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Italian Banking and Financial Law

Regulating Activities



Edited by Domenico Siclari



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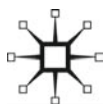
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Edited by

Domenico Siclari

University of Rome "La Sapienza", Rome, Italy

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To my wife, Annalisa, and to our son, Pietro Maria

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Notes on Contributors

Simone Alvaro is Head of the Legal Studies Office in the Commissione Nazionale per le Società e la Borsa (the Consob), the public authority responsible for regulating the Italian securities markets. He graduated in Law *summa cum laude* from the University of Bologna Alma Mater Studiorum and holds a PhD in Corporate Law from the University L. Bocconi of Milan. In 2001, he joined the Consob and was assigned to the Staff of the President of the Consob, in addition to being the official spokesperson for the Consob dealing with the Italian Parliament. In 2011, he was nominated coordinator of the Company Control and Initial Public Offerings committees set up by the Consob as part of an initiative aimed at simplifying the regulatory framework. In the academic field, he has taught courses for the Italian Tax Police on the laws governing the financial markets and is Professor of Law at the Higher College of Economics and Finance. His research interests include financial law, corporate governance, derivatives, sovereign wealth funds and Islamic finance.

Gioacchino Amato is a lawyer and serves on the Italian Stock Exchange Commission (the Consob) in the Capital Market Department. He holds a PhD from the University of Rome “La Sapienza” and a LLM from UC Berkeley. He is a lecturer at Luiss Guido Carli Rome University and at Ural State University, Ekaterinburg, Russia. He has authored many papers and articles about capital market and stock exchange regulation. He is also the author of the book *Price-sensitive financial information*.

Raffaele Capuano graduated in Law and Justice from the University of Rome “La Sapienza”, specializing in European Studies at the European Studies Institute of Rome and became a barrister and solicitor. He is the Director General of Covip, the Italian Supervisory Authority on Pension Funds, since January 2007. Previously, he was Director at the Italian Ministry of Economy and Finance, Department of Treasury, and Head of the Unit in charge of the regulation of financial markets and intermediaries. During his career, he has developed relevant international negotiation skills, being appointed member of several International and European working groups dealing with regulation and supervision in financial markets. During the 2003 Italian presidency of the

European Union, he was appointed chairman of the council working group in charge of MiFID. Under the current Italian presidency, he is the Chairman of the Council Financial Services Working Group in charge of the revision of the European Directive on Pension Funds.

Massimiliano Carnevali graduated in Banking and Finance summa cum laude from Cattolica University of Milan. He began his career in 1999 at Borsa Italiana, where he became head of Listed Companies Compliance and Disclosure department. In 2008, he joined Mediobanca as senior compliance officer, and in 2011, he was appointed Chief Compliance and Anti-Money Laundering Officer of Mediobanca Group.

Marco Di Pietropaolo is Senior Lawyer at the Legal Services of Bank of Italy. He is mainly involved in banking supervision and recovery and resolution issues, and he participates in the works for the cooperation of Bank of Italy in the SSM and SRM.

Paola Fico graduated in Law summa cum laude and was admitted to the Italian Bar. In 2002, she joined the Consob, the Italian regulator of financial markets. Since 2004, in Borsa Italiana, the Italian stock exchange, she has been in charge of regulatory affairs, organizing responses to various regulatory initiatives affecting Italian financial markets in strict coordination with the Regulatory Law and Strategy Department at London Stock Exchange. This activity involves developing policy work in the area of markets, companies, trading models/methods and market surveillance, post trading, giving input into discussions in relation to changes in processes, assessing impacts of up coming regulations on market rules and practices, especially in the area of market transparency and rules of conducts for financial intermediaries, and giving elaborate advice to internal and external users. In the field of European regulatory affairs, she has worked closely with securities markets experts since the beginning of the FSAP, contributing to continuous consultation processes both at domestic and international level as well as to industry's initiatives to promote common best practices in Europe. She had been part of various European stakeholders, groups.

Valerio Lemma is Associate Professor of Economic and Financial Markets Law and a lawyer at the Università degli Studi Guglielmo Marconi, District of Rome, Italy. He has degrees in Economics and in Law, and holds a PhD in Finance. He is also a visiting associate professor at Regent's University of London, coordinator at Financial Market Regulation Master's programme at Luiss University of Rome, member of the scientific committee at PhD in International Risk

Management and Public administration theory, University of Rome G. Marconi, member of the editorial board of *Rivista Trimestrale di Diritto dell'Economia* and of the scientific committee of *Bankpedia Review* and *Istituto per il governo societario*.

Andrea Miglionico is a research fellow in Law of Economics in the Department of Law, Philosophy and Economic Studies at the University of Rome "La Sapienza". He graduated in Law from University of Rome "La Sapienza" and holds a doctorate in European Financial Services Law from University of Rome and a LLM Master of Laws in Banking Law and Financial Regulation from London School of Economics and Political Science. He is a PhD candidate in Regulation of Financial Markets at the Centre for Commercial Law Studies, Queen Mary University of London. His research interests focus on Banking and Finance Law.

Emilia Petrocelli is a graduate in Law and in Economics. She began her career in 2002 at the Consob, Italy's stock market and corporate regulatory body, in the Supervision Department of Banks and Financial Intermediaries, where she took part in the review of the Italian Consolidated Law on finance, for the implementation of MiFID. In 2007, she joined IW Bank, the online bank of UBI Banca Group, where she held the roles of chief legal officer and chief compliance officer. In 2011–2012, she took part in the constitution of the Italian branch of the Dutch bank BinckBank NV, with the role of chief legal and compliance officer. In 2013, she joined Mediobanca, where she is senior compliance analyst.

Diego Rossano is Assistant Professor of Economics Law in the Department of Business Studies and Economics at the University Parthenope of Naples. He holds a PhD in Community Public Finance from the Second University of Naples, and he is a member of the editorial board of *Rivista trimestrale di diritto dell'economia* (directed by Professor Francesco Capriglione). His research focuses on the financial markets and on the methods used to ensure the exchange of information among contractors. He is also the author of articles spanning between banking law and regulation of markets.

Domenico Siclari is Associate Professor of Economic and Financial Markets Law in the Department of Economics and Law at the University of Rome "La Sapienza", Italy. He had previously worked as officer at Bank of Italy in Rome (1999–2003), in the field of banking and financial supervision, focusing on payment system oversight and has attended several meetings for study and research at the European Central Bank, in

Frankfurt am Main. He was later a Counsellor of the Italian Parliament-Chamber of Deputies (2003–2013), where he has been in charge of the Finance Division of Research Department since 2004. His main work and research areas are banking and financial regulation and supervision, business law, economic public law, regulation models. In 2006, he pursued his research at the Max-Planck-Institut für ausländisches öffentliches Recht und Völkerrecht in Heidelberg. He holds a PhD in Economic Public Law from the University of Rome “La Sapienza”. In December 2013, he received the National Academic Qualification as Full Professor. He is also a member of the scientific committee at PhD in Public, Comparative and International Law at University of Rome “La Sapienza”. Since March 2011, he has been a member of Referees Committee of *Rivista Trimestrale di Diritto dell'Economia* as well as a member of Advisory Board of *Law and Economics Yearly Review* since July 2012.

