

## **Corporate liability and Internal Supervisory Body: An Italian Evidence**

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*The aim of this work is observing relations between governance bodies in case of establishment of a compliance function in order to reduce the corporate liability connected with risks of illegality. In particular, a more detailed study is made of the conformation and functions of the Supervisory Body, appointed – according to Legislative Decree 231/2001 - to “vigil” upon the Model of organisation, management and control with the intent to exempt the body from liability in the case of the crimes contemplated by said Decree. The empirical analysis was conducted on information conveyed through the Internet sites of the 29 banks quoted in the four segments of the Italian Stock Exchange. More specifically, in order to ensure the greatest possible effectiveness of the system, the Supervisory Body should be set up as a structure with clear role in comparison with other forms of internal control.*

Field of Research: Management, Corporate Governance

### **1. Introduction**

Over the last few decades, the international legal scenario has been characterised by a widespread attempt to improve company governance, based on the principle of a fair valorisation of all social players, respecting the values of substantial impartiality, correct behaviour, transparency in information transmitted internally and externally, global responsibility.

In this context, we can collocate the numerous legal interventions by the main organisations operating at international level and qualifying their actions on the basis of the enunciation of universally valid principles, respect for which must necessarily be adopted in the company’s sphere of responsibility in order to safeguard and guarantee economic development based on equality.

Added to such interventions are those coming from organisations including a limited number of nations (such as the EU) and those of national origin (by national law, Supervisory and Control authorities, associations representing companies operating in specific sectors, the companies themselves by means of internal self-regulation).

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Such complex regulations necessarily require the presence of external and internal bodies to control the respect and correct application of the same.

In this context, the concept of compliance is intended as the conformity of company activities with obligatory or recommended dispositions coming from outside or generated within. Substantially, company compliance is a voluntary activity of preventive nature with the purpose of avoiding the risk of non-conformity of company activities with laws and standards and to suggest, when anomalies are found, the best solutions in order to:

- reduce the risk of non-conformity, that is the risk of juridical or administrative sanctions thus suffering consequent economic and financial losses as well as reputation and image;
- guarantee the gradual diffusion within the company of the culture of correctness and truthfulness;
- transmit firstly transparency in behaviour and information, consequently with the growth of credibility from internal and external stakeholders and therefore a greater capability of attracting consent and resources.

Despite the scarcity of specific legal references at both international and national level, in most cases compliance activities are not always formalised in a specific function but carried out by the bodies appointed to manage internal company control.

Vice versa, where we find the formalisation of the corresponding role, it is advisable to manage relations between the compliance function (assigned to a Chief Compliance Officer) and the other forms of internal control in order to avoid duplications or areas lacking responsibility.

As shown, the voluntary introduction of compliance activities is the result of assessing the relationship between the possible connected benefits and the overall costs incurred by the company for implementation. Thus follows the necessity to identify the requisites inherent such a function (subjects involved, objects of observation, available resources, feasible processes) also with regard to the position to be occupied in the ambit of the internal control system (generally submitted already to other forms of control).

The activation of a compliance function is closely correlated with the company's necessity/desire to preventively manage problems relative to its own responsibility in the hypothesis of non-conformity with governmental decisions and managerial actions, that is, illegality or high risk of non compliance.

At international level, problems connected with the imputation of direct responsibility of an enterprise in the case of non-observance of laws, or illegality, are faced differently despite recent attempts of harmonisation (especially by OECD and the European Commission). The problem arises, especially, with regard to penal responsibility because characterised by a strongly individualistic approach.

The main Common Law countries long ago acquired the concept that the enterprise is penally liable, although from different viewpoints: the alter ego model (identification theory) adopted by Great Britain and Canada; the respondeat superior model (vicarious liability) adopted by the United States; the corporate culture model (organisational liability) specific of Australia but with the evident tendency to be adopted also in other Countries.

Civil Law countries, vice versa, have shown a considerable delay in accepting the penal responsibility of an enterprise. Referring specifically to Italy, the first

significant intervention in this respect was with Legislative Decree 231/2001 (often integrated with reference to the relative crimes) with the purpose: on one hand, to formalise the penal responsibilities (even if starting from responsibilities of administrative kind) of juridical persons, companies and associations even not of juridical status; on the other hand, to propose such requisites for compliance (adoption of suitable organisation models and the activation of suitable control bodies) observance of which will guarantee the enterprise in question, even in the presence of crime, with exemption from responsibility or a reduction of the sanctions.

