

Annual Report 2009

Rome, 31 March 2010



CONSOB

COMMISSIONE NAZIONALE
PER LE SOCIETÀ E LA BORSA

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Speech by the Chairman to the Financial Market

Milan, 28 June 2010

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 interest in the life of the market and the issues afflicting the entire market at this moment in time. To stop the global crisis from precipitating further we have to face increasingly complex problems, our expert knowledge, suitable analysis and firm decisions being put to use to find the best possible solutions.

This annual meeting – held after Consob's submission of its annual report to the Ministry of the Economy by 31 March each year, and then forwarded to Parliament with evaluation notes and comments – offers Consob the opportunity to inform you and ask your opinion on its national and international operations. In addition, the meeting also allows us to provide an overview of guidance which, complying with and to the extent of current regulations, will affect our operations in the near future, at the same time providing input to the market and its operators – especially investors – on its own awareness, experience and all else useful in assessing the developments that we agree upon and intend to pursue together.

This occasion is also an opportunity to reconfirm the validity of support received from the Government and Parliament, of the periodic meetings with the Financial Stability Board and the Financial Security Committee, and the ongoing collaboration with the legal authorities, the Bank of Italy, other regulatory bodies and the *Guardia di Finanza*.

Since 1 April this year the Commission has been operating with one member less than normal. Our heartfelt thanks go to Paolo Di Benedetto, who resigned before his term of office officially ended, for his contribution to the Commission's work.

The Commission also renews its sincerest thanks to its host city, Milan, where Consob is proud to have its offices in the prestigious Palazzo Carmagnola.

Lastly, I wish to thank Borsa Italiana for its gracious hospitality again this year.

1 Developments in the financial crisis

For almost three years the financial markets have been shaken by a crisis without precedent during the post-World War II years. Triggered by a secondary sector in the US banking system – subprime mortgages – the crisis spread rapidly to affect the entire global financial system, highlighting a ricochet effect that could never have been imagined between different factors and geographic areas apparently only remotely connected.

The disturbance peaked in September 2008 with the crash of the US merchant bank, Lehman Brothers. This event cycloned through the global financial markets leaving them, even now, characterised by strong uncertainty and extreme volatility. In the months that followed the collapse of Lehman Brothers, share prices in the major advanced economies suffered swift plunges to record losses of up to 48% in March 2009. Despite this, the stock exchanges proved to be the only efficient liquidity tank in a phase in which the markets suddenly found themselves illiquid.

Government, monetary and supervisory authorities' intervention played a key role in fending off the worst of the damage. Emergency plans were prepared with mass aid, particularly for the banking systems which were shored up from public funds.

The face of the markets changed deeply as a result.

The regulatory framework proved to be totally inadequate in preventing and handling systemic crises. The outcome was an indiscriminate increase in finance that became increasingly distant from the real support needs of a productive economy. This increase was not matched by a suitable capacity to identify and govern the instability risk that the financial system was gradually accumulating.

2 From micro to macro

When the more violent effects of the emergency seemed to be behind us, the markets entered a new phase of disturbance, different this time.

The succession of changes in political leadership in Greece gave rise to a review of the public deficit, from which serious financial discrepancies emerged that were hitherto unknown to the European statistical and monetary authorities. This episode created strong market tension and brought the issue of public accounts back under the spotlight, not only in Greece but in the entire Euro Area.

From the beginning of this year no factor has conditioned the share market trends as much as the fears for long-term sustainability of the debts

and deficits of the sovereign states. With this, the tension generated by the subprime mortgages was further fuelled by the public finance figures. Unlike the crises in the past, triggered in the private sector, the epicentre shifted from the "micro" plane to that of economic and financial "macro" aggregates.

The combination of low economic growth, loss of competitiveness, increasingly evident discrepancies in public accounts and an aging population have reawakened fears that the dawn of the Euro seemed to have dissipated.

In the space of just a few weeks the solidity of the Euro Area began to show cracks and weak points. The major institutional investors were forced to reconsider their investment decisions and review their risk management strategies, modifying their exposure to individual currencies to the detriment of the Euro and to the benefit of other currencies.

This portfolio rehashing phase led to turmoil on the foreign currency markets too. The underlying issue remains the immense need for capital to finance the public debt in many countries where the recent crisis has further upset the financial balance.

The changes were so drastic there were fears that not only Greece was at stake. At certain times it was believed that capacity of the Euro itself or, at worst, the European integration process were at risk. Political hesitation, especially in certain countries, and the poor cohesion with which – at first – Europe handled the Greek bail-out operation heightened the perception of risk, and consequently also uncertainty and volatility.

No country was left untouched by the markets' apprehension. But not all countries are vulnerable in the same way. Those with a higher overall debt, both public and private, and the lowest economic growth are more exposed than others. The tension was also mirrored in the government bonds market, where the "dash for quality" phenomenon reappeared. The spread between the returns on securities of the various Euro Area sovereign states widened, in some countries reaching watchlist level.

3 The new European challenges

Against this new wave of commotion the major European governments reacted by implementing ambitious plans to remedy financial imbalance. It is a step in the right direction in helping to restore conditions of faith in the system. Nevertheless, in the mid term we have to rise above the logic of emergency aid.

We have to reorganise the institutional setup underlying the concept of a single currency. The Euro is still an uncompleted project. Monetary integration was not accompanied by political integration as was hoped by Europe's founding fathers, De Gasperi, Adenauer, and later by those

who put the Euro project into action, Kohl and Mitterand. We rapidly need to construct that missing pillar, political union. Otherwise, to use an expression dear to President Ciampi, the Euro will remain "lame".

