

Italian-listed Companies: New Corporate Governance Changes for Upcoming 2020 Shareholders' Meetings

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The upcoming annual general meetings season provides companies the opportunity to attract Italian and foreign investors by adopting best-in-class corporate governance rules.

Overview

Following the entry into force of Directive (EU) No. 2017/828 (*i.e.*, the SHRD II) and the publication of the new Corporate Governance Code, Italian-listed companies are increasingly focusing their attention on sustainability in corporate management, transparency in organizational structures, and shareholder engagement activities, in order to enhance their attractiveness in international markets as well as among domestic and foreign investors.

Getting ready for the new 2020 Corporate Governance Code

On December 9, 2019, the Italian Corporate Governance Committee defined the contents of the new Corporate Governance Code that was approved in its final version on January 31, 2020 (the 2020 Code). The 2020 Code will apply starting from January 2021.¹ The 2018 Corporate Governance Code² will remain in force until then.

Long-term sustainability, engagement, proportionality, and simplification are the four drivers of the 2020 Code. In fact, the 2020 Code nudges Italian-listed companies to be more sensitive toward long-term sustainability through specific recommendations relating to remuneration policies for executive directors and key managers, providing that a significant part of their variable remuneration be linked to a companies' performance in terms of ESG (environmental, social, and governance) requirements.³

Takeaways:

- Starting from 2022 Italian-listed companies will have to disclose, *via* the annual report on corporate governance and ownership structure, the measure and extent of the implementation of the new principles and recommendations under the 2020 Code.
- Boards are called to integrate business plans, internal control and risk management systems, as well as remuneration policies with appropriate sustainability goals.

- Companies should start reassessing and reviewing their governance structures, internal regulations, and corporate policies in order to be ready to introduce the necessary changes by the end of 2021.
- Improving management and corporate structures in line with the objectives and principles under the 2020 Code may provide companies opportunities to attract new investors.

Implementing SHRD II in Italy: the impact for Italian-listed companies

Directive (EU) No. 2017/828 (Shareholders' Rights Directive II or SHRD II) — now implemented in Italy by Legislative Decree no. 49/2019 — represents the most important new regulation to align corporate benefit with shareholders' interest.

Focus on: binding shareholders' vote on remuneration policy

Legislative Decree no. 49/2019 has transposed in the Italian legal framework the provisions of SHRD II on remuneration of directors and key managers of listed companies. In particular, the provisions require a **mandatory and binding vote** of the shareholders' meeting on the remuneration policy, *i.e.*, the first section of the remuneration report ("say on pay" mechanism) at least every three years and whenever the board proposes to change the remuneration policy.

In the case that the shareholders' meeting does not approve the remuneration policy, listed companies shall continue to pay directors' and key managers' remuneration in compliance with the remuneration policy most recently approved, or with standard and/or market practice. However, the company shall submit a new remuneration policy to the shareholders' vote at the latest on the occasion of the next shareholders' meeting, since only the occurrence of exceptional circumstances (such as if the companies' long-term interest and sustainability and/or ability to remain on the market are at stake) allows issuers to temporarily derogate from the remuneration policy, provided that specific procedural conditions under the applicable law are met. In addition, the SHRD II introduces the non-binding vote of the shareholders' meeting on the second section of the remuneration report detailing the remuneration paid to directors, statutory auditors, key managers, and general managers.

Pending publication of the results of the CONSOB consultation paper on the SHRD II's implementation (the SHRD II Consultation Paper) and the subsequent amendments to the Issuers' Regulation, Assonime has provided certain clarifications to companies. Those clarifications address the applicable legal and regulatory framework for drawing up 2019 remuneration reports, in accordance with the provisions included in the Italian Financial Act, as amended by Legislative Decree no. 49/2019, as well as those provisions included in the current version of the Issuers' Regulation (not yet amended).

Takeaways:

- The new provisions relating to the shareholders' votes on remuneration policy will apply starting from the upcoming general meetings season.
- Shareholders will be requested to cast two separate votes with respect to the two sections of the remuneration report (the vote on the first section is binding for its final approval and the vote on the remunerations paid detailed in the second section is not binding). Given the different impact of the votes (binding vs. non-binding) setting the two sections in separate items if the AGM agenda is advisable.

Focus on: related-party transactions

Regarding related-party transactions, Legislative Decree no. 49/2019 implementing SHRD II does not introduce significant amendments to the existing legal framework — *i.e.*, art. 2391-bis of the Italian Civil Code and CONSOB regulation no. 17221/2010 (the Related-party Regulation) — but rather specifies the extent of the Italian authority's potential regulatory intervention in such respect, calling upon CONSOB to make the necessary changes.

Therefore, the transposition of SHRD II represents the opportunity for CONSOB to seek further amendments to the existing regulations, with the intention to better clarify and/or rewrite certain provisions. Seeking such amendments is part of a process of gradual fine-tuning of EU law and the Italian regulatory framework, and will foster consist approaches and best practices. Therefore, even though the Related-party Regulation is already broadly consistent with the contents of SHRD II, in October 2019 CONSOB started formal procedures to amend and align its content and, following CONSOB's review of the Related-party transactions, Italian-listed issuers will need to check the accuracy of their related-party internal procedures and amend them accordingly.

