CONSOB

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PER LE SOCIETA' E LA BORSA

# *ANNUAL MEETING WITH THE FINANCIAL MARKET*

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Mr. President, Minister Tremonti, ladies and gentlemen

We are honoured by the President of the Republic again attending the presentation of Consob's annual report to the financial market. On behalf of the Commission, I thank him for this attention and add a personal note of warm gratitude for a presence that I consider confirmation of an authoritative and friendly interest in the activity that I am about to conclude.

I thank the Chairman and the Board of Directors of Borsa Italiana for having again hosted this event in Palazzo Mezzanotte.

***The reaction to the misdeeds***

1. A strong market can support shocks, it metabolizes them and continues on its path. This is what happened after the crises in Asia and in Russia and that of a leading hedge fund. By contrast, an intrinsically weak market will be further weakened by unexpected events. September 11 did not affect the economic fundamentals, on the contrary it testified to the resilience and flexibility of the financial system. The war in Iraq lasted a short time, without impinging on the supply of oil. And yet importance has been given only to the bad news, the good news has been ignored. Stock markets, after a prolonged and at times precipitous fall, have ended up in the doldrums, with a high level of volatility. Uncertainty prevails and investors, with their confidence shattered, have neither the will nor the occasion to bet on a lasting upturn.

Perhaps they are not wrong: the correction of the earlier excesses has not run its course; there is no sign of a solid recovery that would generate more favourable profit expectations; banks' transfer of credit risks and the tribulations of private pension systems may still cause victims; and the sight of the gallery of

corporate horrors, which continues to add to its already large collection from various sources, leads investors to doubt the reliability of company accounts. When macroeconomic uncertainty is coupled with microeconomic mistrust, a depressive effect is guaranteed.

2. In the United States there were good reasons for mistrust, today there are less.

It took only a few months for it to be clear that the story of Enron as an isolated rotten apple was a fairy tale. With the end of the stock exchange euphoria, it was realized that there were too many rotten apples; the numerous corporate frauds that subsequently came to light proved even worse than those committed at Enron. It also became clear that underlying the frauds were systemic vices and weaknesses: distortions in the structure of incentives; rough-shod riding over internal controls; acquiescence and conflicts of interest in the auditing profession; fraudulent conduct and conflicts of interest in investment banks; the ineffectiveness of self-regulation; and the inadequacy of supervisory regulation.

But the reaction of the American authorities to these shameless attacks on the good faith of investors, and thus on the integrity of the markets and the very functioning of a capitalist system that has its roots in the financial markets was immediate and tough. Judges and regulators have already obtained not only the payment of substantial sums in restitution by investment banks, to be devoted in part to the financing of independent research, but also an internal reorganization to prevent conflicts of interest. The stock exchanges have tightened their listing requirements. But above all in just a few months Congress passed the most far-reaching legislative reform since the Securities Exchange Act of 1934. The Sarbanes-Oxley Act addresses corporate governance, financial reporting, the requirements for auditing firms, public control on the quality of auditing, the procedures and time limits for the disclosure of material facts and evaluating

companies' results, and the duties of financial analysts. Rigorous and binding obligations have been introduced for directors, especially those responsible for the internal audit function, and the applicable criminal sanctions have been made more severe. In many cases the Act delegates the implementation of its provisions to the supervisory authority; accordingly, the SEC is rewriting and adding to its rules.

The new US legislation has been criticized from opposite standpoints. On the one hand, some doubt its effectiveness; on the other, there are those who argue that a knee-jerk reaction to the scandals has led to excessive interventionism. Looking at individual measures, support can be found for both positions. However, there can be no denying that the Sarbanes-Oxley Act and the implementing rules issued by the SEC have strengthened the defenses serving to protect investors and established a benchmark for other countries' legislation.

3. There are no signs of an equal drive to reform in European countries, notwithstanding some legislative initiatives adopted in the wake of the events in the United States. Even though Europe has contributed some major works to the gallery of horrors, it is a fact that the cases that have emerged have been on a smaller scale than those that have come to light in America. In the conditions of concentrated ownership prevailing in continental Europe, there is less scope for management hubris to cause damage, while the appropriation of value from minority shareholders is achieved in less clamorous ways. There was also evidence that European supervisory rules and practices were more effective than those in the United States before the adoption of the new legislation. However, we should set aside any satisfaction we may have secretly harboured for the misfortunes of others; today, Europe must measure up to the new standards set in the United States.

