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New Italian Corporate Governance Code for listed companies:
***sustainable success* and *proportionality* at the heart of the new edition**

Sustainability and proportionality are at the heart of the new Corporate Governance Code for listed companies recently approved by the Italian Corporate Governance Committee (the "**New CG Code**") and published on 31 January 2020.

The New CG Code – which will replace the current Corporate Governance Code (the "**2018 CG Code**") and will be applicable on a "comply or explain" basis, starting from the first financial year beginning after 31 December 2020 – has a renewed structure, divided into "*Principles*" and "*Recommendations*".

The main innovation is the introduction of the concept of "*sustainable success*", which is defined as "*the objective that guides the action of the board of directors and which consists in the creation of long-term value for the benefit of shareholders, taking into account the interests of other stakeholders relevant to the company*".

Significantly, *Principle* I of the New CG Code provides that "*the board of directors shall manage the company pursuing its sustainable success*".

This appears consistent with the broader international scenario focused on the growing importance of ESG factors (*Environment, Social and Governance*) in the management of companies, as recently highlighted, *inter alia*, by the "Statement on the Purpose of a Corporation" signed by 181 CEOs of the Business Roundtable and the letter sent by the Chair and CEO of BlackRock to companies' CEOs ("A Fundamental Reshaping of Finance"). Also, the New CG Code is in line with the UK Corporate Governance Code of July 2018, which underlines the importance for a company to succeed in the long-term by stating that "*a successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society*" (see "Principle A").

This newly introduced soft-law recommendation is of particular relevance for Italian companies to which the New CG Code is addressed since, as of today, within the Italian legal framework no law provision requires directors to take into account, in managing the company and pursing its corporate purpose, objectives (such as long-term value creation and stakeholders' interests) other than those related to the (profits of the) company itself and (indirectly) its shareholders.

As a matter of fact, unlike in the UK – where Section 172 of the Companies Act 2006 provides that directors must act in the way they consider would be most likely to promote the success of the company, also taking into account long term consequences and stakeholders' demands –in the context of the Italian legal framework, ESG factors are currently taken into account mainly for the purposes of an *ex-post* disclosure. Indeed, Legislative Decree No. 254 of 30 December 2016 introduced specific disclosure obligations for "entities of public interest" (which include, *inter alia*, listed companies, banks and insurance companies), aimed at describing the impact of the company's business on environmental, social and employee-related issues, respect for human rights and the fight against active and passive bribery.

Differently, the provisions of the New CG Code are aimed at encouraging issuers to embed sustainable success in their business models, governance structures and corporate strategies, in order to pursue the creation of long-term value for the benefit of the company and its shareholders, also taking into account the interests of other relevant stakeholders.

In this perspective, *Recommendation* 1 of the New CG Code invites boards of directors, with the support of an *ad hoc* board committee, to examine and approve the business plan of the company and its group also on the basis of the analysis of long-term value creation related issues.

Boards are also recommended to define the nature and level of risk which is deemed in line with the strategic objectives of the company, by including in such evaluation all the elements which may be relevant for the purposes of pursuing sustainable success of the company.

Coherently, boards of directors – with the support of the risk committee – is recommended to establish an internal control and risk management framework which should also efficiently contribute to the achievement of the sustainable success of the company.

In order to support directors in performing their duties effectively in light of ESG factors, the New CG Code recommends to the chair of the board to ensure that all of its members are given the opportunity to participate in specific inductions aimed at providing them with adequate knowledge of the sectors of activity in which the company operates, of the company dynamics and their evolution, also with a view to the sustainable success of the company itself as well as the principles of proper risk management and the applicable regulatory and self-regulatory framework.

Sustainability related issues also affect relationships and engagement activities between companies and their stakeholders. This aspect has already been taken into account by Directive (EU) No. 2017/828 (so-called "Shareholders' Right Directive II" – "SRD II"), according to which "*greater involvement of shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors, in particular as referred to in the Principles for Responsible Investment, supported by the United Nations. In addition, greater involvement of all stakeholders, in particular employees, in corporate governance is an important factor in ensuring a more long-term approach by listed companies that needs to be encouraged and taken into consideration*" (see Recital no. 14).