### 2. Literature review

The concepts of company governance and social responsibility in Italian literature, although being studied since the XV century, came under deeper formal scrutiny at the beginning of the 1900s, and have continued to the present day thanks to contributions from: Zappa G. 1927; Onida P. 1951; Coda V. 1965; Ferrero G. 1968; Azzini L. 1978; Masini C. 1979; Brunetti G. 1979; Airoldi G. 1980; Amaduzzi A. 1988; Airoldi G, Brunetti G., Coda V. 2005. As regards internal control system: Cassandro P.E. 1987; Coda V. 1998; Fortuna F. 2001; Beretta S. 2004; Salvioni D.M. 2007; Huse M 2007. With reference to control systems in European and Italian banks: the activity of the Basle Committee on Banking Supervision; the documents drawn by Bank of Italy, Consob, Italian Banking Association. With reference to corporate penal liability: USA Model Penal Code; US Federal Sentencing Guidelines Manual 2007; French Penal Code 1991; EU Regulations draft in 1995 and 2005; OECD Conventions since 1997.

### 3. Methodology and Research Design

Research is focalised on ascertaining the presence and composition of the Supervisory Body (= *Organismo di Vigilanza - OdV*) since this is the body appointed to oversee the adoption of the Model of organisation, management and control foreseen by the Decree as the condition for exempting company responsibility. In particular, faced with the non-compulsory adoption of the Decree and the substantial silence of legislators regarding the composition of the OdV, the intention was to verify the choices made by a significant sample of enterprises, also regarding the eventual presence and the composition of a specific compliance function.

Empirical analysis presupposes deeper theoretical insight on: the requisites that members of the OdV should possess; desired solutions in terms of how the Board is structured; the functions performed; relationships with other forms of internal control and with the appointed persons; communication flows from and to the Board.

In particular, the intention is to highlight the situations in which the surveillance function attributable to said board is assigned to existing control bodies or to an ad hoc unit.

The choice of an organ already operating within the enterprise would favour the company's need to curb additional costs; by opting for this choice, however, it is necessary to clarify the profiles of compatibility with the existing structures.

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With regard to the ad hoc constitution of a board, at theoretical level, it is necessary to guarantee its independence, objectivity and competency, while still allowing the company to unite professional in-house members of staff or other forms of internal control or, when activating the compliance function, external professionals (obviously provided with the necessary independence required of OdV members).

The analysis was carried out in April 2008 on the internet sites of the 29 banks quoted in the Blue Chip, Star, Standard, and Expandi segments of the Italian Stock Exchange.

The choice of the banking sector was justified by the greater problems in risk management faced by banks and consequently stricter regulations applied by national Supervisory Boards. It can therefore be assumed that this sector is the most sensitive to the possible exemptions contemplated by Legislative Decree (L.D.) 231/2001 (compulsory for the Star segment as from March 2008).

In particular, a study was made of:

- references to the adoption of L.D. 231/2001 or explicitly through the availability of a specific document regarding the Model of organisation, management and control or within the Corporate Governance Report (complying with point 8.C.2 of the Self-Discipline Code issued by the Italian exchange in March 2006);
- when the aforesaid Decree was adopted, the presence of information relative to the composition of the OdV. The objective was to verify if practice is more oriented towards the perfect harmony between the OdV and a control body already existing in the company or, vice versa, willing to activate “mixed” solutions (ad hoc bodies), where the Supervisory Body is the point of convergence of various competencies traditionally governed by different organs and functions, eventually completed by external representatives;
- the formalised existence of a compliance function and the eventual harmony of the same with the OdV.