In the meantime the US reform raises other problems for Europe. The new legislation has extraterritorial consequences since it also applies to foreign issuers listed in the United States (and in some cases to European companies controlled by American companies). The possible incompatibilities between American law and legal systems in Europe are most pronounced with regard to the obligation for auditing firms to register with the new American Public Company Accounting Oversight Board, the latter's powers vis-à-vis foreign accounting firms, the functions and membership requirements of audit committees, and the obligations of chief executive officers. The European Commission and individual countries are negotiating to obtain the recognition, at least in some cases, of the validity of European rules, which, although with formal differences, are basically equivalent in substantial terms for the purpose of protecting investors. In Italy, for example, there is already public control on the activity of auditing firms and the tasks and membership requirements of boards of auditors are the same as those of audit committees. On some matters the SEC has already accepted the European position; as yet the question of the overlapping of controls on auditing firms has not been resolved.

Even if the negotiations are successful, the time has come and the opportunity is propitious for the introduction in Italy of some necessary innovations regarding external audits, with account also taken of the recommendations of the committee set up by the Minister for the Economy and Finance. At the very least it is to be hoped that the Ministry of Justice will issue the regulation on the independence requirements for auditing firms, which has now been pending for five years.

***The European internal market***

4. The fragility of Europe's institutional structure has not prevented significant and partly unexpected progress in the implementation of the action plan for the construction of a European internal market for financial services.

In 2002 the regulation on the application of international accounting standards was approved, together with the directives on financial collateral arrangements, distance selling, market abuse and financial conglomerates. In 2003 the directives on pension funds and the modernization of the accounting directives will almost certainly be approved and the prospectus directive may be approved. The takeover bid directive and that on investment services could also see the light of day before the end of this legislature of the European Parliament in 2004. The Commission has proposed a directive on transparency requirements for listed companies.

The procedure proposed in the Lamfalussy Report, approved by the Stockholm European Council in 2001 and subsequently by the European Parliament, has begun to work. The adoption of the technical measures implementing directives, prepared by the Committee of European Securities Regulators (CESR) and proposed by the Commission, is entrusted to the Securities Committee, made up of representatives of the Member States, without recourse to the codecision procedure. It is to be hoped that the divisions that frequently held up decisions in the Council will not reappear in this Committee.

5. From time to time the proposal re-emerges to establish a single European regulator. It would be necessary to create the necessary legal basis, which is lacking today, in an ad hoc provision of the new European constitution. But it is far from obvious that this is the best way, at least today, to ensure consistent rules in the European financial marketplace. A more gradual and flexible approach

appears advisable, which would also be in line with the trend towards decentralized controls that is emerging in other fields within the Community.

The functions assigned to CESR by the Stockholm European Council, again following the indications of the Lamfalussy Report, outline this approach. CESR is required to establish the interpretation and verify the transposition of Community legislation and to provide guidelines and common standards for national regulations and verify their implementation in terms of content and practice. Convinced action by the regulators of the Member States in this direction would make it possible to remove the obstacles that the fragmentation of supervisory rules and practices put in the way of integration. It would result in a desirable, but not always desired, reduction in the autonomy of the individual national authorities, which will have to accept, without nationalist or protectionist resistance, the constraints that derive from their participation in the European market for financial services.

6. The directives approved and those that will be approved will introduce important innovations into the legal systems of the Member States. The market abuse directive is a significant example in Italy's case.

Under Italian law insider trading and market manipulation are criminal offences. Except when it is acting at the request of a magistrate, Consob sends the results of the investigations it carries out on its own initiative to the judicial authorities. In its inquiries Consob can carry out inspections and require the transmission of data and information only in the case of persons subject to supervision; it can request but not require other persons to testify. The present system is not very effective in terms of prevention and repression. This is partly due to objective difficulties; in Italy, as in other European countries, it is always difficult to link the perpetrator of an insider trading offence to the source of the privileged information. But it also needs to be noted that Consob's powers are

limited and that criminal proceedings are inevitably slow and take a long time to reach a conclusion.

