6. ONE-TIER MODEL AND LIST OF CANDIDATES FROM THE OUTGOING BOARD: BETTER CORPORATE GOVERNANCE FOR ITALIAN MARKET OR JUST XENOPHILIA?

Fabio Bianconi
Sabrina Bruno
Francesco Surace

6.1. Introduction

With reference to board models, international empirical research has mainly devoted its interest to compare the UK vs. German jurisdictions, which is the one-tier to the two-tier vertical model. According to literature, there is no conclusive empirical evidence of the superiority of one model over the other. Both systems have been shown effective for corporate governance and it is not possible to assign superiority to either of them (Jungmann, 2006). More generally, for different reasons, it has been argued that no corporate governance system has empirically proven to be the most efficient (Esposito De Falco, 2014).

In addition, an OECD survey shows a connection between ownership structure of financial systems and board models: the existence of different ownership structures means that corporate governance rules (including board models) shall vary from one State to another as there is no possible model that may fit all jurisdictions and "*the heterogeneous corporate landscape means that the corporate governance agenda varies between countries*" (OECD, 2003).

Accordingly, it was argued that there is no need to set corporate governance standards at a global level because international differences in corporate governance depend more upon market differences than upon legislative differences (Easterbrook, 1997).

However, in favour of the one-tier board, Davies (2000) pointed out the flow of information theory according to which the allocation to a single board of both supervisory and strategic powers – which are complementary to one another – makes those in charge of control work more effectively while, in the two-tier board, members of the separate supervisory organ have more limited access to information. This argument has been confirmed by Hopt (1998) stating that, in the two-tier model, the flow of information from management to the supervisory board, and within the latter from the chairman to the other members, can be very weak, especially if members are too many and do not frequently meet. At the same time, though, Davies (2000) argued that, in the two-tier model, the function of the supervisory board is not just the exercise of controlling powers over management but, historically, also that of building networking relationships with stakeholders: from this viewpoint, the supposed superiority of the one-tier model cannot be advocated.

In any case, with reference to the Italian traditional model (i.e., the two-tier horizontal model) compared to the one-tier model, the flow of information theory cannot be applied as members of the board of internal auditors are personally obliged, under

Virtus Interpress ©

the Civil Code, to attend all board and executive committee meetings, having, therefore, immediate access to all information as directors in the one-tier board (Bruno, 2004).

No empirical study deals with and efficiently compares the three Italian board models (also because Italian listed companies adopting models different from the traditional board are still very few); therefore, the superiority of the one-tier Italian model over the other two boards has not to be proven with specific data.

Nevertheless, the superiority of the one-tier board model, over others, has recently been argued in Italy. A study published by the Research Center of Consob, the Italian Stock Exchange Authority, claimed the "superiority" of the one-tier board, bringing forward two main arguments: i) the need to simplify and rationalise the system of internal controls for listed companies – in order to avoid the overshooting of rules and recommendations, and the consequential overlapping of supervisory duties and functions among the various bodies; and ii) the need to foster competitiveness of Italian listed companies in order to attract foreign capital by encouraging standardisation and convergence, as the one-tier board model is the most common in the world. It has been stated that the one-tier board model has primacy in worldwide financial markets and therefore has inspired most recent corporate governance rules, and that "if the easy possibility to recognise a board model and to apply international common rules of corporate governance may represent an important factor to make Italian listed companies more competitive on international financial markets, the one-tier board model is *the most efficient model* to reach this aim. The most suitable to simplify the system of internal controls especially for listed companies that want to attract the interest of Anglo-Saxon investors, who are more at ease with this governance structure, as well as *all institutional investors* (Italian and foreign) operating on international markets where they interact with companies mainly adopting the one-tier model" (Alvaro, D'Eramo, & Gasparri, 2015). Likewise, former President of Consob encouraged an amendment to the Italian Civil Code to provide for the one-tier board as the default model in order to "simplify governance, favour listing of small and medium enterprises and attract more foreign investors" (Corriere della Sera, 2018). Similar conclusions have been proposed in a study published by the Association of Italian Companies where, in addition, it is argued that the adoption of the one-tier model may ease the admission of Italian companies to listing in a foreign exchange (Assonime, 2019). Finally, comparing the one-tier with the two-tier traditional horizontal model, it has also been argued that the latter is more expensive as the cost of the 675 internal auditors in Italian listed companies reaches 33 million Euros (Olivieri, 2018). Some important Italian listed companies have recently switched their board model to the one-tier, in particular, by providing justification of a need to attract foreign investment since institutional investors prefer the one-tier board, being the model they know better.

Another recent trend in Italian corporate governance is the amendment of bylaws by certain companies, allocating power to the outgoing board to file its own list of candidates to renew the board of directors. This is actually the rule in many jurisdictions, but it has not been the case under Italian law, where the right to file one or more lists of candidates for in the event of board renewal, is expressly granted to shareholders. Also, in this case, some important Italian listed companies have recently amended their bylaws to introduce such power by explaining that this is common

Virtus Interpress ©

practice in other jurisdictions and therefore it is favoured by foreign institutional investors.

Based on these two issues – that are at the core of the most recent Italian corporate governance debate and practice – the research questions of the chapter are:

1. Do institutional investors really prefer the one-tier board in Italian investee companies?

2. Do institutional investors show preference with reference to the power to file a list of candidates?

These types of questions are likely to favour survey and archival data. Hence, the research method used is a survey associated with a deductive approach. Primary data developed through a survey methodology have the advantage that the research design is developed specifically to address the research question. Thus, the survey method is a valuable and valid approach for our research related also to strategy issues (Slater & Atuahene-Gima, 2004).

Therefore, the main purpose of this chapter, after having examined the theoretical background, also under the legal perspective of both corporate governance set of rules, is to explore institutional investors' preferences regarding structure of the board of directors and power to file a list of candidates in case of renewal of the board, and to draw final considerations and conclusions.

Providing an answer to these questions seems particularly important in both academic and practitioner fields. The interest arises from the recent practice started by some important Italian listed companies to adopt one or both of the above-mentioned rules and from the general support born in the public opinion around both of them. To the best of our knowledge, there are no previous studies that investigate these issues in the Italian context. Therefore, the present chapter aims to contribute to the literature in this field.

