

Informative Note

Proposed reform of the Code of Good Governance for listed companies

29th January 2020

The National Securities Market Commission (CNMV) submitted the proposal to amend certain recommendations of the Good Governance Code for listed companies in force since 2015 to public consultation on the 15th.

Among the objectives of the reform are the following:

- update some contents of the current Code to adapt them to legal changes that have occurred since its entry into force or to clarify or complement its scope;
- strengthen the aspects related to controls in order to avoid possible irregular practices;
- incorporate a more up-to-date approach to sustainability; and
- update the Code's approach to diversity in councils, after the previous recommendation on gender set a time limit for achieving its 2020 target.

This proposed amendment to the Code will be subject to public consultation until 14th February 2020. Below are the main recommendations proposed for the amendment of the Code of Good Governance.

General aspects

- i. With regard to the scope of application, it is proposed that the terminology be adapted to that used in the revised text of the Securities Market Law following its adaptation to MiFID II. In this sense, the expression "official secondary market" is replaced by "regulated market", referring not only to markets based in Spain but to any market domiciled in the EU.
- ii. Amending **Recommendation 2** is proposed (listing of companies belonging to groups) in order to extend its scope of application to all cases in which the listed company is controlled by another entity (listed or unlisted), if there are or will be business relations between the two or both carry out related activities.
- iii. The communication policy of listed companies is complemented in **Recommendation 4**, adding that, without prejudice to the legal obligations to disseminate information, entities should have a general policy for communicating economic-financial and corporate information through the channels considered appropriate (media, social networks or other channels) that contribute to maximising the dissemination and quality of information available to the market and investors and to the correct compliance with market abuse regulations.



Financial information

Listed companies that are required to prepare a statement of non-financial information must publish it on their website (as it forms part of the management report). For this reason, it is proposed that section d) of **Recommendation 6** regarding the publication on the listed company's website of the report on corporate social responsibility policy be eliminated.

Board of Directors

- i. Amending **Principle 6** in relation to **Recommendation 8** with regard to transparency of information and informed voting is proposed.

It establishes the responsibility of the board of directors to ensure that the annual accounts are prepared in accordance with accounting principles and criteria and in those cases where, due to differences in professional criteria or judgment or any other circumstance, the auditor includes a qualification in the accounts, it is considered appropriate that both the Chairman of the audit committee and the auditor clearly indicate this fact and offer their respective explanations at the general meeting.

- ii. At the end of 2020, it no longer makes sense for the Code to recommend that the policy for selecting directors of companies should promote the number of female directors to represent at least 30% of the total members of the Board of Directors in 2020, and it is therefore appropriate to reformulate the recommendation into a direct recommendation to have a minimum percentage of female directors.

Accordingly, it is recommended that the Board approve a policy "aimed at encouraging an appropriate composition of the board of directors", removing the reference to a policy "for the selection of directors" from **Recommendation 14**.

Adopting company selection policy to encourage a sufficient number of women in senior positions (executive directors) with greater responsibility is also proposed.

- iii. The new **Recommendation 15** establishes that the number of directors of the least represented sex should account for at least 40% of the total members of the board of directors, so that the recommendation provides for a situation of real equality in the composition of the board.
- iv. As a result of the cases of alleged irregular practices detected in some listed companies (cases of corruption, among others), it is proposed that **Recommendation 22** be amended so that directors report and, if appropriate, resign in cases that could damage the credit and reputation of the company (also including situations that affect the director through his actions or omissions as such or in general through his relationship with the company).

It is also proposed that the board should examine as soon as possible once it becomes aware of any situation affecting a director that could damage the credit and reputation of the company, without waiting (as is currently envisaged) for the director to be indicted or brought to trial for a corporate offence.

- v. Finally, **Recommendation 24** proposes that any director who resigns or is removed before the end of his term of office should explain the reasons for his resignation or his opinion regarding the reasons for which he was removed, and that the company should act transparently regarding the causes, both immediately and in the annual corporate governance report.

