

BENEDETTO BRANCOLI BUSDRAGHI\*

CATS AND DOGS  
IN ITALIAN BANKS: WHO CONTROLS  
THE BOARD OF DIRECTORS?

**ABSTRACT:** *Although corporate governance is paramount for the sound and prudent management of credit institutions, the organization of corporate bodies is not extensively regulated. The distribution of powers and duties between the corporate bodies, including the organization of the controls over the management body, are only partially harmonized and they broadly depend on national company law. European banks rely on three different models, which entail a different placement of the controlling body: above, within or next to the Board of Directors.*

*Italian banks have specific features: (i) the transposition of the CRD4 explicitly requires banks to set up a control body; (ii) the latter has a unique duty of cooperation with the Supervisory authorities, insofar as it is obliged to report any relevant breach it may come to know in the performance of its duties; (iii) the most widespread Italian corporate model places the control body next to the Board of Directors, in a way that is quite peculiar across EU legal orders. It is contended that such a model is still a viable solution; however, the effectiveness of the control body could take advantage of a fine-tuning of its composition.*

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## ***1. Foreword***

The 2007-2008 financial crisis was also rooted in the governance arrangements of credit institutions. In order to ensure the sound and prudent management, banks need a robust governance framework, composed of both appropriate decision-making lines and effective controls systems at all levels, starting from the top, i.e., from the corporate governing bodies.

What is then the most appropriate model to steer a bank and to control its management and its highest corporate body? Shall control bodies be placed above, aside or within the Board of Directors?

European regulation has set detailed requirements on corporate micro-organization. However, only a few provisions regard the organization and the distribution of powers and duties among the corporate bodies. Such issue mainly depends on national company law, a field that has been subject to a low level of harmonization in EU regulation.

The present paper outlines the costs and benefits of the main governance models adopted by Euro-area banks, with specific regard to in Italian banks. The latter may legitimately choose between three different administration models and some specific features of their legal order may deserve a focus: (i) the transposition of the CRD4 explicitly requires banks to set up a control body; (ii) the control body has a unique duty of cooperation with the Supervisory authorities; (iii) despite the possibility to align their corporate governance to the most widespread European schemes, most Italian banks place the control body aside the management body, in quite a peculiar way.

The paper is divided into six parts. Part two recalls the regulatory requirements for corporate bodies’ organization, along with their rationale; the third, the fourth and the fifth parts define the hallmarks and the costs and benefits of the three most widespread corporate models in banks; the last part explains why (and to what extent) the establishment of an independent control body can be an appropriate solution.

## ***2. The governance in EU regulation***

The governance of European banks is subject to both hard law and soft law pro-

visions, such as Directive 2013/36/EU<sup>1</sup> (the so-called capital requirements directive, “CRD4”) and the guidelines of the European Banking authority<sup>2</sup> (“EBA guidelines”), respectively. The resulting framework is rather detailed with regard to the so-called “lower governance”, i.e. organization of control functions, risk management, remunerations, outsourcing, etc. However, little is provided about the corporate bodies and their relationships with the shareholders. The regulation focuses instead on the exercise of certain functions: some provisions concern the “management body” and the “management body in its supervisory function”, but the regulation does not impose any specific position in the corporate chart. In a nutshell, grasping the target matters more than who does the job.

More in detail, banks shall have a “management body”, identified as the corporate body bearing the overall responsibility for the institution. As such, it shall approve and oversee the implementation of the strategic objectives, as well as its business and risk strategy; Article 88 CRD4 confers on the same body the implementation and the supervision over governance arrangements. The management body shall also ensure the integrity of the reporting systems, as well as the adequacy of internal capital and liquidity, while overseeing and challenging the senior management on the daily business. The tasks mentioned above provide colors on the real nature of the management body: despite its name, it does not simply have managerial functions, but also (mainly?) supervisory and control duties. Consistently, the management bodies of significant credit institutions shall establish an audit committee pursuant to Directive 2006/43/CC and a (non-executive) risk committee. The latter shall advise the management body on the overall risk appetite and strategy and assist it in overseeing the implementation of that strategy by the senior management (Art. 76 of CRD4).

Another batch of provisions is devoted to the management body when acting “*in its supervisory function*” (emphasis added). Such a body shall have full access to the

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1 Dir. 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

2 Final Report Guidelines on internal governance under Directive 2013/36/EU, EBA/GL/2017/11, 26 September 2017.

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risk situation of the bank and it is even a point of reference for the control functions.<sup>3</sup> Clearly, as confirmed by the General Court of the European Union, the management body in its supervisory function has a strong focus on controls and its tasks would be incompatible with the performance of executive duties.<sup>4</sup> Hence, CRD4 seeks to impede conflicts with business functions, e.g., preventing the chairman from exercising simultaneously the functions of chief executive officer, unless justified and authorized by the Supervisory authorities (Art. 88 CRD4). The varied set of duties of management body, ranging from active management to controls, ends up in a double hat: decision maker and supervisor.<sup>5</sup> However, it is unclear who or what the management body is, as CRD4 explicitly refrains from taking a position.<sup>6</sup>

In this respect, national law may well assign managerial and supervisory functions to different bodies or different members within the same body (Art. 3, paragraph 2, CRD4), as long as the management and the supervisory function interact effectively. Such a feature of CRD4 is consistent with the low level of harmonization of Eu company law. As Member states are free to tailor their response to the local economy needs, banking regulation has been drafted in a way to match several different models. This, in turn, requires a “reconciliation” at national level. With reference to Italy, it is worth mentioning that the transposition of CRD4 has gone beyond the wording of the Directive: Banca d’Italia’s Circular no. 285 of 17 December 2013 requires banks to set bodies entrusted with “strategic oversight”, “management” and “control”, consistently with the provision of the Italian civil code.<sup>7</sup> Against this framework, the control body has to verify the proper administration of the bank and its compliance with the applicable regulation, along with the adequacy of its governance and accounting arran-

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3 Accordingly, the removal of the risk manager (“CRO”) shall be approved by the management body in its supervisory function (Art. 76 CRD4), as if the CRO reported to it.

