SOME CONSIDERATIONS ON CORPORATE GOVERNANCE IN BUSINESS GROUPS

(Speech by the CNMV Chairman at the Conference on Corporate Governance and Business Groups organised by the Complutense University and Endesa, held on 19 October 2018)

Good morning to you all.

I am very grateful to the Complutense University and to Endesa for their invitation, which has afforded me the opportunity to be here with all of you today.

Congratulations to the organisers for managing to make a conference like this one a reality, with such distinguished participants and on such an interesting topic, which is at the heart of the concerns that drive an institution such as CNMV, an institution

- whose mission is to promote market transparency and investor protection, and
- which is legally responsible for monitoring the governance of our listed companies and fostering best practices in this area.

In the next few minutes, I am going to discuss three issues that I believe to be of interest in this area.

1. The first is a highly topical issue: the forthcoming transposition into Spanish law of the European Directive 2017, amending the 2007 Directive on shareholders' rights with regard to related-party transactions.

As you know, this is a very important directive which deals with matters of great interest and will force us to significantly amend various aspects of our law:

- Firstly, as regards the right of listed companies (and of their significant shareholders and shareholder associations) to know the identity of their shareholders, a concept in relation to which in the Directive reference is made (and this is going to be novel, at least in terms of reflection in Spanish written rules), to real shareholders, who are the last link in the chain of intermediaries or depositaries.
- Also with regard to the duty established in the Directive, for institutional investors and asset managers (concepts which are precisely defined) to make public and give an account of their policy on involvement, including

involvement by means of voting, in the companies in which they have an ownership interest.

- In addition, in terms of the transparency duties of these same players (institutional investors and asset managers) with respect to their investment strategy, to the extent that it is consistent with the timing and nature of their liabilities and their investors' expectations.

- The Directive, moreover, regulates the transparency duties applicable to proxy advisors, one of the most significant phenomena in the development of the corporate governance of listed companies.

- It also refers to the remuneration policy approved at the general shareholders' meeting which every listed company must hold and to the annual remuneration reports, subject to the annual vote of the shareholders at that meeting itself, a matter already provided for in our legislation (and which will only require a few adjustments).

- Finally (and I am going to refer to it here in a special way), the Directive harmonises the related-party transaction system in various respects.

In relation to them, the Directive is going to oblige us to introduce some amendments and complete our current system in relation to certain points, which is essentially materialised in four respects:

- The obligation to include information on them in annual and half-yearly financial information (in accordance with IAS 24).

- In its necessary approval, except in the case of certain standard transactions, by the board (unless they must be approved by the shareholders at the general shareholders' meeting, since they involve essential assets or, in the case of transactions with board members or shareholders represented on the board, because their value exceeds 10% of the company's assets).

- In the rule of reversal of the burden of proof, or rather the burden of argument, in the event of a challenge to a general shareholders' meeting resolution adopted as a result of the decisive vote of a shareholder affected by a conflict of interest.

- And above all, with regard to related-party transactions with board members, the principles of transparency, independence (with the consequent duty of abstention for board members affected by a conflict of interest both on the

board and at the general shareholders' meeting), as well as fairness, which must govern any analysis of the admissibility of related-party transactions.

What changes will the Directive require and what can I tell you about CNMV's position on this?

I would like to clarify that the debate, to which we are contributing, is still ongoing. However, before the summer, during the public consultation carried out by the General Secretariat of the Treasury, we had the opportunity to convey to the Ministry of the Economy, which logically leads the work, some initial considerations on the approach to be followed in the transposition. In any case, we are in permanent dialogue with the Ministry on this matter.

- **Concept of related-party transactions**

The Spanish Limited Liability Companies Law (LSC) – for the purposes of its authorisation system – only refers to related-party transactions with board members and with significant shareholders of listed companies.

We at CNMV have proposed that other related-party transactions covered by the IAS 24 concept (such as transactions with key executives and transactions with companies over which the company exercises joint control) should also be considered as related-party transactions, both for board approval and for the ad hoc advertising regime provided for in the Directive.

- **Approval of related-party transactions by the board or the shareholders at the general shareholders' meeting**

We have proposed to lower to 1 per thousand the limit (currently 1%) of the annual revenue of the exemption relating to standardised transactions at generally applied prices.

With respect to the cases of mandatory approval at the general shareholders' meeting, we believe that it is reasonable for them to continue to be those currently provided for in the LSC: transactions carried out with essential assets, meaning in particular those whose value exceeds 25% of the assets, and transactions with board members the value of which exceeds 10% of the assets.

- **Ad hoc advertising**

It is always difficult to set thresholds, but it would seem reasonable to set the determinant of the advertising obligation provided for in the Directive at, for example, 5% of the net assets or 2.5% of the annual turnover if the transaction consists of the delivery of supplies or the provision of services.

We believe that for these purposes it is more reasonable and equitable to base thresholds on net assets rather than on the balance sheet or volume of assets.

These types of thresholds are always imperfect and imprecise, but the percentages of the assets have too different a meaning depending on the level of leverage entailed by each company's type of business.

- **Voting at the general shareholders' meeting of shareholders affected by a conflict of interest**

We consider that the best option in this regard should be to allow shareholders who are related parties to participate in the vote provided that the transaction has been approved by the majority of the independent board members. This, while maintaining, of course, the regime established in Article 190 of the LSC, mentioned above, of reversal of the burden of the argument on the fulfilment of the transaction of the corporate interest in the event of a challenge.

