



**THE SUPERVISORY BODIES AT ITALIAN
LISTED COMPANIES**

ANALYSIS OF THE INDEPENDENCE CRITERIA

FTSE MIB 2013

Highlights

- 34 Boards of Statutory Auditors and 4 Supervisory Boards have been analyzed, including 116 Statutory Auditors and 75 Board members in charge at January 31st, 2013.
- Concerns arise over the strict independence of almost one-third of the members of internal controlling bodies (32.5%): 9 Chairmen of the Board of Statutory Auditors (or 26%), 22 Statutory Auditors (27%) and 31 members of the Supervisory Board (out of 65 defined as independent by the companies, or 48%).
- Main factors of risk highlighted in the analysis: excessive tenure within the Group (22 Supervisory Board members, 11 Auditors and 3 Chairmen), excessive remuneration (11 Auditors and 2 Chairmen), excessive memberships at related companies (10 Auditors, 3 Chairmen and 1 Supervisory Board member).
- In 4 cases (Atlantia, Banco Popolare, Buzzi Unicem and Tod's) concerns arise over the entire Board.
- 12 companies do not disclose any information on Auditors' biography on their websites, while the large majority of other ones disclose only partial information without reporting all memberships held by the Auditor.

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1. Introduction and methodology

The Italian Law regulates the Board of Statutory Auditors since 1882 and discussions about the effectiveness of its controlling duties started almost at the same time. Recent scandals reawakened the debate over the supervisory bodies at listed companies: the derivative scandal that hit the third Italian banking group, Banca MPS, the contested acquisition of Lactalis American Group by Parmalat and the huge losses caused by related party transactions to the insurer Fondiaria-Sai, are just few examples that arise questions about the effectiveness of internal controls.

Frontis Governance analyzed the supervisory bodies at 38 major Italian companies, listed on the FTSE MIB index, in order to better understand the actual level of independence of their members (STMicroelectronics NV and Tenaris SA are excluded as not incorporated in Italy). Depending on the governance system adopted by the company, the supervisory duties may be assigned to the Board of Statutory Auditors (traditional system) or to the Supervisory Board (dual system). Both boards are elected by the shareholders and have almost the same supervisory duties, but the Supervisory Board is also entitled to strategic powers, including the appointment of the Management Board members. Due to the substantial differences between the two boards, the analysis follows two parallel lines: 34 Boards of Statutory Auditors, on one side, and 4 Supervisory Boards on the other one.

The detailed curriculum of each Statutory Auditor and Supervisory Board member has been analyzed (when publicly available on the company's website or on other public sources) in order to verify their strict independence from the company and the major shareholders. The analysis is based on the independence criteria defined by Frontis Governance's guidelines, that apply ECGS' corporate governance principles and internationally recognized best practices to the Italian market's specificities. The independence criteria used in this study are generally more strict than the ones provided by the Italian Law or by the Corporate Governance Code. The English version of the ECGS' principles is available at www.ecgs.org website, while the Italian version of Frontis Governance's guidelines is available at www.frontisgovernance.com.

2. Definition and role of the Board of Statutory Auditors

The Italian Civil Code defines the Board of Statutory Auditors as the corporate body, mandatory in all companies whose share capital is higher than € 120'000 (and in other cases defined by the art. 2477), that is responsible of overseeing: the compliance with the law and the articles of association, the respect of the principles of fair administration and the adequacy of the organizational structures of the company and their actual functioning (as per art. 2403).

Basically, the Board of Statutory Auditors is the main internal structure charged of the supervisory of fair management, the highest level of protection of all stakeholders' interests. Such role is even more delicate at listed companies, where the greater distance between shareholders and management inevitably emphasizes the attenuation of owners' controlling powers.

The Italian Civil Code provides that the Statutory Auditors attend all Board of Directors' meetings, including the ones held by the eventual Executive Committee (art. 2405). Each Auditor may undertake inspection activities, even without previous notice, and may request information on company's specific operations, even related to subsidiaries (art. 2403-bis). Shareholders may report to the Statutory Auditors concerns over the fairness of company's operations (art. 2408). To emphasize the relevance of their supervisory duties, the Italian Law makes Statutory Auditors jointly liable of eventual damages caused by wilful misconduct or serious negligence committed by the Directors.

