



Good Governance Code of Listed Companies



**Good Governance Code
of Listed Companies**

Comisión Nacional del Mercado de Valores
Edison, 4
28006 Madrid

Passeig de Gràcia, 19
08007 Barcelona

© Comisión Nacional del Mercado de Valores

Reproduction of the content of this report is permitted provided that the source is acknowledged.

The CNMV distributes its reports and publications on the Internet at www.cnmv.es

Layout: Composiciones Rali, S.A.

Contents

I	Introduction	7
I.1	The Good Governance Code of Listed Companies	7
I.2	Good Governance Code update	8
I.3	Characteristics of the Good Governance Code	9
I.3.1	Voluntariness, subject to the “comply and explain” principle	9
I.3.2	Evaluation by the market	10
I.3.3	Scope of application	10
II	Principles	11
II.1	General arrangements	11
II.2	Shareholders’ general meeting	11
II.3	Board of directors	11
III	Recommendations	15
III.1	General arrangements	15
III.1.1	Bylaw restrictions	15
III.1.2	Listed companies from the same group	15
III.1.3	Reporting of compliance with corporate governance recommendations	16
III.1.4	Meetings and contacts with shareholders, institutional investors and proxy advisors	17
III.1.5	Exercise of the delegated authority to issue shares or convertible securities without pre-emptive subscription rights	18
III.2	Shareholders’ general meeting	18
III.2.1	Information transparency and informed voting	18
III.2.2	General meeting attendance and participation	20
III.2.3	Policy on attendance payments	21
III.3	Board of directors	21
III.3.1	Board of directors responsibility	21
III.3.2	Board of directors structure and membership	22
III.3.2.1	Size, diversity and director selection policy	22
III.3.2.2	Board of directors membership	23
III.3.2.3	Director removal and resignation	25
III.3.3	Board of directors operation	27
III.3.3.1	Director dedication	27
III.3.3.2	Meeting frequency and director attendance	28
III.3.3.3	Director information and advice	29

III.3.3.4	The board chairman	30
III.3.3.5	The board secretary	31
III.3.3.6	Periodic board evaluation	32
III.3.4	Board of directors organisation	33
III.3.4.1	The executive committee	33
III.3.4.2	The audit committee	34
III.3.4.3	The risk control and management function	36
III.3.4.4	The nomination and remuneration committee	37
III.3.4.5	Other special board committees	39
III.3.5	Corporate social responsibility	40
III.3.6	Directors' remuneration	42

I Introduction

I.1 The Good Governance Code of Listed Companies

The Unified Good Governance Code of Listed Companies (hereafter Unified Code) was approved by the Board of the Comisión Nacional del Mercado de Valores (CNMV) on 22 May 2006, as a single document incorporating the corporate governance recommendations pursuant to section 1. f) of the first provision of Order ECO/3722/2003 of 26 December.

Since its approval, a series of intervening legal texts have affected various of its recommendations. In order to adapt or eliminate recommendations affected by new legislation, in June 2013 the CNMV Board approved a partial update of the Unified Code.

In recent years, there have been a flood of initiatives concerning good practice in corporate governance matters. Not only that, their numbers have multiplied since the start of the global financial crisis, reflecting the widespread conviction of the importance of listed companies being run in a proper and transparent manner, as a key driver of value generation in the corporate sector, improved economic efficiency and the strengthening of investor trust.

Spain has been no exception to this overall trend, and the country has seen solid advances in good corporate governance. It bears mention here that one of the objectives of the 2013 National Reform Plan was to broaden the current framework of good corporate governance in Spain, with the twin goal of improving the efficiency and accountability of Spanish firms' governance and ensuring that national standards attain maximum levels of compliance with international good governance principles and practices.

The Council of Ministers agreed at its meeting on 10 May 2013 to create a Committee of Experts on corporate governance matters to propose such initiatives and legislative changes as it deemed advisable to guarantee good governance in the corporate sector, and to lend support and advice to the CNMV in modifying the 2006 Unified Good Governance Code.

As stated in the text of the Council of Ministers resolution, the objectives pursued were to ensure the proper functioning of the governing and administrative bodies of Spanish companies in order to maximize competitiveness, build trust and transparency for shareholders and domestic and foreign investors, improve internal control and corporate responsibility systems, and ensure the correct internal distribution of functions, duties and responsibilities under standards of maximum rigour and professionalism.

This new good governance code of listed companies (the **Good Governance Code**), prepared with the support and advice of the Committee of Experts and approved by resolution of the CNMV Board on 18 February 2015, responds integrally to these objectives.

The Committee of Experts began by separating those issues best dealt with by proposing improvements in the current legal framework, eventually enshrined in Law 31/2014 of 3 December amending the Spanish Company Law to improve corporate governance, from those more suitably addressed by voluntary recommendations backed by “comply or explain”, as set out in this Good Governance Code.

To this end, further to its mandate, the Committee of Experts analysed and took into consideration the relevance and compliance record of the recommendations contained in the 2006 Unified Code, international good governance standards, particularly the recommendations of the European Commission, sundry reports and proposals from international organisations, doctrinal contributions and the legislation of peer countries.

I.2 Good Governance Code update

The new Good Governance Code has the following main novelties.

- (i) The Good Governance Code employs a new format based on selecting and identifying the principles informing each set of specific recommendations.

These principles are grouped in section II of the Good Governance Code.

- (ii) A significant number of the 2006 Unified Code recommendations have since been written into legislation (in cases such as the powers exclusive to the general meeting or the board of directors, separate votes on general meeting items, vote splitting, etc.), so do not form part of this Good Governance Code.

Likewise, the definitions of the various director categories are contained, firstly, in Order ECC/461/2013 of 20 March¹, and, more recently, in the Spanish Company Law², for which reason they are not included here.

- (iii) Finally, a new set of recommendations deals specifically with corporate social responsibility. In its report of 19 May 2006, the Special Working Group on the good corporate governance of listed companies expressly excluded from its remit matters relating to corporate social responsibility.

However, corporate social responsibility is increasingly acknowledged, in both Spain and neighbour countries, as a key issue which must be addressed by companies’ corporate governance systems, and which therefore has a justified place in any code of good corporate governance recommendations.

1 Order ECC/461/2013 of 20 March defining the content and structure of the annual corporate governance report, the annual remuneration statement and other reporting instruments of public listed companies, savings banks and other entities issuing securities admitted to trading on official secondary markets.

2 Article 529 duodecies of the Spanish Company Law.

I.3 Characteristics of the Good Governance Code

I.3.1 Voluntariness, subject to the “comply and explain” principle

The Committee of Experts, in carrying out its mandate, has, as stated, drawn a distinction between corporate governance improvements that should be made legally binding and those that should remain subject to voluntary good governance recommendations under the internationally recognised “comply or explain” approach. It is this last set that are covered by the Good Governance Code.