The new directive calls for administrative punishments for market abuse and provides for the competent supervisory authority to be given much stronger investigative powers. Member States may also impose criminal sanctions but are not obliged to do so. Consequently, a whole chapter of the Consolidated Law on Financial Intermediation will have to be rewritten. Parliament and the regulatory authority will therefore have to address some major issues: to create a system of administrative sanctions that, as required by the directive, is "effective, proportionate and dissuasive"; to assess the desirability of maintaining criminal sanctions and, if so, to define the relationship with those of an administrative nature; to identify the body responsible for imposing administrative sanctions, taking account of the preference of Community law, cooperation agreements and international practice to entrust this task to an independent administrative authority; and to reconfigure not only Consob's powers but also its internal organization in order to separate the investigative phase from that of passing judgement and imposing sanctions.

***Listed companies***

7. A reform has recently been approved that modernizes Italian company law in line with the needs of the market and Community obligations. For listed companies, which are subject to the special regime established by the Consolidated Law on Financial Intermediation, there are some significant innovations.

The reform has improved the rules on transparency, especially as regards directors' conflicts of interest and intragroup relationships. The deposit of shares in order to attend shareholders' meetings has been transformed from a general obligation into a provision that can be included in companies' bylaws, with a

shorter period of deposit and simplified procedures, thereby making attendance easier for minority shareholders and especially for institutional investors. The issue of bonds has been liberalized and the rules applying to listed companies have appropriately been extended to companies whose shares are widely distributed among the public.

By contrast, the new penal provisions give rise to problems. The quantitative and qualitative, objective and subjective thresholds introduced for the punishability of false corporate disclosures are a cause of uncertainty, *inter alia* for Consob's reports to the judicial authorities. The amendment of the rules on market manipulation involving financial instruments, conceived merely as a rationalization, has been interpreted as restricting the scope of the offence; it will not survive the transposition of the new directive.

If the criminal code is to be invoked only as a punishment of last resort, in the belief that it is not always the most suitable way to counter corporate and market offences, severe administrative sanctions and effective civil law remedies must be available. In Italy the former are mild and the latter inefficient, despite the innovations introduced by the Consolidated Law. The procedure for derivative actions is complicated and they are difficult to bring because they have to be initiated by shareholders owning at least 5 per cent of the capital; they are also costly in terms of both legal expenses and the time required to settle disputes.

Furthermore, the fact that false corporate disclosures can be investigated by the authorities on their own motion only for listed companies increases the special nature of the rules applicable to such companies and might reduce the propensity to go public.

8. The new legislation needs to be reconciled with the Consolidated Law on Financial Intermediation.

In the new models of management and control that have been introduced as an alternative to the existing one, the functions of the board of auditors are assigned to a supervisory board or an audit committee within the board of directors. The members of the supervisory board are appointed by the shareholders' meeting, whereas those of the audit committee, appointed by the board of directors, may not be executive directors and must satisfy the same independence requirements as auditors. The boards of auditors of listed companies are now entrusted with important supervisory tasks and are required to report the irregularities they find to Consob. Even though the new legislation establishes the general principle that all compatible provisions are to apply to the new control bodies, this is a question that deserves a more specific legislative clarification.

Under the Consolidated Law, the bylaws of listed companies must provide for minority shareholders to be represented on the board of auditors. In the absence of a specific provision, the question arises as to whether this rule also applies to the supervisory boards and audit committees introduced as an alternative to the board of auditors. If this were not so, an unfortunate retrograde step would have been taken with respect to the Consolidated Law.

The election of directors by the shareholders' meeting and the satisfaction of formal independence requirements can provide (but as events in the United States have shown do not always provide) a guarantee for minority shareholders in systems, such as those of the Anglo-Saxon countries, where the ownership of companies is widely distributed and controlling shareholdings are not common. They provide much less of a guarantee when, as in continental Europe and especially Italy, many companies are subject to majority or working control. In practice, it will always be the controller who chooses the directors who should control him. Appointment by the shareholders' meeting and the satisfaction of formal independence requirements are not enough to prevent such directors from

being substantially dependent on the controller. The presence of representatives of the minority shareholders provides a more effective defense of shareholders' rights. The Italian association of fund managers has requested the companies making up the MIB 30 index to adopt this solution and has also recommended that the minority shareholders should nominate the chairman of the board of auditors or the supervisory board as the case may be.

9. The introduction of bylaws that permit the representation of minority shareholders and the easing of the rules on the depositing of shares for participation in shareholders' meetings offer minority shareholders an opportunity. To profit from it, they must be present and active in shareholders' meetings. This is not the case in Italy. Even though auditors representing minority interests are provided for in the bylaws of all the listed companies, they exist in less than one in four.

