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Draft Bill of 24 May 2019 adapting Spanish law to Directive (EU) 2017/828 as regards the encouragement of long-term shareholder engagement in listed companies

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The Draft Bill of 24 May 2019 goes beyond the transposition of Directive (EU) 2017/828, regulating loyalty shares, introducing a ban on the use of corporate directors in listed companies and eliminating the obligation of quarterly financial reporting.

On 28 May, the Ministry of Economy published on its website the "Draft Bill amending the Recast Version of the Companies Act, approved by Royal Legislative Decree 1/2010 of 2 July, and other financial rules and regulations, to adapt them to Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement". The text is submitted for public consultation until 14 June 2019.

The aim of the future law is to incorporate in the Spanish legal system the aforementioned directive as regards the encouragement of long-term shareholder engagement in listed companies, and to this end it amends: the Collective Investment Schemes Act 35/2003 of 4 November ("LIIC"); the Recast Version of the Companies Act, approved by Royal Legislative Decree 1/2010 of 2 July ("LSC"); the Recast Version of the Securities Market Act, approved by Royal Legislative Decree 4/2015 of 23 October ("LMV"); the Private Investment Entities, Collective Investment Firms of a Closed-Ended Type and their Managers Act 22/2014 of 12 November ("LECR"); the Insurers and Reinsurers (Unified Regulation, Supervision and Solvency) Act 20/2015 of 14 July ("LOSSE"); and the Auditing of Accounts Act 22/2015 of 20 July. However, the text goes beyond what is required for transposition purposes, proposing amendments to the Companies Act and

the Securities Market Act not required by Directive (EU) 2017/828, which is by no means very common for the Spanish legislator.

The amendments only affect public limited companies whose shares are admitted to trading on a regulated market and which have their registered office or operate in a Member State of the European Union (new Art. 495(1) LSC), as well as those legal persons other than listed public limited companies that issue securities traded on regulated markets where Spain is their Member State of origin (new Seventh Additional Provision LMV).

The following is a summary of the main aspects of the reform, which will have to follow the appropriate parliamentary procedure as a bill:

1. Amendments to the Companies Act and the Securities Market Act which are not required for transposition of the Directive encouraging long-term shareholder engagement, as such content is not provided for in said Directive:

   a) *The board of directors of a listed company will be composed exclusively of natural persons*. Art. 529 *bis* (1) LSC is amended on the grounds of improving corporate governance and transparency. This requirement "shall only apply to appointments, including renewals, which take place as from 1 January 2020" (First Transitory Provision of the Draft Bill).

   b) The Spanish Securities Market Authority ("CNMV") had given several opinions on the appropriateness of *eliminating* the obligation to prepare and publish *the quarterly financial report* for companies listed on Spanish regulated markets. The Draft Bill proposes to repeal Art. 120 LMV in order to "homologate the Spanish law with that of practically all the countries of the European Union and with all the relevant markets in Europe. Hence, companies that wish to may continue to present quarterly information but those that are overburdened or believe that this would involve short term pressures may not do so.

   c) In order to reduce the disincentives to issue financial instruments other than shares (notably fixed income securities) in Spain, the Seventh Additional Provision LMV is amended to *exempt* issuers of securities that do not have to disclose their annual financial report and legal persons for which Spain is not their Member State of origin *from the obligation to publish annual corporate governance reports*.

   d) *Recognition of loyalty shares in the Companies Act*.

   The Draft Bill introduces a new subchapter to Title XIV, Part VI, Chapter 3 of the Companies Act under the heading "Additional loyalty votes" (Arts. 527 *ter* to 527 *octies*). According to the preamble to the Draft Bill, the proposed rules to govern these loyalty shares are "similar to the rules already in place for years in countries such as France and Italy, although, on the one hand, its application will in all cases require an express decision by the company

