CONSOB

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PER LE SOCIETA' E LA BORSA

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SPEECH BY THE CHAIRMAN, LAMBERTO CARDIA

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Honourable Minister for the Economy and Finance, Ladies and Gentlemen

The Commission is grateful to Borsa Italiana for hosting today's meeting in this splendidly restored exchange, which evokes many memories of the history of our markets.

In June 2003 Professor Luigi Spaventa completed his chairmanship of Consob and returned to university teaching.

We thank him for his commitment to Consob, for his contribution of expertise and ideas, and for the valuable role he played in international fora, which was widely appreciated and made it easier for Consob to carry out the increasingly demanding tasks it is called upon to perform at that level.

At the end of October Professor Filippo Cavazzuti retired early from his position of Commissioner to return to the University of Bologna. Consob benefited greatly from his commitment and expertise and is duly grateful to him.

Paolo Di Benedetto was appointed Commissioner in June 2003 and brings to Consob a rich endowment of experience and expertise.

Since November the Commission has operated one short of its full complement pending the appointment of the fifth Commissioner.

Consob's presence in Milan will shortly be consolidated in new premises. Owing to the discovery of archeological remains, the renovation of Palazzo Carmagnola in Via Broletto, which the Municipality of Milan has made available for Consob's use, will now be completed towards the end of 2004 or at the latest early in 2005.

Corporate crises and confidence in the markets

1. The crises that involved issuers and intermediaries during 2003 had a powerful impact on the Italian financial market owing to the scale of the activities and interests that were impaired and the seriousness of the pathologies revealed.

Corporate crises are inherent in the working of market economies; they can undermine the confidence of market participants when they reflect structural shortcomings in the prevention and prompt detection of the sometimes fraudulent behaviour that is the cause.

Last year was marked by a conjunction of situations impinging on the protection of savings; problems emerged regarding the transparency of the management of listed groups and investors' relationship with intermediaries. After the cases of the trading of Argentinian bonds and financial products structured in a way potentially capable of misleading investment choices, with the Cirio case the corporate bond market was involved for the first time in Italy.

It was in this tense situation that the scandal of the Parmalat group came to light. It proved to have systemic implications, and both underscored and symbolized the ineffectualness of companies' internal controls and audits of listed companies; it also had serious repercussions on financial markets.

In this case, as in those of Giacomelli and other smaller companies in difficulty, the widespread distribution of corporate bonds among the public revealed shortcomings in the relationship between investors and intermediaries.

The pervasive nature of the crises fosters a climate of uncertainty and mistrust and could well have adverse medium-term effects on the growth of the markets and the financing of firms; it increases the fear and perhaps the risk of analogous cases occurring in the future.

On 7 October 2003 I informed Parliament of the spread of a climate of mistrust and of the need for rapid measures in favour of those investors who could be considered "innocent injured parties".

That testimony, which met with a variety of contrasting assessments and did not immediately lead to any action, was based on awareness that the events that had occurred, especially the default on Cirio bonds, were shaking the market's confidence and gradually acquiring considerable international notoriety.

There was also the consideration that a prolonged crisis of confidence might have led to an increase in the cost of capital and a reduction in the availability of credit; it might also have further diminished the already limited propensity of Italian firms to turn to the capital market and thus made the financing of their growth more difficult.

On 31 October 2003, the question was raised again. Subsequently, the banking system launched a variety of initiatives, based on individual procedures and evaluations, designed to indemnify investors.

This, moreover, was before the markets were hit by the Parmalat affair, which exploded in December – basically as a consequence of the pressure of Consob's supervisory activity, which had been intensified in the wake of the Cirio default – and seriously harmed the financial system. This affair, which almost immediately took on the features of an international fraud, forced everyone to question the effectiveness of the existing legal framework, the validity of common and specific operational practices, and the ability of the system to prevent the repetition of such harmful events, especially for savers, the weakest link in the chain.

2. The problems that emerged, even considering their unexpected sequence and seriousness, are nonetheless not restricted to the Italian market. There have

been crises in all the main markets. Enron and WorldCom are the most striking examples and emblematic of the difficulties faced by legal systems and markets' operational arrangements in effectively governing the conduct of issuers and the mechanisms of intermediation. The difficulties have appeared in all the different models of corporate governance and financial system, typical of the various combinations of markets and intermediaries in the allocation of savings.

The problem confronting all the different systems is the possible failure, especially in the event of fraudulent behaviour, of the functions of screening, verifying and evaluating information performed by a multiplicity of actors, some operating on an international scale.

The tasks of these different actors are complementary and not alternative; each of them possesses only partial information and its activity depends to some extent on the quality of the functions performed by the others. Each actor operates in an integrated system of controls that are basically intended to produce warning signals and make collusion more difficult. However, this complementarity may also facilitate the contagion of the whole system by the failure of one or more functions, especially if the failure occurs in one or more of the fundamental components, such as the board of directors, the board of auditors and/or the auditing firm.

In the absence of the signals warning of fraud that the system's endogenous forms of control should send, the activity of the public bodies charged with supervision may prove ineffective.