Stefano Torregiani is a PhD student at the University of Genoa in the Department of Law. His research mainly concerns financial disclosure, liability for misleading information and corporate frauds. He obtained an LLM degree from the University of Chicago Law School in 2014. He is a member of the Genoa Centre for Law and Finance and is a lawyer in Milan.

1

Introduction

Domenico Siclari

Italian Banking and Financial Law, Volume III provides an overview of the Italian regulation of banking and financial activities that follows, historically, the evolution of the “economic constitution” and market trends.

In accordance with Article 47 of the Italian Constitution and the EU law, banks and financial intermediaries are subject to extensive regulation, in order to foster their correct and prudent conduct. Banking and financial markets regulation keeps evolving in response to the growing internationalization of finance and integration of markets and intermediaries, in addition to the growing complementarity between banking and financial products. A key point of such regulation lies in granting transparent contractual conditions and correct relations with customers.

In the Italian regulatory system, the supervisory model, where the Bank of Italy is entrusted with prudential supervision over credit institutions, investment firms and all other financial intermediaries to ensure the stability of the financial system while the Consob is responsible for the transparency and conduct of investment services and for the disclosure of information made available by issuers, led to a potential conflict between the different objectives of the regulation and supervision.

For long, in fact, primacy was given to the objective of financial stability at the expense of the objective of competition between intermediaries. This is also why those two objectives (financial stability vs. competitiveness of the financial system) were assigned by the law to the same supervisory authority.

Recently, however, the Italian system of regulation has not been inclined only to the financial stability of banks but also included other

purposes (competitiveness of the financial system, investors' protection) under the impetus of the EU law to achieve protection of all public interests involved in regulating banking and finance.

More generally, the Italian administrative and regulatory system is sometimes perceived as one of the main obstacles to a higher growth of the productive system. Some causes of this ineffectiveness are deeply rooted and date back to the Italian unification: a strong administrative tradition; an excessive political influence over the administration; the relevance of the juridical culture. Some reactions to these inefficiencies have led in some cases to further problems: for example, an immoderate number of laws and administrative acts, often too complicated.

It is therefore essential to reduce the bureaucratic burden on business and to reorganise the judicial system to make it more efficient, as a factor that influences the impact of structural reforms. The current effort consists of overcoming the limits of the regulatory state by simplifying the regulation, rendering it more user-friendly and effective. Rules need to be clear, easy to implement and stable over time to stimulate competition and encourage the reallocation of resources toward activities with higher growth potential.

Therefore, Supervisory Authorities should now exert their task observing the principle of valuation of the decision-making autonomy of authorised persons and the principle of proportionality meant as a criterion for the exercise of power implying the minimum sacrifice of the recipient's interests.

The strategic use of regulation is becoming more and more, even in Italy, a tool to combat the ongoing economic crisis and foster economic growth: an example are all the regulatory initiatives aimed at implementing the so-called finance for growth. Nevertheless, regulation enforcement and compliance strategies remain essential.

The book deals with regulation of banking activities, investment services or activities, collective portfolio management, Italy's supplementary pension system, relations between intermediaries and customers, public offering of financial instruments and products, public takeover bids, listed companies, insurance and reinsurance business. Among the current topics, it also examines the link between investor protection and confidence in the financial markets, the relationship between the quality of corporate governance and the development of the financial markets as well as the financial markets as a source of financing for companies.

2

Regulation of Banking Activities

Marco Di Pietropaolo

2.1 The regulatory framework of banking activities in Italy

The regulatory framework of banking activities in Italy have been traditionally characterized in the last 20 years by the central role of a consolidated law, regulating the main aspects of typical banking activity, that is the business of taking deposits or other repayable funds from the public and granting credits for its own account (see the definition of “credit institution” under Art. 4, para. 1, point 1, of EU Regulation no. 575/2013 (CRR) and, under the Italian legislation, the corresponding definition of banking activity in Art. 10 of Legislative Decree no. 385 of 1993). The mentioned consolidated law was adopted in 1993 (Legislative Decree no. 385 of 1 September 1993 – *Testo Unico Bancario*, Consolidated Banking Law, hereinafter TUB) in order to provide a comprehensive point of reference for the regulation of banking activities, repealing several provisions previously in force (see Art. 161 of the TUB, containing a long list of such provisions). The TUB grounded the Italian banking legislation on the EU law principles (single banking licence, home country control, mutual recognition) that were stemming from the EU banking directives (namely, the first and second EU banking directives, no. 77/780 and no. 89/646).

The TUB contains the main provisions regulating banking activities, from the definition of banking activity (Arts 10 and 11) and the conditions for granting banking licence (Art. 14) and authorizing the acquisitions of qualifying holdings (Art. 19) to the regulation of crisis and insolvency (Arts 70–105) and deposit guarantee schemes (Arts 96 to 96-*quiquies*). Furthermore, the TUB identifies and regulates the credit authorities intervening in the regulation and supervision of banking activities (Arts 2–9). Such authorities are the Interministerial Committee

on Credit and Savings (*Comitato interministeriale per il credito e il risparmio* (CICR)), the Ministry of Economy and Finance and the Bank of Italy (Art. 1, lett. *a*, of TUB). The latter plays a core role in regulation and it is the Italian national competent authority for supervision according to EU legislation (Art. 4, para. 1, point 40, of the CRR, according to which “‘competent authority’ means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned”).

The TUB also contains the main provisions on prudential supervision, both on an individual basis (Arts 51–58) and on a consolidated basis (Arts 59–69) and regulates other aspects of banking activities outside the scope of prudential supervision, such as in the field of transparency of contractual conditions and correctness of relations with customers (Arts 115–128-*ter*). The TUB also provides the criminal and administrative sanctioning framework, in case of breach of banking regulation (Arts 130–145 TUB).

The other core law dealing with financial activities is the Consolidated Law on Finance (Legislative Decree no. 58 of 1998), which also regulates activities of banks outside the scope of the typical banking business of taking deposits and granting credits, such as investment services or the function of custodian of assets of undertakings for collective investment. The provisions on banks as issuers of financial instruments or listed company are contained in the Consolidated Law on Finance.

Other legislation defines many other important aspects of the regulatory framework for banks (e.g. the civil code for company law; Legislative Decree no. 231 of 2007 for AML/CFT; Legislative Decree no. 11 of 2010 for payment services). The typical core banks’ activity, however, is still mainly regulated by the TUB.

