



September 2015

Follow @Paul_Hastings



Italy: Reforms of the Code of Corporate Governance of Italian Listed Companies

By [Bruno Cova](#)* & [Flavio Acerbi](#)

I. Introduction

On 9 July 2015, the Corporate Governance Committee¹ (*Comitato per la Corporate Governance*) of Italian listed companies approved several amendments to the Corporate Governance Code (the “Code”). The Code constitutes the main source of soft law in the area of corporate governance for the Italian listed companies and has proved the inspiration of several legislative reforms of the Italian corporate law. Adherence to the Code by Italian listed companies is voluntary and based on the so called “comply or explain” principle.²

These amendments intend to reflect developing best practices in corporate governance and cover different areas, including corporate social responsibility, the risk profile of the company, the system of internal control and risk management, the role of the Nomination Committee and the compensation of the Statutory Auditors.

In the paragraphs, below we provide a summary of the most significant amendments to the Code approved by the Corporate Governance Committee in July 2015.

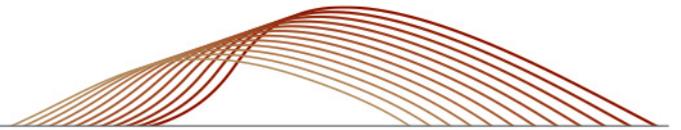
II. A New Focus on Sustainability Matters

The Corporate Governance Committee expands the role of the Board of Directors with reference to the sustainability of the business. In particular, the Code provides that the Board of Directors has to define the risk profile of the issuer consistently with the issuer’s strategic objectives considering also the risks that may be relevant for the sustainability of the issuer’s business activities in the medium-long term.³

On the one hand, this provision stresses the importance for the Board of Directors to adopt a medium – long term perspective and avoid any short-termism. In this regard, this new provision expands the principle set out in Article 1, whereby the Board of Directors has to pursue the overarching goal of “*creating value for the shareholders over a medium-long term period*”.⁴

On the other hand, the new provision includes the principle of sustainability among the interests that the Board should take care of, consistently with the most recent European legislation.⁵ This new provision seems also to suggest that sustainability matters (such as environmental matters, social and employee-related matters, human rights concerns, anticorruption and bribery matters)⁶ may have a relevant impact on the business and should be considered in the definition of the risk profile and strategic objectives of an issuer.

The Comment to Article 1 of the Code further develops this concept, highlighting “*the essential role of the Board of Directors in evaluating the actual functioning of the internal control system*”



and the management of any risk that may affect the sustainability of the issuer's business in a medium-long term perspective".

To further stress the importance of the sustainability matters for a good corporate governance, the Corporate Governance Committee recommends the most relevant issuers (i.e., issuers included in the FTSE-MIB index)⁷ to consider *"whether or not to set-up a committee having the task to supervise sustainability issues related to the relevant business and to its interactions with all the stakeholders"*.⁸ This recommendation is not binding and is not subject to the "comply or explain" principle, as it is included in the Comment section of the Code.⁹

III. The Strengthening of the System of Internal Control and Risk Management

The Corporate Governance Committee passed changes on the system of internal control and risk management, which significantly strengthen the effectiveness of internal controls.

In particular, the revised Article 7 of the Code now clarifies that an effective system of internal controls and risk management contributes to the reliability of the information provided to the corporate bodies and not only of the publicly disclosed financial information.¹⁰ Notably, this provision includes the reliability of the internal flow of information among the core tasks of an effective system of internal control and risk management. As a consequence, the Board should ensure the reliability and effectiveness of the internal flow of information and take prompt actions in the event of any circumstances that may hinder or question the reliability of the internal flow of information.