The use of voluntary good governance codes backed by “comply or explain” has proved a useful mechanism for achieving some good corporate governance objectives, and indeed is the trademark system in main European Union states and other developed countries. Not only is it flexible in its application but can also serve as a benchmark for good corporate governance practices. The European Union has explicitly recognised its value to the legislator, as witness its recent Green Paper on the corporate governance of listed companies.

That said, the recent amendments to the Spanish Company Law ensuing from the Committee of Experts’ report incorporate a series of basic corporate governance precepts which it was felt should be binding on all companies. The value and effectiveness of these precepts is regarded as beyond doubt, while their absence would effectively impede the achievement of good corporate governance.

The current corporate governance framework for Spain’s listed companies accordingly comprises two differentiated tiers:

- a) On the one hand, the binding provisions contained in the Spanish Company Law and other applicable laws and regulations.
- b) On the other, the corporate governance recommendations contained in the Good Governance Code, which are strictly voluntary in nature as the terms considered basic and indispensable have been written into legislation.

In keeping with this fundamental principle of voluntariness, the Good Governance Code does not replicate the relevant legal precepts among its recommendations. It therefore omits recommendations which may be pertinent in other countries or advocated by the European Commission, but are no longer necessary in Spain since they form part of national law.

In this respect, Spanish company legislation³ upholds the “comply or explain” principle in requiring listed firms to specify their “*degree of compliance with corporate governance recommendations, justifying any failure to comply*” in the pages of their annual corporate governance reports.

In other words, Spanish legislation leaves it up to companies to decide whether or not to follow these corporate governance recommendations, but requires them to

3 Article 540 of the Spanish Company Law.

give a reasoned explanation for any deviation, so that shareholders, investors and the markets in general can arrive at an informed judgement.

For this system to work, it is vital that companies explain clearly their reasons for departing from code recommendations.

I.3.2 Evaluation by the market

The task of evaluating the explanations companies give for their non or partial compliance with recommendations will fall to shareholders, investors and the markets in general. In other words, failures of compliance will not give rise to actions by the CNMV, as this would directly invalidate the voluntary nature of the recommendations of the Good Governance Code.

The foregoing is without prejudice to the monitoring powers and other competences with regard to the annual corporate governance report of listed companies assigned to the CNMV in the Spanish Company Law and Order ECC/461/2013 of 20 March, whereby the supervisor may order companies to make good omissions or false or misleading data.

Under the terms of Order ECC/461/2013 of 20 March⁴, listed companies must state their degree of compliance with each recommendation of the Unified Good Governance Code (or the subsequent amendments made by the CNMV), indicating whether they comply with them fully, partially or not at all and giving reasons, as the case may be, for any practices or criteria departing from the same. In this way, shareholders, investors and the market in general, will be sufficiently informed to evaluate the company's actions.

I.3.3 Scope of application

The Good Governance Code addresses listed companies, meaning all those firms whose shares are admitted to trading on an official secondary market⁵.

Its recommendations are directed at all listed companies, whatever their size and market capitalisation (except where expressly indicated that a recommendation is applicable only to large cap firms). This is not to deny that some recommendations may be unsuitable or excessively burdensome for smaller sized firms. In such cases, however, all they need do is state their reasons for non-compliance and any alternatives chosen, i.e., their freedom of decision and organisational autonomy are safeguarded in all respects.

4 Article 5.7 of Order ECC/461/2013.

5 Article 495.1 of the Spanish Company Law.

II Principles

II.1 General arrangements

1. In general, companies should avoid bylaw clauses whose underlying purpose is to hinder possible takeover bids.
2. When various listed companies belong to the same group, they should take appropriate steps to safeguard the legitimate interests of all interested parties and to resolve conflicts of interest should they arise.
3. Companies should give clear information to the general meeting concerning their degree of compliance with Good Governance Code recommendations.
4. Listed companies should maintain a publicly disclosed policy for communication and contacts with shareholders, institutional investors and proxy advisors.
5. Boards should make limited use of the delegated power to issue shares or convertible securities without pre-emptive subscription rights and inform shareholders appropriately about such use.

II.2 Shareholders' general meeting

6. The general meeting should be conducted according to principles of transparency and with appropriate information provided.
7. The company should aid shareholders in exercising their rights to attend and participate in general meetings in conditions of equality.
8. The policy on general meeting attendance payments should be disclosed in full.

II.3 Board of directors

9. The board of directors will be directly responsible individually and collectively for steering the company and supervising its management, with the shared goal of promoting the corporate interest.
10. The board of directors should have the optimal size to facilitate its efficient functioning, the participation of all members and agile decision-making. Director selection policy should seek a balance of knowledge, experience and gender in the board's membership.

11. The board of directors should have a balanced membership, with a large majority of non-executive directors and an appropriate mix of proprietary and independent directors, with the latter occupying, as a rule, at least half of board places.
12. The grounds for director removal or resignation should not impinge upon their freedom of judgement. They should protect the company's name and reputation, allow for changing circumstances and ensure independent directors a stable mandate as long as they retain their independent status and are not in breach of their duties.
13. Directors should allocate sufficient time to the company to discharge their responsibilities effectively and to gain a solid grasp of the company's business and the governance rules to which it is subject, taking part to this effect in induction and refresher courses organised by the company.
14. The board of directors should meet with the necessary frequency to properly perform its management and oversight functions with the attendance of all members or an ample majority.
15. Directors should be equipped with sufficient information to operate effectively, and should be entitled to call on the company for any guidance they require.
16. The chairman is responsible for the leadership and efficient running of the board. Where he or she is also a company executive, additional powers should be given to the lead independent director.
17. The work of the board secretary is to facilitate the efficient running of the board.
18. The board should periodically evaluate its overall performance and that of its members and committees. This evaluation should be externally facilitated at least every three years.
19. The executive committee, where one exists, should have a composition mirroring that of the board of directors, and keep the board regularly informed of its decisions.
20. As well as its legally defined functions, the audit committee should be formed by a majority of independent directors. Its members, particularly the chairman, should be appointed with regard to their knowledge and experience in accounting, auditing or risk management matters, while its terms of reference should reinforce its remit, independence and scope.
21. The company should maintain a risk control and management function in the charge of an internal unit or department, supervised directly by the audit committee or, where appropriate, another dedicated board committee.
22. As well as its legally defined functions, the nomination and remuneration committee, which in large cap companies should be split into two separate commit-

tees, should have a majority of independent members. Its members should be appointed with regard to their knowledge, skills and experience, while its terms of reference should reinforce its remit, independence and scope.

23. The membership and organisation of any committees established by the board under its powers of self-organisation should be similarly configured to those of mandatory committees.
24. The company should deploy an appropriate corporate social responsibility policy, as a non-delegable board power, and report transparently and in sufficient detail on its development, application and results.
25. The remuneration of board members should suffice to attract and retain the right people and to sufficiently compensate them for the dedication, abilities and responsibilities that the post demands, but should not be so high as to compromise the independent judgment of non-executive directors. Remuneration policy should seek to further the corporate interest, while incorporating the necessary mechanisms to avoid excessive risk-taking or rewarding poor performance.