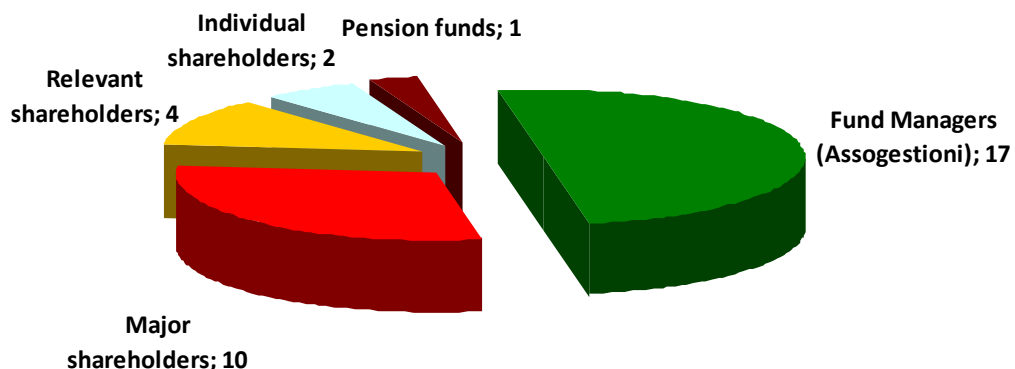
In view of a so delicate role, that is even paid by the company itself, all Auditors necessarily have to meet the strictest requisites of professionalism and independence. All Auditors must be registered in professional registers defined by the Ministry of Justice, or university professors of law or economics, and at least one of them must be a certified auditor (art. 2397 of the Italian Civil Code). Furthermore, all Auditors must satisfy the independence requisites defined by the law (art. 2399): they cannot be relatives of the company's Directors (or of the Directors of related companies) or in any continuative professional relationship with the company (and its controlling, controlled and sister companies).

3. Analysis of Statutory Auditors: main results

Before illustrating the main results of the analysis, a brief description the Auditors' election mechanism is necessary. All Statutory Auditors are elected by the shareholders at the ordinary general meeting, through the "slate of nominees mechanism" (*meccanismo del voto di lista*). The slates of nominees are submitted by shareholders that holds a minimum percentage of the share capital, as defined by the articles of association or by the Market Authority (Consob). To enhance the strict independence of the board, the law provides that the Chairman is appointed from the eventual slate of nominees submitted by minority shareholders, that are not connected in any way to the ones that submitted the majority list. If no minority slates are submitted, the Chairman will be elected among the nominees submitted by the major shareholders.

Thanks to such election mechanism, defined by the Consolidated Law on Financial Intermediation, 24 Chairmen currently on charge at FTSE MIB companies (or 70%) were elected from "minority slates of nominees" (of which 17 submitted by a pool of fund managers coordinated by Assogestioni, the Italian asset managers association), while remaining 10 were nominated by the major shareholders.

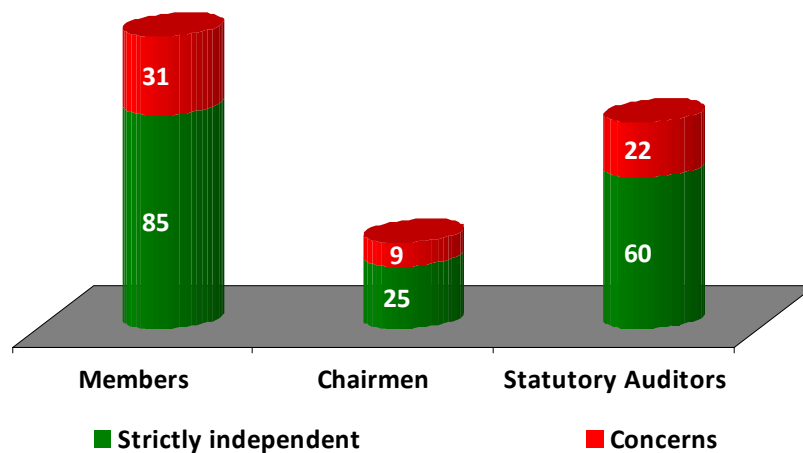
Shareholders that nominated the Chairmen of the Boards



Several factors of risk emerged from the in-depth analysis of 34 Boards of Statutory Auditors, related to significant of formal aspects that may arise concerns over the strict independence of the members. Such aspects do not necessarily imply the non compliance with laws or regulations.

According to the ECGS' definitions (applied to the Italian market by Frontis Governance), concerns arise over the strict independence of 31 members out of 116, of which 22 Statutory Auditors (or 27%) and 9 Chairmen (26%). Factors of risk emerged over 4 Chairmen nominated by minority shareholders: one each by fund managers, a relevant shareholder, pension funds and an individual shareholder.