Consequently, SRD II – implemented in Italy by Legislative Decree No. 49 of 10 May 2019 – requires institutional investors and asset managers to develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. The policy shall describe, *inter alia*, how they monitor investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance, conduct dialogues with investee companies, exercise voting rights and other rights attached to shares, cooperate with other shareholders, and communicate with relevant stakeholders of the investee companies.

In line with the above, the New CG Code recommends the board of all listed companies to strengthen its dialogue with shareholders and other relevant stakeholders, and to adopt a specific policy – to be disclosed in the annual corporate governance report – regulating engagement practices and mechanisms, also taking into account the policies adopted by institutional investors and asset managers in this respect.

On this regard, the New CG Code entrusts the chair of the board with the task of *(i)* proposing to the board (together with the CEO) the adoption of an engagement policy, and

(ii) ensuring the entire board is promptly informed (within the first available meeting) of the development and significant content of the dialogue carried out with shareholders.

In order to enhance corporate bodies' sensitivity towards sustainability and long-term strategies, the New CG Code also focuses on remuneration policies concerning directors, members of the controlling body and top management.

In particular, the board of directors is recommended to establish – with the support of a remuneration committee – a remuneration policy for executive directors and top management, which should be functional, *inter alia*, to pursue the sustainable success of the company by providing that a significant part of the variable remuneration is linked to long-term performance objectives, also non-financial.

This is consistent with SRD II provisions, already implemented in the Italian Consolidated Financial Act, according to which the remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company, and directors' performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance factors.

In addition, in order to align executives and top management remuneration to long-term shareholders' interest, the New CG Code recommends that share-based remuneration plans be mostly subject to a total vesting and holding period of at least five years.

Having said the above, the New CG Code is not only focused on sustainability. Simplification and proportionality have also been considered as drivers for its renovation.

The New CG Code now refers generically to "administrative bodies" and "controlling bodies", in order to simplify the application and the understanding of its content regardless of the corporate governance model concretely adopted by the company in the specific case. Such solution may also facilitate the application of the *Principles* and *Recommendations* set forth by the New CG Code by foreign companies, adopting a one-tier or a two-tier model, envisaging to listing their shares on Italian regulated markets.

In this respect, the board is recommended to assess the functionality of the company's corporate governance structure in relation to its business objectives and strategies, and, if deemed necessary in order to define a more functional model, to submit to the shareholders' meeting reasoned proposals aimed at adopting such model.

The New CG Code also aims at supporting access to capital markets for medium and small-sized companies and those with a strong ownership concentration through *Recommendations* that are simplified and proportionate to the features of both categories.

For this purpose, the New CG Code differentiates and defines:

- "*large companies*", *i.e.* companies whose market capitalization exceeded 1 billion Euro on the last open market day of each of the previous three calendar years; and
- "*companies with concentrated ownership*", *i.e.* companies in which one shareholder, or more shareholders participating in shareholders' agreements, have, directly or indirectly (through subsidiaries, trustees or intermediaries), the majority of the votes in the ordinary shareholders' meeting.

The proportionality approach will apply also in relation to "independence" criteria.

Although the requirements of independence have not been subject to significant changes compared to the 2018 CG Code, the New CG Code now recommends the board to set out,

at least at the beginning of its mandate, quantitative and qualitative criteria for assessing the significance of the relations held by directors and/or members of the controlling body with the company or other subject related to the latter (such as, for instance, controlling/controlled entities, other directors, top managers and respective families, *etc.*) applying the "*substance over the form*" principle. Such provision is in line with the annual recommendations of the Corporate Governance Committee issued on 19 December 2019, which invited board of directors to apply with "*greater rigor the independence criteria*" defined by the 2018 CG Code, by defining *ex ante* the quantitative and/or qualitative criteria to be used for the evaluation, and specified that such criteria "*should relate to the overall position, not limited to the merely economic benefit, of the director whose independence is being assessed*".

According to the New CG Code, independence requirements should be met by all members of the controlling bodies, as already recommended by the 2018 CG Code.

As for board members, the New CG Code introduces some changes.

