

Monitoring the Comply or Explain in Corporate Governance Codes: the Italian Experience

Carmine Di Noia

(Assonime and Italian Corporate Governance Committee)

***14th European Corporate Governance Conference
Can Corporate Governance contribute to Long-Term Investment***

Athens, March 28 2014

The Italian Corporate Governance Code

- ❖ Since 1999, principles of best practice for Italian listed companies are stated in the Corporate Governance Code (“*Codice di Autodisciplina*”, CGC)
 - Companies are invited to adopt the Principles (and application criteria) on a comply or explain basis

- ❖ Revisions of the Code governed by a *Committee for Corporate Governance*
 - The new (2011) Committee (in charge for 3 years) is composed now of 23 representatives appointed by associations of Issuers and Investment companies and the Italian Stock Exchange (part of the LSE Group)
 - The Committee is assisted by 3 Experts and a Technical Secretariat
 - The Committee will meet at least annually

- ❖ Last Revision of the Code: 2011

The Italian CG Code 2011

- ❖ Main areas involved:
 - Update the Code after recent legal reforms
 - E.g. EU Audit and Shareholders Rights Directive + EU Remuneration Recommendations
 - Specific rules for blue chips + possibility to adopt a “lean” approach for smaller firms
 - Number of Independent Directors in Board and Committees
 - Lead Independent Director
 - Board Effectiveness
 - A thorough revision of the Internal Control and Risk Management System
 - Governance of the Remuneration setting process + Remuneration Report

“Comply or explain” in the Italian CGC

- ❖ Each Italian listed company adopting the Code shall provide in its CG Report:
 - Accurate, concise and easily understandable information on the manner in which each single recommendation contained in the principles and criteria has been effectively implemented during the period covered by the report
 - The Code contains also Comments (which are NOT on a comply-or-explain basis)
 - If an issuer has not implemented (in whole or in part) one or more principles or criteria, it shall supply adequate information with regard to the reasons for the omitted or partial application
 - In the event that *principles* and *criteria* relate to optional conduct, a description of the line of conduct followed is required, though it is not necessary to provide the reasons for the choices made

“Comply or explain” in Italian law

- ❖ Since 2009, the “comply-or-explain” principle has a full legal basis because corporate governance (and remuneration) reports are “regulated information” according to EU transparency directive.
 - Publication of a “*Report on CG and ownership structures*” is mandatory for Italian companies with securities admitted to trading on regulated market, irrespective of the compliance with CGC
 - The Report shall provide information about:
 - The adoption of a CG code of conduct issued by regulated stock exchange companies or trade associations, giving reasons for any decision not to adopt one or more provisions,
 - The corporate governance practices actually applied by the company “over and above” any legal or regulatory obligations
 - A number of specific issues (e.g. the composition and duties of the administrative and control bodies and their committees)