The conclusions drawn by the European Council on 17 June on adoption of the "Europe 2020" agenda seem to head in the right direction. The initial guidance has been prepared for reform of the stability and growth treaty to ensure appropriate macro-economic monitoring.

Confidence in the markets can be consolidated when Europe has adopted joint tax and budgetary policies that take inspiration from the principles of long-term sustainability and are founded on essentially balanced public accounts.

It will be tough. It means amalgamating needs that may seem to be in conflict: on the one hand the structural recovery of public finances, and on the other the relaunch of economic growth as an inescapable prerequisite to guaranteeing a healthy future. But it isn't a "mission impossible". The major European countries are preparing for it even now. By calling upon its best possible efforts, Italy could be among them too.

In recent years much action has been taken in terms of public cost saving, particularly regarding control of outgoing quantitative flows. There is still a lot to be done to improve cost flow quality. Likewise with regard to inflows, in an attempt to provide the country with a fair and extensive taxable base, also through effective action against tax evasion, to be tackled with determination.

A full relaunch of the economy calls for mass effort to guarantee legality in all areas of the country, especially in the south where there is real potential of becoming a strong source of development. Until now the widespread commitment of everyone is offering highly significant results, acting as a comfort and stimulus to a business class that is particularly exposed. It is to be hoped that the presence of southern companies on the stock market, still few and far between, will increase.

4 Regulatory reform

In this context, where governments and parliaments are called upon to face extraordinary challenges, the supervisory authorities must contribute. The growing level of market globalisation requires suitable input, and that can only be global. Initiatives limited to national level risk being of little effect and can even be counterproductive. The supervisory authorities now need to rise above the tricky questions of regulatory arbitrage more than ever before.

Consob has a strong commitment within the CESR, the European Committee for supervisory authorities, and IOSCO, the sector's worldwide organisation. In addition it participates in Financial Stability Board and OECD initiatives.

In the international organisations not only do longstanding players in the field of economy and finance make their voices heard, but also – increasingly and more forcefully – the 'new entries' such as China, India and Brazil. Expansion of the working parties makes governing international meetings more complex. However, common guidance and assessments are finally starting to emerge. The OECD, based on an Italian government initiative, recently adopted a "charter of principles of fairness, integrity and transparency in economic activities", also approved by non-member states such as Brazil and Russia.

The international institutions' efforts to introduce new global standards, launched in 2008 by the G20 Summit and with full backing from Europe, especially the Italian government, have nevertheless not produced conclusive results and no wide-ranging coordinated action has yet been taken.

The sovereign issuers' crisis seems to have given new impetus to the rules redefinition process. An initial answer to the problems emerging from the financial crisis envisaged putting together new global rules on individual critical areas: rating agencies, hedge funds, intermediaries' asset stability, accounting standards and securitisations.

We understand, now, that the best approach to governing this crisis and preventing others is a full review of the "regulatory perimeter". Over the years, in fact, a parallel world has developed – not only unsupervised, but not even fully identifiable by the tools available to the supervisory authorities.

Transactions on regulated markets, characterised by a high level of regulation and supervision, in fact now represent a reduced proportion of trading, especially in financial instruments other than shares. The CDS market has become of key importance in steering operator assessments of issuer insolvency risk, even for sovereign issuers. It is a non-transparent market dominated by just a few oligopolistic operators.

The question of bringing off-market transactions and financial instruments created through financial innovation back to within the regulatory perimeter is now urgent.

Recent developments at international level, with active contributions from Consob, finally seem to have made a move in the right direction.

On 17 June 2010 the European Council recognised the need to close the loopholes in regulations by urgently completing the reforms necessary to restore solidity and stability to the European financial system, in accordance

with guidance provided in the European Commission's Communication of 2 June 2010.

The European Commission very recently published an important consultation paper on OTC derivatives and post-trading infrastructures that it is hoped will be a preamble to the introduction of transparency measures for financial instruments currently traded off-market and common standards regarding central counterparties. It is important that the majority of derivatives are settled through central counterparties.

Also through CESR contributions, the MiFID review aims for an overall reform of the section on markets and other trading venues (multilateral systems, internalisers and other hybrid platforms) and of the rules on supervisory authority transparency and disclosure.

Another consultation paper refers to short selling, which in Italy as in Europe has kindled widespread debate. This year the CESR issued transparency standards for net short positions on shares, and is discussing the best rules for other types of financial instruments such as government securities. The European Commission's consultation is more extensive and also envisages the option of introducing special measures to regulate CDS transactions and to assign greater powers to the European Securities Market Authority (ESMA) to coordinate vital urgent initiatives to ensure orderly market trading.

At global level, at their Annual Conference in Montreal in June 2010, IOSCO approved the new "Principles of Securities Regulation" assigning supervisory authorities the task of constantly redefining the "perimeter of regulation" to avoid the development of new unregulated phenomena and to limit systemic risk. Newly introduced principles regard the regulation of hedge funds, rating agencies and financial analysts.

Another international principle adopted by IOSCO just recently refers to conflict of interest in all the regulatory areas. This issue is close to Consob's heart, given its focus on this aspect of supervisory activities.

5 The new architecture of the European supervisory system

From January 2011 the European Union should be equipped with new supervisory infrastructures. The launch of three authorities is envisaged, for the banking sector, financial markets and the insurance sector. The embryo of these new organisations is formed from coordination committees that already exist among the national authorities. The ESMA is planned for the financial instruments markets, which will be based on the current CESR.

The new architecture of the European supervisory system meets the need to remain in step with market developments, where the boundaries of national financial markets tend to dissipate. In order for the ESMA to be a success, a clear definition of powers and competences is crucial, particularly with regard to relations with the European Commission and the authorities of individual countries. We have to avoid haziness, overlaps and shadow areas that could translate into muddled decision-making mechanisms and imprecise action. The safeguarding of ESMA independence from the Commission in Brussels and the national governments goes without question.