The minority shareholders who are in a position to exert an influence and exercise their rights are not individuals, partly because, even though proxies may be collected in Italy, this is hardly ever done. Institutional investors can and should take action. But a study of the ordinary shareholders' meetings called to approve the 2001 annual reports of the fifty largest listed companies shows that the presence of Italian investment funds, which on average owned 5 per cent of the capital, amounted to no more than 0.5 per cent of the capital and to about 1 per cent of that present at the meetings. Absenteeism was most pronounced in the meetings of banks and financial companies. Attendance at extraordinary shareholders' meetings was higher, but directors and auditors are appointed in ordinary shareholders' meetings, which in any case are an important opportunity to express a judgement on the management. In comparison, the attendance of foreign funds was much higher. The efforts of the association of fund managers to encourage greater activism on the part of Italian funds are praiseworthy. The impression nonetheless remains that the latter's sins of omission with respect to

shareholders' meetings are not unrelated to the predominance of funds belonging to banking groups.

10. Disclosure and transparency requirements take on special importance in a system in which ownership is concentrated and the voice of minority shareholders consequently weak, the activism of institutional investors is modest, and the legal defenses are relatively ineffective and in any case expensive. As a great American judge once said, to prevent the ills of markets, there is no better disinfectant than the light of the sun. Italian legislation on transparency is among the most advanced; regulatory rules and supervision devote close attention to issuers' compliance with ongoing and periodic disclosure requirements.

Recent regulatory amendments have imposed disclosure requirements for material corporate transactions with related parties, potentially involving conflicts of interest with respect to shareholders, and the monthly reporting of transactions carried out by the parent company involving listed securities issued by group companies.

The threshold of 2 per cent of the capital for the mandatory disclosure of holdings in listed companies is lower than in any other country and well below that of 5 per cent set in the proposed transparency directive. Recent events have pointed to the desirability of improving the current rules. Regulatory amendments will bring a desirable reduction in the time allowed for publishing announcements; the intervals for the mandatory disclosure of purchases above the 2 per cent threshold could be made smaller; and the notion of holding, which already includes the right to make acquisitions in the future, could be extended to other recently introduced derivatives. It is up to Parliament, if it thinks fit, to set the 2 per cent threshold at an even lower level.

11. Consob frequently requires listed issuers to provide shareholders' meetings with additional information, so as to ensure the completeness and adequacy of that which is made available. On other occasions it asks companies to correct the accounting data contained in their periodic reports. The changes they make avoid the need for Consob to use its power of challenging their annual financial reports.

The end of the euphoria of the 1990s has created uncertainty about the ability of some companies to continue in business and evident balance sheet strains. Auditing firms that issue a disclaimer or a heavily qualified opinion are doing their duty. The independence of their work must not be influenced by the protests of the interested parties. Consob has required listed companies that are in a critical state to make updated information on their performance public on a monthly basis; at present twelve companies are subject to this requirement.

A recent European regulation makes it obligatory for listed companies to draw up their consolidated accounts in accordance with international financial reporting standards, specifically IAS. This achieves the dual objective of improving the quality of information and harmonizing it across the European Union.

Member States are given the right to extend the obligation to individual company accounts and to unlisted companies. It is to be hoped that this right will be exercised, at least for individual company accounts, so as to ensure the comparability of financial information in the case, for example, of issuers that do not draw up consolidated accounts. It will be necessary to adapt national law accordingly, above all as regards the implications for tax rules. The European regulation does not appear to provide for the application of accounting standards adapted to the branch in which companies operate, a singular innovation introduced in Italy for football clubs.

In response to a request from the European Council and the European Parliament, CESR has adopted some important general rules aimed at making the

administrative controls on the quality of the information contained in the accounts of listed companies and prospectuses published in Europe more effective and more homogeneous across the Union. The risk-based method of supervision proposed by CESR also provides the basis for an agreement with the US authorities.

12. Consob's supervisory duties with respect to listed issuers are clearly defined by the Consolidated Law. The Commission nonetheless receives requests to intervene or express an opinion on matters that are outside the scope of its authority and that of the regulatory authorities responsible for markets in other countries.