4 ECJ, *Caisses regionales de crédit mutuel v. European Central Bank*, Joined Cases T-133/16 to T-136/16, 24 April 2018, § 79.

5 Recital no. 56 of CRD4 confirms that the management body shall be understood as having both executive and supervisory functions.

6 Art. 3, para. 1, num. 7 simply identifies the “*management body*” as a “*body or bodies (emphasis added), which are appointed in accordance with national Law, which are empowered to set the institution’s strategy, objectives and overall direction, and which oversee and monitor management decision-making, and include the persons who effectively direct the business of the institution*”; in turn, the “*management body in its supervisory function*” is defined as the management body “*acting in its role of overseeing and monitoring management decision-making*”.

7 Such a framework has been inherited from the former Circular no. 263 of 27 December 2006.

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gements, including the internal controls system.

As mentioned above, banking regulation needs to be reconciled with national company law. Major points of attention regard the relationships between the management body and the management body in its supervisory function, as well as the hierarchical position of the control body, which is not considered as such by banking regulation: shall it be above, aside or within the Board of Directors?

### ***3. The separation of powers: the side-by-side control (so-called “classic model”)***

#### ***3.1. The main features of the “classic model”***

First of all, some Member states allow the appointment of a control body next to the management body, at the same hierarchical level. Such a model envisages the set-up of two separate corporate bodies, both appointed by the shareholders: a Board of Directors and a Board of Statutory Auditors. The former is entrusted with the management of the company, while the latter is fully devoted to controls.

Such a set-up is rather precautionary for the shareholders, who retain strategic and very high level tasks and they may also rely on the assistance of an independent controlling body. Interestingly, it is only adopted in a few legal orders, e.g., Italy<sup>8</sup> and Portugal.<sup>9</sup>

In Italian banks, shareholders appoint Directors, Statutory Auditors and external accounting auditors; they also perform additional high level strategic tasks, i.e. they approve financial accounts, profit allocation and remuneration policies and they decide on whether to bring an action against the Directors (Art. 2364 of the Italian *Codice civile*, the Civil Code).<sup>10</sup> The general management of the company is conferred on the Board of Directors. Its tasks include whatever necessary to pursue the corporate goal, including the overall assessment of the management and of the corporate organization

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8 Specific provisions are set for listed companies and for credit institutions, but they simply fine-tune the Italian civil code, whose provisions are in any case the bulk (P. FERRO-LUZZI – G. CASTALDI, *La nuova Legge Bancaria*, vol. II, Milano, 1996, pp. 800 ff.). On the governance of banks, also refer to R. COSTI, *L'ordinamento bancario*, Bologna, 2012; C. BRESCIA MORRA, *Il diritto delle banche*, Bologna, 2016; F. CAPRIGLIONE, *Manuale di diritto bancario e finanziario*, Milano, 2015.

9 For the Portuguese legal order, reference can be made to M.A. RAMOS, *Direito comercial e das sociedades – Entre as Empresas e o Mercado*, Coimbra, 2018; A. MENEZES CORDEIRO, *Direito das Sociedades*, Coimbra, 2017.

10 On the Italian governance models, see G. F. CAMPOBASSO, *Diritto commerciale, vol. 2, Diritto delle società*, Milano, 2015; G. FERRI, *Manuale di Diritto Commerciale*, Milano, 2016.

(Arts. 2380-bis and 2381 of the *Codice civile*). In banks, the Board of Directors shall also establish a risk committee. It is therefore clear that Directors' duties encompass control tasks, also in a view to safeguard shareholders from misconduct by the managers.<sup>11</sup> Aside, the Board of Statutory Auditors (*Collegio sindacale*) performs a full scope control on corporate activities. It shall monitor the compliance with the applicable regulation and with the company's bylaws, the proper administration of the bank, with particular regard to the adequacy of internal governance and of the accounting system as well as to their functioning (Art. 2403 of the *Codice civile*). Due to the performance of control duties, the Statutory Auditors are required to be independent and to liaise with the internal control functions. Nonetheless, the Statutory Auditors are also entrusted with some advisory tasks (e.g., report on the financial accounts pursuant to Art. 2429) and they are even required to replace the Directors in some cases, i.e., lapsing of all of them or failure to act (e.g., Art. 2386 of the *Codice civile*). However, such tasks are so peculiar that they do not affect the controlling nature of the Board of Statutory Auditors. The Portuguese *Conselho fiscal* has features and duties similar to the Italian *Collegio sindacale*. It is set up in addition to the Management Board. In principle, the shareholders' meeting shall appoint both the Statutory Auditors and the Directors (Arts. 415, 423 and 435 of the *Código das Sociedades Comerciais*).

