CONSOB

COMMISSIONE NAZIONALE PER LE SOCIETÀ E LA BORSA

ANNUAL REPORT 2007

ROME, 31 MARCH 2008

COMMISSIONE NAZIONALE PER LE SOCIETÀ E LA BORSA

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ANNUAL REPORT 2007

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SPEECH BY THE CHAIRMAN TO THE FINANCIAL MARKET

MILAN, 14 JULY 2008

Minister of the Economy and Finance, Excellences, Ladies and Gentlemen,

on behalf of Consob I would like to express my sincere thanks, not only to you, Minister, but also to the Members of Parliament, the Government Officials, the civil and military authorities, the members of the Church and all those attending who, by their presence here today, lend particular prestige to our Institute and confirm their awareness of the market and problems which – now, as never before – come to light and are faced in a complex, constantly and rapidly developing global scenario.

This annual meeting – which for over ten years has received the support of Parliament, the Government and, in particular, of the Minister of the Economy – allows Consob to explain and submit for approval all its activities, and to illustrate the guidelines it intends to follow, offering its experience to the market and investors in strict observance of current regulations.

The Commission also renews its thanks to our host city, Milan, and to its Mayor: conceding to Consob the prestigious Palazzo Carmagnola in Via Broletto she confirms her helpfulness. We hope the study for the extension of Palazzo Carmagnola will prove positive.

Lastly, we would once again like to express our gratitude to Borsa Italiana for their hospitality here at this truly noble venue.

1. Financial turbulence and the stock markets

For about a year now, the signals of uncertainty and weakness of the international financial markets have been of a profoundly disruptive nature.

The crisis, which began in the US residential mortgages market, has had a significant impact on stock market performance, on the position of the leading intermediaries, on the stability of financial systems and on economic performance.

The positive trend seen for several years has been broken. Signals of the fragility of the financial system have emerged, the tumultuous growth of which was due to incentives not always compatible with principles of correct risk management and distribution.

The rapid reaction of the European Central Bank and the US Federal Reserve, together with the supervisory authorities, has up to now avoided dramatic consequences for investors. The efforts to coordinate action at national and international level have been without precedent, in terms of intensity.

One year later, we still cannot say that the crisis is over. Problems have emerged that need adequate, fast answers in order to face the current tension and prevent new difficulties. The approaches and the supervisory regulations have to be revised in part. It is important to ensure a stronger complementary balance between the aims of stability and the aims of transparency and fairness. The now irreversible integration of the financial market segments requires more incisive coordination and cooperation formats.

Nevertheless there is still a long way to go before we can guarantee, especially in the European market, an effective cross-border coordination between the authorities responsible for markets and intermediaries. Despite agreements signed to ensure cooperation in the initial stages of difficulty in the market, crisis situations still seem to be handled primarily from a national viewpoint.

In Italy, the immediate consequences of international market disruption were more limited than in other countries.

In order to assess the level of involvement of Italian operators and investors, Consob intervened as soon as the first signs emerged of the cash crisis that hit several segments of the market.

The information gathered in summer 2007 showed that the exposure of listed companies in the banking and insurance sectors to subprime mortgage-related financial instruments was limited.

Consob asked the individual companies to inform the market of the foreseeable impact on the financial situation in their next accounting reports or without delay if the impact was expected to be significant.

Surveys on portfolios managed for customers also showed that Italian household exposure to subprime mortgage-related risks was not particularly critical. Indeed, in Italy, unlike in other countries, there were no cases of temporary no-redemption measures forced upon open-end mutual funds due to inability to calculate the unit values.

A much more complex evaluation regards the indirect and more long-term consequences of the financial turbulence.

The resulting cash crisis had negative effects on the credit market and on the companies' capacity to raise financial resources. The financial performance of issuers, especially in the banking and insurance sectors, is still exposed to risk of a possible deterioration of the economic cycle and of further drops in stock market prices.

In this situation of systemic difficulty, the Authorities have made enormous efforts, so as to protect investors, to agree on a common line of action in seeking an adequate balance between the desire to receive urgent disclosures and the need to safeguard the integrity of the pricing mechanism.

When individual intermediaries face difficult situations, the management of ongoing reports to the market is particularly delicate. The dissemination of partial information, especially if negative, can increase tension initially.

The need to balance opposing needs also arises in recapitalisation transactions aimed at rebalancing the financial structure of banks that are particularly exposed. In European countries, the right of all shareholders to participate in share capital increases to avoid dilution of the voting capital can make fund raising difficult and costly, unlike in the United States where the transaction can be concluded with a restricted number of subscribers and only later reported to the market.

The subprime mortgage crisis has revealed problems of a structural nature in the securitisation market, especially with regard to financial instrument assessment and transaction transparency.

With regard to rating agencies, the ability of promptly changing their ratings and the validity of their rating assignment models have been debated, since any related conflict of interest might induce distorting effects.

The initiatives of the International Organization of Securities Commissions (IOSCO) and of the Committee of European Securities Regulators (CESR) and others announced recently by the European Commission are an attempt to provide an answer to this collapse of the market. New regulations and supervisory formats on internal governance and conflict of interest management are expected. Given the special nature of rating agency activities and their vocation to operate on a global scale, it is both necessary and urgent

that regulatory initiatives are strongly focused at international level and that the right measure of intensity is defined so as to avoid excessive costs.

