

# 2020 annual shareholders' meeting of Italian listed companies

March 2020

As the season for shareholders' annual general meetings is fast approaching, we are sharing with our clients and friends some suggestions that we believe provide strategic flexibility and reflect best practices in corporate governance.

In this newsletter, we discuss the following topics:

- Social responsibility and the adoption of a new Italian Corporate Governance Code;
- Boards' Diversity; and
- Directors' remuneration.

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In light of the restrictions imposed by the authorities to fight Covid-19, issuers might evaluate to postpone their annual meeting, also taking into consideration the term of 180 days possibly set out under their by-laws and relevant provisions of Italian law.

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## Social responsibility

The new Italian Corporate Governance Code will be effective starting from the first fiscal year beginning after December 31, 2020 (the "New CG Code"), and it responds to the trend of increasing attention by investors and regulators<sup>1</sup> to sustainability, social responsibility and shareholder engagement.

Leading investment companies are announcing their intention to take steps to address the risks posed to "economic growth and prosperity" by global climate change assessing Environmental, Social and Governance ("ESG") factors with the same rigor that they analyse traditional measures such as credit and liquidity risk.

Engagement in a direct dialogue between companies and investors to understand if they are adequately disclosing and managing sustainability-related risks will also become crucial.

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<sup>1</sup> See, *inter alia*, the adoption by the European Commission in March 2018 of the "Action Plan for Financing Sustainability Growth"

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## New CG Code

The New CG Code establishes two guiding principles for the management of listed companies: sustainability and shareholders' engagement. Boards of directors of listed companies are now called to manage the companies pursuing their "sustainability success" (Principle I of the New CG Code) and to approve engagement policies to develop a dialogue with investors (Recommendation 3 of the New CG Code).

### Sustainability Success

Under the New CG Code, the "sustainability success" (*i.e.*, the objective that guides the action of the board of directors and which consists in the creation of long-term values for the benefit of shareholders, taking into account the interest of other stakeholders relevant to the company) is not only a principle which should inspire boards' decision-making processes. It should also be put into practice by the boards which should adopt tangible measures to meet the objective. Namely, the boards should:

- embed sustainability goals into business plans and risk management systems; and
- adopt remuneration policies aimed at promoting the achievement of sustainability goals.

Therefore, in anticipation of the New CG Code going into effect and in light of the new sustainability-driven investment strategy being adopted by institutional investors, **listed companies are invited to reassess their strategies, business models and corporate practices to ensure that they adequately incorporate ESG goals**. Companies should not think of this as a mere gesture signalling the adoption of the new best practices, but as an opportunity to gain a competitive advantage in an area that is increasingly important to the investment community.

### Shareholder Engagement

The New CG Code introduced a recommendation for listed companies to adopt engagement policies addressing dialogues with shareholders, complementary to those adopted by institutional investors and asset managers.

Starting in 2022, engagement policies, which must be approved by the board of directors upon proposal of the Chairman in consultation with the Chief Executive Officer, must be disclosed in the annual corporate governance report to be made available to the public.

Moreover, this innovation is part of a broader regulatory framework at European level aimed at responding to the growing demand from institutional investors to engage "behind the scenes" with management in order to better monitor companies' performance or propose changes to certain corporate or business aspects, including ESG matters, as recently evidenced by the announcement of the aforementioned Chairman and CEO of a leading investment company.

While the EU Directive No. 2017/828 (the so-called "Shareholders' Rights Directive II") introduced transparency requirements to the engagement policies adopted by institutional investors, the New CG Code extended the concept to those adopted by listed companies. The New CG calls for a coordination between the companies' and investors' engagement policies, with the aim to encourage a common view on how management should pursue the "sustainable success" of the company.

While a proactive and well-planned shareholder engagement strategy can be an effective tool to achieve a companies' long-term goals, shareholders' engagement may pose legal risks (*e.g.*, selective disclosure of inside information) or the risk of excessive influence by investors pursuing individual interests.

Therefore, listed companies should carefully consider the above factors when preparing their engagement policies.

## Diversity

The Italian legislature introduced stricter provisions to ensure gender balance in the corporate boards of listed companies. In particular:

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- listed companies must elect at least 2/5 (*i.e.*, 40%) of members of their board of directors and of effective members of their board of statutory auditors from the under-represented gender; and
  - the new mandatory ratio applies for 6 consecutive mandates.

