Chapter XX

SPAIN

Carlos Paredes and Rafael Núñez-Lagos[1]

I OVERVIEW OF GOVERNANCE REGIME

i Introduction

Corporate governance of listed companies in Spain is primarily regulated by the standard compulsory corporate legislation 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 2010), which sets out the rules for all limited liability companies, including a section with specific rules for listed companies. A major amendment of the Companies Law 2010 came into force on 24 December 2014. This amendment implemented the proposal issued by an *ad hoc* expert committee appointed by the government in 2013 and had a significant impact on matters such as the following:

a the rights and obligations of directors, including directors' liability;
b directors' remuneration;
c the composition and functioning of the board and its committees;
d shareholders' rights; and
e shareholders' meetings.

1 Carlos Paredes and Rafael Núñez-Lagos are partners at Uría Menéndez..

A number of the new legal provisions merely enacted pre-existing recommendations which became mandatory.

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 to the peculiarities of the Spanish economy, where the process of the 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, for the first time in the Spanish market the Olivencia Code 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, which 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).

In 2006 the National Securities Market Commission (CNMV) approved a corporate governance Code (the Unified Code) which was a harmonisation and review of the recommendations and principles previously stated by both the Olivencia and the Aldama Committees. It adopted 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 took into account the comments and proposals put forward by economic operators and institutions.

In February 2015 the Unified Code was replaced by yet another new corporate governance code (the Corporate Governance Code) approved by the CNMV and adapted to the reform of the Companies Law 2010 that took place in 2014. It contains 25 principles and 64 recommendations, which listed companies may follow when preparing their annual corporate governance reports. 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). Some new recommendations on corporate social responsibility were introduced in 2015, while others contained in the Unified Code are no longer present in the Corporate Governance Code as they are now mandatory provisions. Although its recommendations are voluntary, every listed company, whatever its size, market capitalisation and nature, must explain its level of compliance with the provisions of the Corporate Governance Code on a yearly basis.

ii Legislation and supervision

The Corporate Governance Code shares the international standards that characterise the recommendations on good governance practices. According to the Companies Law 2010, 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 are obliged to prepare an annual corporate governance report – a document to be produced in a format pre-established by the CNMV[2] in which the relevant company or entity must include a substantial amount of information relating to:

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

b any restrictions on the transfer of securities or on voting rights;

c the structure of the board of directors, including information on its composition, functioning rules, existing committees, remuneration, relationship with significant shareholders, procedures for the selection of directors, and measures in place to seek a balanced representation of women and men on the boards of companies;

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

e risk-control systems, including tax-related risks;

f information on the functioning of the general shareholders' meeting;

g evaluation and assessment of the level of compliance with the Corporate Governance Code recommendations or, where applicable, an explanation of any deviations; and

h the main characteristics of the internal control and risk management systems in connection with the process of disclosing financial information.

According to the most recent data available, which relates to the 2013 and 2014 fiscal years, the degree of compliance with the recommendations of the Unified Code[3] by listed companies included in the IBEX 35 index is remarkably high: 93.8 per cent of the recommendations were complied with in 2014 (93.7 per cent in 2013). Although

2 The current format is contained in CNMV Circular 5/2013 of 12 June, as recently amended by CNMV Circular 7/2015 of 22 December.

3 Reference is made to the degree of compliance with the recommendations of the Unified Code and not to those of the Corporate Governance Code as there are no available data yet.

somewhat reduced, this ratio also remains high if all companies listed in Spain (and not only the 35 largest ones included in the IBEX 35) are considered. Of the Unified Code recommendations, 85.4 per cent (85.4 per cent in 2013) were followed by the 141 companies that were listed in Spain in 2014, while there was partial compliance with 6.3 per cent of the recommendations (7 per cent in 2013). Sixty-five listed companies complied with more than 90 per cent of the recommendations and 12 claimed to have complied with all of them. Only three listed companies, two of them in the process of being wound up, registered a compliance level of under 50 per cent.

