



5th Annual Directors Forum

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I am very grateful to IESE and KPMG, and especially to my good friend Francisco Uría, who invited me to participate in this fifth edition of the Annual Directors Forum. I am also very thankful to you, Juan José, for your warm introduction.

I will take the opportunity two years after the last major LSC (Spanish Corporate Enterprises Act) reform and since the publication of a new Code of good governance of listed companies, to give a brief overview of developments so far.

Secondly, I will refer to two issues that I consider to be of particular interest and to which we are giving special consideration at CNMV:

- The Audit Committees on which we are planning to publish shortly a Technical Guide with criteria and recommendations.

We have noticed a fair amount of diversity in terms of how Audit Committees work and we want to contribute, as much as possible, to the spread of best practices.

I would like to underline the importance of Audit Committees for good corporate governance, a body that our listed companies began to create in the late 1990s, following the Olivencia Code, and with whom they must nowadays obligatorily count on; not only these companies but also all the termed EIPs (a concept that includes not only listed companies but also all financial institutions, including insurance companies, and unlisted companies that exceed a certain size). As you know, all Audit Committees, not only those of listed companies are supervised by CNMV.

- And the second aspect that I want to refer to is the compensation of managers and top management.

This is an area that has greatly advanced in recent years in three ways: (greater transparency, greater control by the general shareholders' meeting and greater alignment of remuneration with the company's medium-long term interests). But there is still room for improvement. At the moment, this is a burning issue on an international scale.

OVERALL PICTURE TWO YEARS AFTER THE CORPORATE GOVERNANCE REFORM

The overall progress of the reform and update of 2014-2015 of our corporate governance regime is, in my opinion, quite positive.

Our Corporate Enterprises Act was in need of an in-depth reform.

It had to catch up with the times, which are much more demanding in terms of corporate governance.

And it had to include a more comprehensive system which would be better adapted to the characteristics of listed companies.

It was necessary to strengthen the role of the general shareholders' meeting and extend the Board's powers, and deal more appropriately with everything related to transactions and conflicts of interest.

And it was also time to update the complementary non-binding rules and the code of good governance, taking into account the experience gained and developments in this area at international level.

Of course, a detailed explanation of the innovations introduced two years ago, and the effect they have produced would make sense, but I will limit myself to discussing just a few matters.

- One of the developments has been the implementation of a mandatory rule, which until 2013 was a mere recommendation: that independent directors cannot remain as such for more than 12 years.

This measure has had a great renewal effect on Boards and, in particular, is helping to create a greater degree of diversity within them. In addition, renewal is fostering a general change of mentality.

- Another aspect to be mentioned is precisely the principle of diversity, which was taken into account in the 2014-2015 reform. Diversity in many ways, of capabilities and professional experience but also, and in particular, in the presence on Boards of female Directors.

The Code recommends the inclusion of specific objectives that promote the presence of women on Boards. Specifically, it urges the Board to approve a Director election policy aimed at achieving at least 30% representation in terms of the number of female Directors by the year 2020.

The truth is that we are still far behind in this area. We are below the European average and should even feel somewhat embarrassed.

The percentage of women on Boards has increased since 2012 but only moderately, and almost exclusively with regard to Independent female Directors. In 2015, the number of female Directors reached 15.6%, and in 2016, 16.5%.

The figures were somewhat better by the end of 2016 if we focus on Ibex-35 companies, in which the percentage of female Directors increased to 22.5%, but we are still far from the recommended 30%.

From here I encourage you to continue making an effort in this regard. It is no longer a matter of producing additional regulations or recommendations. The idea is for the Board of Directors of every company to consider it relevant and for them to strive to achieve the objective.

By way of an example, on the CNMV Board the percentage of women is 42%, three out of seven.

- Another important point of the reform has been everything related to the requirements and procedure for the appointment of Directors, in particular:
 - The rules on the composition of the Appointments Committee, which should be exclusively made up of external Directors and chaired by an independent Director.
 - The requirement that, for a Director to be considered independent, he/she must have been put forward by the Appointments Committee.

This requirement, which makes the appointment of people close to management a little more difficult, is certainly helping independent Directors to become increasingly more independent.

In any case, I have always thought that the most important thing is that independent Directors should be people with an adequate professional reputation and standing; in situations of conflict and tension there is nothing like the Director feeling that his or her reputation is at stake.

I would also like to point out that the new Code incorporated specific recommendations on corporate social responsibility.

When the previous Code was prepared in 2006, it was finally decided not to include this matter. The fact that it has now been included is undoubtedly a sign of increasing social awareness of the impact of businesses on society and the need for companies to contribute to sustainability and always keep all their stakeholders in mind.

AUDIT COMMITTEES

As I pointed out at the outset, the accumulated experience on the functioning of Audit Committees and the dialogue we have had with listed companies, auditors and other interested parties have revealed certain differences in the way they operate and some doubts on the scope of the functions and responsibilities of this important body.

With this in mind, we have considered it appropriate to make public certain criteria and recommendations through the legal instrument of the Technical Guide, included in Art. 21 of the Securities Market Law since 2015 based on which we publish the criteria, practices and procedures that the Committee deems appropriate for compliance with the regulations which it will apply in its supervisory actions.

Specifically, we plan to approve a Technical Guide on Audit Committees within this month. And we hope that it will be especially useful for the Public Interest Entities group that until the entry into force of the Spanish Auditing Act were not under the obligation to constitute an Audit Committee, and that therefore are taking the first steps in this field.