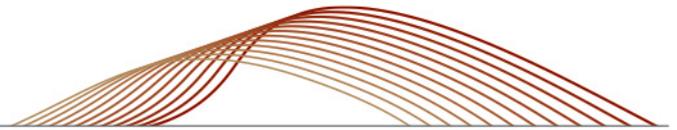
The reliability of the internal information channels and of the information provided to the Board of Directors is crucial especially in critical situations. In this respect, the Code now provides in the Comment to Article 1 that *"under relevant circumstances, the Board of Directors acquires any necessary information and adopt any suitable measure to protect the company and the information to the market"*.

While the new wording in the Code is a mere explication of principles already enshrined in Italian corporate law, it is a useful reminder of the directors' duty to act in an informed manner (i.e., to satisfy themselves that they have all the information that is necessary to take action) and to adopt appropriate remedial actions to protect the company and ensure that the markets are adequately informed.

The Board may be assisted in this respect by the Control and Risk Committee appointed within the Board. In fact, as provided in the new Code, the Control and Risk Committee *"supports, with adequate preliminary activities, the Board of Directors' assessments and resolutions on the management of risks arising from detrimental facts that the Board may have been become aware of"*.¹¹

This is an important development as, pursuant to the Code, the Control and Risk Committee is composed by a majority, or exclusively, of independent directors.¹² In practice the new provision means that, in addressing circumstances having the potential to negatively impact the company (the so-called "detrimental facts"), the Board of Directors will be able to benefit from the support of a committee that can assess the circumstances and the potential remedial actions with the highest degree of independence.

The Code requires each issuer to provide for the coordination of the corporate bodies and functions with specific tasks in the context of the system of internal control and risk management *"in order to enhance the efficiency of the internal control and risk management system and reduce activities overlapping"*. To fully understand the importance of this provision we have to keep in mind that the Italian legislator has passed in the last years several reforms on internal corporate controls,



which have resulted in a poorly coordinated and occasionally inconsistent set of rules. In order to reinforce this provision (which had largely been unheeded by issuers), the Code now requires each issuer to describe in its annual Corporate Governance Report the instruments adopted to ensure the coordination among the corporate bodies and functions responsible for the system of internal control and risk management.¹³ Among these corporate functions the Code in the Comment to Article 7 now mentions the legal and compliance functions, *“with particular regard to the management of legal and non-compliance risks, including the risk that crimes are committed against, or in the interest of, the company”*. It is noteworthy that the Code explicitly mentions the legal and compliance risks, which thus each issuer should consider in the context of its risk profile.

This provision is noteworthy also because, by referring to crimes potentially committed against (as opposed in) the interest of the company, it clearly signals that legal and non-compliance risks go beyond the crimes for which the company can be held liable under Legislative Decree No.231 of 2001 on the *quasi*-criminal liability of corporations.

The Code provides in the Comment to Article 7 that an adequate internal control and risk management system - at least in the most significant issuers (*i.e.*, issuers included in the FTSE-MIB index) – should include a so-called “whistleblowing” system, consistently with domestic and international best practices and ensuring *“a specific and confidential communication channel as well as the anonymity of the reporting person”*. This provision is not included in the mandatory part of the Code (since it is included in a Comment). However, this provision is presented as a reasonable interpretation of the flexible concept of “adequate” system of internal control and risk management, which may influence the interpretation of Italian courts on this regard. In fact, under Italian law the executive directors have a duty to assess the adequacy of the organizational, administrative and audit system of the company, which include also the system of internal control and risk management.

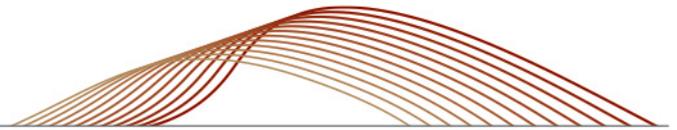
IV. Role of the Nomination Committee

Under Italian law, the Board of Directors of Italian listed joint stock corporations governed by the so called “traditional” governance mechanism (*i.e.*, 97% of the Italian listed companies)¹⁴ is appointed by the shareholders pursuant to a voting-list mechanism, which is intended to grant the minority shareholder at least a representative on the Board. Each issuer’s bylaws have to discipline the voting-list mechanism, including the right to present a list of candidates.