To give just one example, it is not one of Consob's tasks to give an opinion on the fairness of the exchange ratios established for mergers and acquisitions. Once the shareholders' meeting has given its approval, the valuations of the experts engaged can only be contested in the courts. Generally speaking, responsibility for settling disputes between shareholders and directors lies with the courts, to which Consob itself has recourse when it exercises its well-defined powers of challenging resolutions.

Nor is it up to Consob to express an opinion on the technical, industrial or political merits of controversial corporate actions or battles to change companies' ownership structures, which are not infrequent in a closed system such as Italy's. Consob is required to check that such actions and battles are carried out in accordance with the rules and to intervene when the rules are broken — nothing less, but also nothing more.

***Households' investments, the official list, corporate bonds***

13. In the last five years of the last century, Italian households, disappointed by the fall in the yield on government securities and attracted by a rise in equity

markets that appeared unresistible, enormously increased their exposure to risk and in just a short time reached the levels obtaining in the more advanced countries. The percentage of their financial wealth consisting of shares of Italian listed companies quadrupled, that of investment funds nearly quintupled and that of equity funds sextupled; the percentage of corporate bonds doubled, while that of government securities fell by two thirds. Overall, households' investments in risk-free financial assets decreased from just under 80 per cent of the total in 1995 to about 50 per cent in 2000.

Just as the switch to risky investments was rapid, the beating investors took with the 45 per cent fall in markets in two years was painful and had significant effects. Between the end of 2000 and September 2002 the percentage of households' financial wealth consisting of shares of Italian listed companies fell by two thirds, that of equity funds halved. These decreases were mostly due to the fall in prices but a not insignificant part (between one third and one fifth) can be attributed to disinvestments. In relative terms, households' exposure to risky assets nearly returned to its level in 1995.

14. On the corporate side, the fall in prices and the consequent increase in the cost of capital not only led to a drastic reduction in the supply of shares of newly-listed companies but also encouraged buybacks with a view to delisting. In the three years 2000-2002, there was a negative balance of more than 8 billion euros between funds raised through new share issues and those returned to the market through buybacks aimed at delisting . After rising until 1999, the number of companies listed on the MTA electronic share market declined in the two following years and remained stationary in 2002.

The smallest number of listed companies thus remains a characteristic of Italy's stock market. In other respects the changes were limited. The companies that went public have given new lymph to the official list, but the bulk of the

capitalization of the market is still accounted for by the old wood and, among the more recent growth, by privatizations. The free float has increased, but is still only just above half the market capitalization and is much lower, especially for large companies, than that of any other country, including those of continental Europe. Of the 231 companies listed on MTA, only 32 are not subject to majority or working control. Only rarely are acquisitions made by way of share exchanges, which in other countries have served to dilute the holdings of the leading shareholders. Although less significant than just a few years ago, the double counting due to the presence in listed companies' portfolios of investments in other listed companies still concerns one fifth of the capitalization of the market. Recent operations serving to shorten the chain of control will improve this situation and reduce the singularly high ratio between capital controlled and capital owned.

15. Thus, despite some progress, the quality of participation in the Italian stock market remains unsatisfactory. This cannot be blamed on the technical quality of the trading facilities, which, thanks to extensive and timely innovation, cut a good figure in international comparisons: spreads are relatively small and the ratio between volume of trading and market capitalization relatively high. The main problem lies in the persistence of a low propensity on the part of Italian firms to go public, the causes of which are to be found in turn in certain features of the structure of Italian finance and industry. The system is still dominated by banks with a preference for traditional forms of finance and less willing or less able (as shown by research carried out for Borsa Italiana) to provide services for the run-up to listing. Firms are small and reluctant to grow; they prefer family control and self-financing; and they concentrate on traditional sectors of production, which require limited capital spending on innovation and therefore need less external equity capital. Consequently, the advantages of going public are small in relation to the cost of listing and the consequent obligations.

16. Perhaps owing to stock market conditions, private equity is gaining in importance in Italy as well. The contribution to the growth of firms of this sort of third way between banks and the market depends considerably on how it is configured. The benefit is small when funds are raised in rich areas where they are surplus to firms' opportunities or desire to invest and used to acquire major shareholdings in listed companies; in such cases, resources that are the fruit of production are turned, one could say, into "financial" assets. The investment of private funds in the equity capital of promising unlisted medium-sized firms to improve their management, foster their growth and, where appropriate, take them to the market is a much more interesting model of private equity that encourages industrial development and experimentation with new forms of corporate governance.