Pursuant to Art. 420 of the *Código das Sociedades Comerciais*, the Board of Statutory Auditors shall supervise the management of the company, monitor the compliance with the law and with the articles of association, verify the accounting policies and documents, give an opinion on the report and proposals submitted by the management and oversee the internal control system. It is acknowledged that the Statutory Auditors act primarily in the interest of the company and of its shareholders and not in the interest of third parties. In this perspective, the Portuguese *Conselho fiscal* receives notifications of irregularities (Art. 420 of the *Código das Sociedades Comerciais*). Similarly, also the Italian *Collegio sindacale* shall be keen to hear the complaints of the

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11 F. PARMEGGIANI, *Il collegio sindacale e il comitato per il controllo interno: una convivenza possibile?*, in *Giurisprudenza commerciale*, 1, 2009, pp. 306-308. Such understanding of internal control was developed by A. BEARLE – G. MEANS, *The modern corporation and private property*, New York, 1932, and also by J. TIROLE, *The Theory of Corporate Finance*, Princeton-Oxford, 2006, p. 29. The Board of Directors can therefore be perceived as an intermediate principal and intermediate agent between the shareholders and the managers (R. B. ADAMS, *The Dual Role of Corporate Boards as Advisors and Monitors of Management: Theory and Evidence*, ECGI, 2000).

shareholders willing to report regrettable facts (Art. 2393 of the *Codice civile*) and it may even sue for damages the Board of Directors or address the Court (Art. 2409 of the *Codice civile*).

Nevertheless, banks are peculiar undertakings, insofar as they involve a broad variety of stakeholders that may deserve some safeguards: depositors, bondholders and financial counterparties. In this view, the banks' Statutory Auditors may be required to act in the interest of all the stakeholders. Consistently, due to the specificities of the banking business, the Italian rule-makers have imposed a peculiar duty on the control body, that has become an ally of the Supervisory Authorities: the Statutory Auditors shall inform without delay the relevant Supervisors of any act or fact they come to know of in the performance of their duties that may constitute a breach of law (Art. 52 of the Italian legislative decree no. 385/1993 – hereinafter “Consolidated Law on Banking”). As mentioned above, the practice to set-up an independent control body alongside to the Board of Directors is not widespread in the Euro-area and it may trigger misunderstandings. However, a deeper analysis outlines that the model at stake may perfectly fit into the banking regulation. Indeed, the management body entrusted with strategic supervision can be identified in the Board of Directors.

The latter can also act as management body, whenever it retains executive powers; otherwise, the management body could be identified in the executive committee or simply in the CEO, or, in lack of it, even in the General Manager, i.e., a non-Director.

In Portugal, as the Board of Statutory Auditors is set up in addition to the Supervisory Board and to the Management Board, it does not raise concerns. In Italy, the *Collegio sindacale* acts as control body for the purposes of banking regulation. The risk committee shall be established within the Board of Directors, while the Board of Statutory Auditors shall perform as audit committee.

### ***3.2. The costs and benefits of the “classic model”***

The “side by side” control model described above entails costs and benefits. First of all, it has the non-negligible advantage of involving shareholders in the corporate life through the assignment of material powers, such as the approval of financial accounts and the appointment of corporate Boards, strengthening their grip over the

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company and its Directors.<sup>12</sup> Besides, the Statutory Auditors provides an additional layer of controls; it has even been contended that they would act as principal of the Directors, thereby reinforcing the control over them.<sup>13</sup> However, from a different standpoint, the “side by side” control performed by the Statutory Auditors may appear redundant, due to the overlapping of several controlling bodies. In fact, on the one hand, the management of the company is assigned to the Directors, while controls would primarily be conferred on the Statutory Auditors; the latter were deemed to focus on corporate organization, mainly *ex post* and without interfering with the business, in a view to balance conflicting interests in the execution of the corporate contractual agreement. Nonetheless, the nature of control functions has progressively changed, through a stronger focus on business and risk management, with the goal to detect the earliest signs of a crisis<sup>14</sup> and eventually to perform as advisors. The formal “thick-the-box” approach have thus been relegated to the backstage.<sup>15</sup> Moreover, the daily business has more and more required a very high time commitment, thereby encouraging the delegation of active management from Directors to full-time managers. Hence, the Board of Directors has somehow changed its face, switching its main duties from management to control:<sup>16</sup> the Directors have thus started to perform themselves the control duties that were formerly assigned to the Statutory Auditors. The latter could even be considered unsuitable to act as advisors, because their controlling role would draw red line between the Board of Statutory Auditors and the top management.

It has been contended that the controls of the corporate bodies somehow differ with regard to their object and to their goal, as the Statutory Auditors would not control with the purpose of taking managerial decisions, but instead in order to report

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12 In companies listed in Italy, a specific protection is granted to minority shareholders, as the Chairman of the Board of Statutory Auditors is selected from the minority list (Art. 148, para. 2-*bis*, of the Italian legislative decree no. 58/1998).

13 F. PARMEGGIANI, *Il collegio sindacale e il comitato per il controllo interno: una convivenza possibile?*, in *Giurisprudenza Commerciale*, 1, 2009, pp. 306 at 324-325.

14 P. MONTALENTI, *Amministrazione e controllo nelle società per azioni: riflessioni sistematiche e proposte di riforma*, in *Rivista di diritto societario*, 1, 2013, pp. 42-71

15 P. FERRO-LUZZI, *Per una razionalizzazione del concetto di controllo*, in M. BIANCHINI – C. DI NOIA, *I controlli societari. Molte regole, nessun Sistema*, Milano, 2011, pp. 130-131

16 M. A. EISENBERG, *The structure of the corporation: a legal analysis*, Boston-Toronto, 1976, p. 16; M. A. EISENBERG, *The Board of Directors and Internal Control*, in *Cardozo Law Review*, 19, 1997, pp. 237-247; W. O. DOUGLAS, *Directors who do not direct*, in *Harvard Law Review*, 47, 1934, p. 1314.

