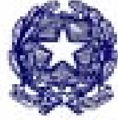

CONSOB

COMMISSIONE NAZIONALE
PER LE SOCIETA' E LA BORSA

SPEECH OF THE CHAIRMAN OF CONSOB TO THE FINANCIAL MARKET

ROME, 5 APRIL 2001

The presence of the President of the Republic at this meeting of the Companies and Stock Exchange Commission (Consob) with the financial market is a great honour. On behalf of Consob I offer the Head of State warm thanks and a respectful welcome.

Mr. President, Minister, Ladies and Gentlemen,

For our annual meeting in the city of Milan, we are guests this year of Bocconi University. The Commission and I thank the Presidente and the Chancellor for this hospitality. It has been my privilege on occasion to teach at Bocconi, working with and learning from colleagues. I am firmly convinced that the contribution of the reflection and research carried out in universities is of vital importance for every public administration, and particularly for an institution like Consob. It teaches us how better to comprehend the evolving reality in which we operate, induces us to ask whether the means used are proportionate to the results we hope to achieve, and obliges us to question established practice and conventions.

Consob's organization has made important progress in the last twelve months. The planned division of functions between the Rome office and the Milan office has been accomplished and the staff of the latter strengthened. A project for the reform of career paths has been prepared, with a view to removing the all too many obstacles that now impede the progress of younger staff. Massimo Tezzon has been appointed General Manager, a position he held in an acting capacity.

The Finance Law for 2001 has made the setting of the fees payable to Consob by the institutions supervised more flexible, because they no longer have to be related directly to services rendered. This simplification will enable the Commission to rationalize the fee schedule after consulting the interested parties. Meanwhile, Consob has already reduced its fees for the current year.

The Consolidated Law on Financial Intermediation has defined a valid model of objective-based supervision of intermediaries, making it the task of the Bank of Italy to contain risk and ensure financial stability and of Consob to ensure transparency and proper conduct. This Law requires that the two institutions act in a coordinate way: this happens at all levels, with an attitude of profitable and continuous cooperation.

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Towards a single market of capital and financial services in Europe?

1. Further and faster integration of European financial markets would yield great benefits: for the public, better opportunities to diversify their investments and lower costs, thanks to livelier competition in the supply of services; for the corporate sector, the chance to raise funds on better conditions in broader and more liquid markets. As empirical research shows, the development of the financial markets would make a major contribution to Europe's economic growth.

The euro has given a powerful push towards the integration of markets, but numerous obstacles hinder further progress. The differences in legal and judicial systems, in tax rules, in the culture of market participants can be reduced only gradually. While trading costs are low in Europe, the fragmentation of post-trading services aggravates the overall cost of cross-border transactions, not least owing to positional rent and barriers to competition. The financial services industry complains of this but does nothing to achieve more efficient solutions. The balkanization of regulatory structures in the European Union is a further, grave impediment to integration.

2. Given the silence of the European treaties, which deal with monetary affairs but not with finance, Community action has availed itself of the instruments provided for the creation of the single market, producing legislation that has failed to foster the convergence of regulatory systems. The legislation is incomplete, leaving numerous important matters entirely to national discretion. Where it does exist, it is insufficient, establishing only minimum harmonization requirements and doing so often in ambiguous fashion. It is at times inconsistent, in the absence of common inspiring principles. And it is rigid and slow and hence subject to being rapidly outdated by the far more rapid pace of the markets.

We know the results. Common rules do not exist in several important areas. The principle of mutual recognition is too narrowly applied both for investment services and, especially, for issuers, who are not equipped with a single European passport for raising capital. The impossibility of achieving sufficient harmonization in the protection of retail investors prevents complete reliance on home-country controls. There are divergent national interpretations of Community provisions. The provisions governing admission to listing, which are more than twenty years old, the legislation on collective investment undertakings and that on investment services have been rendered obsolete by the innovations in products and trading systems. It takes at least three years for new directives to be introduced and existing ones updated. The time it takes for these to be transposed into national law after that is left to the will, good or bad, of the member states.