The remainder of the chapter is organized as follows. Section 6.2 introduces a comparison between the traditional model and the other two models of corporate governance in Italy, and the main features of the recent trends in Italian corporate governance. Subsequently, we review the applicable theory and main literature in section 6.3. We present our methodology in Section 6.4. Finally, we present the results of the analysis in section 6.5 and provide concluding discussions and comments in the last two sections of the chapter.

6.2. Theoretical background and recent practice

6.2.1. Italian "traditional" model vis-à-vis two-tier and one-tier models

The Reform of company law enacted by the Legislative Decree N. 6 of 17th January 2003 amended the Italian Civil Code, dated 1942, to introduce the options between: i) the two-tier "vertical" model – typical, in its structure, to Germany and the Netherlands – where the general meeting of shareholders appoints the supervisory board which, in turn, appoints the board of directors; and ii) the one-tier model – typical of Anglo-American jurisdictions – where the general meeting of shareholders appoints the board of directors who, under Italian law, is obliged to appoint, among its members,

Virtus Interpress ©

those who make up the internal control committee (Ghezzi & Malberti, 2008).

These two models add up to the so-called "traditional" model[3] where the general meeting of shareholders appoints both the board of directors and the board of internal (or statutory) auditors (*sindaci*); because of its structure, the latter model may also be defined as a two-tier board, albeit "horizontal" (to distinguish it from the "vertical" two-tier). The Italian legislature admittedly took great inspiration from German and French jurisdictions for the new two-tier board and mostly from the EU Regulation of *Societas Europaea* for both the new two-tier and the one-tier model: the two-tier implements the separation between ownership and control, while the one-tier board provides for a simplified, more flexible governance compared to alternative models, enhancing flow of information, and reaching time and costs savings with a high level of transparency. Justifications of the reform in terms of efficiency have been, however, criticised under various grounds (see, for example, Bruno, 2004).

According to the Italian Civil Code, powers, functions and pre-requisites for the appointment of those in charge of supervision (*sindaci*, supervisory board, internal control committee; according to each structure) change from one model to the other. However, under the Legislative Decree N. 58 of the 24th of February 1998, specifically regulating financial markets, these differences almost disappear with reference to listed companies, even though some of them remain. Distinctions among the three models in Italian listed companies can be summarised as follows:

- The internal control committee (in the one-tier model) is *not* specifically allocated the power to call the general meeting of shareholders in case: i) the board itself fails to do it or to timely do it, or ii) in case "particularly serious facts" to be dealt with urgency are envisaged (art. 2406 civil code provides such power for *sindaci* and it is referred to by art. 2409-*quaterdecies* with reference to the supervisory board, while no provisions include the internal control committee, and therefore the power cannot be exercised in the one-tier model).
- While the supervisory board is in charge of approving the financial statements, *sindaci* are in charge of reviewing the financial statements and drafting an annual report that is submitted before the annual meeting of shareholders; on the contrary, the internal control committee – being part of the board of directors – has no particular, separate function for them.
- With reference to remuneration of executive directors, only *sindaci* must "be heard" by the board of directors before the latter may resolve upon its amount: their opinion is mandatory, but not binding for the board (art. 2389, subsec. 3 of the civil code). No such power, with reference to remuneration, is allocated to the control functions in either of the two other models.
- Regarding powers, *sindaci* as well as the supervisory board have the power to monitor that "laws and bylaws are complied with and that principles of fair administration are fully satisfied" while, in the one-tier model, the internal control committee is not allocated such general power (see art. 149 of the leg. Decree n. 58/1998).
- With reference to flow of information within the company, *sindaci* are required by law to attend all meetings of the board of directors and of the executive committee, as

[3] Provided by the Italian Civil Code since the Commercial Code dated 1882.

Virtus Interpress ©

well as general meetings of shareholders: in case of unjustified absence, they shall be dismissed (art. 2405 of the civil code and art. 149, subsection 2 of the leg. Decree n. 58/1998); the rationale of this duty is that attendance to the meetings is critical to acquire material information and more effectively exercising control. In the two-tier "vertical" model, this duty applies to just one member of the supervisory board (see art. 149, subsection 4-*bis* of leg. Decree n. 58/1998); the result is that flow of information may be poor. Obviously, in the one-tier board, there is no problem of flow of information as the members of the internal committee are part of the board of directors within which they share all information.

- Only with reference to *sindaci*, the law requires to simultaneously appoint both actual *and* substitute members who automatically replace the actual members should one or more of them, for any reason, step down (arts. 2397 and 2401 of the civil code): the rationale of this rule is that there should be continuity and stability in the supervision of the company in the interest and on behalf of shareholders, and *sindaci* shall follow the management of the business step-by-step so that "directors – knowing to be supervised by an independent and careful authority – are obliged to behave honestly, even against their will" (Vivante, 1923). There are no similar provisions in the other two models.
- *Sindaci* can *only* be dismissed for cause and, in addition, the resolution must be approved by the court: the rationale is to reserve *sindaci* the utmost independence (art. 2400, subsection 2 of the civil code). On the contrary, members of the internal committee as well as of the supervisory board can be removed at any time, with or without cause (see arts. 2383, subsection 3 and 2409-*duodecies*, subsection 5 of the civil code).
- Finally, professional pre-requisites are mandatory for all *sindaci* (who must be either qualified auditors, or University professors of economics or law, or lawyers or accountants, see art. 2397 of the civil code). For the other models, just one of the members must be a qualified auditor and no other pre-requisite is mandatory by law for the other members (see art. 2409-*duodecies*, subsect. 4 and 2409-*octoesdecies*, subsect. 3 of the civil code).

To sum up the various provisions, it shall be pointed out that Italian legislature historically meant for the board of internal auditors to be the body *in charge of the widest power,* to permanently supervise companies' affairs and financial statements as well as compliance with all provisions of law and bylaws, to examine shareholders' complaints and represent shareholders' collective interests whenever directors are in conflict with shareholders' views and interests. It should be highlighted that, before the introduction of *sindaci* by the Commercial Code in 1882 for companies limited by shares, the system was the one-tier board like in all other European jurisdictions. The provision of *sindaci* was deemed to be the system that better responded to the needs of the enterprise: the requirement of an organ *fully independent* from directors and management, highly competent and in charge of the widest powers over them, was fundamental to protect all interests without allocating the protection of company affairs just to directors (arts. 183 and 184 of the Commercial Code 1882 introduced *sindaci* for the first time in Italy; Relazione del Ministro di Grazia e Giustizia e dei Culti (Mancini) od Esposizione dei Motivi del Progetto del Codice di Commercio pel Regno d'Italia, 1878;

Virtus Interpress ©

Marghieri, 1929).