III Recommendations

III.1 General arrangements

III.1.1 Bylaw restrictions

Principle 1: In general, companies should avoid bylaw clauses whose underlying purpose is to hinder possible takeover bids

Spanish company legislation⁶ stipulates that bylaw clauses of public limited companies which directly or indirectly impose a ceiling on the number of votes issued by the same shareholder, companies belonging to the same group or parties acting in concert with them will be rendered null and void once the offeror in a takeover bid has secured a percentage equal to or higher than 70 percent of voting capital, unless the offeror was not subject to or had not adopted equivalent breakthrough measures.

Having said that, the existence of an active, transparent control market provides an unparalleled spur to the good governance of corporate entities. Listed companies should accordingly renounce the option of establishing bylaw restrictions or “safeguard” conditions designed to hinder or prevent a possible takeover bid and subsequent change in ownership control.

Recommendation 1

The bylaws of listed companies should not place an upper limit on the votes that can be cast by a single shareholder, or impose other obstacles to the takeover of the company by means of share purchases on the market.

III.1.2 Listed companies from the same group

Principle 2: When various listed companies belong to the same group, they should take appropriate steps to safeguard the legitimate interests of all interested parties and to resolve conflicts of interest should they arise

Corporate groups are characterised by having a unity of management, and their natural strategy, that of maximising the group’s benefit, does not necessarily equate to maximising the benefit of each of the companies that make it up. At times, a group’s objectives may be at odds with those of component companies and conflicts

6 Article 527 of the Spanish Company Law.

of interest may arise. This problem is especially acute in the case of “intra group” related-party transactions involving subsidiaries with external shareholders other than those of the dominant firm.

It is therefore advisable for listed companies forming part of groups to clearly demarcate each one’s area of activity, to draw up a protocol for the approval of their mutual business dealings, and, in general, to create a framework of rules that can forestall potential conflicts.

Recommendation 2

When a dominant and subsidiary company are both listed, they should provide detailed disclosure on:

- a) **The activity they engage in and any business dealings between them, as well as between the listed subsidiary and other group companies.**
- b) **The mechanisms in place to resolve possible conflicts of interest.**

III.1.3 Reporting of compliance with corporate governance recommendations

Principle 3: Companies should give clear information to the shareholders’ general meeting concerning their degree of compliance with Good Governance Code recommendations

Companies are free to choose whether or not to follow the recommendations set out in the Good Governance Code. None are imperative and some may apply more to companies in general or large enterprises and therefore not be relevant to a particular firm. That said, shareholders, investors and other stakeholders have a legitimate interest in knowing the corporate governance principles and standards adopted by listed companies and, particularly, their reasons for not complying with certain recommendations.

In order to strengthen transparency, directors are urged to inform the annual general meeting of the most relevant changes in corporate governance matters with a clear explanation of why the company is not complying with a particular Code recommendation, if this be the case.

Recommendation 3

During the annual general meeting the chairman of the board should verbally inform shareholders in sufficient detail of the most relevant aspects of the company’s corporate governance, supplementing the written information circulated in the annual corporate governance report. In particular:

- a) **Changes taking place since the previous annual general meeting.**

- b) The specific reasons for the company not following a given Good Governance Code recommendation, and any alternative procedures followed in its stead.

III.1.4 Meetings and contacts with shareholders, institutional investors and proxy advisors

Principle 4: Listed companies should maintain a publicly disclosed policy for communication and contacts with shareholders, institutional investors and proxy advisors

An international good governance practice, already figuring in the 1998 Olivencia Code, is that as well as maintaining transparent information, listed companies should pay special attention to the views of shareholders and large institutional investors lacking board representation.

There are two separate points to be considered here:

- a) The company's corporate governance rules and practices.
- b) The company's business situation and outlook.

The recommendation focuses on the first of these points though, logically, discussions with large investors during meetings or roadshows may also extend to business issues of interest to them. However, it is vital in these discussions to reconcile the strict prohibition on companies illegally furnishing inside information – breaching the imperative principle of equality of information to shareholders – with what is a licit and useful general exchange about business and market developments between a company's senior officers and its shareholders or investors, as market abuse regulations⁷ expressly acknowledge.

Recommendation 4

The company should draw up and implement a policy of communication and contacts with shareholders, institutional investors and proxy advisors that complies in full with market abuse regulations and accords equitable treatment to shareholders in the same position.

This policy should be disclosed on the company's website, complete with details of how it has been put into practice and the identities of the relevant interlocutors or those charged with its implementation.

⁷ Recital 19 of Regulation (EU) No. 596/2014 of 16 April on market abuse: "This Regulation is not intended to prohibit discussions of a general nature regarding the business and market developments between shareholders and management concerning an issuer. Such relationships are essential for the efficient functioning of markets and should not be prohibited by this Regulation."

III.1.5 Exercise of the delegated authority to issue shares or convertible securities without pre-emptive subscription rights

Principle 5: Boards should make limited use of the delegated power to issue shares or convertible securities without pre-emptive subscription rights and inform shareholders appropriately about such use

Capital increase agreements that exclude pre-emptive subscription have a dilutive effect for existing shareholders. This can be a sensitive or sore point for institutional investors, especially when the general meeting has delegated powers to the board for the approval of new share issues. It seems advisable therefore that when a board approves a new share issue without pre-emptive subscription rights by virtue of such delegation, the amount of the issue should not exceed 20% of share capital.

Further, the use directors make of the delegated power to exclude pre-emptive subscription rights should be subject to full disclosure to facilitate shareholders' control.

Recommendation 5

The board of directors should not make a proposal to the general meeting for the delegation of powers to issue shares or convertible securities without pre-emptive subscription rights for an amount exceeding 20% of capital at the time of such delegation.

When a board approves the issuance of shares or convertible securities without pre-emptive subscription rights, the company should immediately post a report on its website explaining the exclusion as envisaged in company legislation.

III.2 Shareholders' general meeting

III.2.1 Information transparency and informed voting

Principle 6: The shareholders' general meeting should be conducted according to principles of transparency and with appropriate information provided

Listed companies draft a number of reports of a mandatory or voluntary nature in the exercise of the powers assigned to their supervisory bodies and committees.

The analysis and periodic evaluation involved in preparing these reports fulfills an important control function with respect to the company's activity and, as such, is a useful aid to good corporate conduct. For such reports to be effective they must be properly publicised, and shareholders given the right to see them. Companies, however, do not always make them available, since there is no law expressly obliging them to do so.

Publicity, moreover, must be balanced with the needs of confidentiality and, in some reports, the safeguarding of certain contents.

At the same time, the general meeting is one of the most important moments in a company's life and the expression of its collective will. Its broadcasting is a useful way for non-attending shareholders, potential investors and the market in general to be apprised of the discussions held on different agenda items and the responses given by the company and its directors.

Further, in order to establish a closer, more direct communication between the audit committee and shareholders and help them cast their votes in an informed manner, it is important that shareholders be able to exercise their right to information by formulating questions. When such questions are of a technical or specialist nature, especially in the case of financial or accounting matters, consideration should go to having the chairman of the audit committee explain the answers to the meeting.