These are the effects of the institutional framework in which the decision-making process takes place. The proposals of the Commission, which has power of initiative, must be approved by the Council and the European Parliament. Within the Council, compromises between the national

representatives often produce agreements that are at once minimal and unnecessarily detailed. The European Parliament is called on to pass judgement even on technical and detailed provisions. Set within such an architecture, the slow and uncertain progress of Community legislation comes as no surprise.

3. Two opposite and extreme solutions to these institutional problems would be neither effective nor practicable. One would be to rely on regulatory competition rather than legislative convergence, with the aim of obtaining a spontaneous adjustment to the regulatory environment preferred by industry. However, this would either result in the level of investor protection being decided by a single member state or, more probably, give the individual member states an opening to erect protectionist barriers to the benefit of domestic industry; in any case, consolidation between markets of different jurisdictions would eventually necessitate a harmonization of rules. At the other extreme, the proposal to create a single European regulator appears to be incompatible with the persistence of profound regulatory and legislative differences. And if such an institution was to be vested with supranational regulatory power, the Treaty would have to be amended.

With its Financial Services Action Plan, presented almost two years ago and adopted by the European Council meeting in Lisbon, the Commission defined the manifold legislative measures to be adopted in order to obtain market integration. The Commission's initiative deserves support for the contents of the proposals. Yet it will be nothing more than a declaration of good intentions as long as the decision-making process at Community level remains what it is today.

In July 2000 the Council of economic and finance ministers asked a group of experts to put forward proposals for promoting integration. The group found little to add to the Action Plan's list and observed that speedy implementation would instead require action to modify the legislative machinery. The principal recommendation, accepted, not without procedural compromises, by the recent European Council meeting in Stockholm, is to limit directives co-decided by the EU Council and Parliament to the definition of framework principles, while empowering a Securities Committee made up of high-level representatives of the member states to draft the implementing provisions and adapt directives to the evolution of the markets. Another committee, composed of a representative of the authority competent in each member state for securities markets other than in the sphere of prudential control, will assist the Commission in this task and also work to coordinate supervisory practices and ensure convergence of the measures transposing directives into national law. Fearing an encroachment upon its prerogatives, the European Parliament is reluctant to accept this solution. Its resistance could be an obstacle to the approval of directives that delegate matters to secondary legislation for more expeditious decision-making.

These obstacles to carry out a legislation necessary for a single market in financial services are

important in their own right and a sign of the contradictions between the challenges that Europe ought to face and the fragility of its institutional construction.

The growth of the markets

4. Last year the Italian share market gained ground on the other major European markets. Its capitalization rose to 14 per cent of the total capitalization of the markets in the euro area, compared with 11 per cent in 1999. Even more rapid was the growth it recorded in trading, which now accounts for 15 per cent of the total. For the first time since the inception of reliable time series, turnover exceeded capitalization.

Forty-nine Italian companies were listed last year, 33 of them on the Nuovo Mercato; only in 1986 were so many admitted. The companies involved are young firms, which with a very few exceptions do not belong to groups already listed and operate prevalently in innovative sectors. Their initial public offerings raised around 5 billion euros, an unprecedented amount and far greater than the total for the previous five years.

Listed issues of covered warrants doubled, from 1,500 to 3,000, and turnover in these instruments rose from 14 to 31 billion euros. Borsa Italiana strengthened its competitive position in this segment, dedicating a platform to it with a capacity to handle up to 20,000 issues. Consob introduced regulatory changes streamlining the procedures for placement on the primary market. The gaps in Community legislation prevent the mutual recognition of prospectuses that issuers have requested.

5. A significant downturn in share prices in all the main industrial countries began in the second half of 2000. The ratios reflecting returns (the multiples between prices and earnings and between prices and dividends) had reached levels never seen before either in the United States within the span of a century or in Europe over several decades. If prices had not fallen, the gradual reversion to the long-term averages that had always occurred in the past would have required abnormally high rates of earnings growth in the coming years, which not even audacious assumptions of productivity growth could have justified. When earnings expectations were revised downwards even with respect to their current levels, the correction ensued, as usual, on the price side; again as usual, it was sharp, sudden and accompanied by high volatility. It is still a question whether it was enough to bring the indices of profitability back to values not too far from the long-term averages, even after these are adjusted for the observed reduction in the risk premium.