After the introduction of the two alternative board models between 2004 and 2016, only five Italian listed companies out of 237 had changed to the two-tier vertical model; no one had chosen the one-tier board, all the others kept the traditional model. However, in 2016 and 2018, two large banks, Intesa Sanpaolo and UBI Banca, approved new corporate bylaws to adopt the one-tier system, switching from the two-tier system that had been the basis of the constitution of the two banking groups and that, in the Italian experience, did not show clarity – in terms of definition and division of powers between the two bodies (management and supervisory boards) – and efficiency – in terms of speed in making decisions.

For example, Intesa Sanpaolo, the largest Italian bank, resolved in 2016 to opt for the one-tier board, but if we look at its bylaws, we will find that the so-called "one-tier board" is different from the Anglo-American model and resembles very much the traditional Italian two-tier horizontal board: the board has basically been construed similarly to the traditional two-tier horizontal board by equating rules of appointment, functions and powers of the internal control committee and the board of internal auditors.[4]

Another example, UBI Banca, resolved to change the two-tier vertical board into the one-tier in 2018 in order to adopt "a governance model clearly comprehensible at an international level" considering the functions allocated to the European Central Bank because of the Single Supervisory Mechanism – even though, on the contrary, it is possible to argue that there are actually various European countries adopting the two-tier model for banks, such as Germany, the Netherlands, and France. In addition, according to UBI Banca, the two-tier horizontal model "allocates the control function to an organ – the board of internal auditors – that is external to the organ in charge of strategic supervision"; the one-tier model has been preferred in order to foster continuous exchange of information and interactions among all bodies, "in particular, by allocating control functions to an organ which keeps tight ties with the organ in charge of the strategic supervision, also because this is the governance model mostly recognised at European and international level".[5] However, also, in this case, the bylaws have introduced provisions – similar to those introduced by Intesa Sanpaolo – that adopt for the internal control committee rules taken from the Civil Code or the leg. Decree n.

Virtus Interpress ©

[4] Here is a list of the main provisions: i) it is upon the general meeting of shareholders to appoint also the members of the internal control committee of the board and its chairman (so the main difference between the traditional two-tier board – where the general meeting appoints both the board of directors and the board of internal auditors as well as its chairman, and the one-tier board – where the general meeting appoints the board of directors that, in turn, elects those who will be members of the internal control committee among themselves, disappears) – see Art. 7.3. sub 3 of Intesa Sanpaolo bylaws (August 9, 2018; ii) the directors who are members of the internal control committee are prohibited from being simultaneously also members of other internal committees, which is obviously forbidden to *sindaci* (who are not directors) and, at the same time, is not the case in other jurisdictions that adopt the one-tier model (e.g., UK, USA or even France) – see Art. 13.5.6.: this prohibition supposedly aims at making the internal control committee detached from other members of the board; iii) the dismissal of the members of the internal control committee has to be "duly justified" unlike under the Civil Code where – applying the same rule provided for all directors – it is possible also without cause but with a similarity with *sindaci* who can be dismissed only for cause (see Art. 15.2); iv) in case one of members of the internal control committee, for any reason, cease their function, the first person not elected in the list will automatically replace the member who stepped down – which is a rule applicable to *sindaci* but not to directors who may be co-opted by others (see Art. 15.3.2.); v) it is upon the general meeting to fix the remuneration for the members of the internal control committee apart from the other directors – which is the rule applicable to *sindaci* (see Art. 16.3); vi) the internal control committee is granted the same functions that, under the law, are allocated to *sindaci,* including to report to competent authorities on any unlawful act or fact (see Art. 23.1); vii) the internal control committee is granted the same powers/instruments as *sindaci* (see Art. 23.5). See https://www.group.intesa sanpaolo.com/scriptIsir0/si09/#/governance/ita_documenti_societari.jsp.

[5] See Relazione per l'Assemblea straordinaria del 19 ottobre 2018, in https://www.ubibanca.it/contenuti/RigAlle/04%20 RELAZ%20NUOVO%20STATUTO.pdf.

58/1998 to regulate *sindaci*.[6] Therefore, while both cases utilise a one-tier board, the governance model is completely different in that it reflects the Italian traditional model with *sindaci*.

Both banks started the process that led to the approval of the bylaw changes by setting up an *ad hoc* Commission, within the Supervisory Board, in charge of analysing pros and cons of the two-tier vertical model *vis-à-vis* the one-tier, and the conclusion was that the one-tier model ensures:

- optimization of administrative efficiency in terms of leaner and more immediate relations between strategic supervision and management;
- centralization of strategic supervision and management in a single body – the board of directors;
- immediacy in the circulation of information;
- favour by institutional investors that are major shareholders in both banks.[7]

The resolutions that led to the bylaw amendments obtained over 98% of shareholder support in both banks.

6.2.2. List of candidates submitted by the outgoing board

Moving to the other recent trends in Italian corporate governance, it has to be considered that the traditional approach of Italian law is that decisions pertaining to nomination, composition and appointment of directors belong to shareholders. However, there is no specific provision in the civil code allocating the power to file lists of candidates to shareholders or indeed to other bodies. Historically, with reference to State-owned companies that were privatised, it was Law n. 332/1994 that allocated the power to file lists of candidates for the board of directors to both incumbent directors and shareholders – reaching a threshold of at least 1%. Later on, art. 147-*ter* of leg. Decree n. 58/1998 was introduced according to which bylaws of listed companies shall provide for the election of directors on the basis of lists of candidates and shall determine the minimum threshold that *shareholders* are required for their filing. While the reference to lists filed by shareholders was specifically introduced in 1998, no provision, on the contrary, expressly refers to lists submitted by the outgoing board of directors. However, the provision according to which lists of candidates shall be submitted by shareholders in case of renewal shall not be deemed as mandatory, and therefore, company bylaws may (but should) provide that, in addition to shareholders, the outgoing board may file its own list of candidates.