The TUB generally applies irrespective of the type of banks involved, although some special provisions only refers to cooperative banks (in the two different forms of *banca popolare* and *banca di credito cooperativo*: Arts 28 to 37 of the TUB; see also, Art. 150-*bis* that provides for several derogation to general provisions of the civil code on cooperatives companies). The TUB therefore overcomes the specialization of banks (and of the corresponding discipline) which previously characterized the Italian banking law.

The centrality and longevity of the TUB has been granted so far also by virtue of its flexibility: only the main provisions on banks’ activity are contained in the TUB, which leaves wide leeway to the recourse to secondary law, that is to regulation adopted by credit authorities, making

it possible to take into account future developments with the benefit of the effectiveness of supervisory action.

This two-level regulatory structure of the TUB applies particularly, but not only, for prudential rules. Arts 53 and 67 of the TUB provide the power of the Bank of Italy to issue general provisions in the fields of capital adequacy, limitation of risk in its different forms, permissible holdings, corporate governance, management and accounting procedures, internal control mechanisms, remuneration and incentive systems. The provisions shall be issued by the Bank of Italy in conformity with the deliberations of the Interministerial Committee on Credit and Savings (CICR), which is chaired by the Minister of Economy and Finance and shall deliberate upon proposal of the Bank of Italy. In case of urgency, the Minister of Economy and Finance substitutes the CICR for the adoption of the deliberations (see Arts 2 to 4 of the TUB). A similar procedure is also provided for the adoption of secondary provisions in the field of transparency of contractual conditions and correctness of relations with customers, but in this case the deliberations of the CICR are adopted on a proposal of the Bank of Italy with the agreement of the Consob (Art. 127, para. 3, of the TUB).

This “circular” regulatory procedure – with a proposal of the Bank of Italy to the CICR, which then deliberates on the general aspects of secondary regulation while Bank of Italy establishes more detailed rules in conformity with CICR’s deliberations – was intended to maintain a core role of the technical expertise of the Bank of Italy as the banks’ supervisor and, at the same time, a link with the political ministerial stance through the CICR.

The CICR is the credit authority in charge of the “high supervision in the field of credit and protection of savings” according to Art. 2 of the TUB, a competence which has never been well defined in concrete terms and which poses a threat to the operational independence of the authority competent for supervision (in this regard, see the opinions of the ECB CON/2006/51, para. 2.3 and CON/2007/17, para. 2.3; the independence of national competent authorities is now required also by Art. 19, para. 1, of EU Regulation no. 1024/2013 – that is the Single Supervisory Mechanism (SSM) Regulation). The role of the CICR in the regulatory process is currently under discussion, also taking into account that regulation is more and more determined at EU level, without the need of a link of the general principles of banking legislation with the political stance at national level. Hence, the law delegating to the government the implementation in Italy of EU Directive 2013/36 (Capital Requirements Directive (CRDIV)) provides that secondary law

in this field shall be adopted by the Bank of Italy without the previous deliberation of the CICR (Art. 3, para. 1, point *b*, of Law no. 154 of 7 October 2014).

The Bank of Italy issues secondary regulation by means of general decisions (denominated *Disposizioni di vigilanza* and previously *Istruzioni di vigilanza*), either on specific issues or regulating several aspects of banking activities (adopted by means of circulars): these are in particular circulars no. 229 of 1999, no. 263 of 2006 and no. 285 of 2013, which are periodically revised (and in some parts have been repealed). The latter circular adapts the secondary legislation to the Basel 3 principles, as transposed at EU level by CRDIV and CRR and aims at constituting a comprehensive rulebook of secondary provisions for banking activity in Italy.

As far as the procedure for the adoption of secondary regulation in the banking field is concerned, the general due process principle of participation of interested parties in the administrative proceedings are not applicable to regulation, according to Art. 13 of law no. 241 of 1990 (i.e. the general law on administrative proceedings). The same law also generally exempts regulations from the obligation to state the reasons on which the decisions of administrative bodies are based (Art. 3, para. 2, of law no. 241 of 1990). The TUB provides for the general rule of publicity of the Bank of Italy's regulation and also of the principles and criteria of its supervisory activity; regulation is published in the Bank of Italy bulletin or, where its scope extends to persons other than those subject to supervision, on the Italian Official Journal (see Arts 4 and 8 of the TUB).

The Italian legal framework of regulatory powers takes into account the better regulation principles, also in order to strengthen the supervisor's consideration of the intermediaries' perspective. Those principles have fully become a common ground for regulation adopted by all financial supervisors in Italy in 2005, by means of the law on the protection of savings (Art. 23 of law no. 262 of 2005; the Bank of Italy adopted a regulation for the detailed implementation of this provision on 24 March 2010: see Official Journal no. 102 of 4 May 2010). Under this law, the regulations of the Bank of Italy and other Italian supervisory authorities (the Consob, Ivass, Covip) must be justified with reference to the general choices of regulation and supervision. Furthermore, those regulations shall be accompanied by a report that assesses their impact on the activity of regulated institutions and on the interests of investors and savers. The regulations shall take into account the principle of proportionality, which is defined as the exercise of the power

appropriate to its objective with the minimum sacrifice of the interests of the regulated institutions. To this end, representatives of the supervised entities and of consumers shall be consulted on the content of the regulations, prior to the approval. The regulations shall be reviewed at least every three years in order to adapt them to changing in market conditions and in the interests of investors and savers.

2.2 The harmonisation of banking regulation in the EU

The discretion of EU Member States and their national authorities in the field of banking regulation has progressively lessened with the increasing involvement of the EU legislature. This involvement has had a new impulse in the aftermath of the financial crisis, moving from a regulatory perspective to an institutional one, initially with the creation of the European System of Financial Supervision (ESFS) – and in particular, as far as banks are concerned, of the European Banking Authority (EBA) and the European Systemic Risk Board (ESRB), which are two of the components of the ESFS (see Art. 2 of EU Regulation no. 1093/2010 – the EBA Regulation) – and later with the institution of the SSM, the Single Resolution Mechanism (SRM) and Single Resolution Fund (SRF), and the consequent conferral of powers, respectively, on the European Central Bank (ECB) in the field of supervision and on the Single Resolution Board for resolution (see EU Regulation no. 1024 of 15 October 2013, conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions – that is the SSM Regulation; and EU Regulation no. 806 of 15 July 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund – that is the SRM/SRF Regulation).