Overall evaluation of the strict independence



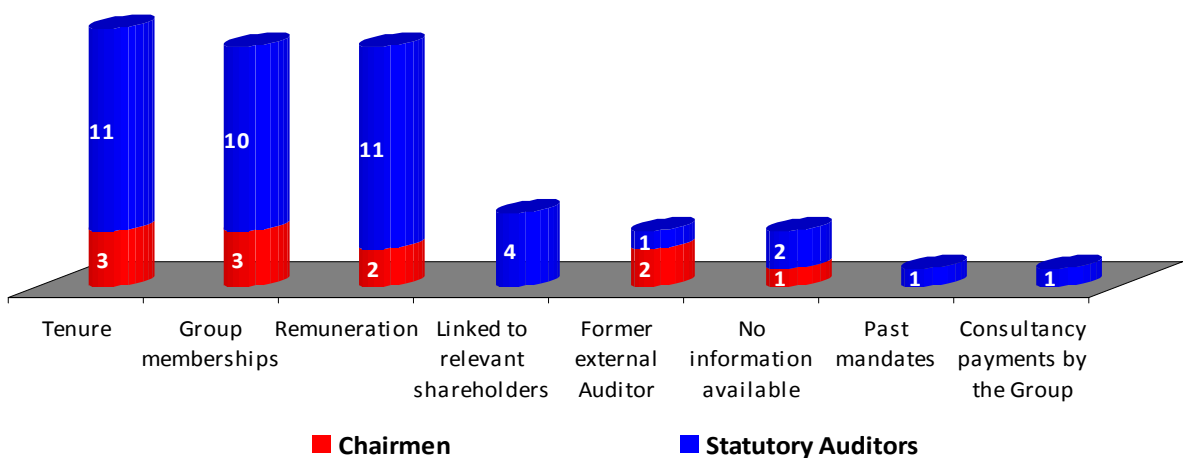
Main factors of risk are related to:

1. the tenure, exceeding 9 years within the Group (as per the Italian Corporate Governance Code, members in charge for more than 9 years should be considered as non-independent): 3 Chairmen and 11 Auditors;
2. an excessive total remuneration received by the Group in 2011 (last information available): 2 Chairmen and 11 Auditors;

- 3. excessive memberships held at subsidiaries or related companies: 3 Chairmen and 10 Auditors.

Some members arise more than one concern, so that the aggregate number of factors of risk is higher than the number of alleged non-independent Auditors. Among the most evident cases of multiple concerns: the Chairman of the Board of Statutory Auditors of Fiat Industrial, Mr Paolo Piccatti (who is in charge at the parent company Exor, previously known as IFIL, since 1995, and who received a total remuneration of € 230'700 in 2011 from the Group), and of the Statutory Auditor of Mediaset, Mr Francesco Vittadini (11 years of tenure at the company, 23 memberships at subsidiaries and related companies and € 181'117 total remuneration in 2011). Mr Vittadini has also been serving as Statutory Auditor at the connected listed company Mediolanum since 2002.

**Board of Statutory Auditors at FTSE MIB companies:
main factors of risk**



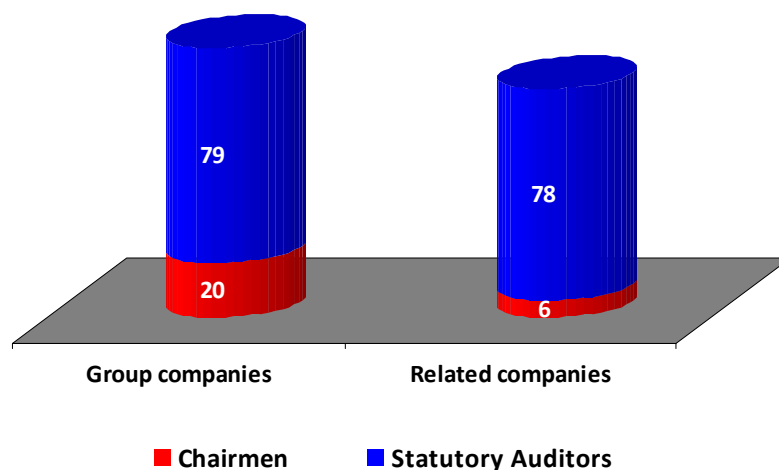
As shown more in-depth at the following sections, concerns arise over the strict independence of all Statutory Auditors at 4 companies: Atlantia, Banco Popolare, Buzzi Unicem e Tod's.