Despite this, it has been noted – particularly in relation to 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 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.

Finally, as previously mentioned, a number of prior recommendations are now mandatory legal provisions and therefore all listed companies (and in some cases even non-listed companies) are obligated to comply with them.

II CORPORATE LEADERSHIP

i Board structure and practices

Spanish legislation (namely the Companies Law 2010) provides for a standard one-tier board structure for public companies. 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 the company. 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 are listed.

Composition of the board

The board must have at least three members, which can be individuals or entities. The Corporate Governance Code recommends, in the interests of maximum effectiveness and participation, that the board should have no fewer than five and no more than 15 members. It is also recommended that companies should strike a balance between executive and external 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 or relationships with the company, its managers or its significant or controlling shareholders), although a third category may exist consisting of those who are neither proprietary nor independent directors.

The Companies Law 2010 includes detailed definitions of the various types of directors. The definitions are mandatory.

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 Corporate Governance Code, whereas the proprietary members should represent the significant shareholders in a proportion generally no greater than the capital that they represent, the number of independent directors should be at least half of all board members. Exceptionally, in companies with low market capitalisation and in those in which an individual shareholder, or various acting in concert, control more than 30 per cent of the share capital, the number of independent directors should be at least one third of all board members

Sector-specific eligibility requirements apply to directors of certain types of companies, particularly: (1) credit institutions and investment firms pursuant to Law 10/2014 of 26 June (the Solvency Legislation) and its implementing regulations, especially Royal Decree 84/2015 of 13 February, (2) insurance and reinsurance entities, pursuant to Law 20/2015 of 14 July and its implementing regulation (Royal Decree 1060/2015 of 20 November), and (3) collective investment managers and depositaries, pursuant to Royal Decree 1082/2012 of 13 July (as amended by Royal Decree 83/2015 of 13 February). The Solvency Legislation implements the CRD IV/CRR IV[4] package in Spain and the specific rules on corporate governance contained therein (the Solvency Legislation). It is aligned with the guidelines of the European Banking Authority of 22 November 2012 (EBA/GL/2012/06) and the Basel III Accord, adopted by the Basel Committee on Banking Supervision.[5]

Separation of the roles of CEO and chair

The chair of the board of a public company has the power to call meetings, draw up agendas and chair board meetings and, unless the articles of association state otherwise, also shareholders' meetings. The chair must play an active role in promoting directors'

4 The Directive and Regulation intended to implement the Basel III solvency framework in the European Union: (1) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV); and (2) Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (CRR IV).

5 In July 2015, the Basel Committee published the revised 'Corporate governance principles for banks' which contain new guidelines related, not only to the composition of the board, but also to other features of corporate governance of credit institutions, such as internal audit and governance of group structures.

participation in board meetings, ensuring that directors receive sufficient information, fostering debate and active involvement in the meetings while safeguarding each director's own judgement (the Companies Law 2010).

According to the law and the Corporate Governance Code, companies can decide how to determine the specific powers of the chair, and no specific rule or recommendation is provided on the separation of the chair and CEO positions. Therefore, the chair might also be the CEO of the company. However, when this is the case, such a concentration of powers must be counterbalanced by appointing a senior or lead independent director who will be responsible for requesting the holding of board meetings, including new points on the board agenda, coordinating and convening external directors and supervising the evaluation of the chair by the board. Until the latest reform this was merely a recommendation of the Unified Code, but it is now a mandatory legal provision.

Unlike boards in other European jurisdictions, Spanish boards have predominantly seen CEOs combining such roles with that of chair. Despite the influence wielded 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,[6] although this has come in many cases with the vesting of additional balancing powers in one of the independent directors, even before this was mandatory. While we anticipate that this evolution will probably change during the coming years and that we will see more companies splitting the roles of 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 a 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 when change is really needed at the company.

