislation is mainly composed of the Companies Law, approved by Royal Legislative Decree 1/2010, of 2 July ('the Companies Law'), which sets out the rules for all limited liability companies, including a section with specific rules for listed companies. In addition, Law 24/1988, of 28 July, on the securities markets ('the Securities Market Law') provides additional rules relating to listed companies and specific information requirements relating to corporate governance practices.

As to the voluntary corporate governance codes, the first corporate governance code ('the Olivencia Code') was drafted by the Olivencia Committee in 1998 as a response to a demand by the markets and the economic agents to increase efficiency, agility, accountability and transparency in the governance of listed companies, as well as to ensure a more effective protection of shareholders. The Olivencia Code – the recommendations of which were limited to the scope of the functions of the board of directors – was very much influenced by the developments that had originated in the Anglo-Saxon world and that had spread to different countries. Nevertheless it adapted these developments

1 Carlos Paredes is a partner at Uría Menéndez.

to the peculiarities of the Spanish economy where the process of privatisation of public companies determined an increase in the number of shareholders and an awareness of the need for adequate safeguards for their position. Although its recommendations were not generally followed by Spanish listed companies, the Olivencia Code for the first time in the Spanish market highlighted the debate regarding the composition, practices and functioning of boards of directors, led to a thorough analysis of the Spanish market in terms of listed companies, shareholding structure and board behaviour, and created the basis for the growth of the corporate governance practices over the coming years with the introduction of new concepts, such as that of independent directors and the disclosure of conflicts of interest.

A second wave of corporate governance reforms came in 2003 with the creation of the Aldama Committee and the production of a new corporate governance code that not only focused on the role of the board but also on the functioning of general shareholders' meetings and the rendering of services by outside professionals, such as auditors or investment banks. This was completed by the enactment of compulsory legislation relating to some of the most important recommendations included in the Olivencia Code, which, until that date, were not generally followed by Spanish companies (such as a detailed regulation of the fiduciary duties of directors as regards conflicts of interest, including the duty to abstain and refrain from participating in board discussions relating to a subject for which a conflict of interest exists).

The current version of the Spanish corporate governance code ('the Unified Code') is a harmonisation and review of the recommendations and principles previously stated by both the Olivencia and the Aldama Committees. It adopts modern trends in corporate governance, stated by different entities and institutions such as the OECD, the Basel Committee on Banking Supervision and the European Commission, and it takes into account the comments and proposals put forward by economic operators and institutions. The Unified Code was presented in 2006 and was then approved by the National Securities Market Commission ('the CNMV') as the document that includes the 58 recommendations that listed companies may follow when preparing their annual corporate governance reports. Although its recommendations are voluntary, the concepts and definitions of the Unified Code are compulsory, and each listed company must explain its level of compliance with its provisions on a yearly basis. The recommendations range from those relating to general shareholders' meetings, to those referring to the board or its directors, including board composition and functions, selection, appointment and removal of directors, remuneration and internal committees of the board (executive committee, audit committee, and remuneration and appointments committees). Given the time elapsed and the changes taking place in the corporate environment since it was first approved in 2006, an overall revision of the Unified Code may well be expected in the near future.

ii Legislation and supervision

The Unified Code shares the international standards that characterise the recommendations on good governance practices. According to the Securities Market Law, recommendations are given on a 'comply or explain' basis. It is up to companies to decide whether or not to follow corporate governance recommendations, but in the event that a recommendation is not followed a reasoned explanation must be given.

In this regard, all listed companies and entities issuing listed securities, as well as savings banks,[2] are obliged to prepare an annual corporate governance report – a document to be produced in a format pre-established by the CNMV in which the relevant company or entity must include a substantial amount of information relating to:

a the capital structure, including shareholders with significant stakes and the existing relationships among them, the stakes held by members of the board, the treasury shares of the company and any shareholders' agreements in place;

b the structure of the board of directors, including information on its composition, functioning rules, existing committees, remuneration, relationship with significant shareholders and procedures for the selection of directors;

c related-party transactions with shareholders, directors and managers, including intra-group transactions;

d risk management policies;

e information on the functioning of the general shareholders' meeting; and

f evaluation and assessment of the level of compliance with the Unified Code recommendations or, where applicable, an explanation of any deviations.