Investments of the second kind are necessarily long term and high risk. They are better suited to the participation of large qualified shareholders than to the raising of funds from small savers, who are not in a position to intervene in the choice of the firms to invest in. This is all the truer when the fact of belonging to a banking group may expose the manager of investments in unlisted companies to conflicts of interest.

17. In flight from government securities and then, in the last two years, from equities as well, Italian investors have made large net purchases of corporate bonds: more than 180 billion euros between 1995 and 2000 and more than 130 billion euros in the two following years. For the most part purchases were of bank bonds, but there was also strong growth in purchases of foreign bonds and in the last two years of bonds issued by companies other than banks. This market appears to represent a natural haven in alternative to the equity market for inexpert and risk-adverse investors, although sometimes the appearance may be misleading.

Apart from normally being illiquid, non-bank bonds are exposed to the risk of the issuer's insolvency. This should be made clear in the prospectus and reflected in the ratings produced by specialized agencies, although the situation can change and the ratings be revised during a bond's life. Most bonds are purchased at banks and are not listed on the domestic market. Issues of Italian industrial bonds are usually small and, in contrast with the situation in the rest of Europe, half of them (one fifth in value terms) do not have a rating.

Italian investors have suffered heavily from the insolvency of a sovereign borrower and to a lesser extent from that of an industrial borrower. In other countries, including some smaller ones, industrial insolvencies have involved much larger sums and much higher percentages of total issues.

Preventive action by the supervisory authority in such cases is far from easy. When checks are made to see whether investors have been informed of the risks that accompany the promise of high yields, there is usually a mass of forms signed (passively) to accept them. Purely formal observance of conduct of business rules is not sufficient, however, to exclude punishable offences. The obligation intermediaries are under to know the features and risks of products and to inform customers accordingly should be all the greater where a prospectus does not have to be published and handed over. Careful investigations are being made into the conduct of intermediaries in connection with recent insolvencies. Consob intends to make regulatory amendments within the scope of its authority with the aim of introducing procedures whereby clients will receive more adequate information on the risks associated with investments, especially as regards nonrated bonds, which statistics show to have a higher probability of insolvency.

The market for bank bonds raises problems of a different kind. In the last few years the proportion of total issues consisting of structured bonds, which have a significant derivative component, has grown rapidly compared with that of traditional bonds (with or without an early redemption clause) and is now close to

one third. Since these products are sometimes highly complex (and, like all bank bonds, not subject to the rules on public offerings), it is questionable whether the information made available to investors is adequate. Not always does the answer appear to be affirmative; financial engineering may be aimed not so much at mitigating the risks incurred by investors as at transferring them from the intermediary to its clients. The same holds for some innovative forms of asset management.

Consob will devote part of its website to information on the characteristics of the more complex and hence more problematic financial products. It has already provided information on reverse convertibles, issues of which have fallen to zero. A forthcoming European directive provides for the prospectus requirement to be extended to bank bonds.

***Markets and intermediaries***

18. Technology and competition give rise to major changes in the structure and functioning of markets and intermediaries and in the distinctions between their respective roles. Virtual trading locations multiply, divide and compete. Multilateral trading systems are created alongside the existing stock exchanges; especially abroad, intermediaries set themselves up as markets; large investors want to be direct counterparties in the market without the need for intermediaries. These are the forces at work, which it is desirable to regulate but that it would be foolish to try to counter through regulation. Besides, we do not know what the outcome of these processes will be; we could be passing through a period of creative destruction that will end with just a few strong markets and intermediaries surviving.

The first thing to have gone by the board is the idea of the concentration of trading. Already it is only partial. In Italy the following are exempt from the concentration requirement: bloc trades, transactions carried out by non-resident

investors and those for which clients authorize the execution at better conditions on unregulated markets. The existence of a plurality of regulated markets, together with a plurality of alternative trading systems, will make the concentration requirement meaningless in operational terms. This is recognized in the proposed second investment services directive, which contains no reference whatsoever to concentration.

Without concentration there is the risk that it will no longer be possible to find and punish violations of the best-execution rule for clients' orders. How, for example, will it be possible to continue to require compliance with the rule in the case of execution on the regulated market (i.e. on the stock exchange to date) when there is more than one regulated market and there are also alternative trading systems? Moreover, how will it be possible to ascertain that an individual trade was carried out at conditions no less favourable than those offered by other trading systems, without even considering the search costs for both the intermediary and the client? The directive itself is in difficulty when it attempts to define the requirements for best execution in a list that is both incomplete and too long.