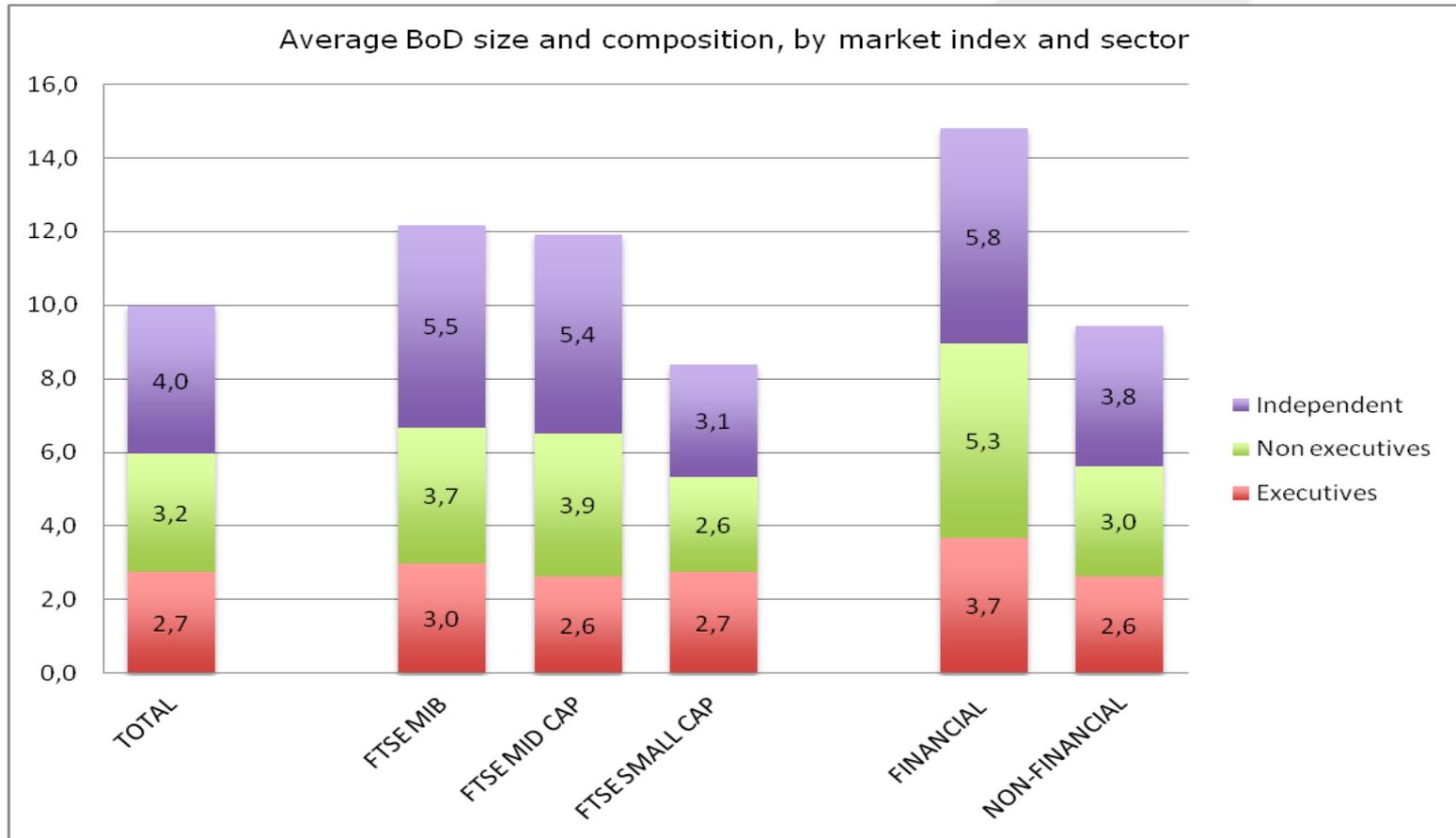
The Italian monitoring (1): Assonime-Emittenti Titoli report

- ❖ Since 2001, Assonime and Emittenti Titoli produce a monitoring Report (now under the supervision of proff. Massimo Belcredi and Stefano Bozzi, Università Cattolica, Milano) on the compliance of Italian listed companies with the CGC
- ❖ The report provides an in-depth analysis on:
 - Compliance of Italian listed firms with main recommendations of the CGC
 - Details on their CG
- ❖ The report includes a focus on a specific topic:
 - Structure and costs of the Internal control system (2008)
 - Directors' remuneration (2009)
 - Slate voting and minority representation in corporate bodies (2010)
 - Procedures governing transactions with related parties (2011)
 - Directors' remuneration (2012 – 2013)
- ❖ The reports in Italian (English for last 5 years) may be downloaded from the Assonime website: <http://www.assonime.it/AssonimeWeb2/sito.jsp?id=245047>

The decision not to comply with single recommendations

- ❖ A high level of compliance:
 - 93% of companies declare to follow the Code (stable over time)
 - A more mature application of individual principles and criteria
- ❖ More information (Code 2011) + More transparency bring out new areas for «improvement»
- ❖ Temporary period:
 - Compliance with the «old» Code: overall good
 - Compliance with the «new» Code: ongoing
 - Rapid increase in the transparency of decisions made
 - Gradual renewal (post election) of Board «composition» requirements