The harmonisation of EU banking law through the adoption of EU directives dates back many decades, starting from the already mentioned first and second banking directives of 1977 and 1989 until the recent fourth version of the CRDIV. This process is linked with the achievement of the EU single market, in order to concretely give effect in the banking field to the freedom of establishment and the freedom to provide financial services. Those directives are traditionally legally based on (the current) Art. 53, para. 1, TFEU (and the corresponding articles in the former treaties), that is “for the mutual recognition of diplomas, certificates and other evidence of formal qualifications and for the coordination of the provisions laid down by law, regulation or

administrative action in Member States concerning the taking-up and pursuit of activities as self-employed persons”, “in order to make it easier for persons to take up and pursue activities as self-employed persons”. The removal of the main differences between Member States legal frameworks in the banking field is therefore justified, in order to make it easier to take up and pursue the business of credit institutions for the smooth functioning of the internal market.

The regulatory discretion of national legislature of EU Member States has been progressively eroded by the growing amount and details of EU directives in the banking field (as far as the power of EBA are involved, see a list of such Directives in Art. 1, para. 2, of the EBA Regulation). However, a substantial change in the EU legislature approach, consisting in a tradition of 30 years of flexible and only partially harmonised banking legislation, occurred with the financial crisis with a view to trying to correct the regulatory weaknesses highlighted by the crisis.

The traces of the new approach toward a stricter harmonisation can be clearly found in the de Larosière Report of 25 February 2009. The report underlined several reasons for recommending regulatory consistency in the banking field both at global level (see par. 224–230 and recommendation 25) and, with more emphasis given the need of the single market, at EU level (see par. 99–109 and recommendation 10). Significant divergences between national regulations are detrimental for the singleness of the EU financial market and lead to market distortions, regulatory arbitrage and spill-over effects. Regulatory inconsistency is particularly inefficient for cross-border groups, incrementing the cost of compliance and hindering a group approach to risk management and capital allocation; the management of crises of cross-border institutions in a non-harmonised context proved to be difficult, due to uncoordinated national resolution measures and the tendency to ring fencing.

As recommended in the de Larosière Report, the need of more consistent rules at global level has led to the reform and to a strengthened role of the Financial Stability Forum, which has been renamed and reorganized as the Financial Stability Board (FSB) and given a broadened mandate to promote financial stability. The FSB and the Basel Committee on Banking Supervision are the most eminent global standard-setters for banking activities. Their proposals do not have a direct binding character but rather legally constitutes “soft law”, having, however, a strong impact on regulatory reforms: the main recent evidences of this influence are in the Basel III framework, which has been transposed in the EU by means of the CRDIV/CRR legislative package, and in the FSB “Key Attributes of effective resolution regimes for financial institutions”, the principles

of which have been transposed by the EU Directive no. 2014/59 (Bank Recovery and Resolution Directive (BRRD)).

The de Larosière Report also identified the main cause of the lack of regulatory harmonisation in the EU banking sector in the wide range of national options left to Member States by directives, which contain also several possible national derogations, exceptions and vague provisions. The report therefore recommended to base future EU legislation, wherever possible, on regulations which have general application and are binding in their entirety and directly applicable in all Member States rather than on directives, which leave discretion to the national authorities as to the choice of form and methods (Art. 288 TFEU). When directives are used, a maximum harmonisation of core issues has also been suggested.

These suggestions have been taken into account by the EU legislature in the recent review of the EU Capital Requirement Directive (CRD) and Markets in Financial Instruments Directive (Mifid), both of which are now complemented by a Regulation (CRR and Mifir, respectively). These regulations have their legal basis in Art. 114 TFEU, as measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States, aimed at the establishment and functioning of the single EU financial market.

The reasons for this new more stringent approach, which significantly reduces the regulatory discretion of the Italian and other Members States' legislature, are those identified in the de Larosière Report and explicitly mentioned in the preamble of such regulations. The direct applicability of the CRR aims at ensuring uniform prudential requirements, thus preventing national divergences that may cause regulatory arbitrage and competitive distortion, and reducing the compliance burden for cross-border institutions (see whereas no. 9, 11 and 12 of CRR).

The CRDIV/CRR package ensures a deeper level of harmonisation of EU banking legislation and leaves less room for national regulation. The CRDIV contains, *inter alia*, the provisions on the access to the banking activity, on governance and on the supervisory framework, such as the authorization of the business, the acquisition of qualifying holdings, the exercise of the freedom of establishment and of the freedom to provide services, the powers of the competent authorities of the home and the host Member States and the provisions governing the initial capital and the supervisory review of institutions. The CRR is rather focused on the prudential requirements for institutions that are meant to ensure financial stability.

Although a high level of harmonisation is pursued in the new EU context, CRDIV and CRR still provide for various options, waivers and

derogations, which are left to the decision either of the competent authorities or of the Member States (see e.g. Art. 49, para. 1 and 3, CRR; Art. 467, para. 2, CRR; Art. 160, para. 6, CRDIV). This is in line with the de Larosière Report, which explicitly considers harmonisation not an end in itself and admits the maintenance of national approaches on some aspects, insofar as they are beneficial to single countries and respectful of the principles of internal market (see para. 107 and 108 of the report).

The recent approval of the BRRD and the establishment of the SRM aim at ensuring a high level of harmonisation also in the field of banks' recovery and resolution, which was traditionally characterised only by the mutual recognition of national reorganisation measures and winding-up proceedings, according to EU Directive 2001/24. Therefore, the Italian provisions on banks' crisis and the competences of the Bank of Italy (Arts 70 to 105 of the TUB) will have to be revised, in accordance with the directive and in the context of the SRM.

2.3 The single rulebook and the role of the EBA

The approval of more stringent EU "level 1" measures, by means in particular of the adoption of EU regulations rather than directives, is only the first component of the "single rulebook", which aims at fostering harmonisation of the banking regulatory framework in the EU, thus reducing national discretion. In 2010, the ESFS – which includes the three new European Supervisory Authorities (ESAs: the EBA, the ESMA and the EIOPA) – was established in order to improve the consistency of national supervision, first of all by means of harmonised regulation, that is the so-called European single rulebook, applicable to financial institutions in the whole internal market. The ESAs have been entrusted with the task "to contribute to the establishment of high-quality common regulatory and supervisory standards and practices, in particular by providing opinions to the union institutions and by developing guidelines, recommendations, draft regulatory and implementing technical standards (ITS)" (see, as far as EBA is concerned, Art. 8, para. 1, point *a*, of EBA Regulation).

The harmonised EU single rulebook is composed not only of the mentioned "level 1" measures (regulation and directives), but also of "level 2" measures adopted pursuant to Art. 290 TFEU – according to which a legislative act may delegate to the commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act ("delegated" acts) – and to

Art. 291 TFEU, which provides the conferral of implementing powers on the commission where uniform conditions for implementing legally binding union acts are needed (“implementing” acts).