Among the companies that have introduced the recognition of the right of the board of directors to present its own list of candidates, UniCredit is undoubtedly an

[6] Basically, the same provisions introduced by Intesa Sanpaolo have been proposed by UBI Banca with reference to: i) appointment also of the members of the internal control committee of the board and its chairman by the general meeting of shareholders (Art. 11.2. lett. B); ii) the internal control committee is clearly meant as different from other internal committees regulated under different articles (Arts. 31 and 33) and, in addition, it is required to at least one member of the internal control committee to take part to the meetings of the risk committee (same rule applies to *sindaci*); iii) the internal control committee is granted the same functions and the same powers/instruments that, under the law, are allocated to the *sindaci*, including to report competent authorities on any unlawful act or fact (see Arts. 33.1 and 33.2). See http://www.ubibanca.it/contenuti/RigAlle/16%20STATUTO%20-%20MONISTICO1.pdf.

[7] See for Intesa San Paolo, Relazione del Consiglio di gestione, https://www.group.intesasanpaolo.com/scriptIsir0/si09/contentData/view/Relazione%20del%20Consiglio%20di%20Gestione_ita.pdf?id=CNT-05-00000003DFA39&ct=application/pdf; and for UBI Banca, Relazione per l'Assemblea straordinaria del 19 ottobre 2018, in https://www.ubibanca.it/contenuti/RigAlle/04%20RELAZ%20NUOVO%20STATUTO.pdf.

Virtus Interpress ©

optimal example in terms of shareholders' consent to the amendment to the bylaws, which took place in the extraordinary general meeting of December 2017, reaching the majority vote of 98.6%. The motivation of the proposed amendment stated: *"Granting the board of directors the right to present its own list of candidates would improve the candidate selection mechanism in a context where the board of directors is already capable of identifying the best qualitative and quantitative characteristics of candidates, and, after their appointment, to verify that they meet those characteristics as well as the personal and professional features required by law"*[8]. Moreover, given the absence of a major shareholder, this option was aimed at ensuring greater stability in the corporate governance structure, mitigating the risk of non-submission of lists by shareholders in a fragmented shareholder context.

On the contrary, for companies with controlling shareholders, the introduction of this amendment has historically been criticised by proxy advisors with a negative impact on the votes from institutional investors. An example of this critical approach is undoubtedly represented by the extraordinary shareholders' meeting of Mediaset S.p.A., where institutional investors and proxy advisors expressed themselves against such change in the bylaws. As a matter of fact, over 90% of the minority shareholders represented at the EGM, with a low impact in terms of overall results considering the level of Mediaset's free float, voted against the amendment of the bylaws.[9]

6.3. Literature review

6.3.1. The efficiency of different board models

As mentioned above, according to international literature – comparing one-tier vs. two-tier vertical model – there is no conclusive empirical evidence of the superiority of one board over the other.

It shows that both systems are effective for corporate governance and that it is not possible to assign superiority to either of them (Jungmann, 2006).

On the other side, focusing on corporate governance systems in general, Hansmann and Kraakman (2004), Coffee (1999), Romano (1999) had argued a global convergence of jurisdictions to the Anglo-American model, reflecting the power of global competition, improved technology, and market liberalization; through a global cross-reference mechanism all differences would have disappeared and the most efficient corporate governance model – i.e., the Anglo-American – would have imposed itself because of its superiority. On the contrary, Schmidt and Splinder (2004) showed to be sceptical about global convergence by arguing that national differences in corporate governance structures are likely to persist since no one system of corporate governance has proven itself to be competitively superior: even though corporate governance systems can be defined at the theoretical level, in practice this is not clear as "there is a complementarity between the different elements of an economic, social, and legal

[8] In addition, "these amendments to the articles of association pursue the goal of ensuring continuity in the management of the company, including in relation to the activities carried out by the board of directors' internal committees, thus maintaining an appropriate composition of the management body which is also fostered by the presence of highly qualified members and experts in the company's business".

[9] The current free-float at Mediaset S.p.A. amounts to 27% of outstanding share capital (see http://www.mediaset.it/investor/azionisti/azionariato_it.shtml)

Virtus Interpress ©

system in which governance is embedded". Some authors point out that each corporate governance system is a holistic system, not merely a loose set of separate rules. In addition, the rules are elements mutually linked one to the other by a complex structure of incentives. Again, there is an interconnection among the components of each system and incentives for the actors that create meaningful barriers against cross-references to or from other systems (Bratton & McCahery, 1999). Accordingly, Bebchuk and Roe (2004) showed that the corporate structures that an economy has at any point in time are likely to depend on those that it had at earlier times. From the latter argument, known as "*path dependence theory*", it can be inferred that, among the three Italian board models, the traditional (or horizontal) two-tier board could claim its superiority (Bruno, 2004).

However, with reference to France – where it is possible to compare the functioning of both board models (one-tier and two-tier) within the same jurisdiction – there is empirical evidence that having a two-tier vertical board does have a positive effect on Tobin's Q, a proxy to long-term performance, but no significant effect on cash holdings (Rouyer, 2013). The clear separation between management and control lends further support for agency theory whereby a better control of managers ensures that excess cash is returned to shareholders and performance is enhanced (EA.). In addition, Adams and Ferreira (2007) showed that combining monitoring and advisory functions in one board – as it happens in the one-tier model – can have an adverse impact in that managers are less inclined to share information, especially when there are independent directors; obviously with less information, even an independent board cannot monitor effectively; this implies that increasing board independence may decrease shareholder value. By contrast, this situation does not apply in two-tier boards where enhancing the independence of the board will not affect the incentives of managers to share information and will increase shareholder value (EI.). Still referring to France, however, Millet-Reyes and Zhao (2010) show that ownership and board structures are used together as corporate governance tools and that, while family control has a negative impact on corporate governance, French institutional block holders play a positive role as monitors of one-tier boards; by contrast, they are more likely to misuse the two-tier board by promoting interlocked directorship, board opacity and their own interest as creditors.