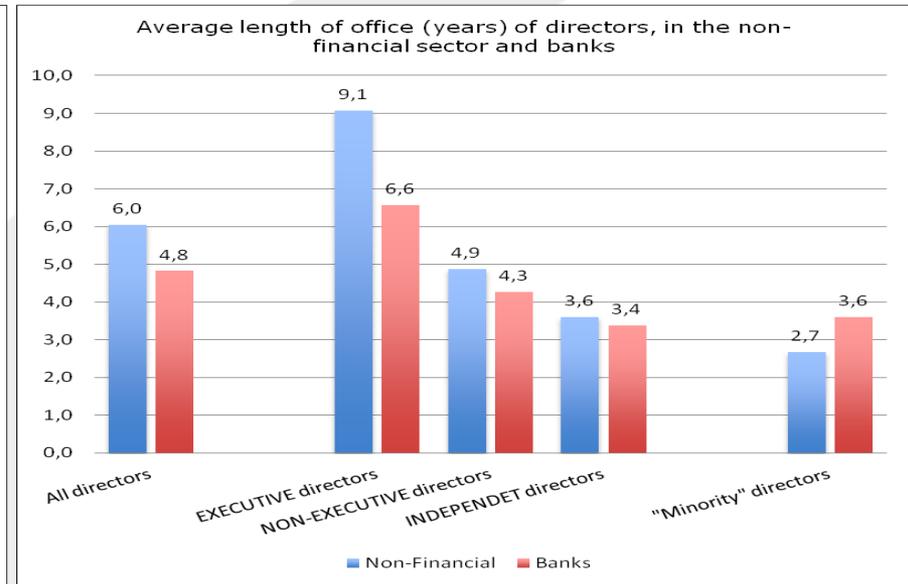
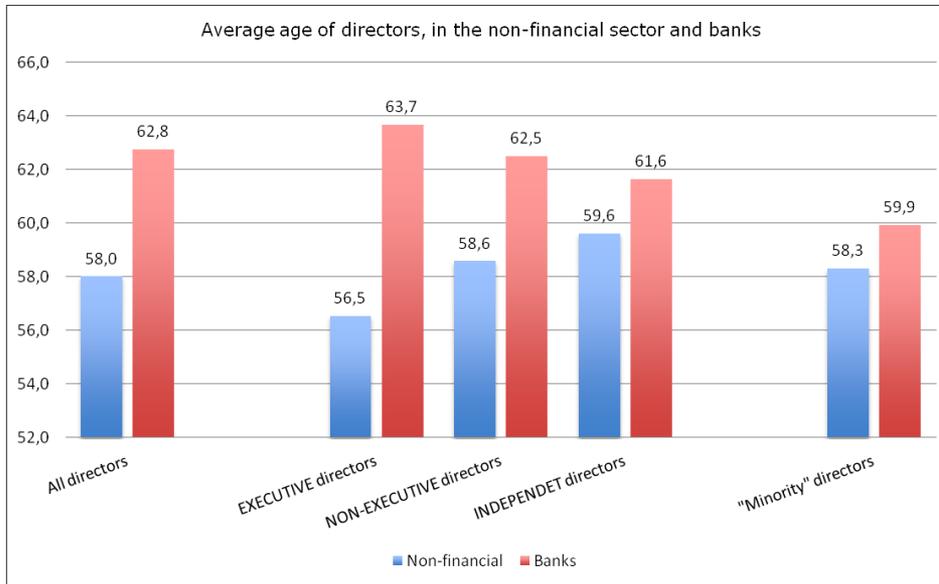
Composition of BoD



❖ Size and sector effect

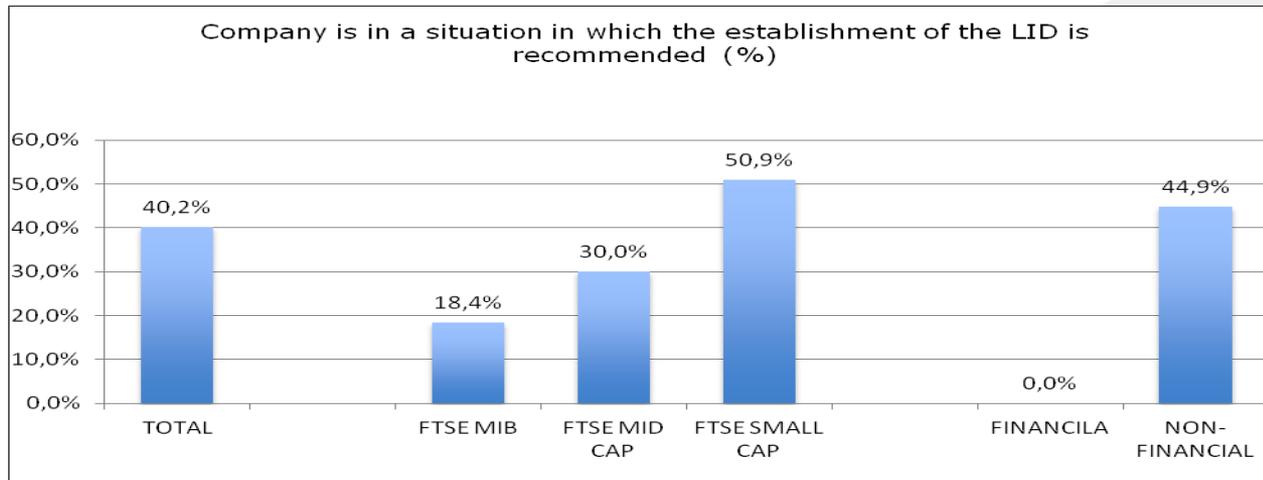
- 90% compliance with board (and Remuneration/Audit committees) composition recommendation

