I thank the International Council of Securities Association and its Italian member Assosim, with which Consob maintains a solid, good - I hope - and cooperative - I trust - relationship, for this invitation. Let me extend a warm welcome in Rome to all foreign participants who were brave enough to fly and travel in these sombre times.

There is a taxonomy of luncheon or dinner speeches: before, during or after the meal. In my experience of a frequent listener and, more rarely, as a speaker, I am convinced that the infra-meal speech is the worst: warm dishes get cold and ice creams melt in the plate. Of the other two kinds, I think that the pre-meal variety is the less unacceptable: at least you know that it must end and you can look forward to your meal instead of only being able to regret that the meal was over. I am therefore grateful to the organizers for their choice, especially because failing, as I am afraid I shall fail, to meet your expectations, if there are any, I can at least hope that the following lunch will improve the mood of this intimidating audience.

You are an admirably expert and highly technical crowd. I belong instead to a much maligned and despised species: that of economists, the object of a great number of jokes. I was however happy to notice, on behalf of the vested interests of my profession, that practitioners, or their associations, have recently made some use of economists: even without entertaining any ambition of remotely approaching the status of lawyers, it is at least a promising beginning. Economists have been used in particular as advocates to provide theoretical and empirical arguments in favour of often opposing views in the great war on the Investment Service Directive Mark2 (ISD2) which has raged for long and, as the time nears for its conclusion, is still raging in some sensitive battlefields.

Let me express, on that war and those battles, an absolutely a-technical and impressionistic reaction - such as you would expect from an economist, and as such not to be taken too seriously. Yes, there are norms and rules that can be improved to everybody's benefit. Yes there are changes that, though at some party's loss, would be welfare improving in the aggregate because aggregate welfare gains would exceed the sum of individual losses. But there are also cases in which the issue is mostly one of distribution of offsetting gains or losses across national industries and systems, without a clearly defined welfare effect in the aggregate: witness the fact that practitioners and firms engaged in the same professional activity, but based in different countries, and all perhaps represented in this room, often express different, or indeed opposing views on the same question. It is of course always possible to gather allegedly general economic arguments supporting each view. They all make sense, but the trouble is that they can never prove conclusively the unqualified superiority of one or the other solution. The economist in such cases cannot reliably be single handed (as requested by an American President): you will always find one speaking persuasively for "the one hand" of the dilemma; but you can always find equally acceptable views for the "other hand". There are two possible outcomes in these cases: either a stalemate, in which nothing is done and everything remains as it was; or else some reasonable compromise on the contentious issues such that all parties concerned are ready to accept some sacrifice.

In the case of ISD2, I have no doubt that the first outcome - that of a stalemate in which nothing is done - would by far be the worst. Life with the existing ISD1 has because very difficult and the times nightmarish, for market participants and regulators alike, for all the reasons spelled out in the Commission's explanatory memorandum, but basically became the old directive has lagged way behind market developments and is unfit to deal with a new, more variegated and more dynamic reality.

Major changes have occurred as a result of two concurrent trends: the increase in the number, and hence the fragmentation, of competing trading venues, and a growing competition between exchanges, as we conceived
them in the past, and intermediaries or investment firms setting up their own trading venues which has blurred the distinction between the two. Some may like these developments, some may dislike them, but they are a fact of life. Personally, I welcome any outcome of competition, also considering that present day exchanges, at least in the continent, have evolved from a publicly controlled and public utility status into privately owned and for-profit entities which inherited however the monopoly position inherent in the former situation. Consob has changed its rules in these very days in order to allow the existence, alongside Borsa Italiana, of other regulated markets authorized to trade stocks listed by Borsa Italiana even without the issuers' request. I cannot say that Borsa was altogether happy: but this is only natural. I shall only add that the UK placed itself ahead of other countries, and ahead of ISD2, when it clearly separated the activity of listing from the admission to trading by entrusting the former to the UKLA.

I am not sure how far the trend towards fragmentation, with a growing number of competing exchanges and MTF's, will go. Especially I do not know - and would not venture to foresee - whether we shall witness a cycle, with fragmentation being an episode of creative destruction, at the end of which there will be only a limited number of survivors: time and the market will tell.

There are however two reasonably certain consequences of the current process: the end of one mythical notion - that of concentration; and a growing uncertainty as to the meaning and operational relevance of a traditional tenet of investor protection - that of best execution.