Since the implementation of the market abuse directive[(1)], in Italy a regulation was introduced on conflict of interest in rating agencies which granted regulatory and supervisory powers to Consob. This regulation was repealed prior to its entry into force[(2)]. Perhaps we missed the opportunity to launch an activity which, also in liaison with rating agencies operating in Italy, could have contributed to greater transparency and fair conduct.

The opportunity to make non-regulated markets more transparent, which now appears to be recognized at international level, is another open question.

More public information on trading between institutional counterparties could in fact encourage a more conscious risk management by all investors. The availability of data on the market would reduce investor dependence on the rating agency report monopoly and would facilitate correct, balanced assessment of the more complex products.

In general, as also emerged during affairs linked to the banking takeovers, potential tension between the aims of market transparency and the objectives of intermediary and system stability needs to be governed.

Accurate risk management by financial institutions is important not only in order to grant the sound and prudent management. The current crisis has confirmed that in situations of strong market tension, stability and transparency are tightly linked.

The model for the supervision-based distribution of tasks among Authorities allows for the various levels of public interest to be pursued transparently. More intense forms of liaison and cooperation between the Authorities are encouraged, as seen in the recent crisis. The Authorities' acceptance of responsibility mechanisms on behalf of the market and institutions is therefore strengthened. This avoids the danger of establishing hierarchies between objectives to which the law, quite rightly, recognizes equal dignity in terms of investment protection.

The time has come for a review of the Supervisory Authority system and architecture, also to put an end to situations of uncertainty and the risk of duplicated action, until now handled by mutual cooperation and responsible joint intent.

A new season has begun for cooperation between the national financial market supervisory authorities, also as a result of experience accumulated and more incisive regulatory tools.

On 31 October 2007, Consob and the Bank of Italy exercised their joint regulatory powers on the organisational and procedural structures for intermediaries, and signed a memorandum of understanding on the coordination of supervisory duties.

A joint communication and memorandum of understanding are about to be adopted by Consob and ISVAP to coordinate regulation and supervision of the transparency of contracts for insurance products with a strong financial content.

An agreement is due to be signed between Consob and the Italian electricity and gas boards on the regulation and supervision of electricity derivatives markets.

In March 2008, the Ministry of the Economy, the Bank of Italy, Consob and ISVAP formed the Committee for the Safeguarding of Financial Stability with the aim of preventing and handling financial crises with potential systemic effects.

The uncertainties linked to the disruption of the financial market are reflected in share price performances. The main international indices, which closed 2007 with a positive balance albeit much lower than in previous years, have recorded a strong negative performance for the first half of 2008(3).

The Italian market had already recorded a consistent drop in share prices in 2007, which continued - as in the rest of Europe - in the first half of 2008(4). This is having a negative impact on the capacity to attract new issuers. The number of admissions to listing as a result of IPOs in the first half of 2008 has more than halved compared to the same period two years ago(5).

The development prospects for the Italian financial market are linked to the evolution of the Borsa Italiana-London Stock Exchange merger, completed in October 2007 when the British holding, listed on the London stock exchange, acquired ownership of Borsa Italiana S.p.A. The operation is set in a context of increased competition between markets, regulated or otherwise, in which the need to diversify the services offered and increase trading volumes forces management companies to actively seek alliances and business combinations.

To facilitate preventive consultation and a joint approach to important decisions regarding the two markets, on 13 December 2007 Consob and the Financial Services Authority (the FSA) signed a memorandum of understanding.

A review of the organizational structure of the Italian market is in progress with the aim of standardising and improving efficiency of the decision-making and management processes. This move gives rise to fears that decision-making may gradually shift towards the London market.

Italian banks, Borsa Italiana shareholders, initially acquired a total of 28% of the holding's share capital. This has now fallen to around 19%. In the future, the presence of Italian shareholders could reduce even further.

One year after the merger, a sense of uncertainty and apprehension persists regarding the real advantages for the Italian stock exchange. It is Consob's task and duty to ensure that the changes have no negative impact on the quality and competitiveness of our market.

It is important to ensure that the definition of strategic objectives and the organizational structure of Italian market management companies is compatible with the necessary and correct institutional operations as assigned by law. In this scenario we could even reconsider the allocation of duties between the supervisory authorities and the management companies: Consob currently approves the prospectus but plays no part in the decision regarding admission to listing, unlike UK authority.

The expected adoption of the British trading infrastructure as a common platform common to both markets calls for significant changes in the market microstructure. A gradual adjustment for operators has to be guaranteed, minimising the risk that events occur during the transition period that might jeopardise orderly trading.

According to a commitment made by the UK holding in the takeover document, based on identical quality of the services offered, the merger should not lead to an increase in tariffs. Consob believes that standing firm by this commitment is imperative to guaranteeing competitiveness of the Italian financial sector, one of the key objectives of market supervision.

The integration of the two markets will also have an impact on listing decisions for Italian companies. To ensure that these remain positive, it is important that the integration process takes the specifics of the Italian system into account when defining the rules and procedures.