This regulatory scheme is reproduced in the ESFS, with the elaboration of the level 2 measures by the ESAs and their endorsement and formal approval by the commission. The ESAs, and in particular EBA in the banking field, have been entrusted with the power to develop harmonised binding technical standards (BTS) in financial services. These can be regulatory technical standards (RTS), in cases covered by Art. 290 TFEU (see Arts 10–14 of EBA Regulation), or ITS, in cases covered by Art. 291 TFEU (see Art. 15 of EBA Regulation). In both cases, the ESAs submit a draft technical standard to the commission for its endorsement. The commission takes the decision on the endorsement and then formally adopts the BTS by means of delegated or implementing acts, in the form of regulations or decisions published in the Official Journal of the European Union (see e.g. commission delegated regulation no. 241/2014, supplementing the CRR with RTS for own funds requirements; commission implementing regulation no. 680/2014, laying down ITS with regard to supervisory reporting of institutions according to the CRR).

The distinction between RTS and ITS entails differences in the procedure for their adoption. A regulatory technical standard, *inter alia*, may be objected by either the European Parliament or the Council, and in this case, it shall not enter into force (see Art. 13 of EBA Regulation). The distinction between the two types of standards is based on the corresponding distinction between “delegated” and “implementing” acts. According to the EU Court of Justice, “when the EU legislature confers, in a legislative act, a delegated power on the Commission pursuant to Art. 290(1) TFEU, the Commission is called on to adopt rules which supplement or amend certain non-essential elements of that act. In accordance with the second subparagraph of Art. 290(1) TFEU, the objectives, content, scope and duration of the delegation of power must be explicitly defined in the legislative act granting such a delegation. That requirement implies that the purpose of granting a delegated power is to achieve the adoption of rules coming within the regulatory framework as defined by the basic legislative act. By contrast, when the EU legislature confers an implementing power on the commission on the basis of Art. 291(2) TFEU, the commission is called on to provide further detail in relation to the content of a legislative act, in order to ensure that it is implemented under uniform conditions in all Member States” (CJEU, 18 March 2014, C-427/12, points 38–39). Although the distinction

may leave space for interpretations, the EU legislature has discretion in deciding which kind of power (delegated or implementing) has to be conferred on the commission, and consequently judicial review is limited to manifest errors of assessment (see point 40 of the mentioned judgement).

The role of the commission in the adoption of BTS and the corresponding lack of autonomous powers of direct regulation of the ESAs is related to the application of the Meroni doctrine, according to which a delegation of powers from the EU Institutions have to be limited to “clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority”; however, the delegation is not admissible where “it involves a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy” (CJEU, 13 June 1958, C-9/56).

The limits of the delegation of powers to ESAs, in particular to ESMA as far as its powers relating to the “short-selling” of financial instruments are concerned (Art. 28 of EU Regulation no. 236/2012) have been recently examined by the EU Court of Justice, also with reference to the Meroni doctrine (CJEU, 22 January 2014, C-270/12, especially par. 41–55). The Court stated that “the powers available to ESMA under Art. 28 of Regulation no. 236/2012 are precisely delineated and amenable to judicial review in the light of the objectives established by the delegating authority”, hence judging that “those powers comply with the requirements laid down in *Meroni v High Authority*”.

For the purpose of building a common supervisory culture, EBA is also entrusted with the development of a “supervisory handbook”, which shall set out best practices for supervisory methodologies and processes (Art. 29, para. 2, of the EBA Regulation). Differently from the technical standards, the handbook should not take the form of a legally binding act, but it should, however, enhance convergence of supervisory practices, thus complementing the single rulebook.

EBA, as well as the other ESAs, may also issue guidelines and recommendations addressed to competent authorities or financial institutions, with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common and consistent application of Union law (see Art. 16 of EBA Regulation). Guidelines and recommendations are not directly binding, but competent authorities and financial institutions “shall make every effort to comply”. Compliance is also pursued through some disincentives to non-compliance: if competent authorities intend not to comply, they

shall inform the EBA, stating their reasons for non-compliance (“comply or explain” mechanism); furthermore, non-compliance is subject to publicity and the EBA may also decide, on a case-by-case basis, to publish the reasons provided by the competent authority for not complying (see Art. 16, para. 3 of EBA Regulation). Although not directly binding, EBA guidelines and recommendations can be classified as EU “soft law”, creating strong incentive for compliance and determining legal consequences for their addressees, thus contributing to the construction of the EU banking regulatory framework.

A similar comply or explain mechanism is also provided for the recommendations issued by the ESRB in its field of competences (see Arts 16 to 18 of EU Regulation no. 1092/2010). ESRB recommendations may be either of a general or of a specific nature and can be addressed to the Union as a whole or to one or more Member States, ESAs, or national supervisory authorities. ESRB recommendations ask for remedial actions, explicitly including, where appropriate, for legislative initiatives (see e.g. recommendation ESRB/2011/3 of 22 December 2011 on the macro-prudential mandate of national authorities – asking for the designation in the national legislation of an authority entrusted with the conduct of macro-prudential policy, either as a single institution or as a board composed of the authorities involved in financial stability – which requires to be enacted in the national legislation).

2.4 The SSM and its relation with the single rulebook

Italy participates in the SSM, and the Bank of Italy is the Italian national competent authority (NCA), taking part in the SSM according to Art. 6, para. 1, of the SSM Regulation (EU Regulation no. 1024/2013). The SSM is intended as a single system for the exercise and the division of competences in the field of banking prudential supervision.

Art. 4 of the SSM Regulation, indeed, entrusts tasks to the ECB for “prudential supervisory purposes”; these tasks have been conferred in accordance with Art. 127, para. 6, TFEU, which provides for the conferral, by means of a Council Regulation to be adopted unanimously, of “specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”.

Other banking issues outside the scope of prudential supervision, for example as regards AML/CFT and transparency of contractual conditions and correctness of relations with customers, are also subject to EU legislation aimed at national harmonisation (e.g. directive 2008/48 on

credit agreements for consumers; directive 2005/60 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing). They remain, however, outside the scope of the SSM and the competences of the ECB and therefore under a more direct involvement of national authorities (see “whereas” no. 28 of the SSM Regulation on supervisory tasks not conferred on the ECB, which remain a national authorities’ competence).

The ECB tasks are carried out within the framework of Art. 6 of the SSM Regulation, which provides for the distinction between “significant” and “less significant” supervised entities or groups. The less significant ones remain within the remit of the NCAs, for the exercise of the tasks under Art. 4 of the SSM Regulation, with the exception of the authorisation of banking activity, its withdrawal and the assessment of the acquisition and disposal of qualifying holdings, which will be subject to “common procedures”, applicable both to significant and to less significant banks, according to Arts 14 and 15 of the SSM Regulation.

The SSM is therefore a system subject to the common EU regulatory framework (the single rulebook), and it is structured as a mechanism for the exercise of supervision in the participating Member States (i.e. those whose currency is the euro or those who have established a close cooperation in accordance with Art. 7 of the SSM Regulation), not for the regulation of banking activities by means of different provisions. The above described competences of the commission in the adoption of BTS, and of the EBA in their development, is consequently confirmed by the SSM Regulation.