### 4. Discussion of Findings

From the results shown in Table 1 the following considerations can be deduced (at this time, not considering the quotation segment):

- ♦ 58.6% of companies confirm their adoption of L.D. 231/2001 only within the Corporate Governance Report, while 20.7% also make available (further to some summarised information within the Corporate Governance Report) a special document giving more in-depth details of the methods adopted by the company to comply with the requirements of said Decree (in particular, the implementation of the Model for organisation and management). 20.7% of the quoted banks, on the other hand, give no indications in this direction, so it can be presumed either that they do not adopt the prescriptions of the Decree or they do not consider it necessary to communicate their choice. In this respect, it must however be remembered that of the 6 banks not providing any reference: one does not make available the Corporate Governance Report; one (belonging to the

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foreign sector) follows the Spanish Unified Code which, as can be seen, does not refer to the Decree in question; one presents, as its last Corporate Governance Report, a very old version (referring to year 2003) drawn up before the new indications of the Self-Discipline Code dated 2006; the remaining three evidently do not consider it opportune to adopt the Decree at the moment;

Table 1 - Adoption of Legislative Decree n. 231/2001 and OdV composition

Segment	N°	Corporate governance			L.D. 231/01			OdV composition			Compliance function	
		Dualistic Horizontal system	Dualistic Vertical system	Monistic system	No reference	Only in Corporate governance report	Also in specific document	No reference	Existing control body	Ad hoc organism (Table 2)	No reference	Reference
Blue chip	17	11	4	2	3	9	5	4	4	9	5	12
Star	3	3				3			1	2	2	1
Standard	7	7			1	5	1	2	2	3	3	4
Expandi	2	2			2			2			2	
<b>Total</b>	<b>29</b>	<b>23</b>	<b>4</b>	<b>2</b>	<b>6</b> (20,7%)	<b>17</b> (58,6%)	<b>6</b> (20,7%)	<b>8</b> (27,6%)	<b>7</b> (24,1%)	<b>14</b> (48,3%)	<b>12</b> (41,4%)	<b>17</b> (58,6%)

- ♦ with regard to the composition of the OdV, 30.4% of the quoted banks adopting the Decree explicitly announce the coincidence with an existing control body; 60.9% prefer to institute a board ad hoc constituted of a mix between a number of existing company organs and eventually specifically dedicated internal and external members; 8.7% of the banks give no reference to the composition of the OdV;

Table 2 – Composition of the OdV in the case of instituting an organism ad hoc

Segment	OdV composition
Blue chip	Independent Director+Global Banking Services Division Manager+Human Resources Division Manager+Group Internal Auditor+Compliance and Corporate Affairs Manager+Corporate Identity Manager
Blue chip	Independent Director+Legal Affairs Office Manager+Human Resources Division Manager+Group Internal Auditor
Blue chip	Independent Director+Compliance & Corporate Affairs Manager+Internal Auditor
Blue chip	Audit Committee+Group Internal Auditor+Internal Auditor
Blue chip	Independent Director+Legal and Compliance Manager+Internal Auditor
Blue chip	Two Independent Directors+Internal Auditor
Blue chip	External independent advisors+Internal Auditor
Blue chip	Three Non executive Directors (whose one independent)+Criminal law advisor+Financial advisor+Internal Auditor+ Risk Manager
Blue chip	Two Independent Directors+Internal Auditor+Group Organization Division Manager+Human Resources and Legal Affairs Manager
Star	Two Independent Directors+Internal Auditor
Star (2 cases)	Audit Committee+Internal Auditing
Standard	Audit Committee+Group Internal Auditor+Internal Auditor
Standard	231 Committee (Independent Director+Human Resources Manager+Internal Auditor)

- ♦ it can therefore be affirmed that **79.3% (23 on 29) of the quoted banks comply with the Decree and, of these, 91.3% also give specific information concerning the composition of the OdV;**
- ♦ the compliance function is explicitly foreseen in 58.6% of the cases and is mostly assigned to the General Manager or Managing Director in the Legal and Staff Compliance department. Contrary to expectations, in 15

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enterprises whose organigram or Corporate Governance Report appoint a compliance function, only 5 include the relative person in charge among the members of the OdV.