The Unified Code recommendations, although voluntary, are given within a frame of categories and concepts deemed to be imperative and directed to all listed companies, whatever their size, market capitalisation or nature.

According to the most recent data available, which relate to the 2011 fiscal year, the degree of compliance with the recommendations of the Unified Code by listed companies included in the IBEX 35 index is remarkable: 90.2 per cent of the recommendations were complied with in 2011, while 5.1 per cent of the recommendations were complied with partially. Although somewhat reduced, this ratio also remains high if all companies listed in Spain (and not only the 35 largest ones included in IBEX 35) are considered. 81.3 per cent of the Unified Code recommendations were followed by the 149 companies that were listed in Spain in 2011, while 7.6 per cent of the recommendations were partially complied with.

Despite this, it has been noted – especially in respect of non-IBEX 35 companies – that the quality of the information given to explain the deviations needs to be improved, and that on many occasions compliance with the recommendations is more in form than in essence. In any case, the evaluation of the degree of compliance of the recommendations and the explanations given by the relevant companies is left to the markets and to the CNMV. In this regard, the CNMV has powers to request

2 Savings banks are a particular type of credit institution in Spain, akin to French *caisses d'épargne* or Italian *casse di risparmio*. They are organised as foundations rather than companies and as a result they are not governed by shareholders – which they do not have – but by representatives of collective stakeholders, which are primarily customers, employees, and local authorities. As of today, practically all savings banks have transferred their business to ordinary banks; furthermore, new legislation is expected which will possibly entail the disappearance or transformation of (almost) all existing institutions. As a result of this, although a full set of laws and regulations on the matter is still in place, it will likely be deprived of practical relevance in the near future.

additional explanations from any issuer regarding its corporate governance practice and the information on its practice included in the annual corporate governance report, including the publication of amendments and the imposition of fines or other sanctions in the case of breaches of applicable law.

II CORPORATE LEADERSHIP

i Board structure and practices

Spanish legislation provides for a standard one-tier board structure for public companies (Companies Law 2010). Listed companies must have a board of directors, with this structure being mandatory. Very often, however, powers are delegated by the board to an executive committee, or to one or more executive directors or CEOs, that in fact assume the ordinary management of companies. Only European companies incorporated in Spain can opt for a two-tier board, where directors assume the management of the company and the supervisory body controls their performance, but such companies are not at all common in Spain and, currently, none of them is listed.

Composition of the board

The board must have at least three members, which can be individuals or entities (Companies Law 2010). The Unified Code recommends, in the interest of maximum effectiveness and participation, that the board should have not less than five and not more than 15 members. It is also recommended that companies should strike a balance between external and internal directors.

External directors can be of two different types: proprietary (those representing or appointed by holders of significant or controlling stakes in the company) and independent (those with no links and relationships with the company, its managers and its significant or controlling shareholders), although a third category may exist consisting of those who are neither proprietary nor independent directors. The Unified Code includes imperative definitions for the different types of directors.

Internal directors are the executive directors. External directors should account for an ample majority of the board, while executive directors should be the minimum number that is practical while taking into account the complexity of the corporate group and the ownership interests they control. Under the Unified Code, whereas the proprietary members should represent the significant shareholders in a proportion that matches the capital that they represent, the number of independent directors should be at least one-third of all board members.

Separation of the roles of CEO and chair

The chair of the board of a public company has the power to call the board meetings, draw up the agenda and chair the sessions (Companies Law 2010). The Unified Code recommends that the chair should additionally have an active role in promoting directors' participation in board meetings. It is also recommended that the chair assures that directors receive sufficient information, that they are active in the meetings and that they are provided with safeguards to perform their roles adequately. The chair is also expected to coordinate the work of the board members, strengthening the collegiate character of the board.