In Italy, the correction was especially drastic for the most innovative sectors. At the end of 1999 the price-earnings ratio of telecommunications, information technology and media companies was around 50 per cent higher than that of industrials and double that of bank shares. It has now begun to

approach the norm of the other sectors.

This correction should not be too surprising, especially in the case of newly-listed companies. Many of these had a very short history or none at all: for many, it was not possible to refer to definite balance sheet figures. The expected rates of revenue and earnings growth that would have justified the offering prices and at times those reached after placement were so ambitious as to seem implausible.

Hopes of such high returns should have been accompanied by certainty as to the assumption of higher risks. In the case of new and fast-growing sectors, evaluation must refer to the aggregate of firms coming to the market: a population that necessarily has a much higher mortality rate than that in the traditional sectors. Those who invest in the companies that manage to survive and grow may obtain a higher return, but those investing in the companies destined to go under will suffer a loss. Before the sector reaches maturity and the selection process is complete, we can expect not only high price volatility but also a strong correlation in the performance of all the securities of the segment.

Both the volatility of daily returns and the correlation among them are particularly high for the securities listed on the Nuovo Mercato: high not only by comparison with the securities of the traditional sectors, which is to be expected, but also with respect to those of the new markets of other European countries. This difference is a sign not only of the smallness of the stock exchange and of the insufficient sectoral diversification of the companies listed on the Nuovo Mercato, but also of an inability of the market to express prices that adequately discount each firm's specific risk factors.

The Italian financial system

6. The rapid and massive shift from intermediation to markets in recent years is reflected in the data on the change in the composition of households' financial wealth. Between the end of 1995 and the beginning of 2000, the proportion of currency, deposits, bonds and government securities fell from 71 to 42 per cent. Over the same period the proportion of equities doubled, from 13 to 26 per cent, thanks largely to the increase in direct ownership of listed shares. The proportion managed by Italian collective investment undertakings increased from 4 to 20 per cent; the figure rises to 30 per cent including foreign collective investment undertakings and individual portfolio management accounts. The percentage of foreign assets doubled.

This remarkable change in the type of instruments in which savings are invested has not been accompanied by a corresponding change in the institutions that manage them. As has been remarked, the role of the banks "remains dominant". If securities intermediation is taken into account along with deposits, the weight of the banking system has increased, reaching unprecedented levels.

Nearly all investment fund management companies are owned by the banking sector; income from asset management activity contributes substantially to banks' profitability. The bulk of securities intermediation is carried out by bank-controlled companies. In addition to doing business with issuers, banks sponsor new issues, coordinate share offerings and participate in underwriting syndicates; they produce and distribute research reports on the outlook for individual securities; they issue what are often very complicated financial instruments for sale to the public. To complete the picture, the banking sector controls the stock exchange management company, the government securities market and the market service companies.

7. The debate on the relative merits of bank versus market-based systems is by now largely outdated, not least because of the prevalence in Europe of the "universal bank" model. But an accentuated concentration in the same institutions of all the activities connected with investment and management of savings no doubt impedes effective interaction between institutions representing different and in some ways opposing interests, to the potential detriment of investor protection.

Precisely for this reason one must welcome the decision by Assogestioni to prepare and ask its members to sign a protocol of autonomy, signifying that fund managers' choices, which must be aimed at maximizing the returns of those who entrust them with their savings, are autonomous of the direct and indirect interests of the parent company. For the same reason one must appreciate instances of divergence between the conduct of funds and those of the banks that control them. Consob has established a fruitful dialogue with Assogestioni on such questions.

8. Supervision for the purposes of investor protection must be more watchful when contractual arrangements and operating practices offer incentives for zero-sum games in which the investor's loss is a gain for the manager or intermediary.

In principle, management commissions do not fall into this category. They represent the price of a service freely supplied and freely demanded: it will be up to increasingly intense competition to bring commissions down to a lower equilibrium level. The necessary condition is transparency: investors must be able to know all the components of the costs they will incur, to compare the conditions offered by competitors, to make informed choices on the basis of expected returns net of commissions. Supervision for transparency serves to establish better standards of conduct on the part of intermediaries, keeping in mind the need not to add to the time they spend on compliance and the related costs.