introducing the category in the articles of association - taken with special quorum and majority vote requirements that protect minority shareholders - and, on the other hand, its elimination is facilitated with a less demanding quorum and majority vote". The concept of these new privileged shares is detailed in the proposed Art. 527 *ter* LSC: "*Assignment of additional loyalty votes*. As an exception to the provisions of Arts. 96(2) and 188(2), the articles of association of a listed company may alter the ratio between the nominal value of the share and the right to vote in order to confer one additional vote on each share held by the same shareholder for two consecutive uninterrupted years. 2. The articles of association may extend but not diminish the minimum period of uninterrupted ownership provided for in the previous paragraph". The reinforced majority for the recognition of these loyalty shares (new Art. 527 *quater*) by the articles of association is established in "the favourable vote of shareholders representing, in person or by proxy, at least two thirds of the share capital at the meeting where shareholders in attendance represent fifty per cent or more of the total subscribed capital with voting rights and the favourable vote of shareholders representing at least eighty per cent of the share capital at the meeting where shareholders in attendance represent twenty-five per cent or more of the share capital, which in any case will be necessary where fifty per cent is not reached". For the elimination of this provision in the articles of association, the quorum and qualified majorities established in Art. 201(2) LSC shall apply. The additional loyalty votes are taken into account for the purposes of reporting significant shareholdings and the obligation to make a takeover bid. Unless otherwise provided in the articles of association of the listed company, these additional votes are computed for the purposes of determining the quorum at the general meeting and calculating the majorities necessary for the passing of resolutions (new Art. 527 *quinquies* LSC).

2. Amendments to the Collective Investment Schemes Act, the Private Investment Entities, Collective Investment Firms of a Closed-Ended Type and their Managers Act, the Insurers and Reinsurers (Unified Regulation, Supervision and Solvency) Act, the Auditing of Accounts Act, the Companies Act and the Securities Market Act brought about by the transposition of the Directive encouraging long-term shareholder engagement:

   a) The provisions of the Directive on the transparency policy of institutional investors, asset managers and proxy advisors are incorporated in order to "enhance transparency in the conduct of capital market participants". To this end, firstly, the Collective Investment Schemes Act and the Private Investment Entities, Collective Investment Firms of a Closed-Ended Type and their Managers Act are amended, and the aforementioned managers are required to draw up and *publish a policy "describing how they integrate shareholder engagement in their investment policy"*, as well as to publicly disclose on an annual basis how this policy has been implemented (new Arts. 47 *ter* LIIC and 67 *ter* LECR; see the special provision for managers providing asset management services to insurers or pension plans and funds in Arts. 47 *quater* LIIC and 67 *quater* LECR and, in connection with this, the also new Arts. 79 bis and 79 *ter* LOOSE).

b) *The right of the listed company to know the identity of the shareholders, including the beneficial owners* of the shares. The main novelty of the amendment lies in this right (new Art. 497 *bis*: "right to identify the beneficial owners"), recognised to the listed company "to request the identification of the beneficial owners directly from the intermediary entity or indirectly through the central securities depository. Associations of shareholders or shareholders who individually or jointly hold at least three per cent of the share capital shall request the identification of the beneficial owners from the intermediary entity necessarily through the central securities depository. In both cases, the intermediary entity shall directly and promptly report to the requester the identity of the beneficial owners. Practical aspects of the transmission of information by custodians or intermediaries entitled as shareholders are developed in the new Arts. 520 *bis* and 520 *ter* LSC. A cascade information transmission mechanism is provided for in Arts. 520 *bis* (2) and 524 *bis*, as well as the obligation for intermediary entities entitled as shareholders of the listed company to facilitate "the exercise of the rights inherent in the shares by the beneficial owners whose shares they hold or manage, including the right to attend and to vote at general meetings, and they shall exercise the rights deriving from the shares according to the authorisation and express instructions of and for the benefit of the beneficial owner" (new Art. 523 *bis*). The new Arts. 497, 523 *bis*, 524 *bis* and 527 *bis* expressly refer to Commission Implementing Regulation (EU) 2018/1212 of 3 September 2018 laying down minimum requirements implementing the provisions of Directive 2007/36/EC of the European Parliament and of the Council as regards shareholder identification, the transmission of information and the facilitation of the exercise of shareholders, which will apply from 3 September 2020.

c) Attention is drawn to the obligation of the company, when *voting has been* exercised *by electronic means*, to send to the person who cast his vote electronically an electronic confirmation of the receipt of his vote, as well as to the right recognised for the shareholder or his representative and the beneficial owner of the shares, to request "a confirmation that the votes corresponding to his shares have been correctly registered and accounted for by the company, unless they already have this information" (Art. 527 *bis* LSC).