In the near future, regulatory functions will be allocated more and more often to the ESMA European office. Supervisory functions are expected to remain at local level, though they will be increasingly implemented under the coordination of the European authority. The role of the national authorities will eventually be downsized. It is in the country's interests to ensure that Italy is adequately represented in terms of quality and quantity in the new European authorities. Investment protection is also affected by the commitment to play a key guiding role in the new decision-making bodies.

The independence of the ESMA and other European authorities to be set up in the near future could be better guaranteed, if the new institutions are anchored in European treaties, as we see today in the ECB. Similar protection should be included at national level for the independent authorities which should be strongly rooted in the Constitution. It is hoped that at European and national level the supervisory system will develop into a final model based on two pillars: one authority for stability, one for transparency and fairness. This model is still incomplete in Italy. The insurance and pensions sectors remain significant exceptions. It is to be hoped, stronger than before, that an organisational reform of the system of authorities will begin.

6 Rating agencies

A particularly important sector of activities subject to new regulations is the rating agencies. Their operations, for some time under the eye of the market supervisory authorities, was thought to be one of the factors that triggered the 2008 crisis, especially in relation to the rating of securitisation products.

As far back as 2003 IOSCO adopted its own general principles on which rating agencies ought to have been based.

After the United States, the crisis also led Europe and Japan to bring rating agencies back under the umbrella of a public regulatory system. From 7 June 2010 rating agencies have been able to submit applications for registration.

With approval from European law in 2009, Consob was indicated as Italy's national authority in this respect.

Regulatory developments on this issue at both EU and global level are not over yet. There are particular worries that the measures introduced so far are neither effective nor final, also in view of the absence of competition in this sector.

Just a few days ago the European Commission presented a new regulatory proposal which, after approval, it is hoped will rapidly transfer the responsibility for registration, supervision and sanctions to the ESMA. Given the international nature of the sector's leading operators such a proposal is more appropriate than ever.

The new regulatory measures have to be accompanied by global efforts to promote greater competition between rating agencies and to reduce the relevance of ratings in intermediary asset requirements and in investments permitted by collective investment managers. These objectives are indicated by the Financial Stability Board as priorities on the agenda for reform of the regulatory framework in favour of market stability.

In fact, the effects of credit ratings can be overly amplified by rules that induce their automatic use as mechanisms in market players' investment decisions.

On this point, in September the European Commission is due to present its communication on the significance of ratings given to government securities and the fairness of the methods used.

As part of its own duties, Consob has anticipated the thoughts now being considered under other countries' legislation, clarifying that the existence of a rating does not exempt a manager from due diligence in relation to the instruments in which he proposes to invest customers' funds. Furthermore, in March 2009 Consob eliminated all reference to previously established ratings in defining the minimum credit rating of a fund's bond component from prospectuses concerning open-ended mutual fund units.

7 The Italian share market

The Milan stock exchange felt the crisis more than other major financial markets.

From the Lehman Brothers crash on 15 September 2008 to date the FTSE Mib index has lost around 30%, as has the FTSE All-Share index. In the same period the leading markets suffered lower losses: 4% Frankfurt, 7% London, 10% New York and 19% Paris.

Even price volatility was stronger in Milan than in other stock exchanges.

The particular sensitivity of the share market to international tension reflects the limited size of our market.

At the beginning of 2008 the Milan stock exchange capitalisation stood at around 730 billion euro. It has now dropped to less than 400 billion euro.

Compared to the main European financial markets, Milan stock exchange capitalisation is now approximately half that of Frankfurt, just over a third that of Paris and a quarter of the LSE capitalisation. In addition, trading volumes on the Milan market – also as a result of trading venue efficiency – is high but tends to amplify fluctuations, given that it rests on a modest capitalisation base.

The phenomenon is accentuated by a lack of float, reflecting the ownership structure of Italian businesses. In effect, 40% of Italian stock exchange capitalisation is untradeable as it is formed from controlling packages. The corresponding figures on other markets are 10% for London, 25% for Frankfurt and 30% for Paris.

The breakdown of listed prices helps to increase the Italian list's exposure of to international financial tension. Over 30% of Milan stock exchange capitalisation refers to the banking and insurance sector compared to 20% in London and 15% in Frankfurt and Paris.

These figures confirm the historic lack of appeal in our economic system for stock market listings.

Despite repeated efforts to stimulate growth, the number of Italian companies listed on the Milan exchange has remained constantly below 300 over the last ten years.

The recent crisis further discouraged new entries, instead aiding an exodus. From the beginning of 2008 to mid June, 13 companies were admitted to listing, 7 of which on the main list and 6 on the AIM Italia . In the same period there were 27 cancellations from the list. The balance is 14 down.

The trend seems to predict a slowly thinning market. We cannot accept a future of slow decline.

In Italy the stock exchange can and has to play a more important role than that covered until now. In a country in which the leverage on public spending places strong limits on the need to shore up public accounts, the stock exchange must once again become what classic theory has always envisaged: a large catchment area for investments, which businesses can seize upon to finance growth with a view to innovation and competitiveness.

In Italy investments as a resource, even despite the recent calamities, remain abundant. As a development engine the stock exchange has unexpressed potential. It can do much more, if it manages to fully exploit the virtuous circle of transferring resources back to the country's production base, and bringing finance back to its true role and physiological limits.

8 The stock exchange as a development engine

Most of Italy's businesses are not attracted overmuch by the ideal of listing.

