

Annual Report 2010

Rome, 31 March 2011



CONSOB

COMMISSIONE NAZIONALE
PER LE SOCIETÀ E LA BORSA

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Chairman

Giuseppe Vegas

Members of the Commission

Vittorio Conti

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Paolo Troiano

Director General

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Speech by the Chairman to the financial market

Milan, 9 May 2011

“Corruptissima re publica plurimae leges”
Tacitus, *Annales* (III, 27)

Your Excellencies, Ladies and Gentlemen,

also in the name of the Commission I wish to thank you for your presence which testifies the interest in our work and in our financial market. I also wish to thank the President of the Senate who has sent us a message for the occasion.

A greeting goes to my predecessor, Lamberto Cardia, for the balance and determination with which he managed to lead Consob in a period of great reforms and of market events of exceptional importance. I express my gratitude also to Professor Vittorio Conti, who has given continuity to the Institute's work while awaiting a return of its operations to the composition laid down by the law. I welcome Mr. Paolo Troiano and the secretary general Mr Gaetano Caputi. I take this occasion to thank, in my name and in the name of the Commission, the executives and all the Consob personnel, for the commitment shown daily with hard work and competence.

Heartfelt thanks for the renewed hospitality also to the City of Milan and to Borsa Italiana, of which Consob has retraced the history and the role in the national economy in a study, being distributed today, prepared on the occasion of the celebration of the 150th anniversary of Italian national unification. The first to introduce a meeting with the financial community in 1997 was Tommaso Padoa Schioppa, who I remember with a feeling of deep esteem; since then, this meeting is, for Consob, an important moment of discussion with companies and investors.

Consob's role in the development of the financial system gives it a duty to listen to and consider the action of all those who operate today and of those who will join them in the future, in the conditions that others will have helped to define.

This is why the Institute has already opened to the market, beginning discussions with the industry and consumers' associations on the subjects of the simplification of the rules, competitiveness of the financial system and of the banking intermediation models. This is why today's programme will feature not only the report that I am about to present but also the reflections of Mr Paolo Scaroni, Chief Executive Officer of Eni and Deputy Chairman of the London Stock Exchange, and of Federica Andrighetto, student of the Bocconi University, to whom I express my gratitude for having agreed to speak.

1 The international context and the challenges for our country

Despite a stage of cyclical inversion has started, our country shows weak growth, less than that of the other advanced economies, and marked by numerous elements of fragility. The geo-political tensions in the North-African area and the events that struck Japan make the economic scenario even more uncertain. The sovereign debt crisis in some peripheral countries of the euro area and the bubble in raw material prices further undermine the prospects for growth.

The Italian banking system remains solid however; families maintain lower levels of indebtedness with respect to other industrialised countries and the situation of the public accounts will benefit from the measures to contain spending.

The conditions exist for Italy to come back to growth. The boost for development can no longer come from public spending but from private savings, entrepreneurial dynamism, making the best use of the talents and excellences of our young people and from investments in research and development.

In our country there are numerous businesses which, fleeing from the sirens of public subsidies, have become, through their own efforts alone, global leaders. They constitute an important example for all the others.

We need to remove the elements of friction and the bottlenecks that prevent our country from using the resources available as well as possible: the high public debt, imperfections in the markets of employment and products, shortcomings in the sectors of education and research and widespread illegality in large areas of the country, are only some of the problems we have to deal with today, to which must be added factors that make our country unattractive also for foreign investors, such as the excessive slowness of civil justice and a legal context made up of too many laws. Legislative production has now settled down at around 15,000 pages a year: kilometres of laws that create jobs only for the legal profession and for the Courts; in this situation primary and secondary regulation of financial markets cover almost 700 pages.

Identifying the obstacles to growth is the first step in defining a line of action for the future, but this is not enough: we need a transversal approach which will mobilise all the protagonists of the economic and financial system towards the ultimate aim of creating development. For this reason public intervention and private sector initiatives must be coordinated, in order to make socially acceptable the inevitable trade-off between development and equity, between efficiency and protection of the weakest subjects.