Concentration is already to no little extent a myth, even when, as in Italy, trading on the one (so far) regulated market represents a presumption of best execution: block trades and non-resident investors are exempt and clients can authorize the execution outside the regulated market. With the presence of several regulated markets and the coexistence of MTF's, there can be no concentration rule.

How can then best execution be assessed and enforced? Here is a problem to which I can find non obviously feasible solution.

With a plurality of trading venues, the agency relationship between the client, who is the principal, and the broker, who is his agent, becomes very complicated. In particular, exclusive consideration of the requirement of a "best" price across all the available trading venues neglects another relevant dimension of the problem: the cost, for the client and for the broker, of an extensive search across these trading venues.

This dimension and the resulting difficulties, it seems to me, are partly neglected by the drafters of ISD2 when, in article 19.1 and 19.4a, they nobly strive to define best execution in a non-concentrated regime. How it is possible to ensure that "orders are executed in such a way that the client obtains the best possible result in terms of price, costs, spread and the likelihood of execution, taking into account the time, size and nature of customers orders" I do not know. The task of identifying "the factors that may be taken into account for determining best execution or the calculation of best net price prevailing in the marketplace for the size and type of order and type of client" is left to level 2 implementing measures. I do not envy my CESR colleagues when they shall be called to undertake this exercise!

On the other hand article 19.2 and 19.4b seem to indicate a more promising approach, which does not presuppose an ontological definition of best execution. In these paragraphs the thrust is on the adequacy of the procedures implemented by investment firms, as indeed it should be. This follows the line, which I am inclined to share, proposed in a 2001 paper by Board, Sutcliffe and Wells, when they argue in favour of "a light but defensible regime based on the reality of new market places that "abandon(s) attempts to distinguish between different types of exchange (...) and instead focus(es) regulation on Authorised Firms".

A workable alternative to the imposition of rigid and unwieldy rules based on a precise definition of best execution requires however a high degree of transparency: pre-trade as well as post-trade, I hasten to add. The old dictum of judge Brandeis that sunlight is the best disinfectant holds also here. If information on prices that are quoted on all trading venues are immediately available, this by itself will at the same time make it easier for investment firms to execute their clients' orders at the best conditions and provide a disincentive for them not to do so because their clients are more likely to complain otherwise. I am well aware that article 25 of ISD2 is one of those battlefields I was mentioning at the outset. But, though fully aware of the technical or often narrowly economic reasons that motivate the opposition to pre-trade transparency for investment firms dealing on own account in the case of small size transactions, I believe that the principle behind this obligation has a cogent validity. If anything, my doubts, or rather my queries, concern the implementing measures detailed in article 25.4: another hard task for my friends at CESR. At level 2 the Commission, and CESR before the Commission, should proceed with a light touch: there can hardly be a universal definition of "the size of transactions customarily undertaken by a retail investor" and, even more, of "the shares or classes of shares for which there is sufficient liquidity" in view of the application of the pre-trade transparency obligation, these being cases in which one size does not and cannot fit all.
Let me come to another delicate issue of ISD2, or at least such considered by Italian investment firms: that of eligible counterparties, other than investment firms, which are permitted access to, or membership of, a regulated market. Article 22.3 of the proposed directive mandates that also insurance companies must be given access to markets - which is not the case in Italy at the moment. The following paragraph however says that Member States may also recognise UCITS and their management companies, pension funds and their management companies, and other companies meeting pre-determined requirements as eligible counterparties.

This provision, if implemented by a Member State where only investment firms are given access to regulated markets, opens the way to disintermediation away from investment firms. I venture to foresee that there will be powerful resistances against this option, if ISD2 is approved in its present form and when it is transposed into national legislation. This, in my view, is one of those issues on which it is difficult or impossible to express an objective opinion, because there are gains and losses to each conflicting choice, none of which is obviously superior to the other. Disintermediation of collective investment schemes and pension funds, with the creation of in-house trading departments, may on the one hand reduce their trading costs to the benefit (it is to be hoped) of their customers. As such, the innovation would certainly be welfare improving. Mere consideration of trading costs, on the other hand, fails to capture some negative externalities that may arise from its impact on the investment service industry, and especially on its smaller segments. Loss of business may compel smaller firms to close down, with a resulting increase in the degree of concentration. Alternatively, such firms, to stay alive, may be led to engage into riskier activities (scalping, infra-daily transactions) or into other less palatable and acceptable kinds of behaviour: Consob has already registered an increase of both in recent times, as the going got worse.