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to the Directors and, more important, to the shareholders.<sup>17</sup> However, in large banks' practice, the boundaries between the fully-fledged controls performed by the Statutory Auditors and those carried out by the Directors have become rather thin: the duties of the former have been squeezed between the strategic supervision of the Directors and the assessment of its risk committee; downstream, ongoing controls are executed by the Risk management function, by the Compliance function and by the Internal audit, that clearly outweigh the Statutory Auditors in terms of FTEs and knowledge of the ongoing business. To a certain extent, the duties of the Board of Statutory Auditors also overlap with the role of the financial accounts auditors, e.g., with regard to the accounting system controls. As per the methodology, all corporate bodies rely on similar information packages – without prejudice to the power of the Statutory Auditors to carry out inspections (Art. 2403-bis of the *Codice civile* and Art. 420 of the *Código das Sociedades Comerciais*). The exact role of the Board of Statutory Auditors may thus be misunderstood and an unclear governance could discourage international investors. Moreover, in Italy the benefits of the additional layer of controls provided by the Statutory Auditors are poorly demonstrated. The proof of pudding is in the eating: it can be observed that a failure of the Board of directors is usually accompanied by a failure by the Board of Statutory Auditors. As a matter of fact, in years 2016 and 2017, the Bank of Italy has imposed sanctions on members of the Board of Directors in 25 cases. All such cases have regarded banks governed through the “side by side” control model. In 23 cases (i.e., more than 90%), the fines have also been imposed on the members of the Board of Statutory Auditors, for failure to control.<sup>18</sup> Only in a very few cases the Statutory Auditors have avoided liability, maybe due to a proactive approach or for lack of negligence.<sup>19</sup>

The target of Statutory Auditors' controls is also a question mark. It is contended that deficiencies in risk management are assumed as a primary source of instability

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17 G. PRESTI, *Di cosa parliamo quando parliamo di controllo?*, in M. BIANCHINI – C. DI NOIA, *I controlli societari. Molte regole, nessun sistema*, Milano, 2011, p. 146.

18 Survey based on the decisions publicly available on the website of *Banca d'Italia*.

19 Liability could be avoided, e.g., by properly reporting breaches to the Board of Directors and to the Supervisory authority pursuant to Art. 52 of the Consolidated Law on banking.

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for banks, but the applicable regulation does not require a focus on this issue, nor are Statutory Auditors required to have specific experience in risk management. In light of the above, can it be contended that the side-by-side control model is ultimately out of fashion?

#### **4. A control body above the management body (the “two-tier model”)**

##### **4.1. The main features of the two-tier model**

The second model of corporate organization consists in the establishment of a control body above the management body (so-called two-tier model).

Such a scheme is generally widespread in northern EU legal orders, such as France<sup>20</sup> and Germany.<sup>21</sup> Under the two-tier model, the company is run by a Management Board, normally more streamlined than the Board of Directors in the “side by side” model described above; it is typically composed by managers and carries out the daily business subject to a close oversight from the Supervisory Board.

Clearly, such system may somehow entail the weakening of equity investors. Indeed, the shareholders are usually only required to appoint Supervisory Board members, to decide on their remuneration and to approve the amendments to the articles of association. Compared with the “classic model”, the two-tier model deprives the shareholders’ assembly of the power/duty to approve the accounts and to appoint and remove the management body. In turn, such powers are assigned to the Supervisory Board. Hence, the latter board performs hybrid duties: on the one hand, it shall carry out strategic supervision; on the other hand, the Supervisory Board retains managerial powers, that, although high-level, are nonetheless material.

Finally, the Management Board – appointed by the Supervisory Board – concretely manages the company.

Interestingly, for a very long time, the Italian *Codice civile* has solely envisaged the classic model and it has welcomed the one-tier and the two-tier model only as late

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20 Reference can be made to F. DUQUESNE, *Droit des sociétés commerciales*, Paris, 2018

21 See e.g., K. SCHMIDT, *Gesellschaftsrecht: Unternehmensrecht*, Colon, 2018.

as 2003.<sup>22</sup> In fact, legal constructions follow social needs and such governance models were not desired until shareholding paths were rather concentrated and the shareholders could have a direct grip on their companies. However, the opening of and the interconnections between financial markets have paved the way to a kind of regulatory competition, where legal orders sought to break the chains and facilitate the business, so as to increase the profitability outlook of the undertakings and, in turn, to maximize their value. This has led to a growing *laissez-faire* with regard to corporate organization, in a view to facilitate the smooth functioning of the markets and the reliance on the “invisible hand”. In this view, the rule-makers have allowed alternative schemes, so as to enable a more effective governance in a globalized economy.<sup>23</sup> However, the implementation of the two-tier model in Italian banks has specific features, that tip the scale of the Supervisory Board on controlling tasks instead of managerial duties. In light of such a double hatting, the Italian *Codice civile* seeks to prevent managerial powers from polluting supervisory activities. In this regard, the assignment to the Supervisory Board of certain managerial powers, e.g., the power to decide on certain transactions, is a mere possibility and there is no duty for it: the Supervisory Board may approve key transactions and strategic plans only upon statement of the corporate articles of association (Art. 2409-*terdecies*, paragraph 1, lit. f-*bis*). In any case, the managerial powers conferred shall be clearly defined and limited to truly strategic transactions and the Supervisory Board members are deprived of any executive function. Italian company law thus limits the possibility to transfer managerial powers from the Management Board to the Supervisory Board. In a different perspective, in the French *société anonyme*, the Supervisory Board (*Conseil de surveillance*) shall appoint a management board (*Directoire*) and perform controls; meanwhile, art. L225-68 of the *Code de commerce* explicitly entrusts it with some management powers, such as the award of guaranties (except banks) (without prejudice to the types of transactions assigned by the articles of

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22 On the one-tier and on the two-tier model in Italy, reference can be made to F. BONELLI, *Gli amministratori di s.p.a. dopo la riforma delle società*, Milano, 2004.