The chairman of the audit committee should also be responsible for informing the general meeting about any scope limitation or qualification in the external auditor's report, with the auditor itself called on to do so in exceptional cases.

The Code's contents in this case draw on the relevant text of the European Commission⁸ as well as the provisions of the Spanish Company Law⁹.

Recommendation 6

Listed companies drawing up the following reports on a voluntary or compulsory basis should publish them on their website well in advance of the annual general meeting, even if their distribution is not obligatory:

- a) Report on auditor independence.
- b) Reviews of the operation of the audit committee and the nomination and remuneration committee.
- c) Audit committee report on third-party transactions.
- d) Report on corporate social responsibility policy.

Recommendation 7

The company should broadcast its general meetings live on the corporate website.

Recommendation 8

The audit committee should strive to ensure that the board of directors can present the company's accounts to the general meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the chairman of the audit committee and the auditors should give a clear account to shareholders of their scope and content.

8 European Commission Recommendation of 15 February 2005.

9 Article 529 quaterdecies of the Spanish Company Law.

III.2.2 General meeting attendance and participation

Principle 7: The company should aid shareholders in exercising their rights to attend and participate in general meetings in conditions of equality

Listed companies impose disparate rules for accrediting general meeting attendance and proxy rights.

In order to facilitate shareholders' participation in general meetings, companies should be flexible in applying the rules on proof of share ownership, and show themselves predisposed to accept the validity of attendance, proxy and remote voting cards or forms and other means of accrediting attendance or proxy representation. The risk is that the board could exercise this flexibility in strategic or selective fashion in situations of shareholder conflict or when the company is being targeted with an unsolicited takeover bid.

Still on the subject of general meeting participation, the Spanish Company Law¹⁰ allows shareholders representing at least 3 percent of share capital to request that new items be placed on the agenda of the annual general meeting, and to submit reasoned proposals on items already on or to be added to the agenda attached to the meeting notice. The deadline for such submissions is five days after the publication of the meeting notice. The company must announce and circulate the corresponding supplementary meeting notices and alternative proposals.

The OECD Principles of Corporate Governance¹¹ state that procedures for general meetings should ensure that votes are properly counted and recorded. The transparency of results, especially important in cases of a tight vote, should also extend to vote calculation and counting procedures for new agenda items and alternative proposals.

Recommendation 9

The company should disclose its conditions and procedures for admitting share ownership, the right to attend general meetings and the exercise or delegation of voting rights, and display them permanently on its website.

Such conditions and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner.

Recommendation 10

When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the general meeting, the company should:

- a) **Immediately circulate the supplementary items and new proposals.**

¹⁰ Article 519 of the Spanish Company Law.

¹¹ Section V.A.8 of the OECD Principles of Corporate Governance 2004.

- b) Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the board of directors.
- c) Put all these items or alternative proposals to the vote applying the same voting rules as for those submitted by the board of directors, with particular regard to presumptions or deductions about the direction of votes.
- d) After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.

III.2.3 Policy on attendance payments

Principle 8: The policy on general meeting attendance payments should be disclosed in full

The practice of paying for attendance to the general meeting is not regulated under Spanish law. These payments comprise a consideration given, at the company's expense, to shareholders attending the general meeting either in person or by other means like proxy voting or remote or electronic voting. At times the payment takes the form of a gift to each shareholder regardless of their capital ownership. At others, a monetary consideration in proportion with the number of shares attending.

In most cases, payments have the commendable purpose of encouraging shareholders to participate in general meetings and combating absenteeism. There is a risk, however, of the board of directors using them in strategic or selective fashion to secure the approval of a particular proposal or defend itself against a third-party initiative.

Recommendation 11

In the event that a company plans to pay for attendance at the general meeting, it should first establish a general, long-term policy in this respect.

III.3 Board of directors

III.3.1 Board of directors responsibility

Principle 9: The board of directors will be directly responsible individually and collectively for steering the company and supervising its management, with the shared goal of promoting the corporate interest

All directors, whatever the origin or cause of their appointment, must share the common purpose of defending "the corporate interest".

Further, in the context in which these recommendations will be applied, it cannot be ignored that any business activity impinges on other areas of interest which need to be addressed.

Recommendation 12

The Board of Directors should perform its duties with unity of purpose and independent judgement, according the same treatment to all shareholders in the same position. It should be guided at all times by the company's best interest, understood as the creation of a profitable business that promotes its sustainable success over time, while maximising its economic value.

In pursuing the corporate interest, it should not only abide by laws and regulations and conduct itself according to principles of good faith, ethics and respect for commonly accepted customs and good practices, but also strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.

III.3.2 Board of directors structure and membership

III.3.2.1 Size, diversity and director selection policy

Principle 10: The board of directors should have the optimal size to facilitate its efficient functioning, the participation of all members and agile decision-making. Director selection policy should seek a balance of knowledge, experience and gender in the board's membership

The structure and membership of the board of directors is a cornerstone of good corporate governance that conditions its effectiveness and influences both the quality of its decisions and ability to successfully promote the corporate interest.

The board should have the right size to efficiently discharge its responsibilities and for its decisions to be debated in depth and enriched with contrasting opinions. It seems in this light that the optimal size would continue to lie between five and fifteen members.

Diversity of board of directors membership is another key issue, addressed by the inclusion of a new programmatic norm in company legislation¹².

In this context, companies are encouraged to put on record their commitment to a diverse board of director membership from the first stage of identifying prospective candidates. They should also think of including concrete targets as a means to combat the still insufficient presence of women on company boards.

12 Article 529 bis of the Spanish Company Law.

Recommendation 13

The board of directors should have an optimal size to promote its efficient functioning and maximise participation. The recommended range is accordingly between five and fifteen members.

Recommendation 14

The board of directors should approve a director selection policy that:

- a) Is concrete and verifiable;
- b) Ensures that appointment or re-election proposals are based on a prior analysis of the board's needs; and
- c) Favours a diversity of knowledge, experience and gender.

The results of the prior analysis of board needs should be written up in the nomination committee's explanatory report, to be published when the general meeting is convened that will ratify the appointment and re-election of each director.

The director selection policy should pursue the goal of having at least 30% of total board places occupied by women directors before the year 2020.

The nomination committee should run an annual check on compliance with the director selection policy and set out its findings in the annual corporate governance report.

III.3.2.2 Board of directors membership

Principle 11: The board of directors should have a balanced membership, with a large majority of non-executive directors and an appropriate mix of proprietary and independent directors, with the latter occupying, as a rule, at least half of board places

Current Spanish company legislation incorporates definitions of the various director classes¹³: internal or executive and external (proprietary, independent and other external).

External directors should be in an ample majority on the board, in order to neutralise possible agency conflicts between senior officers and shareholders or between shareholders represented and not represented on the board.

