

**2020**

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

# SPAIN



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# Guidelines Introduction

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These guidelines are intended to supplement Glass Lewis' Continental Europe Policy Guidelines by highlighting the key policies that we apply specifically to companies listed in Spain and the relevant regulatory background to which Spanish companies are subject, where they differ from Europe as a whole. Given the growing convergence of governance regulations and practices across companies subject to European Union rules and directives, Glass Lewis combined our general approach to Continental European companies in a single set of guidelines, the Continental Europe Policy Guidelines, which set forth the underlying principles, definitions and global policies that Glass Lewis uses when analysing Continental European companies.

While our approach to issues addressed in the Continental Europe Policy Guidelines are not repeated here, we will clearly indicate in these guidelines when our policy for Spanish companies deviates from the Continental Europe Policy Guidelines.

## CORPORATE GOVERNANCE BACKGROUND

The National Securities Market Commission (*Comisión Nacional del Mercado de Valores* or "CNMV") is the Spanish government agency responsible for regulating national financial securities markets and ensuring their compliance with applicable regulations. The CNMV is an independent agency that falls under the Spanish government's Ministry of Economy and Finance.

The Spanish Companies Law (*Ley de Sociedades de Capital* or "LSC"), Securities Market Law (*Ley del Mercado de Valores* or "LMV"), the Sustainable Economy Law (*Ley de Economía Sostenible* or "LES"), and the Commercial Code (Código de Comercio) provide the legislative framework for regulation and basic principles of corporate governance in Spain. In 2014, Law 31/2014 of December 3, 2014 was introduced to update the LSC implementing further key provisions affecting corporate governance in line with developing European standards, among which include, binding votes on remuneration policy, stricter regulations on director classification and committee independence, and the implementation of new ownership thresholds for shareholders' rights. The law also requires companies to disclose an annual corporate governance report. Its content and structure is determined by the CNMV and will, at a minimum, include details on (i) the ownership structure of the company; (ii) any voting restrictions or restrictions on the transfer of securities; (iii) the management structure of the company; (iv) related party transactions; (v) risk control systems in place; (vi) the convocation of the general meeting; (vi) the degree of compliance, or explanations behind failure to comply, with corporate governance recommendations; and (vii) the main characteristics of the internal control and risk management systems in place relating to the release of financial information.<sup>1</sup> Further, in February 2015 the Spanish Good Governance Code of Listed Companies ("the Good Governance Code" or "the Code"), which sets out principles and provisions of best practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders, replaced the previous best practice recommendations ("the Unified Code"), largely in order to harmonise with the amended Companies Law. The new format of the Code identifies certain good governance principles, which in turn provide for a set of specific recommendations. It operates on a "comply or explain" premise, whereby companies are required by Spanish law to specify their degree of compliance with corporate governance recommendations, justifying any failure to comply.<sup>2</sup>

## MARKET AND REGULATORY UPDATES

Law 11/2018 has transposed EU Directive 2014/95/EU on the disclosure of non-financial and diversity information into Spanish law. The law has introduced a binding vote on non-financial information statements, giving shareholders a direct say on matters related to environment, social issues, human rights, anti-corruption and

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<sup>1</sup> Article 540 of Spanish Companies Law.

<sup>2</sup> Article 61-bis of Sustainable Economy Law.

sustainable development.

In addition, the Spanish Companies Law is under review and expected to come into force on January 1, 2020. The proposed changes are intended to transpose Directive (EU) 2017/828 of the European Parliament ("SRD II") regarding the promotion of the long-term involvement of shareholders in listed companies.

Among the anticipated changes is the potential for shares to carry double voting rights, provided that the shares have been held by the same shareholder for an uninterrupted period of two years. The introduction of such "loyalty shares" would require shareholder approval of amendments to a company's articles of association. Further, the draft law also stipulates that all directors of a listed company must be "natural persons". As such, the election of legal entities, representatives of which could be changed without shareholder approval, will no longer be permitted.

Glass Lewis' submission to the public consultation regarding the proposed new legislation may be viewed at: <https://www.glasslewis.com/glass-lewis-submission-on-spanish-srd-ii-consultation-introduction-of-loyalty-shares/>

## **SUMMARY OF CHANGES FOR THE 2020 SPAIN POLICY GUIDELINES**

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis. This year we've made noteworthy revisions in the following areas, which are summarized below but discussed in greater detail in the relevant section of this document:

### **NON-FINANCIAL INFORMATION REQUEST**

We have updated these guidelines to reflect the changes to the Spanish law regarding reporting on non-financial information.