In at least one case, however, lack of transparency goes hand in hand with an incentive to operate in a manner not in the interest of customers. When a fund is charged so-called turnover fees, the investor is not in a position to evaluate the costs in advance; above all, he cannot be certain whether and to what extent the turnover of the portfolio is motivated by the search for a higher yield or serves

instead to increase the revenues of the manager and the intermediary. Investors must be aware of this.

Some problems, albeit of a different nature, also arise in the case of individual portfolio management services that invest in funds — not in any fund but only in those belonging to the family, to use a figure of speech. In response to the criticism that with this arrangement the manager's group ends up receiving twofold commissions, i.e. on the management of a portfolio and on the funds in which that portfolio is invested, it has been argued that the choice and mix of the different funds constitute an additional service. However, empirical research shows that the risk-return profile of a "one-brand" investment is a good deal less efficient than that obtainable with an investment spread over a wider set of funds: a finding that is self-evident, considering that restricting holdings to a single family constrains the optimal composition of the portfolio.

9. So-called structured bonds, that is to say bonds with which derivative contracts are frequently associated, are issued by banks because they lower their funding costs. Targeted above all to retail customers, before admission to listing they are distributed to the branches along with a simple fact sheet (and without even this until a short time ago). Those admitted to listing, for which there is a prospectus, represent a fraction of the total. Funds invest only a minimum part of their portfolios in structured bonds. But when they do so they show a distinct preference for those issued by the group to which they belong, which in some cases account for more than 50 per cent of their holdings of these instruments.

The latest additions to the genus of structured bonds are reverse convertible bonds. Between August 1998 and February 2001, the volume issued amounted to 12.3 billion euros, with an average duration of 9 months. They are complicated instruments, with many variants, and often incorporate exotic options. The simplest version offers a high coupon but provides for repayment in shares if the price of the share has fallen below a certain level. Banks that issue them — with a high degree of concentration, seeing that five institutions account for more than three quarters of the issues by Italian issuers — normally transfer all the risks of the operation to a merchant bank. Even if the issuers are banks, Consob is of the view that most of the bonds in question should be accompanied by a prospectus, since they are "financial products that make it possible to acquire … shares". Consequently, Consob has challenged non-compliance with the requirement.

Between August 1998 and January 2001, around 37 per cent of the issues that matured gave rise to delivery of securities instead of cash. In these cases the value of the securities repaid was usually substantially lower than the bond's subscription value. The repayment mechanism exposes the subscriber to the potential risk deriving from wrong incentives. Disposals of the underlying securities by the intermediary that bears the risk could in fact drive the price down below the threshold for repayment in cash. An analysis of price breaks shows what are sometimes considerable anomalies connected with disposals: large size of order, substantial fall in price, subsequent rebound. Where the

crime provided for in Article 181 of the Consolidated Law on Financial Intermediation (manipulation involving financial instruments) is suspected, the findings are transmitted to the competent judicial authority. As with insider trading, the announcement of such transmission on Consob's website only mentions the securities involved in the suspected offence. In all these cases the market has displayed elementary common sense, not confusing the securities involved in the suspected crime with the companies that issued them. A statistical analysis shows that no significant price change has occurred following announcements.

10. The large number of companies that have applied for stock-exchange listing in the last two years is certainly a positive development. The new listings largely concern young firms raising capital for growth and investment, not just to enable the owner to cash in a share of ownership without giving up control. But precisely the youth of these companies, lacking a history to which to refer, raises a number of problems.

In Italy, unlike some other jurisdictions, the decision on admission to listing and approval of the prospectus, both of which are public acts, are entrusted to different institutions: the former to Borsa Italiana, the latter to Consob. The requirements for admission to listing include a minimum number of annual accounts; the granting of derogations is within the authority of Borsa Italiana.

All companies, but particularly those without a history, should also provide a complete and accurate picture of all the non-financial factors that allow the company's prospects to be assessed: for example, the actual and expected number of customers, of service subscribers, of network users. It is hardly conceivable, and not the case in comparable cases abroad, that Borsa Italiana should check the information provided point by point when it admits a company to listing or Consob to do so when it approves the prospectus.