The Unified Code has left the decision to companies on how to determine the specific powers of the chair, and makes no specific recommendation on the separation of the chair and CEO positions. Therefore, the chair might also be the CEO of the company. When this is the case, it is recommended to counterbalance such a concentration of powers by appointing a senior or a lead independent director who would be responsible for requesting the holding of board meetings; including new points on the board agenda; coordinating the relationships with external directors; and supervising the evaluation of the chair by the board. Unlike other European jurisdictions, Spanish boards have predominantly seen CEOs combining such roles with that of chair. Despite the pressure held by proxy agencies and the evolution of other European jurisdictions, in recent times the percentage of CEOs also carrying out the chair's tasks has actually increased among Spanish companies,[3] although this has been accompanied in many cases by the vesting of additional balancing powers with one of the independent directors. While we anticipate that this evolution will probably change during the coming years and that we will see more companies splitting the roles of a chair and CEO, we believe that no standard rules can be formulated in this area.

For instance, there is no clear empirical evidence that the separation of roles positively affects share prices or companies' performance. The separation of roles may increase confusion and duplication of tasks within the board (especially in a system where it has not been the prevailing structure for years); it may also cause some inefficiencies in decision-making processes and generally increase costs; lastly, depending on the moment at which such separation occurs, it may disrupt the positive performance of the company, as it may demoralise the existing CEO and create animosities within the board. While we believe that there cannot be any standard rule for companies on whether to combine the roles of chair and CEO, a decision to split the two roles in a board must be made after a careful analysis of the situation of the relevant company. It would be more reasonable to agree such matters at the time of the succession of the CEO or at any other time in which change is really needed at the company.

Committees

It is standard that in addition to a managing director holding delegated powers from the board, Spanish listed companies have an executive committee with similar powers that in practice works as a reduced board. In some companies, the function of the executive committee is to hold meetings more regularly than the board (weekly or fortnightly), while the board as a whole meets with a reduced frequency (once a month). The Unified Code recommends notwithstanding that the board is kept fully informed of the discussions and decisions adopted by the executive committee and that the structure, in terms of the qualification of directors (independent, proprietary and executive) of this committee replicates that of the board.

In addition, the law requires that an audit committee be created within the board, formed by members of the board (a majority of whom must be external directors) and,

3 This trend seems however to have taken a downward turn. In the period 2009–2011, the percentage of companies whose CEO was also chair of the board diminished from 58.3 per cent to 52.3 per cent.

upon recommendation of the Unified Code, presided over by an independent director. At least one of its members must have accounting or auditing knowledge. The role of the audit committee is mainly of an advisory nature and refers to the supervision of auditing practices, the relationship with external and internal auditors, devoting special attention to the independence of external auditors, the oversight of risk management policies and the review of the financial information that the company has to make public.

The Unified Code also recommends that a nomination or remuneration committee (or both) is created within the board. Such committee should be formed by a majority of independent directors and presided over by one of such directors. The nomination and remuneration committees have advisory powers in matters such as the selection of candidates for the board, the right to formulate proposals (or inform the proposals made by the board) relating to the appointment of directors and the right to propose (or inform on the proposals of the board) remuneration policies. A vast majority of the larger Spanish listed companies have created a nomination or remuneration committee, or both.

ii Directors

The involvement of external directors in the board's practice is essential, since they normally account for the majority of the members of the managing body, and there are recommendations discouraging the presence of executive directors (or even proprietary directors) in specific board committees. For example, the Unified Code states that the audit and the nomination or remuneration committee must be exclusively composed of external directors and chaired by an independent director, and that a majority of the nomination or remuneration committee should be independent directors.

The Unified Code states that the board as a whole should be entrusted with the duty of defining the strategy of the company, thus including the active and decisive participation by outside directors. Other topics that should require approval by the board in full include the investment and financial policy, the structure of the group, the corporate governance policy, the remuneration and evaluation of senior officers, the risk control, the dividends policy or decisions on the appointment or removal of senior officers, directors' remuneration, financial information to be disclosed, or strategic and related-party transactions when these are not subject to the shareholders vote.

External and, particularly, independent directors also play a significant role in the committees of the board, which normally have the power to approve and submit specific proposals to the board, evaluation reports or opinions on the proposals to be made by the board. In this regard, the nomination or remuneration committee normally proposes the decisions on the remuneration to the board for directors and senior officers, the individual remuneration and contractual conditions of executive directors and the standard conditions for senior officer employment contracts. In addition, a prior evaluation or report from the audit committee, or the nomination or remuneration committee, is normally needed to approve certain proposals by the board.