### **DOUBLE VOTING RIGHTS**

We have updated these guidelines to clarify that we will generally recommend voting against any article amendments intended to facilitate double voting rights/loyalty shares.

# A Board of Directors that Serves the Interests of Shareholders

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## ELECTION OF DIRECTORS

Spanish companies are usually governed by a unitary board consisting of executive directors (*consejeros ejecutivos*) and non-executive directors, the latter subdivided into proprietary directors or shareholder representatives (*consejeros dominicales*), independent directors (*consejeros independientes*) and other external directors (*otros consejeros externos*).<sup>3</sup> However, the board chair, with the approval of the board of directors, may delegate some of the board's management functions to an executive committee.<sup>4</sup>

## INDEPENDENCE

In Spain, we place directors into four categories based on an examination of the type of relationship they have with the company:

1. **Independent Director** — An independent director has no material financial,<sup>5</sup> familial<sup>6</sup> or other current relationships with the company,<sup>7</sup> its executives, or other board members, except for board service and standard fees paid for that service.
2. **Affiliated Director** — An affiliated director has a material financial, familial or other relationship with the company or its executives, but is not an employee of the company.<sup>8</sup> This may include directors whose employers have a material relationship with the company or its subsidiaries or major shareholders. In addition, we will consider directors affiliated if they:
  - Have served on the board for 12 consecutive years or more;<sup>9</sup>

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<sup>3</sup> Defined in Article 529-duodecies of Spanish Companies Law.

<sup>4</sup> Article 249 of Spanish Companies Law.

<sup>5</sup> Per Glass Lewis' Continental Europe Policy Guidelines, "material" as used herein means a relationship in which the value exceeds: (i) €50,000, or the equivalent (or 50% of the total compensation paid to a board member, or where no amount is disclosed) for board members who personally receive compensation for a professional or other service they have agreed to perform for the company, outside of their service as board members. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a board member receives fees directly; (ii) €100,000, or where no amount is disclosed, for those board members employed by a professional services firm such as a law firm, investment bank or large consulting firm where the firm is paid for services but the individual is not directly compensated. This limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director's firm; (iii) 1% of the company's consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company); (iv) 10% of shareholders' equity and 5% of total assets for financing transactions; or (v) the total annual fees paid to a director for a personal loan not granted on normal market terms, or where no information regarding the terms of a loan have been provided.

<sup>6</sup> Per Glass Lewis' Continental Europe Policy Guidelines, familial relationships include a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces, nephews, in-laws, and anyone (other than domestic employees) who shares such person's home. A director is an affiliate if the director has a family member who is employed by the company.

<sup>7</sup> A company includes any parent or subsidiary in a group with the company or any entity that merged with, was acquired by, or acquired the company.

<sup>8</sup> Article 529-duodecies of Spanish Companies Law. If a company classifies a director as non-independent, Glass Lewis will classify that director as an affiliate, unless there is a more suitable classification.

<sup>9</sup> Paragraph 4 of Article 529-duodecies of Spanish Companies Law. As outlined in our Continental Europe Policy Guidelines, we refrain from recommending to vote against directors who are not considered independent due to lengthy board tenure on that basis alone in order to meet recommended independence thresholds.

- Have been employed by the company within the past five years;<sup>10</sup>
  - Have — or have had within the past three years — a material relationship with the company, either directly or as a partner, shareholder, director or senior employee of any entity that has such a relationship with the company;<sup>11</sup>
  - Have close family ties with any of the company’s senior employees<sup>12</sup>;
  - Hold cross-directorships or have significant links with other directors through their involvement in other companies or entities;<sup>13</sup> and/or
  - Have not been nominated by the nominating committee<sup>14</sup>
3. **Inside Director** — An inside director simultaneously serves as a director and as an employee of the company.<sup>15</sup> This category may include a board chair who acts as an employee of the company or is paid as an employee of the company.
  4. **Shareholder Representative**<sup>16</sup> — A director who is either the beneficial owner of 3% or more of the company’s share capital, or represents the owner of 3% or more of the company’s share capital.

### Voting Recommendations on the Basis of Board Independence

Glass Lewis believes a board will be most effective in protecting shareholders’ interests when the majority of the board members are non-executive directors<sup>17</sup> and at least one-third of all directors are independent.<sup>18</sup> However, at least half of all board members of companies included in the IBEX 35 index should be independent directors, unless the company has shareholders individually or concertedly controlling over 30% of the issued share capital.<sup>19</sup> Where 50% or more of the members are executive directors and/or the board does not include a sufficient number of independent members, we typically recommend voting against some of the inside and/or affiliated directors in order to satisfy the above-mentioned non-executive and independence thresholds.