The country's economic fabric, as we know, is based on small and medium-sized enterprises. And it is in this sector that we see the widest gap between the number of producers and the number listed. Compared to the European average, the SMEs are under-represented on the Milan stock exchange. In other major EU markets small companies with capitalisation below a hundred million euro represent over 60% of listed companies, against 40% in Italy. The gap is even wider if we consider the fifty million euro threshold, which in other countries includes around half the listed companies compared to just one quarter in Italy.

Without doubt there has to be a cultural development towards a more open ownership of companies, often accepted under sufferance. The low propensity to listing, especially in the manufacturing sector, reflects the deep-rooted structural weaknesses in our country. Their persistence weighs on its capacity for growth.

Intervention to overcome the restrictions in share market development is an opportunity to free up the hitherto unexpressed potential for growth in a business fabric which, though in difficulty, remains lively and dynamic.

Quite a number of Italian companies have successfully managed to go through the restructuring process necessary to compete on the global markets, in most cases without needing to accumulate risk capital through listing. To continue along their globalisation path, the new conditions emerging from the crisis mean they need more capital and less debt.

An opening-up of the share market could be the effective tool that is needed to strengthen the capital base of companies, offering them long-term resources to support their innovative capacity. A tax system that guarantees a more balanced treatment of the various components of financing could play a key support role in this sense.

Important leverage for the share market development could lie in the rules.

Listing is accompanied by higher standards of transparency and more stringent rules of conduct: these have been seen until now as excessive costs rather than opportunities to attract investments.

Efforts to reduce the economy's grey areas, also in tax terms, could play an important role in bridging the gap seen between the status of a listed company and an unlisted company.

The costs of listing can also be reduced through greater flexibility in the application formalities, more suited to the needs of an SME. The regulatory strategy could take into account the differences in size, structural and risk exposure of individual companies.

The various institutional and market operators need to agree in defining such a strategy.

The results of initiatives adopted so far, with the creation of specialist markets for SMEs (MAC and Aim Italia) should be assessed in the light of the difficult economic context in which they were launched. The experience gained has to be exploited to relaunch, certainly not to abandon, the potential growth of a capital market better designed and better suited to Italian production.

The problem of sustainability of the regulatory obligations of market listing for SMEs is not only felt in Italy.

The European Commission recently launched a consultation to update the directive on issuers' transparency obligations (the Transparency Directive). Amongst other things, the aim is to identify areas where the regulations can be simplified for the smaller listed companies with a view to encouraging capital market access.

In the United States, where the Sarbanes Oxley Act had a particularly significant impact on this type of issuer, simplification and streamlining measures were adopted in 2007 that had a positive effect on the US market.

In defining its new regulations on related party transactions, Consob allowed smaller and newly-listed companies to adopt simplified internal procedures.

The corporate governance self-regulation codes could be steered in the same direction.

9 Market and issuer supervision

The re-heightened tension on the markets has brought action to safeguard regular market operations in the more intense speculative phases back into the limelight.

Through the CESR, at the beginning of May the European authorities agreed on a common strategy to implement a coordinated supervisory plan to combat any market abuse.

In mid-May the German supervisory authority introduced a ban on "naked" short selling, i.e. not covered by ownership or loan of the securities sold. The ban is valid for the German regulated markets and concerns ten financial sector shares, government securities issued by Euro Area countries and the related CDS.

Contrary to what happened in the more acute stage of the financial crisis at the end of 2008, when the bans were introduced at various levels in all the major markets, the German decision appears not to be shared at present, though developments after the European Commission's consultation cannot be excluded.

In any event the introduction of the ban has not mitigated market tension. Operators have for the most part considered the action to be weak. Fears of new restrictive intervention on physiological market operations have heightened the uncertainty.

At the end of July 2009 Consob lifted the bans on short selling which, with various degrees of restriction, had been adopted since October 2008. In confirming that decision, in hindsight following the German Authority's decision, the Commission repeated its strong commitment to full exercise of its supervisory powers to ensure orderly trading and to combat anomalous conduct and any market abuse.

It should be mentioned that, also as a result of intense Consob supervision, in Italy the efficiency and essential fairness demonstrated by the infrastructures providing post-trading services for both share and government security swaps have proved effective in protecting market integrity. Compliance with the compulsory delivery of the securities on the settlement date offers effects largely similar to the ban on naked short selling, without altering marketing operations or creating regulatory arbitrage.

No measures regarding short selling can be effective unless they are coordinated, at least at European level. Experience over the last two years, particularly in these last few months, has shown that fragmented intervention and the adoption of diversified practices can reduce the effect and favour regulatory arbitrage. It is hoped that as soon as possible after the consultation launched by the European Commission, the European Union will approve standardised regulations.

From the end of 2008 to date the health of many listed companies has deteriorated. The recession and subsequent drop in demand have extended the impact of the crisis to non-financial sectors, creating an overall decrease in profitability and revenue. The smaller companies particularly

suffer from the credit squeeze, which has only shown signs of loosening up in the last few months.

In the first few months of 2009, just before the 2008 annual reports season, a joint Consob-Bank of Italy-ISVAP initiative called upon boards of directors and internal and external control bodies to report their company financial position without reticence, highlighting any going concern risks. In several cases, much more than in the past, the auditors reported they were unable to issue an opinion on the financial statements.

The same appeal was repeated by the three Authorities at the beginning of this year for the 2009 annual reports, drawing attention to the areas most sensitive to the impact of the crisis. In a situation in which half the listed companies reported stock exchange capitalisation lower than their shareholders' equity, it was decided to ask boards of directors to disclose their assessments on the gap, in many cases significant, between market prices and book values. The overall picture available to financial statements users is therefore more complete.

