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# CORPORATE GOVERNANCE PRINCIPLES

Italy

Hermes EOS  
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For professional investors only

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**HERMES**  
INVESTMENT MANAGEMENT

## CORPORATE PURPOSE AND HERMES RESPONSIBLE OWNERSHIP PRINCIPLES

As investors we aim to deliver long-term value creation for our clients. This can only be achieved sustainably if companies create and preserve value over time, not only for their shareholders but also for stakeholders, society and the environment. Our expectation, therefore, is that companies should be run not only for shareholders, but should also have a wider purpose that benefits society. In turn, this supports the needs of savers and pensioners, who rely on sustainable returns from their investments, to provide them and their families with a secure future.

This document should be read in conjunction with the Hermes Responsible Ownership Principles<sup>1</sup>. They provide our views on corporate purpose and other issues that we believe are important for companies globally.

## INTRODUCTION

We welcome the adoption and publication of the Italian Corporate Governance Code (the Code), updated in July 2018, issued by Borsa Italiana<sup>2</sup> and generally support its recommendations and suggestions. We support its enhanced comply-or-explain principle, which is consistent with the European Commission's recommendation on the quality of corporate governance reporting<sup>3</sup>. In addition, we support the Italian fund managers' association, Assogestioni in its proxy access (voto di lista) role.

However, the guidelines set by the Code do not sufficiently cover all the issues we regard as important. In our Italian Corporate Governance Principles, therefore, we highlight specific points and set out our preferred approach to particular matters. For instance, we outline priorities that will help companies improve corporate governance – thereby helping to increase investment and improve sustainable company performance. We also seek to work with companies and regulators to further enhance standards as best practice evolves. The following sections are intended to assist Italian companies and their directors in understanding our views on these issues.

## SHAREHOLDER RIGHTS

### One share, one vote principle

Italian law allows listed companies to introduce double voting rights for investors who have held and registered their shares for a consecutive two-year period. We strongly support the principle of one-share one-vote, which ensures proportionality between equity ownership and voting powers, and thus economic risk bearing. As a general rule, we believe equal voting rights should be attached to shares regardless of the total holding or other characteristics of an investor. We therefore believe that divergence from the one-share one-vote principle is undesirable. Similarly we do not support enhanced dividends for long-

term shareholders because these practices disadvantage some shareholders, increase investment risk and may reduce management accountability to shareholders as a body.

## TRANSPARENCY AND DISCLOSURE

### Meeting notification and proxy documents

For minority shareholders, the annual general meeting (AGM) is a formal opportunity to obtain information about management's and the board's stewardship of their investments and, if necessary, to request clarification of any decisions taken during the year. The AGM is therefore an important accountability mechanism, and the communication of detailed information on all agenda items at least 30 days in advance of the meeting is a prerequisite for its effectiveness. All documents should be clearly displayed and accessible on the company's website. We also urge companies to publish the detailed results of the votes at the general meeting on their website as soon as reasonably practical after the meeting.

### High-quality reporting

Material social, environmental and governance considerations are key components of the assessment of risks and opportunities and should be reported as such. We encourage companies to adopt the International Integrated Reporting Framework<sup>4</sup>.

## BOARD OF DIRECTORS

### Board diversity

Boards are most effective when they have access to knowledge and experience from a wide range of backgrounds that are relevant to the company, including with regard to its long-term strategic direction, suppliers, employees, customers and geographic footprint. In addition, a wide variety of viewpoints and perspectives is likely to result in a better quality of debate and therefore decision making. Boards that have too much commonality of background run the risk of groupthink and complacency, both clear signs of governance failure. We believe that boards should take account of diversity in its broadest sense, including gender, nationality and ethnicity, as well as skills, experience and other attributes when considering possible candidates for the board and other senior positions.

We support the new principle of the Code which recommends that listed companies apply diversity criteria, including by gender, in the composition of both the board of directors and the board of statutory auditors. The criterion which relates to achieving the objective of gender diversity balance, now asks for at least a "one-third quota" of the less represented gender on the board of directors and among the statutory auditors. This retains the comply or explain requirement of the Golfo-Mosca law, after the law becomes obsolete in 2020<sup>5</sup>.