23 For a more comprehensive overview on the rationale and on the goals of the reform, refer to C. ANGELICI, *La riforma delle società di capitali. Lezioni di diritto commerciale*, Padova, 2003; M. VIETTI, *Nuove società per un nuovo mercato. La riforma delle società commerciali*, Roma-Salerno, 2003.

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association). Moreover, in Italy it is not permissible to refer matters to the general meeting – unlike Germany, where certain matters can be reserved to the Supervisory Board (*Aufsichtsrat*), without prejudice to the power of the Management Board (*Vorstand*) to further escalate to the shareholders' meeting (Art. 111, para. 4, AktG).<sup>24</sup> Besides, Italian law does not envisage the participation of labor representatives in the Supervisory Board (rather the contrary, the start of a working relationship between a Supervisory Board member and the company would trigger the lapsing of the Director concerned). Such a framework results in a full liability of the Management Board and in an increased focus of the Supervisory Board on control duties. In this regard, it is worth mentioning that the Supervisory Board, like the *Collegio sindacale* in the classic model, shall cooperate with the Supervisory Authorities, reporting breaches pursuant to article 52 of the Consolidated law on banking. These tasks require the Supervisory Board to encompass an internal controls committee.

Such a duty is unique in the Euro-area, but the idea of a link between the Supervisory Board and the Supervisory Authorities is not unusual in the Euro-area. In this regard, it is worth recalling, for example, that the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – “BaFin”) enjoys a right to participate in shareholders' meetings, as well as in the meetings of the supervisory board (Section 44 of the *Gesetz über das Kreditwesen* – i.e., the German Banking Act). Hence, BaFin could eventually mandate representatives to attend those meetings so as to address issues directly during the summits.

The two-tier model perfectly fits into the banking regulation framework: the Management Board acts as management body and strategic supervision is assigned to the Supervisory Board. The same board also acts as control function.

#### ***4.2. The costs and benefits of the two-tier model***

As hinted above, the two-tier model has been designed to match the needs of large corporations, eventually active on international markets. In this view, credit

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<sup>24</sup> V. CALANDRA BUONAURO, *I modelli di amministrazione e controllo nella riforma del diritto societario*, in *Giurisprudenza Commerciale*, 1, 2003, pp. 535 at 543-544.

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institutions with a very granular shareholders' path could take advantage from such a system, as the Supervisory Board could challenge the management and contribute to strategic decisions much better than a fistful of small stockholders.

The two-tier model even takes a firm step towards a new perception of corporate control bodies: not only *ex post* and formalistic controllers, but instead partners and advisors, that also retain strategic powers. Such activity could take advantage from a closer position between the controlling body and its main target. Moreover, the Supervisory Board would be quite influential on the Management Board, since it is entrusted with the power to remove its members and acts as its principal. In some cases, the two-tier model could facilitate a "non-core" participation of several stakeholders in corporate activities, through the means of a seat in the Supervisory Board; indeed, this would attribute a formal role in corporate life. In the same vein, the two-tier system could also facilitate the involvement of labor representatives, as well as the transfer of property in family business. In fact, some heirs could seat in Supervisory Boards and perform controls, while others could be entrusted with the management. Such a solution could also facilitate the follow-up of mergers between large banks, by assigning to the minority shareholders positions within the Supervisory Board, entailing non-negligible powers. It is worth mentioning that the two-tier model may also increase the liability towards the Supervisory authorities. In fact, supervisory concerns are mainly addressed to corporate bodies and they may be to addressed the shareholders only in very limited cases. In this perspective, unlike the shareholders in the classic model, the Supervisory Board would also be liable for the quality of the Management Board.<sup>25</sup>

Nevertheless, as a dark side of the moon, the two-tier model has the effect of extending the decision-making line, slowing down the process.

Finally, it is worth mentioning that the two-tier model may weaken the shareholders: not only are they dispossessed of certain powers (i.e., the approval of the accounts and the appointment of the Management Board), but the intermediation of the Supervisory Board could even shield the management body from their direct

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<sup>25</sup> The appointment of the Board of Directors lies with the shareholders, that, however, fall outside the scope of banking supervision. The link is nevertheless somehow reinforced whenever the Board itself is tasked with the proposal of a list of candidate Directors for the renewal of the Board.

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control. This may typically be the case of cooperative banks, where every shareholder is entitled to a single vote, regardless to the amount of its stake. As a consequence, the shareholders' assembly of cooperative banks can be steered by associations of shareholders capable to convey several votes (e.g., trade unions). In such a context, the presence of a Supervisory Board hinders interferences. However, this is not *per se* detrimental, as long as it could eventually even benefit the governance of the company.