In this context the protection of savings constitutes a decisive juncture in ensuring that income from capital, supplementing income from employment and pensions, performs the function of a sort of "private social shock absorber" making up, in a period of crisis such as the present one, for the shortcomings of the public welfare system. Savings also perform an indispensable function for development purposes: they constitute in fact a bridge between generations, because their fruits can help to give young people a less uncertain future than the one they face now.

2 Consob's role

Consob is entrusted with the double role of protecting investors and promoting the growth of the financial market. Investor protection and the financing of corporate investments can only be based on a liquid, efficient capital market.

The conflict between development of the financial system and investor protection is only apparent: in an integrated capital market, an excess of protection which increases regulation costs leads directly to a shift of security broking activities towards more permissive jurisdictions. Besides, the use of the passport, provided for in the European directives, enables companies and brokers to collect savings in our country – which has a real and proper reservoir – remaining subject to the standards of supervision of other economic systems.

The tension between the two objectives disappears in the long term: in a well-developed capital market with a strong presence of institutional investors there is an increase in the corporate dialectic, the robustness of governance mechanisms and the incisiveness of the scrutiny of the financial community on the conduct of companies and intermediaries.

The risk of a conflict between investor protection and market development arises in a situation of formalistic approaches. Regulation and enforcement must instead be concerned with the substance of the phenomena and must manage the risks of arbitrage between jurisdictions that arise from the divergence between the supervisory practices of the national Authorities, also when the systems of rules are perfectly harmonised at the international level.

But above all this, regulation must avoid the temptation to seek the "perfect rule" or pressures towards overregulation which inevitably emerge after great financial crises. Attempting to control the entire perimeter of financial activities is a losing bet from the start because innovation, arbitrages and the global dimension of the markets modify the outlines continually, and this gives rise to products that can become increasingly opaque and toxic and makes so-called "shadow systems" grow. These

phenomena can open deep cracks in the mesh of regulation and potentially herald new "bubbles". With respect to certain products the moment has arrived to ask ourselves whether it is advisable to ban their distribution to investors.

The Authorities must set themselves the objective of presiding over the possible risks deriving from financial innovation.

In a context of limited resources it is impossible to cover the entire area of potentially suspicious cases. Perfect regulation is no use if the Authorities are unable to carry on supervision that intercepts the most serious and damaging phenomena and to impose prompt and dissuasive sanctions.

Consob intends to take up this difficult challenge in both the national and the international context.

On these subjects the Institute has begun structured discussions with the players on the domestic financial market and an intense exchange of opinions in the new European Securities and Markets Authority (ESMA).

3 Simplicity of rules and credibility of enforcement

The complexity of rules does not help development of the financial system and may be harmful for investor protection. What is necessary is a system of clear and simply applied rules supported by an inflexible system of sanctions.

An example of excessively complex regulation is the rules on prospectuses.

Prospectuses contain not only information which is inadequate with respect to the need to know and the average financial culture of retail investors, but very different supervisory practices have been established around Europe, which range from simple checks on the presence of the information required by the rules (so-called box ticking) to very pervasive controls, which have created opportunities for arbitrages between countries, with the risk of a sort of unfair competition.

This variety can penalise our system, encouraging domestic issuers to choose more permissive jurisdictions; the risk emerges that in practice there will be a reduction in the level of protection of Italian investors, whom the issuers (often "foreign-clothed") can in any case continue to target using the instrument of the European passport.

The solution to this problem is therefore to be sought in the simplification and standardisation of the documents of all categories of

products delivered to savers. The latter must be able to choose comparing investment alternatives easily.

Simplification could also make our financial market more attractive for issuers that have already chosen, or intend to choose, to be listed abroad.

In the community context this would mean extending to the various financial products the approach already adopted for mutual investment funds with introduction of the so-called key investor information document (KIID), two pages with no technical terms and easy to understand. In this sense the revision of the Prospectus Directive and the project for harmonisation of the rules on complex products (so-called packaged retail investment products or PRIPs) constitute important occasions to rewrite rules which, in a reversed perspective, must be calibrated on investors' real needs rather than on an abstract need for coherence with the principles of the legislative framework of reference.