The information contained in the prospectus is supplied by the directors on their own responsibility, attested by the company's board of auditors, certified by the independent auditors and guaranteed by the issue coordinator. According to the law, Consob must "monitor the accuracy of the information provided to the public", verifying case by case its consistency, reliability and verisimilitude. To this end, the Commission usually requests additional data and specifies the risk profiles that the issuer must indicate. But, ordinarily, it cannot undertake investigations alternative to those conducted by the persons who assume responsibility in the prospectus for the truth of the information, much less express opinions on the economic plausibility of the figures. Of course, where the available facts present serious grounds for doubt, the Commission may activate aggressive powers of investigation. However, recourse to these can only be exceptional and not represent an ordinary procedure of supervisory action, considering, among things, the short period of time within which the operations have to be carried out. This also accords with the rules of other countries and the principles

of IOSCO, the organization bringing together the supervisory authorities of more than a hundred countries.

In the case of young firms offering their shares to the public, the board of auditors, the independent auditors and the intermediaries that “bring” the issuer to the stock exchange and underwrite the issue must perform their task of guarantee and certification vis-à-vis third parties with particular care. The members of the board of auditors and the sponsors, by signing the prospectus, and the independent auditors make themselves jointly responsible to the subscribers and to the market for the truthfulness and completeness of the information it contains. These persons have not always performed their tasks with due diligence and a full awareness of their respective responsibilities.

In particular, at times considerable shortcomings have been found in sponsors’ presentations. In more than a few cases, the evaluation of the company’s situation and prospects was conditioned by market research performed when the offering was imminent. Many of the attestations accompanying applications for admission to listing were inadequate, especially in the case of new firms. The financing and shareholding relations of the sponsor bank with the issuer were not highlighted with due emphasis, even when the bank bringing the company to the stock exchange was one of its principal financial backers.

A similar problem of potentially conflicting interests is also posed in the case of research reports distributed to the public by banks and intermediaries, which can have various kinds of relationships with the issuer.

11. In the case of research reports, Consob has decided to render the provisions of Article 69 of the Regulation on issuers more effective. After consultation, it is preparing to release a communication in which it will specify what may constitute the “specific interest” of the publisher of research reports “in the issuers, the financial instruments or the transactions analyzed”, which is to be disclosed “with graphic highlighting”, “indicating the reasons and extent thereof”.

The figure of the sponsor, not mentioned in the Consolidated Law, is defined in the rules of the markets managed by Borsa Italiana. In the case of non-compliance with the rules it is up to Borsa Italiana to impose sanctions, which run from censure to a declaration of unfitness. It is likewise up to Borsa Italiana to justify derogation from the minimum number of annual accounts as a condition for admission to listing.

In this case again Consob relies on the rules autonomously imposed by the market management company, asking and trusting that their application will be rigorous and punctual not only for the protection of investors but also in the interest of the market.

The problems of corporate governance

12. In an open international environment, the Italian corporate model is compared and competes with those prevailing in other countries. A good system of corporate governance has to offer adequate guarantees against directors and controlling shareholders being able to carry out transactions that harm the legitimate rights of minority shareholders, to their own benefit and that of persons connected to them. The better these guarantees, the lower will be the cost of raising capital and the more developed the share market.

The quality of corporate governance is seen in the distribution of powers inside the company. It is conditioned by the ownership structure and influenced by the environment in which the company operates. Counterweights to the power of the directors lie in effective systems of internal control and the possibilities given to minority shareholders to make their voice heard and take the initiative. These counterweights will be that much weaker, the more concentrated are ownership and control and the more dispersed are minority holdings. Outside the company, the auditors, intermediaries, analysts, institutional investors and the media can exercise an important function of monitoring the conduct of the directors: the better they do so, the more complete and transparent will be corporate disclosure.

13. The specialized literature, whether academic or produced by international organizations, does not offer a flattering opinion of the quality of corporate governance in Italy. In the rankings compiled using different parameters of protection of minority shareholders' rights, Italy is among the last of the major industrial countries.

We cannot agree with these drastic evaluations, both in the light of the scant robustness of the criteria and methods of measurement adopted and, especially, because these judgements refer to what is now a remote past and do not consider a better present. Much that is new has happened in a few years.