In the exercise of its tasks, the ECB shall apply all relevant Union law and, where Union law is composed of EU directives, the national legislation transposing them (Art. 4, para. 3, first subparagraph, of the SSM Regulation). The single rulebook shall apply, and the ECB shall take decisions subject to and in compliance with the relevant Union law, in particular any legislative and non-legislative act, including those referred to in Arts 290 and 291 TFEU, and therefore RTS and ITS adopted by the commission in accordance with Arts 10 to 15 of the EBA Regulation. Furthermore, the ECB in the exercise of its tasks shall be subject to Art. 16 of the EBA Regulation (dealing with the adoption by EBA of guidelines and recommendations) and to the provisions of that Regulation on the EBA supervisory handbook (Art. 4, para. 3, second subparagraph).

The EBA, therefore, remains entrusted with developing the single rulebook and ensuring supervisory convergence and consistency of supervisory outcomes within the Union (see in the preamble of the SSM Regulation “whereas” no. 32; see also “whereas” no. 11, 12, 30, 31, 34,

remarking the consistency of the SSM with the European single rulebook developed by the EBA and adopted by the commission). The single rulebook is therefore the regulatory pillar of banking activities in the whole EU, including for the SSM; the latter is rather the supervisory pillar of the banking union, with a more limited scope of application to the participating Member States.

The ECB, although not directly competent as the EBA for the development of the single rulebook, has, however, a role of contributing where necessary “in any participating role to the development of draft regulatory technical standards or implementing technical standards by EBA” and “shall draw the attention of EBA to a potential need to submit to the Commission draft standards amending existing regulatory or implementing technical standards” (Art. 4, para. 3, subparagraph 4, of the SSM Regulation).

Due to its role as supervisor of the largest euro area banks, representing almost 85 per cent of total banking assets in the euro area, it can be expected that the ECB will play an important advisory role in the rulemaking process, notwithstanding its limited role in the EBA governance, which provides the participation of one representative nominated by the Supervisory Board of the ECB in the EBA Board of Supervisors, without voting rights (Art. 40, para. 1, point *d*, of the EBA Regulation). The ECB advisory role in the rulemaking process is exercised also by means of its opinions in the field of prudential supervision of credit institutions, both on EU and on national legislative proposals, pursuant to Art. 127, para. 4, of the TFEU.

2.5 The ECB regulatory powers

The ECB is entrusted with the power to adopt regulations in the context of the SSM, within the limits set in the SSM Regulation and within the framework of the single rulebook. The general power of the ECB to adopt regulations stems from Art. 132 TFEU (as well as from the corresponding Art. 34 of the ESCB/ECB Statute), according to which “in order to carry out the tasks entrusted to the ESCB”, the ECB shall make regulations to the extent necessary to implement the tasks defined in, *inter alia*, Art. 25, para. 2, of the Statute of the ESCB and of the ECB. Art. 25, para. 2, of the ESCB/ECB Statute is about the possible performance by the ECB of specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions (with the exception of insurance undertakings), “in accordance with any regulation of the Council under Art. 127, para. 6, TFEU”, that is with the SSM Regulation.

Therefore, the ECB has the power to adopt regulations not only for the performance of its tasks in the field of monetary policy and other ESCB tasks (see Art. 127, para. 2, TFEU) but also for prudential supervision; in this latter field, the provisions of the SSM Regulation has to be taken into account to identify the scope of the regulatory power of the ECB.

Pursuant to Art. 4, para. 3, second subparagraph, of the SSM Regulation, the ECB can adopt regulations “only to the extent necessary to organise or specify the arrangements for the carrying out of the tasks conferred on it by this Regulation”. The regulatory power of the ECB is therefore limited by the competences of the EBA and of the commission for the development of the single rulebook and, at the same time, can be exercised only where necessary and within the boundaries of Art. 4, para. 3, of the SSM Regulation.

Regulations, as well as decisions, may also be adopted by the ECB in order to establish “the detailed operational arrangements for the implementation of the tasks conferred on it” by the SSM Regulation. This power is contained in a transitional provision (Art. 33, para. 2, subparagraph 2, of the SSM Regulation), and it is indeed conferred on the ECB starting from the entry into force of the SSM Regulation (“after 3 November 2013”) rather than from the actual take-over of the supervisory tasks by the ECB (on 4 November 2014). The provision seems aimed at the adoption of the implementation arrangements and measures for the smooth transition from the national supervision and for an effective start of the SSM, such as the setting up of appropriate reporting procedures and arrangements for cooperation with national competent authorities (as underlined in subparagraph 4 of Art. 33, para. 2, of the SSM Regulation).

ECB regulations have general application and are binding in their entirety and directly applicable in all Member States whose currency is the euro. They form part of EU law and prevail over national law for the aspects that they regulate.

Before adopting a regulation, the ECB shall conduct open public consultations and analyse the potential related costs and benefits, unless such consultations and analyses are disproportionate in relation to the scope and impact of the regulations concerned or in relation to the particular urgency of the matter, in which case the ECB shall justify that urgency (Art. 4, para. 3, subparagraph 3, SSM Regulation). In accordance with the Inter-institutional Agreement concluded between the European Parliament and the ECB (OJ L 320, 30 November 2013, p. 1), the ECB shall transmit to the Parliament’s competent committee the draft

regulations before the beginning of the public consultation procedure. Where Parliament submits comments on the acts, there may be informal exchanges of views with the ECB on such comments. Such exchanges of views shall take place in parallel with the open public consultation.

The main regulation adopted so far by the ECB is the so-called “SSM Framework Regulation”. According to Art. 6, para. 7, of the SSM Regulation, the ECB shall adopt and make public “a framework” to organise the practical arrangements for the implementation of Art. 6 of the SSM Regulation, that is the cooperation between the ECB and the national competent authorities within the SSM. This framework, which has to be adopted in consultation with national competent authorities, has been adopted on 16 April 2014 by means of a Regulation of the ECB on the basis of Art. 34 of the ESCB/ECB Statute and Art. 4, para. 3, Art. 6 and Art. 33, para. 2, of the SSM Regulation (EU Regulation no. 468/2014).

Pursuant to Art. 6, para. 7, of the SSM Regulation, the framework shall include “at least” the specific methodology for assessing and reviewing the criteria laid down in the SSM Regulation for determining whether a credit institution is significant or not and the procedures governing the cooperation between the ECB and the NCAs as regards the supervision of both significant and less significant credit institutions.

The Framework Regulation also addresses other issues deemed necessary for the organisation of the SSM tasks and cooperation between the ECB and the NCAs, such as macro-prudential decisions (in accordance with Art. 5 of the SSM Regulation), investigatory powers, authorisations and qualifying holdings, the sanctions regime (see Art. 18 of the SSM Regulation), due process rules for the adoption of the ECB’s supervisory decisions (e.g. the right to be heard and access to files, in accordance with Art. 22 of the SSM Regulation) and the SSM language regime.