Consob is already reflecting on the methods of simplification of prospectuses of non-equity products and has formed a working group with industry representatives and consumers' associations to assess the possibility of a slimming down of approval procedures and of the contents of prospectuses relating to the more simple financial instruments – those that we can call "over-the-counter" bonds – identified on the basis of certain criteria, such as simplicity, duration and liquidability.

The credibility of rules is fundamental for ensuring the confidence of investors in the markets and for encouraging the growth of a financial system, but the credibility of rules depends on the timeliness and effectiveness of the enforcement action.

An exorbitant sanctions apparatus not proportionate to the seriousness of illicit actions is counter-productive. It creates mistrust in the deterrent force of sanctions, because the response of the institutions called upon to apply them can only be delayed; it generates uncertainty as to the law, owing to the difficulty of the addressees in identifying the elements that represent illicit conduct and owing to the inevitable disparities of treatment in application of the rules; it leads to infringement being committed, with the reasonable hope of impunity.

Analogous effects result from supervisory action that puts on the same level minor infringements and conduct that profoundly damages the interests of investors and the market.

Consob intends to modulate its supervision on the basis of a principle of priorities, in order to sanction the most serious infringements rapidly and severely. A number of measures to improve assessment actions and make any application of sanctions rapid and efficient, also by making use of the instrument of supervisory inspections, can be adopted by the Institute in autonomy.

Other measures require a reconsideration of the sanctions system of the Consolidated Law on Finance according to a substance-oriented approach. In some cases it is necessary to graduate the punishment to the importance of the crime, in others the flexibility of the action needs to be increased, enabling interruption of the sanctions procedure when it is possible to remove the sanctionable conduct rapidly.

Such modifications would have the advantage of freeing resources for the assessment and repression of the most serious conduct, increasing the effectiveness and dissuasive capacity of the sanctions, to the benefit of a better protection of investors.

4 Protection of minority shareholders and development of the stock exchange

Corporate governance and so-called intra-company mechanisms for the protection of minorities play a very significant role in the development of equity markets. The link of causality, documented by ample economic literature, is simple: if company law protects minority shareholders adequately, savings flow to businesses through the stock exchange, and share ownership broadens. This is a demonstration that the trade-off, which I mentioned earlier, in reality does not exist: if minority shareholders are protected, the equity market develops; on the contrary, undeveloped equity markets and high ownership concentrations can be symptoms of their insufficient protection.

For this purpose, since the entry into force of the Consolidated Law on Finance, the rules laid down to protect minority shareholders have undergone significant innovations. The contestability of control has been increased through new rules on takeover bids; a number of regulations relating to protection of minorities have been adapted from the more advanced common law systems; these include the possibility of exercising a liability action against directors; participation in corporate decisions has been made easier, making changes to the rules on convocation of the shareholders' general meeting and on exercising voting rights. The regulations on related party transactions and changes in the area of directors' remuneration constitute the last piece of a regulatory mosaic which aims to increase the transparency of listed companies and to govern their conflicts of interest.

However in the Italian case this relationship might not have worked. Our equity market continues to be under-developed and characterised by concentrated ownership structures.

In the period 1998-2010 the number of companies de jure or de facto controlled increased from 156 to 178, although the proportion in terms of capitalisation fell by 8 percentage points, while the average interest held

by the leading shareholder remained more or less stable, falling from 47 to 45 per cent.

The presence of institutional investors – which today find in the legislative framework adequate instruments for an incisive participation in corporate life – has not changed substantially in the last 10 years considered, except for the nationality of such investors. From a situation of substantial parity in 1998, when both foreign and Italian institutional investors with interests of more than 2 per cent were present in approximately one company out of four, we have come, at the end of 2010, to a presence of foreign investors in 40 per cent of companies and of Italian investors in 8 per cent.

The phenomenon of so-called interlocking continues to be widespread: at the end of 2010, approximately 74 per cent of listed companies had a board made up of at least one member with positions in other listed companies; for 45 issuers the interlocking regarded more than 50 per cent of directors.