For regulatory purposes it is perhaps advisable to adopt a different approach to the problem. In the first place there should be complete transparency for bids and offers in retail trading on all markets. This would facilitate arbitrage and allow intermediaries to provide best execution and give them an incentive to do so, in order to avoid protests from clients able to compare prices on the various markets. While the directive would allow intermediaries to "internalize" orders by acting as the counterparty, it correctly requires those that do so to announce prices in advance. The vociferous objections to this rule appear to be dictated more by fear of its effects on the costs and profits of some large foreign intermediaries than by considerations of a general nature.

Once a satisfactory level of transparency has been achieved for quantities and prices, supervision should shift its attention, in a context of fragmented trading locations, from markets to intermediaries. Rather than impose rigid rules or requirements, regulatory authorities will need to pay more attention to order execution procedures with a view to evaluating their adequacy, among other things in the light of the trading location chosen.

19. The Consolidated Law on Financial Intermediation refers to regulated markets in the plural and not to the stock exchange in the singular. Consob's implementing regulations turned the plural into the singular. At present Community law governs only "admission to official listing" and does not distinguish between admission to listing and admission to trading, a distinction that is made instead in the new directive on investment services. In Italy the only regulated market in existence today provides for admission to both listing and trading. In England admission to listing is not in the hands of the markets, which can admit to trading all the securities admitted to listing by a public authority. In Germany and Belgium securities can be admitted to trading on regulated markets other than the official one even without the issuer making an application.

Consob has recently amended its regulations in this respect. From 1 July 2003 it will be possible for other regulated markets subject to Consob's supervision to be recognized and for securities admitted to listing by Borsa Italiana to be admitted to trading thereon without the issuer making an application. Borsa Italiana, which undoubtedly deserves credit for having created a modern and efficient market on a par with the highest international standards, was understandably not pleased by this innovation. I should like to point out, however, that in the long term competition is always beneficial — even competition between markets, especially when this prevents the privatization of a public-sector monopoly from giving rise to a private-sector monopoly.

The reasons that have led Borsa Italiana to ask to be listed are understandable, especially with a view to international alliances and mergers. Consob has no objection to this desire but, as things stand, is faced with an obstacle to its realization. There is no legal basis for Consob to undertake Borsa Italiana's listing and supervision, since that company clearly cannot list and supervise itself. A change in the law could resolve this problem.

20. Italian investment firms fear the effects of some of the innovations in the proposed new investment services directive. One provision would allow insurance companies to be eligible counterparties in the markets and leave it up to individual Member States whether to allow investment funds, pension funds and their management companies to be eligible counterparties.

Such disintermediation could enable asset managers to reduce their transaction costs, hopefully to the benefit of clients. For this reason the possibility of such entities being eligible counterparties deserves favourable consideration in terms of the general interest. However, it is not possible to overlook some potentially harmful effects on the investment services industry, especially smaller firms. These could be driven out of the market by the reduction in their turnover, with a consequent increase in the degree of concentration. Alternatively, the further reduction in fee income might lead firms to engage more heavily in intraday trading or crossed trades with immediate closure or conduct detrimental to the market, such as improper cancellation of orders or front running, practices that are already too widespread and which have become more frequent with the decline in intermediaries' profitability.

21. An increase in concentration in the field of securities intermediation could lead to a reduction in the analyses and research services provided to investors. In establishing whether this would be harmful, it is first necessary to consider the reliability and independence of such services. Early on Consob documented the

frequent lack of these requisites and, compatibly with a law that ignored financial analysts, adopted regulatory countermeasures to the extent possible in the absence of comparable rules in other countries. The corporate scandals of the last two years have opened everybody's eyes to the seriousness and extent of the problem.

In the United States the SEC has established new regulations, both as part of an overall settlement with the investment firms accused of misconduct and in a rule issued in February 2003. Some European countries are moving in the same direction. The European directive on market abuse provides for the regulation of full and fair disclosure of conflicts of interest, including those with regard to the remuneration of analysts. IOSCO intends to issue standards, to which the national legislation of member countries should refer, on transparency, rules of conduct for analysts, their remuneration and qualifications, and intermediaries' procedures. These initiatives should lead to national legislation converging towards a common regulatory framework.