The area of the stock exchange listings in difficulty has expanded.

To date Consob has imposed compulsory transparency regimes on 44 companies. These companies were asked to supplement their periodic financial statements with information regarding their business plans and debt rescheduling plans. For 22 companies that had declared financial crisis a monthly reporting obligation was imposed regarding developments in crucial factors such as the net financial position, past due debt positions and dealings with related parties.

10 Regulations on related party transactions

The difficult situation faced by listed companies draws greater attention to the need for tougher rules on conflict of interest so as to protect minority shareholders.

The first few months of 2010 saw the end of the long process of preparing the new regulations on related party transactions. Adoption of the regulations were preceded by two years of intense and rewarding discussions with the market, confirmed by their extensive participation in the two stages of consultation.

The regulations are highly important to the Italian market, characterised by a low level of contenders in terms of control and by the predominant role of major shareholders or coalitions, where protection against the risk of expropriation depends largely on the efficiency of fairness and transparency mechanisms in handling transactions that potentially involve conflict of interest.

The new regulation qualifies as a "consolidated law" on related party transactions, defining the transparency rules for significant transactions, the principles of fairness in organisational decisions and a firm line of conduct for listed companies.

Welcoming contributions emerging from the consultations, the Commission decided to extend the margins of company discretion where there is no indication that the overall protection of shareholders has weakened. In fact, companies can opt for implementing methods more suited to their own operational needs and the assessment of risks specific to the transactions.

All of which without prejudice to the central role of independent directors. It is on the professional quality and firm demonstration of independence from the related party interests that objectives achieved by the new regulations will be measured.

11 Borsa Italiana and the London Stock Exchange. Admission to listing

Three years ago, control of Borsa Italiana was taken over by the London Stock Exchange. A few months later the markets were hit by the financial crisis. The financial statements, necessarily provisional, cannot help but take into consideration the adverse conditions of the context in which the takeover occurred, at the time described as a "merger among equals".

At first the merger appeared mostly positive. Favourable feedback emphasised the synergic effects, potential and development.

At that time Consob pointed out the risks of gradual marginalisation for the Milan exchange. Three years on a number of these risks appear to have taken on greater consistency. Italian shareholders among the London Stock Exchange ownership structure have reduced from 28% to 18%. The governance agreements to ensure suitable representation of Italian shareholders are not easy to apply. The heart of the decision-making mechanisms appears to be focused on London. Initiatives to restore a stronger presence of Italians among the ownership structure are to be considered favourably.

In the uncertain changes in organisational setup of the stock exchange company some thought should be given to the issue of optimum allocation of responsibility for admission to listing on the official market. Theoretical models and empirical evidence give no clear indications as to what the best solution might be.

Since 1998, this activity was transferred to the stock exchange company from the public authority, in line with the decision made by most

European companies – the only exception being the United Kingdom, which opted for a different route.

Restoration of the public function of listing could be worth considering, separating the task from admission to trading which is instead a duty typical of the stock exchange companies. Such an option, enhancing the complementary nature of the two roles, could guarantee higher quality standards for the share market.

Development in this direction, however, could not be implemented by a mere regulatory amendment, but has to stem from open discussion.

12 MiFID and the markets

The European exchanges are now operating according to the new regulatory framework introduced by the MiFID.

On its entry into force in 2007, among the various new elements introduced by the MiFID was the abolition of compulsory trading on regulated markets. The aim of the European legislation was to encourage market competition, to reduce transaction costs for the investors. This led to launch of the alternative trading platforms which, leveraging low transaction costs, in just a few years have attracted growing trading volumes. At the end of 2009, 15% of the total volumes traded in the main European securities were through alternative platforms. The volume share of the regulated markets fell by the same percentage. The trend appears to be on the increase, even if in Italy the phenomenon is still limited compared to other European markets.

The current developments mirror a structural change in the trading industry. MiFID has exposed the European regulated markets to competition, not without its imbalances, from other trading platforms that undoubtedly have the competitive edge.

The much needed review of the directive, envisaged in 2010 three years on from its entry into force, is the chance to rebalance the regulatory framework, reinforcing the central nature of the regulated markets that play an essential role in the integrity and fairness of trading operations.

Application experience has shown that most of the competition was to the benefit of wholesale investors, whilst the benefits for retail investors were modest. The fragmentation of trading has had a negative impact on transparency, also as a result of the difficulty in building a consolidated and reliable wealth of information to include data on trading and prices.

Trading fragmentation across multiple platforms means less efficiency of the traditional market control tools, created in a regulatory and market context based on the central role of regulated markets.

13 MiFID and intermediaries

The MiFID has strengthened the principle of focus on the customer, which had already been adopted previously under Italian regulations.

According to the European directive, intermediaries' investment services must be provided with priority given to the customer's interests.

Since the EU regulations entered into force in autumn 2007, Consob has accompanied the finance industry through the implementation stage of the new rules. The conduct of intermediaries in customer relations, in fact, becomes crucial to market efficiency and to guaranteeing correct operation of the virtuous circle of savings-investments.

Consob's activities were performed with the aim of prevention and a spirit of cooperation so as to steer company organisational processes towards compliance with the new regulatory framework.

Where misalignments were found, the Authority intervened with extraordinary measures, issuing orders to bring intermediary conduct back into line with the regulations.

Amongst other action taken, investigations were conducted on five major Italian banking groups to confirm compliance with the regulations.

The investigations concentrated on pursuing the interests underlying the best and most suitable customer service, in particular for retail customers, rather than the industry's interest in selling financial products. Shortcomings were discovered, particularly in the area of conflict of interest between non-professional customers and intermediaries, the source of which were the sales and pricing policies, budget preparation methods and related staff incentive schemes.