The decline in the public sector budget deficit and the reduction in interest rates, the total or partial privatization of large companies, the equity offerings by young companies born in new sectors have fostered a large entry of individual investors into the share market. Notwithstanding the persistent absence of pension funds, institutional investors have become a massive presence. The replacement of the lira by the euro has stimulated the arrival of foreign investors. A variegated constituency with a common, substantial interest in the improvement of the quality of the market has thus been created. The positive effects of this pressure have been seen in legislative and regulatory innovations, in changes in both corporate structure and investor behaviour, and in the first, still timid stirrings of self-regulation.

The Consolidated Law on Financial Intermediation and the administrative regulation deriving

from it have promoted greater transparency, informational symmetry and price significance in the markets. These are the preconditions for enhanced effectiveness of the measures introduced by the Consolidated Law to strengthen the protection of shareholders: expansion of the powers of qualified minorities that can block the resolutions of the special shareholders' meeting, bring actions for liability against the directors and call the shareholders' meeting, elect a member of the board of auditors and solicit proxies; greater allocation of responsibilities to internal controls, with the function of board of auditors enhanced and, in the case of their inaction, assignment to Consob of powers to intervene in their regard and even to report them to the courts.

The pressure of more numerous and aggressive institutional investors has had a major impact on the structure of the market. Accurate and tough-minded valuation of the holding discount and the market entry of new firms not belonging to groups and endowed with full management autonomy have reduced the presence of pyramids consisting of several listed companies, which was a signal feature of the Italian market. Between 1990 and 2000, the number of listed companies attributable to the ten largest private-sector groups declined from 70 to 30; the ratio of capital controlled (in terms of voting rights) and capital owned (in terms of the right to dividends) fell from 2.4 to 1.8. Resort to shares with limited voting rights has diminished. The market's greater liquidity, due to the large increase in trading volumes, better allows investors to express their opinion of securities by exercising the so-called exit power: over the decade, the average holding period of a security shrank from four years to less than one.

The initiative by Borsa Italiana to draw up in cooperation with issuers a code of conduct for listed companies, with the latter free to choose whether or not to adopt the code but required to disclose non-adoption, is a positive sign of the spread of a better market culture, even if the rules of the code are mild compared with corresponding experiments abroad.

Much has therefore changed for the better. But by comparison with other systems, with which we have to compete, the progress achieved cannot be considered sufficient. While this depends partly on the ownership and control structure of listed companies, which still leaves broad scope for opacity of management, it is also necessary to recognize that in our system the degree of protection of minority shareholders is still below the levels guaranteed elsewhere.

14. The structure of our corporate system still offers opportunities for transactions potentially conflicting with the interests of minority shareholders.

Although their weight is reduced, structures persist in which the concentration of control, with the dilution of ownership rights, increases the divergence between the interests of the controlling and the minority shareholders. For this reason as well, the contestability of control continues to be limited. In the 123 companies not controlled by the public sector that were listed continuously between 1990

and 2000, the average stake of the largest shareholder remained basically unchanged at just below 50 per cent. In the companies that entered the stock market during the decade, the leading largest shareholder's interest was smaller but still averages 44 per cent. In over half of the small number of companies in which the largest shareholder's interest is less than 25 per cent of the ordinary share capital, there are either voting agreements or, in the case of cooperative companies (mainly banks), restrictions on the exercise of voting rights.

15. To increase the protection of minority shareholders, the Consolidated Law introduced several mandatory rules while also creating scope for companies bylaws to introduce clauses more favourable to the shareholders, as the code of conduct also recommends. To date, that scope has remained almost unexploited.

Up to last October, only five listed companies had lowered the threshold of capital necessary for shareholders to be able to call the shareholders' meeting; only four had increased the quorum for the adoption of resolutions by the ordinary shareholders' meeting; only four had introduced postal voting. More important is the fact that, while only one company increased the number of members of the board of auditors to five, nine companies reduced the number from five to three, thereby avoiding the presence of two members elected by the minority shareholders, who would have been entitled to call the shareholders' meeting. It is some consolation to find several of the most important companies among those that availed themselves of the right to introduce ameliorative clauses. However, no company reduced the thresholds for reporting matters to the board of auditors and the courts or for bringing an action for liability.