We need to reflect on the reasons for which nothing has changed in ownership and control structures despite the improvement in the regulatory framework for the protection of minorities. One obvious explanation is the fact that, since the Second World War, Italy has been characterised by an ownership system founded on family and State in which companies have struggled to reach the stock exchange, while large companies have taken advantage of forms of control based on pyramidal groups or voting agreements, which has made them almost incontestable reducing the propensity of investors for equity investments.

Moreover, such conduct has had the effect of discouraging listing and has led major shareholders to keep their stake at more than 50 per cent.

It is time for a different cultural approach, which must supersede the one according to which it is better to have a solid controlling interest in a company which, for this reason, is forced to remain a dwarf, rather than keeping an interest, perhaps a more risky one, in a growing company capable of tackling global markets.

Consob's role in this area is to use the supervisory instruments available to increase transparency of the governance structure of listed companies and, in this way, market scrutiny on such companies. For the first time, Consob has decided to attend the shareholders' meetings of major listed companies in order to check that discussions are carried on properly and effective methods of participation are really offered to minority shareholders'.

But all this is not enough. Minority shareholders and institutional investors must also do their part, participating in corporate life.

5 The market of corporate control

The potential of attraction of the Italian economic system is still too low compared with that of other competitor countries. The same institutional features that penalise domestic companies create a negative business environment for foreign investors, reducing the competitive advantages associated with the dimensions of the domestic market, the geographical position and the relatively low labour costs.

Acquisitions of Italian companies by foreign investors can bring significant benefits for the country's economy in terms of employment growth, formation of the human capital, technological and organisational innovation, provided that they are motivated by transparent objectives.

However, acquisitions are not always based on a desire to increase the value of the company: sometimes they hide intentions of empire building, exploitation of private benefits, acquisition of market power and creation of dominant positions. It thus becomes crucial to define rules on the subject of takeover bids capable of countering the risk of value destruction, while still guaranteeing efficiency of the market for corporate control. It is fundamental, moreover, to protect the interest of the market so that acquisition operations do not have a negative effect on governance of the target company after the bid.

To obtain a complete vision of the problem it is necessary however to take account of the impact that the rules on takeover bids, interacting with the regulations governing the methods of exercising control, generate on the prospective attractiveness of the Italian financial market for companies and investors.

Italian legislation has always strongly favoured contestability, limiting the possibilities of defending companies against hostile bids. The undesired effect was to accentuate the closure of company ownership structures.

In other jurisdictions a more complex and articulated response was made to these issues in terms of greater availability of instruments to strengthen control (think of the multiple voting shares used widely in most of continental Europe and in the English-speaking countries) or in terms of greater possibilities of defence (think of the poison pills that American jurisprudence – where there are no rules on mandatory takeover bids – permitted right after the great wave of hostile acquisitions of the early 1980s). Also in the United Kingdom, a country which has constantly been taken as a reference for Italian regulations on this subject, recent corporate events have reopened the debate on the need to define less asymmetric rules in favour of hostile bids.

Seeking an effective balance between the different interests involved in the static and dynamic allocation of control thus becomes the crucial point of regulation.

Introducing instruments to separate ownership and control is an issue which requires further investigation, while expanding the possibilities of defence of listed companies is a road immediately open to us. In particular we could develop the orientation, already adopted on the occasion of certain recent amendments to the Consolidated Law on Finance, which allowed listed companies to opt-out from the passivity rule.

This approach would preserve the regulatory action of the market, which would be selective and linked to the specific characteristics of each company. Unlike what would happen in the case of a generalised application of changes to the takeover rules, any dissenting investors could object "with their hands", that is voting on the occasion of the shareholders' meeting to modify the by-laws, or "with their feet", selling the shares.

6 Re-launching the Italian equity market

I have talked about rules, sanctions, the role of the Authorities, governance of companies and the market for corporate control, but the priority remains that of defining how these factors, together with public policies and with private sector initiatives, can contribute to the recovery of the serious delay in development of the Italian stock exchange.