Further to the principle of proportionality between share ownership and board representation, the ratio of proprietary members to independents should reflect the

13 Article 529 duodecies of the Spanish Company Law.

proportion between the capital represented on the board by proprietary directors and the remainder of capital. This is not intended as a mathematical equation, but rather as a rule of thumb to ensure that independents are sufficiently present and that no significant shareholders can exert an influence on the board's decisions that is disproportionate to their capital ownership.

These recommendations should be supplemented by appropriate disclosure rules with respect to the appointment of proprietary directors. The idea is not to limit the appointment of directors representing holders of equity stakes below 3 percent, but to invite companies to explain the criteria informing their appointment decisions, especially when these criteria lead to requests from shareholders with comparable interests being dealt with in a different manner.

The importance that the European Union and international practice attach to independent directors for their role on board committees, the differing viewpoints they bring to the debate, and their input to analysis and review of the company's strategy, advises the setting of a minimum threshold for their presence on company boards.

In light of the best and most consolidated international practices, it is felt that this threshold should be set at half of board of director places.

This percentage may be excessive in certain cases. And the size of many of Spain's listed companies would advise relaxing the rule for those below the IBEX-35, for whom compliance would be burdensome, or those who have shareholders individually or concertedly controlling a large portion of their capital. In these cases, the threshold recommended is one third of board places.

Recommendation 15

Proprietary and independent directors should constitute an ample majority on the board of directors, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.

Recommendation 16

The percentage of proprietary directors out of all non-executive directors should be no greater than the proportion between the ownership stake of the shareholders they represent and the remainder of the company's capital.

This criterion can be relaxed:

- a) **In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.**
- b) **In companies with a plurality of shareholders represented on the board but not otherwise related.**

Recommendation 17

Independent directors should be at least half of all board members.

However, when the company does not have a large market capitalisation, or when a large cap company has shareholders individually or concertedly controlling over 30 percent of capital, independent directors should occupy, at least, a third of board places.

Recommendation 18

Companies should disclose the following director particulars on their websites and keep them regularly updated:

- a) Background and professional experience.
- b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.
- c) Statement of the director class to which they belong, in the case of proprietary directors indicating the shareholder they represent or have links with.
- d) Dates of their first appointment as a board member and subsequent re-elections.
- e) Shares held in the company, and any options on the same.

Recommendation 19

Following verification by the nomination committee, the annual corporate governance report should disclose the reasons for the appointment of proprietary directors at the urging of shareholders controlling less than 3 percent of capital; and explain any rejection of a formal request for a board place from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary directorship.

III.3.2.3 Director removal and resignation

Principle 12: The grounds for director removal or resignation should not impinge upon their freedom of judgement. They should protect the company's name and reputation, allow for changing circumstances and ensure independent directors a stable mandate as long as they retain their independent status and are not in breach of their duties

Changes in the circumstances motivating the appointment of a director may counsel his or her removal.

That said, independents should enjoy a certain stability of tenure, provided they are not in breach of their duties, and not be subject to the will of the company's senior officers or significant shareholders. Of course, theoretical compliance with independence standards does not of itself guarantee that directors will act as such, especially if the fulfilment of their duties brings them into occasional conflict with other board members or members of the management team.

The Code also puts forward recommendations on circumstances affecting board members which might harm the company's name or reputation.

Recommendation 20

Proprietary directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary directors, the latter's number should be reduced accordingly.

Recommendation 21

The board of directors should not propose the removal of independent directors before the expiry of their tenure as mandated by the bylaws, except where they find just cause, based on a proposal from the nomination committee. In particular, just cause will be presumed when directors take up new posts or responsibilities that prevent them allocating sufficient time to the work of a board member, or are in breach of their fiduciary duties or come under one of the disqualifying grounds for classification as independent enumerated in the applicable legislation.

The removal of independent directors may also be proposed when a takeover bid, merger or similar corporate transaction alters the company's capital structure, provided the changes in board membership ensue from the proportionality criterion set out in recommendation 16.

Recommendation 22

Companies should establish rules obliging directors to disclose any circumstance that might harm the organisation's name or reputation, tendering their resignation as the case may be, and, in particular, to inform the board of any criminal charges brought against them and the progress of any subsequent trial.

The moment a director is indicted or tried for any of the offences stated in company legislation, the board of directors should open an investigation and, in light of the particular circumstances, decide whether or not he or she should be called on to resign. The board should give a reasoned account of all such determinations in the annual corporate governance report.

Recommendation 23

Directors should express their clear opposition when they feel a proposal submitted for the board's approval might damage the corporate interest. In particular, independents and other directors not subject to potential conflicts of interest should strenuously challenge any decision that could harm the interests of shareholders lacking board representation.

When the board makes material or reiterated decisions about which a director has expressed serious reservations, then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next recommendation.

The terms of this recommendation also apply to the secretary of the board, even if he or she is not a director.

Recommendation 24

Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the board. Whether or not such resignation is disclosed as a material event, the motivating factors should be explained in the annual corporate governance report.

III.3.3 Board of directors operation

III.3.3.1 Director dedication

Principle 13: Directors should allocate sufficient time to the company to discharge their responsibilities effectively and to gain a solid grasp of the company's business and the governance rules to which it is subject, taking part to this effect in induction and refresher courses organised by the company

To perform their duties effectively, directors must devote time to knowing the company's reality, keeping up with developments in its business and participating in meetings of the board and any board committees they belong to. This general principle has recently been written into company legislation¹⁴, which stipulates that directors must make a sufficient time commitment and take all measures necessary for the company's efficient management and supervision.

In this respect, it is probably not possible to specify directors' dedication standards which can be recommended on a general basis. There is no way to delimit all the possible activities a director may engage in besides his or her work on the board of the listed company, nor is it possible to accurately estimate the time demands of each.

14 Article 225.2 of the Spanish Company Law.

Companies and, especially their nomination committees, should accordingly approach these rules with care, giving them concrete expression in the board of directors regulations, with particular regard to the maximum number of directorships members can hold in companies outside the group.

Recommendation 25

The nomination committee should ensure that non-executive directors have sufficient time available to discharge their responsibilities effectively.

The board of directors regulations should lay down the maximum number of company boards on which directors can serve.

III.3.3.2 Meeting frequency and director attendance

Principle 14: The board of directors should meet with the necessary frequency to properly perform its management and oversight functions with the attendance of all members or an ample majority

The board of directors must be constantly present in the life of the company and, as such, must meet with the sufficient frequency to effectively discharge its duties of management, oversight and supervision of the management team, board committees and the executive committee where one exists.

Listed company boards of directors should meet at least eight times a year, in accordance with a fixed calendar, and with pre-set agendas to which each director may propose the addition of initially unscheduled items.

Director absences should be kept to a strict minimum. When an absence is inevitable, the director should delegate his or her powers with precise instructions. On this point, company law establishes that directors can delegate their powers to a fellow board member, but that non-executive directors can only do so to another non-executive director in order to avoid altering the balance of the board¹⁵.

Recommendation 26

The board should meet with the necessary frequency to properly perform its functions, eight times a year at least, in accordance with a calendar and agendas set at the start of the year, to which each director may propose the addition of initially unscheduled items.