The problems revealed by the crises

3. The problems that have emerged concern two areas of vital importance for the confidence of the market:

- the quality of corporate information and the effectiveness of the related internal and external control mechanisms;
- the fairness of dealings between savers and intermediaries in light of the multiple roles played by financial intermediaries.

The importance of these two aspects differed, at least in part, in each case, although they are complementary in some respects. In the Parmalat case, the preponderant factor was the falsification of corporate information, which for many years concealed the company's real situation. In the Cirio case, instead, the critical aspects of the financial situation were gradually revealed, also thanks to the pressure Consob brought to bear. Despite this, bonds came to be widely distributed among the public without the necessary disclosure of thorough and timely information on their riskiness when they were being sold.

The geographical context in which the various events occurred also differed. The Parmalat affair was marked by a substantial involvement of international players. The size of the group and the location of its industrial and financial activities in more than 30 countries made it more difficult to detect the signs of crisis and focus investigatory activity. The group's great international exposure did not facilitate the market's checks and controls. Some of the players involved, especially some international banks, appear to have been significantly involved in creating critical components of the group structure and carrying out transactions that, although legal in themselves, helped to prevent or delay the ringing of alarm bells in the market.

The international aspects of the other cases were less important, although in most of the groups involved the presence of companies located abroad, some of them just financial shell companies and many of them set up in tax or legal havens, was an obstacle to the necessary transparency.

4. The conditions described above increased the structural opaqueness of the companies concerned and highlighted the importance of internal controls. The main shortcomings that have come to light are precisely in this field. It was also obvious that there had been repeated violations of the rules of conduct applicable to governing bodies and auditing firms, possibly to the point of obstructing the authorities' performance of their supervisory functions.

Even the corporate information disclosed indirectly – that is, provided by the market through research reports and ratings – did not signal the possibility of serious anomalies or help the detection of possible offences or irregularities.

In some cases, including that of Cirio, this function failed because rating agencies' and financial analysts' coverage of the listed parent company or group companies was at best scarce. In other cases, especially that of Parmalat, the parent company and group companies were very widely covered, but neither the reports nor the ratings gave any warning that a crisis was brewing.

5. Problems have emerged with regard to the evolution of the role played by banks, which have increasingly expanded their activity in the direction of investment services while maintaining a central position in the mechanisms for the allocation of savings. At the same time there has been a gradual shift in the financing of firms in favour of market-oriented solutions at the expense of bank credit.

This evolution has been influenced by banks' greater carefulness in assessing the creditworthiness of the firms they finance and in taking on risks directly.

Another aspect of this evolution is the recent intense growth in the securitization of loans. These transactions blur the boundary between banks and other intermediaries; some risks, which in the past were borne exclusively by

banks, are now incorporated in financial instruments and transferred to other financial intermediaries, institutional investors and sometimes even non-professional investors.

At the same time the composition of households' wealth has changed with a consequent increase in their exposure to risk.

In this new situation banks are no longer simply debtors vis-à-vis households and creditors vis-à-vis firms but link the two directly; they provide households with securities trading and investment management services and firms with placement and advisory services.

One effect of this change is that savers no longer enjoy the guarantee that their capital will be returned, as in the case of bank deposits, but themselves assume the risk inherent in their investments. The information that the system must provide to investors on the companies they finance therefore takes on particular importance. It is above all in this respect that banks are required to play their role of professional intermediaries, in the interest of their customers as required by law. In this way legal and reputational rather than capital risks become the most important risks associated with intermediation.

The need to enhance the ability of intermediaries to perform the new role they have taken on is underscored by the widespread coexistence of a variety of different interests: banks lend to firms, provide advice on issues, place and trade the securities issued, buy and sell them as asset managers, and carry out research in order to advise their customers and the market to buy and sell them.

The potential conflicts between the different interests involved may lead intermediaries to encourage placements of bonds by companies or groups towards which they do not wish to increase their own exposure.

6. Another problematic aspect derives from a loophole in the legal framework of the financial system that has led to behaviour that does not conform with the basic principles of the legislation.

The distribution to the public of complex products bearing the hallmarks of banks, but created by combining a variety of financial instruments, has been able to take advantage of the exemption from the requirement to draw up and publish a prospectus reserved to financial products issued by banks. Despite Consob having submitted a contrary opinion during the drafting of the Consolidated Law on Finance, the new law extended the scope of this exemption well beyond the limits laid down in the earlier legislation, which had restricted its application to securities issued by banks in raising funds for the purpose of granting loans.

Here again, internal controls have shown themselves to be of limited effect and not sufficiently attuned to the specific nature of the problems connected with securities intermediation.

Overall, the facts that have emerged suggest the need for effective measures aimed at encouraging, at every level, the adoption of standards of fairness and transparency in the provision of investment services and a new enlightened approach to the performance of this delicate and valuable activity.

Proper practices cannot only be the fruit of legislative prescriptions. Above all there must be a convinced espousal of ethical market values and full awareness that maintaining investor confidence is an essential means of ensuring the continuity and development of intermediaries' business.