The Executive Board

Currently, most entities do not follow **Recommendation 37** that the composition of the executive committee be similar to that of the board.

Therefore, in order to compensate for the risk that the executive committee does not adequately reflect the board, it is proposed that it be modified by requesting only the presence of at least two (2) external directors, at least one of whom is an independent director.

The audit committee

- i. In **Recommendation 39** it is proposed the clarification that the risk management knowledge of the members of the audit committee should cover both financial and non-financial risks.
- ii. **Recommendation 41** proposes to clarify that the duties of the audit committee include submitting the annual work plan to the audit committee "for approval", informing it of any incidents and submitting an activity report at the end of each year.
- iii. **Recommendation 42** also strengthens the powers of the Audit Committee, including the power to supervise non-financial information and the financial and non-financial risk management and control systems.

In this regard, it is suggested that **Recommendation 42** be strengthened by including the following:

- a. Express mention that non-financial risks and, in any case, relevant risks, include reputational risks and risks related to corruption;
- b. That the audit committee, in relation to information and internal control systems, should be responsible for ensuring in general that the policies and systems established in the area of internal control are effectively applied in practice;
- c. And, in relation to the whistleblowing mechanism, that it should include cases in which, due to their relevance or characteristics, communications can be made anonymously in all cases.

Risk management and control function

Including express mention that non-financial risks include those related to corruption in **Recommendation 45** is proposed.

Other specialised committees of the board

- i. Specific expressions such as "environmental, social and corporate governance aspects" or "sustainability" are introduced when referring to the supervision of compliance with the company's policies and rules.

- ii. It is proposed to amend the wording of the current **Recommendation 53** to the effect that, if institutions consider that it is more effective to assign the minimum functions provided for in **Recommendation 54** to a specialised committee, such a committee should be composed only of external directors, at least two of whom should be independent.
- iii. **Recommendation 54** refers to the minimum functions of the specialised committee, eliminating those referring to the supervision of non-financial risks and the process of reporting non-financial information (attributed in **Recommendation 42** to the audit committee).
- iv. Finally, it is proposed that **Recommendation 55** be deleted since the report on corporate social responsibility policy is mandatory for listed companies with more than 500 employees and therefore its wording need not be maintained for smaller companies which are exempted by law from having to prepare the statement of non-financial information.

Remuneration

- i. It is proposed that **Recommendation 59** be amended so that payment is deferred for the period of time that, in general, may be considered sufficient for the institutions to carry out actions to effectively verify that the performance indicators or conditions established for the legitimate receipt of variable remuneration have been met.
- ii. In order to adequately align the interests of executive directors with the long-term interests of the entity and also of minority shareholders, it is suggested that **Recommendation 62** be amended so that in the case of referenced or share-based compensation plans, either by virtue of their conditions of consolidation or by prohibiting their sale once such conditions have been met, a period of at least three (3) years is established between the time the shares, options or other referenced financial instruments are granted and the time the director can dispose of them.

On the other hand, it is considered appropriate to modify the wording of the recommendation to clarify that it is not necessary to respect the requirement of the previous minimum period to be able to transfer or exercise such shares or financial instruments when the director maintains an economic exposure to the variation of the price of the shares for a market value that is equivalent to an amount of at least twice his annual fixed remuneration, either exclusively through the ownership of a number of shares whose market value equals or exceeds the previous amount, or through a combination of shares, options or other financial instruments that represent a joint market value and an equivalent net economic exposure.

- iii. **Recommendation 64** is extended by including among the payments due to termination or contractual extinction, compensation, amounts not previously consolidated in the long-term savings systems that cover the contingency of cessation of management functions, amounts paid under post-contractual non-competition agreements and any other payment whose accrual or payment obligation arises as a result of or attracts the termination of the contractual relationship between the director and the company.

Finally, attached as **Annex** the proposed text of the amended recommendations.

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