3.1 Memberships at related companies

Appointing the same person as Auditor at several related companies seems to be quite a standard procedure at Italian listed companies. Such practice may not automatically mean a lack of independence, nonetheless it is significant of the great confidence the major shareholders have in a specific Auditor.

On aggregate, 116 Auditors at major Italian listed companies hold 183 memberships at subsidiaries or related companies. Apart from the aforementioned Auditors of Mediaset and Exor, the most evident cases are: 17 and 14 memberships at related companies respectively held by Mr Francesco Martinelli and Mr Angelo Gaviani, both Statutory Auditors at Lottomatica, 9 memberships held by the Auditor of Generali Mr Giuseppe Alessio Verni, and 8 memberships in related companies held by the Chairman of Buzzi Unicem’s Board of Statutory Auditors, Mr Mario Pia. Another interesting case, although slightly different, is related to Mr Franco Fontana, Chairman of the Board of Statutory Auditors at Enel Green Power, that is part of Enel Group held at 31% by the State. Professor Fontana currently serves as Statutory Auditor at other 6 companies directly or indirectly controlled by the Italian Government. He also served as Chairman of Enel’s Board of Statutory Auditors from 2001 to 2010 (Prof. Fontana was nominated by the pension funds Enpam and Inarcassa, both independent shareholders).

Memberships at subsidiaries or related companies



Despite the aforementioned concerns, it needs to be highlighted that memberships at related companies are restricted to a relatively low number of members: at least 28 Chairmen out of 34 do not hold any membership at connected companies (no information is available on the memberships held by Salvatore Ferragamo's Auditors). At 5 other Boards, where detailed information is available, Chairmen hold on average 5.2 memberships at related companies: Azimut (5), Buzzi Unicem (6), Enel Green Power (6), Fiat Industrial (7) and Tod's (2).

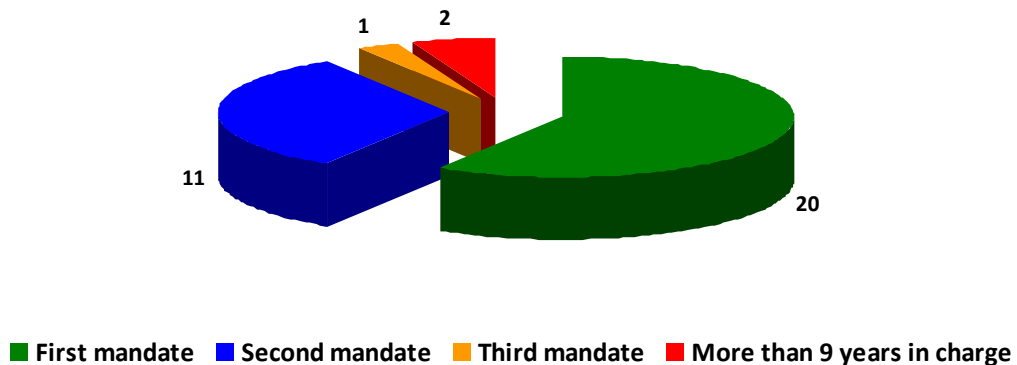
Statutory Auditors at 6 major companies do not hold any membership at other Group or related companies: Ansaldo, Campari, Diasorin, Impregilo, Luxottica and Mediobanca (but serious concerns arise over Ms Maurizia Angelo Comneno, who spent 30 years, almost her entire professional life, at the main shareholder UniCredit, before being appointed as Auditor of Mediobanca).

3.2 Tenure

As per the Italian Civil Code, the mandate of Statutory Auditors lasts 3 years. There are no legal limits to the number of times each Auditor may be re-elected. Nonetheless, the Corporate Governance Code provides that if an Auditor is in charge for more than 9 years, over the last 12, he should be considered as non-independent. Therefore, each Auditor should not be appointed for more than 3 consecutive mandates.