Further, we believe shareholder representation on the board can be beneficial to all shareholders but should be proportional to economic interest. As a result, the composition of the board should mirror the company’s share capital structure.<sup>20</sup> Where the relation between shareholder representatives and independent board members does not match the proportion between the economic interest represented by shareholder representatives and the free float, we may recommend voting against some of the shareholder representatives to make the representation proportional.

10 Paragraph 4 of Article 529-duodecies of the Spanish Companies Law, sets a three-year look-back for employees and a five-year look-back for executive directors. Glass Lewis believes a five-year period is appropriate for measuring the potential conflict of interest for any former employee or executive.

However, Glass Lewis does not apply the five-year lookback period to directors who have previously served as executives of the company on an interim basis for less than one year. In contrast, Glass Lewis may consider a lookback period irrelevant in cases where a former executive has other significant ties to the company, such as being a member of the founding family of the firm or a former executive who continues to receive variable remuneration.

11 Spanish Companies Law applies a three-year lookback for directors who have served as a partner of the company’s or group’s independent auditor. Further, a director is considered non-independent if he/she has served as an executive or shareholder of a company which received donations from the company or group in the past three fiscal years. This provision does not apply to trustees. Paragraph 4 of Article 529-duodecies.

12 Article 529-duodecies of Spanish Companies Law defines “close family ties” as spouses or persons related up to the second-degree. We define second-degree relatives as anyone including and up to parents, children, siblings, cousins, aunts/uncles, nieces/nephews and grandparents.

13 Paragraph 4 of Article 529-duodecies of Spanish Companies Law. In accordance with the law, a director will be considered non-independent when serving as an executive in another company where an executive of the company in question serves as a director.

14 Paragraph 4 of Article 529-duodecies of Spanish Companies Law.

15 Paragraph 1 of Article 529-duodecies of Spanish Companies Law classifies an executive director as one who performs a lead management position in the company or group. Directors who are senior officers or managers of companies belonging to the group may be considered shareholder representatives under the law. However, Glass Lewis will generally consider directors exercising executive functions in a group entity to be insiders.

16 Real Decreto 1362/2007. Under Article 529-duodecies of Spanish Companies Law, a shareholder representative who no longer represents a shareholder due to a sale of shares in the company, may not be appointed as an independent director until the shareholder has sold all of its shares in the company. An independent director may hold shares in the company provided it is not of significance.

17 Recommendation 15 of the Good Governance Code.

18 Recommendation 17 of the Good Governance Code.

19 Recommendation 17 of the Good Governance Code.

20 Recommendation 16 of the Good Governance Code.

## Voting Recommendations on the Basis of Committee Independence

Spanish law requires the audit, remuneration and nominating committees to be exclusively composed of non-executive directors, with the audit committee comprising of a majority of independent members, while remuneration and nominating committees must include at least two independent members.<sup>21</sup> We believe these committees should be composed of a majority of independent directors.<sup>22</sup> Further, in accordance with Spanish law, all committees should be chaired by an independent director.<sup>23</sup>

## OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

Our policies with regard to performance, experience and conflict of interest issues are not materially different from our Continental Europe Policy Guidelines.

## BOARD STRUCTURE AND COMPOSITION

Our policies with regard to board board-level risk management oversight and board diversity are not materially different from our Continental Europe Policy Guidelines. However, our policy regarding the size of the board of directors takes into account local best practice. The following are clarifications regarding best practice recommendations in Spain.

### SEPARATION OF THE ROLES OF BOARD CHAIR AND CEO

Under Spanish Law, the role of board chair may be held by an executive director, however, his/her appointment must be approved by two-thirds of the board of directors. In such cases, the non-executive directors must appoint a lead independent director (*consejero coordinador*).<sup>24</sup> Likewise, the Good Governance Code states that when the roles of board chair and CEO are combined, an independent lead director with additional powers, such as maintaining contacts with the company's shareholders, organising regular evaluations of the board and coordinating the chair's succession plan, should be appointed.<sup>25</sup>

When the roles are combined and the board has failed to implement adequate measures to prevent and manage the potential conflict of interests deriving from the combination of the two positions such as appointing a demonstrably independent lead director, we may recommend voting against the chair of the nominating committee.