Note, however, that the Solvency Legislation specifically provides that the chairman of the board of directors of a credit institution or investment firm cannot act as CEO unless the institution justifies an exception that is authorised by its institutional supervisor (i.e., the Bank of Spain or the CNMV).

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6 This trend seems, however, to have taken a downward turn. In the period 2009–2011, the overall percentage of listed companies whose CEO was also chair of the board diminished from 58.3 per cent to 52.3 per cent. More recent statistics are not publicly available.

Committees

It is standard that in addition to a managing director holding powers delegated from the board, Spanish listed companies have an executive committee with similar powers that works, in practice, 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). Notwithstanding this reduced frequency, the Corporate Governance Code recommends that the board is kept fully informed of the discussions and decisions adopted by the executive committee and that, in terms of the qualification of directors (independent, proprietary and executive), the structure of this committee replicates that of the board.

In addition, the Companies Law 2010 requires that an audit committee and a nomination and remuneration committee (or two separate nomination and remuneration committees) be created within the board of every listed company. Each committee must be formed by members of the board, all of whom must be external directors. At least two[7] of those external directors must be independent and the committee must be presided over by one of the independent directors. The role of the audit committee is mainly of an advisory nature and concerns 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. At least one[8] of its members must have accounting or auditing knowledge.

The nomination and remuneration committee has 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 the proposals of the board on) remuneration policies.

The creation of a nomination and remuneration committee has only become mandatory for listed companies following the latest reform of the Companies Law 2010. However, as a formerly recommendation of the Unified Code it was generally followed by most of the larger Spain-listed companies.

Finally, according to the Solvency Legislation, credit institutions and investment firms must create a remuneration committee and a nomination committee, and may be required by the Bank of Spain or the CNMV, as applicable, to set up a risk committee, if appropriate considering the size of the institution, its organisation, and the nature, scale and complexity of its activities.

7 As from 17 June 2016, the majority of the members of the audit committee will need to be independent.

8 As from 17 June 2016, all members of the audit committee, as a whole, will need to have relevant technical knowledge of the sector to which the audited company belongs.

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, as previously mentioned, there are rules limiting the presence of executive directors (or even proprietary directors) in specific board committees.

According to the law, boards as a whole have the duty of defining company strategy, which includes active and decisive participation by outside directors. Other topics that 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, risk management, the tax policy, the dividends policy, decisions on the appointment or removal of senior officers, directors' remuneration, financial information to be disclosed, and 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 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 and remuneration committee proposes to the board the decisions on the appointment of independent directors, the remuneration for directors and senior officers, the individual remuneration and contractual conditions of executive directors and the standard conditions for senior officer employment contracts.

Appointment and term of office

Directors of Spanish listed companies may be appointed for a term of up to four years. Before the latest reform of the Companies Law 2010, the maximum term was six years and, while there was a growing trend to amend the articles of association to reduce the term to five, four or even three years, many companies appointed directors for six years. New appointments will have to comply with the four-year limitation, but directors already in office can complete their current tenure.

According to the current legislation, no director can qualify as an independent director if he or she has held office in the same company for more than 12 years. The recommendations and voting policies of the major proxy advisers, which support shorter term limits – such as three and even one year – than those provided by law, may also contribute towards increasing the rotation levels of all types of directors.

Liability of directors

The liability of directors stems directly from the fiduciary duties imposed on them by law and, if applicable, by the articles of association. Specifically, the law states that directors have two basic duties: to act diligently, with the standard of diligence befitting an orderly businessperson (duty of care); and to act loyally, in the company's best interest (duty of loyalty). If either duty is breached, directors may be held liable for any harm caused to the company, its shareholders or third parties, provided that they have acted wilfully or negligently.

The recent reform of the Companies Law 2010 has brought about significant changes to the liability regime. Most importantly, it has enacted the business judgement rule, well-known in several US states and other jurisdictions but until now alien to the Spanish legal system. The law now states that the duty of care is fulfilled when a strategic or business decision is made by directors acting in good faith, with sufficient information and following an appropriate decision-making process – provided, however, that no company director has a personal interest in the relevant decision. When these requirements are met, the decision will not be second-guessed by a reviewing court.

