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**Italian-German Seminar in Milan – 23rd and 24th May 2007.**

**THE ITALIAN TWO TIER MANAGEMENT AND CONTROL SYSTEM AND  
CORPORATE GOVERNANCE CODE**

**Introduction**

It had been predicted that companies with a broad shareholding base, and in particular, companies with shares listed on regulated markets would have been the privileged and natural targets for the two tier model in Italy.

The prediction appears to have been correct, based on current findings. More than three years have elapsed since the two tier model was introduced to Italy, but so far, not many companies have implemented the model. However, there has been a “sharp rise” in the number of listed companies adopting this system over the last year, and in particular, three banks with listed shares.

The legal discipline for these companies, combines with the ‘soft law’ provisions set out in the Corporate Governance Code.

## **The Italian Corporate Governance Code: in particular the two tier model.**

The Code is still based mainly on the administration and control model that is traditional for us:

The discipline governing the two tier board system is essentially one of review, based on assimilations between bodies of the traditional system and bodies of the two tier model.

The discipline is formed of 3 principles and an application method.

The three principles can be summarised as follows:

- 1)** implementation of the provisions set out in the Corporate Governance Code (established for the Board of Directors and for the Board of Auditors) since compatible, through their adaptation to the two tier model;
- 2)** mandatory requirement to inform the market of the reasons the two tier model has been adopted instead of the traditional model;
- 3)** detailed illustration of the methods with which the Corporate Governance Code has been implemented in the annual reports on corporate governance after adoption of the two tier model.

The basic application method is twofold: **a)** the articles of the Code that make reference to the Board of Directors and the Board of Auditors, or their members, are applied to the Management Board and Supervisory Board, or their members, respectively; **b)** due to the specific options of the by-laws adopted, in the configuration of the management and supervisory bodies also in consideration of the number and the powers and duties attributed to them and the specific circumstances existing, the issuer may apply the provisions concerning the Board of Directors or directors to the Supervisory Board or its members.

**Two tier model: which rules apply? It depends on the by-law options. The recommended statutory configuration for listed companies which have adopted the two tier model.**

The announcement of a dual method that establishes rules which are almost in contrast is justified by the statutory flexibility of the Italian two tier model.

Therefore, the main problem is to determine which provisions set out for the Board of Directors and for the individual Directors are to be applied to the Supervisory Board or to its members.

In essence, the answer to the query is: “it depends on the statutory structure”.

However, it is important to consider that:

- a) The Corporate Governance Code in the comment under heading 12 (alternative administration and control systems) establishes that “*With specific reference to the two tier model, however, in the opinion of the Committee, ....., it is likely – **and in principle preferable** – that the Management Board does not take up an excessive size, but should rather be a body made up of ... directors who are actively involved in the management activity. As a consequence highly strategic duties should be attributed to the Supervisory Board, with the power to adopt resolutions upon strategic transactions and industrial and financial plans of the issuer*”.
- b) this two tier model is the model basically adopted by the listed companies governed by such a system (perhaps they have also misused the model by assigning administrative functions to the Supervisory Body);
- c) from another point of view, non-Executive Directors, to whom many of the rules established in the Corporate Governance Code refer, perform functions which are equivalent in many ways to the functions of the Supervisory Board members.

**The sources to reconstruct the ‘standard’ discipline governing listed companies which have implemented the two-tier model.**

The contents of the principal rules recommended by the Corporate Governance Code referred to the two-tier model can be reconstructed to a first approximation, starting from the following data:

- a) the principal provisions set out by the Corporate Governance refer to the Board of Directors and the Directors, to identify those provisions applicable to the Supervisory Board and to the Management Board, respectively;
- b) the limited information contained in the comment to heading 12 of the Corporate Governance Code (that – it must be remembered – sets out the principles and criteria applicable to the administration and control models which differ from the traditional model).

Moreover, a glance at the corporate governance rules adopted by the listed companies disciplined by the two tier model is useful.

## **An initial review of the rules recommended for the Supervisory Board: appointment, structure and composition, role and functions.**

### **1) appointment**

The appointment of the members of the Supervisory Board occurs according to a transparent procedure. The procedure shall ensure, inter alia, timely and adequate information on the personal and professional qualifications of the candidates. In particular, slate voting, is recommended.

### **2) structure and composition**

A second group of rules is suggested by the comment to Article 12 of the Corporate Governance Code establishing the suitability of applying the recommendations referred to the composition and the structure of the Board of Directors to the Supervisory Board instead of to the Management Board.

- a)** Firstly, reference is made to the recommendation of structuring the Board into internal committees with proposing and consultative functions. In particular, the committees which are suggested to be set up correspond to the nomination committee, the remuneration committee and the internal control committee.
- b)** Secondly, the recommendation contained in the comment to Article 12 could refer to the suitability of having an adequate number of independent members on the Supervisory Board conferred with the highly strategic duties that should be attributed to it, in order to implement heading 3 of the Corporate Governance Code.

### **3) role and functions**

The statutory conferral of highly strategic duties on the Supervisory Board basically renders applicable a number of general principles established by the Corporate Governance Code referred to the role of the Board of Directors and based on the guiding function that this body assumes in the traditional model.

It is more interesting to underline the role that could be conferred on the Supervisory Board (or better on the internal control committee, representing a structure of the Supervisory Board) in transactions with related parties. The Corporate Governance Code, in fact, suggests the involvement of the internal control committee in the preparation of the procedures designed to ensure the fairness of the transactions with related parties, for example: in the form of pre-approval.

### **... and the Management committee**

Although the Corporate Governance Code recommends that listed companies governed by the two tier model shall have a management committee composed of all executive directors, in actual fact, except for one case, the listed companies disciplined by this model have established management committees composed mainly of non-executive managers, replicating accepted practice typical of the traditional model.

As has been said, the control function performed by the Directors / non-executive managers, in some ways, can be considered analogous to the function performed by the Supervisory Board members.

Having established the actual presence of several non-executive members in the management committees, the main problem that arises in relation to our Corporate Governance Code is whether: **i)** the rules set out for non-executive members are recommended only in the case of Supervisory Board members; or **ii)** the recommendation refers to Supervisory Board members and non-executive Managers.

In essence, the question (still without a definitive answer) concerns the independent members: is it necessary for a suitable number of independent members to be present, both on the Supervisory Board and on the Management Board, pursuant to the Corporate Governance?