In the SHRD II Consultation Paper, CONSOB proposed several amendments to the Related-party Regulation and the Issuers' Regulation such as, *inter alia*, (i) aligning the current "related-party" definition with the one provided for by the applicable international accounting standards; (ii) introducing the mandatory abstention for directors and/or shareholders who are involved in the related-party transaction (currently, the Related-party Regulation instead provides a whitewash mechanism); and (iii) redefining certain exemptions from the application of the Related-party Regulation and issuers' internal related-party procedures.

In particular, the definition of the scope of mandatory exemption for involved directors is a key point of attention for listed issuers, as it can significantly impact their corporate governance (*e.g.* the abstention could cause a deadlock forcing independent directors to take an executive role). This mandatory exemption could also give rise to clashes with the general corporate law rules on conflicts of interest. Moreover, according to SHRD II and the SHRD II Consultation Paper, the process for granting additional remuneration to directors and key managers (such as stock option plans, long-term incentive plans, or MBOs) shall be considered exempt from the application of related-party procedures only (i) if "compliant" (and no longer just "consistent", as per the current language of the Related-party Regulation) with the remuneration policy to be approved by the shareholders' meeting, as well as (ii) non-discretionary in nature.

Takeaways:

- The publication of the results of the SHRD II Consultation Paper regarding, *inter alia*, related-party transactions is still pending.
- Listed companies should consider starting to review internal related-party transactions policies, in order to be able to properly amend their content timely following CONSOB's regulatory implementation of SHRD II.

Focus on: shareholders' engagement and right to submit questions

In order to encourage shareholders' active participation and engagement (which represents a core value of the new regulations), Legislative Decree no. 49/2019 has extended the timeframe shareholders can use to submit their questions to companies before the convened shareholders' meeting. In particular:

- Shareholders may submit questions at least five trading days before the shareholders' meeting (instead of five calendar days), and the company is required to answer questions during the meeting, at the latest.
- In the event that the notice of call requires the company to publish Q&As before the meeting, shareholders may ask questions within the deadline set for the record date — *i.e.*, seven trading days before the shareholders' meeting (instead of three calendar days), and the company is required to answer the questions at least two days before the meeting.

Finally, listed issuers adopting e-voting mechanisms might be required to provide vote confirmation receipts (upon specific request only) since, following each shareholders' meeting, shareholders must be able to verify that their vote has been validly recorded and counted by the company.

Takeaways:

- New provisions relating to shareholders' rights to submit questions will apply starting from the upcoming general meetings season.
- Information provided to the shareholders with respect to the right to submit questions before the shareholders' meeting shall be updated.

Further steps regarding gender diversity in the boardroom

Over recent years, both the legislator and market participants have considered gender-balanced boards as a key tool to improve corporate governance and the performance of listed companies.

In parallel to SHRD II, new provisions in the 2020 Budget Law (Law no. 160/2019, which extended the validity of Law no. 120/2011, the "Golfo-Mosca" Law) strengthened the board gender diversity balance by imposing a mandatory gender quota of **six board mandates** (instead of three) in any corporate board.. This requirement starts from the first renewal of a board and provides a mechanism whereby the quota of the less represented gender must be no less than **two-fifths** of the members (instead of one-third). Uncertainties as to the application of the above-mentioned mechanism to the renewal of three-members corporate bodies (*e.g.* a board of statutory auditors) in the forthcoming AGM season have lead CONSOB to issue a temporary clarifying guideline: boards should round up the criteria currently provided by the applicable regulatory provisions, which CONSOB has proposed to amend accordingly in a recent public consultation (see Art. 144-*undecies*.1 of the Issuers' Regulation).

Newly listed companies will be able to gradually implement these new provisions, by applying a one-fifth quota (instead of two-fifths) for the first mandate following their listing.

Takeaways:

- Listed companies renewing their corporate bodies in 2020 must implement new gender quota requirements increasing the number of members of the less-represented gender from one-third to at least two-fifths.
- A voluntary assessment of the results and effects of the application of the diversity policies *vis-à-vis* the new SHRD II provisions may help companies to improve boardroom gender diversity.
- Depending on a company's current language, their by-laws may need to be amended in order to follow up and reflect the regulatory changes.

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Endnotes

¹ The 2020 version of the Corporate Governance Code is available at <https://www.borsaitaliana.it/comitato-corporate-governance/codice/2020.pdf> (Italian version only).

² The current version of the Corporate Governance Code, which will apply until January 1, 2021, is available at <https://www.borsaitaliana.it/comitato-corporate-governance/codice/2018clean.pdf> (Italian version) and at <https://www.borsaitaliana.it/comitato-corporate-governance/codice/codiceeng2018.en.pdf> (English version).

³ This is consistent with the SHRD II provisions already implemented in the Italian Financial Act (Legislative Decree no. 58/1998, as subsequently amended and integrated), according to which the remuneration policy should contribute to the business strategy, long-

term incentive interests and sustainability of the company, and directors' performance should be assessed using both financial and non-financial performance criteria (including ESG criteria).