As to liability issues, all directors, whether executive or external, face the same liability regime and are vested with equal and complete information rights regarding the company. Frequently, executives of the company are invited to join board meetings to explain specific issues and reinforce the director's knowledge and awareness of business and company structures.

Appointment and term of office

Directors of Spanish companies may be appointed for a term of up to six years. While many companies appoint their directors for such a term, there is a growing trend to amend the articles of association to reduce the duration of the role to five, four or even three years. As to the rotation of the board, in Spanish practice traditionally this has not been carried out to a high degree. However, this practice may be changing, as one of the recommendations of the Unified Code states that independent directors should not hold their office for more than 12 years. This recommendation, which companies have tended to follow in the past few years, is increasing the rotation level within Spanish boards.[4]

Directors' remuneration

As to the remuneration of directors, a thorough review was implemented by Law 2/2011 of 4 March on the Sustainable Economy ('the SE Law'), to which we will subsequently refer. Previously, in December 2009, a proposal was set out to modify the Unified Code in order to establish improved performance criteria in determining the remuneration of directors and is still under consideration.

The SE Law, which was finally enacted after a lengthy drafting process, was intended, among other aims, to increase transparency on remuneration policies of listed companies and financial institutions. International principles of corporate governance are applied therein in order to reinforce solvency and to ensure that directors carry out an appropriate risk management. The SE Law follows European Commission's recommendation 2009/3159/EC on remuneration policies in the financial services sector and the commitments undertaken at the G20 meeting held in London on 2 April 2009.

In particular, the SE Law establishes that the board of listed companies must prepare and submit an annual report on the remuneration of their directors to the advisory vote of the general shareholders' meeting, as a separate item on the agenda. This provision, which made the pre-existing recommendation on the 'say-on-pay' practice imperative, was applied for the first time in the 2012 general meeting season. According to the SE Law, the report must include:

- *a* complete, clear and comprehensible information about the remuneration policy approved by the board for the current year, and, if appropriate, the policy planned for future years;
- *b* an overall summary on how the remuneration policy was applied during the financial year; and
- *c* detail on individual remunerations accrued by directors.

As no regulatory developments have been issued thus far, each company has had to tailor the remuneration report based on its own interpretation of the newly enacted criteria.

4 According to publicly available working papers, future regulatory developments may result in a new mandatory definition of 'independent director' whereby no director would qualify as such if he or she has held office in the same company for more than 12 years. However, this is a somewhat controversial matter, and could well be removed from the regulations prior to their enactment.

It is unlikely that such developments (including the approval of a standard form for the report) will be completed before the end of 2013.

The SE Law also provides that savings banks, in the same way that listed companies do, must prepare and submit an annual report on the remuneration of directors and members of the supervisory committee to the advisory vote of the general assembly, as a separate item on the agenda.

Furthermore, the SE Law provides that financial institutions and companies that render investment services must increase transparency on their remuneration policies and the consistency thereof with the promotion of sound and effective risk management. For this purpose, the SE Law reinforces the Bank of Spain's role in the implementation and supervision of remuneration policies and the corporate governance rules of financial entities. In particular, the Bank of Spain is vested with powers to require financial institutions to limit variable components of their remuneration system in order to preserve a solid capital basis. Both the requirements affecting the design and approval of remuneration policies and the supervisory powers of the Bank of Spain in respect thereof are regulated in detail by Royal Decree 771/2011 of 3 June, which amended specific regulations on capital requirements for financial institutions. Furthermore, Royal Decree-law 2/2012 of 3 February, on recapitalisation of the financial sector, sets out specific restrictions for financial institutions that benefit from state aid. These restrictions affect both the quantum of the remuneration and its variable components and pension benefits associated with them, with the latter two items being reduced to zero in certain cases.