It is perhaps too soon to assess the extent of adoption of the code of conduct, since stock exchange rules set the forthcoming shareholders meetings on annual accounts as the deadline for notification by listed companies. The fact remains that by the end of last October 161 of the companies listed on the official market had not made any notification and 21 had given a mere statement of intention. Of the 48 companies that have adopted at least one of the code's rules, only eight (although several of them important) have adopted that prohibiting the delegation of powers to individual directors for significant transactions and particularly for those with related parties.

Even the Consolidated Law's mandatory rules for the protection of minority shareholders have been inadequately implemented on occasion. The appointment of the members of the board of auditors representing the minority has encountered difficulty due to the timing and manner in which the machinery for their election has been introduced. With few exceptions, directors have not called the shareholders' meeting to adopt the provisions indicated by the Ministry of Justice as guidelines for the experience requirements for members of the board of auditors. Many companies have not amended their bylaws to establish the additional rights of holders of savings shares in the event that ordinary or

savings shares are excluded from trading. As I shall discuss in more detail later, the rules of conduct and disclosure that members of the board of auditors and board of directors should follow in the event of specific corporate transactions are often disregarded, at least insofar as their substance is concerned.

16. In practice — elsewhere as well in Italy — minority shareholders find it difficult to assert their rights effectively in the shareholders' meeting, ideally the appointed forum for the exercise of corporate democracy. Nor is legal action an effective remedy, except in extreme cases. Recourse to the shareholders' meeting or legal means is not viable for minority shareholders who do not hold substantial stakes, since the economic and information-acquisition costs are too high. As Italian and foreign legal scholars have observed, in modern financial markets the minority shareholder is less a co-owner than a financial investor whose investment most often is not permanent. Today, far more than in the past, shareholders express their opinion of management with rapid "entries" and "exits", whose consequence is reflected in the price of the shares and hence in the cost of capital for the company. But for this expression of opinion to be timely, reasoned and motivated, disclosure by the company must be timely, continuous and thorough, especially with regard to all transactions that could give rise to transfers of income or wealth to the detriment of the minority shareholders. This is also a precondition for voices more powerful than the small shareholders — institutional investors, analysts, the specialized media — to be able to make themselves heard in order to exercise continual control on the behaviour of the directors.

It is also, indeed especially, in this respect that the situation in Italy is unsatisfactory both in absolute terms and compared to that in other countries.

17. The admission to listing rules in force in the United Kingdom lay down stringent requirements to guarantee company's capability of carrying on its business independently of the controlling shareholder. Listed companies' transactions with parties involving a potential conflict of interest are regulated in detail, with requirements for continuing as well as periodic disclosure to the shareholders and the market and for the shareholders' meeting to be called if the transaction exceeds certain limits. Similar rules apply in the United States. The Securities Exchange Act in the United States and the Companies Act in the United Kingdom also establish continuing disclosure requirements for transactions by corporate officers in securities of their company.

Many of these rules, such as those on listing requirements and on disclosure and conduct requirements for listed firms, are not imposed by law but are born from self-regulatory action and the exercise of control powers on the part of the stock exchanges, in the awareness that the growth of the markets depends on the degree of protection they offer to investors. Only subsequently are rules and controls transferred to a public institution. In the United Kingdom a public authority adopted the London Stock Exchange's listing rules in their entirety after the transformation of the Exchange into

a for-profit company.

Disclosure and conduct requirements in turn foster and stimulate control by the external environment. The greater transparency and continuous monitoring of corporate transactions to which issuers are exposed in London and New York often dissuade companies accustomed to greater opacity from seeking listing in those markets.

18. In Italy, the voices of the external environment have been quite feeble, at least in the past. The ranks of institutional investors lack the pension-fund segment. Virtually all the Italian funds are offshoots of banks, which are themselves listed or in close relationship with listed issuers. The ownership structure of virtually all the media, and the press in particular, does not provide an ideal environment for independent analysis of corporate developments.