### SIZE OF THE BOARD OF DIRECTORS

In contrast to our Continental Europe Policy Guidelines, which specify a maximum board size of 20 members, we believe that boards should be composed of no more than 15 members in Spain in line with the recommendation of the Good Governance Code.<sup>26</sup> If a board has fewer than five directors or more than 15 directors, we will typically recommend voting against the chair of the nominating committee.

### BOARD DIVERSITY

In accordance with Spanish law, the company's board must ensure that the procedures for appointing its members promote gender diversity, experience and knowledge with no implied bias entailing any kind of discrimination in regard to the appointment of female directors.<sup>27</sup> The Good Governance Code recommends

21 Articles 529-quaterdecies and 529-quindecies of Spanish Companies Law.

22 Recommendation 47 of the Good Governance Code. While we generally believe that a majority of the members of the remuneration committee should be independent of shareholders owning 3% or more of the company's share capital or voting rights, we will take into account the company's ownership structure when evaluating the composition of this committee. However, we believe that a majority of the members of the remuneration committee should be independent of controlling shareholders (i.e., those owning or controlling 50% or more of a company's total share capital) in accordance with EU Commission Recommendation of 15 February 2005 on the role of non-executive directors of listed companies and on the committees of the board.

23 Articles 529-quaterdecies and 529-quindecies of Spanish Companies Law.

24 Article 529-septies of Spanish Companies Law.

25 Recommendations 33 and 34 of the Good Governance Code.

26 Recommendation 13 of the Good Governance Code.

27 Article 529-bis of Spanish Companies Law.



that boards should have adequate diversity of knowledge, gender and experience to perform their tasks efficiently, objectively and in an independent manner.<sup>28</sup> The Code recommends that the director selection policy should pursue the goal of having at least 30% of total board places occupied by female directors before the year 2020.<sup>29</sup> In addition, companies must disclose the number of female directors sitting on the board and its committees as well as indicate the development of this number over the last four years. Further, the Corporate Governance Report should include a description of the board's diversity policy, including its objectives, the measures adopted and how they were applied, and the results achieved in the reporting period. The diversity policy should include information such as professional experience, age, and gender diversity. An explanation should be offered where such a policy has not been applied. Small and medium-sized entities are only obliged to provide information on the measures that have been adopted in terms of gender diversity.

While Glass Lewis values the importance of board diversity, believing there are a number of benefits from having individuals with a variety of backgrounds serving on boards, we generally do not base voting recommendations solely on strict board diversity quotas. However, we may recommend voting against the chair of the nominating committee if a company fails to make progress towards best practice prevalent in the market and has not disclosed a sufficient explanation or plan to address the issue.

## BOARD SKILLS

Glass Lewis believes companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. From 2019, our analyses of director elections at IBEX-35 index companies will include board skills matrices in order to assist in assessing a board's competencies and identifying any potential skills gaps.

## BOARD COMMITTEES

In accordance with Spanish law, the board must establish an audit committee, individual nominating and remuneration committees or a joint nominating and remuneration committee. The committees must be composed entirely of non-executive directors, with the audit committee comprising of a majority of independent members, while remuneration and nominating committees must include at least two independent members. The chair of each committee must be independent. At least one member of the audit committee must possess expertise in accounting or auditing.<sup>30</sup>

The Good Governance Code recommends that companies establish individual nominating and remuneration committees or a joint nominating and remuneration committee composed of a majority of independent directors.<sup>31</sup> Large cap companies should operate separately constituted nomination and remuneration committees.<sup>32</sup>

Further, the Spanish Central Bank (*Banco de España*) determines that credit institutions which, on the basis of their size, internal organisation and the nature, scale and complexity of their activities, should establish a risk committee. This committee shall be made up of non-executive directors who have the appropriate knowledge, capacity and experience to fully understand and oversee the risk strategy and the institution's propensity to risk. At least one-third of the members, and in any event the chair, should be independent directors.<sup>33</sup>

Our policies with respect to committee performance and standards for assessing committees are not materially different from our Continental Europe Policy Guidelines.

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28 Principle 10 of the Good Governance Code.

29 Recommendation 14 of the Good Governance Code.

30 Articles 529-terdecies, 529-quaterdecies and 529-quindecies of Spanish Companies Law.

31 Recommendation 47 of the Good Governance Code.

32 Recommendation 48 of the Good Governance Code.

33 Article 38 of Law 10/2014 on the regulation, supervision and solvency of credit institutions. Per Rule 27 of Circular 2/2016 of Spanish Central Bank, entities whose total volume of assets at individual level is greater than or equal to €10 billion at the closing date of any of the two preceding financial years must establish a risk committee.