As a corrective measure the Commission ordered that board of directors meetings be called, bringing their attention to the critical points discovered in relation to compliance with strategic, functional and operational decisions. The force of the warnings depended on the intensity and variety of misalignments and the specific nature of the companies contacted.

Recommendations were also issued on the importance of remuneration policies that do not generate conflict of interest with fair customer service. The companies are expected to immediately adopt measures which, though discretionary, are suitable remedies for each misalignment. Failing which the Commission will be obliged to take tougher measures to determine the corporate decisions of intermediaries failing to comply, if necessary adopting active administrative measures, e.g. injunction orders and/or sanctions.

With regard to medium-sized intermediaries, further initiatives are in progress that call upon corporate officers of nine groups to continue monitoring organisational and procedural adequacy in terms of MiFID regulations.

This supervisory activity was performed in a market context characterised by the ongoing liquidity crisis, to which the banking system has responded by increasing the issue of bonds placed with retail investors, the countervalue of which has more than doubled in the last two years and represents approximately 80% of the total bank bonds placed.

Consequently, the impact of bank bonds on household investments has again increased, in the last fifteen years gradually growing from 2% in 1995 to 7% in 2000, and to 10.4% in 2009. This weighting is far greater than that seen in the other major European countries.

It is a phenomenon to which Consob pays specific attention, given that the retail investor portfolios include largely illiquid bonds, often more risky than government securities, without those risks being adequately reflected in the returns offered.

In 2009 the Commission adopted a communication on the distribution of illiquid financial products. The actual benefits achieved today through the guidance formulated in the communication on such products can be assessed in terms of greater liquidity of bank bonds, also guaranteed by their trading on regulated markets or multilateral systems.

Regarding derivative brokerage with local authorities, the Commission has called meetings with the boards of directors of two Italian banks among the most active in this particular segment, bringing their attention to the need to guarantee customers that the hedging capacity of existing transactions will be monitored.

14 Investment management

Structural weaknesses persist in the mutual funds segment which have for years characterised investment management in Italy.

The tax regime continues to penalise Italian funds more than non-Italian funds or those registered outside this country. Management and distribution costs remain high and absorb most of the returns.

To stem the current haemorrhaging of AUM, the industry has to be organised more efficiently. The initiative to define standard formats, procedures and operating methods to manage subscription and redemption orders is an indispensable step towards building a common base for the more open and flexible distribution models.

The development of professional investment management formats is fundamental to the protection of small investors. The structural characteristics of mutual funds are diversified equity and liquidability that are difficult to replicate through direct investment in financial instruments.

In preparing the new European regulations on harmonised mutual funds, the technical contribution of the CESR group of experts chaired by Consob was decisive. The principles adopted for the code of conduct, internal organisation and risk management reflect the approach already implemented in Italy. The rules of transparency to investors will be even more effective as a result of the new standardised format of summary information documents.

Having defined rules that draw strong inspiration from the values of small investor protection, a traditional feature of Italian law, levels the field for the national industry and offers expansion of the options for reasoned investment decisions.

15 Financial education and the Conciliation Chamber

The imbalance still seen in Italian investor portfolios to the detriment of investment management also reflects a poor awareness and capacity to orientate among the financial products offered. Independent advisory services and widespread financial awareness have lacked development.

It is to be hoped that intermediaries will enhance investment to advice to a strategic, high professional content service, the remuneration for which is linked to the service provided rather than to the product sold.

For more than ten years Consob has been implementing financial education initiatives for small investors, in the conviction that a higher degree of awareness of their rights and how to exercise them, along with a more in-depth knowledge of the products and a better perception of the risks, can increase their capacity to protect their own interests.

The aim of disseminating financial awareness to a population of large investors goes beyond the means of just one institution. All players in the economic system, both public and private, are called upon to help.

On 9 June 2010 an important joint initiative between Consob, the Bank of Italy, Covip, Isvap and the Antitrust Authority was implemented to offer a one-stop financial education shop for investors making use of banking, financial, pension and insurance services that are often presented individually and their technical characteristics are not always clearly perceived. A web portal will soon be available which will systematically provide education material and technical support tools for investors.

In turn, Consob has set up a Conciliation and Arbitration Chamber to settle disputes arising between investors and intermediaries.

The new organisation has begun the action necessary for operational startup and has adopted Articles of Association and a Code of Ethics. Its offices are working on examining the three thousand or so applications for registration on the lists of conciliators and arbitrators. Consob intends to complete the procedure as quickly as possible so that the Chamber can become fully operative by the end of this year.

The exercise of class action, recently introduced to Italian law, could play a positive role in protecting the weak position of an individual consumer.

16 Disciplinary measures

Supervisory activity can claim to be effective and suited to preserving market integrity and investor confidence if it can manage to combine rapid investigation action with the suitability, proportionate and deterrent nature of its sanctions.

Since 2006 when the new sanctions system was implemented following the introduction of market abuse regulations, Consob has launched 800 sanction proceedings, which in 691 cases resulted in sanctions being inflicted. The total countervalue of the financial penalties was 85.8 million euro, whilst the value of assets confiscated in market abuse cases stands at over 66 million euro.

Since 1 January 2009 the Commission has adopted 304 decisions which in 254 cases resulted in sanctions. The total of these penalties was 27.2 million euro.

This is a significant workload not only in terms of quantity, but also for the significance and complexity of the individual affairs supervised.

With regard to sanction proceedings deadlines, which some have claimed are excessively long, their reasoned nature must be associated – as reiterated by the Court of Cassation (sentence no. 5395 of 9 March 2007) – “with the characteristics and complexity of the actual circumstances”, which more and more often involve exchanges of information with non-Italian authorities and a long process of reconstruction of the material conduct and events.