In addition, the intention of the existing proposal to modify the Unified Code is to adopt, under the 'comply or explain' principle, the European Commission's Recommendation 2009/3177/EC, which complements Recommendations 2004/913/EC and 2005/162/EC as regards the remuneration of listed companies' directors. According to the proposal, the Unified Code would incorporate recommendations on the following topics:

a Share-based remuneration, for the purpose of increasing directors' professional commitment and linking share-based remuneration with predetermined and measurable performance criteria.

b Structure of directors' remuneration and variable components. In this area, the recommendations would be intended to foster variable remuneration reflecting directors' professional performance, as well as clawback clauses and certain limits on termination payments.

c As to the role of the general shareholders' meeting, companies should encourage all their shareholders, in particular institutional shareholders, to attend these meetings and to make a prudent use of their votes when deciding on issues relating to directors' remuneration.

d With regard to the remuneration committee, it would be recommended that at least one of its members should have knowledge and experience in the field of remuneration policy. Likewise, this committee should have specific additional powers, such as:

- the periodic review of the remuneration policy for executive directors or senior executives;

- ensuring that when using external consultancy services, the consultant does not simultaneously advise the human resources department, the executive directors or the senior executives of the company concerned; and
- disclosing information to the shareholders on the committee's performance and the identity of the external consultants, if any, who provided support to the committee.

III DISCLOSURE

As indicated in Section I *supra*, all listed companies and entities issuing listed securities as well as savings banks are obliged to prepare an annual corporate governance report – a document to be produced in a format pre-established by the CNMV. The annual corporate governance report is prepared and approved by the board of directors and must be delivered to the CNMV and published on the company's website no later than the date on which the annual general shareholders' meeting is called. In addition, the corporate governance report must also be included as a separate section in the directors' report relating to the annual accounts. Among the contents of the corporate governance report there is an evaluation and assessment of the level of compliance with the Unified Code recommendations or, where this is the case, an explanation for any deviations from such recommendations.

Listed companies and savings banks must also disclose an annual report on directors' remuneration (see Section II, *supra*) and submit it to the advisory vote of the general shareholders' meeting (in the case of listed companies) or the general assembly (in the case of savings banks).

Furthermore, directors of listed companies must present a liability statement together with the annual accounts and the mid-year accounts. This statement must generally confirm that the relevant accounts being made public have been prepared in accordance with applicable accounting principles, and reflect a fair view of the financial situation of the company and its consolidated group, its net worth and results.

Finally, whenever a one-on-one or selective meeting takes place between directors and shareholders, the information provided to shareholders must be disclosed to the public in the same manner as price-sensitive information. Regularly conducting these meetings is not standard practice in Spain, except for larger companies in the IBEX 35 index, in which foreign shareholders are predominant and for which corporate governance is, in certain respects, more in line with international market standards.

IV CORPORATE RESPONSIBILITY

Following international and European developments, the impact of the financial crisis has led, in Spain, to a review of corporate governance practices in the fields of management and control of risks and directors' remuneration – two areas where companies should anticipate a more precise regulatory framework in the future.

As to the management and control of risks, a working group created by the CNMV delivered in June 2010 a report on internal control of the financial information of listed companies, providing guidelines for the preparation of the description of the internal control system on financial information, and for the tasks that should be carried out by the audit committee to supervise its performance. In particular, among the recommendations set out by the working group, with regard to a limited review by the external auditor of the system governing internal control over financial reporting, this review should be aimed at ensuring that the information included in the corporate governance report is both accurate and consistent with the findings of the external auditor during its auditing and limited review work. In its report, the working group defines a body of general principles and good practices for internal control, with the aim of helping listed companies to design, implement, run and monitor their systems of internal control over financial reporting. In addition, the report also includes guidance for companies regarding disclosures on internal control over financial reporting.

Furthermore, in the past legislation has been enacted, through modification of the Audit Law to reinforce the powers of audit committees and the role of external directors within them, and to foster the efficacy of the internal control and of the management of risks systems, as well as of the process of elaboration and disclosure of financial information of companies. In particular, the committee must produce an annual report on the independence of the external auditors, taking into account the provision of any services other than auditing services. The composition of the audit committee after the enactment of said legislation is dealt with above in Section II, *supra*).