Recently, however, environmental conditions have shown some signs of improving. Thanks to the diffusion of shareholdings, the press devotes more attention to corporate problems. Partly owing to growing competition, institutional investors are becoming more aggressive towards behaviour that could reduce the returns on the assets they manage. Their voice is beginning to be heard in shareholders' meetings and via their trade association.

But as long as disclosure remains deficient, the market is unlikely to be able to exercise systematic control.

As far as periodic disclosure is concerned, the Consolidated Law makes it the duty of the board of auditors to demand that the directors report on significant transactions by the company and its subsidiaries, particularly those potentially involving a conflict of interest. As I had occasion to say last year, and confirm this year, the recommendations that Consob addresses to boards of auditors are often disregarded in substance if not in form. For this reason Consob is preparing to establish guidelines for the conduct of boards of auditors, with a view to enhancing the rigor and active nature of the controls they perform.

The shortcomings are greater in the field of continuous disclosure. The Consolidated Law specifically addresses the disclosure of price-sensitive information and only regulates public disclosure in general terms. The stock exchange rules on admission to listing, which are weak in defining the requirements concerning company's capability of carrying on its business independently, do not deal at all with the continuous disclosure of corporate operations.

19. Under the existing system, there are two conceivable paths to improving this situation; they are not alternatives but can run side by side and even overlap each other.

The first, and preferable in principle, is that taken in other countries. Let the market

autonomously establish its rules, aware that its growth and ability to compete with other marketplaces depend on their quality. Borsa Italiana does not speak for the community of market participants: once a public entity, it has become a private company with shareholders that are themselves issuers and intermediaries interested in the listing process. Yet, at the same time that Borsa Italiana was privatized, it was assigned the function, of public interest, of deciding on admission to listing. The Consolidated Law requires that the market rules should "ensure … the protection of investors". Borsa Italiana could establish listing requirements that achieve the same objectives as those contained in the UK listing rules with regard to dealings with the controlling shareholder and transactions with related parties.

Failing this, there remains the path of regulation. This cannot involve rules of conduct for directors (such as mandatory calling of the shareholders' meeting for transactions with related parties in excess of a certain threshold), which should be based on the Civil Code. The reform of corporate law could have served such a purpose, but the opportunity was not taken in the legislature just ended. By contrast, regulation can intervene in the sphere of continuous disclosure. The Consolidated Law empowers Consob "on a general basis or otherwise" to require that "the information and documents needed to inform the public" be disclosed. In the absence of a regulatory initiative on the part of the management company, Consob may lay down definite rules on compliance with a requirement to disclose corporate transactions with related parties.

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An American scholar has remarked that there is something magic in the existence of a securities market: a market in which investors are willing to pay huge amounts to persons they do not know to acquire intangible rights whose value depends entirely on the information that is made available and the honesty of the seller. This magic can work day after day and a market can prosper if, and only if, there is a defensive system of institutions and rules protecting the investor in two respects: by reducing his informational disadvantage to the greatest extent possible and by protecting him from the risk that those to whom he has entrusted his investment might carry out transactions to his detriment for their own benefit. Public intervention is certainly necessary to ensure this defence, but it is not sufficient.

As my namesake— an illustrious one — wrote well over a century ago: "The law does not exist only because it is written in statutes. It needs an enlivening spirit that makes a reality of it. It needs men who are able to demand observance of it for themselves and who observe it for others". For more than one reason, these wise words hold particularly for company and market law. Where it best protects savers, it was largely not imposed from above but born from below: from the autonomous making of

the rules to be observed in order to participate in a market, established in the awareness that the protection of investors contributes to financial development, and the latter to the growth of a capitalist system. When this awareness is widespread, and widespread is the “enlivening spirit” that make the laws real, regulation can be less invasive and hence less costly for the interested parties, who can find more room for autonomously devising the most efficient means for achieving the objectives that inspire the legislation on markets. When these objectives are shared, those who do not observe the rules incur a higher cost: alongside and more effective than the sanctions established by the rules, the loss of reputation and name and the shame inflicted by the market.

The quality of a financial market does not depend only on that of the rules governing it or that of the public institutions supervising it. It also depends on the quality of the conduct of the participants that raise, manage and intermediate capital there. It is precisely in this direction that the Italian financial market can and must make further progress.