As recently clarified by Consob, the ratio must be rounded up to the next whole number except in the event of corporate bodies made up of 3 members or fewer. **Companies will need to verify if they need to change their by-laws in order to comply with the new requirement, and act immediately should the shareholders' meeting be called to appoint corporate bodies in the 2020 annual shareholders' meetings.**

Newly-listed companies can continue to apply the reduced ratio of 1/5<sup>th</sup> for the first mandate following the IPO.

Compliance with diversity rules should not be solely seen as an obligation, but also as an opportunity to attract investors as investment decisions of funds and banks are now driven, at least in part, by diversity considerations.

## Related parties transactions

Consob is in the process of approving a new regulation on transactions with related parties (the "New RPT Regulation") implementing the provisions of SHRDII.

To this end, between October and December 2019, Consob carried out a consultation procedure aimed at evaluating, *inter alia*, the following key changes to the current regulatory framework, which may eventually be transposed into the New RPT Regulation:

- Definition of "related party": the definition would work as a reference to international accounting principles, as applicable from time to time (to date, IAS 24), in lieu of the previous fixed definition.

***This change allows a more flexible definition, in line with the concept of "related party" used in the preparation of financial statements.***

- Directors' abstention from voting: directors acting as counterparties, or qualifying as related parties to such counterparties, in the context of large or small RPTs would have to refrain from voting on the relevant resolutions.

***Unless a corrective measure is introduced (e.g. whitewash procedure), this rule may risk blocking board resolutions on RPTs as a quorum may be very hard to reach, particularly in small or family-run companies with a limited number of directors.***

- Exemptions: amongst others, (i) RPTs involving, and granting the same conditions to, all the shareholders; and (ii) resolutions on remuneration of executive directors and key managers, as long as (a) they are in line (and no longer only consistent) with the remuneration policy approved by the annual shareholders' meeting, and (b) remuneration is quantified based on non-discretionary criteria.

***In spite of the expanded list of exemptions, there is an overall increased focus on remuneration. Thus, remuneration criteria may no longer be discretionary or divert from the remuneration policy.***

- Sanctions: (i) directors (including independent directors) of listed companies can be directly sanctioned for issuers' non-compliance with rules governing RPTs; and (ii) greater maximum sanctions.

***The expanded and heightened sanctions should be carefully considered by issuers as it implies an increased focus on directors' duties in connection with the application of rules on RPTs.***

***Even though the proposed changes can only be evaluated once they are transposed into the New RPT Regulation, we believe that it is worthwhile for issuers to start considering any required amendments to their procedures on RPTs, in order to ensure future compliance<sup>2</sup> or even strive to become the best in class by anticipating compliance with the New RPT Regulation.***

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<sup>2</sup> To date, we have no evidence of any transitional regime aimed at allowing proper implementation of the new measures on RPTs.

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## Directors' remuneration

The vote of shareholders on the remuneration policy for directors, statutory auditors, executives with strategic responsibilities and general managers will be binding on Italian listed companies starting from the 2020 annual shareholders' meetings.

This represents a major innovation<sup>3</sup>, enacted to implement SHRD II, as, thus far, the vote of the shareholders on the remuneration policy has only been advisory in nature. The remuneration policy will have to be submitted to the shareholders' meetings at least every 3 years, or earlier, in case of any changes to the policy.

***We suggest that listed companies set the duration of their remuneration policy in line with the remaining duration of their Board of Directors, in order to approve, upon renewal of the Board, a new remuneration policy of the same term.***

In the event that shareholders fail to approve a policy, issuers may continue to remunerate directors and key managers consistent with the last remuneration policy adopted or, in the absence of any such policy, in accordance with standard and/or market practice. However, it will be the company's responsibility to submit a new remuneration policy to the shareholders' vote at the next general meeting at the latest.

Shareholders are now also required to cast an advisory vote on the report on compensations paid to directors, statutory auditors, executives with strategic responsibilities and general managers. Although such vote is advisory and not binding, every year listed companies will have to report how they have taken into consideration the vote casted on such report in the previous year.

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<sup>3</sup> Introduced by Legislative Decree no. 49/2019.