Another important ECB Regulation (EU Regulation no. 1163 of 22 October 2014) – adopted on the basis of Art. 4, para. 3, and Art. 33, para. 2, of the SSM Regulation – establishes the methodology for calculating, allocating and levying the annual supervisory fee pursuant to Art. 30 of the SSM Regulation. According to this provision, the ECB shall levy an annual supervisory fee on credit institutions and branches established in the participating Member States; the fees shall cover (and not exceed) the expenditure incurred by the ECB in relation to the supervisory tasks conferred on it.

The SSM Regulation contains also other provisions on the ECB regulatory powers in the performance of banking supervision tasks, which are more limited in their scope than Art. 4, para. 3, of the SSM Regulation.

In particular, with reference to less significant credit institutions – which are in principle under the direct supervision of the NCAs and not of the ECB – the ECB may issue regulations, guidelines or general instructions, which are not directly addressed to supervised entities but rather to national competent authorities and are aimed at identifying the modalities according to which the NCAs' tasks are performed and NCAs' supervisory decisions are adopted (Art. 6, para. 5, point *a*, of the SSM Regulation).

This provision is included in a set of general powers of the ECB with regard to less significant credit institutions, in order to maintain the singleness of the supervisory mechanism. The SSM is indeed intended as a single-tier system with an internal division of competences among the NCAs and the ECB and under the responsibility of the latter for its “effective and consistent functioning” (see Art. 6, para. 1, of the SSM Regulation). Hence, with reference to less significant credit institutions, Art. 6, para. 5, of the SSM Regulation entrusts the ECB also with the oversight of the system and the power to request information from NCAs (points *c* and *e* of para. 5); the responsibility of the ECB for the functioning of the whole SSM is clearly confirmed also by its power to decide to exercise directly itself all the relevant powers for one or more less significant credit institutions (point *b* of para. 5). The ECB may also make use of the specific powers referred to in Arts 10 to 13 of the SSM Regulation with regard to less significant credit institutions (request for information, general investigations, on-site inspections – see point *d* of Art. 6, para. 5, SSM Regulation) and is competent to adopt decisions relating to such institutions in the field of common procedures (authorisation of banking activity and its withdrawal; acquisitions of qualifying holdings – see Art. 6, para. 4, first subparagraph; Art. 4, para. 1, points *a* and *c*; and Arts 14 and 15 of the SSM Regulation).

Furthermore, the ECB adopted a regulation concerning the establishment of a Mediation Panel and its rules of procedure, as expressly provided for by Art. 25, para. 5, of the SSM Regulation (EU Regulation no. 673/2014). The panel is established “with a view to ensuring separation between monetary policy and supervisory tasks”, in order to resolve differences of views expressed by the competent authorities of participating Member States concerned, regarding an objection of the Governing Council to a draft decision proposed by the Supervisory Board (the procedure for the adoption of ECB decisions, by means of non-objection of the Governing Council to a complete draft decision proposed by the Supervisory Board of the ECB, is described under Art. 26, para. 8, of the SSM Regulation).

In addition to regulation, for the purpose of carrying out the tasks conferred on it by the SSM Regulation, the ECB may also adopt guidelines and recommendations, subject to and in compliance with Union law in general and the single rulebook specifically (Art. 4, para. 3, subparagraph 2, of the SSM Regulation). The ECB may also address “instructions” to NCAs for the performance of the prudential supervision tasks mentioned in Art. 4 of the SSM Regulation (Art. 6, para. 3, of the SSM Regulation; see also Art. 9, para. 1, subparagraph 3). As already mentioned, as far as less significant credit institutions are concerned, the ECB may issue guidelines or “general” instructions to national competent authorities for the performance of their tasks and the adoption of their decisions, in addition to regulations (Art. 6, para. 5, point *a*, of the SSM Regulation).

The ECB will also develop a “supervisory manual”, which is an internal document for SSM staff describing the processes and methodology for the supervision, including off-site and on-site reviews, risk assessments and model validations, as well as the procedures for cooperation within the SSM and with authorities outside the SSM. The manual is not intended to be legally binding, being it an internal act for the use of the ECB and the SSM staff. The manual does not overlap with the EBA supervisory handbook, which is aimed at setting non-binding supervisory best practices for all EU competent authorities, including the ECB, whereas the SSM manual should detail the concrete working methodology for supervision within the SSM.

As already mentioned above, the CRDIV and CRR, although aimed at establishing a single rulebook for the whole EU banking sector, leaves some options and discretions to Member States and to competent authorities, as far as they are not detrimental for the single market. When these options are conferred to Member States, they have to be exercised by them, and not by the ECB, also in the SSM context, as explicitly stated by the SSM Regulation. The ECB, indeed, shall apply national legislation transposing directives (including the national law by means of which Member States’ options are exercised) and – where EU regulations explicitly grant options to Member States – the national legislation exercising those options (see explicitly Art. 4, para. 3, subparagraph 1, of the SSM Regulation; see also “whereas” no. 34 thereof). The same should apply in cases where options granted by EU law to Member States are exercised by national competent authorities by means of their regulations (e.g. in Italy, according to Art. 53 of the TUB), since in this case the NCAs are acting in their capacity as national regulators for the exercise of the options, which remain Member States’ options.

On the contrary, when options are granted by EU law to competent authorities, the SSM Regulation does not provide a specific rule, such as the one just mentioned for Member States' options. The whereas no. 34, in the preamble of the SSM Regulation, only provides that options granted to Member States "should be construed as excluding options available only to competent or designated authorities".

The power of the ECB to exercise options granted to competent authorities could be deemed stemming from Art. 9, para. 1, of the SSM Regulation, according to which the ECB is considered as a competent (or designated) authority according to EU law: "for the exclusive purpose of carrying out the tasks conferred on it by Arts 4(1), 4(2) and 5(2), the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by the relevant Union law. For the same exclusive purpose, the ECB shall have all the powers and obligations set out in this Regulation. It shall also have all the powers and obligations, which competent and designated authorities shall have under the relevant Union law, unless otherwise provided for by this Regulation". However, where competent authorities' options have to be exercised in a general way, rather than with respect to a single entity, the possibility of the ECB to exercise options should be coordinated with the limited scope of the ECB regulatory powers, which is conferred "only to the extent necessary to organise or specify the arrangements for the carrying out of the tasks conferred on it" (Art. 4, para. 3, subparagraph 2, of the SSM Regulation).