In our country the equity market has always played a modest role, which in the last decade has undergone a further contraction, only in part explained by unfavourable economic performance. Between 2001 and 2010 the number of domestic listed companies remained substantially unchanged (just less than 300) and the proportion of capitalisation to GDP almost halved (from 47 to approximately 27 per cent); dividends (and repurchase of own shares) amounted to more than capital increases and every year resources of an average 2.6 per cent of capitalisation were returned to shareholders.

The bond market is also historically undeveloped; it represents a financing channel accessible above all to banks and large non-financial companies with high credit-worthiness.

The under-sizing of the Italian stock exchange is linked fundamentally to the small number of medium-sized companies on the stock exchange. This is a phenomenon rooted in the structural fragmentation of our productive system into a very high number of small and medium enterprises, lacking the minimum dimensions necessary to cope with the fixed costs associated with listing and reluctant to accept the greater transparency and contestability of ownership structures required on entry to the equity market.

For some of these companies the generational transfer and the opening of new markets, which entails an increase in the manufacturing scale, could be the right moment to make a dimensional leap and to open the share capital or the managerial frameworks to people with the professionalism necessary to lead them towards growth and listing. But the role of institutional investors is still too weak, in particular of those specialised in risk capital investments, which should support companies in the delicate stages of transformation that characterise their growth; the development of trading platforms dedicated to medium-sized enterprises is still unsatisfactory.

There is no market to act as a transmission channel and to create a virtuous circle between growth of the local economy and national growth, a market that would select the most profitable initiatives, accepting the physiological default rate that inevitably characterises the most innovative projects and that can be absorbed by the system through adequate portfolio diversification, which only specialised investors are capable of carrying on in a professional manner.

In our country the creation of platforms dedicated to medium-sized companies has had limited success, as is testified by the succession during little more than a decade of the Mercato Ristretto, Nuovo Mercato, Mercato Expandi and AIM Italia. The comparison with the experience abroad is crushing: in February 2011 19 companies had been admitted to AIM Italia and to the MAC (with a total capitalisation of approximately 0.4 billion euro) compared with 968 on the UK AIM (capitalisation 66 billion euro), 127 on the German Entry-Standard (17 billion) and 136 on the French Alternext (approximately 5 billion).

In prospect it is indispensable to eliminate, or at least reduce, the increasing costs of a regulatory nature that slow down growth in the size of companies.

In this context banks continue to be the main channel for obtaining and distributing resources within the system. The peculiarities of banking intermediation, from the side of funding and from the side of lending funds, have contributed to orienting the investment decisions of families towards portfolios concentrated on products with a high liquidity risk, and the financing decisions of companies, in particular small and medium-sized ones, towards short-term debt. Both lenders and borrowers are more exposed to the fluctuations of the economic cycle than what happens in financial systems characterised by more evolved equity markets.

The new rules laid down by Basel III introduce obligations on the subject of liquidity risk management and financial leverage and more stringent capital requirements for credit risk, to which banks are already adjusting through significant recapitalisation operations. These circumstances, as well as placing the banking industry in competition with

the non-financial sector in the collection of risk capital, inevitably entail a rationing of credit, above all in relation to the most risky and innovative enterprises.

Expanding the role of the equity market is therefore a priority. It is a fact that the most evolved financial systems tend to distance themselves from the "bank-centric" structure. Balancing the centrality of bank lending in the financing model of companies and in the investment decisions of families, according to a process that prioritises integration, rather than opposition, is a need which we can now no longer postpone.

Consob intends to work for the development of the equity market acting on the system of rules that determine listing costs and, as far as possible, stimulating the inflow of investments to the stock exchange.

The central theme is introducing a graduation of obligations for listed companies in relation to their dimension. As of today the regulatory framework, deriving both from community legislation and from specific provisions of the Consolidated Law on Finance, not only does not provide for a similar graduation, but sets almost identical rules for regulated markets and multilateral trading facilities (MTFs), thus determining for listed companies on the two types of trading venues not very different compliance costs.