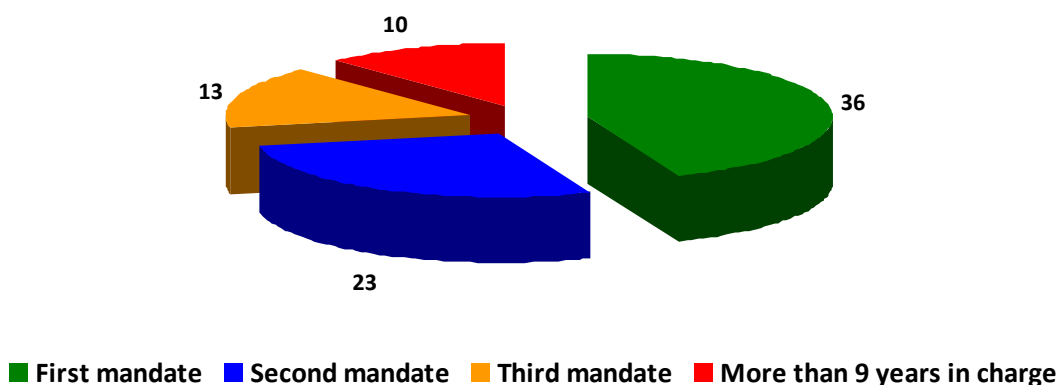
The average tenure of FTSE MIB Statutory Auditors' Chairmen is currently equal to 3.6 years: 20 Chairmen out of 34 are at their first mandate, 11 at their second one, only one at his third one, while the Chairmen of Buzzi Unicem (Mr Pia) and Tod's (Mr Enrico Colombo) have been in charge for 10 and at least 12 years respectively (no information is available before 2001 with regards to Tod's Statutory Auditors).

Chairmen of the Boards of Statutory Auditors' tenure



The average tenure of the analyzed Statutory Auditors is much higher and reaches 5.1 years. Also in this case, large part of Auditors are at maximum at their second mandate (72%), but the percentage of members exceeding 9 years of service strongly increases to 10 out of 82 Auditors, or 12%. Together with the aforementioned Auditors of Exor (and Chairman of the controlled Fiat Industrial), Mediaset and Mediolanum, the most evident cases are: Lottomatica, where both Statutory Auditors, already mentioned with regards to the memberships at Group companies, exceed 9 years of tenure (19 years Mr Martinelli and at least 11 years Mr Gaviani), and Tod's, where all members are in charge at least since 2001.