In Italy, Parliament will need to provide a legal basis for regulatory activity. The input of the interested parties will certainly be important. The Italian association of financial analysts has recently updated and improved its code of conduct and made provision in the event of violations for reprimands, which may also be public. This initiative is responsible and commendable but also demanding; it will have to be assessed in the light of the rigour with which it is implemented. Effective self-regulation makes it possible for public regulation to be less intrusive and costly, both for the market, which has to comply with it, and for the regulatory authority, which has to enforce it.

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The Consolidated Law on Financial Intermediation has assigned new duties to Consob, others derive from Community law. Supervision and regulation must keep abreast with the innovations in markets and financial intermediaries. The

number of persons subject to supervision is growing, savers' investments in risky assets are expanding. The potential pathologies are on the increase; to forestall them, there is a need for continuous and systematic preventive controls. European and international commitments are becoming more and more demanding.

In other countries the resources allocated to the supervision of markets have increased in the wake of the recent corporate scandals. Not so in Italy; between 2001 and 2003 the funds transferred to Consob by the state have contracted by more than 7.5 million euros.

Since 1995 Consob has been able to make persons subject to supervision pay fees. As far as possible it has made good the reduction in state transfers by curbing expenditure through the application of appropriate mechanisms for the planning and control of the use of its resources. It has not been able, however, to avoid a further increase in the market's contribution, which has risen from less than 40 per cent of budgeted revenues in 1997-98 to more than 50 per cent in 2000-01 and to nearly 64 per cent in 2003.

It is not possible to foresee the future evolution of the composition of Consob's revenues since the three-year budget allocations are subject to sudden curtailment in relation to the state of the public finances. Greater certainty would be an advantage, both for Consob and for the industry, which has the right to know how much of the cost of supervision it is required to pay. Experience abroad shows that there are other ways of financing supervisory activity, what is important is that one should be chosen and adhered to consistently.

Consob, which is about to celebrate its thirtieth anniversary, was the first of the now large family of so-called independent administrative authorities — the first but by no means the favourite. It does not enjoy privileges that Parliament gave to its younger counterparts, it is still subject to a number of constraints that it was deemed advisable to impose at the start.

At its birth Consob was little more than a department of the then Ministry of the Treasury. It overcame this situation only some ten years later, when, endowed with legal personality, it was authorized to take on staff from outside the civil service. It did not succeed, however, in freeing itself from a series of bureaucratic and administrative constraints: a hard-to-modify system of rigid career paths with limited scope for crossing from one to another; the need to obtain the approval of the Prime Minister's Office for every organizational change of any significance. Practices linked to Consob's origins and set down in its organizational rulebook require decisions to be taken jointly by the members of the Commission that could be handled better by executives. I am unable to understand the benefits deriving from these constraints. I clearly perceive the costs they entail: obstacles to recruitment, to the recognition of ability, to organizational flexibility and to innovation.

Yet flexibility, the development of professional kills, the ability to adapt to innovations are especially important for an authority called upon to stand guard over the protean reality of the financial industry and endowed with different duties and powers from those of other independent authorities.

It is necessary to understand the functioning and development of the financial markets in order to supervise them better and forestall their pathologies. It is best to main a continuous and transparent dialogue with them, in part so as to develop efficient regulatory solutions. Modern regulation complies with the principle of proportionality between administrative costs and results, formulates rules that address the substance of problems and does not trap the supervisor and the supervised in the pedantic application of highly detailed formal rules. Supervision must continuously identify the areas where the risks are greatest, so as to allocate the resources available selectively. Today, with markets for which national boundaries do not exist, a national authority has to tackle a larger sphere, above all it must operate in a European dimension. It is worth asking how a

universal geometry of the independent administrative authority can take adequate account of these special features.

I am convinced that in recent years, despite the organizational constraints to which it is subject, Consob's culture and operational practices have developed in the right direction. If this is so, the merit lies in the first place with my fellow commissioners, with whom I have spent five years marked by shared aims, mutual respect and, most importantly, freedom of judgement. I assign equal merit to Consob's staff: made up of highly qualified persons; working under great pressure because the market always demands an immediate response; committed to public service; and convinced that complete independence from other powers is Consob's and their greatest asset.

A modern institution capable of facing up to the market on equal terms in the performance of its duties is what Consob must increasingly become, by adapting its rules and procedures. I am sure it will succeed.