CONSOB

Italy Corporate Governance Conference

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Introduction

Before discussing more in details some of the issues that have emerged in this conference, I will give an overview of some questions which remain still open since the Italian corporate law reform of 2003.

Italian companies, both listed and unlisted ones, have not had the possibility to choose among alternative governance systems (one-tier "*monistico*" and two-tier board "*dualistico*"). This is mainly due to the lack of a normative/regulatory framework which could provide both autonomous and clear rules for such alternative systems.

First, almost all listed companies are used to stick to the "traditional" system (based on "*collegio sindacale*"), a quite unique one throughout the world (adopted only in Portugal and Japan) and largely unknown to most institutional investors.

Second, after the 2003 reform, a flow of chaotic laws created a *plethora* of bodies which were all responsible for the implementation of internal controls. This implied duplications of tasks as well as potential inefficiencies. It produced also huge and undue compliance costs for the listed companies. In my opinion the time has come for the adoption of an organic reform for the simplification of the internal control systems.

Moreover, while the Italian legislative framework is still concentrated on the topic of internal controls, it almost neglects another core issue of corporate governance (CG): the functioning and related powers of the board of directors. The law, in fact, simply regulates its composition. I will discuss all this in a minute…..

Now I would like to return to three issues which were discussed in the conference: a) slate voting (*voto di lista*), b) multiple voting shares; c) interaction between the Italian CG code and general company law provisions.

1. Slate voting and independent/minority directors

Slate voting (*voto di lista*) allows minority shareholders to nominate directors in the management board. This is a standard mechanism made to ensure both board monitoring and the protection of shareholders against expropriation. In Italy, it has been made mandatory by the law. Each listed company MUST therefore have a representative of minority shareholders in the management board.

At the end of 2014, minority shareholders presented a slate in 89 firms (almost 40% of the total amount of listed firms) and they were able to elect on average 1.8 directors. Italian mutual funds have presented slates in the 9% of all listed companies and in the 46% of the FTSE Mib.

One of the reason for a mandatory application in Italy of the slate voting – which was initially introduced only for privatized companies and, after the Parmalat scandal in 2004, was extended to all listed companies - is the high ownership concentration. In fact, in more than two firms out of three a single shareholder can either exercise a majority control or play a dominant role.

There is some positive evidence from mandatory slate voting.

Firms where at least one minority director sits on the board seem to adopt stricter procedures on related party transactions and the appointment of at least one director by minority shareholders facilitates a negative vote on the remuneration policy of the executive board, especially when the minority director sits in the remuneration committee.

Furthermore, institutional investors showed a strong appreciation of this voting system.

Nonetheless, this mechanism introduced two elements of confusion in the elections of the board and this may have implied significant costs.

First, we have “independent” directors and “minority” directors, where minority directors are often independent directors as well; but the difference between the two of them might sometimes be not sufficiently clear to small investors.

Second, in some cases slates presented by institutional investors with only few candidates (because institutional investors do not want to control the company) obtained the majority of the votes, but the majority of the board members was elected by slates with lower votes.

For example, during the 2014 Telecom shareholders meeting the slate presented by mutual funds, containing three candidates, obtained the majority of the votes, while the largest shareholder (Telco), which was second, was able to elect ten directors. In 2015 shareholders meeting of Unicredit, the slate presented by the major shareholders (Allianz, Fondazione Cassa di Risparmio di Torino e Carimonte) obtained 44 per cent of the votes, and elected sixteen directors, while the slate presented by funds obtained the majority of votes, but elected only one candidate.

Therefore, the major cost of mandatory slate voting is that it has a negative impact on the decision to go public.

I think slate voting could be amended introducing different methods of board election as well as giving more responsibility to the board itself, similarly to what actually happens in other advanced countries.

A final issue is that even the presence of independent directors is mandatory by the law, while in all major countries this is a matter left to self-regulation.

To conclude on this point, my opinion is that the whole issue of independent directors, minority directors, slate voting and, more generally, board election procedures should be left to self-regulation.

2. Multiple voting shares

Multiple voting shares are one of the new key issues in Italian corporate governance.

The Italian Government has rightly introduced this big change in our corporate law, following suggestions advanced by Consob in the frame of the *PiùBorsa* project, all along with other proposals, fostering the development of our stock exchange.

It is important to distinguish between two different kinds of multiple voting structures: “true” multiple voting shares *and* loyalty shares.

The possibility of issuing multiple-voting shares will effectively encourage IPO, as it gives greater freedom to entrepreneurs to decide for the optimal ownership structure, balancing the trade-off between control and capital raised on the market.

For the time being, we had only two IPO's with multiple voting shares. This does not mean that the innovation is worthless. I think that once the IPO market will fully recover, the use of this instrument will increase.

Loyalty shares are a very positive innovation as well: they are a tool to encourage long-term investment and, consequently, the presence of stable investors with greater monitoring power and less propensity towards short-termism. This would reduce share price volatility and consequently increase market efficiency.

So far, loyalty shares have been more successful than multiple voting shares. They have been adopted by 17 companies, mostly medium and small ones.

3. The Italian Corporate Governance code and general company law provisions

The introduction of a corporate governance code in the Italian market had positive effects, forcing Italian companies to convergence towards international standards of governance.

The code is based on the core concept of the one-tier board structure (*sistema monistico*) typical of the Anglo-Saxon countries, though, as mentioned before, almost all Italian companies do adopt the traditional governance system based on "*collegio sindacale*" (internal auditors).

The application of the code by the Italian companies led to a contamination traditional/one-tier system. The introduction into the traditional system of elements which are typical of the one-tier system, such as independent directors and internal committees, was a successful experiment but, perhaps, it has also been a source of confusion, especially

with relation to the role divisions between *collegio sindacale* and board committees.

There is a tension, and sometimes a contradiction, between the idea of governance promoted by self-regulation and the actual governance dictated by the law. One possibility to solve this tension is facilitating the adoption of the one-tier model by the listed companies, making law provisions more clear. This is what I said in the introduction.

The adoption of the one-tier model may indeed facilitate listing and capital raising from foreign investors, because the one-tier model is by far the best known governance structure by foreign investors.

Last, but not least, the adoption of the one-tier model could further help to simplify the internal control system and to reduce compliance costs.

Conclusions

Let me conclude with few general remarks.

I think that the overall objective of corporate governance regulation is to strike the right balance between investors protection and economic efficiency.

Most corporate governance tools – such as the discussed mandatory slate voting, the regulation of related parties transactions, the mandatory takeover bids, and so on – have a key relevance for investor protection, but may have an impact on the decision to go public.

It is not surprising, in fact, that some of these tools are lacking in the United States and in other non-European countries, with developed capital markets.

Hence, it is important to find the right solutions that can contribute to the development of the stock market, while keeping at the same time a high level of investors protection.

In order to achieve this target, we must be conscious that rules, especially if mandatory ones, should be formulated in a simple way and should be principle-based. This would increase directors accountability without placing an excessive burden on listed companies.