## ELECTION PROCEDURES

Our policies with regard to election procedures are not materially different from our Continental Europe Policy Guidelines. The following are clarifications regarding best practice recommendations in Spain.

### TERM LENGTH

Although Glass Lewis favours the annual election of directors, under Spanish company law directors may be elected for a term of up to four years and are eligible for re-election.<sup>34</sup> We generally do not recommend voting against any directors based on this issue.

### RATIFICATION OF THE CO-OPTION OF BOARD MEMBERS

In certain instances, board members are appointed directly by the board to serve as directors. Spanish company law allows the board to fill vacancies through co-option by appointing another individual until the next general meeting of shareholders.<sup>35</sup> We apply the same standards for such proposals as we do when analysing a standard election of directors proposal.

### ELECTION OF DIRECTORS AS A SLATE

Spanish law requires companies to allow shareholders to vote separately on certain agenda items proposed at general meetings including amendments to the company's articles of association and the appointment, ratification, re-election and removal of each director.<sup>36</sup> This is especially relevant to the appointment of directors, where shareholders should be able to evaluate and vote on each candidate individually, rather than as a slate.

### ELECTION OF LEGAL ENTITIES TO THE BOARD

In Spain, it is common for shareholder representatives who are corporations/legal entities to be nominated to serve on the board of directors. Occasionally, companies do not disclose the names of the physical persons representing the legal entities until after they have been elected to and/or serve on the board. Lacking this information, shareholders are unable to form key judgments about the physical shareholder representative. As a result, we will recommend abstaining from any shareholder representative proposed solely as a legal entity.

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<sup>34</sup> Article 529-undecies of Spanish Companies Law.

<sup>35</sup> Article 244 of Spanish Companies Law.

<sup>36</sup> Article 197-bis of Spanish Companies Law.

# Transparency and Integrity in Financial Reporting

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In Spain, companies are required to submit their financial statements and the allocation of profits and dividends for shareholder approval.<sup>37</sup> Shareholders are also required to approve a company's choice of independent auditor, who may be appointed for terms of between three to nine years.<sup>38</sup> Our policy for these issues in Spain is not materially different from Glass Lewis' Continental Europe Policy Guidelines.

## ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

As a routine matter, Spanish company law requires that shareholders approve a company's annual accounts and management report, and where applicable the consolidated accounts and management report, within six months of the end of fiscal year in order for them to be valid.

## NON-FINANCIAL INFORMATION REPORT

Spanish law requires that large companies disclose additional non-financial information on environmental, social and diversity issues. The information related to corporate social responsibility must be incorporated into the management report or presented in a separate report.

The report on non-financial information must be put to shareholder vote as a separate point in the annual general meeting.<sup>39</sup>

Glass Lewis evaluates the level of a company's non-financial reporting on a case-by-case basis in the context of the financial materiality of the information to the company's operations. We will generally recommend voting for proposals seeking to approve a company's report on non-financial information provided that sufficient information is made available to shareholders in accordance with the law and that a company identifies a meaningful reporting framework that was used in drafting of the report.

However, in instances where it is clear that a company has not properly managed or mitigated environmental or social risks to the detriment of shareholder value, Glass Lewis may consider recommending that shareholders vote against the approval of the non-financial information report.

## ALLOCATION OF PROFITS/DIVIDENDS

In accordance with Spanish company law, prior to the distribution of dividends, companies are required to allocate at least 10% of their after-tax profits to a legal reserve.<sup>40</sup> Additional allocations for legal reserves are no longer required when the legal reserve reaches 20% of a company's share capital (i.e., the nominal value of all company issued shares) as of the last day of the year.<sup>41</sup> After the statutory requirement for allocation to the legal reserve has been met, shareholders may decide to declare a dividend payable to shareholders (in cash or shares), to allocate a portion to a specific reserve and/or to carry the profits forward in retained earnings.<sup>42</sup>

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<sup>37</sup> Articles 164 and 253 of Spanish Companies Law.

<sup>38</sup> Article 264 of Spanish Companies Law.

<sup>39</sup> Articles 49 of Spanish Commercial Code.

<sup>40</sup> Article 274 of Spanish Companies Law.

<sup>41</sup> *Ibid.*

<sup>42</sup> Articles 273, 275 and 276 of Spanish Companies Law.