The task of the supervisory authority

7. In the face of corporate crises as large and severe as those that hit the Italian market last year, there is a need for market protection that goes beyond the

physiological level of expectations placed in the regulatory and supervisory system. The factors pointing in this direction include the number of small investors involved in the crises, the scale of the investments compromised, the breadth and depth of the shortcomings that came to light, most notably but not only those of the system's internal control functions.

Consob sought to respond to the needs for protection that were brought to light by the various crises with an exceptional effort, within the limits allowed by the incomplete current framework of securities and company law and by the inadequate technical instruments and human resources available for supervision.

As far as the Parmalat affair is concerned, it needs to be remembered that it involved a criminal phenomenon, with penally punishable offences committed by a series of complicit persons and actions in the form of forging documents, concealing information and using illicit legal and accounting devices, not only in Italy but also (and perhaps even mainly) abroad, in a global web extending to offshore tax and legal havens.

Consistently with Consob's institutional mission, its actions were directed above all to safeguarding the transparency of the market and stimulating the activity of the internal control and external audit bodies and functions.

Consob gradually stepped up its supervisory activity from the start of 2003, when it was first put on the alert by warning signs that had previously been lacking.

The pressure applied by Consob intensified in the second half of 2003, partly as a consequence of the analysis of corporate bonds conducted in a meeting of the Interministerial Committee for Credit and Savings in connection with the Cirio affair, which showed that it was desirable to extend the examination beyond that one case.

In a crescendo of increasingly stringent formal requests, Consob carried out more than 60 supervisory interventions between July and December, with aim of discovering the true economic and balance sheet situation and financial position of the company and the group.

The outcome of this effort is well known and was covered in recent financial news reports. In mid-December Parmalat had to announce to the market, at Consob's explicit request, that an alleged balance sheet asset – liquidity claimed to amount to just below 4 billion euros – in reality did not exist. The finding of false accounting data was promptly reported to the judicial authorities; as a consequence, the accounts were challenged. From that moment on a relationship of close and fruitful collaboration was established with the judicial authorities, assisted by the immediate activation of international cooperation (especially with the SEC). This collaboration is facilitating the investigations, since the group in question is highly ramified at international level, especially as regards financial operations. After the discovery of the fraud, Consob carried out the permitted checks on the conduct of the firms appointed to audit the Parmalat group and of the members of the Board of Auditors.

We have confidence in the action of all those who in different capacities are seeking to bring to light the causes and the responsibilities for such a grave collapse. In especially serious and painful corporate crises, the constant and careful action of the judiciary is a bulwark for all those involved in the system.

We hope the efforts of those who are working to keep the group viable will be crowned with complete success. This would ensure work for Parmalat's employees and give investors who placed their trust in the company hope of recouping at least some of their money.

8. Supervisory activity in the Cirio case led Consob to take repeated action vis-à-vis Cirio Finanziaria S.p.A. in connection with its controls on the transparency

of financial information disclosed to the market. These interventions began in the second half of 2000, were intensified in the following years and culminated with Consob legally challenging the company's annual accounts. In parallel, close cooperation developed with the judicial authorities, which Consob notified in early 2003 and to which it is still providing all the information in its possession that can be of help in the investigations under way.

Consob is also cooperating closely with the judicial authorities with regard to the sale of several complex financial products and of Argentinian bonds.

Exceptionally intense supervisory action was carried out in the other crises that surfaced in 2003 involving numerous smaller listed companies.

In some specific cases, such as those of the football clubs, the financial difficulties were traced in part to the persistence of structural weaknesses in the composition of income and balance sheet assets. The critical nature of such weaknesses was not addressed when in 1996 Parliament decided, perhaps prematurely, to allow football clubs to be for-profit companies, a pre-requisite for their listing. The possibility of adopting special accounting policies, granted to football clubs by a law passed in 2003, only meant that the problems would emerge over a longer span of time.

A sizable number of listed issuers whose business continuity is potentially at risk, as attested to by corporate control bodies or by evident signs of capital weakness, were ordered to give the market a monthly update of the situation of the company and of the group to which it belonged, if any. Many of them are still under such orders.

The frequency with which improper and illicit practices were found in corporate crises led to stepped-up activity aimed at identifying the behaviour underlying such practices, reporting it to the judicial authorities where appropriate, and challenging company's annual accounts.

9. The problems that came to light following the widespread distribution among the public of bonds issued by what subsequently turned out to be troubled companies, starting with Cirio, Argentinian bonds and other complex products required intensive checks on the behaviour of the financial intermediaries involved in the different phases of the process.

Throughout last year the human resources assigned to supervision of financial intermediaries were largely engaged in performing inspections at the main Italian banks.