Furthermore the Court of Cassation (in sentence no. 209292 of 30 September 2009) confirmed the binding, non-discretionary nature of the final decisions, which the Institute has the duty to adopt on completion of its investigations, even beyond the established maximum deadline. This deadline, especially in cases where recourse to cooperation agreements is necessary, can prove too tight.

At this moment in time, the sanctions system according to the Consolidated Law on Finance could benefit from certain improvements which, though retaining its deterrent and repressive capacity, render the reaction of sanctions more selective, adapting them proportionately to the seriousness of the events. Less afflictive forms of intervention than those currently adopted could allow for more rapid proceedings, reserving longer times and their appropriate sanctions to the more serious cases.

It also seems fitting that every effort should be made a supranational level to achieve a reasonable level of standardisation in the definition of sanctions systems among the various countries, at least in Europe.

17 Relations with the legal authorities

Cooperation with the legal authorities is part and parcel of Consob's supervisory duties. Since May 2005, on entry into force of the EU directive on combating market abuse, the submission of reports – until then one-way from Consob to the legal authorities – became a bidirectional flow of information. The same directive introduced the "dual track" system into Italian law. Action to combat market abuse is handled by Consob for administrative cases and by the courts in criminal cases. The cooperation is intense and rewarding, fully compliant with the prerogatives of each authority.

Given the differing roles and powers, there is no competition and nor can any exist. The public can occasionally get the impression that action by the courts in market-related affairs is faster and more incisive than action taken by Consob. Appearances can be misleading. Our investigations can play a driving role in legal authority investigations, and vice versa. It is in this concept that the force of the "dual track" system lies. More often than not the valuations converge and corroborate each other. Consob operates silently, in compliance with the official secrets act that covers its supervisory activities. As a form of market, company and investor protection, the publication of proceedings papers is limited to the formats and timing prescribed by law.

In 2009 Consob submitted 58 reports to the legal authorities regarding alleged criminal offences subject to sanctions. 7 of those reports concerned allegations of market abuse, and the remainder were offences common to the code of criminal procedure (particularly embezzlement and fraud), mainly discovered as a result of supervision of financial salesmen.

The cooperation was particularly profitable during investigations into the affairs involving "Alitalia", "BNL/Unipol", "Mariella Burani" and the football clubs listed on the stock exchange.

The criminal trial hearings continued in relation to the Ifil Investments S.p.A. and Giovanni Agnelli & C. Sapa affairs and in that regarding the takeover of Banca Antoniana Popolare Veneta. In both cases Consob brought parallel civil proceedings.

At the beginning of 2010 the criminal proceedings began regarding the Unipol's attempted takeover of Banca Nazionale del Lavoro. Consob brought parallel civil proceedings for obstructing the performance of supervisory functions.

Again at the beginning of 2010 Consob brought parallel civil proceedings in three new criminal proceedings on market abuse, one of which insider trading and the other two market manipulation. In all these cases Consob had submitted special reports to the relevant legal authorities, and the configuration of the crimes with which the offenders were charged essentially coincided with the results of Consob's supervisory investigations.

Lastly, only in May this year, there was the sentence of the Second Chambers of the Milan Court of Appeal which, on the Parmalat default affair, confirmed criminal liability and the punishment already inflicted in first instance proceedings on the former company chairman, Calisto Tanzi, for the offences of obstructing Consob's supervisory functions and market manipulation. In revising the first instance proceedings sentence, for the first time criminal liability was confirmed for the same offences of one of the three directors declared independent by the company, who acted as chairman of the internal control committee.

In this context it is worth recalling the extensive efforts of Consob over the years in defining the role and responsibilities of independent directors as persons expected to act as drivers for the transparency and fairness of information flows within a listed company, as confirmed by the recent regulations on related party transactions.

18 The Institute's resources

The Institute's funding from taxes has seen constant decrease over the years, in the space of a decade – from 2000 to 2010 – passing from 44.7% to 0.9% of its financial needs. The onus upon private entities has consequently increased through the mechanism of supervisory contributions based on calculations subject to Prime Minister's Office approval.

In this respect, we can only state that a supposed public contribution has always been a direct consequence of the duties of general

interest performed by Consob and its minimal level, now merely symbolic, appears inadequate.

Consob's workforce was established by law as 715 human resources, a number that has gradually increased in proportion to new duties assigned to the Institute. The current workforce numbers 578 staff, of which 47 (less than 10%) on short-term contracts.

Completion of the workforce is closely linked to the availability of new premises in Rome and Milan, the handover of which is now imminent.

Given the need for recourse to open competitions, the staff recruitment process can take quite some time. The last two years have seen an acceleration, however. As a result of competitions currently in progress the workforce will increase by approximately 80 employees and will be completed through the recruitment of a further 50 resources.

In both the Italian and international spheres, Consob continues to be a centre of excellence in terms of both professionalism and skills.

The efforts of the Commission and top management have always focused on maintaining and gradually improving the high quality standards of its human resources. In some cases, in fact, it has proved difficult to quickly find resources capable of replacing particularly expert managers in terms not only of technical skills, but above all with the capacity to combine both a strong institutional sense of supervision with an in-depth knowledge of the markets.

Radical changes in the economic and regulatory scenarios call for dedicating more resources to training, targeting awareness of areas and approaches of innovative supervision, and for the capacity to operate in international environments.

Consob is part of a supervisory system that is becoming increasingly integrated. Its participation in the new European Authority with a highly professional team could help to steer regulatory and supervisory activities towards principles that adequately reflect the risks and specific features intrinsic to the Italian financial system.