## APPOINTMENT/RATIFICATION OF AUDITOR

Glass Lewis believes shareholders should be able to annually review an auditor's performance and to annually ratify a board's auditor selection. Nevertheless, Spanish law allows companies to elect an auditor for an initial period of three to nine years. As entrenchment can erode the independence and effectiveness of the auditor, the auditor must be rotated every ten years, however, the maximum term may be extended by four more years in case an additional auditor is appointed to act as a co-auditor.<sup>43</sup> Further, the principal individual auditor must be rotated after an initial five years.<sup>44</sup>

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<sup>43</sup> Article 40.1 Spanish Auditing Act 22/2015.

<sup>44</sup> Article 40.2 Spanish Auditing Act 22/2015.

# The Link Between Pay and Performance

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In Spain, the Good Governance Code provides best practice remuneration recommendations and the LMV and the LES provide the legislative framework for the structure and content of the remuneration policies of publicly listed companies. Further, regulation regarding remuneration policies of financial institutions is included in Law 10/2014 on the regulation, supervision and solvency of credit institutions.

Other than aspects of remuneration disclosure and policies specific to Spain mandated by the Good Governance Code or required by the aforementioned laws and regulations, our assessment of a company's remuneration policy is not materially different from the approach to evaluating remuneration outlined in Glass Lewis' Continental Europe Policy Guidelines.

## VOTE ON EXECUTIVE REMUNERATION

In accordance with the Good Governance Code and Spanish Law, companies must prepare and submit an annual remuneration report for advisory shareholder approval and submit their remuneration policy to a binding vote at least once every three years.<sup>45</sup>

Any material change to the remuneration policy must be submitted to a vote at a shareholders meeting in order to take effect. Should a company fail to gain shareholder approval for its remuneration report, it must submit its remuneration policy to shareholders for approval at the next annual general meeting, unless its remuneration policy has been approved at the same meeting.<sup>46</sup>

## REMUNERATION POLICY

Spanish companies' remuneration policy will determine the parameters within which executive directors may be remunerated. It must include the maximum annual remuneration amount for all directors and the parameters for setting variable pay. Further, any remuneration paid to directors on termination of their term in office must remain within the limits stipulated by the remuneration policy.<sup>47</sup>

We expect companies to fully disclose and explain their remuneration policies in a manner that is consistent with shareholder interests. When separate votes are offered on the policy and remuneration report, our voting recommendations for an advisory vote on the remuneration report may reflect ongoing structural concerns as well as remuneration decisions and outcomes during the past year. Our voting recommendations for a binding vote on the remuneration policy will reflect an overall assessment of the structural alignment between pay and company performance as well as any changes that would affect the alignment of executive and shareholder interests.

## STRUCTURE AND CONTENT OF REMUNERATION REPORTS

Spanish companies' remuneration reports should be clear, complete and comprehensible. A remuneration report should include a description of a company's remuneration practices during the year, as well as a break-down of individual remuneration and a description of the remuneration policies planned for future years.<sup>48</sup>

<sup>45</sup> Article 529-novodecies of Spanish Companies Law.

<sup>46</sup> *Ibid.*

<sup>47</sup> Article 529-octodecies of Spanish Companies Law.

<sup>48</sup> Article 61-ter of Sustainable Economy Law In accordance with Spanish law.

The Spanish Companies Law states that the Ministry of Economy and Finance and the CNMV will determine the structure and content of remuneration reports. Spanish companies are expected to revise their remuneration reports in accordance with a standardised format in clear, uniform tables. Remuneration reports must contain the remuneration policy for the current year, including a robust breakdown of individual remuneration to include fixed salary, board fees, bonuses, long-term incentives, committee fees, and severance payments and equity awards received by individual executives including the number of awards, their value, exercise price and exercise period.<sup>49</sup> In addition, a summary of changes from the previous year, as well as the policy regarding the upcoming year and prior year must also be included.

From financial years ending December 31, 2018, companies that do not wish to use the standardised electronic document are allowed to file remuneration reports in a free format, the content of which must comply with the minimum requirements established by legislation. These free format reports must be accompanied by statistical appendices in order to continue to provide a minimum amount of information in a standardised format.<sup>50</sup>

## SHORT-TERM AND LONG-TERM INCENTIVES

In accordance with the Good Governance Code and Order 461/2013, companies should, at a minimum, disclose the performance criteria used to calculate the entitlement of any performance-related remuneration, the main parameters and grounds for annual bonus schemes (“STIs”), an estimate of the total of variable payments as a function of the degree of compliance with pre-set targets or benchmarks, as well as explain the relative weight of variable to fixed remuneration.<sup>51</sup> In practice, however, it is uncommon for Spanish companies, particularly small companies, to fully disclose the performance metrics and targets for STIs.