## **5. A control body within the management body (the “one-tier model”)**

### **5.1. The main features of the one-tier model**

The shortcomings of the two-tier model may be partially addressed through the one-tier system. Such a model envisages a shareholders' assembly, a Management Board and a Control Committee. The tasks of the shareholders normally include the approval of financial accounts and the amendments to the articles of association, as well as the appointment of the members of the Management Board. Under the one-tier model, corporate controls are assigned to a management control committee. The latter is not separate from the Board, but it is part of it; still, such a committee has to be independent.

In this respect, in France, Art. L225-17 of the *Code de commerce* allows to assign the management to a Board of Directors (*Conseil d'administration*) appointed by the shareholders' meeting; the law does not envisage the appointment of Statutory Auditors, but controls are simply assigned to the internal controls committee.

In Italian banks, the duties of the shareholders are aligned with the tasks retained under the classic model. Moreover, pursuant to *Banca d'Italia* Circular no. 285, the by-laws shall also assign to the shareholders the duty to appoint and dismiss the members of the management control committee. Such a provision seeks to reinforce their independence *vis-à-vis* the rest of the board.

The Control Committee performs some of the controls assigned to the management body in its supervisory function, as the committee shall supervise the adequacy of the corporate organization, of the internal controls system and of the accounting and administrative software, as well as its suitability to properly reflect the management (Art. 2409-*octiesdecies* of the *Codice civile*).

As per the reconciliation with banking regulation, in Italy the Control Com-

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mittee of credit institutions acts as control body; as such, it bears the responsibility to report breaches to the supervisory authorities (Art. 52 of the Italian Consolidated Law on Banking); in turn, such a task implies a duty to control the merits of the management. The committee is also vested with the power and the duty to carry out inspections.<sup>26</sup>

In light of such specificities, banking regulation tends to align the power of the management control committee with those of the Board of Statutory Auditors.<sup>27</sup> Against this backdrop, the Management Board performs both managerial and supervisory tasks, acting as both management body and management body in its supervisory function.

### ***5.2. The costs and benefits of the one-tier model***

The one-tier model could foster effectiveness. First of all, the governance structure is clearer, because such a model would avoid any overlapping between control corporate bodies – still, the one-tier model would not cast away all uncertainties on the boundaries of the control duties of the committee and those of the other non-executive Directors. In comparison with the two-tier model, the one-tier model would shorten the decision-making process, by avoiding the involvement of an additional player (such as the Supervisory Board) placed above the Management Board. In turn, the reduction in the number of corporate boards would allow saving costs and administrative resources, as the company would not be required to spend resources to select, appoint and remunerate the members of an additional corporate body.

Besides, the one-tier model entails a closer relationship between the management body and the controlling body; the members of the control committee would be in a good position to provide advices to their colleagues.

Moreover, as the one-tier model is used in several countries, it could facilitate the simultaneous listing of a company in several financial markets.

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<sup>26</sup> Banca d'Italia Circular no. 285, Part I, Title IV, Chapter 1, Section III, para. 3.2.3.b. The same power is attributed to the committee of listed companies (Art. 151-ter, para. 4, of the Consolidated Law on Finance) and, according to T. DI MARCELLO, *Sistema monistico e autonomia organizzativa*, Roma, 2012, p. 221, the specificities set for listed companies could be considered as simple specifications of the general rules.

<sup>27</sup> A. GUACCERO – T. DI MARCELLO, *Codice civile, società quotate, banche, intermediari e assicurazioni: un solo monistico?*, in *Analisi giuridica dell'economia*, 1, 2016, pp. 103-119.

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However, such a model has the dangerous side-effect of leaving full powers in the hands of a single body.<sup>28</sup> Its powers should therefore be counterbalanced through internal governance arrangements, such as the set-up of committees, in order to enable a swift and effective control on the company.<sup>29</sup> In such a framework, the fact that the controlling members are part of the Management Board stretches a shadow over their impartiality and it becomes crucial to ensure both their independence from the company and their independence of mind. Worth mentioning, the savings on costs could be non-material in large companies. Finally, even the benefits of having a control body included in the Board of Directors are undemonstrated: indeed, in the “classic” model, the Statutory Auditors attend Directors’ meetings and there is no reasons to believe that their information packages are thinner than those of the Directors.

### **6. Which model fits better?**

The overview provided above allows inferring that all governance models have their roots in historical development, are path-dependent and entail advantages and disadvantages;<sup>30</sup> the broad wording of CRD4 does not preclude any schemes and all of them may indeed fit banking regulation, depending on national transposition. But which model is more suitable to run a bank?

The decision is clearly bank specific: it shall ensure the suitability of corporate, administrative and accounting organization to the nature and to the needs of the undertaking. Such an assessment shall take into account the shareholders’ path, the size and the complexity of the bank, along with its strategic goals in the medium and long term and consistently with the group’s corporate structure. Hence, there is no panacea for corporate governance, no one size fits all and it is rather cumbersome to define ex ante and in abstract terms which model to choose.

More specifically, the proper functioning of the model also depends on its im-

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28 In any case, according to the Ministerial report on the legislative decree no. 6/2003, the internal controls committee would not affect the quality of the internal controls, since the Committee members have the same duties and shall meet the same professional and independence requirement as the Statutory Auditors.

29 B. LIBONATI, *Noterelle a margine dei nuovi sistemi di amministrazione delle società per azioni*, in *Rivista delle società*, 2008, p. 301.

30 K. J. HOPT, *Comparative Corporate Governance: The State of the Art and International Regulation*, *Law Working Paper ECGI*, 170, 2011, p. 19.

