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Dear Ministry of Economy and Business of Spain,

Hermes EOS Response to the Proposed Transposition Text for the amended EU Shareholder Rights Directive

Hermes welcomes the opportunity to provide our comments on this consultation. Hermes Investment Management is an asset manager with a difference. With £34.1 billion¹ in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world. Our stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on €522 billion² on behalf of international institutional investors. The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients.

We would like to again express our strong support for an updated and strengthened legislative framework for investor stewardship and corporate governance in Spain. We believe this is a timely and necessary intervention to continue to raise awareness and performance on responsible and active ownership.

In our view, stewardship should be evidence based and focused on quality and achieving real outcomes on material issues. As such we welcome the introduction of annual reporting on the implementation of engagement policies. These reports will be the key mechanism for clients, beneficiaries and relevant authorities to understand and assess stewardship performance. Similarly, we welcome the clarification that shareholder rights are to be used exclusively for the benefit of the end beneficiary.

Below we set out our response to the consultation. Our comments and suggestions are provided with the objective of improving corporate governance and stewardship in Spain, and therefore increasing the market's attractiveness to a broader set of investors, in particular international. We hope that our comments and suggestions are of assistance. If you would like to discuss our views in further detail, please do not to hesitate to contact us at (andy.jones@hermes-investment.com).

Yours sincerely,

Andy Jones, Associate Director, Hermes EOS

¹ As at 31 March 2019

² As at 31 March 2019

Comments on the transposition of the Directive

The Ministry and the transposed text seek to achieve effective and long-term engagement by shareholders. The transposed text provides an evolved framework and tools towards achieving these goals. However there remains a significant gap between the stated objective and the strength of the framework; in particular regarding the limited requirements for the engagement policy and implementation report. This implementation gap will restrict the ability of the transposition text to create the positive environmental, economic and social outcomes in Spain sought by the Directive.

In our view two key steps can address this implementation gap:

1. Clarification, with additional principles and/or detail, the expectations on good practice engagement policy and outcomes focused implementation reporting. This could be in supporting guidance issued by the CNMV.
2. A clear monitoring and enforcement mechanism of such disclosures against those principles. This could again be a role for the CNMV.

We provide suggestions for both of these points below and additional items below.

Reporting on engagement policy and its implementation

To really drive effective engagement and be able to monitor it is being achieved, the transposition text or supporting guidance should provide further principles or detail on information to be reported as part of the annual reporting on the implementation of the engagement policy. From our experience, regular public reporting, or at least reporting to clients/beneficiaries, on engagement should generally include the following information:

On investee companies:

- Voting behaviour:
 - votes in favour of, against and abstaining on the management recommendation (in aggregate);
 - votes against management by issue (in aggregate);
 - support for shareholder resolutions (by issue/objective);
 - rationale for the most significant vote decisions;
 - link between engagement and voting, and engaging around the vote; and
 - the proportion of assets owned/managed that are covered by the above transparency.

With regard to companies engaged:

- the process for selection of companies for engagement;
- the number of companies engaged and the proportion of assets owned/managed that are covered by engagement in the reporting year;
- seniority of company representatives typically engaged (e.g. investor relations, subject specialists, CEO/CFO, chair, board member);
- issues addressed through engagement;
- progress made against predefined engagement objectives (in aggregate); and
- resource that is dedicated to engagement (and, if separate, its interaction with fund managers).

On the most significant engagements:

- objectives of the engagements that are most material to the company or industry in which it operates and according to the geography;
- interaction type (e.g. meeting/call/statement at annual general meeting), seniority levels engaged and issues addressed;
- engagement and collaboration with other investors and stakeholders;
- where relevant, how the engagement has been escalated;
- the outcomes of engagement and progress against objectives; and
- monitoring of the company and its response to the concern raised.

As included in the list above, the requirements for the engagement policy should include a requirement to specify how the approach to engagement differs across funds to make the

information more useful and relevant information for their clients and beneficiaries. Investment strategy and consideration of, and approach to, ESG factors will vary across funds. Similarly, the reporting on implementation of the engagement policy should specify the number of funds and AUM covered by each aspect of engagement and voting reported.