With respect to long-term incentives (“LTIs”), the Good Governance Code recommends that share options or other share-based incentives be linked to a company’s performance and safeguards should be in place to ensure that they reflect professional performance, rather than simply changes in the market or a company’s sector that are outside of an executive’s control.<sup>52</sup>

Lastly, the Good Governance Code urges that non-executive directors be excluded from participating in any variable incentive program that is linked to a company’s financial indicators or share price.<sup>53</sup>

## SEVERANCE PAYMENTS

While we generally believe that severance payments should be limited to two years’ fixed salary, executive severance agreements in Spain often exceed this cap. In line with Recommendation 64 of the Spanish Good Governance Code of Listed Companies, we believe severance payments should be capped at two years’ total pay subject to meeting performance conditions and that all companies should disclose their policy on such payments.<sup>54</sup>

## EXECUTIVE REMUNERATION FOR FINANCIAL INSTITUTIONS

In accordance with Spanish law, the remuneration policies of financial institutions must not encourage excessive employee and executive risk taking and they must be in line with a company’s business strategy, goals, values and long-term interests.<sup>55</sup> Please see Glass Lewis’ Continental Europe Policy Guidelines for further details regarding the additional measures that apply to financial institutions in Europe.

<sup>49</sup> Article 10 of Order 461/2013.

<sup>50</sup> Circular 2/2018, of 12 June, of the CNMV.

<sup>51</sup> Recommendation 58 of the Good Governance Code and Article 10 of Order 461/2013.

<sup>52</sup> Recommendation 58 of the Good Governance Code.

<sup>53</sup> Recommendation 57 of the Good Governance Code

<sup>54</sup> Recommendation 64 of the Good Governance Code.

<sup>55</sup> Article 33 of Law 10/2014 on the regulation, supervision and solvency of credit institutions.

## REMUNERATION POLICY RELATIVE TO OWNERSHIP STRUCTURE

Glass Lewis recognises that differences in the ownership structures may affect incentive structure for executives. In particular, where a company is controlled and managed by a family or individual, as is common in Spain, we believe the use of equity incentives for representatives of the controlling family or individual is inappropriate and may serve to further entrench the controlling shareholders' stake. Additionally, in general, we expect companies with dispersed ownership to demonstrate a more precise and linear pay-performance link than those with ownership that is more concentrated.

# Governance Structure and the Shareholder Franchise

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Shareholders of Spanish-listed companies may be asked to approve amendments to articles and ratify the acts of the board and/or management. In Spain, companies request that shareholders discharge the members of the board of directors and/or management from any and all of their actions committed during the fiscal year.<sup>56</sup> Our policy on these issues does not deviate materially from Glass Lewis' Continental Europe Policy Guidelines.

## SHAREHOLDERS' RIGHTS

Under Spanish law, shareholders holding at least 3% of a company's share capital may submit additional items to the agenda of the general meeting already convened.<sup>57</sup>

Further, a shareholder (or group of shareholders) holding at least 3% of a company's share capital, and shareholder associations who hold at least 1% of a company's share capital, are entitled to request beneficial ownership information for any shareholder.<sup>58</sup>

In accordance with our Continental Europe Policy Guidelines, we are generally not in favour of reducing these thresholds below the minimum legal requirement.

## SHORTENED NOTICE PERIOD

The Spanish Companies Law allows for the shortening of a company's extraordinary general meeting notice period from 30 days to 15, subject to annual shareholder approval of shareholders representing two thirds of the issued capital.<sup>59</sup> This authority, which is often sought at Spanish AGMs, is contingent upon a company having adequate electronic voting and communication provisions in place.

We recognise that the current notice period for an extraordinary general meeting of 30 days in Spain may not always be practicable; however, we believe that a 21 day notice period would be more reasonable. Despite assurances that shareholders will be able to vote electronically at an extraordinary general meeting, we continue believe 15 days is simply insufficient time for shareholders to receive a ballot, weigh the issues and submit voting decisions. In practice, such a short notice period may leave some shareholders with no time to review a proposal before submitting voting decisions in order to meet a voting deadline. Further, issues raised at extraordinary general meetings are by nature often more complex than routine annual general meeting proposals, thereby requiring a more in-depth review.