All directors, whether executive or external, face the same liability regime. This regime is based on a presumption that all members of the management body are jointly and severally liable. However, the applicable standard of diligence is qualified by the nature of their position and the specific responsibilities entrusted to them. For example, a CEO is likely to be judged more strictly than an external director who has no presence in any committee and no specific role on the board.

All directors are vested with equal and complete information rights regarding the company. Frequently, company executives are invited to join board meetings to explain specific issues and reinforce directors' knowledge and awareness of business and company structures.

Directors' remuneration

Directors' remuneration is no doubt one of the trending topics of corporate governance and has been the subject of much debate and legal change in recent years.

Law 2/2011 of 4 March on sustainable economy (the SE Law) first made the pre-existing recommendations on the 'say on pay' practice mandatory. Since 2012, boards of directors of listed companies have been obligated to prepare and submit annual reports on the remuneration of their members to the advisory vote of the general shareholders' meetings, as a separate item on the agenda. Currently, the report must include, in the standard format established by the CNMV:[9]

a complete, clear and comprehensible information about the remuneration policy approved by the board for the current year;

b an overall summary on how the remuneration policy was applied during the financial year; and

c detail on individual remuneration accrued by directors.

According to the most recent data available, which relate to the 2014 fiscal year, IBEX 35 companies generally use a wider range of criteria than smaller listed companies to establish the fixed part of their directors' remuneration. Every IBEX 35 company and 85 per cent of all other listed companies have approved variable retribution plans for executive directors. Forty-six per cent of IBEX 35 companies and 60 per cent of all other listed companies obtained, at their general shareholders' meetings, a favourable vote of over 95 per cent on their annual remuneration report. Only one IBEX 35 company obtained less than 60 per cent of the votes.

The reform of the Companies Law 2010 brought about further changes. In addition to the remuneration report, company boards are now required to approve and

9 The current format is contained in CNMV Circular 4/2013 of 12 June, as recently amended by CNMV Circular 7/2015 of 22 December.

submit a policy on directors' remuneration for approval by the general shareholders' meeting, at least every three years. Each company policy will set out for each year at least: (1) the aggregate compensation awarded to the board as a whole for the performance of non-executive duties; and (2) with respect to executive directors, the amount of fixed remuneration, the parameters for variable remuneration and the main terms and conditions of their executive contracts, including duration, severance payments, exclusivity and post-employment obligations, including non-compete and paid leave arrangements. The board will then be entitled to decide on each director's remuneration pursuant to the policy as approved by the general shareholders' meeting. The shareholders' vote on the policy is no longer advisory but binding. In addition, if, in any given year, the remuneration report is rejected by the shareholders on the advisory vote, the remuneration policy for the following year will need to be put to a vote prior to its implementation even if the approved policy currently in place is less than three years old or otherwise in force. In practice, although a remuneration policy is valid for up to three years, the shareholders may shorten its duration by voting against the remuneration report at any subsequent meeting.