Age and tenure of directors

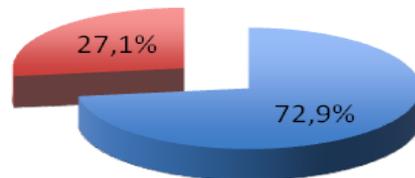


- ❖ Age and tenure vary according to directors' role and company sector
- ❖ Age differences especially pronounced for executives

Lead Independent Director



Lead Independent Director:
a) Companies where it is recommended



■ Companies with LID ■ Companies without LID

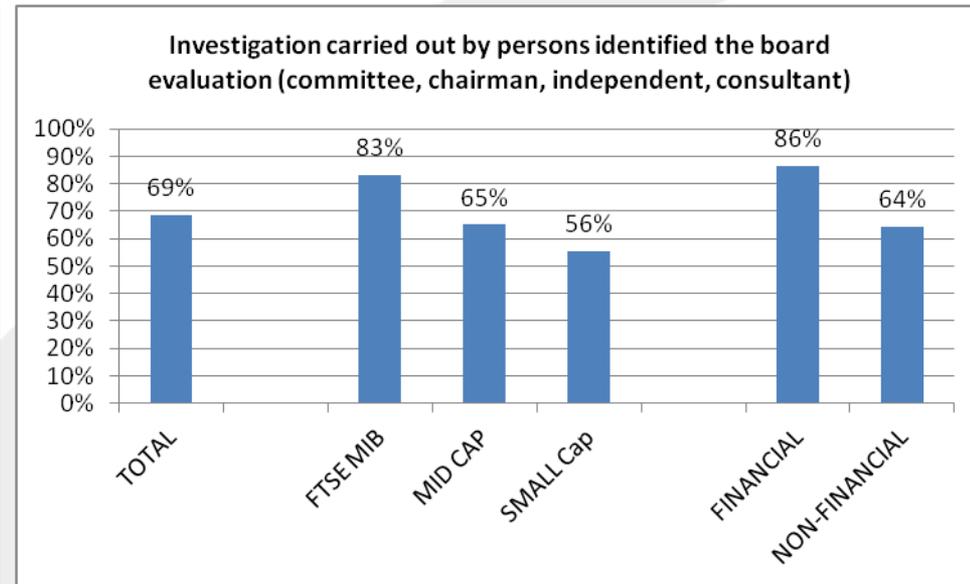
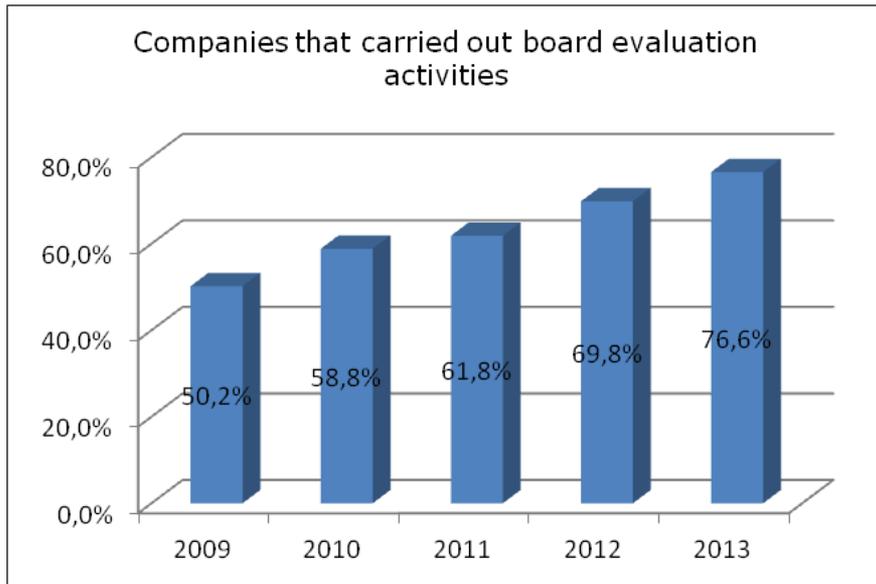
Lead Independent Director:
b) Companies where it is not recommended