As regards corporate responsibility, in the previous decade an increasingly significant number of Spanish listed companies undertook to approve internal policies on the matter and issue annual reports on their implementation. These reports, which were voluntary in all respects and – until recently – were not the subject matter of any specific legal provisions, have become common practice in listed companies and show an upward trend in the undertaking of commitments with stakeholders. Since 2011, corporate responsibility has been dealt with in the SE Law. Pursuant to this law, public companies may (but are under no obligation to) issue an annual report on corporate responsibility based on certain international standards, such as transparency of management, good corporate governance and commitment to the environment. Any such report must state whether it has been verified by third parties. Reports issued by companies employing over 1,000 individuals must be submitted to the National Council for Corporate Responsibility for monitoring purposes. Under the SE Law, any company may also request acknowledgment as a socially responsible company.

V SHAREHOLDERS

The shareholding structure of Spanish listed companies is somewhat concentrated. The average percentage owned by the major shareholder is around 35 per cent, but there has been a slight decrease in this trend since 2007. The average percentage in the hands of the three major shareholders has increased to roughly 50 per cent. The concentration level is slightly reduced among companies from the IBEX 35 index, although it has been increasing over the past few years. There are a few exceptions among Spanish listed companies where there are no major shareholders.

This shareholding structure partly explains why the shareholder activism movement that has swept through the American and European markets during the past decade has not been so active in Spain. To date, the Spanish market has not seen significant shareholder action (and certainly not action driven by hedge funds), except in very specific cases linked to disputes over the control of target companies, normally in the context of tender offers or minority shareholders' fighting against the management of specific companies.

It is worth noting that shareholder communication is gaining increasing importance, especially among the largest Spanish companies, which are also those in which the shareholding concentration level is more reduced and where foreign shareholders are predominant. These companies have normally been among the first to comply with the 'say-on-pay' recommendation and regularly conduct one-on-one and selective meetings with shareholders.

A review of recent developments in the field of corporate governance in Spain would not be complete if a reference to the shareholders' electronic forum and shareholders' associations were not made. In July 2010, the Companies Law was amended to provide for (1) the obligation of listed companies to include a duly protected shareholders' electronic forum on their website, accessible by individual shareholders and any voluntary associations established thereby, designed to furnish information prior to general meetings; and (2) the admissibility of incorporation of associations of shareholders for any given listed company aimed at the exercise of their rights and the defence of their common interests.

The forum may include motions to be incorporated on the agenda announced in the meeting notice (provided that the requesting party holds at least 5 per cent of the share capital), requests for support for such motions, initiatives to gain a sufficient percentage to exercise any minority right established by law (normally restricted to holders of a 5 per cent interest or more), as well as offers or requests for proxy voting. As to the shareholders' associations, these must be registered at a special registry yet to be created with the CNMV. To date, no such associations have been created, since the rules establishing the general regulations, enacted in July 2010, have not yet been implemented.

VI OUTLOOK

In general terms, the recommendations of the Unified Code are increasingly being followed by listed companies, as shown by the annual corporate governance reports published by the CNMV every year. The least-followed recommendations are those relating to the approval and disclosure of directors' remuneration. Nevertheless, the SE Law has obliged listed companies to comply with demanding provisions on directors' remuneration, and the proposal to modify the Unified Code, if approved, will establish even more demanding recommendations in this regard.

CARLOS PAREDES

Uría Menéndez

Carlos Paredes is a partner at the Spanish law firm Uría Menéndez. He is currently based in the Madrid office.

His practice focuses on commercial and company law, mergers and acquisitions, corporate governance, banking and securities law, corporate restructuring transactions and issues of equity and debt. He regularly advises private and listed companies, financial entities and venture capital firms.

He is acknowledged as one of the best lawyers in his areas of practice by the main national and international rankings (*Best Lawyers in Spain*, *Chambers Europe* and *Chambers Global*).

Mr Paredes is a lecturer on business and corporate law in several universities and masters programmes at various prestigious Spanish institutions and has published several articles on different topics within his practice areas.

URÍA MENÉNDEZ

Príncipe de Vergara 187
Plaza Rodrigo Uría
28002 Madrid
Spain
Tel: +34 91 586 0334
Fax: +34 91 586 0785
cpg@uria.com
www.uria.com