Expansion of the instruments that attract Italian companies to the risk capital market could play a significant role in encouraging listing. With this objective in mind, the MAC system (Mercato Alternativo del Capitale) was introduced one year ago[6]. This is the direction that the initiative announced by Borsa Italiana intends to follow in creating a multilateral trading system along the lines of UK Alternative Investment Market (AIM)[7], which has shown considerable ability in attracting small companies. A greater recourse to statutory freedom could also contribute in articulating capital investment instruments, exploiting margins offered by the regulatory framework, which could be further extended by Legislators - at least for companies applying for admission to listing.

2. Protection of share minorities and rulings on conflict of interest

The Italian regulatory system includes new means of participation for share minorities in corporate governance.

The obligation of list voting has also been introduced for the election of boards of directors and it has been established that the chairman of the board of statutory auditors has to be appointed from among auditors elected by the minorities.

These are innovative rules, even in international terms. Consob has an important role in defining implementation measures and supervise their general observance, with the aim of encouraging more open corporate dialectic among shareholders.

Representation of minority shareholders is of particular significance in Italian listed companies, given the structural and developmental characteristics of their ownership structures.

If on the one hand the major shareholders and coalitions still play a decisive role(8), on the other hand there is a growing number of institutional investors - especially international - interested in stimulating and monitoring decisions(9).

The recently concluded season of shareholders' meetings was an initial test of the new system for the election of directors and statutory auditors.

Positive signs have emerged regarding the basic decisions of Legislators and Consob's regulatory measures, particularly with regard to the thresholds for the presentation of lists and to transparency measures aimed at ensuring actual independence of the minority lists.

Institutional investors, especially international investors, have seen their participation in the appointment of control bodies as an effective tool to implement transparent forms of corporate activism, not necessarily in conflict with the existing control structure. In other European countries, more aggressive institutional investors and sovereign funds encounter a much less open situation with regard to their participation in corporate governance.

However, a number of recent shareholders' meetings of listed companies showed that it could be difficult to guarantee full transparency of the links between the lists presented by share minorities and by major shareholders. Consob had to intervene to integrate the information provided and to make control bodies more responsible in applying the rules on minority protection. In the light of this experience, which shows that a certain resistance to change persists, Consob launched a market consultation paper with the aim of steering conduct towards a greater acceptance of the spirit of the law.

Along the same lines was the proposed ruling on related party transactions, on which Consob called for public consultation last April.

The proposal outlines a wide-ranging reform. Both procedural and transparency rulings are envisaged, including the immediate public disclosure of the more significant transactions.

Consob's intention is that the new measures will strengthen the role of independent directors, who would be assigned more decisive tasks in the entire process of implementation of significant related party transactions.

The role of independent directors in protecting investors as a whole is an open challenge for all laws. Enhancing their role in transactions involving conflict of interest is an objective in line with the development of international corporate governance principles. The experience of other countries, such as the United States, the 2005 European Recommendation[10] on the role of non-executive directors, the decisions of Italian Legislators and the self-regulatory code for listed companies - which has not always seen substantial application - are all following this path.

Consob believes that a punctual involvement of independent directors in significant related party transactions does not jeopardise their independence. On the contrary, it allows a reduction in the reporting asymmetries present in the structure of boards of directors, particularly with regard to related party transactions, and encourages well-informed decisions focused exclusively on pursuing the interests of the company.

Obviously, specific skills and professionalism are needed to perform such duties - requisites that independent directors must meet in order to guarantee the decision-making independence crucial to qualifying their role.

The proposed measure also takes into account the different structural features of certain categories of listed companies.

More streamlined procedures have been identified for small companies, newly-listed companies and for companies that are issuers of widely-distributed financial instruments. A lower significance threshold was envisaged to identify significant transactions in companies where the risk of drawing private benefit is higher due to separate ownership and a higher level of structural control[11].

This is a complex plan that implies extensive, open debate among all market members. The Commission will make its decisions only after a full, in-depth examination of all comments, reports and contributions submitted, with particular focus on the balance between costs and benefits and the time needed for the adjustment of the organisation and composition of boards of directors and statutory auditors.

In the current market situation, negative performance could induce major shareholders to launch takeover bids with the aim of delisting the securities. Guaranteeing

minority shareholders the option to make well-informed decisions regarding acceptance of such a bid is therefore an urgent matter.

As part of the enactment regulations for the Takeovers Directive, Consob's draft measures to protect minority shareholders in such transactions are at an advanced stage.

The provision requiring a re-opening of the terms of the bid, for example, could alleviate pressure to sell, felt by minority shareholders when a delisting of the security or reduction of its cash value is envisaged. Information regarding the level of subscription in the initial stages of a takeover bid could be a decisive factor in making a more informed choice.

Independent directors could be more responsible in preparing assessments by the board of directors of the target company on the merits of the bid. The company's report to the market should illustrate their opinions separately.

The decision of the Legislator regarding implementation of the Takeovers Directive followed a similar direction: the adoption of measures hindering the success of the takeover bid should be not forbidden when the bids are launched by the major shareholder. In these cases, as other countries' experience demonstrates, the trustee duty of directors could justify defensive measures if the takeover bid is not considered to be in the interest of all shareholders.