Statutory Auditors' tenure



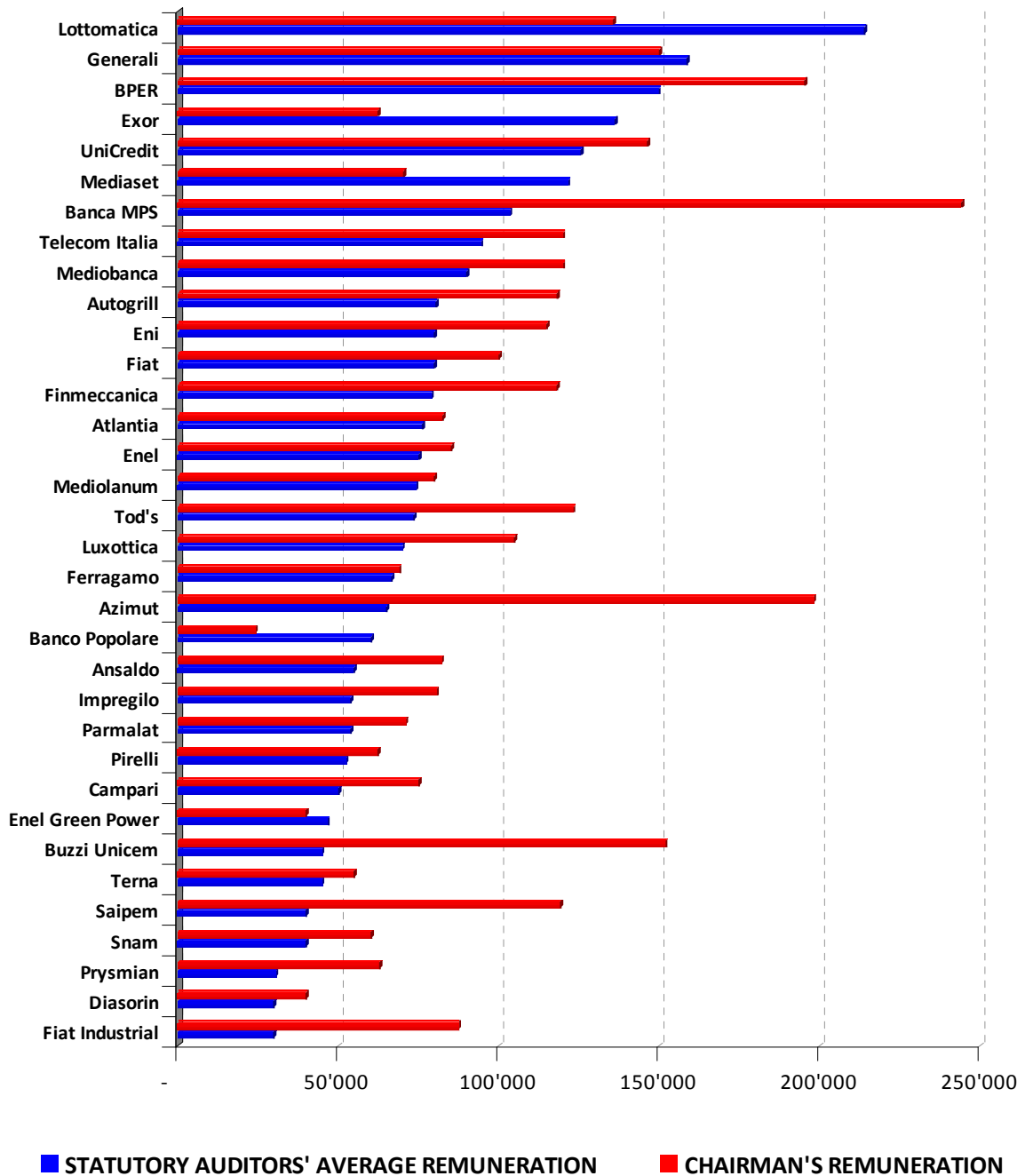
3.3 Statutory Auditor's remuneration

The total amount paid by the Group to the Statutory Auditors represents a clear, transparent and, as far as possible, objective parameter to evaluate their strict independence. Except for personal and professional characteristics, that are the main guarantees of the effectiveness of all supervisory duties, receiving substantial payments may represent the highest level of risk that may undermine the strict independence of the Auditor from the company or its major shareholders.

The definition of remuneration thresholds, needed to identify the level of risk, is not easy and in any case it can never be objective. A possible threshold may be defined as the deviation from the average remuneration paid by all FTSE MIB companies in 2011. On average, Statutory Auditors received € 80'750 and Chairmen € 101'450 in 2011. The average cost of the entire Board, that has to be made by 3 or 5 members, was equal to € 296'200 at companies adopting the traditional governance model.

The following graph clearly shows the companies where the remuneration of the Statutory Auditors exceeded the market averages. In order to better define a threshold, the following analysis takes into account only those remuneration exceeding the market averages of at least 50%: concerns may arise over the Statutory Auditors that received more than € 121'000 by the Group in 2011, and over the Chairmen that received more than € 152'000.

Statutory Auditors' remuneration: FTSE MIB 2011



As per the graph, concerns may arise over the remuneration of 3 Chairmen of the Board of Statutory Auditors at: Banca Monte dei Paschi di Siena, Azimut and Banca Popolare dell'Emilia Romagna. Nonetheless, both Chairmen at Banca MPS and BPER are no more in charge, and 2012

remunerations are not yet available, therefore there are no clear concerns over the remuneration at both banks. On the other hand, the graph cannot highlight the serious concerns over the Chairman of the Board of Fiat Industrial, as the total remuneration he received in 2011 (€ 230'700) is reported at Exor's financials, the parent company where Mr Piccatti serves as Statutory Auditor.

With regards to the Statutory Auditors, 6 companies' Boards are reported by the graph as exceeding market averages: Lottomatica, Generali, BPER, Exor, UniCredit and Mediaset. Nonetheless, average remunerations paid by the company cannot clearly represent the concerns over each Auditor. Analyzing the individual remunerations, as many as 11 Statutory Auditors exceeded the threshold of € 121'000. The most evident cases are: the already mentioned Mr Piccatti in Exor and Mr Vittandini in Mediaset, Lottomatica's Auditor Mr Martinelli (€ 275'655), Mr Vernì at Generali (€ 211'300) and Mr Giovanni Zanasi at BPER (€ 193'000), who is not in charge anymore at the bank.

Beyond remunerations due as member of corporate bodies, it is necessary to highlight the specific case of Atlantia's Auditor, Mr Tommaso Di Tanno, whose legal and tax firm received € 344'000 payments related to consultancy services provided to Atlantia's subsidiary Autostrade per l'Italia. Although such payments were not related to continuative relationships (and by this way complying with art. 2399 of Italian Civil Code, that defines the events of loss of mandate and ineligibility), serious concerns may arise over the maintenance of his strict independence. Furthermore, Mr Di Tanno was already mentioned by Frontis Governance's analysis when he served as Chairman of the Board of Statutory Auditor at Banca MPS: in 2010 his firm acted as advisor of the merger between Anima SGR and Prima SGR, that is part of Banca MPS Group.