<sup>1</sup> <https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf>

<sup>2</sup> [www.borsaitalia.it](http://www.borsaitalia.it)

<sup>3</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014H0208&from=EN>

<sup>4</sup> <https://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>

<sup>5</sup> <https://www.borsaitalia.it/comitato-corporate-governance/codice/comunicato2018eng.en.pdf>

The board should also ensure that diversity is effective across the company. Where there is an under-representation of women on the executive board and in senior positions across the organisation, in comparison with the market average, we expect companies to develop a gender diversity target and to set a timescale for achieving it. We encourage boards to monitor key indicators to assess the inclusivity of the company culture and its alignment with the company's values and strategy. Employee surveys, staff turnover, promotion ratios and pay gap by category of employees should be included within the assessment.

## Independence

While representation of significant shareholders on the board can be justified and useful, we expect there to be a strong core of independent directors to ensure that the interests of minority shareholders are protected, to exercise objective judgement and, if necessary, to act as agents for change. We strongly recommend that at least half of the directors on the board, including those nominated by significant shareholders, should be independent in companies with a dispersed ownership structure, and at least one third of the directors should be independent in controlled companies.

Companies should provide a biography of all directors, including their area of expertise and should clearly state whom they consider to be independent, in particular explaining why the board considers those with apparent impediments to their independence to be independent. We press for enhanced disclosure of the interests that link directors with the company, in order for shareholders to assess their materiality. Companies should describe precisely how conflicts of interests are managed.

## The role of shareholders in the voto di lista system

We may take a proactive role in the submission of independent and qualified candidates using the voto di lista system, where this is in line with the long-term interests of our clients. In this context, we make resources available for discussions with the nomination committee of Assogestioni and/or other investors, as long as this does not constitute the creation of a 'concert party' under local takeover rules. Our approach to the selection of candidates is guided by these Principles.

## Evaluation of the board

We support greater transparency on the work of the board, and the rules and procedures in place to facilitate its functioning. We also support refreshment of the board as the needs of the company evolve. We welcome the recommendations in the Code that evaluations of the board and its committees should be performed annually to ensure that the evaluations are effective during the board's three-year term. We encourage companies to implement a formal process for these evaluations and to communicate on the areas identified for improvement.

## Chairing the board

Since the responsibilities and competencies of the chair of the board and the CEO are different, we believe they are most effectively discharged by two people. The separation of the roles ensures the focus of the CEO on the management of the company, while a separate chair role introduces an additional element of overview and accountability.

If the roles are combined, the reasons should be clearly explained. In these situations, as required by the Code, additional safeguards should be put in place, in particular a lead independent director with appropriate powers should be nominated.

An independent chair helps to ensure the CEO's accountability for managing the company in the interests of shareowners. In our view, chairs are non-independent and executive when they receive material compensation in exchange for their time commitment to the company. We do not support the granting of variable compensation to the chair, as it can influence his or her oversight of the executive board.

## Lead independent director

We advise the nomination of a lead independent director, particularly where the chair can be classed as non-independent, including where the roles of chair and CEO are combined. The role and prerogatives of the lead independent director should be clearly defined in published rules of the board or in the articles of association. Their key duties should include leading the assessment of the performance of the chair and acting as a direct link to shareholders. Where the chair is non-independent, he or she should be able to convene the board in certain circumstances. We believe that the lead independent director is accountable for managing conflicts of interest and compliance with good governance.

## Vice chairs

We do not support the practice of appointing two or more vice chairs, as, in our experience, this may indicate that there are factions within the board. Where these appointments are made, we expect a clear and separate allocation of duties to be published to ensure directors are accountable for their specific responsibilities.

## Nomination committees

We believe there is a strong need for a nomination committee, consisting of a majority of independent directors, in all listed Italian companies, regardless of shareholding structure. We are sceptical about the practice of justifying the lack of a nomination committee through the existence of a syndicate pact or the voto di lista system. The nomination committee should express opinions to the board about the size and composition of the board, as well as in relation to the professional and other skills required on the board. The committee should also periodically review the election mechanism, express opinions on the suitability of the parameters regulating the voto di lista system in place and formulate proposals for their improvement where needed.

## Related party transactions

Related party transactions should be carried out with suitable scrutiny and regularly reviewed by the board. When the board is to assess or review potential related party transactions, directors linked to the related party should disclose their conflict of interest and should not only abstain from voting, but absent themselves from discussions of such matters, with no exception. We encourage companies to adopt strict internal policies and procedures to manage related party transactions. Independent directors without any interest in the transaction should approve all related party transactions in advance. As investors, we expect sufficient information and justification of material related party transactions.