This solution would mean including in the law what has been Spain's best practice in this area, which has frequently been applied in relation to very relevant transactions, such as mergers with the parent company or with another subsidiary or investee of the parent company.

The Directive does not require the two safeguards mentioned above to be cumulatively present in order for the related-party shareholder to be able to vote (the favourable vote of the rest of the shareholders or non-opposition by the majority of the independent board members). The corresponding precept fully allows for a more flexible reading, which seems to be the only one consistent with the reference in it to the fact that in order for the shareholder affected by a conflict of interest to be able to vote, "adequate safeguards must be applied before or during the voting process" (not "and during it").

The proposed solution takes into account CNMV's experience, which includes mergers and other transactions proposed by majority shareholders in which denying them the vote is unnatural and disproportionate. It is more than reasonable as a guarantee to require the prior approval of independent board members (in addition to applying the aforementioned rule of reversal of the burden of proof or argument).

Corporate law must be balanced; it must protect minority shareholders while at the same time preserving the status quo whereby, in accordance with the majority principle, the owners of companies are the ones who decide, and the corporate groups have an adequate margin to structure themselves and operate.

It should also be borne in mind that our corporate law does not contain a German-style group regime and, therefore, the solution cannot simply be to not apply the rule that the majority shareholder does not vote.

2. The **second issue** I wanted to address is the **special position that corresponds to the board members** of a listed subsidiary, whether they are proprietary board members or independent board members.

With regard to proprietary board members, that is, board members (in this case) who in some way represent the majority shareholder on the subsidiary's board, which is a peculiar concept in Spanish law but also very interesting and useful for analysing corporate governance problems, I would like to make three points:

- These are board members who must discharge the same duties and responsibilities as the rest of the board members, and the same duty of loyalty with respect to the corporate interest of the listed subsidiary.

- There is no obstacle preventing them from taking into account the indications or interest of the parent company, of its *dominus*. And the determination, on the one hand, of what is in line with the corporate interest may be considered to be characterised by a reasonable margin of discretion. But the proprietary board members related to the majority shareholder must also draw upon the interest of the subsidiary company of whose board they form part to guide their actions.

- Secondly, there is no problem in a proprietary board member sharing, according to an established order, information with his *dominus*. This issue, which was once much debated, can be said to no longer give rise to doubts in Spanish doctrine and practice from the point of view of company law.

  Logically, the majority shareholder must make proper use of the information, limited to the monitoring and management of his shareholding, and the duty to preserve its confidentiality extends to him. However, there is no problem with there being dialogue between him and the board member, or the dialogue including the transmission of information known to him in his capacity as board member in reasonable terms for the purposes of such monitoring and management.

  And this sharing of information does not give rise to any doubts either, provided that it is done for the same purpose and under the same conditions, from the point of view of the prohibition of the disclosure to third parties of inside information, which would occur in the normal exercise of a function, to use the Market Abuse Regulation expression.

- Thirdly, it seems clear that conflicts of interest affecting their *dominus* should be extended to proprietary board members. One consequence of this is their duty to abstain on the board in relation to transactions with the company to which the shareholder they represent is a party.

I understand that the same considerations apply to executive board members, whose position, in the case of a majority shareholder, must be assimilated for such purposes to that of proprietary board members.

With regard to independent board members, I would like to draw attention to their special responsibility in the case of listed subsidiaries, given the natural tension that can arise between the corporate interest of the subsidiary (the common interest of the subsidiary's shareholders) and the interest of the parent company.

I am referring, in particular, to all related-party transactions with the parent company or with other companies in the group, but also, in general, to the principle that the actions of the board must be guided by the corporate interest, that is to say, as Recommendation 12 of our GGC states, *"the achievement of a profitable and sustainable business in the long term, which promotes its continuity and the maximisation of the economic value of the company"*.

I have said on occasion that we want CNMV to be seen as an authority that provides protection for independent board members who may be impeded in the performance of their duties. I reiterate this in general, but also, in a special way, by addressing those who are so in companies that are majority controlled by the parent company of a group.

Furthermore, in the coming weeks we will submit for public consultation a Technical Guide on Nomination and Remuneration Committees with the aim of fostering the best operating practices of these types of board committees to become as generalised as possible. One of the aspects or concerns of the Guide is going to be to reinforce the elements that ensure that independent board members are truly independent, which is especially important in the case of listed companies controlled by a shareholder.

3. Finally, I would like to refer to a very specific issue, to another of the Recommendations of the 2015 Good Governance Code, specifically Recommendation 2:

> *"When the parent company and a subsidiary are listed, the two should provide detailed disclosure on ... the activity they engage in and any business dealings between them ... [and] the mechanisms in place to resolve possible conflicts of interest that may arise."*

As a result of what is stated in one of the sections of the current ACGR model, approved by a CNMV Circular, information is only provided on the existence and content of these types of agreements defining the respective areas of activity and the mechanisms relating to conflicts between the parent company and subsidiary in the case of two listed companies in Spain. The recommendation even tends to be considered non-applicable when the subsidiary is listed in Spain and its majority shareholder is listed outside Spain.

Both concepts make little sense and should be corrected. The recommendation should refer to all cases in which a listed company belongs to a group of companies that carry on activities with group or interrelated industrial logic, including both the case of a parent company listed outside Spain and that of an unlisted parent company. And the model should also demand in these cases an adequate description of the mechanisms for delimitation and management of conflicts that may exist.

Thank you very much for your attention. I hope that this conference will be very interesting and productive for you all.