Recommendation 27

Director absences should be kept to a strict minimum and quantified in the annual corporate governance report. In the event of absence, directors should delegate their powers of representation with the appropriate instructions.

¹⁵ Article 529 quater of the Spanish Company Law.

Recommendation 28

When directors or the secretary express concerns about some proposal or, in the case of directors, about the company's performance, and such concerns are not resolved at the meeting, they should be recorded in the minute book if the person expressing them so requests.

III.3.3.3 Director information and advice

Principle 15: Directors should be equipped with sufficient information to operate effectively, and should be entitled to call on the company for any guidance they require

Company legislation¹⁶ expressly grants directors the right to request and obtain from the company any information they need to discharge their board responsibilities. These obligations and rights are even more emphatically stated in the case of listed companies¹⁷.

In order to give more weight to what is an essential resource for a well-functioning board, it is recommended that directors be advised well in advance of the business to be transacted in each session, so they can judge if they are sufficiently informed and, if not, procure the additional information they need. It is also important that directors be kept permanently up to date with issues of particular relevance to their board duties.

Also, given the complexity of the matters that directors must address, they may at times wish to call on specialist advice. The company should provide suitable channels for the exercise of this right, extending exceptionally to external assistance when this is warranted by the importance or controversial nature of the decision to be made.

Recommendation 29

The company should provide suitable channels for directors to obtain the advice they need to carry out their duties, extending if necessary to external assistance at the company's expense.

Recommendation 30

Regardless of the knowledge directors must possess to carry out their duties, they should also be offered refresher programmes when circumstances so advise.

16 Article 225.3 of the Spanish Company Law.

17 Article 529 quinquies of the Spanish Company Law.

Recommendation 31

The agendas of board meetings should clearly indicate on which points directors must arrive at a decision, so they can study the matter beforehand or gather together the material they need.

For reasons of urgency, the chairman may wish to present decisions or resolutions for board approval that were not on the meeting agenda. In such exceptional circumstances, their inclusion will require the express prior consent, duly minuted, of the majority of directors present.

Recommendation 32

Directors should be regularly informed of movements in share ownership and of the views of major shareholders, investors and rating agencies on the company and its group.

III.3.3.4 The board chairman

Principle 16: The chairman is responsible for the leadership and efficient running of the board. Where he or she is also a company executive, additional powers should be given to the lead independent director

The chairman's contribution is essential to the efficient functioning of the board, as company legislation expressly acknowledges¹⁸.

Where the debate lies is in whether or not it is advisable for an executive director to occupy the chairmanship.

Both arrangements have their benefits and drawbacks. The concentration of powers can provide companies with clear internal and external leadership, while avoiding the information and coordination costs that would otherwise be generated. But this should not blind us to its main pitfall: the vesting of a great deal of power in the hands of a single person.

In these circumstances, and given the divergence of international practice and the lack of empirical evidence for a precise recommendation, the criterion is maintained of issuing no opinion on the advisability or otherwise of separating the two positions.

That said, certain corrective measures are judged necessary when both offices are combined in the same person. Hence company legislation stipulates a qualified majority of two thirds for the chairman's appointment in such cases, and regulates¹⁹ the obligation to appoint a lead director from among the independents on the board, with the additional proviso that executive directors should abstain from voting on his or her appointment.

18 Article 529 sexies of the Spanish Company Law.

19 Article 529 septies of the Spanish Company Law.

In this context, it is recommended that the lead director's functions be enlarged to include, for instance, relations with the company's shareholders on corporate governance matters or the direction of chairman succession planning, in order to facilitate and strengthen this important role.

Recommendation 33

The chairman, as the person charged with the efficient functioning of the board of directors, in addition to the functions assigned by law and the company's bylaws, should prepare and submit to the board a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the board and, where appropriate, the company's chief executive officer; exercise leadership of the board and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each director, when circumstances so advise.

Recommendation 34

When a lead independent director has been appointed, the bylaws or board of directors regulations should grant him or her the following powers over and above those conferred by law: chair the board of directors in the absence of the chairman or vice chairmen give voice to the concerns of non-executive directors; maintain contacts with investors and shareholders to hear their views and develop a balanced understanding of their concerns, especially those to do with the company's corporate governance; and coordinate the chairman's succession plan.

III.3.3.5 The board secretary

Principle 17: The work of the board secretary is to facilitate the efficient running of the board

The secretary plays a key role in the board's operation. In order to strengthen this role, the Code recommends that he or she exercise close oversight of the board's performance in corporate governance matters.

Recommendation 35

The board secretary should strive to ensure that the board's actions and decisions are informed by the governance recommendations of the Good Governance Code of relevance to the company.

III.3.3.6 Periodic board evaluation

Principle 18: The board should periodically evaluate its overall performance and that of its members and committees. This evaluation should be externally facilitated at least every three years

Regular evaluation of the performance of the board of directors, its members and committees is of fundamental value. This is recognised in company legislation²⁰ which requires listed companies to annually evaluate the performance of their board and board committees, and draw up an action plan to address any weaknesses detected.

Consideration should also go to engaging external facilitators to assist the board in this evaluation, so it is enriched by objective opinions.

Recommendation 36

The board in full should conduct an annual evaluation, adopting, where necessary, an action plan to correct weakness detected in:

- a) The quality and efficiency of the board's operation.
- b) The performance and membership of its committees.
- c) The diversity of board membership and competences.
- d) The performance of the chairman of the board of directors and the company's chief executive.
- e) The performance and contribution of individual directors, with particular attention to the chairmen of board committees.

The evaluation of board committees should start from the reports they send the board of directors, while that of the board itself should start from the report of the nomination committee.

Every three years, the board of directors should engage an external facilitator to aid in the evaluation process. This facilitator's independence should be verified by the nomination committee.

Any business dealings that the facilitator or members of its corporate group maintain with the company or members of its corporate group should be detailed in the annual corporate governance report.

The process followed and areas evaluated should be detailed in the annual corporate governance report.

²⁰ Article 529 nonies of the Spanish Company Law.

III.3.4 Board of directors organisation

The sheer breadth and importance of the supervision and control functions lodged with the board of directors warrants the creation of support structures charged with producing reports, studies and preparatory materials in matters requiring decisions of special transcendence.

III.3.4.1 The executive committee

Principle 19: The executive committee, where one exists, should have a composition mirroring that of the board of directors, and keep the board regularly informed of its decisions

The executive committees in place at many of Spain's listed companies fulfill an important function.

Their existence however poses two risks for the quality of corporate governance. Firstly, they may become a *de facto* substitute for the board, divesting it of any meaningful power. And secondly, when their composition does not match the board's, they may discharge their responsibilities from a different perspective.

The first of these risks is defused by the regulation of non-delegable board powers – essentially the core management and supervisory function – in company legislation²¹.

The second can be mitigated by the repeat recommendation that the executive committee's membership mix should reflect that of the board itself, and their secretaries should be the same person.

Finally, the board in full should also be cognisant with the decisions adopted by the executive committee.