6.3.2. List of candidates from the outgoing board

From a theoretical viewpoint, the Italian traditional approach, consisting of the allocation of nomination, composition and appointment powers to shareholders, has been criticised highlighting that, historically, this has not always been the case (e.g. the Dutch *structuur regime*) and, in addition, that there are examples in other jurisdictions where board members are elected by employees (e.g., *Mitbestimmung)* or lists are filed by incumbent directors (e.g., USA) (Stella Richter, 2016). Moreover, the argument goes, since the board of directors is responsible for the adequacy of the internal organization, it should be inferred that this also includes the power to set its own model and composition; the power to select and nominate insurgent directors should, therefore, be allocated to the board of outgoing directors by introducing a default rule in the

Virtus Interpress ©

legislation; even though there is no need to introduce a legal provision in this respect – since the same result could be reached by amending the bylaws – the introduction of such default rule could foster such transformation and bar objections by companies claiming that their bylaws are silent on this point (ID).

However, reflecting on the issue from a general theoretical standpoint, the historical argument brought by the mentioned author can be contradicted by mentioning that, at the origins of the company limited by shares, there were actually two models: the East India Company and its Dutch counterpart, the *Verenigde Oost-Indische Compagnie*, each one having a different structure; the former characterised by shareholders' primacy, the latter by directors' primacy. It was the East India Company model that indeed was copied by the Napoleon Code and, through it, adopted in Italy: therefore, the Italian model belongs to the tradition that sees shareholders' primacy and not directors' primacy (Bruno, 2012). In addition, Italian legal tradition is also very far and different from the US model where directors' primacy is dominant, corporations' structure is hierarchical, and where the directors' election system shows many defects and weaknesses that result in a self-perpetuating oligarchy which therefore cannot be taken, by itself, as an example of good corporate governance (EA.).

6.4. Methodology

The study involves two data collection stages: pilot survey and formal survey. The pilot survey is designed to test the viability of the study and purify the data collection instrument. Three academic researchers and two industry executives critiqued the research instrument for relevance and clarity. The questionnaire for the main study was refined based on feedback from the pilot study.

A total of 40 survey questionnaires were sent (by mail). Among 40 sent questionnaires, 22 returned.

For clarification of the mailed questionnaires, the concerned person was informed via telephone calls, email, and physical meeting.

Among the 22 returned questionnaires, only 20 were in a usable format.

Not all investors answered on a preferred governance system model. First of all, it has to be considered that institutional investors in Italy also belong to European countries that know two-tier as well as one-tier board models, such as France and Nordic countries. In addition, a survey of the financial community was conducted to identify whether it is possible to assume the existence of an ideal or more efficient governance system.

One Proxy Advisor and various investors participated in the survey, representing a total of 10 trillion AUMs (with geographical origins in Italy, France, UK, Germany, and Holland).

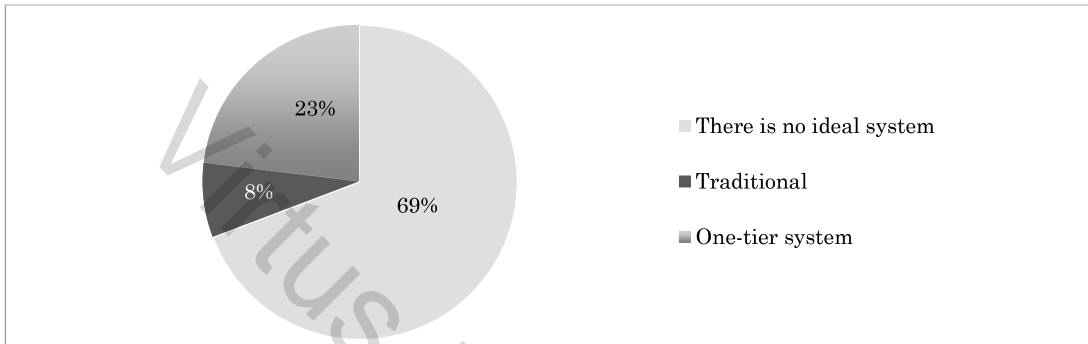
6.5. Results

The vast majority of respondents (69%) believe that there is no ideal system, but that governance should be designed based on the characteristics and the complexity of the corporate business, taking into account the primary need to guarantee a system of

Virtus Interpress ©

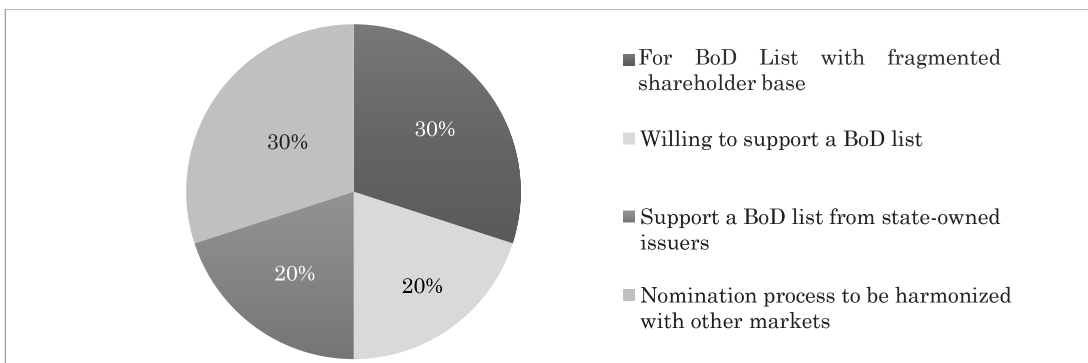
checks and balances. 23% of investors, with different nuances, believe that the one-tier model is preferable compared to the traditional and the two-tier one. 8% of respondents believe that keeping the board of statutory auditors separate from the board of directors (i.e., the traditional model) is currently the best choice in the Italian context. 8% of respondents believe that the details of the curriculum vitae of the statutory auditors is generally much lower than that of directors, and the shareholders themselves do not correctly perceive the importance and the sensitivity of the role of the statutory auditor.