The Technical Guide is based on five basic principles related to Audit Committees:

- Responsibility
- Scepticism
- Constructive dialogue among its members
- Ongoing dialogue with the internal audit, the auditor and management
- Sufficient analysis capacity

While all these principles are relevant, we would highlight two:

- The one on scepticism, which implies that all members of the Committee must have a critical attitude and question the data, evaluation processes and the previous conclusions reached by the entity's executives and managers.
- And the one on constructive dialogue, which means that members of the Audit Committee should be encouraged to express themselves with freedom and have a critical attitude. Diversity of opinions should be fostered. All this with the aim of improving the analysis that the Committee must carry out in the performance of its functions.

Apart from these principles, I would like to highlight three fundamental ideas on which the Technical Guide we are preparing is based:

- Firstly, the independence of the Audit Committee, which, inter alia, implies that the executives should only be present at meetings when they are invited to attend and only to discuss the specific points in relation to which they have been summoned. This is an important issue as it is bad practice for executives to systematically attend meetings of the company's chief executive officer or of top management as guests.
- The second relevant idea is that there should be as close a relationship as possible with the external auditor. Both to facilitate his or her work and safeguard his or her independence as well as to maintain good communication with him or her at all times.
- The Audit Committee should regularly collect from the auditor information on the audit plan, its execution and any other matters related to the audit process, including any possible disagreements that may arise between the auditor and management.
- Finally, another idea that provides the basis for a good part of the Technical Guide is the importance for the Audit Committee to oversee the effectiveness of internal control systems and risk management. In connection with this, the Guide calls for the Committee to interact as closely as possible with the Internal Audit Manager, even recommending that that body participate in his or her annual evaluation, influencing his or her remuneration and setting the targets linked to his or her variable remuneration.

REMUNERATION

Finally, as I mentioned earlier, allow me to reflect on the remuneration system and practices of Managers and Top Management of our listed companies.

The system currently applied in Spain is similar to that of countries such as the United Kingdom and is focused, as I said at the outset, on promoting transparency, assigning control to shareholders and encouraging long-term alignment between managers and shareholders.

In comparative terms, we can say that we have a good standard in terms of rules, although there is still much room for improvement in regard to their application. It is an area where there is great social awareness, and certainly, not only in Spain.

I think of countries such as France and the United Kingdom, where the issue of the remuneration of executive directors and top management of large companies has become a very sensitive issue, even from a political point of view. This issue is probably the second most important after Brexit in terms of the number of opinion articles published in the last few months in the Financial Times.

The tendency is clearly of a greater intrusion: attention is drawn to the gap between top management's and managers' average remuneration or even general average remuneration in companies. It is proposed to implement caps on the possible proportion of future expected benefits derived from contributions to pension plans in relation to the total amount of annual remuneration and relevant restrictions in relation to the cases in which top management may receive compensation upon their removal and its maximum amount.

It is a debate that we have to bear in mind.

In any case, we still have room for improvement without going beyond the principles on which our regulations are based: transparency, board control and alignment of the remuneration system with the company's medium-long term vision.

In CNMV we are thinking of modifying the IARC (Annual Report on Director Remuneration) to expand the section related to the explanation of the way in which the retributive policy has been applied. The idea is for companies to explain and justify in more detail why their directors, particularly their executive directors, earn what they do.

Now, in many reports, the explanations are often rather limited. We want them to be broader and more articulated so that shareholders and potential investors can adequately assess the extent to which the objectives and metrics on which the variable remuneration of managers and top management are based have been met.

This is an issue on which, for instance, American and British companies often place special emphasis.

We also aim to improve the quality of the information provided on long-term saving systems and on the compensation to which directors are entitled as a result of the termination of their relationship with the entity, and explicitly include the first remuneration item within directors' total annual compensation, since in the annual report model it appeared as a separate item.

We are conducting a specific review in relation to these matters and I can reveal to you that we have detected that the information that some entities provide about the remuneration items that I have just referred to is often incomplete.

Thus, companies often do not provide enough details as to when the funds accumulated in long-term pension or savings schemes are consolidated and do not detail the time when the executive Director is entitled to receive the accumulated funds.

Moreover, information regarding the compatibility of the funds accumulated in savings schemes and the right to receive severance payments is sometimes not provided or is confusing.

We have also found that the way in which companies complete the tables on remuneration systems on shares is often unclear or complete.

As some of you know, at CNMV we are reviewing the Annual Corporate Governance Report model, to improve its format by making it more user-friendly, to give flexibility to companies that want it and avoid duplication. But we are also working on a modification of the Annual Report on Director Remuneration that brings clarity and raises standards in relation to issues such as those I have just mentioned.

I shall not elaborate any further.

The progress, even in terms of culture, witnessed in our country in the last 20 years is impressive in terms of corporate governance of listed companies. This progress has been particularly important in the last two years, following the major reform of the LSC in 2014 and the publication of the new Code of Good Governance for listed companies in 2015. There are areas, however, where there is still some way to go, such as the visibility of women on Boards of Directors.

One of the elements that have contributed most to the improvement of the governance system of our listed companies has been the Audit Committees, which nobody knew about 25 years ago and which have become a truly key part of the system. Through the Technical Guide that we are going to approve in the next few days we hope to contribute to their proper operation and to ensure that best practices are extended to all companies.

And another field where relevant advances have been made is remuneration. But more transparency is still necessary and we must bear in mind the existing social debate, both in Spain and at international level, which could have a significant impact when addressing the issue in the medium-term.

Thank you very much for your attention.