We note that electronic disclosure and voting provisions for shareholder meetings required by Spanish law mitigate to some extent the negative aspects of a shortened notice period. However, we believe that a notice period below 21 days does not provide shareholders with sufficient time to adequately review proposals being presented at an extraordinary general meeting.

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<sup>56</sup> Article 160 of Spanish Companies Law.

<sup>57</sup> Paragraph 2 of Article 495 of Spanish Companies Law.

<sup>58</sup> Paragraph 2 of Article 497 of Spanish Companies Law.

<sup>59</sup> Article 515 of Spanish Companies Law.



## DOUBLE VOTING RIGHTS

The draft of the Spanish Companies Law currently under review as at October 2019 includes the potential for shares to carry double voting rights. Once provided for in a company's articles of association, the double voting rights will apply to shares held in a listed company by the same registered shareholder for at least two years. The articles may extend, but not reduce, the minimum period of uninterrupted ownership requirement.

Glass Lewis is generally opposed to the creation or extension of stock with differential voting rights as it implicitly creates multiple classes of stock, which we believe to be detrimental to the equal exercise of shareholder rights. As such, we will generally recommend shareholders vote against the implementation of provisions relating to such loyalty initiatives into a company's articles of association.

# Capital Management

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Glass Lewis believes that adequate share capital is important to a company's operation. In Spain, the Companies Law provides the legal framework for authorities involving share capital increases and decreases, share repurchases and the issuance of shares or convertible/non-convertible debt instruments.

With the exception of country-specific regulations regarding capital proposals described below, our policies on these issues are not materially different from Glass Lewis' Continental Europe Policy Guidelines.

## AUTHORITY TO REPURCHASE SHARES

Spanish law limits the number of shares which may be repurchased to no more than 10% of a company's capital. Furthermore, the authority to repurchase shares cannot be granted for a period exceeding five years.<sup>60</sup> Given these limits, we will generally support buyback programs in Spain.

## ISSUANCE OF SHARES AND/OR CONVERTIBLE SECURITIES

In Spain, shareholders are required to approve all proposals related to the issuance of shares and/or convertible securities. According to Spanish law, shareholders may delegate the power to set the terms and conditions of an issuance to the board or management. Notwithstanding the aforementioned, if shareholders approve the amount of the increase and allow the board to determine the date and conditions of the issuance, the board's authority will be for one year.<sup>61</sup>

If, however, shareholders grant the board full discretion over the increase as well as the issuance, the board's authority will be for five years and will be capped at 50% of the company's total share capital.<sup>62</sup>

In addition, Spanish companies may determine whether to issue the shares and/or convertible securities with or without preemptive rights. However, in the event that it wishes to waive such rights, the board must request shareholder approval given that issuing additional shares may dilute existing holders.<sup>63</sup>

The Good Governance Code recommends that authorisations to issue shares without preemptive rights should be limited to 20% of a company's issued share capital.<sup>64</sup> As such, we may recommend voting against an authority to issue shares and/or convertible securities if the board will be granted the authority to issue shares without preemptive rights in excess of 20% of a company's share capital or if it does not clearly limit share issuances without preemptive rights to 20%. However, we will consider each authority on a case-by-case basis, taking into account a company's rationale for exceeding the aforementioned limit. We apply this limit in cases where there is a single proposal to increase a company's share capital or, in the aggregate, when there are separate/multiple proposals for the issuance of shares and convertible securities.

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60 Articles 146 and 509 of Spanish Companies Law.

61 Article 297 of Spanish Companies Law.

62 *Ibid.*

63 Article 308 of Spanish Companies Law.

64 Recommendation 5 of Good Governance Code.

## ISSUANCE OF DEBT INSTRUMENTS

In Spain it is a routine matter for shareholders to grant the board authorisation to issue and/or trade in non-convertible, convertible and/or exchangeable debt obligations not exceeding 100% of the company's total share capital.<sup>65</sup> Generally, the board is granted the authority to establish a fixed or variable interest rate, and more globally, to establish all other aspects of the debt instruments.<sup>66</sup>

In line with our Continental Europe Policy Guidelines, we will generally recommend voting in favour of such proposals if the requested authority is reasonable and we have no reason to believe that the increase in debt will weaken the company's financial position.

Further, it is common for Spanish companies to propose the issuance of non-convertible debt instruments and convertible debt instruments in separate proposals at the same meeting. When this is the case, we will combine the requested amounts under each proposal and evaluate the issuance of debt instruments in the aggregate.

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<sup>65</sup> Article 405 of Spanish Companies Law.

<sup>66</sup> Article 406 of Spanish Companies Law.

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