

How Italian-Listed Companies Can Strengthen Corporate Governance at 2019 Shareholder Meetings

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The upcoming annual general meeting season provides companies the opportunity to attract Italian and foreign investors by demonstrating improved corporate governance.

Overview

Italian-listed companies are increasingly focusing on sustainability in corporate management and their organizational structures, in order to enhance their attractiveness in international markets and among domestic and foreign investors. Companies may also consider further changes to improve their management and performance in the market.

Proposals to amend the by-laws

Introduction of loyalty shares

In 2014, the Italian legislature adopted specific provisions allowing Italian companies to issue loyalty shares (*azioni a voto maggiorato*), which superseded the principle of “one share-one vote.”¹ Italian joint stock companies (*società per azioni*) can adopt loyalty shares by assigning the increased voting right to their ordinary shares that are already listed on Italian regulated markets to the Italian Stock Exchange (*Borsa Italiana*) or, if they are private joint stock companies, by assigning the increased voting right to their ordinary shares in the course of the initial public offering (IPO) process. Loyalty shares were introduced to promote and support the listing of Italian companies, and to permit controlling shareholders of such companies or companies already listed to sell their shares. Consequently, companies can increase the liquidity of their stocks and permit controlling shareholders to maintain a significant role in the company. According to the Italian Securities Commission (CONSOB), 44 companies listed on the Italian *Mercato Telematico Azionario* have adopted loyalty shares to date.²

Companies can adopt loyalty shares by modifying their by-laws with the approval of shareholders at an extraordinary shareholders’ meeting. The by-laws may provide for a voting right increase from one vote to up to two votes for each share held by the same shareholder for a continuous period of at least 24 months from the date of registration in the specific register. Such register, in the case of companies that adopt the increased rights during the IPO process, counts the possession during the period before enrollment in the register. Companies’ by-laws may also provide for increasing the minimum period of

possession of the shares, and the right of shareholders to waive all or part of the increased rights attached to the loyalty shares.

Takeaway: Companies may adopt loyalty shares to support IPOs, increase the liquidity of their stocks, and permit controlling shareholders to maintain a significant role.

Slate presented by the outgoing board of directors

Listed companies, especially those with a spread shareholding and no controlling shareholders, may consider amending their by-laws to provide that the outgoing board of directors is entitled to present its slate for the appointment of the new board of directors according to the slate voting system (*voto di lista*). The slate voting system is imposed by law for the appointment of members of both the board of directors and board of statutory auditors. The law grants minority shareholders the right to appoint at least one member to each board from the minority slate that obtained the largest number of votes and is not linked to the majority slate that won the most votes.

If the by-laws entitle the board of directors to present its own slate — in line with the best practices recommended by the Italian Corporate Governance Code (the Code)³— the nominating committee must advise the board on scouting candidates and identifying the professional requirements and profiles that best suit the board's needs. Notably, the Code recommends the majority of the nominating committee be independent directors.⁴

Takeaway: Slates presented by the board of directors are best practice for public companies: they strengthen the independence of the management from the shareholders and enable the nominating committee to identify professional requirements and profiles best-suited to the company's business and performance objectives.

20% thresholds for pre-authorized rights offerings without a listing prospectus

Article 1(5)(a) of EU prospectus regulation (Regulation (EU) 2017/1129) grants an exemption from publishing the listing prospectus when issuing and listing securities fungible with securities already admitted to trading on the same regulated market. This exemption applies only if the securities represent, over a period of 12 months, less than 20% of the number of securities already admitted to trading on the same regulated market.

A listed company may want to consider proposing at its shareholders' meeting to grant delegate powers to the board of directors to increase the share capital according to Article 2443 of the Italian Civil Code up to 20% of the share capital, including the right to exclude the pre-emption rights up to 10% of the outstanding share capital.⁵

Takeaway: Shareholders' delegation of powers to the board of directors to increase the share capital by up to 20% permit the company to raise new capital on a timely and efficient basis without undergoing the CONSOB process to clear the listing prospectus, and thus avoiding a further specific shareholders' corporate approval process.

Listed companies and the right to identify their shareholders

Shares of listed companies are often held through complex chains of intermediaries, which makes the exercise of shareholders' rights more difficult and may represent an obstacle to the shareholders' engagement, because such companies are often unable to identify their shareholders.

According to Directive (EU) 2017/828, which amends the Shareholders' Rights Directive (Directive 2007/36/EC, SHRD I) regarding the encouragement of long-term shareholders engagement (the SHRD II), identifying shareholders is a prerequisite to direct communication between the shareholders and the company, and therefore is essential to facilitating the exercise of shareholders' rights and shareholders' engagement.