This activity led to specific responsibilities being identified and charges being brought against the intermediaries inspected, which traded the securities with customers who were not professional investors. As things now stand, it has been found that the procedures used were frequently unsuitable to ensure either that investors were properly informed about the risk/return profiles of the instruments traded, taking the customer's characteristics and investment goals into account, or to identify and warn the customer of the potential conflict of interest where a bank was exposed to the issuer of the bonds it traded with customers. In the cases where specific conflicts of interest were found, together with procedural shortcomings, banks were also charged with infractions relating to conduct.

The sanction procedures are under way and Consob is waiting to receive the briefs of the interested parties.

10. The events that occurred in an ever more watchful and sensitive international context and the renewed acknowledgement of the need to fully protect the interests of small investors raise more general problems regarding effective supervisory action.

The growing complexity of financial products and services, the importance of financial strategies in the conduct of issuers, the internationalization of markets and strategies, the integration of the different segments of the financial markets and the transformations under way in the structure of trading and the role of intermediaries are progressively changing the context in which Consob operates. This transformation requires an increasing ability on the part of the supervisory authority to interpret developments and to anticipate potential weaknesses as far as possible.

In particular, an effort must be made to enhance the ability for prompt detection in the market of signs of anomaly both with respect to the standards of completeness and symmetry of information and from the point of view of the integrity of the markets and the supply of intermediation services.

Even if more far-reaching reform measures appear necessary, it is in any case necessary to improve supervisory strategy and the ability to "listen to the market".

This involves a broadening of the scope and types of phenomena that must be kept under observation, given the greater possibility to combine aggregate and diversified information flows. In this way it is possible to construct adequate analytical models to support effective supervision. Consob has already stepped up its monitoring of some phenomena that are increasingly influencing the operation of the market and investors' evaluations.

As regards the controls on corporate disclosure, an overall improvement in the quality of external auditing is necessary. Consistently with European indications, among the strategic guidelines for the development of supervision Consob has identified targeted controls on the internal procedures auditing firms adopt to check the quality of audits. This refers above all to controls on the adequacy of auditing firms' organizational structure in the light of developments in their portfolio of clients.

11. Within the limits permitted by the Consolidated Law on Finance, supervisory action was also extended to non-regulated markets, with the prompt acquisition of complete data flows. Systematic monitoring of the markets in credit derivatives is a matter of growing importance. These transmit signals on the riskiness of even unlisted or unrated issuers, whose financial instruments may come to be distributed to non-professional investors. In May 2003 the Commission established stricter reporting requirements for alternative trading systems as regards the products traded, transaction volumes and price formation mechanisms.

The data collected point to a change in Italian households' propensity for risk and an international diversification of their portfolios; they confirm the growing competition that exists between financial products and between issuers to attract the savings formed in Italy.

The data cover more than 300 alternative trading systems and reveal a phenomenon of significant dimensions. In the first quarter of 2004 trades amounted to around 22 billion euros. More than 15,000 different bonds were traded, the majority of them issued by banks, with total turnover amounting to around 12.5 billion euros, of which 4.4 billion euros in corporate bonds. In the same period the total volume of trading in bonds on regulated markets amounted to about 3.7 billion euros.

By their nature bonds, but other financial products as well, tend to be traded on systems other than regulated markets, basically because they lack sufficient liquidity; they also tend to be placed through channels other than public offerings. This calls into question essential elements of the philosophy underlying the Consolidated Law on Finance, which makes the supervision of regulated markets and of the solicitation of investors a task of primary importance among the duties

assigned to Consob. In reality, the combination "public offering - regulated market" is typical only for equity instruments.

In order to face the new needs, the Commission is preparing to review the rules governing widely-distributed instruments insofar as they apply to the issuers of bonds, with a view to subjecting issuers (Italian or controlled by Italian groups) whose bonds are negotiated on alternative trading systems to more stringent transparency requirements.

The availability of additional information will facilitate the detection of anomalies and make for better evaluation of the conduct of the intermediaries that engage in trading. It will also provide indications on the directions in which the financial market is changing and on how regulation will have to adapt in order to take account of these changes.

Corporate governance and the role of minority shareholders

12. The crises of 2003 involved companies whose ownership structures were distinguished by family control with highly concentrated ownership. Parmalat, Cirio and Giacomelli were each controlled by a natural person or by a company wholly owned by members of the same family. All three had a free float of less than 50 per cent. These features are typical of a large number of listed Italian companies. Around 40 per cent of listed companies other than those in the banking and insurance sectors display similar characteristics as regards the type of controlling shareholders and the degree of control.

High concentration of ownership is not necessarily a factor of weakness of the corporate governance system: a lesser degree of market influence on corporate control corresponds to a greater alignment of interests between the controlling shareholder, who presides over the running of the company, and the other

shareholders. However, the greater stability of the structures entails the risk of their being excessively self-referential. Adequate control mechanisms are therefore needed to prevent the minority shareholders being deprived of their rights and to orient the company's strategies to the creation of enterprise value.

To this end, the rules and institutes of corporate governance must favour an effective dialectic relationship between executive functions and control functions in the different corporate bodies. Scant use is still being made of the powers that the law attributes to minority shareholders for the protection of their interests.