Figure 6.1. Preferred governance system



Almost all the respondents pointed out that, in expressing an assessment on lists filed by the outgoing board of directors, the characteristics and professional skills of directors are the main elements to be taken into consideration. 30% of respondents said they favoured the use of the board of director list only in companies with a widespread shareholding structure. 20% of respondents are potentially willing to vote for the board list. 20% of the respondents believe, however, that it can be positive also in companies with a concentrated ownership structure: obviously the board list, in this case, would incur the risk of being representative of the controlling shareholder, but the board would be more accountable and the selection process could result more transparent, and the list would still be evaluated on the basis of the set of experiences and skills. 30% of respondents believe that the nomination process should be strengthened and made more similar to those present in other markets.

Figure 6.2. Survey results



Virtus Interpress ©

6.6. Discussion

Analysing the bylaws of the two major banks that have switched from the vertical two-tier board – judged to be too burdensome – to the one-tier board, the additional provisions, in both cases, basically aim at introducing safeguards, normally applicable to *sindaci*, in the interest of shareholders. This means, on one side, that the two-tier traditional model, by itself, ensures more independence and effectiveness to the supervision function (otherwise it would be useless to copy those provisions) and, on the other side, that the justification normally brought for the adoption of the one-tier, that is, simplification, is undermined if the role of *sindaci* is basically duplicated. The only differences with the two-tier traditional model, that still remain, according to these bylaws are: i) professional pre-requisites for appointment (required for all *sindaci,* rather than just one of them); and ii) the need of a decree from the judiciary in case of dismissal of *sindaci* (not required for members of the control committee). Both provisions should be highly valued as they ensure, respectively, competence and independence for *sindaci*. In addition, by the two banks, the one-tier model has been preferred because it allows the allocation of control to directors who are also those in charge of strategic supervision: the possibility of contributing to setting the strategy and taking decisions should allow the exercise of *ex-ante* control power and bar the possibility of taking unlawful decisions. However, it can be argued that also *sindaci* could and should stop, during a board of directors' meetings, decisions that might appear unlawful. Moreover, the scheme of allocating both management and control functions on the same people might create difficulties for them in playing different roles at the same time: one eminent author brilliantly explained, with reference to *sindaci,* that their task is of supervision and protection and they must not take part in management as this "total abstention is deemed by the legislature an essential requirement for the good functioning of the company…*if they took part to the management they should supervise themselves and this would be a non-sense*" (Vivante, 1923). One recent example may show how burdensome playing two different roles at the same time could be: at the Tim S.p.a. shareholders' meeting of May 4th, 2018, one of the shareholders, Elliott, filed the request to add the dismissal of six directors as an item of the agenda. The board of directors rejected the shareholder's proposal and all directors resigned. At that point, the shareholder Elliott turned to the board of statutory auditors filing the same request to add that item in the agenda pursuant to art. 126-*bis* of the leg. Decree n. 58/1998 and the latter body unanimously resolved to add the item, considering that the overall set of powers attributed by the current regulation to the controlling body includes autonomous reaction functions, whenever the board of directors does not provide for it. Under art. 126-*bis* of the leg. Decree n. 58/1998, indeed, also the controlling bodies of the other two board models have the same power as *sindaci* to add items in the agenda so, in theory, if Tim S.p.a. had a one-tier board, the same power of adding the item to the agenda could have been exercised by the internal control committee: one could ask, however, whether the internal control committee of a one-tier board, in the same situation, would have shown such strong independent and autonomous judgment to exercise such power quite in opposition with the other fellow members of the board….

Virtus Interpress ©

In any case, it has to be highlighted that neither the European Commission, nor the European Central Bank (or Bank of Italy) ever expressed any preference on board models: quite differently, they rather issued rules trying to overcome the differences existing among the three models (Banca d'Italia, 2013) or specifically acknowledged the coexistence of different board structures (one-tier, two-tier or mixed models) "which are often deeply rooted in the country's overall economic governance system" clarifying it "has *no* intention of challenging or modifying this arrangement" (European Commission, 2012). In addition, the Council Regulation (EC) 2157/2001 on *Societas Europaea*, for example, makes reference expressly and indistinctly to all models existing in European jurisdictions, including the Italian traditional board.[10] While, when the European Union tried to harmonize management and control structures of European companies, the attempt miserably failed as the Draft Fifth Company Law Directive (Procedure 1972/0003/SYN) – that was never agreed to come into law – could show.

Overall, we believe it is useless to insist on the comparison of governance models because the qualification of one system as one-tier or two-tier is not alike in all countries. In particular, there are different kinds of two-tier boards while powers and functions are differently allocated within the one-tier model in each jurisdiction: what the Italian civil code qualifies as one-tier is not at all the same as in the UK or US if we think that, for example, under UK legislation, namely the Companies Act 2006, there are *no provisions* referring to the appointment of non-executive directors or a supervisory internal committee within the board while the Italian civil code, on the contrary, mandatorily requires the appointment of the internal control committee in the one-tier board model; in addition, powers, legal instruments and functions are very different. The distinction between executive and non-executive in the United Kingdom was born in practice and the role of the latter is contemplated under the Corporate Governance Code, a self-regulatory instrument strengthened by the "comply or explain rule": under it *there is no reference whatsoever to supervisory functions from non-executive directors over the executive directors*; quite on the contrary, the concept of unity and trusteeship strategy among them is paramount in British law (Davies, 2002). Non-executive directors should rather provide "*constructive challenge, strategic guidance, offer special advice, and hold management to account*".[11] These various elements shall be added to the different legal characteristics and ownership structures of financial markets to be considered to evaluate overall efficiency. The qualification of a system as one-tier or rather two-tier, by itself, is not conclusive of how corporate governance works because specific rules vary from one jurisdiction to another: one-tier or two-tier is not a self-evident label but it underlies diverse mechanisms, provisions and ways of functioning.