## Importance of board and shareholder engagement

Communication between boards and serious, committed long-term shareholders on strategy, finance, corporate governance and risk management – including the management of risks and opportunities stemming from environmental and social issues – is essential. Through this exchange of views, shareholders can better comprehend, and if necessary, attempt to influence the boards of companies in which they invest, developing relationships of trust based on an improved mutual understanding. Our experience has shown that constructive engagement between shareholders and directors in these areas can lead to improvements in the governance, performance and value of companies. Conversely, lack of engagement can lead to increased risk. Chairs, lead independent directors and other non-executive directors, in particular board committee chairs, should make themselves available for meetings and teleconferences with minority shareholders, as an essential part of their responsibilities. Developing relationships of trust with long-term shareholders can be invaluable for boards. We therefore expect boards to welcome more and better quality engagement between long-term investors and directors, and for independent directors to participate in engagement.

## EXECUTIVE REMUNERATION

### Compensation principles

We are increasingly concerned that executive remuneration structures and practices around the world are not fit for purpose, neither serving long-term investors nor, in many cases, aligning properly with the core long-term objectives of companies.

We therefore continue to hold many discussions on reforming pay with remuneration committee members, executives, human resource professionals, remuneration consultants and other investors around the world. We are often encouraged by their response to our views. However, pay practice within companies rarely reflects our discussions on our pay principles<sup>6</sup>. Our current thinking on executive pay can be summarised as follows:

**Simplicity:** pay schemes should be clear and understandable for investors as well as executives. Pay structures should be much simpler and less leveraged than they are at present, for example taking the form of a single incentive scheme and lower variable and total possible pay. Remuneration reports must explain how alignment with long-term shareholders is achieved.

**Shareholding:** the executive management team should make material investments in the company's shares and become long-term stakeholders in the company's success. Significant shareholding requirements for directors should remain in place for a specific period of time following departure from the company, with no share sales allowed for at least one year.

**Alignment and quantum:** pay should be aligned to the long-term success of the company and the desired corporate culture, and is likely to be best achieved through long-term share ownership. Pay is often

too high and pay schemes often seem to pay out significant sums which conflict with many shareholders' and other stakeholders' views of performance. Boards should be able to justify to investors, the workforce and the public the rationale for the CEO's and the most senior management's pay, taking account of the pay of the wider workforce. If they are not able to do so, directors should use their discretion to adjust actual or potential pay downwards. The rules of pay schemes should support this.

**Accountability:** remuneration committees should use discretion to ensure that pay properly reflects business performance. Pay should reflect outcomes for long-term investors and take account of any decrease in the value of, or drop in the reputation of the company. Remuneration committees should take a more robust view on pay, using their judgement and being accountable for their decisions. They should avoid paying more than is necessary and not place too much reliance on existing practice and benchmarking which help to perpetuate many of the problems that we seek to address. The potential outcomes of a pay policy should be rigorously scenario tested with a cap on the total possible pay published in advance, to help reduce the risk of unintended consequences.

**Stewardship:** companies and investors should regularly discuss strategy, long-term performance and the link to executive remuneration. Executives should be encouraged to achieve strategic goals, rather than focus attention on total shareholder return or stock price appreciation. They should take account of the company's effect on key stakeholders.

We expect senior executives to willingly embrace these principles and, if they do not, for boards to consider the implications. Remuneration committees must take responsibility for the design, disclosure and dialogue on executive pay and we will hold them accountable for this.

### Severance payments

We are concerned about any contractual agreement between the company and its directors or managers which entitles an individual to a severance payment in excess of the equivalent of one year's remuneration in the event of a change of control or early termination of employment. We welcome the recommendation in Article 6 of the Code, which encourages full disclosure and transparency of termination indemnities, in accordance with communication published by the Italian Securities and Exchange Commission CONSOB<sup>7</sup>.

### Advisory vote on remuneration policy

Say-on-pay provides shareholders with an opportunity to formally express their opinion about the design and implementation of a remuneration policy. Beyond the vote it supports a constructive dialogue between the board and institutional investors on the creation of long-term value. We therefore encourage Italian companies to regularly engage with shareholders on this topic.

<sup>6</sup> <https://www.hermes-investment.com/wp-content/uploads/2017/09/Remuneration-Principles-Clarifying-Expectations.pdf>

<sup>7</sup> [http://www.consob.it/mainen/documenti/english/en\\_newsletter/2014/year\\_20\\_n-25\\_23\\_june\\_2014.html](http://www.consob.it/mainen/documenti/english/en_newsletter/2014/year_20_n-25_23_june_2014.html)

## SOCIAL, ETHICAL AND ENVIRONMENTAL RESPONSIBILITY

Companies should effectively manage environmental and social factors that are relevant to their business, with a view to enhancing long-term sustainability. They should also disclose to shareholders on a regular basis how they identify and manage the relevant risks and provide evidence that these processes are effective. In addition, companies should clearly define board and senior management responsibilities for environmental and social issues. We believe that directors of companies are accountable to shareholders for the management of social, ethical and environmental risks and opportunities in the same way that they are accountable for the company's financial performance.