The measure restricting the aggregation of positions in control bodies, as introduced by the investment law reform, also has an impact on corporate governance systems.

In implementing its regulatory powers - given the impact on company organisation and the activities of certain professional categories - the Commission has given special consideration to comments from the market, in whatever form submitted, both at consultation stage and implementation stage.

The method to weight several positions covered within companies of the same group has been changed: directorship offices have been assimilated to those relating to control. The entry into force of the measure has been postponed so that the market can adapt gradually.

Any further improvements, that can only be assessed after a fair period of time and after a thorough examination of operating practices, cannot diminish the effective application of the law or penalise who has already complied with currently regulatory provisions.

3. Intermediaries and asset management in the new MiFID framework

The regulatory framework in which intermediaries operate today is the result of an exacting modernisation path that has called for strenuous effort and considerable investment of resources.

The law on investment, which anticipates the direction taken also at European level, has extended the regulation of investment services to the distribution of banking and insurance products with financial content. The rules of conduct introduced on implementation of the MiFID directive have steered the updating and reform of collective investment management.

The competitive scenario has reached an adequate degree of standardisation and consistency with the rules. Further initiatives would be worthwhile to guarantee substantial equality of conduct in the distribution of different products.

To offer intermediaries a higher level of certainty, Consob has prepared interpretation guidance and has been willing to acknowledge guidelines prepared by the industrial associations. This is a new way of liaising with the operators that aims to guarantee application flexibility.

Included in this framework is the consultation paper on the distribution of illiquid financial products, which calls for particular diligence by intermediaries when proposing investment in products for which there is no market trading with adequate levels of liquidity and transparency. In such cases the appropriateness and suitability assessments and complete information to the customer become even more important.

The need to protect the interests of the customer is also vital in the public placement of bank-issued products, such as subordinated bonds and hybrid products, useful amongst other things to strengthen regulatory capital. In the more recent past these products were reserved exclusively for institutional investors.

The MiFID provided new customer relations models that should contain the outflow of resources from savings management towards more complex products, that is a phenomenon of particular relevance on the Italian market.

A comparative analysis of the main European economies shows that in Italy asset management still has a strong potential to satisfy the demands of investors, especially in the light of incentives on medium-long term investment formats, also welfare-related.

The concentration of asset management company ownership structures headed by banking groups still remains a structural weak point, though the first deconsolidation operations are under way. Approximately 90% of Italian open-end funds were placed by banking networks forming part of the group.

In many cases, group strategies have preferred the distribution of products other than funds, such as bank bonds and insurance products. The remuneration policy of the sales networks has often generated strong incentives to distribute structured products. The independent distribution networks are excluded from this logic.

In the placement of units of funds, fee payback agreements have channelled most of the fees paid by customers to the sales networks, limiting the flow of resources to the management companies. The lack of funds along with a low level of independence with respect to their own group strategies has restricted the development of quality in the management structures.

The use of group distribution channels shows no sign of changing in the near future. Consob has launched an initiative to introduce conditions of full and rapid transferability of units of funds by means of dematerialisation. This initiative should encourage "open architecture" operations on the electronic platforms of alternative distribution channels. A stronger distribution competition should increase the quality of services offered to investors, contributing to an improved selection of operators. The differences between active management, with a higher added value, and management that replicate the portfolio-objective composition will become more evident.

It is crucial that the Italian asset management sector invests in technology, but above all in human resources with the right skills and professionalism.

Development of the sector is an objective for the entire Italian economic system, to which a contribution is expected also from regulators in defining a cost-conscious proportional regulator and supervisory context.

It cannot be excluded that, as the characteristics of the asset management sector develop, in future the Authorities and Legislator may need to consider simplifying the regulatory structure, also in the light of initiatives announced at European level.

4. Consob's regulatory and supervisory strategy

2007 was the year of consolidation of European rules on the financial markets.

Italy has more or less completed its adaptation to the new regulatory framework following implementation of the MiFID, takeovers, issuer reporting obligations and prospectus directives(12). It is to be hoped that the directive on auditing will also be transposed as soon as possible(13).

New European regulatory measures are planned in the rating agency and mutual investment fund sectors. Consideration is now being given to transparency of markets that are not share-related, on which to date no regulatory action was considered necessary.

On non-European matters, following approval of the Task Force report on the subprime crisis, IOSCO has defined a work plan to assess possible action regarding the

transparency of issuers, risk management by intermediaries and the evaluation of structured financial products. Any principles produced by IOSCO will be included in the standards adopted by the international financial institutions (International Monetary Fund and World Bank) in periodic reviews of the adequacy of financial systems in the EU member states.

Consob plays an active role in Supervisory Authority coordination bodies, and takes on certain responsibilities: it was recently re-elected to the IOSCO Executive Committee, of which it has been a constant member since 1986, and for the first time ever, on 1 January this year a member of Consob was appointed secretary general of the CESR.

International and European harmonization of the legal systems does not in itself cancel out space for competition among the national legal systems and supervisory authorities, nor does it ensure complete elimination of regulatory arbitration options for companies and issuers.