In a country like Italy, dominated by banks which control both the near totality of the asset management activity and at the same time the larger investment firms, the issue is more complex, because the distributional effects are more difficult to assess. There will be cases in which redistribution will only occur between different units of the same bank, while in the cases of independent investment firms, or of firms the business of which is not largely captive of the parent bank, the losses will be significant.

It is often maintained that a reduction in the number of investment firms would cause a decline in the service provided to the public by the competing activity of research and analysis: another negative externality of disintermediation. Yes, this may be an undesirable result: but only if we can be reasonably sure of the quality and independence of the research disseminated by investment firms, especially if of banking origin.

This issue has come, and still is, under intense scrutiny as a result of Enron and all that: as if we needed Enron, and all that, to realize that something (or a lot), somewhere (or almost everywhere), sometime (or most of the time) was rotten in that kingdom. I cannot resist the temptation to give vent to a bit of national pride in the matter. Before the end of the bubble years (and much before Enron), and before mightier authorities did the same, Consob conducted an inquiry on the advice provided by analysts. We were shocked to find that the "sell" indication covered only 7% of the stocks analysed, while most of the rest was "buy": little did we know that the US authorities would find, two years later, that the "sell" there was only 2%. As a result Consob was I think the first or amongst the first, to introduce some regulatory obligations on research, requiring prompt dissemination through the web and disclosure, in bold letters, of the conflicts of interest arising from the relationships entertained by the analysts and especially by the firm on behalf of which the analysis is conducted with the issuer that is the object of the analysis. The reason why we subsequently had to relax the rules on dissemination somewhat was that other European countries, and in particular the UK, did not impose similar obligations, so that national industry was discriminated against: a case of regulatory arbitrage leading to a race towards the bottom. I must also pay tribute to the efforts made by the Italian Association of Financial Analysts. Prodded by Consob, but also on their own far-sighted initiative, they have produced an internal code (with some important innovation, approved by their general meeting only a few days ago), which very much reflects the best practice and is in tune with current initiatives regarding both legislation and the setting of international standards. To these I shall finally turn, apologising for this chauvinistic interlude.

Analysis and research (or, more precisely, the production of recommendation) have found their place in the European legislation on market abuse and in the draft level 2 implementing measures now submitted to consultation. Such measures, broadly aligned with the industry’s best practices, essentially deal with the standards and conditions to be followed in the presentation of recommendations and with mandatory disclosure requirements of interests and conflicts of interest. They are mild in one sense: they do not deal with analysts compensation, except for the request of disclosure when the remuneration is tied to investment banking transactions, and rely on organizational Chinese walls to prevent conflicts of interest. It is on the other hand interesting that recommendations which are erroneous or biased or influenced by material interests are considered a case of market manipulation if they are preceded or followed by orders to trade or by transactions on the part of the authors of the recommendations.

I feel that the IOSCO Statement of Principles on security analyst conflicts of interest, which a selected chairs’ committee has been asked to submit to the organization’s Technical Committee by next September, may turn out to be at the same time broader, simpler and more elegant. The principles are expected to deal with the standards of disclosure of conflicts of interests, with the limitation or management of such conflicts, with
reporting and compensation systems, with the elimination of outside influence, with the integrity and competence of research analysts.

I hope that all these efforts will produce a better world. The silver lining of the so numerous recent episodes of corporate failure is that they have unveiled the fault lines that market exuberance had concealed before and provided a unique window of opportunity for undertaking the necessary corrections. This opportunity must be seized before a new wave of euphoria makes us forget the past and slows down the pressure for reform.

This window of opportunity is, as I said, a silver lining. But the clouds are still there, not only for the investors, but also for the industry.

True to promise, I believe I have made you longing for your lunch. But just in case this were not enough, let me conclude on a cheerless note, tempered however by a note of confidence. Ever since the year 2000 we have gone through a very bad period not only for investors but also for the investment industry. To give an example at home, last year the commission fees perceived by Italian investment firms have declined by 13 per cent and those perceived by banks by 18 per cent, due to a fall both in turnover and in fee levels. We all hope that 2002 does not fall in the well-known definition of an average year: a year worse than the previous one, but better than the one to come. It is not easy in these conditions to undertake the organizational changes and the restructuring needed to face the many challenges confronting the industry: an unfavourable environment may increase the minimum inevitable casualty rate.

Still, I am confident that the industry will successfully adapt and react, as it has always done in the past.