Between investor protection and equity market development, the priority identified is to guarantee retail investors the widest possible range of information, also considering the need of medium-sized companies to gain access to listing at facilitated conditions. But, as I have said, the conflict between the two objectives is only apparent if we consider that the failure of platforms dedicated to medium-sized companies has been due, among other things, to lack of interest on the part of investors in a form of investment structurally characterised by strong information asymmetries and high risk, factors which regulation does not manage to, and cannot, control.

Support for medium-sized companies seems to require, then, not only structuring the obligations associated with the status of a listed company on the basis of the dimensions, but also, and above all, removal of the bottlenecks on the supply side.

One way to go is the creation of new platforms reserved for professional investors, not subject to full application of the community rules laid down for markets accessible to small investors.

Expansion of the role of institutional investors specialised in risk capital investment becomes a strategic priority, with respect to which we could assess appropriate tax benefits and the development of partnership models between private and public subjects.

Another possible critical issue in the listing process involves the distribution of duties between Consob and Borsa Italiana. The current framework, which assigns the function of listing to the market management

company and the function of control of prospectuses to Consob, forces companies into double discussions for the production of data and information which mostly coincides, and this gives an incentive to the free riding of alternative trading platforms with respect to investments made in traditional stock exchanges.

Bringing listing activity back to Consob, copying the experience of the United Kingdom, in order to level the playing field between different types of trading venues, is an option that is being assessed in discussions with industry and investors.

The segmentation of regulated markets constitutes a further subject of discussion with the industry. We could distinguish between a "basic market", destined for companies that meet the minimum requisites of community regulations, and "high requisite" markets, to which companies that undertake to observe more stringent rules could gain access.

7 European financial supervision

At the beginning of the year the new European financial supervision system came into force. Its complex institutional architecture has at the top the European Systemic Risk Board (ESRB) and at the base three new Authorities specialised in the sector of banks, financial markets and insurance.

There are two fundamental objectives of the new institutional framework: overseeing systemic risks and harmonising rules and their application.

Explicit provision for the function of supervision of macro-stability is an important acknowledgement of the global dimension of the phenomena, which however is still not supported, above all in relation to markets for financial products, by adequate instruments of analysis and intervention.

The procedure envisaged for the assessment of emergency situations is also very complex and can involve all the European and national Supervisory Authorities as well as the European Council and Commission, with negative effects on the promptness of reaction.

With respect to the objective of harmonisation, the planning of the new Authorities acknowledges the need to strengthen oversight in relation to possible arbitrages between jurisdictions, responding to the demands of the European Commission to pursue with greater determination the objective of a single rule book. Despite the growing degree of convergence of legislative production of the individual countries, there are still several divergences in national supervisory practices.

ESMA must be made able to meet the challenge of effectively "level the playing field". At the moment it can issue binding technical standards for the national Authorities only in the areas expressly envisaged in primary European legislation and after an endorsement procedure on the part of the European Commission. On the subject of supervisory practices and approaches it can issue non-binding recommendations and guidelines, assisted only by the comply or explain principle. The plurality of players could lead to compromise solutions at too low a level.

As a national Authority that is a member of the ESMA management bodies, Consob will work to seek solutions in the direction of full harmonisation of rules and to guide our system towards shared standards.

Your Excellencies, Ladies and Gentlemen,

the country is at a turning point: it can be content with the current conditions, with the risk of increasing the gap with respect to the other advanced countries, or it can free its energies to remove the obstacles that impede growth and participate in the global recovery. Its history shows that it has all the necessary abilities.

While respecting the free choices of the players in the economic system, Consob will do everything it can to encourage the full unfolding of market forces and to accompany the Italian financial market in its development process, an essential condition for the country's recovery.

The market, for its part, must not look only to particular and short-term interests. Transparency of conduct towards investors and the absence of moral hazard are the prerequisites for a reduction in the cost of capital and for growth of businesses.

Consob cannot be a substitute for investors' and entrepreneurs' courage but, in continuous discussions, will accompany them to ensure they find the best conditions to tackle the challenges of change successfully, guaranteeing their protection and the certainty of rules.