Regulatory harmonization has not yet resulted in full harmonization of the supervisory and sanction regimes[(14)].

Like the parliamentary bodies of the Italian Government, Consob has become a standard-bearer in terms of development of the institutional role of European Committees for the coordination of financial market authorities[(15)]. Proposals to introduce the qualified majority vote principle and to grant binding powers on the standards issued are still opposed by certain countries.

Another matter to be faced is the problem of ensuring better role allocation among the various European organisations, taking into account the increasing level of integration between the various financial market sectors and the need to reinforce the role of supervisory authorities also in defining the regulatory framework.

In a European context characterised by a persistent lack of consistency, Consob's approach to regulatory duties and enforcement takes into account the option of not having a negative impact on the competitive position of the Italian financial system, at the same time ensuring adequate investor protection.

There is a need to rationalize the national regulatory framework, now heavily revised following the implementation of directives and implementation of the investment reform.

The overall onus of regulation, in terms of costs and possible systematic inconsistencies, has to be proportional to expected benefits and to the development needs of the markets. In all instances of regulation production, apparently, it is vital that the principles of better regulation are firmly adopted, subjecting new regulatory proposals and the overall framework of existing rules to impact analysis.

Consob is willing to go ahead with a systematization and simplification operation on its own regulations based on the following guidelines:

- reduction of overall obligations for entities supervised, with specific focus on areas already widely harmonized at European level;
- differentiation of the rules according to sizing and risk parameters of the entities supervised;
- reduction in the level of detail of provisions and the development of operational guidelines after consultation with the operators;
- consideration of the potential effects of regulation on the level of competition, and competitiveness in general, in the Italian financial market.

In defining the supervisory models, Consob is committed to a development that favours the analysis of systemic and specific risk factors, based on which a scale of priorities will be defined.

Recent new regulations envisage the enhancement of systematic control on certain areas, i.e. corporate disclosures and independent auditor activities. The emergence of general phenomena, potentially critical in investor protection, such as the distribution of complex financial instruments, also calls for constant and extensive monitoring.

The aim is to formulate a strategic plan that, through consultation with operators and investors, identifies regulatory, supervisory and organisational tools to handle market and regulatory risks.

Alongside a stronger focus on preventive analysis of risk factors is the commitment to daily market supervision, complex and detailed once again last year.

Consob has been involved in new supervisory areas including, in order of importance, the transparency of financial-insurance product offerings (almost 1,200 prospectuses in the last 12 months), corporate governance in the two-tier model and quality control of independent auditors.

A particularly delicate area is the supervision of disclosure transparency and market integrity in complex corporate affairs characterised by elements of uncertainty.

Supervision tasks aim at preventing as far as possible, or at least rapidly eliminate, any discrepancy between disclosures by means of constant verification of potential anomalies and the immediate adoption of initiatives to restore regular market operations.

Affairs of particular significance regarded a number of leading Italian groups, such as Enel and Telecom, the first involving takeovers at international level and the second by projects for industrial reorganisation and changes in the control structure. In both cases Consob issued various requests for integration of disclosures to the public, also in strict cooperation with other European Authorities.

Significant profiles on market disclosures and the protection of minority shareholders arose in a number of voluntary takeover bids on listed securities by the controlling party.

In these cases, the Commission asked the listed company involved in the takeover bid to provide greater details of the role played by independent directors in the assessment of the bid, on the observance of corporate governance regulations and on the involvement of independent experts.

Somewhat similar aspects also emerged in the case of takeover bids launched on units of closed-end mutual investment funds. Consob followed these bids particularly closely so as to identify any violation of transparency and accuracy rules on disclosures to the market and the rules regarding diligent and correct conduct of the coordinators.

One well-publicised affair, which continued throughout 2007 and has still not been resolved, concerns the privatisation of Alitalia. The difficult corporate position, the specific features of procedures for disposal of the public investment and the role played by the company in guaranteeing public air transport services on national routes resulted in highly complex situations that led the Government to adopt extraordinary, most certainly unique measures with respect to the situation of a company listed on a regulated market.

Since July 2004 the company has been subject to monthly market disclosure obligations with regard to its financial position as risks to business continuity had arisen.

During the entire disposal procedure, Consob took continuous action, also with regard to the major shareholders, to ensure the disclosure of useful information to the market, calling meetings with corporate members and requesting press releases and integrations to the disclosures already made. In general terms, Government bodies were also asked to disclose, and rapidly update, the timing and methods for the procedure, repeatedly emphasising that only official positions should be disclosed to the public.

The complexity of the entire affair, involving numerous occasions of highly uncertain disclosure content, required Consob's constant supervision of the integrity and regular operations of the market. Investigations are still in progress.

The latest situation, in the current post-implementation stage of the law decree[16] that, amongst other things, envisaged the exception measure of suspending disclosures on final preparations for the takeover bid on Alitalia, Consob agreed with Borsa Italiana's decision to suspend trading of the security. In fact, as it was not possible to guarantee complete market awareness of developments in corporate events, it was decided that regular trading conditions were no longer met. The removal of reporting obligations, however, does not imply removal of prohibitions, pursuant to the Consolidated Law on Finance, on matters of insider trading and manipulation. Consob continues to supervise the observance of these prohibitions.