Rules that are as clear and easy to apply as possible, the choices that companies make both individually and, above all, in the form of self-regulatory codes implemented in full and not simply serving as a facade, and the concrete actions of investors, especially institutional investors, contribute to the achievement of this objective.

13. The Consolidated Law on Finance is intended to enhance the value of companies' internal controls and also counted on minority shareholders playing an active role.

Yet confrontation of different positions within companies is still limited, although the current round of shareholders' meetings offers encouraging signs of a reversal of that tendency.

Minority shareholders do not elect members of the board of auditors in about three quarters of all listed companies and in about 60 per cent of the larger ones included in the Mib30 and Midex indices. One major cause is the high threshold of ownership established by company bylaws for presenting minority slates.

The request, put forward in recent shareholders' meetings, that the thresholds be lowered in order to reduce effective avoidance of the legislative provision therefore appears to be justified.

Mechanisms for electing the board of directors that permit minority shareholder representation are found in little more than one tenth of listed companies, in compliance with the rules for the privatizations; in only a few cases have companies made them part of their bylaws of their own volition. Experience shows that in companies in which minority shareholders have elected directors, the latter have made a positive contribution to ensuring effective corporate governance. The choices of other large companies are moving in this direction.

The presence of independent directors is required by the code of conduct of listed companies, on the basis of the principle "comply or explain". The information needed to understand and evaluate the extent to which individual companies actually apply the code is sometimes less than transparent, compromising the code's regulatory function. A positive contribution in this respect is the initiative by the Association for Italy's Limited Liability Companies recommending standard formats for presenting the information.

14. It is also up to investors to show more initiative. Institutional investors' attendance at shareholders' meetings remains modest. The attendance rate of Italian fund managers at the meetings held to approve large companies' annual accounts for 2002 was even lower than in the previous year. However, there are significant signs of change. Italian funds have taken part more actively in recent shareholders' meetings and their trade association has declared it intends to intervene always, albeit with token holdings, in order to ask for improvements in corporate governance practices.

Investor activism is discouraged by the limited scope afforded by the concentration of ownership of listed companies. Developments are taking shape on this front as well.

The trend of recent years towards an attenuation of the concentration of ownership of listed companies and an increase in the contestability of their control continued in 2003, though at a bland pace.

For listed companies as a whole, the free float reached almost 55 per cent, a figure exceeded only in 1998, when the effects of privatization policies had worked through. In the early 1990s the percentage was around 40 per cent. The relative importance of companies controlled by a single shareholder diminished, especially as a proportion of total stock market capitalization.

A contribution to the reduction of the concentration of ownership came from operations to simplify the investment chain within some large groups, which diluted the stake held by substantial shareholders. There was an attenuation of the disparity between the portion of capital held and the portion controlled by means of pyramidal structures, a gap that in some groups had become very wide.

The trend in recent years towards more widely distributed ownership mainly involves larger companies and those of the banking sector. However, even in these cases the real opening of control to the market remains limited by shareholders' agreements and legislative restrictions on the contestability of control: special powers and vetoes assigned to public entities exist in 15 privatized listed companies that account for 30 per cent of total market capitalization; for 32 banks, accounting for 27 per cent, the banking supervisory authority's approval is necessary for the acquisition of substantial holdings.

The evolution of the rules and supervision at international level

15. The implementation of the single European market in financial services was given fresh impetus by the legislation approved in 2003 and the early months of 2004. Differences were overcome that had been holding back the harmonization of the rules on matters crucial for the integration of the markets such as takeover bids, investment services and securities markets, and corporate disclosure. The solutions, many of which were prepared during the Italian Presidency, are based on a delicate balance between very different experiences and market structures.

The so-called "new generation" directives place considerable emphasis on the role of the supervisory authority and its investigatory powers.

The Market Abuse Directive requires the authority identified as responsible for its implementation to be entrusted with an "active" role in the prevention, detection and repression of market abuses. It must be given adequate investigatory powers as well as inhibitory powers capable of stopping violations and the power to adopt precautionary measures such as the sequestration of assets. These powers have long been possessed by the leading supervisory authorities abroad.

The system of sanctions must also be adequate, with provision made for administrative sanctions that are proportionate, effective and sufficiently dissuasive, as well as for "reputational sanctions" and the "disqualification" of offenders.

The Prospectus Directive will lead to the repeal of the existing provisions of the Consolidated Law on Finance that permit exemptions from the rules on the solicitation of investors for the bonds and other products offered by banks.

The adoption of common rules for controls on auditing firms and for accounting standards is of great importance.

The Commission has recently submitted a proposal for a directive that envisages the introduction of a public system of supervision for auditing firms and the requirement for companies to establish an Audit Committee charged with checking the activity of the auditors and the adequacy of their internal controls and risk management systems.

As of 2005 issuers with securities traded on regulated markets will make the epochal change from national accounting rules to the International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS). This is likely to be beneficial for the process of harmonization and market integration.