Recommendation 37

When an executive committee exists, its membership mix by director class should resemble that of the board. The secretary of the board should also act as secretary to the executive committee.

Recommendation 38

The board should be kept fully informed of the business transacted and decisions made by the executive committee. To this end, all board members should receive a copy of the committee's minutes.

21 Articles 249 bis and 529 ter of the Spanish Company Law.

III.3.4.2 The audit committee

Principle 20: As well as its legally defined functions, the audit committee should be formed by a majority of independent directors. Its members, particularly the chairman, should be appointed with regard to their knowledge and experience in accounting, auditing or risk management matters, while its terms of reference should reinforce its remit, independence and scope

Company legislation²² establishes the obligatory nature of the audit committee, along with its composition, chairmanship and minimum responsibilities (report to the general meeting; supervise the efficiency of internal control, the internal audit function, risk management systems and the drawing-up and presentation of mandatory financial statements; propose the selection, appointment, re-election and replacement of the external auditor and supervise its independence).

Recommendations under this head are intended to reinforce existing legal rules on the operation of the internal audit function, to enlarge the remit of the audit committee and to establish additional membership criteria that enhance its independence and expertise.

Recommendation 39

All members of the audit committee, particularly its chairman, should be appointed with regard to their knowledge and experience in accounting, auditing and risk management matters. A majority of committee places should be held by independent directors.

Recommendation 40

Listed companies should have a unit in charge of the internal audit function, under the supervision of the audit committee, to monitor the effectiveness of reporting and control systems. This unit should report functionally to the board's non-executive chairman or the chairman of the audit committee.

Recommendation 41

The head of the unit handling the internal audit function should present an annual work programme to the audit committee, inform it directly of any incidents arising during its implementation and submit an activities report at the end of each year.

Recommendation 42

The audit committee should have the following functions over and above those legally assigned:

22 Articles 529 terdecies and 529 quaterdecies of the Spanish Company Law.

1. With respect to internal control and reporting systems:
 - a) Monitor the preparation and the integrity of the financial information prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.
 - b) Monitor the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.
 - c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2. With regard to the external auditor:
 - a) Investigate the issues giving rise to the resignation of the external auditor, should this come about.
 - b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.
 - c) Ensure that the company notifies any change of external auditor to the CNMV as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.
 - d) Ensure that the external auditor has a yearly meeting with the board in full to inform it of the work undertaken and developments in the company's risk and accounting positions.
 - e) Ensure that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.

Recommendation 43

The audit committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.

Recommendation 44

The audit committee should be informed of any fundamental changes or corporate transactions the company is planning, so the committee can analyse the operation and report to the board beforehand on its economic conditions and accounting impact and, when applicable, the exchange ratio proposed.

III.3.4.3 The risk control and management function

Principle 21: The company should maintain a risk control and management function in the charge of an internal unit or department, supervised directly by the audit committee or, where appropriate, another dedicated board committee

One consequence of the economic and financial crisis is that international organisations, most prominently the OECD and European Union, have stressed the urgency of establishing mechanisms for the effective control and prudent management of risks.

Company legislation²³ includes the approval of a risk control and management policy among the board's non-delegable powers.

As well as setting out the recommended minimum contents of this policy, the Code goes a step further, in view of its importance, and recommends that listed companies establish a risk control and management function in the charge of an internal unit and under the supervision of a dedicated board committee (which could be the audit committee or another committee with an appropriate membership).

Recommendation 45

Risk control and management policy should identify at least:

- a) The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance-sheet risks.
- b) The determination of the risk level the company sees as acceptable.
- c) The measures in place to mitigate the impact of identified risk events should they occur.
- d) The internal control and reporting systems to be used to control and manage the above risks, including contingent liabilities and off-balance-sheet risks.

23 Article 529 ter of the Spanish Company Law.

Recommendation 46

Companies should establish a risk control and management function in the charge of one of the company's internal department or units and under the direct supervision of the audit committee or some other dedicated board committee. This function should be expressly charged with the following responsibilities:

- a) Ensure that risk control and management systems are functioning correctly and, specifically, that major risks the company is exposed to are correctly identified, managed and quantified.
- b) Participate actively in the preparation of risk strategies and in key decisions about their management.
- c) Ensure that risk control and management systems are mitigating risks effectively in the frame of the policy drawn up by the board of directors.

III.3.4.4 The nomination and remuneration committee

Principle 22: As well as its legally defined functions, the nomination and remuneration committee, which in large cap companies should be split into two separate committees, should have a majority of independent members. Its members should be appointed with regard to their knowledge, skills and experience, while its terms of reference should reinforce its remit, independence and scope

A well-functioning board requires not only selecting the right directors but also keeping them motivated. To succeed in this endeavour, the board, in turn, will require the input of a dedicated committee.

Also, the multiple technical factors that come into play when designing remuneration systems for directors and senior officers call for a similarly specialised committee in this area with an understanding and capacity for judgement commensurate with the complexity of the task.

The recommendations that follow are intended to fill out the functions of these committees in a way that enhances both their independence and the specialization of their members.

Regarding membership, the Code recommends that a majority should be independent directors and that large cap firms – for these purposes, IBEX-35 members – should split the committee into its constituent parts (nominations and remuneration).

Recommendation 47

Appointees to the nomination and remuneration committee – or of the nomination committee and remuneration committee, if separately constituted – should have the right balance of knowledge, skills and experience for the functions they are called on to discharge. The majority of their members should be independent directors.

Recommendation 48

Large cap companies should operate separately constituted nomination and remuneration committees.

Recommendation 49

The nomination committee should consult with the company's chairman and chief executive, especially on matters relating to executive directors.

When there are vacancies on the board, any director may approach the nomination committee to propose candidates that it might consider suitable.

Recommendation 50

The remuneration committee should operate independently and have the following functions in addition to those assigned by law:

- a) Propose to the board the standard conditions for senior officer contracts.
- b) Monitor compliance with the remuneration policy set by the company.
- c) Periodically review the remuneration policy for directors and senior officers, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other directors and senior officers in the company.
- d) Ensure that conflicts of interest do not undermine the independence of any external advice the committee engages.
- e) Verify the information on director and senior officers' pay contained in corporate documents, including the annual directors' remuneration statement.

Recommendation 51

The remuneration committee should consult with the company's chairman and chief executive, especially on matters relating to executive directors and senior officers.

III.3.4.5 Other special board committees

Principle 23: The membership and organisation of any committees established by the board under its powers of self-organisation should be similarly configured to those of mandatory committees

In the event that the board decides, under its powers of self-organisation, to establish special committees besides those legally mandated²⁴, the Code recommends that their terms of reference should be drafted along similar lines.

Given the many and vital shared concerns between corporate governance and corporate social responsibility, companies are encouraged to identify and assign specific functions in this area to a special committee, which could be the audit committee, the nomination committee or an *ad hoc* corporate governance and social responsibility committee, in order to deliver the more intense, committed management required.