A particularly serious case emerged towards the end of the first half of 2007 when, also as a result of specific requests from Consob, Banca Italease disclosed the existence of

significant counterparty risks on unlisted derivative contracts stipulated with customers. Consob performed investigations, including a number of hearings, against the bank's directors, statutory auditors and the independent auditors, and issued reports to the Legal Authorities on facts possibly of criminal significance. The conduct of the bank in the provision of investment services was and still is subject to supervision.

The numerous legislative changes in recent years have drastically changed the sanctioning system in both substantial and procedural legal terms, increasing their dissuasive capacity.

For the suppression of market abuse in particular, a structured system was defined: financial penalties, even of significant amounts, are accompanied by additional prohibitive and equity sanctions, together with fines for corporate liability of the company of the offender.

With regard to procedures, the most significant aspect involved the power granted to Consob to directly inflict sanctions, on completion of investigation proceedings, to safeguard the principle of separation of investigation and decision-making powers.

Between 1 January 2007 and 30 June 2008 the Commission concluded 283 sanction proceedings. The total fines applied amounted to 46 million euro. In addition, assets were first seized and later confiscated for a total value of 42 million euro following confirmation of findings on insider trading. Additional prohibitive sanctions were inflicted upon 16 natural persons, for market abuse offences, totalling 129 months.

After extensive investigation, including inspections, into the distribution of unlisted derivative products, sanctions were imposed on the bank intermediaries. Procedural failings were discovered in the customer selection criteria and on the transactions recommended, in the pricing and in the structuring processes for new derivative products.

In the light of experience gained, a systematic review of the current financial penalty regime could be worthwhile to verify its overall consistency, effectiveness and adequacy.

The reduction in the amount of minimum sanctions for certain types of violation and the introduction of alternative sanction formats, i.e. written reprimands, could allow sanctions more in proportion with the objective and subjective seriousness of individual offences.

Application problems were also posed by the regulation establishing that the additional mandatory confiscation involves the product or illegal gains and the assets used to commit the offence, also identifiable as equivalent values(17). This formula per se implies a kind of automatic procedure which, at the time of quantifying the assets to be confiscated can result in the adoption of a measure materially disproportionate to the

seriousness of the facts and the sanction applied. It is to be hoped that this provision will be reviewed.

Consob's supervisory duties involve frequent and intense cooperation with the Legal Authorities, sharing tasks and increasingly extensive information.

Legislative developments have strengthened the intensity and extent of the sphere of application of cooperation between Consob and the Legal Authorities, particularly with regard to the supervision of market abuse. The Commission's optional powers for application in preliminary investigations have also expanded considerably.

The role of the administrative authority operates side by side with the Legal Authorities, not only to suppress criminal offences but also to ascertain the administrative nature of offences, on which Consob now has independent sanctioning powers. This cooperation has involved the investigation of several cases in which the Commission offices have seen intense cooperation and exchange of information and documents with the relevant public prosecutors.

In the last 18 months Consob has submitted over 130 reports to the Legal Authorities on alleged cases of offences subject to criminal sanctions. 14 involved alleged market abuse. In 19 new criminal proceedings, Consob brought parallel civil proceedings to protect the interests of regular market operations[18].

In the same period, decisions regarding claims for compensation against Consob for alleged failure to supervise were, with only one exception, in favour of the Institute[19].

In 2007 the first cases were brought in opposition to Consob decisions to inflict administrative sanctions for market abuse. The 6 cases concluded thus far have upheld the existence of the offence sanctioned by Consob and, in a very recent case, also ordered confiscation of the gains and assets used to commit the offence.

These decisions covered, amongst other things, the relationship of sanctions applicable for market manipulation offences, confirming the "dual track" system, i.e. inflicting both administrative and criminal sanctions upon the offender and the complete independence of proceedings resulting in their application.

A further 6 cases were concluded with regard to financial statements challenged by Consob[20]. In 5 of these cases, the findings of Consob were upheld. In one case the findings of the Institute were not upheld.

The increasingly complex and detailed series of activities that Consob is called upon to perform, also as a result of new tasks assigned by law and brought about by market developments requires adequate resources, powers and specialised capacity to act.

The growth of Consob has recently benefited from a staff increase of 100, with no onus on the State, whose overall contribution to funding of the Institute covers only slightly more than 10% of its needs.

The gradual reduction of state contributions, but above all the principles of autonomy and independence that govern the Institute's activities do not justify the fact that, for alleged public finance needs, Consob is subject to limits and restrictions to its self-organisation capacity and its staff recruitment policies.

The independence of the Authority is founded on the nature of its primary interest of protection, compliant with the principles that at European and international level define the requisites of a supervisory authority.

5. Conclusions

We find ourselves in a period of strong uncertainty as far as the integrity and stability of the financial systems and the real prospects of economic growth are concerned. The impact on trust is exasperated by increasingly intense interaction between financial and economic development phenomena. This generates a widespread demand for protection and action to overcome the risk of progressive deterioration of general economic conditions.