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plementation, with specific regard to the selection of suitable Directors and Statutory Auditors. In fact, apart from integrity requirements, board members shall have professional skills and experiences suitable to their role and to the complexity of their company: the suitability of board composition is a key element to ensure the viability of any governance model. With specific regard to Italian banks, until the Nineties, the largest Italian banking groups were state-owned and subject to specific regulation. In 1990, Law no. 356/1990 imposed the transformation into joint stock companies and the conferral of the shares upon newly established “banking foundations.”<sup>31</sup> Some foundations have then progressively dismissed (part of) their shares and in the course of the new millennium some shareholding paths have become more granular. The weakening of some relevant shareholders may entail a lack of leadership, which could indeed be filled through the establishment of another principal to lead and control the company.<sup>32</sup> This could have hinted a widespread adoption of the two-tier model. However, despite the opportunity to opt for allegedly more “modern” models, Italian credit institutions still demonstrate a clear favor for the “classic model”. The latter is the favorite scheme of banks that have different sizes, complexity and business model. In fact, out of the 30 largest Italian banks, 27 have adopted the classic model.<sup>33</sup>

There is no clear link between the model adopted and the role in the group (parent company, holding, or subsidiary), nor does the governance scheme seem to be linked to the size. In fact, the two-tier model has been adopted by two banks: the first one is the sixth largest bank and parent company of an Italian banking group; the other one is the 20th largest Italian bank, a subsidiary of a foreign group. Only one bank has adopted the one-tier model, i.e., the parent company of the second largest Italian banking group. All the other surveyed banks have adopted the classic model; 14 of them are subsidiaries, 16 are parent companies. Hence, it seems that there

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31 E. FRENI, *Le privatizzazioni*, in S. CASSESE, *La nuova costituzione economica*, Roma-Bari, 2008, p. 249

32 G. GALGANO, *Diritto commerciale*, 2, *Le società*, Milano, 2010, pp. 353-354.

33 A survey has also outlined a scarce spread of the alternative models among listed companies (also non-banking): in 2014, out of 244 companies on the Italian stock market, 237 (97%) had the classic model, 2 the one-tier model and 5 the two-tier model. Among non-listed companies, according to a survey performed by the Italian Chamber of Commerce, as of 1 March 2013, out of 48.033 *società per azioni*, only 180 companies (0,374%) had the one-tier model, while 119 (0,247%) had the two-tier model and the rest the classic model (S. ALVARO – D. D'ERAMO – G. GASPARRI, *Modelli di amministrazione e controllo nelle società quotate Aspetti comparatistici e linee evolutive*, in *Quaderni Giuridici Consob*, 7, 2015, p. 20).

is no direct connection between the governance model and the size of a bank, nor between the governance and the performance. The financial crisis has demonstrated that no administration model is by itself capable of preventing failures and mistakes.<sup>34</sup> The scarce interest of large banks and public companies for the two-tier and the one-tier models may be attributed to several causes. A first set of reasons lay with the Italian legal background, where shareholders were not very granular and were directly linked to the corporate bodies external controlling board. Changes in the shareholders' structure may still suffer from a "left-over effect", as the corporate structures that an economy has at a given point in time are influenced by the corporate structures it had earlier.<sup>35</sup> Moreover, the classic "side by side" model is not on the same level as the other two. In fact, it is still the "standard" method of governance, since the others are only applicable upon explicit decision.<sup>36</sup> Besides, the classic model's regulation remains applicable "where compatible": this may create uncertainty on the corporate organization, leading the parties to opt for a safer harbor and chose the classic model.<sup>37</sup> It has therefore been argued that Italian companies may have sought to avoid the risks inherent in alternative systems, because of the difficulties in weighting *ex-ante* its costs and benefits, suggesting to avoid acting as first mover.<sup>38</sup>

Whatever the reasons for sticking to the classic model, such a solution seems far from unreasonable. In fact, regulated industries such as banking may entail a broad number of stakeholders. This holds especially true for banks, whose "claimants" include depositors, investors, customers and even central banks, also in their roles of last

34 G. B. PORTALE, *Amministrazione e controllo nel Sistema dualistico delle società bancarie*, in *Rivista di diritto civile*, 1, 2003, pp. 25-39. The financial crisis brought to the light severe mistakes in German banks having different types of administration model (R. E. BREUER, *Die Professionalisierung der Aufsichtsratsarbeit in der Bank*, in K.J. HOPT – G. WOHLMANNSTETTER, *Handbuch Corporate Governance von Banken*, Munich, 2011, p. 526).

35 L. A. BEBCHUCK – M.J. ROE, *A Theory of Path Dependence in Corporate Ownership and Governance*, in *Stanford Law Review*, 52, 1999, pp. 127-170. It is contended that sunk adaptive costs, complementarities, network externalities, endowment effects and multiple optima may discourage changes. Besides, existing ownership structures might have "persistence power", even in the face of some inefficiencies, due to internal rent-seeking.