d) *New rules for proxy advisors*. A new Part X ("Proxy advisors") is introduced in Title IV of the Securities Market Act (Arts. 137 *bis* to 137 *quinquies*). This part applies to proxy advisors who provide their services with respect to listed companies which have their registered office in a Member State of the European Union and the shares of which are admitted to trading on a regulated market situated or operating within a Member State, provided that the proxy advisor has its registered office in Spain, or, where the proxy advisor does not have its registered office in a Member State of the European Union, it has its head office in Spain or an establishment in Spain if it does not have its registered office or its head office in a Member State of the European Union. The proxy advisor is defined as 'a legal person that analyses, on a professional and commercial basis, the information that listed companies are legally obliged to publish and, where appropriate, other types of information, with a view to informing investors' voting decisions by providing research, advice or voting

recommendations that relate to the exercise of voting rights and is subject to a series of transparency obligations (publication on its website of the code of conduct they follow, preparation of an annual report addressed to its clients with the content detailed in Art. 137 *quater*, etc.). In addition, non-compliance with these obligations and the obligation to disclose "without delay to its clients any actual or potential conflicts of interest or business relationships that may influence the preparation of its research, advice or voting recommendations and the actions it has taken to eliminate, mitigate or manage the actual or potential conflicts of interest" (Arts. 282(22) and 295(23) LMV) are classed as administrative infringements.

e) Art. 541 LSC (in respect of the *annual remuneration report*), as is the current Art. 529 *novodecies* (approval of the *directors' remuneration policy*) are amended to, inter alia, allow listed companies "to temporarily derogate from the remuneration policy, provided that the policy includes the procedural conditions under which the derogation can be applied and specifies the elements of the policy from which a derogation is possible. Exceptional circumstances as referred to in [...] shall cover only situations in which the derogation from the remuneration policy is necessary to serve the long-term interests and sustainability of the company as a whole or to assure its viability". Art. 538 LSC is amended, which will require listed companies to include in the directors' report, in a separate section, in addition to the annual corporate governance report, the annual report on directors' remuneration.

f) *Transactions with related parties*: a new Part VII *bis* is introduced in the Companies Act (Arts. *529 vicies* to 529 *quatervicies*). As indicated in the preamble to the Draft Bill, "the first important change is the referral of the definition of a related party transaction to that contained in the international accounting standards adopted in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as required by the Directive. Today, such a definition can be specifically found in IAS 24 of Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council". The publicity of related party transactions (529 *unvicies*), the approval of related party transactions (529 *duovicies*) and the various exceptions to one and the other (529 *tervicies*) are regulated separately. It should be noted that the announcement by the company, "at the latest at the time of their conclusion", of transactions with related parties carried out by the listed company or companies in its group that exceed 5% of the equity value appearing in the last individual or consolidated balance sheet of the company or 2.5% of the annual turnover deducted from the individual or consolidated income statement of the company, must be accompanied by a report issued by an independent third party assessing "whether or not the transaction is fair and reasonable from the perspective of the company and of the shareholders who are not a related party, including minority shareholders, and explaining the assumptions it is based upon together with the methods used" (Art. 529 *unvicies* (4) LSC). These rules do not apply, except where

otherwise provided in the articles of association, to transactions with related parties that cumulatively comply with the following three requirements: "*a*) they are carried out under contracts whose conditions are standard form and applied en masse to a large number of clients; *b*) they are carried out at prices or fees generally established by the person acting as supplier of the good or service in question; and *c*) their value does not exceed 0.1% of the company's annual revenues. Approval of these transactions may be granted by bodies or persons other than the general meeting or the board of directors which have sufficient power of representation. The Board shall establish an internal procedure to periodically assess whether these conditions are fulfilled. The related parties shall not take part in that assessment" (Art. 529 *tervicies* (1)).

As a further change, the following is indicated in the preamble to the Draft Bill: "with regard to the voting by shareholders involved in a conflict of interest, a special rule is established for listed companies, different from that provided in Art. 190 LSC [...]. In view of the requirements for challenging corporate resolutions in listed companies, the protection of minority shareholders has been strengthened with a special rule applicable to listed companies, so that shareholders involved in a conflict of interest may only vote if the transaction subject to a decision has been supported by a majority of the non-executive independent directors in the board of directors. The board of directors shall be competent to approve the rest of [the] related party transactions unless, due to their special characteristics, they are subject to a less demanding and quicker approval procedure". Transactions with companies in the same group within the framework of ordinary management and under normal market conditions, as well as transactions with wholly-owned investees, structural changes subject to Act 3/2009, of 3 April, or those approved in credit institutions within the framework of measures to safeguard their stability may also be approved by a body or person with sufficient powers of representation (Arts. 529 *quatervicies* and 529 tervicies (2), respectively).