The responses to problems that emerge tend to safeguard the financial market's capacity to act as a means of support and to stimulate growth.

The dynamic and driving force of financial innovation, which has contributed considerably to the recent growth phases, should neither be rejected nor obstructed. The products become more and more complex and require a corresponding adaptation of transparency and correctness standards by those who create and distribute them.

The key instrument of defence in guaranteeing the integrity of the investment intermediation system is the market's own reaction mechanisms. The reorganisation and recapitalisation processes involving the leading international intermediaries are heading in this direction. In the current situation, reputational sanctions also become more incisive and can induce operators to adopt corrective measures.

The Authorities, by coming down hard on offences where the extent and their seriousness are a risk to the market, and by steering the conduct of operators towards higher standards of correctness and transparency, contribute to restoring conditions of more trust in the system's recovery and development capacity.

The timing and incisiveness of supervisory action and sanctions, apart from playing an increasingly active preventive role, strengthen the market's selection and self-regulatory mechanisms. The action taken by the Authorities during the recent crisis to ensure clarity regarding the true risk of operator exposure have played an important role in soliciting and

guiding the corrective initiatives of the market and supervisory tasks. The rapid identification of new weak points in the system also allows us to assess possible adjustments to the regulatory framework and international transparency standards.

Consob is aware of the need to adopt development paths for its own tasks that are suited to the problems, new to a certain extent, with regard to protecting transparency and correct conduct.

Recent initiatives aim to strengthen the corporate governance mechanisms of listed issuers and to make intermediaries more liable in relations with investors. The intention is to promote the role of independent directors in protecting the interests of the company in transactions most susceptible to the risk of conflict of interest. Consob has demonstrated its willingness to acknowledge the value of implementation guidelines prepared by the intermediary associations.

The Institute is also focusing attention on the asset management sector, which plays a strategic role in satisfying professional investment demands and the development of the Italian financial sector.

In order to face the long-lasting difficulties in the sector, the supervisory authorities, in agreement with operators, are preparing a report due to be published in the near future and containing specific guidelines and regulatory reform options. These tasks, mainly targeting the opening of distribution channels and reinforcing the independence of management companies, also imply a more decisive operator commitment to implementing appropriate investments and strategic decisions.

Internally, Consob plans to verify the Institute's procedures and organisation to identify action to reduce the length of proceedings and to develop market phenomena monitoring capacity.

The consultation procedures are being expanded, also through in-depth impact analysis of regulatory scenarios. The active participation seen in recent public consultations proposed by the Institute indicates that we are on the right path.

Investor protection implies an increase in the level - still unsatisfactory - of financial awareness.

Financial education initiatives have become a priority for Consob. Action taken by the Institute has to be alongside that of other public and private bodies, and involve citizens from a very young age.

New investor protection instruments were introduced recently by law and assigned to Consob's control. These are the Investors Guarantee Fund and the Conciliation and Arbitration Chamber for disputes arising between investors and intermediaries. Definition of the measures governing the implementation of these two institutes is at an advanced

stage, fired by the need to provide investors with rapid, inexpensive and easily accessible mechanisms and procedures.

The introduction to Italian law of collective compensatory proceedings, as envisaged by the 2008 Finance Law, was recently postponed in order to better define the application methods[(21)]. This postponement must not draw our attention away from the positive role that collective action could play, if properly governed, to protect the weak position of individual consumers.

Minister, Excellences, Ladies and Gentlemen,

30 years have passed since Consob's inauguration in June 1974. I had the honour of participating in the recent transformation process of an Authority that has changed radically, after years of constant effort to modernise the institutional framework and to offer the market a system of clear, precise rules that can be extensively shared and observed by all.

Today, Consob can operate in the knowledge that it possesses the most appropriate instruments, resources and recognition to fulfil the role assigned to it by law. The contribution of increasingly sophisticated skills and strength of a young, motivated staff extends our options in exercising our duties, the complexity of which poses new challenges year after year.

I would like to take this opportunity to thank my Commission colleagues, the Director General, the managers and every member of staff, most of which are young and over half are women, highly committed to their work and with a renewed sense of belonging. I also wish to thank the Trade Union Organisations for their constant stimulus in finding better ways to operate.

Our consolidated, meaningful cooperation with the Bank of Italy and the other Authorities, with all the Courts, the State Legal Office and the Guardia di Finanza, to whom I again express my sincere thanks, indicate a joint intention that guarantees a shared approach in fortifying faith in the system and in facing the growing need to protect investors.

In the difficult times currently faced by the market, Consob renews its commitment to act fairly and with objectives that tend increasingly towards prevention, fully aware of its responsibilities and convinced that the Italian economic and financial system will find the stimulus and energy it needs to overcome the current problems and rediscover its desire to grow, indispensable to market development.

NOTES

(1) Italian Law no. 62 of 18 April 2005 (EU Law 2004), the market abuse directive implementation law, envisaged that the provisions of art. 114, subsection 8 on fairness and transparency in conflict of interest for entities that produce or disseminate research or assessment results should also apply to rating agencies.

(2) Italian Law no. 262 of 28 December 2005 specifically envisaged the exclusion of rating agencies from the application of transparency and fairness regulations pursuant to art. 114, subsection 8 as reformulated under the new law.