If requirements stated above would be seen as beyond the current stewardship capability of most of the industry in Spain we suggest the introduction of a voluntary stewardship code. This will set a clear and higher bar in the market for those wishing to operate at a higher level of active ownership and shareholder responsibility. In time this would likely drive a systemic rise in the stewardship standard in the market. A stewardship code would go beyond the baseline of the shareholder rights directive, for example in areas including a greater focus on outcomes based engagement and reporting, and stewardship across all asset classes.

Monitoring and enforcement

We welcome the stated role of the CNMV in issuing sanctions for non-compliance with the new requirements. We would welcome additional clarity on the implementation of the monitoring and enforcement of i) compliance with the requirements, ii) accuracy of the reported information and iii) appropriateness of the use of the 'explain' option. Monitoring could be achieved through spot checks and a complaints channel managed by the relevant authority (CNMV).

Geographic scope of requirements

The text states that the new requirements on shareholder engagement relate to shares trading on a regulated market, or operating, within a member state ("acciones admitidas a negociacion en un Mercado regulado que este situado u opere en un Estado miembro"). We believe the requirements should not discriminate against the location of the share issuance or company operations.

The promotion of good environmental, social and governance practices by Spanish investment firms should be global. Given the lower levels of regulation and limited engagement activity of local shareholders in some markets (for example, in relation to worker protections), effective stewardship of non-EU companies is no less important. Engagement and 'active ownership' deliver value to investment firms, their clients and the ultimate beneficiaries, such as reduced risk in company activities, and better-informed investment decision making. Clients and beneficiaries investing through Spanish asset managers in particular may expect disclose on engagement policy and implementation across all their investments. The UK has taken this global approach in its transposition of the Directive.

Under the new requirements investment firms have the flexibility to explain differences in any engagement policy across market and/or whether they themselves restrict their engagement activities to certain markets.

Translation error in the official Directive text

Please note that there appears to be a mistranslation in the Spanish language version of the Shareholder Rights Directive text that now appears in the Ministry's text.

The Directive's text in Spanish, and Artículo 47 paragraph 1 (page 10) and artículo 67 (page 25) of the Ministry's consultation text, states that the engagement policy should describe how the investor communicates with important shareholders ("accionistas importantes") of engaged companies. However, the English text of the Directive states that this should be communication with relevant stakeholders (grupos de interes relevantes). Our interpretation of the French and German texts is that they too align to the stakeholder position, though could be interpreted as meaning internal stakeholders of the company. We believe it is important for investors to consider and understand stakeholder interests, so it is important that this point is clarified for the policies required to be published.

Comments on the additional regulatory improvements beyond the transposed Directive

The introduction of loyalty shares

We understand the objective of rewarding long-term shareholders. However, we believe loyalty shares are detrimental to corporate governance, based primarily on our experience in markets which have introduced such systems. Our public Corporate Governance Principles for France encourage French companies to avoid these practices.

Loyalty shares concentrate influence in controlling shareholders, such as founding families and institutional shareholders who already have seats on the board, both of which are prevalent in the Spanish market.

Though we advocate long-termism in investing we also strongly support the principle of one-share one-vote as the best and most democratic principle for corporate governance. One-share one-vote ensures alignment of influence and voting powers with economic interest and risk bearing.

We are further concerned by the text providing no maximum limit to the term after which shareholders would be awarded additional votes. Any minimum term beyond two years would further exacerbate the corporate governance issue stated above. Those controlling shareholders who would benefit most from the loyalty shares have an incentive to set the term higher than two years, and minority shareholders have limited ability to prevent this under the current proposed legislation.

The outcome of this change will likely be the divergence of two corporate governance practices in the Spanish market. Those companies already controlled by dominant shareholders will strengthen this control to the detriment and deterrence of minority investors. Those companies choosing not to implement the loyalty share scheme will benefit from being attractive to a wider pool of diverse capital and the continued engagement and stewardship by that diverse group.

The removal of the requirement for quarterly reporting

We welcome the removal of the obligation on listed companies to produce quarterly reporting and to provide them with flexibility on the frequency of reporting beyond annual. The broader aims of the amended Shareholder Rights Directive should support companies to shift together with their investors towards a longer-term perspective.