### Ethical leadership

We expect companies to have best practice anti-corruption and anti-bribery policies and processes in place and robust compliance mechanisms to enforce them. However, these are not enough on their own. We expect the board to oversee the anti-bribery and corruption controls and – just as importantly – to set the tone from the top, to encourage the highest ethical standards, to drive the expectations and values of the organisation. This is to ensure that the culture is one in which corruption cannot thrive, and that the necessary organisational measures exist to provide the best possible defence against corruption. We therefore seek to engage with companies where we judge the culture and values to be lacking or the effective oversight, management of or reporting on anti-bribery and corruption to be insufficient.

### Climate change

Climate change is a systemic risk to the value of the portfolios of our clients because of its economic and geopolitical consequences. We therefore support the goal of the 2015 Paris Agreement, which 195 countries signed up to, to limit global warming as a result of climate change, to well below 2°C. This historic commitment was helped by the intervention of companies globally, which publicly encouraged political action in the run-up to the Agreement.

Because of the systemic risk to the global economy, we expect every company to publicly support the Paris Agreement and to make this commitment a central tenet of its public policy and sustainability activity. In particular for companies whose value chain relies on significant energy usage or is exposed to the effects of climate change, the board should ensure that support for the Paris Agreement underpins the company's strategy. Every board should ensure that it has climate change on its board meeting schedules at least annually, and that it and senior management engage with experts who can advise them on the strategic risks and opportunities that climate change represents, and challenge the company's approach, if necessary.

We understand that companies may have different views on climate change from organisations of which they are members or from other organisations which they may be able to influence. Every board should make sure that the company uses all available avenues to influence these third parties, to encourage effective action on climate change in

line with the Paris Agreement. Where a company and one of these third parties disagree on climate change, the company should explain publicly the action it has taken to argue for effective advocacy or action on climate change by that third party. It should also explain its reasons for continued participation in, funding or membership of the organisation despite this disagreement.

### Task Force on Climate-related Financial Disclosures

We welcome the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures. We expect companies to adopt the recommendations in full. Companies should conduct scenario analysis to assess future transition and physical risks which will be brought about by climate change. As part of this scenario analysis, they should also identify and discuss their strategic options for a net zero emission world. In addition, we expect companies, especially those in sectors where climate risks are most material, to demonstrate clearly that they are managing both their current and possible future risks effectively. Furthermore, we expect companies to report on the opportunities presented by climate change. For instance, companies in the financial sector should report how they will help to finance the energy transition.

### Human rights

Licences to operate are increasingly affected by the reputation of companies, including their performance on human rights. We support the UN Guiding Principles on Business and Human Rights and the UN Global Compact. We expect companies to use the reporting framework of the Guiding Principles to disclose how they manage human rights issues that are salient to their business.

### UN Sustainable Development Goals

We expect companies to assess the relevance of each UN Sustainable Development Goal (SDG) to their business and to consider how best to incorporate those which may be material into their business models and strategies. We urge companies to report on how they are responding to the SDGs and encourage them to participate with civil society on how best to support them.

### Tax

We expect companies to:

- comply with all tax laws and regulations in all countries of operation;
- recognise the importance of taxation to the funding of good public services on which they and their stakeholders rely, and their commitment to pay their fair contribution;
- ensure that their tax policies and practices do not damage their social licence to operate in all jurisdictions in which they have a presence; and
- disclose the taxes paid by or collected by them in each country.

<sup>5</sup> [https://www.fsa.go.jp/news/30/sonota/20181102\\_2.html](https://www.fsa.go.jp/news/30/sonota/20181102_2.html)

<sup>6</sup> <https://www.hermes-investment.com/wp-content/uploads/2017/09/Remuneration-Principles-Clarifying-Expectations.pdf>

## HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

### Our investment solutions include:

#### Private markets

Infrastructure, private debt, private equity, commercial and residential real estate

#### High active share equities

Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

#### Credit

Absolute return, global high yield, multi strategy, global investment grade, unconstrained, real estate debt and direct lending

#### Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

### Offices

London | New York | Singapore | Denmark

### Why Hermes EOS?

Hermes EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. Hermes EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

For more information, visit [www.hermes-investment.com](http://www.hermes-investment.com) or connect with us on social media:



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