From an articulated analysis of the quotation segments, with regard to banks operating in **Blue Chip** the following results emerge:

- ♦ it is the only segment in which companies adopt governance models of the three types foreseen: the two enterprises with a monistic model belong to the “foreign” segment (with headquarters in Spain) and give no indication of compliance with the Decree; of the 4 banks with a vertical dualistic model, 2 adopted this model in mid-2007 due to a merger; the majority has opted for the horizontal dualistic model;
- ♦ **82.4% of the banks quoted in this segment explicitly refer to the adoption of the Decree and 92.6% of these give information concerning the composition of the OdV;**
- ♦ in all cases where the OdV coincides with an existing control body, the latter corresponds with the Internal Control Committee (in one case, the Committee within the Supervisory Board);
- ♦ when ad hoc organs have been constituted (see Table 2) the solutions are different but, however, all are connected with the presence of the internal auditor. As can be seen, cases are common in which the OdV involves the persons responsible for Human Resources or Legal Affairs. This solution would appear unadvisable especially in the hypothesis of perfect coincidence between the OdV and the original function of the persons involved because, being entrusted with decisional powers and operative proxies, they may lack the indispensable requisite of independence (Confindustria Guidelines, 2004);
- ♦ 70.6% of the banks in this segment foresee a compliance function in some cases involved as a member of the OdV;
- ♦ only in 2 cases it was considered necessary to complete OdV competencies with external subjects.

The enterprises quoted in the **Star** segment are submitted to particular requirements of corporate governance and information transparency; moreover, as from March 2008, they are obliged to adopt the Model of organisation and management as prescribed by the Decree, and therefore complete and exhaustive information should be expected. From the analysis conducted, the following considerations can be made:

- ♦ **100.0% of the banks quoted in this segment refer to having already adopted the Decree in the ambit of the Corporate Governance Report and inform on the composition of the OdV ;**
- ♦ in one case the OdV functions are attributed to the Internal Control Committee; the remaining cases always avail of the presence of the internal auditor and never appoint external consultants (see Table 2);
- ♦ only in one case the organigram shows the presence of the compliance function, staffed by the General Manager who, however, is not involved as a member of the OdV.

With regard to the **Standard** sector it can be affirmed that:

- ♦ **85.7% of the banks adopt the Decree and, of these, 83.3% provides information on the composition of the OdV;**
- ♦ in 40.0% of the cases, the OdV coincides with an existing organ; 60.0% of the cases present a mix of existing organs, particularly the Internal Control Committee and Internal Auditing;
- ♦ 57.1% of the enterprises present a compliance function which, however, is never officially involved as a member of the OdV.
- ♦ Finally, in the **Expandi** segment, no bank refers to adoption of the Decree; it must be remembered, however, that: one enterprise assumes the juridical form of a cooperative share company and considers a sufficient guarantee the verification of the internal control system operated by the Board of Directors, the other presents an outdated Corporate Governance Report issued before the update foreseen by the 2006 version of the Self-Discipline Code.

### 5. Conclusions

The research conducted and the information found enable us to summarise the following important elements and to present some reflections:

- most of the investigated banking institutes comply with L.D. 231/2001, activate the Supervisory Body and communicate the composition of said board;
- in approximately 30% of the cases, the Supervisory Body coincides with another control organ and in 70% of the above enterprises, it consists of a specific structure including, however, subjects already designated to internal control or internal auditing;
- the compliance function is present in more than half of the quoted banking companies and in five cases has its own representative in the OdV.

From the emerging facts, evidence is found of the presence of a plurality of subjects dedicated to different forms of internal control tending to overlap instead of integrating or even being correlated while maintaining their own identity.

The particular attention dedicated at present by companies in the banking sector to the obligatory and optional standards recently issued by various bodies, from those of the EU with the Basle Committee to those of national Supervision with the Bank of Italy and Consob, has given greater emphasis to the function of *compliance* which appears to be diffused but not yet specifically collocated and organised, even if and above all with respect to the functions attributed to the Supervisory Body as foreseen by L.D. 231/2001. Reflections and interrogatives arise mostly in relation to how, how much, when and who should assess the conformity with laws and regulations which should, on one hand, avoid the company's implication in administrative/penal crimes and allow an integrated management of the many company risks and, on the other hand, exempt the company from administrative/penal liability by suggesting the adoption of correct models of organisation and control enabling the prevention of specific risks or crimes.

In the context described above, action is necessary on both fronts, promoting targeted synergies deriving from the possibility/capacity of integrating the *compliance* function with that of internal control in its various forms intended,

if considered suitable and efficient, to prevent any risks or crimes as per L.D. 231/2001, by means of suitable management protocols.

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