For all these reasons, we believe it is not reasonable to insist upon a uniform model or to push towards a global convergence with reference to boards; in particular, authorities should remain neutral in respect to models as there is no empirical evidence testifying conclusive superiority of any of them by itself. In any case, applying the latter

Virtus Interpress ©

[10] See article 39, subsection 2) of the Council Regulation (EC) 2157/2001 stating that: "The member or members of the management organ shall be appointed and removed by the supervisory organ. A Member State may, however, require or permit the statutes to provide that the member or members of the management organ shall be appointed and removed by the general meeting under the same conditions as for public limited-companies that have registered offices within its territory".
[11] See the UK Corporate Governance Code, July 2018, Sub 2, Principle H.

considerations specifically to the Italian traditional board model compared to the one-tier model, no superiority of the one-tier board can be claimed under the flow of information theory because *sindaci* are required, by law, to attend all meetings of board of directors and of executive director committees as well as of shareholders: the breach of this duty is punished by their dismissal if absence is not duly justified. In addition, *sindaci* attend meetings of internal committees. Their task is to acquire "a complete knowledge of all business affairs, so to ensure shareholders about the truth of the financial statements and give them their opinion on the direction of the company's activity"; the rationale of the introduction of *sindaci* by legislature was historically to grant "shareholders [..] the possibility of following *step by step* the company […] through their permanent office, not limited, and concerning the whole managerial activity […] through their widest mandate for the *perennial supervision* of the company's affairs, registers, accounts, with the power, also, of calling the general meeting of shareholders" (Vivante, 1923). Therefore, if the comparison is between the one-tier and the two-tier Italian traditional model, the flow of information argument summarised above to justify the superiority of the former is not applicable.

With reference to the other issue, that is, the submission of a list of candidates from the outgoing board in case of renewal, we do not deem advisable to introduce a legal provision – even though conceived as a default rule – in Italian legislation as suggested by one author. We do not believe this rule could, by itself, foster better corporate governance (actually, looking at the US example, we reach quite the opposite conclusion). Under current legislation, we believe it is perfectly lawful to amend the bylaws to introduce a clause allocating *also* to the board of directors the power to file a list of candidates for its renewal: the powers to initiate general meeting resolutions and to fix their agenda belong to the board of directors under Italian civil code and this may also include the power to file a list of new candidates if the bylaws so provide. Of course, such power cannot cancel shareholders' power to file lists of candidates since, for listed companies, this power is allocated to shareholders by legislation that cannot be contradicted by bylaws.

6.7. Conclusion

Based on our analysis and theoretical background with reference to the new trend, the analysis shows that international literature does not evidence any superiority of this model over the two-tier board. By contrast, the experience is too recent in Italy to proceed with an empirical study that compares the efficiency of the one-tier board *vis-à-vis* the two-tier traditional (or horizontal) model. Only in the years to come will we be able to empirically compare the one-tier and the two-tier traditional boards in Italy and assess efficiency and quality in terms of corporate governance between the two. Moreover, from the survey conducted among institutional investors with reference to the Italian market, 69% of them believe "there is no ideal system". Then the reasoning and justifications brought by Alvaro, D'Eramo, and Gasparri (2015) seem therefore feeble. In addition, it has to be highlighted that the two Italian banks that have recently adopted the one-tier board used to have the two-tier vertical model that, in Italy generally, did not show its full effectiveness in terms of clear division of powers and speed in the

Virtus Interpress ©

decision-making process and that the amended bylaws inserted some provisions typical of the two-tier traditional board in order to ensure more guarantees for shareholders. We should not forget that, historically, companies limited by shares in Italy, as well as in Europe, were born as one-tier board companies; at the end of XIX century, the Italian commercial code was amended to introduce an independent and competent body, *sindaci,* to protect shareholders and exercise the widest control over directors.

In relation to the second trend, that is the filing of a list from the outgoing board, the survey in particular shows that the positive aspects of this procedure may be to enhance a more transparent and meritocratic formal process of selection for new directors through internal nomination committees, external consultants and board evaluation of current members. The process could even be improved by, for example, providing for a call to be launched in the market to invite spontaneous candidacy. Such formal process may show to be very helpful especially if and when, by contrast, the same transparency and meritocracy lack in the selection of candidates included in the lists filed by shareholders: the choice may be influenced by politics (when the State is, directly or indirectly, the block-holder as in various Italian companies) or other mysterious factors. In some circumstances, the Italian market has shown a lack of transparency on the selection criteria and on the procedure followed by majority or minority shareholders to choose candidates determining a poor coincidence with the qualities identified after the board evaluation. There are however some warnings to be pointed out for the list filed by the outgoing board: the process may result in a self-selection increasing the power of directors *vìs-à-vìs* shareholders; in addition, in case the company's ownership structure is concentrated, minority shareholders' rights might be undermined if, in addition to the list from the outgoing board, another list is filed by the controlling shareholder; in such cases, there might be no room for the minority shareholders' slate of directors (so-called, *voto di lista*) since the latter could take fewer votes than the other two lists. Such danger does not appear where the ownership structure is widespread; however, there are few examples of such companies in Italy.

In general, we do not advocate any pressure, in particular from authorities, towards convergence on Anglo-American rules when their utmost efficiency or optimal structure have not been proven. By contrast, we believe "*diversity should prevail and persist, not only because there is no single optimal ownership and governance arrangement, but also because it is a source of innovation and inspiration for the creation of new ideas and activities*" (Mayer, 2018). A convergence in corporate governance, through codes of conduct and best practices, is undisputable but corporate governance codes, rightly, focus on substance, not on formal rules, they disregard labels and provide for practical, not theoretical recommendations.

Virtus Interpress ©

References

1. Adams, R. B., & Ferreira, D. (2007). A theory of friendly boards. *The Journal of Finance, 62*(1), 217-250. https://doi.org/10.1111/j.1540-6261.2007.01206.x
2. Alvaro, S., D'Eramo, D., & Gasparri, G. (2015). *Modelli di amministrazione e controllo nelle società quotate. Aspetti comparatistici e linee evolutive*. Retrieved from http://www.consob.it/documents/11973/201676/qg7.pdf/ffff838f-c6c5-4d2c-a53e-f432a5bef738
3. Assonime. (2019). *Note e Studi 2/2019 – Sul modello monistico di governo societario*. Retrieved

from http://www.assonime.it/attivita-editoriale/studi/Pagine/note-e-studi-2-2019.aspx