(3) The Standard & Poor's 500 index, representing the leading US shares, suffered a 13% drop in the first half of 2008. In the same period, the Dow Jones Euro Stoxx index, representing the leading European shares, fell by 24%.

(4) The Standard & Poor's-MIB index closed 2007 with a 7% decrease and the first half of 2008 with a further drop of 24%.

(5) In the first half of 2008, 5 new companies began stock market trading compared to 15 listed in the first half of 2007 and 10 in the same period in 2006.

(6) The MAC (Mercato Alternativo del Capitale), established in 2007 as an alternative trading system in operation from 1 November 2007, took on the status of Multilateral Trading System when MiFID entered into force. The MAC system is reserved for professional investors and is based on simplified access requirements.

(7) The Alternative Investment Market (AIM), structured as a multilateral trading system and open to retail investors, is characterised by rules more simplified than those for regulated markets, along with a high degree of intermediary responsibility in guiding the company in the market (the Nominated Advisor, or NOMAD).

(8) As at the end of 2007, in 200 of the 297 listed companies, i.e. a little over 50% of the total market capitalisation, a single shareholder held legal or working control. In 43 other companies, with an approximate 15% bearing on total capitalisation, there was a shareholders' agreement governing the company or its parent which, under the terms of contractual clauses or due to the total holding covered by the agreement, it seemed appropriate to allow parties to the agreement to exercise an influential role in controlling the company. Disregarding the 8 cooperatives, in the remaining 46 companies not controlled by a single shareholder or shareholders' agreement, the total holding of major shareholders was over 50%, leading to the assumed presence of informal coalition phenomena.

(9) At the end of 2007, institutional investors with a holding over 2% were present in 60% of listed companies, most of these being foreign investors. Four years earlier, this phenomenon involved only 30% of listed companies.

(10) Commission Recommendation 2005/162/EC of 15 February 2005 on the role of directors without executive office or members of the supervisory council of listed companies and on board of directors' and supervisory committees.

(11) Envisages more stringent measures, in terms of identifying significant related party transactions, for companies adopting certain means of separating ownership and control giving rise to the scenario, illustrated in last year's address to the market, of applying tighter obligations on reporting related party transactions on companies with a higher risk of conflict of interest.

(12) The MiFID Directive no. 2004/39/EC implemented by Italian Legislative Decree no. 164 of 17/9/2007; the Takeovers Directive no. 2004/25/EC implemented by Legislative Decree no. 229 of 19/11/2007; the Transparency Directive no. 2004/109/EC implemented by Legislative Decree no.

195 of 6/11/2007; the Prospectus Directive no. 2003/71/EC implemented by Legislative Decree no. 51 of 28/3/2007.

[13] New VIII Directive no. 2006/43/EC.

[14] The regulatory and supervisory standards promoted by the CESR are not legally binding to EU member states. CESR surveys confirm that there are persistent differences in supervisory practices, particularly with regard to control of prospectuses and market abuse enforcement. To encourage a stronger convergence in the mutual investment fund sector, at the beginning of 2007 the CESR established a specific operations Task Force as part of the Asset Management Expert Group led by the Consob Chairman.

[15] Apart from the CESR, other European coordination committees are the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

[16] Italian Law Decree no. 97 of 3 June 2008.

[17] Article 187-sexies of the Consolidated Law on Finance states that the application of financial penalties in cases of market abuse always involves confiscation of the product or the illicit gains and of the assets used to commit the offence.

[18] Worthy of note among the parallel civil proceedings is the “Antonveneta” affair, which involved criminal proceedings against 68 natural persons, plus 8 legal persons liable pursuant to Italian Law 231/2001, accused of several offences including market rigging and obstruction of the duties of the supervisory authorities. On 23 May 2008, the first instance judge accepted the plea bargain submitted by certain offenders and ordered indictment of the others.

Criminal proceedings were recently instigated for market manipulation offences in the notorious Fiat equity swap.

In the last 18 months, 4 first instance proceedings were concluded and 3 upheld at appeal on market abuse offences, in which Consob had brought parallel civil proceedings, and in which liability of the offenders was confirmed, also ordering compensation for damages.

[19] Specifically, 53 sentences were pronounced on claims for compensation filed against Consob by investors, purchasers of “Cirio”, “Parmalat” and “Argentina” bonds. Most of the decisions declared the intermediaries involved in allocation of the bonds to be liable, with subsequent order that they pay compensation for damages. The compensatory claims against Consob were rejected as no violation by the Institute was recognized with regard to supervisory obligations imposed by law.

In the last few days the Civil Court of Rome ordered Consob to pay compensation for damages to investors for alleged failure to supervise an investment firm and a stockbroker in relation to facts occurring in the period 1994-1996.

[20] Certain decisions made on this topic show different case law positions on the nature of Consob’s interest in taking action and its continuation in cases where, during proceedings, the company is delisted. The Commission is currently studying the matter further, also in the light of the applicability of international accounting standards and the option of declaring accounting positions to be illegal, regardless of any challenge brought.

[21] Italian Law Decree no. 112 of 25 June 2008.