For this reason, SHRD II, which will be implemented by 10 June 2019, strengthens the provisions on identification of shareholders which were laid down in the SHRD I. The directive provides that Member States (i) will ensure that companies having a registered office in their territory have the right to identify their shareholders, and (ii) may restrict companies to request only the identification of shareholders holding more than a certain percentage of shares or voting rights; this provision is also applicable if there is more than one intermediary in the chain of control.⁶

Under the Italian provisions in force implementing the SHRD I, companies or shareholders owning a certain stake may request the identification of shareholders, provided that this right is set out in the by-laws of the company. The provisions also provide that in any case the shareholders may opt out and refuse to provide their identification data.⁷

On 7 February 2019, the Italian government (*Consiglio dei Ministri*) approved the draft of a legislative decree implementing the SHRD II (the Draft Decree), based on a preliminary review. This approval followed a public consultation by the Italian Ministry of the Economy and Finance, which concluded in December 2018. In particular, the Draft Decree proposes transposing the new shareholder identification request provisions in the SHRD II by deleting the by-laws requirement but setting the minimum threshold to exercise the right to request the identification above 0.5% of the share capital.

The draft explanatory report grounds this proposal in the need to avoid that shareholder identification be used as a defensive measure that may be used by directors or controlling shareholders against smaller shareholders aiming at building up more relevant stakes. Whether this provision will be adopted or changed in subsequent versions of the Draft Decree remains to be seen. The final version is expected in the next few months.

Takeaway: Identification of shareholders helps companies to engage with their shareholders and have a clear picture of their shareholding structure (e.g., type and nationality of investors). Companies may find this engagement and clarity useful in structuring corporate transactions.

Shareholders' vote on remuneration policy

The Draft Decree transposes the provisions of SHRD II on remuneration of directors and key managers of listed companies. The Draft Decree proposes a mandatory vote of the shareholders meeting on the remuneration policy at least every three years and whenever the board proposes to change the remuneration policy. This proposal changes significantly the Italian provisions in force,⁸ which require only a consultative and non-binding vote of the shareholders on the remuneration policy. The draft explanatory report grounds this proposal in the need to align the provisions on the remuneration policy of Italian-listed companies with those applicable to banks and insurance companies that are already in force. The Draft Decree departs from the proposal included in the consultation paper of the Italian Ministry of the Economy and Finance as endorsed by most of market participants. Also in this case, we should wait for the next releases of the draft Decree to see if the mandatory vote will be maintained.

Takeaway: Forthcoming Italian legislation will strengthen the say-on-pay regime in listed companies.

Presentation and discussion on the non-financial reporting declaration

Recently, attention to non-financial information and sustainability has increased considerably and plays a key role when measuring and comparing performance of listed companies.

In the 2018 annual general meeting season, Italian-listed issuers implemented for the first time the European provisions on non-financial reporting set out in Directive (EU) 2014/95 and adopted in Italy by Legislative Decree 254/2016.⁹

These provisions require listed issuers to prepare and publish a non-financial report including information, at minimum, on environmental and social issues, human rights, diversity, anti-bribery and anti-corruption policies, health and safety, and on the corporate policies to reduce exposure to such risks.

Investors praised the choice made by several Italian-listed issuers to include in their 2018 shareholders' meeting agenda a specific non-voting item regarding the presentation and discussion on the non-financial report and the general increased disclosure on such corporate social responsibility matters. This best practice may be successfully implemented and expanded in the forthcoming 2019 annual general meeting season.

Takeaway: Voluntary disclosure to shareholders and to the market on corporate social responsibility matters plays a key role in measuring and comparing performance of listed companies.

Boardroom gender diversity

Over recent years, legislators and the market have increasingly paid attention to gender-balanced boards as a key tool to improve corporate governance and performance of listed companies.

In Italy, Law 120/2011 (the Golfo-Mosca Law) imposes mandatory gender quotas for three board mandates following the entry into force of the law in August 2012, by setting out a minimum objective of one-third of corporate board seats (board of directors and board of statutory auditors) for members of the under-represented gender, lowered to one-fifth for the first term.

A recent working finance paper published by CONSOB¹⁰ confirmed that the Golfo-Mosca Law had positive effects. Immediately after the law's entry into force, the portion of female directors increased 17% (known as instant reform effect) and afterwards, 11% (known as follow-up effect). The paper also confirmed that the entry of more women into the boardroom has affected other board features, such as lowering the average age, increasing the diversity in terms of age and professional background, increasing the level of education, and increasing the percentage of female interlockers.