Firstly, with regard to the chair of the board – who, under the 2018 CG Code, cannot be considered as an independent director – the New CG Code provides for such possibility as long as the appointed chair meets all the independence requirements laid down by the same Code. In such a case, however, if the chair is appointed as member of board committees, the majority of the members of such committees should be composed of other independent directors; it being understood that, in any case, the chair of the board cannot also chair the remuneration committee and the control and risk committee.

As for the other directors, the 2018 CG Code currently recommends that in all listed companies at least two directors are independent; the recommended number of independent directors is increased to 1/3 of the entire board (only) for blue chip companies (*i.e.* those companies belonging to the FTSE-MIB index).

On this respect, the New CG Code provides for notable amendments, recommending on a proportional basis:

- to large companies which do not have a concentrated ownership, that at least half of the board is composed of independent directors;
- to large companies with concentrated ownership, that at least one third of the board is composed of independent directors; and
- to all other companies, that at least two directors are independent.

In this respect, however, it should be noted that, pursuant to Consob Regulation No. 20249 of 28 December 2017, *(i)* in companies subject to the direction and coordination of other subjects, all the members of the committees must be independent; and *(ii)* in companies subject to the direction and coordination of another listed company, the majority of the board members must be independent.

Furthermore, in relation to board composition, the New CG Code still recommends companies to apply criteria of diversity, in accordance with the priority objective of ensuring adequate competence and professional skills of its members.

With specific regard to gender diversity, the New CG Code recommends – in line with the 2018 CG Code – that, starting from the first renewal of the board and the controlling body following the termination of the effects of the legal provisions on gender balance, at least one third of their members belong to the "less represented" gender. On this regard, it must be considered that Law No. 160 of 27 December 2019 recently amended Articles 147-*ter* and 148 of the Italian Consolidated Act increasing up to 2/5 the number of seats to be

reserved to the less represented gender (compared to the previous 1/3). Such new gender-balance criterion shall apply for six consecutive mandates (*i.e.* for approximately 18 financial years, as Italian companies generally provide for a three-year mandate) starting from the first renewal following 1 January 2020.

Moreover, with the regard to the board of directors, the New CG Code recommends that boards of large companies which do not have a concentrated ownership should perform on an annual basis – with the support of the nomination committee – a self-evaluation concerning their dimension, composition and concrete functioning. For all other companies, the New CG Code recommends such self-evaluation to be done (at least) every three years, prior to the renewal of the board. The 2018 CG Code currently recommends to all companies (regardless their size and ownership structure) to perform such assessment at least once a year.

Also, while the 2018 CG Code recommends to the (out-going) board of directors of all companies to disclose to shareholders, prior to the renewal of the board, its view on the managerial and professional profiles deemed appropriate for its composition, the New CG Code now refers such recommendation only to companies other than those with concentrated ownership.

In the same perspective, companies other than large ones are no longer recommended – as it is instead in the 2018 CG Code – to adopt a so-called "over-boarding policy" regarding the maximum number of offices that members of the board may hold in boards and/or controlling bodies of other listed or large companies, in order to assess the compatibility with an effective performance of their duties.

The proportionality criterion applies also in relation to the adoption of a plan for the succession in the management of the company. Indeed, currently the 2018 CG Code only invites board of directors to evaluate whether to adopt such a plan. The New CG Code, in line with its long-term view, now recommends the board of directors of large companies to *(i)* define, with the support of the nomination committee, a plan for the succession of the CEO and other executive directors, that identifies at least the procedures to follow in case of their early termination, and *(ii)* make sure of the existence of adequate procedures for the succession of the top management of the company.

In the light of these new provisions, companies will likely start reassessing and reviewing their governance structure, internal regulations and corporate practices during this year, in order to be able to implement possible changes within the first financial year beginning after 31 December 2020.

As recommended by the New CG Code, starting from 2022 companies will have to disclose within their corporate governance report how they have concretely applied the new *Principles*, explaining the reasons underlining the possible choice not to apply (or to apply in a different way) one or more *Recommendations*. This may depend on factors internal and external to the company, according to which the *Recommendations* set forth by the New CG Code may not be functional or compatible with the specific corporate governance model adopted by the same company.