The Solvency Legislation also provides for specific rules intended to increase transparency on the remuneration policies of financial institutions and investment firms and the consistency thereof with the promotion of sound and effective risk management. For this purpose, the Solvency Legislation has reinforced the Bank of Spain's and the CNMV's role in the implementation and supervision of remuneration policies and the corporate governance rules of the entities subject to their respective supervisory authority. In particular, the Bank of Spain is vested with powers to require financial institutions to limit variable components of their remuneration system, establish criteria for variable remuneration to be reduced in the event of losses and require credit institutions and their groups to limit variable remuneration by reference to a percentage of their turnover, in order to preserve a solid capital basis. The supervisory powers of the Bank of Spain in respect of remuneration and remuneration policies are regulated in detail by Royal Decree 84/2015 of 13 February, which powers include the ability to set out criteria on the various concepts and policies mentioned in the Solvency Law. The Bank of Spain is expected to issue a new Circular implementing those provisions in the near future. The Solvency Legislation further establishes limitations on variable remuneration that apply to all credit institutions (state-supported or otherwise) in line with the Guidelines on Remuneration Policies published by the Committee of European Banking Supervisors as of 10 December 2010.[10] Pursuant to these provisions, the variable component of the remuneration of staff whose activities have a material impact on the institution's risk profile cannot exceed 100 per cent of the fixed component. Exceptionally, and subject to a stringent procedure, the shareholders' meeting can decide to extend such a limit to 200 per cent with a two-thirds majority vote. Furthermore, Royal Decree-Law 2/2012 of 3 February on the recapitalisation of the financial sector sets out specific restrictions

10 In December 2015, EBA published an updated set of guidelines on sound remuneration policies, which will apply to the competent authorities across the EU as of 1 January 2017. The existing CEBS guidelines will be replaced on 31 December 2016.

for financial institutions that benefit from state aid. These restrictions affect both the amount of the remuneration and its variable components, as well as the pension benefits associated with them, the latter two items being reduced to zero in certain cases.

Similar limitations to those established therein for credit institutions apply to investment firms pursuant to Royal Legislative Decree 4/2015 of 23 October, on securities markets as implemented by Royal Decree 217/2008 of 15 February, as amended by Royal Decree 358/2015 of 8 May. In addition, in 2014 the CNMV adopted the guidelines on remuneration policies and practices approved by the European Securities and Markets Authority (ESMA/2013/606), mainly intended to ensure compliance with the Markets in Financial Instruments Directive conduct of business and conflicts of interest requirements.

III DISCLOSURE

As indicated in Section I, *supra*, all listed companies and entities issuing listed securities 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. CNMV Circular 3/2015 of 23 June 2015 regulates the specific legal and technical requirements of the information to be published in the websites of listed companies. In addition, the corporate governance report must also be included as a separate section in the directors' report relating to the annual accounts. Required among the contents of the corporate governance report is an evaluation and assessment of the level of compliance with the Corporate Governance Code recommendations or, where this is the case, an explanation for any deviations from such recommendations.

Listed companies 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.

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.

Some non-listed entities must also disclose an annual corporate governance report and an annual report on directors' remuneration. This is the case of saving banks and banking foundations, pursuant to Law 26/2013 of 27 December. Order

ECC/2575/2015 of 30 November regulates the content and disclosure conditions of these reports for the former and Circular 6/2015 of 17 November does the same for the latter.

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 risk management and control, an area where companies should anticipate a more precise regulatory framework in the future.

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 the system's performance. In particular, one of the recommendations among those set out by the working group was that the limited review by the external auditor of the system governing internal control over financial reporting should aim to ensure 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. Accordingly, the form for the annual corporate governance report, as updated by the CNMV in 2015, requires entities to disclose detailed information on their systems for risk management and internal control over financial reporting. The entities must further state whether such information has been reviewed by the external auditor and, if so, must also disclose the auditor's report.

Furthermore, legislation has been enacted in the past, 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 systems of internal control and management of risk, as well as of the process of elaboration and disclosure of financial information of companies.[11] 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 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

11 A newly amended and consolidated Audit Law was enacted by Law 22/2015 of 20 July to implement Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014. The new law, which will enter into force on 17 June 2016, further emphasises the role of audit committees.

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. In 2014, 24.8 per cent (28.2 per cent in 2013) of listed companies reported that one person owned the majority of voting rights or exercised, or could exercise, control over the company. The average free-float percentage increased to 42.9 per cent (41.5 per cent in 2013). In 105 out of 141 listed companies, free float exceeded 25 per cent, in seven companies (eight in 2013) it was less than 5 per cent. In 2013, the concentration level was only slightly lower among companies in the IBEX 35 index (e.g., in 17.1 per cent of those companies (20 per cent in 2012), one person owned the majority of voting rights or exercised, or could exercise, control over the company).[12] There are, however, 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.