Ordinarily, the lists of candidates are presented by the shareholders. However, according to some commentators the incumbent Board of Directors may decide to present a list of candidates to be voted by the shareholders.¹⁵ Indeed, the right to present a list by the incumbent Board may help ease the coordination problems of minority shareholders in companies with a dispersed ownership.

The Code does not explicitly support this interpretative position. However, in the Comment to Article 5 it highlights the importance of an engagement of the Nomination Committee *“in case the Board itself, as far as it is consistent with applicable law, submits a slate for the renewal of the Board”*.

The same Comment to Article 5 provides a clarification on the succession plans of executive directors. The Code does not require issuers to provide succession plans, but only to evaluate such possibility.¹⁶ Succession plans are regarded by many commentators as important governance tools to ensure a smooth and rapid transition in any event of termination of an executive director’s appointment.¹⁷ In order to provide more precise indications, the Code now specifies that succession plans should *“clearly define their scope, instruments and timing, providing both for the involvement of the Board of Directors and for a clear allocation of tasks, also with regard to the preliminary stage of the procedure”*.



V. Remuneration of Statutory Auditors

Pursuant to the “traditional” governance structure of Italian joint stock corporations, the shareholders appoint a Board of Statutory Auditors (*collegio sindacale*).

The Board of Statutory Auditors has wide monitoring responsibilities and play a “*central role in the supervisory system of an issuer*”.¹⁸ Quite often the compensation of the members of the Board of Statutory Auditors is not proportionate to their wide spectrum of responsibilities and potential liabilities. In consideration of this, the Code now stresses that “*the remuneration of statutory auditors should be proportionate to the commitment required from each of them, to the importance of his/her role as well as to the size and business sector of the company*”.¹⁹

VI. Conclusions

Issuers adhering to the Code have to implement its new provisions by the end of the financial year starting in 2016²⁰.

The new provisions, besides providing some helpful guidance and clarifications on various points, mainly focus on the area of risks, with an emphasis on the risks that can affect the sustainability of an issuer.

The Code will help directors in understanding how to address key risks, structure internal controls, and ensure that markets are adequately informed.

Markets will benefit from the increased focus on risks (including legal and compliance risks, particularly relevant in Italy) and internal controls, and the associated disclosure obligations.



*Bruno Cova is a member of the troika of experts advising the Corporate Governance Committee of Italian listed companies on corporate governance reforms. Opinions expressed in this article are exclusively the authors’ and do not necessarily reflect those of Corporate Governance Committee or the troika of experts.

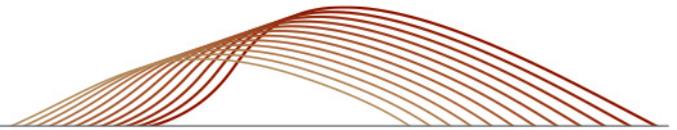
If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Milan Lawyers:

Bruno Cova
39.02.30414.212
brunocova@paulhastings.com

Flavio A. Acerbi
39.02.30414.218
flavioacerbi@paulhastings.com

¹ The Corporate Governance Committee is promoted by the most important Italian business associations (i.e., ABI, ANIA, Assonime and Confindustria), the association of institutional investors (i.e., Assogestioni) and the Italian stock exchange (i.e., Borsa Italiana S.p.A.) with the goal of supporting best practices of corporate governance for Italian listed companies.

² As provided pursuant to EU Directive 2013/34/EU and article 123-bis of the Italian Unified Code (i.e., Legislative Decree No. 58/1998), each listed company is required to include a “corporate governance statement” in its annual management report, indicating “*the corporate governance code which the undertaking may have voluntarily decided to apply*”. In the event a listed company decides to depart from any provision of the corporate governance code to which it voluntarily adhered, it should provide a clear and exhaustive explanation thereof. Likewise, a listed company



should adequately explain its decision not to adhere to any corporate governance code (article 20 of EU Directive 2013/34/EU; see also the Commission Recommendation of 9 April 2014 "on the quality of corporate governance reporting ("comply or explain")").