16. The new directive on markets and intermediaries will bring advantages in terms of greater competition and opening of markets. It will nonetheless be necessary to pay special attention in transposing the new rules since they impose fewer restrictions on the conduct of intermediaries and may therefore give rise to problems for the protection of investors.

The directive broadens the range of investment and ancillary services. It makes important changes to the ways in which services are supplied, in relation to the requirement to obtain the best conditions for clients (best execution), the scope for investment firms to execute client orders internally (internalization), and the provision for rules on pre- and post-trade transparency.

The introduction of the right for investors to ask intermediaries simply to execute and/or transmit their orders (execution only) results in the disapplication, in such cases, of the rules requiring intermediaries to obtain information on their clients and assess the suitability of their investments.

The diversification of trading systems and structures will expand the areas of competition between the functions of markets and intermediaries with respect to those of complementarity, which until now have been prevalent in Italy.

The rapid development of unregulated markets for debt securities is leading market operating companies to redefine their growth strategies, so as to attract business and financial instruments that are currently traded on unregulated OTC markets and often only "nominally" quoted on foreign regulated markets. Legislation could encourage this trend in light of the greater liquidity and transparency of the Italian regulated markets.

The dropping of concentration obligations and the possibility for some categories of investors to access markets directly will have a major impact on the securities intermediation industry.

Trading for customer account, which has seen margins gradually contract, will become an activity producing value added only if it is accompanied by the supply of other services, such as research and investment advice. The competitive pressure will be less for large banks, which will be able to count on intra-group demand for trading services from large institutional investors. On the other hand, the survival of independent market intermediaries is in doubt; it will be up to regulation to guarantee conditions of balanced competition between operators of different sizes.

The competition between markets and intermediaries brings the pivotal role of the governance arrangements of regulated markets to the fore. The listing of stock exchanges management companies, by broadening and diversifying their ownership structures, may alleviate the conflicts of interest deriving from the position of intermediaries/clients in the control of the markets. Consob is in favour of such a development, as it has stated on several occasions. It is necessary, however, to create the legal framework required to avoid the contradictions inherent in a process of "self-listing", which cannot be considered to conform with the principles of Italian law.

One of the reactions of stock exchanges to the new environment has been consolidation of trading structures with those that handle clearing and settlement.

In Italy a model of vertical integration has been adopted, as in other countries of continental Europe. There is no uniform European-wide regulatory framework. The European Commission has only identified the main areas in which to achieve a minimum level of harmonization. The natural monopoly features of clearing and settlement services are not incompatible with private ownership, but it is necessary to prevent this from hindering competition between different regulated markets and between regulated markets and other trading platforms.

The responses to the crises

17. The legal framework created by the reforms of the 1990s, culminating in the Consolidated Law on Finance, improved the efficiency of the market and provided greater protection for investors and shareholders. There nonetheless remained some unresolved contradictions in the juridical and legislative architecture of supervisory functions and the allocation of responsibilities, as well as a general weakness as regards investigatory powers and sanctions.

Today we are again faced with the need to address the questions that are still open. Market developments and increased activity in international fora aimed at defining new rules and standards are moving in the same direction.

Timely and effective responses must be found to this need. The objective of restoring confidence in the market requires measures to rationalize the legal framework, strengthen the incentives fostering conduct consistent with market fairness and transparency, and increase the effectiveness of supervisory instruments and procedures.

In drawing up strategies for reform it is nonetheless necessary to take account of the constraints and opportunities.

Both are present in the growing need for supranational convergence and coordination, in the definition of rules and standards of conduct, and in the improvement and strengthening of enforcement.

The internationalization of the reference context is thus a necessity for national choices; it influences the ability of the real and financial economy to compete and the instruments for the protection of investors.

Constraints and opportunities also exist in relation to the need to encourage firms to raise equity capital in the market. While raising the market's quality standards is a necessary condition for avoiding loss of confidence, it must also be considered that high additional costs, in connection with the status of listed or at any rate "open" company, may further raise the hurdle to be overcome in turning to the market.

The Italian equity market is characterized by its modest size and limited representativeness of the country's industrial fabric. Between December 2002 and the end of April 2004 the total number of companies listed on Italian regulated markets, already low, fell by 22 and only 4 companies went public. The market value of Italian listed companies, equal to 488 billion euros at the end of 2003, rose to 498 billion euros at the end of May 2004, but is still lower than the corresponding figures for the other leading international equity markets.

The effects of the rules intended to encourage companies to seek admission to listing deserve especially careful attention in the Italian context. An appropriate calibration of the rules must take account of the fact that investor protection is also of value from a dynamic perspective. The development and enlargement of the market can play a positive role in improving transparency and fostering conduct consistent with the integrity of the market itself.

The vitality of Italy's small and medium-sized enterprises offers an opportunity for the development of the Italian capital market that has so far been largely unexploited. Overcoming the cultural and legal obstacles to obtaining

finance in the market is thus a priority goal, in order to foster an increase in the size of these companies and the growth of the economy.

