

Italy's 'Vote by Slate' – an innovative method to elect minority directors

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Unknown to most governance experts and underutilised by most institutional investors, Italy's 'voto di lista' rules provide one of the most direct means for minority shareholders to achieve board representation in listed companies. Despite procedural encumbrances, the 'voto di lista' process represents a progressive solution to a pervasive governance problem: how to protect the interests of minority shareholders.

In continental Europe and developing markets, the majority of listed companies are controlled by founding families or shareholder groups – publicly listed but privately controlled. For these companies, the Anglo-American approach to corporate governance is unrealistic. Remedies for protecting minority shareholders, such as sponsoring resolutions, convening special meetings or seeking appraisal in order to assert their rights, are costly and procedurally complex.

Italy has taken a unique approach to protecting minority shareholders and counteracting the potential negative impact of concentrated ownership on management and board accountability. For over 96% of Italian listed corporations, the shareholders' meeting (assemblea degli azionisti) nominates the board of directors (consiglio di amministrazione) and the board of internal auditors (collegio sindacale). The auditing functions are external, so internal auditors monitor directors' actions and ensure that the board pursues the corporate object lawfully, whilst complying with by-laws. Aside from the usual rights, from 2007 the Italian Consolidated Law on Finance requires both the board of directors and the board of auditors to have at least one member elected by minority shareholders.

This idea that interests of non-controlling shareholders with substantial equity in an Italian corporation should be represented on the board of directors dates to the early 1990s. The Italian government privatised the massive interests directly or indirectly held by the state in a wide variety of national industries. Although essentially operating as holding companies, these firms were neither corporations nor companies. Instead, they were special business organisations, owned by the state and managed by officers appointed by the government, though subject to the legal and regulatory rules applicable to any private enterprise.

Most of these firms were converted into corporations, and their shares – all or part – were offered to either selected institutional investors or the market. In some cases, such

as companies operating in key industries (defence, utilities, telecommunications, and transportation), the state was meant to maintain control over the privatised business for a period of time. With the completion of the legal framework for the privatisation process on 31 May 1994, these companies had to amend their by-laws to provide the state with special powers, useable in case of subsequent change of control.

In addition, these companies (as well as banks and insurance companies directly or indirectly controlled by the state) were allowed to limit shareholding by private investors up to a maximum 5% of the equity. However, should such limitations be adopted, they were also required to provide private investors holding at least 1% of the capital shares with the right to submit a slate for the election of the board of directors, and to have their candidates elected to no less than 20% of the total board positions. Now, more than ten years later, these provisions are applicable to all listed companies.

The right to submit a slate for the election of directors and auditors pertains only to shareholders with substantial equity under the assumption that the size of their investments demonstrates long-term economic interest in the company. It would also minimise the risk of disruptive campaigns from factions with an economic or investment agenda inconsistent with the long-term well-being of the business enterprise.

Under current Italian law, the shareholding required for submission of a minority slate for the election of the board of directors varies from 0.5% to 4.5% according to the size of the company's market capitalisation (see table opposite), unless a lower threshold is provided by the company's by-laws. As to the election of directors, the company's by-laws can require a minimum number of votes for a minority slate to qualify for the actual allotment of seats. The election of internal auditors cannot be subject to any 'percentage or minimum amount of votes' to be obtained by minority slates.

For listed mutual companies governed by the 'one head, one vote' principle – like many major Italian banks – the threshold is necessarily different. A slate can be submitted by a single shareholder or group of shareholders with at least 0.5% of the capital shares (unless a lower threshold is provided by the company's by-laws) or by 500 shareholders (unless a lesser number is provided by the company's by-laws).



Submission of lists of candidates for the election of the board of directors

Company's market capitalisation	Shareholdings required
> €20 Bio.	0.5%
€5 Bio. < X ≤ €20 Bio.	1%
€2.5 Bio. < X ≤ €5 Bio.	1.5%
€1 Bio. < X ≤ €2.5 Bio.	2%
€500 Milo. < X ≤ €1 Bio.	2.5%
≤ €500 Milo.	4.5%
	2.5% if any of the following conditions is not met: <ul style="list-style-type: none"> • The float is greater than 25%; • There are no shareholders, or groups of shareholders, participating in a shareholder agreement who own the majority of the votes exercisable in the shareholders' meeting for the appointment of directors.

Given the opportunities it provides to minority shareholders, the 'voto di lista' process has received far less attention than it deserves.

This ambivalence is captured in a recent statement by Donald Cassidy, Director of Corporate Governance Research at Fidelity International, one of the few global investors to take advantage of this process:

"The process offers enormous potential to investors to exercise their rights as responsible shareholders," he argued. "At the same time, the process is somewhat complicated. However, we've had a very positive experience working with local parties, most particularly the Assogestioni [the Italian association of pension funds and investment managers], and look forward to continuing to utilise the process in the future."

The complications referred to by Mr. Cassidy include the following:

- **Timing:** the deadline for the presentation of a minority slate is ten days (by the recommendation of Consob, however, many issuers require a deadline of 15 days). This is inadequate for cross-border information flow and vote processing, the assembling of support from global investors, whose interests should be represented by minority slates, and for them to cast an informed vote.
- **Certification requirements:** the sponsoring shareholder or group must certify ownership of the shares needed to sponsor a minority slate. The

certification requirements are interpreted by many investors as equivalent to share blocking, a process outlawed by EU and Italian law in connection with voting rights at shareholder meetings. Clarification and simplification of certification rights, shareholder communication of support and ownership levels, and their ability to dispose of shares would improve participation by global investors.

- **Support levels:** the decline in assets managed by Italian fund managers has reduced the ability of minority representatives to organise the support needed to sponsor a slate. This increases the need for support from international investors, whose minority interests are largely at stake.
- **Evaluation of candidates:** disclosed information about minority candidates is often inadequate for shareholders to make an informed decision. When international investors have not been involved in selecting and supporting the minority slate, they are often reluctant to vote for candidates without more information about their background, experience and independence.

Simplification of the process may come by the end of this year, as Italy must comply with the EU Directive on shareholders' rights. It's fair to say that the Italian 'voto di lista' process represents an extraordinarily progressive approach to representing minority shareholder interests in boardrooms. With better education of global institutional investors and the elimination of procedural burdens and uncertainties, this uniquely Italian process could become a paradigm for shareholder access to corporate boardrooms.