■ Companies with LID ■ Companies without LID

- ❖ The Code recommends the LID in case of:
 - Chairman-CEO or Chairman-the person controlling the issuer
- ❖ Link to size, sector and ownership structure
- ❖ More frequent meetings of the independent if the LID is appointed

Board evaluation



- ❖ *Board evaluation* is in constant growth
- ❖ Transparency of process change according to size and sector
- ❖ An external consultant: appointed in 32 cases
 - 6 companies with the committee (CR o CCR)
 - 1 with the LID
 - None with the Chairman

The Italian monitoring (2): The CG Committee Report

❖ Annual Report 2013

- Main activities of the CG Committee
- Evolution of the corporate governance framework (both domestic and international)

❖ Report on the compliance with the 2011 release of the Corporate Governance Code

- Based on available data (Assonime-Emittenti Titoli, Consob, consultants)
- Part I: An overview of some significant topics in relation to the issuers' compliance with the Code (with particular reference to the Board of Directors and Board Committees)
- Part II: A focus on Board evaluation
- Recommendation on the quality of explanations

Current application of the CG Code

❖ Main results:

- Almost all listed companies state their intention to comply with the Corporate Governance Code
- 16 companies state that they do not comply (or have discontinued compliance) with the Corporate Governance Code; 9 of these companies disclose the reason for their choice

❖ The Committee's position:

- The choice not to comply – in whole or in part – with the Code does not determine a negative opinion, in the awareness that this may be contingent on several factors. It is preferable not to comply with single recommendations of the Code (while providing detailed explanations for doing so) rather than achieve merely formal adherence to the Code.

Current application of the Code

- ❖ The Committee encourages issuers to pay particular attention, when drawing up their report on corporate governance
- ❖ It underlines that generic and formalistic expressions are inappropriate, in case of non-compliance with one or more Code recommendations
- ❖ It emphasizes the importance of detailed and exhaustive explanations
- ❖ It recommends issuers
 - to disclose any governance solution adopted as an alternative to the non complied recommendation (and)
 - to indicate, in case non-compliance is intended to be limited in time, when the company expects to conform with the provision

Main CG Committee recommendation (1)

❖ Functioning of the Board of Directors

- Information on the effective functioning of the board is greatly improved
- But need to improve the prior notice period for board members to receive documentation before the board; provide information on the degree of compliance with the notice period
- Ensure necessary disclosure and in-depth analysis during Boards

❖ Structure of the Board of Directors

- A greater diversity concerning professional and management skills within the BoD - including international experience – is advisable

❖ LID

- A prearranged commitment to the appointment of a LID, when the conditions of the Code (Chairman-CEO/Chairman-issuer's controller) are met, may be useful

Main CG Committee recommendation (2)

❖ Board evaluation

- Our financial market is keeping up with other European countries having regard to the use of the board evaluation
- It is important to provide greater disclosure on the Board evaluation procedures and to adequately justify any decision not to perform it
- No specific recommendation about the subject to entrust with the Board Evaluation procedure (i.e.: C.G. Committee; R. Committee; Chairman; Independent directors; external evaluator; other)
- The board evaluation should be carried out in a conscious and effective manner
- It is useful to provide the market with a valuation, performed by the outgoing directors, on the optimal BoD composition

Italian Corporate Governance next steps

- ❖ Italian Presidency
- ❖ Assonime-Emittenti Titoli will focus their annual monitoring on the quality of explanations (May 8, CG conference at LSE)
- ❖ The Corporate Governance Committee has approved its plan for future activities:
 - Provide an in-depth analysis on the quality of explanation
 - A possible review of the Italian Corporate Governance Code