# REPORT OF THE SPECIAL WORKING GROUP ON THE GOOD GOVERNANCE OF LISTED COMPANIES

**19 May 2006**

**CONTENTS**


**Introduction** 3

**ANNEX I - Unified Good Governance Code**

I. Core Principles 7
II. Recommendations 9
III. Definitions 35

Appendix 1. Legal provisions relating to the Unified Code Recommendations 38
Appendix 2. Basic agreements between the Unified Code and other Recommendations 41
Appendix 3. Membership of the Special Working Group 65

**ANNEX II – Supplementary Recommendations to the Government, CNMV and Financial Institutions** 66

The Government agreed on 29 July 2005 to set up a Special Working Group to advise the Spanish Securities Markets Commission (Comisión Nacional del Mercado de Valores, CNMV) with regard to the harmonisation and update of the Olivencia and Aldama Report recommendations for the good governance of listed companies, and to make any supplementary recommendations that it considered to be warranted.

The Special Working Group was officially constituted on 16 September 2005. Its membership, as stated in Appendix 3 of Annex I, was approved by the State Secretary for the Economy at the proposal of the Chairman of the CNMV. The five private-sector experts originally invited onto the Group were later joined by Mr. José María Garrido and Mr. Enrique Piñel, advisors to the European Commission in the areas of corporate governance and the reform of company law.

The Special Working Group today unanimously approved:

- The proposal for a Unified Good Governance Code (Annex I); and

- Supplementary Recommendations to the Government, CNMV and Spanish financial institutions (Annex II).

In drawing up its recommendations, the Group elected to confine itself to:

- Good governance recommendations for companies whose shares are traded on the stock exchange, although work may subsequently turn to the issuers of fixed-income securities.

- The internal governance of listed companies, i.e. without venturing too far into the terrain of "corporate social responsibility", which mainly refers to companies' dealings with stakeholders other than shareholders, is not circumscribed to listed companies and is being dealt with independently by a parliamentary sub-commission.

- Recommendations whose fulfilment is voluntary, rather than mixing them in with legal duties or binding rules. This is a point to remember when analysing the Recommendations of this Unified Code, especially when comparing them with the good governance codes of other countries. Thus, readers less familiar with Spanish company law should be aware that what they may see as obvious omissions are in fact already written into current legislation. In this respect, Appendix 1 lists the most important Spanish legal texts governing the issues addressed by the Unified Code.

In its update of Olivencia and Aldama Report recommendations, the Group has borne in mind a number of international recommendations issued since the publication of the Aldama Report. These include the latest version of the OECD's Principles of Corporate Governance, along with:

- Recommendations and proposals of the European Commission such as:

    - Recommendation of 15 February 2005 (2005/162/EC) on the role of non-executive or supervisory directors and the committees of the (supervisory) board.

    - Recommendation of 14 December 2004 (2004/913/EC) on the remuneration of directors of listed companies.

- Proposal for a Directive on the exercise of voting rights by listed company shareholders (COM (2005) 685 final), approved by the Commission on 5 January 2006.

- The recommendations on corporate governance for banking organisations approved by the Basel Committee on Banking Supervision[1].

The main points which the Unified Code has in common with the Olivencia and Aldama Reports and the above international recommendations are summarised in Appendix 2 of the Unified Code.

After several months of work in 2005 and a brief consultation round with market experts in early 2006, the Group submitted its Proposal for a Unified Code and Supplementary Recommendations to public consultation on 18 January 2006, appending a list of questions for consideration and comment. The consultation process involved two distinct stages: a series of presentation events at the four Spanish stock exchanges, at which a large number of suggestions were taken from the floor; and the reception of written comments, up to 28 February, which with the authors' consent were then posted on the CNMV website.

The Group looked carefully at all the comments and criticisms received, and as a result made numerous changes in the final version of the Unified Code that we can summarise as follows:

*Changes in form*

- The recommendations have been couched in terms of "should" rather than "will", to avoid any impression of a legal requirement.

- Reference is made to the fact that the “comply or explain” principle traces to article 116 of the Securities Market Law, and is not an innovation of the Code itself.