Possibly the same circumstance accounts for the relative lack of specific takeover defences provided for either by the law or the internal rules of Spanish listed companies. Staggered boards do not exist, since the authority of the shareholders to dismiss and replace directors at any time is one of the cornerstones of Spanish corporate architecture. 'Golden shares' and other tools based on asymmetric voting rights are banned too. This is because another basic rule of public limited companies states that all shares must vest voting rights that are proportional to their nominal value. Historically, the most frequent defence was to include provisions in the articles of association limiting the maximum number of votes – typically around 10 per cent of all outstanding voting rights– that could be cast by any one shareholder, together, if applicable, with its affiliates and any other shareholders with which it was concerted, irrespective of the actual ownership

12 Latest available data.

percentage. This type of provision too was temporarily banned by an amendment of the Companies Law 2010 approved in 2011.[13] As a result of a subsequent amendment, effective from June 2012, it is now valid again, provided that the relevant provision is deemed repealed if, in the context of a takeover bid, the bidder acquires 70 per cent or more of the target's voting rights (unless the bidder itself is not subject to, or has not adopted, equivalent neutralisation measures). Although some companies still include limitations of this type in their articles of association, they have become rare. This is a consequence not only of the mentioned succession of legislative changes, which has noticeably weakened them as an effective takeover defence; but also of the increasing pressure exerted by some shareholders and proxy advisers in line with current trends.

Shareholder communication is gaining increasing importance, especially among the largest Spanish companies, which are also those with the lower shareholding concentration level and where foreign shareholders are predominant. These companies have normally been among the first to observe 'say on pay' practices (prior to their being mandatory) and regularly conduct one-on-one and selective meetings with shareholders.

A review of shareholders' rights in Spain would not be complete without reference to the shareholders' electronic forum and shareholders' associations. The Companies Law 2010 provides 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 three 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 three 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. The rules establishing the general regulations, originally enacted in July 2010, were further detailed by the latest reform of the Companies Law 2010, but are yet to be implemented.

VI OUTLOOK

In general terms, the recommendations formerly contained in the Unified Code and currently in the Corporate Governance Code have been increasingly followed by listed companies, as shown by the annual corporate governance reports published by the CNMV every year. Traditionally, the least-followed recommendations have been those relating to the approval and disclosure of directors' remuneration. Nevertheless, pursuant

13 By virtue of Law 25/2011 of 1 August, implementing Directive 2007/36/EC of the European Parliament and of the Council, of 11 July 2007, on the exercise of certain rights of shareholders in listed companies.

to the Companies Law 2010, since 2011 listed companies have had to comply with increasingly demanding provisions on the matter, including former recommendations that have become binding legislation. The review of the Unified Code has put more pressure on listed companies to abide by more stringent corporate governance practices. At the same time, these companies have faced and will continue facing stricter scrutiny on remuneration practices through the submission of the remuneration policy to a shareholder vote in 2016, if they have not already done so in 2015, pursuant to the transitional provisions of the Companies Law 2010 reform.

CARLOS PAREDES

Uría Menéndez

Carlos Paredes is a partner at 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 ratings guides (The 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.

RAFAEL NÚÑEZ-LAGOS

Uría Menéndez

Rafael Núñez-Lagos is a partner at Uría Menéndez. He is based in the Madrid office.

His practice focuses on corporate law and corporate governance, and extends to other areas of business practice and private law, including banking, finance, capital markets, and mergers and acquisitions.

URÍA MENÉNDEZ

Príncipe de Vergara, 187
Plaza de Rodrigo Uría
28002 Madrid
Spain
Tel: +34 91 586 0334
Fax: +34 91 586 0785
carlos.paredes@uria.com
rafael.nunez-lagos@uria.com
www.uria.com