36 G. CASELLI, *Elogio, con riserve, del collegio sindacale*, in *Giurisprudenza commerciale*, 1, 2003, p. 251.

37 P. MONTALENTI, *Il diritto societario a dieci anni dalla riforma*, in *Nuovo Diritto delle Società*, 11, 2014, p. 11.

38 F. GHEZZI – C. MALBERTI, *Corporate Law Reforms in Europe: The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law*, in *European Company and Financial Law Review*, 5, 2008, pp. 1-47; C. BELLAVITE PELLEGRINI – L. PELLEGRINI – A. SIRONI, *Alternative vs Traditional Corporate Governance Systems in Italy: An Empirical Analysis, Problems and Perspectives in Management*, 3, 2010, para. 2.1

resort lenders.<sup>39</sup> The banking industry has also other specificities, considering that banks create more moral hazard concerns than a typical firm.<sup>40</sup> In such a framework, the Statutory Auditors of banks do not act in the sole interest of shareholders anymore, but are rather an outpost in the interest of all the stakeholders involved.<sup>41</sup> Seemingly, such a duty can be better performed by the Statutory Auditors than by the Supervisory Board in the two-tier model or by the Control Committee in the one-tier model. First of all, because the Board of Statutory Auditors has no links whatsoever with active management, of any kind. It is not part of the Management Board, nor does it have any duty to approve strategic goals or financial accounts. In a nutshell, it is truly independent and established at the same level as the Board of Directors, which makes it suitable to control it.

It is also worth mentioning that its appointment falls entirely in the remit of the shareholders, while an increasing number of large companies entrust the Board of Directors with the power to provide a list for the renewal of the Board of Directors, that are usually confirmed by the shareholders' assembly.<sup>42</sup> It is debatable whether Directors could then be tempted to refrain from raising objections, in order to gain their renewal. Needless to say, dependent managers would not be in a position to perform effective controls on the Board of Directors, for the simple reasons that they report to it. In this respect, the Statutory Auditors appears to be the best placed body to ensure both an unbiased review and the compliance with the "four-eyes principle".

The role of Statutory Auditors could be even more important in large banks with granular shareholding paths. In such "public companies", the principal-agent relationship tends to flaw, as no shareholders hold control over the company and nearly

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39 J.R. MACEY – M. O'HARA, *The corporate governance of banks*, in *Economic Policy Review*, 1, 2003, p. 92; P. CIANCANELLI – J. A. REYES-GONZALEZ, *Corporate Governance in Banking: a Conceptual Framework*, 2000, contend that the normal agency theory proves to be rather poor in the banking industry, due to its specific features: regulation limits the power of the market to discipline the bank and alters the normal functioning of the principal-agent relationship. It is also contended that, as part of the risk is born by regulators, the owners end up to assume more risk than unregulated firms.

40 J. R. MACEY – M. O'HARA, *The corporate governance of banks*, in *Economic Policy Review*, 1, 2003, p. 99.

41 F. PARMEGGIANI, *Il collegio sindacale e il comitato per il controllo interno: una convivenza possibile?*, in *Giurisprudenza commerciale*, 1, 2009, p. 328.

42 Such an option is fairly spread among non-banking listed corporations such as Prysmian and Eni and has been also exercised by some banks.

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all of them end up being minority shareholders: in such a situation, it is questionable whether they are still capable of having a sufficient grip over the company. As a matter of fact, agency problems may occur especially when the principal does not have the power or the necessary information to control the agent.<sup>43</sup> It is questionable, however, whether agency problems could be better addressed through the “classic” model or through the two-tier model.

Finally, the Board of Statutory Auditors’ controls have a broader scope than other control bodies. As mentioned above, the Statutory Auditors do not simply pursue business and efficiency, but perform a fully-fledged check. Internal controls may have different goals: merits, compliance and administrative adequacy.<sup>44</sup> Nonetheless, the full accomplishment of the Statutory Auditors’ mission in Italian banks could benefit from a fine-tuning. The Board of Statutory Auditors is required to be more and more proactive to monitor business. In turn, this would require a broader scope of skills, in order to be more effective in detecting possible criticalities and to reduce the information gap between the Board of Statutory Auditors. The skills and competence required do not differ that much from those required from the Directors and the Supervisory authorities are increasingly concerned about the quality of Board members. However, the relevant regulation still imposes to the Statutory Auditors to have a background that no longer matches their duties.<sup>45</sup> In this regard, the Statutory Auditors would benefit from specific expertise, including not only taxation and law, but also finance, risk management, internal models and so on. Moreover, their number should also be increased, as they are usually composed of three standing members (only in a few cases they are increased up to five). A larger number, along with the enlargement of the scope of their permissible background, would facilitate the assignment of a broader variety of professional competences, experiences and background and, ultimately,

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43 J. R. MACEY – M. O’HARA, *The corporate governance of banks*, in *Economic Policy Review*, 1, 2003, p. 92.

44 P. MONTALENTI, *Amministrazione e controllo nelle società per azioni tra codice civile e ordinamento bancario*, in *Banca borsa titoli di credito*, 2015, p. 716.

45 Pursuant to Art. 2397 of the Codice civile, at least one Statutory Auditor shall be registered as accounting auditor; the remaining may be selected among full professors of Law or economics, lawyers, accountants/tax accountants, commercial experts or labor consultants (Decree of the Minister of Justice no. 320/2004). The draft fit and proper requirements to be issued by the Minister of Economy and Finance does not specifically require Statutory Auditors to have competence in risk management.

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the quality of the Board. The most recent supervisory methodology and regulations<sup>46</sup> move in the right direction, in order to provide the Board of Statutory Auditors with the tools to act as an increasingly effective coordinator of all controlling bodies.<sup>47</sup>

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<sup>46</sup> Article 10 of the draft fit and proper requirements to be issued by the Minister of Economy and Finance

<sup>47</sup> N. ABRIANI, *Collegio sindacale e "Comitato per il controllo interno e la revisione contabile" nel sistema policentrico dei controlli*, in *Rivista di diritto societario*, 1, 2013, pp. 2-22.