Recommendation 52

The terms of reference of supervision and control committees should be set out in the board of directors regulations and aligned with those governing legally mandatory board committees as specified in the preceding sets of recommendations. They should include at least the following terms:

- a) Committees should be formed exclusively by non-executive directors, with a majority of independents.
- b) They should be chaired by independent directors.
- c) The board should appoint the members of such committees with regard to the knowledge, skills and experience of its directors and each committee's terms of reference; discuss their proposals and reports; and provide report-backs on their activities and work at the first board plenary following each committee meeting.
- d) They may engage external advice, when they feel it necessary for the discharge of their functions.
- e) Meeting proceedings should be minuted and a copy made available to all board members.

Recommendation 53

The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one board committee or split between several, which could be the audit committee, the nomination committee, the corporate social responsibility

24 Article 529 terdecies of the Spanish Company Law.

committee, where one exists, or a dedicated committee established *ad hoc* by the board under its powers of self-organisation, with at the least the following functions:

- a) Monitor compliance with the company's internal codes of conduct and corporate governance rules.
- b) Oversee the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.
- c) Periodically evaluate the effectiveness of the company's corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.
- d) Review the company's corporate social responsibility policy, ensuring that it is geared to value creation.
- e) Monitor corporate social responsibility strategy and practices and assess compliance in their respect.
- f) Monitor and evaluate the company's interaction with its stakeholder groups.
- g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.
- h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

III.3.5 Corporate social responsibility

Principle 24: The company should deploy an appropriate corporate social responsibility policy, as a non-delegable board power, and report transparently and in sufficient detail on its development, application and results

Environmental awareness and understanding, a sense of community, innovation capacity and a forward vision stand alongside the core purpose of value creation as mainstays of business activity.

Companies should accordingly take time to analyse how their business impacts on society and vice versa. In this way, taking as reference their own value chain, they can identify social issues that lend themselves to shared value creation.

The following recommendations set out what should be the minimum content of the corporate social responsibility policy whose approval falls to the board of direc-

tors²⁵ and provide guidance on how to implement the principle of transparent communication with disclosure of non-financial as well as financial information on the company's business.

Recommendation 54

The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:

- a) The goals of its corporate social responsibility policy and the support instruments to be deployed.
- b) The corporate strategy with regard to sustainability, the environment and social issues.
- c) Concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.
- d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.
- e) The mechanisms for supervising non-financial risk, ethics and business conduct.
- f) Channels for stakeholder communication, participation and dialogue.
- g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

Recommendation 55

The company should report on corporate social responsibility developments in its directors' report or in a separate document, using an internationally accepted methodology.

25 Article 529 ter of the Spanish Company Law.

III.3.6 Directors' remuneration

Principle 25: The remuneration of board members should suffice to attract and retain the right people and to sufficiently compensate them for the dedication, abilities and responsibilities that the post demands, but should not be so high as to compromise the independent judgment of non-executive directors. Remuneration policy should seek to further the corporate interest, while incorporating the necessary mechanisms to avoid excessive risk-taking or rewarding poor performance

The structure, level, fixing and transparency regime of directors' remuneration is a key element of any company's good corporate governance system.

However, the experience of recent years has shown that remuneration structures are, at times, overly complex, excessively short-term oriented and lacking a reasonable correlation with the results obtained. It is accordingly necessary to examine the factors determining the structure and setting of remuneration packages from a corporate governance standpoint without undermining companies' management capacity or their competitiveness.

Company legislation²⁶ incorporates a series of provisions that (i) require remuneration systems to be properly aligned to the company's size, its changing economic situation and the prevailing market standards; (ii) establish a procedure for its setting and approval that prevents conflicts of interest between different agents in the decision-making process; and (iii) guarantee the transparency of directors' pay.

In this context, starting from the basic principle of private autonomy, it was decided to draw up a series of recommendations on the structure, composition and form of directors' remuneration, informed by the recommendations of the European Union, which favour the delivery of the company's business objectives and the pursuit of the corporate interest.

These recommendations start by differentiating the various components of remuneration (fixed, variable, delivery of shares or other financial instruments linked to the share price, and termination payments) and the two main classes of company director (executive and external).

As a general rule, directors' remuneration should suffice to attract and retain talented individuals and compensate them for the dedication, abilities and responsibilities that the post demands, but should not be so high as to compromise the independent judgement of external directors.

Remuneration of non-executive directors should not include variable components linked to the director or the company's performance, the delivery of shares, options and other financial instruments or membership of the company's pension scheme, with some exceptions. The idea here is to prevent external directors from facing a

²⁶ Articles 217 to 220 and 529 sexdecies to 529 novodecies of the Spanish Company Law.

conflict of interest when they have to make judgements on accounting practices or other kinds of decision that might immediately influence the company's results, because these results are material to their own remuneration.

Variable payments to executive directors should be linked to predetermined and measurable performance criteria, including criteria of a non-financial nature, which promote the company's long-term success.

Their award conditions should also specify an element of deferment that allows the delivery of objectives to be confirmed, and include an option for the company to reclaim the sums paid.

Further, remuneration through the delivery of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements should, like variable payments, be subject to periods of deferment and a reimbursement clause.

By the same token, remuneration policies should include technical safeguards to ensure that variable payments reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector or circumstances of that kind.

Recommendation 56

Director remuneration should be sufficient to attract individuals with the desired profile and compensate the commitment, abilities and responsibility that the post demands, but not so high as to compromise the independent judgement of non-executive directors.

Recommendation 57

Variable remuneration linked to the company and the director's performance, the award of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements, and membership of long-term savings schemes such as pension plans should be confined to executive directors.

The company may consider the share-based remuneration of non-executive directors provided they retain such shares until the end of their mandate. This condition, however, will not apply to shares that the director must dispose of to defray costs related to their acquisition.

Recommendation 58

In the case of variable awards, remuneration policies should include limits and technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, or circumstances of that kind.

In particular, variable remuneration items should meet the following conditions:

- a) Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.
- b) Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.
- c) Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards ongoing achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.

Recommendation 59

A major part of variable remuneration components should be deferred for a long enough period to ensure that predetermined performance criteria have effectively been met.

Recommendation 60

Remuneration linked to company earnings should bear in mind any qualifications stated in the external auditor's report that reduce their amount.

Recommendation 61

A major part of executive directors' variable remuneration should be linked to the award of shares or financial instruments whose value is linked to the share price.

Recommendation 62

Following the award of shares, share options or other rights on shares derived from the remuneration system, directors should not be allowed to transfer a number of shares equivalent to twice their annual fixed remuneration, or to exercise the share options or other rights on shares for at least three years after their award.

The above condition will not apply to any shares that the director must dispose of to defray costs related to their acquisition.

Recommendation 63

Contractual arrangements should include provisions that permit the company to reclaim variable components of remuneration when payment was out

of step with the director's actual performance or based on data subsequently found to be misstated.

Recommendation 64

Termination payments should not exceed a fixed amount equivalent to two years of the director's total annual remuneration and should not be paid until the company confirms that he or she has met the predetermined performance criteria.