- Many recommendations have had a preamble added to clarify their content.

- The number of recommendations has been reduced and a separate section included with definitions of the main concepts used.

*Changes in content*

- The case where a dominant and subsidiary company are separately listed is no longer described as exceptional. And as the Code's control measures for related-party transactions are deemed sufficient as they stand, the recommendation that where related-party transactions between a dominant firm and listed subsidiary can be presumed to be frequent, the former should not hold a majority on the latter's board has been dropped from the final version.

- Also removed is the 50% limit recommended in the Proposal for the board places held by proprietary directors when their combined ownership interest in no greater than 50%.

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[1] *Enhancing corporate governance for banking organisations, Basel Committee on Banking Supervision,* January 2006.

- And the reference to a minimum number of board meetings.

- The reference to an independent Deputy Chairman as a check to the power of Executive Chairman has been replaced by the proposal that a lead independent director be appointed to coordinate the activity of external members.

- The recommendation that board secretaries should not be directors has been dropped from the Code, which now refrains from expressing an opinion either way.

- Likewise no mention is made of a 12-year limit as a defining condition for directorial independence, though the text retains the recommendation that independent directors should not hold their office beyond this term.

- The Code now explicitly states that the owner of a non significant shareholding (i.e., less than 5%) can be an independent director. In other words, it acknowledges that the receipt of dividends does not disqualify from independence.

- It is accepted that the remuneration report need not be published separately, but can be inserted in some other document like the Annual Corporate Governance Report, Annual Report or Directors' Report, whichever companies prefer. Individual directors' remuneration details are to be included in the notes to the annual accounts.

- The rules on the make-up of the Audit and Remuneration committees have been relaxed to some degree. These need no longer be formed by a majority of independents but simply appoint all their members from among external directors, with an independent in the chair.

A number of recommendations have been retained, at times with small adjustments or clarifications, despite attracting a degree of criticism. In particular:

- The imperative or binding nature of the minimum conditions for a director to qualify as "independent", as stipulated in clause 1.b) of Order ECO/3722/2003, of 26 December. In other words, companies may not call any director "independent" who does not meet the said requirements.

- The recommendation that company bylaws should not contain limitations on voting rights or any other defence mechanisms against takeover bids.

- The recommendation that executive directors be as few as is reasonably possible, though the text now allows for their equity ownership to be taken into account, along with the complexity of the corporate group.

- The recommendation that independent directors should occupy at least one third of board places, while allowing that the actual number resulting may be lower than 3 in very small boards.

- The recommendation on gender diversity, admitting that it may become redundant if Parliament passes new sex equality legislation.

- The recommendation that the board should decide on the wisdom of a director staying on if he or she is tried – not just charged – for any of the offences listed in

article 124 of the Public Limited Companies Act as being an automatic cause for removal in the event of conviction.

- The recommendation that the remuneration report should be put to the advisory vote of the General Shareholders' Meeting.

- The recommendation – now separately formulated in the Code - that remuneration reports set out the individual payments made to board members, including those made to executive directors (among them, as a logical consequence, their remuneration as managers).

- The recommendation that companies establish a "whistle blowing" procedure under the supervision of the Audit Committee, so employees can confidentially or, where appropriate, even anonymously report any irregularities they observe in the company's conduct. The Working Group understands that the cases dealt with will mainly refer to financial or accounting matters, and that companies establishing such mechanisms will do so in strict adherence with the terms of data protection legislation.

Given that listed companies deciding to voluntary subscribe to the Code may need to submit certain matters to their General Shareholders' Meetings (for instance, amendment of the General Meeting and board regulations or in some cases the company bylaws), the Working Group has urged the CNMV not to oblige them to specify fulfilment or otherwise of its corporate governance recommendations until the publication of the Annual Corporate Governance Reports corresponding to 2007.

The Working Group wishes to extend a special thanks to the many professionals and experts who took the time to participate in its sessions; to all those citizens, institutions and Spanish and foreign firms who submitted their comments on the Draft Code; and, finally, to the professionals and support staff of the CNMV, whose dedication and collaborative spirit made the work of the Group considerably lighter.

Madrid, 19 May 2006