A last note is needed with regards to Banco Popolare, that adopted the traditional governance model only on November 2011. The Verona-based bank paid on average € 20'000 to the newly appointed Auditors for just two months in charge. Concerns may arise over the eventual 12-months remuneration of all Auditors, also considering the additional remuneration paid by subsidiaries (€ 87'000 and € 67'000 respectively to the Auditors Mr Gabrielle Camillo Erba and Mr Alfonso Sonato).

3.4 Other factors of risk and transparency

As per the ECGS' and Frontis Governance's guidelines, other factors that raise serious concerns over the strict independence, although less clear than the ones reported at the above sections, are:

- Strong connections with governmental structures, political parties or organizations to which the company makes or from which the company receives material contributions: that is the case of the Statutory Auditor of the State-controlled company Finmeccanica, Mr Silvano Montaldo, who is former Vice President of the Province of Savona and former treasurer of the political party Forza Italia (reported as strongly connected to the former Minister Mr Claudio Scajola), all requisites that should be considered as not adequate, at least at State-owned companies.
- Material connections with the external auditor of the company, whose relationship terminated less than 5 years prior their appointment as Statutory Auditors: these are the cases of the Chairman of the Board of Statutory Auditors of Atlantia, nominated by a pool of fund managers coordinated by Assogestioni and former auditor at KPMG (external auditor of the company since 2006), the Chairman of Campari's Board, nominated by the independent shareholder Cedar Rock Capital and former Chairman of Ernst & Young Italia (Campari's external auditor from 1998 to 2009), and a Statutory Auditor of Salvatore Ferragamo former Partner of Erns & Young (external auditor of the company until 2010).

Also the level of transparency regarding the Statutory Auditors' biography is not always adequate: 12 analyzed companies, or 35%, do not publish any information regarding the Auditors on their websites, while large part of the other ones just publish partial information and do not disclose the updated list of all memberships held by the Auditors. It was not possible to find any detailed information with regards to all memberships held by Salvatore Ferragamo's and Buzzi Unicem's Statutory Auditors, even from alternative sources, as well as about the first appointment of Tod's Auditors (the first information available dates 2001).

4. The Supervisory Board

The differences between the Board of Statutory Auditors and the Supervisory Board are that the latter is also entitled to powers traditionally assigned to the shareholders meeting or to the Board of Directors: the appointment of Management Board's members, the promotion of the liability action and the approval of strategic operations, as well as industrial and financial plans, drawn up by the Management Board (if provided by the By-laws). As it realizes a perfect balance between supervisory and strategic powers, not all members have to meet strict professional and independence requisites: at least one of them must be registered in the Register of Certified Auditors and the Chairman shall be elected by the general meeting.

Only 4 major Italian companies adopt the dualistic model: A2A, Intesa Sanpaolo, UBI Banca and Banca Popolare di Milano, that passed from the traditional model to the dualistic one only on October 2011 (unlike Banco Popolare, another cooperative bank, that passed to the traditional model in the same period).

The analysis must take into account the different role of Supervisory Board members, the majority of which should be strictly independent. Therefore, concerns may arise only when the company's assessment differs from Frontis Governance's independence definition. Although the analysis is limited to the differences, the factors of risk do not decrease: concerns arise over 31 out of 65 Board members deemed as independent by the companies (or 48%).

UBI Banca represents the most evident discrepancies with regards to the independence definition. As per the bank, all 22 Board members are defined as independent, but looking at their curricula it is easy to notice that 15 of them have been members, and in some cases executives, of several banks that were incorporated in UBI Banca in 2007, therefore collecting even dozens of years within the same Group. Among the "elder" members: the provisional Chairman Mr Giuseppe Calvi, Board member at the subsidiary Banca Popolare di Bergamo since 1985; Mr Sergio Orlandi, Director and member of the Executive Committee at Credito Varesino since 1970 (then at Banca Popolare di Bergamo, Banche Popolari Unite and finally at UBI Banca in 2007); Mr Italo Lucchini, that served as Statutory Auditor (since 1984) and Board member (since 2001) at Banca Popolare di Bergamo; Mr Mario Cattaneo, in charge at Banca Lombarda from 1985 to 2007 (when the bank was incorporated in UBI Banca).