Minister, Excellences, Ladies and Gentlemen,

in recent years the regulatory framework of our financial markets has radically changed. Driven by Europe, Italy has introduced new rules, from those to combat market abuse to the reinforcement of transparent conduct. The investment and corporate law reforms have entered into force. The Consolidated Law on Finance has seen extensive review. Consob has been called upon to make exceptional efforts, providing a decisive contribution to both domestic and international regulatory developments.

The supervisory authority has been enhanced with investigative and sanctioning powers and in terms of resources. The already excellent relations with the Bank of Italy and the Guardia di Finanza have been laid on new foundations, and relations with the legal authorities have always remained highly fluid and effective. The Institute's activities have increasingly been introduced to a context of cooperation with the leading foreign authorities.

Compared to a few years ago, Consob is now stronger and better equipped to fulfil its duties. It has more sophisticated means to rapidly identify anomalies and risks. Its capacity to listen to the market has improved.

The Authority has seen front line dedication in affairs that have occupied the financial headlines in recent years. Consob immediately put its new tools to the test. Its powers were exercised with determination and, though with all due respect for others, leaving no stone unturned. In almost all cases the sanctions inflicted were essentially confirmed by the relevant courts, including at Supreme Court level.

The key thread in the work of recent years has been the attempt to move the centre of gravity of supervision as far as possible away from merely repressive action and towards prevention. It is by far the most difficult task for those responsible for control over the markets. But it is the best means and offers the most extensive investment protection, even if it is not easy to grasp its effectiveness. It is in this direction that work needs to advance, both in Italy and on the European and international fronts.

The creation of a European authority to supervise the financial markets is a preamble to a season of reform of the institutional organisations, leading to the adoption of models that are as standardised as possible, with technical soundness and strong political backing.

The European supervisory system will need to clearly establish the mission of European and national authorities, their powers, their independence from both governments and the European Commission, and their assigned responsibility to protect the public interest.

The supervisory distribution model based on its end purpose, as always sustained by Consob and gradually reinforced by Italian law, albeit still incomplete, remains the most suitable.

In other countries the plan is to tread this same path. The adoption or completion of the end purpose model should follow shortly afterwards.

The recent crisis has shown us that areas subject to prompt regulation run parallel, and with uncontained escalation, with activities beyond every rule and supervision. In particular, the use of derivatives has expanded to such an extent that their vital link to the underlying economic phenomena has been lost.

A wide-ranging awareness of the entire spectrum of market components is vital if we are to concentrate supervision on the phenomena of greater risk to investor protection and market integrity.

There is little point in increasing the weight of the regulations. Better an extension of the perimeter, specifically leveraging the virtues of lawfulness, transparency and fairness in a complementary, equally significant relationship with the value of stability.

The dissemination of transparency creates a more suitable environment to develop the freedom for economic initiative it intends to express, even in its more innovative forms, without prejudice to the health of the system and without compression from restrictions that are often more formal than of real substance.

The need for recovery and growth of the economy fully justifies facilitation of a starting point for business activities.

To develop, especially if it hopes to be innovative and competitive, a business needs risk capital and investors capable of accepting long-term prospects.

Bringing Italian businesses, especially SMEs, on to the share market means promoting growth and at the same time encouraging transparency of the economic system. It is a process that, if it is to become a virtuous circle compatible with investor protection, calls for responsibility, selective capacity and ethical conduct from both business owners and intermediaries.

The key objective is to restore sound, long-lasting confidence. It is in the interests of market development that regulation and supervision maintain investment protection as a priority, with particular regard to conflict of interest among majority and minority shareholders and between intermediaries and investors.

Approval of the new regulations on related party transactions and the supervisory tasks completed on the major banking groups are

unquestionable signs of a new strategy, through which the Commission aims to steer conduct and rebalance incentives with a view to economic relations that comply with the principles of lawfulness and fairness.

There have been many occasions, including here at the annual meetings, on which I have insisted upon the need for conclusive, clear regulations, all applied integrally and without discrimination. We all need to be aware that it is possible to operate on the basis of a handful of quality regulations only if their overall and substantial compliance is guaranteed.

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My term of office as the Chairman of Consob is coming to an end. After seven years I am making my preparations to leave a post of enormous responsibility in which I have instilled my fullest efforts, always working in a spirit of service to the institutions and to the country.

I thank the Governments and Parliaments for having honoured me by appointing me to such high office, first as Commissioner and then as Chairman.

My most sincere thanks go to my colleagues at the Commission which - albeit in discussions at times somewhat lively, to be expected of statutory bodies - have shared my efforts over the years and have made their own contribution.

The same thanks are also extended to colleagues whose term of office has already ended.

I would like to express my appreciation and gratitude for my closest collaborators, beginning with the Director General, who have always worked alongside me with a special readiness and sensitivity, particularly when the markets called upon us all to make rapid yet reasoned decisions. My heartfelt thanks go to the entire staff of the Institute for having worked with competence and dedication, and to the trade union representatives who have always fulfilled their duty of reporting and stimulating in the interests of the staff. Consob is a centre of excellence not only in Italy, but also at international level where it meets with unanimous acclaim.

To the person taking over this post I offer my sincere best wishes for a successful term of office. An arduous task awaits him. But I am sure that he will lead Consob with skill and determination, strong in the knowledge of a necessarily proven, solid experience, especially in a context such as that outlined here, which poses increasingly complex challenges and demands constant, balanced commitment both front stage and behind the scenes.

The person called upon with the backing of the Government and Parliament to lead this Institution will have to combine the far from simple task of protecting the market and its investors, contributing to restoring confidence and, within the limits of the Institute's powers, cooperating in safeguarding the interests of the country in the best possible way.