18. Reform of the legal framework, which is necessary to respond to the loss of confidence and adapt the Italian system to developments in the international context, requires a diversified strategy. It is necessary to intervene with regard to the architecture of the supervisory system, the definition of new rules to change the conduct and functions that have shown the major weaknesses, and the range and effectiveness of investigatory powers and sanctions.

These matters cover a broad field; they are being debated in Parliament during the examination of the unified text of the bill for the protection of savings.

As regards the architecture of the supervisory system, the legislation in force today does not provide a clear and unambiguous division of tasks according to objectives. Similar products are treated differently and the experience of the authority responsible for transparency and fairness is not fully exploited.

There are still gaps in the rules on the solicitation of investors: bank bonds and some insurance products with pronounced financial features are exempt from the prospectus requirements; the placement of financial products, including those of banks and insurance companies, that fall outside the scope of the legal definition of "financial instruments" are not subject to the rules on transparency and fairness; and in the case of investment funds and pension funds Consob has been stripped of some of its powers with regard to transparency and fairness.

The complete implementation of an objectives-based model of supervision is a goal to be achieved.

19. The growing integration of the various branches and activities of the financial industry calls for closer cooperation and coordination among the

different authorities performing supervisory functions in the Italian financial market. This suggests broadening the duties of cooperation with the introduction of forms of systematic and timely information sharing among the various authorities. The establishment of a committee to provide a permanent forum for their coordination, proposed in the unified bill, moves in this direction.

The experience gained in recent years clearly shows that international cooperation is an essential instrument of supervision.

The possibility of using them depends on the supervisory authority's fulfilling the independence and accountability requirements established by the International Organization of Securities Commissions (IOSCO) and the applicable EU financial directives and on its guaranteeing the confidentiality of the information it receives.

For these reasons as well the process of legislative reform must safeguard these conditions and lay down appropriate rules disciplining professional secrecy.

20. As regards the governance of listed companies, the reform of company law and the provisions reconciling the Consolidated Law on Finance with the new rules have redrawn the map of the bodies charged with the functions of control and encouraged a fruitful dialogue with the supervisory authorities.

With respect to these issues, the reform of the protection of savings should be based on a number of guidelines consistent with the needs that have emerged and developments in the financial market.

These guidelines, which to a large extent are considered in the bill before Parliament, can be summarized as follows:

– to strengthen the independence and powers of the bodies charged with control functions;

– to strengthen the controls on and transparency of transactions with related parties and of the use of companies domiciled in tax and legal havens;
– to make provision, in line with developments at international level, for suitable requirements of professionalism and appropriate codes of conduct and rules of transparency for financial analysts and rating agencies;
– to enhance the effectiveness of the quantitative limits on the issue of bonds laid down in Article 2412 of the Civil Code by linking them to the consolidated debt of the group in the form of bonds and the guarantees provided by the parent company;
– to impose restrictions on the distribution of securities that are the subject of a private placement by providing for a holding period during which institutional investors may not sell them to the public or other forms of guarantee.

21. The strengthening of the legislative framework must regard the whole supervisory system, understood as both the ability to verify facts and obtain information and the sanction procedures themselves.

It is necessary to transpose the European directive on market abuse without delay and to equip the supervisory authority with appropriate powers of investigation and repression.

Today these powers appear limited, especially in particularly serious cases where it is necessary to carry out rapid investigations of irregularities or violations of the law concerning the protection of savings.

The existing sanction regime must be made more dissuasive; too often the penalties are very light in relation to the seriousness of the offences to which they apply.

The procedure for imposing sanctions could benefit from being made less complex and cumbersome by entrusting it entirely to Consob, without prejudice to

the necessary separation between the investigatory function and the function of imposing sanctions. It would also be desirable to provide for liability to be assigned to the legal person involved, with the introduction of a general obligation of reimbursement by the corporate officers responsible for the violations ascertained.

As regards "reputational" sanctions, the effect of the ascertainment of illicit behaviour must be boosted by providing for Consob to make offences known even in the case where the sanction procedure is cut short by a money settlement or eliminating this possibility, at least in the most serious cases.

Wider use of sanctions in the form of interdictions, which are a powerful deterrent, could also be fruitful.

The principle remains valid that the violation of rules must be punished by sanctions whose application is swift and effective, with all due recognition of the right of defense.

22. Again with reference to possible reform measures, it also appears appropriate to consider the behaviour of the actors in the intermediation industry.

While there is clear and desirable evidence of the growing attention paid by banks to matters regarding their stability – through investments in systems and procedures for the monitoring and management of the risks they assume directly in granting credit – to date they do not appear to have paid due attention to ensuring a more suitable performance of investment services.

Securities intermediation cannot be just a means improving banks' overall profitability, but requires a clear perception of its importance and specific aspects and consequent investment in staff and their training.

Everybody is aware of the essential role banks play, as components of the economic fabric, in the country's life and development. The banking system will

not fail to rise to the new challenges brought by the transformations under way and will produce adequate and timely responses to the needs of investors and all those who operate in the market.