4. Banca d'Italia (2013). *Circolare n. 285* del 17 dicembre 2013. Disposizioni di vigilanza per le banche. Retrieved from https://www.bancaditalia.it/compiti/vigilanza/normativa/archivio-norme/circolari/c285/
5. Bebchuk, L. A., & Roe, M. J. (2004). A theory of path dependence in corporate ownership and governance. In J. N. Gordon & M. J. Roe (Eds.), *Convergence and persistence in corporate governance* (pp. 69-113). https://doi.org/10.1017/CBO9780511665905.003
6. Bratton, W. W., & McCahery, J. A. (1999). Comparative corporate governance and the theory of the firm: The case against global cross reference. *Columbia Journal of Transnational Law*, *38*(2), 213-297. https://doi.org/10.2139/ssrn.205455
7. Bruno, S. (2004). Efficienza e modelli di amministrazione e controllo, *Rivista Diritto Commerciale*, *2004,* 1021-1052.
8. Bruno, S. (2012). Directors' versus shareholders' primacy in US corporations through the eyes of history: Is directors' power "inherent"? *European Company and Financial Law Review, 9*(4), 421-445. https://doi.org/10.1515/ecfr-2012-0421
9. Coffee, J. C. (1999). The future as history: The prospects of global convergence in corporate governance and its implications. *Northwestern University Law Review, 93*(3), 641-708. https://doi.org/10.2139/ssrn.142833
10. Corriere della Sera. (2018, September 11). Nava alla Bocconi. Retrieved from https://www.corriere.it/
11. Davies, P. (2002). *Introduction to company law*. Oxford, NY: Oxford University Press.
12. Davies, P. L. (2000). Board structure in the UK and Germany: Convergence or continuing divergence? *International and Comparative Corporate Law Journal, 2*(4), 435-456. https://doi.org/10.2139/ssrn.262959
13. Easterbrook, F. H. (1997). International corporations' differences: Market or law? *Journal of Applied Corporate and Finance, 9*(4), 23-30. https://doi.org/10.1111/j.1745-6622.1997.tb00621.x
14. Esposito De Falco, S. (2014). *La corporate governance per il governo dell'impresa*. Milan, Italy: McGraw-Hill education.
15. European Commission. (2012). *Action plan: European company law and corporate governance a modern legal framework for more engaged shareholders and sustainable companies.* Retrieved from https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0740&from=EN
16. Ghezzi, F., & Malberti, C. (2008). The two-tier model and the one-tier model of corporate governance in the Italian reform of corporate law. *European Company and Financial Law Review, 5*(1), 1-47. https://doi.org/10.1515/ecfr.5.1.1
17. Hansmann, H., & Kraakman, R. (2004). The end of history for corporate law. In J. N. Gordon & M. J. Roe (Eds.), *Convergence and persistence in corporate governance* (pp. 33-68). https://doi.org/10.1017/CBO9780511665905.002
18. Hopt, K. J. (1998). The German two-tier board: Experience, theories, reforms. In K. J. Hopt, H. Kanda, M. J. Roe, E. Wymeersch & S. Prigge, *Comparative corporate governance: The state of the art and emerging research* (pp. 241-245). Oxford, England: Clarendon Press.
19. Jungmann, C. M. (2006). The effectiveness of corporate governance in one-tier and two-tier board systems – Evidence from the UK and Germany. *European Company and Financial Law Review, 3*(4), 426-474. https://doi.org/10.1515/ECFR.2006.019
20. Marghieri, A. (1929). *Delle società e delle associazioni commerciali. Commento*. Turin, Italy: Unione Tipografico Editrice Torinese.
21. Mayer, C. (2018). *Prosperity: Better business makes the greater good.* Oxford, NY: Oxford University Press.
22. Millet-Reyes, B., & Zhao, R. (2010). A comparison between one-tier and two-tier board structures in France. *Journal of International Financial Management & Accounting, 21*(3), 279-310. https://doi.org/10.1111/j.1467-646X.2010.01042.x
23. Ministero della giustizia e degli affari del culto. (1878). *Relazione del ministro di grazia e giustizia e dei culti (mancini) od esposizione dei motivi del progetto del codice di commercio*

Virtus Interpress ©

pel regno d'Italia.

24. Ministero della Giustizia. (2003). *Schema di D.Lgs. – Riforma organica della disciplina delle società di capitali e società cooperative, in attuazione della L. 366/2001 – Relazione*. Retrieved from https://www.giustizia.it/giustizia/it/mg_1_2_1.wp?facetNode_1=4_44&facetNode_3=18(20 0301)&facetNode_2=1_8(2003)&previsiousPage=mg_1_2&contentId=SAN59897
25. OECD. (2003). *Survey of corporate governance developments in OECD countries*. Retrieved from https://www.oecd.org/corporate/ca/corporategovernanceprinciples/21755678.pdf
26. Olivieri, A. (2018). Perché il monistico piace agli investitori. *Il Sole 24 ore*. Retrieved from https://www.ilsole24ore.com/
27. Romano, R. (1999). Corporate law and corporate governance. In G. R. Carroll & D. J. Teece (Eds.), *Firms, markets and hierarchies* (pp. 365-427). Oxford, NY: Oxford University Press.
28. Rouyer, E. (2013). Company performance and the two-tier board structure: Empirical evidence from France. *International Journal of Business and Economics*, *12*(1), 45-58.
29. Schmidt, R. H., & Splinder, G. (2004). Path dependence and complementarity in corporate governance. In J. N. Gordon & M. J. Roe (Eds.), *Convergence and persistence in corporate governance* (pp. 114-127). https://doi.org/10.1017/CBO9780511665905.004
30. Slater. S. F., & Atuahene-Gima, K. A. (2004). Conducting survey research in strategic management. In *Research methodology in strategy and management* (Vol. 1, pp. 227-249). https://doi.org/10.1016/S1479-8387(04)01108-7
31. Stella Richter, M. Jr. (2016). Il quadro legislativo Italiano in materia di nomina ed elezione del consiglio: Un modello o un'anomalia? *Note e Studi Assonime, 11,* 1-18.
32. UBIBanca. (2018). *Relazione per l'Assemblea straordinaria del 19 ottobre 2018*. Retrieved from https://www.ubibanca.it/contenuti/RigAlle/04%20RELAZ%20NUOVO%20STATUTO.pdf
33. Vivante, C. (1923). *Trattato di diritto commerciale*. Milan, Italy: F. Vallardi.

Virtus Interpress ©