³ Criterion 1.C.1, letter b), of the Code.

⁴ Principle 1.P.2 of the Code.

⁵ We refer especially to Directive 2014/95/EU of 22 October 2014, providing new disclosure obligations for larger undertakings on "non-financial information" - and in particular on environmental, social and employee matters, respect of human rights, anti-corruption and bribery matters - and information on diversity policies.

⁶ See Whereas 6 of Directive 2014/95/EU of 22 October 2014.

⁷ The FTSE-MIB is the primary benchmark index for the Italian equity markets, comprising 40 shares listed on the Borsa Italiana Stock Exchange and capturing approximately 80% of the domestic market capitalization. The Index is comprised of highly liquid, leading companies in Italy.

⁸ Comment to Article 4 of the Code. As provided in the same Comment, the Board of Directors may also allocate these tasks to other existing committees, most significantly the Internal Control and Risk Committee.

⁹ However, since the sustainability matters should be included in the definition of the risk profile of each issuer pursuant to the new criterion 1.C.1, letter b), of the Code the Board of each issuer should reasonably supervise such sustainability matters (if appropriate, with the support of the Control and Risk Committee).

¹⁰ Principle 7.P.2 of the Code.

¹¹ Criterion 1.C.2, letter g) of the Code.

¹² Pursuant to principle 7.P.4 of the Code "The Control and Risk Committee is made up of independent directors. Alternatively, the committee can be composed of non-executive directors, the majority of which being independent; in this latter case, the chairman of the committee is selected among the independent directors. If an issuer is controlled by another listed company or is subject to the direction and coordination activity of another company, the committee shall be made up exclusively of independent directors".

¹³ Criterion 7.C.1, letter d) of the Code.

¹⁴ As of 31 December 2013. See Consob, *2014 Report on corporate governance of Italian listed companies*, page 24.

¹⁵ See for instance Stella-Richter, *Gli adeguamenti degli statuti delle società con azioni quotate dopo il D.Lgs. 303/2006*, in *Consiglio Nazionale del Notariato*, Studio n. 19-2007/1. However, this opinion is not shared by the Assonime, Circular no. 12 of 12 April 2006. On the pitfalls of Italian law on the voting-list mechanism and possible prospective reforms see also Enriques-Zingales, *Il voto di lista non basta nei big a capitale diffuso*, *Il Sole 24 Ore*, 21 Maggio 2015 and Marchetti-Ventoruzzo, *Ecco come si può rafforzare il voto di lista*, *Il Sole 24 Ore*, 2 giugno 2015.

¹⁶ Criterion 5.C.2 of the Code, which also provides that "in the event of adoption of such a plan, the issuer shall disclose it in the Corporate Governance Report. The review on the preparation of the above mentioned plan shall be carried out by the nomination committee or by another committee established within the Board of Directors in charge of this task".

¹⁷ On the succession planning see Larcker-Saslow, *2014 Report on Senior Executive Succession Planning and Talent Development*, at <https://www.gsb.stanford.edu/faculty-research/publications/2014-report-senior-executive-succession-planning-talent-development>; Larcker-Miles-Tayan, *Seven Myths of CEO Succession*, at <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-39-seven-myths-ceo-succession.pdf>.

¹⁸ Comment to Article 8 of the Code.

¹⁹ Criterion 8.C.3 of the Code.

²⁰ With the exception of the new provisions on the Board of Statutory Auditors provided under Article 8 of the Code, which apply in to the renewal of the Board of Statutory Auditors starting from the business year 2016.

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2015 Paul Hastings LLP.