Other concerns arise over Ms Silvia Fidanza, appointed in 2010 but linked to Mr Virginio Fidanza, in charge at the Group for 15 years until 2010, and over the low attendance rates of Mr Pietro Gussalli (67% of Board meetings) and of Mr Giuseppe Zannoni (only 9% of meetings attended). Summarizing, concerns arise over 82% of UBI Banca's Board members.

Substantial differences also emerged with regards to Banca Popolare di Milano, that adopted the dual system only on October 2011, even solicited by Banca d'Italia: the dual system was needed to strongly separate the supervisory from the executive activities, reducing by this way the inadequate influence of internal structures on corporate bodies. Despite the suitable change in the governance system, concerns still arise over the strict independence of the Supervisory Board. According to the Bank's assessments, 12 Board members out of 19 (63%) are defined as independent. Such number strongly differs from Frontis Governance's definition of only 7 independent members, or 37%. Concerns arise over the strict independence of: Mr Giovanni Bianchini, executive at Group companies from 1986 to 2000, Mr Giuseppe Coppini, Vice Chairman at the subsidiary Banca di Legnano and previously at BPM Gestioni, Mr Michele Zefferino, executive at the Bank since 2002, and the newly appointed Mr Ruggiero Cafari Panico, who has strong political connections (former Chairman of the legislative committee at Regione Lombardia), and Mr Alberto Balestreri, in Banca Popolare di Milano since 1988 (previously at the Marketing and Organization Department, then at the Research Office and finally Statutory Auditor at several subsidiaries).

Minor factors of risk emerged over the other two companies adopting the dual system, A2A and Intesa Sanpaolo. Concerns arise over 6 out of 17 Board members defined as independent by Intesa Sanpaolo. According to Frontis Governance's definition, the independence rate at the bank decreases to 58% from 89%. Similarly to what emerged at other banks, the main factor of risk comes from the excessive tenure at Group companies. An explicative example is represented by Mr Gianluca Ponzellini, who has been Statutory Auditor at Banca Intesa from 1998 to 2006, when the bank merged with San Paolo IMI to create Intesa Sanpaolo, collecting at least 15 years within the same Group.

Even minor concerns emerged with regards to the Milan-based utility A2A: differences regarded only 2 out of 14 Board members defined as independent by the company. As per

Frontis Governance's definition, the independence rate at A2A is still very high, equal to 80% of Supervisory Board members. Both factors of risk at A2A are related to strong connections with local governmental structures and their controlled companies.

Conclusions

Recent financial scandals sparked heated debates about the lack of controls on listed companies, in particular on the financial ones. Nevertheless, large part of the debate focused on the external controlling system, that by its nature can often act only *a posteriori*, while the most effective level of control, at any human organization, have to be performed by internal structures.

Shareholders and employees are the most affected by unfair management activities and their attention needs to be always at the maximum level. At listed companies, the high distance between ownership and management emphasizes the risks caused by a lack of control. In such realities, the most effective tool available to shareholders to protect their interests is represented by the corporate bodies: by responsibly exercising their voting rights and by defining the most suitable system of internal structures, aimed at creating sustainable value in the long-term and at effectively controlling the "principles of fair administration" (as defined by the Italian Civil Code).

As per the Frontis Governance's guidelines (based on ECGS' corporate governance principles), companies should not limit themselves to just comply with legislative duties. An effective corporate governance is attained by understanding and improving all voluntary actions and procedures needed to pursue the best interest of the company and its shareholders, also considering the specificities of the sector, corporate dimensions and specific moment.

None of the analyzed companies breaks the law, and in any case the purpose of the analysis is not to discover illegal procedures. What is relevant here, is that the mere compliance with standard rules may undermine the fiduciary relationship between shareholders and company's bodies. Strong connections with relevant shareholders, long-standing professional relationships with the Group or its advisers, excessive payments or significant links with entities

in conflicting interests, are all factors of risk that should always be avoided, whether allowed by the law or not.

Frontis Governance was born on September 2011 as the first proxy advisor completely focused on the Italian market. The mission of Frontis Governance is to provide a professional and independent support to all minority shareholders in exercising their shareholder rights and in analyzing the corporate governance in investee companies.

Since its birth, Frontis Governance joined ECGS (Expert Corporate Governance Service), the only international partnership of local governance experts, in order to provide the most accurate and specialized local market expertise also on foreign markets. The other members of the ECGS' network are: Proxinvest – Managing Partner (France), DSW (Germany), Ethos (Switzerland), Shareholder Support (Netherlands) and Group Investissement Responsable (GIR – Canada).

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