23. The starting point of these remarks consisted in the recent corporate crises and the problems they have revealed. Before us other countries, such as the United States, have had to face a succession of corporate and financial scandals that have shaken the "absolute faith" in the market. As I draw towards the close of these remarks, I find it fitting to entrust the market with the additional task of transmitting a certain optimism, linked to a valid ethical commitment and hence to a responsibility for the future, about what has to be done (as well as what has already been done).

Profit is without doubt the indicator and regulator of the life and vitality of firms. But it is nothing more nor less than this. We cannot make the social and juridical legitimation of firms depend exclusively on profit and consider every other value involved in entrepreneurial activity (the relationship with the public, the owners and the workers) as subordinate. Freedom of economic initiative, besides, is not just an economic value but also a value of the human person, as is work, and entrepreneurial activity and work are also tasks to be performed so as to contribute "to the material and spiritual progress of society" (Article 4 of the Italian Constitution).

In part these ideas are to be found in the unified text of the bill for the protection of savings. Greater corporate transparency and more severe sanctions should help to discourage violations of the rules. But what is even more important is belief in the need to comply with rules of conduct that are the expression of an indispensable ethos, especially at the individual level. And the market undoubtedly also needs an injection of ethics, to ensure its efficient, but above all human, vitality.

24. The future development of the model of supervision, in a manner consistent with that of the market's competitive dynamics and the problems that the recent events have brought to light, requires a broadening of the scope of the phenomena to be considered and more complex monitoring activities. New needs in the field of controls will stem from statutory and regulatory innovations in response to new Community legislation and international coordination measures. With respect to these needs, Consob's existing human resources appear insufficient. Moreover, the professional competence of its staff, including younger members, often leads to their being recruited by market participants. In fact since 1 January 2003 no fewer than 27 employees have given notice and moved elsewhere to take up important positions, not only in terms of remuneration.

There are grounds for satisfaction in the fact that young people trained are sought after by the market, but the size of the ouflow is a cause for concern and the law in force at present does not permit it to be fully and quickly remedied. Moreover, the lack of staff is aggravated by the "extraordinary" activity that the handling of the current crises, unprecedented in number and scale, has required and continues to require.

Attention has been drawn to the seriousness of the situation on a number of occasions and reasoned requests made for the adoption of urgent measures with the specific aim of endowing Consob with an organizational structure and sufficient means to perform the tasks with which it is charged.

In addition to this need, there is the obligation to transpose the Market Abuse Directive into Italian law by 12 October of this year.

In the new context in which international organizations are playing a much more active role than in the past and laying the foundations for common binding rules, further deferment of legislation to strengthen Consob's powers and increase its human and financial resources does not appear possible. In this respect it is

worth noting that the first reaction to the crises that occurred in the US market was to augment the resources of the SEC, as a necessary precondition for the subsequent legislative reform of the financial system, which was then pushed through in a relatively short time.

Honourable Minister, Ladies and Gentlemen,

Today is the thirtieth anniversary of the enactment of Law 216/1974 ratifying the decree law that established Consob. During this period Consob has undergone far-reaching changes to its institutional configuration, to the point that reference has been made to a series of Consobs. Unchanged, however, has been its commitment to adapting the financial system to the new needs arising from the continuous evolution of the markets. The necessity of making the changes arose from needs that also applied to other countries' legal frameworks, as a consequence not only of adverse events but also, and above all, of the obligation to transpose European directives and bring Italian law into line with the international principles aimed at achieving common, or at least compatible, legislation at the national level.

Consob has regularly accounted for the action it has taken and contributed to fact-finding and analysis in the competent parliamentary bodies and since October 2003 has testified in five parliamentary hearings on the matters of concern today. It has responded promptly to requests for opinions and other contributions regarding the proposed rules of the unified text of the bill for the protection of savings and participated, when invited, in meetings of the Interministerial Committee for Credit and Savings, providing and receiving the information prescribed by law. It has participated, and continues to participate, in the Financial Security Committee and in meetings of numerous international bodies, notably CESR and IOSCO, and also chairs the committee charged with drawing up new legislation on mutual funds. Consob's activity in international

fora is widely recognized and appreciated. Evidence of this is to be found in IOSCO's recent annual meeting in Amman, where Consob was re-elected for another two years to the Executive Committee, the Organization's governing body, and its appointment to co-chair, together with the SEC, the Task Force set up to analyze international financial fraud and recommend measures to combat and prevent it.

In the course of its activity Consob has made every effort to apply laws and regulations in a friendly and collaborative spirit vis-à-vis the market and all its participants. But it has also acted in the calm conviction of the necessity of always performing its tasks on the basis of a single yardstick designed to ensure neutrality, and conscious of the responsibilities it shoulders in performing the mission with which it has been entrusted by Parliament.

The Commission of which I have the honour to be chairman will hold fast to this course of conduct and continue to perform its functions "*nec spe nec metu*", in the interest of the whole community, for the protection of all its components, certainly neither last nor least that of investors.

The professionalism and dedication of those who work for the institution assure fulfilment of this goal. The Commission is deeply grateful to the managers and all the other members of Consob's staff.