The Golfo-Mosca Law will expire in 2020. To preserve and continue its positive effects, the Code was amended in July 2018 to introduce specific recommendations on gender diversity balance in the composition of the boards of directors and board of statutory auditors. The Code invites Italian-listed companies to apply such recommendations, on a comply or explain voluntary basis, starting from the first renewal of their corporate boards following the expiration of the Golfo-Mosca Law.

To this aim, the Code recommends that listed companies apply diversity criteria, including gender diversity criteria, for the composition of the board of directors and board of statutory auditors consistently with the primary objective of ensuring that any board member has proper competence and professional skills. Also, the Code recommends listed companies to adopt measures to promote equal treatment and opportunities regardless of gender within the company structure, and to monitor their implementation.

In line with the Golfo-Mosca Law provisions, under the new recommendations, at least one-third of the seats on the board of directors and board of statutory auditors are reserved for the less represented gender. To achieve this goal, listed companies should apply any of the following tools they deem most appropriate considering their proprietary structure:

- Specific by-laws provisions
- Diversity policies
- Board guidelines to shareholders
- A slate presented by the outgoing board of directors itself

The Code also recommends companies to require shareholders presenting slates for the appointment of the corporate boards to provide proper information on consistency of the list presented with the diversity criteria and goals defined and pursued by the company.¹¹

The 2019 annual general meeting season may give listed companies the opportunity to start an assessment of the results and effects of the application of their diversity policies and the Golfo-Mosca Law provisions over the composition and performance of their corporate boards in order to improve and strengthen such policies and implement the Code recommendations on diversity in the most effective and suitable way.

Takeaway: A voluntary assessment of the results and effects of the application of their diversity policies and the Golfo-Mosca Law may help companies to improve the boardroom gender diversity, which has increased considerably and plays a key role in measuring their performance.

Authorization to purchase and dispose of treasury shares

Italian-listed companies generally include in the agenda of the annual general shareholders meeting the authorization to purchase and dispose of treasury shares according to Article 2357 of the Italian Civil Code.

Based on the outcomes of the 2017 and 2018 annual general meeting season that followed the entry into force of EU Regulation No. 596/2014 (Market Abuse Regulation), which reformed the safe harbors and exemption provisions applicable to buy-back of shares, listed companies may include in the proposal of authorization to purchase and dispose of treasury shares to the annual shareholders' meeting the express authorization to the board of directors to launch buy-back programs compliant with Article 5 of the Market Abuse Regulation and Commission Delegated Regulation (EU) 2016/1052, as well as with accepted market practices established by CONSOB.

Takeaway: Shareholders authorization to the board of directors specifically covering buy-back MAR compliant programs permits the company to launch buy-back programs and stock up with treasury shares when market conditions are most favorable.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Antonio Coletti

antonio.coletti@lw.com
+39.02.3046.2061
Milan

Maria Cristina Storchi

mariacristina.storchi@lw.com
+39.02.3046.2044
Milan

Isabella Porchia

isabella.porchia@lw.com
+39.02.3046.2078
Milan

Guido Bartolomei

guido.bartolomei@lw.com
+39.02.3046.2085
Milan

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Endnotes

¹ See article 127-quinquies of Legislative Decree 58/1998 as amended (the Single Financial Act).

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- ² http://www.consob.it/web/consob-and-its-activities/listed-companies/mainen/issuers/listed_companies/voto_maggiorato_plurimo_lnk.htm?nav=true.
- ³ See the latest version of Corporate Governance Code approved by the Corporate Governance Committee in July 2018, available at <https://www.borsaitaliana.it/comitato-corporate-governance/codice/codiceeng2018.en.pdf>.
- ⁴ See comment to article 5 of the Code.
- ⁵ See articles 2443 and 2441, paragraph 4, of the Italian Civil Code.
- ⁶ See article 3a of SHRD II.
- ⁷ See article 83-duodecies of the Single Financial Act.
- ⁸ See article 123-ter of the Single Financial Act.
- ⁹ Legislative Decree No. 254 of December 30, 2016 and Directive 2014/96/UE. See Latham & Watkins' *Client Alert* "[Italy Implements Directive Requiring Non-Financial Disclosures for Large European Undertakings](#)," March 30, 2017.
- ¹⁰ Boardroom Gender Diversity and Performance of Listed companies in Italy, Working Financial paper no. 87 – September 2018.
- ¹¹ See new Principles 2.P.4 and 8.P.2, Criteria 2.C.3 and 8.C.3 and the related comments.