2.6 Conclusion

Regulation of banking activities in EU Member States is increasingly and rapidly moving toward a deeper level of harmonization. Although a role of national regulators is still provided and necessary in many fields and a certain degree of national discretion is still left, even where EU regulations are adopted, the integration of financial markets and the response to the financial crisis are steering regulation toward a EU rather than national dimension. The Italian and other EU national supervisory authorities are key actors of this change, participating in the decision making bodies of EBA and, as far as the SSM is concerned, of the ECB and taking part in the preparation, implementation and enforcement of EU regulation.

Note

This chapter only expresses personal opinions of the author and does not represent the official position of the Bank of Italy.

3

Investment Services or Activities

Massimiliano Carnevali and Emilia Petrocelli

3.1 Introduction. Investment services and activities: definition

On 1 November 2007, the Legislative Decree issued the 17 September 2007 no. 164 entered into force, implementing MiFID in Italy.¹ On the regulatory side, in compliance with the legislation that has implemented MiFID, the Commissione Nazionale per le Società e la Borsa (the Consob) and the Bank of Italy issued (*inter alia*) the following main regulations:

- Resolution no. 16190 issued by the Consob on 29 October 2007, which amended the rules on intermediaries;
- Resolution no. 16191 issued by the Consob on 29 October 2007, which amended the rules on markets; and
- Resolution issued jointly by the Consob and the Bank of Italy on 29 October 2007, which provides for the rules concerning the organization and the procedures applicable to intermediaries authorised to provide investment services and collective portfolio management.

According to the provision of Art. 1, para. 5, of the Legislative Decree no. 58/1998 (as amended by the Legislative Decree no. 164/2007), “investment services and activities” mean the following activities where they concern financial instruments:

- a) dealing for own account;
- b) execution of orders for clients;
- c) subscription and/or placement with firm commitment underwriting or standby commitments to issuers;
- c-bis) placement without firm or standby commitment to issuers;

- d) portfolio management;
- e) reception and transmission of orders;
- f) investment advice;
- g) management of multilateral trading systems. Art. 1, para. 6, of the Legislative Decree no. 58/1998 also provides a list of “non-core services”, which are ancillary services provided by banks/financial intermediaries jointly with investment services and activities. Such services are:
 - a) safekeeping and administration of financial instruments and related services;
 - b) safe custody services;
 - c) lending to investors to enable them to carry out transactions in financial instruments where the lender is involved in the transaction;
 - d) advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings;
 - e) services related to the issue or placement of financial instruments, including the organisation and constitution of underwriting and placement syndicates;
 - f) investment research and financial analysis or other forms of general recommendation regarding transactions on financial instruments;
 - g) foreign exchange trading where this is connected with the provision of investment services;
 - g-bis) activities and services identified by regulation by the Minister for the Economy and Finance, after consulting the Bank of Italy and the Consob, and relating to the provision of investment or accessory services on derivatives.²

It has to be noted that MiFID increased the number of investment services and activities and of financial instruments, including the following main changes:

- investment advice, which was previously a non-core service, has become one of the investment services and activities;
- the operation of a multilateral trading facility has become one of the investment services and activities;
- the provision of investment research and financial analysis has become an ancillary service;
- commodity, weather and all credit derivatives are now financial instruments.

3.1.1 Authorization to provide investment services

According to the provision of Art. 18, para. 1, of the Legislative Decree no. 58/1998, the provision of investment services and activities to the public on a professional basis is reserved to entities with a specific authorization issued, according to the circumstances, by the Consob or the Bank of Italy.

Not all entities can be authorized. The authorization can be issued to:

- Italian asset management and investment firms (SIMs): they can be authorized by the Consob to offer all the investment services;
- Italian banks: they can be authorized by the Bank of Italy to offer all the investment services;
- asset management companies (SGR): they can be authorized by the Bank of Italy to carry out portfolio management activities, to provide investment advisory services, to market units and shares of UCIs managed by third parties (in compliance with the rules of conduct established by the Consob after consultation with the Bank of Italy) and to provide the service of the reception and transmission of orders, if authorised to practice the AIF (Alternative Undertaking for Collective Investment) management service;
- financial intermediaries enrolled in the register envisaged by Art. 106 of the Consolidated Banking Law kept by the Bank of Italy: they can be authorized to trade on own account and execute the orders of clients (solely in relation to financial derivatives), as well as carry out the subscription or placement service;
- banks in European Economic Area (EEA) nations: they can offer services in Italy which they are authorized to offer by the supervisory authority of the country they belong to;
- investment firms in EEA nations: they can offer services in Italy which they are authorized to offer by the supervisory authority of the country they belong to;
- non-EEA investment firms: they can be authorized by the Consob to offer all the investment services in Italy;
- non-EEA banks: they can be authorized by the Bank of Italy to offer all the investment services in Italy;
- stockbrokers enrolled in the consolidated national register kept by the Minister for the Economy and Finance: they can perform activities for the execution of orders, placement, portfolio management, reception and transmission of orders and advice.

It has to be noted that accordingly to a literal interpretation of Art. 18 of the Legislative Decree no. 58/1998, investment services and activities

are reserved to authorized entities on the condition that they are carried out to the public and on a professional basis.

In this context, the exemptions provided by MiFID find their application. According to such exemptions, no authorization has to be required (*inter alia*) by persons which provide investment services exclusively for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings, by persons providing an investment service where that service is provided in an incidental manner in the course of a professional activity collective investment undertakings and pension funds.

Further exemptions might be provided according to Art. 18, para. 5, letter b of the Legislative Decree no. 58/1998 that entitles the Minister for the Economy and Finance to adopt (after consulting the Bank of Italy and the Consob) rules implementing and integrating the reservations of investment services and activities, in compliance with the provisions of community law. Such decree has not yet been issued.

3.1.2 Cross-border provision of investment services

MiFID provides the passport system, that enables an investment firm established and authorized in an EEA Member State (the home state) to undertake certain activities in another EEA Member State (the host state) without obtaining additional authorization from the host state regulator. The latter recognizes the firm's existing home state authorization as sufficient to cover its host state activities; therefore, it does not impose its own authorization requirements. Investment firms cannot elect their home state for this purpose. A firm can use the passport to provide services in a host state by establishing a local branch or dealing directly on a cross-border basis.

In order to prevent abuse, MiFID follows the Investment Services Directive (Directive 93/22/EEC) in obliging Member States to impose minimum authorization requirements in respect of the activities covered by the passport. Otherwise, it would be possible to establish a firm in a state with minimal or no requirements and use the passport to bypass more stringent requirements elsewhere.

The activities for which the passport is available are divided into lists of "investment services and activities" and "ancillary services". Investment services and activities are subject to minimum authorization requirements across the EEA, whereas ancillary services are not. In addition, the passport can be used to provide investment services and activities alone, whereas ancillary services can be provided in a host state only to the extent that investment services and activities are also provided.

In order to be considered an investment firm and thus benefit from the passport, a firm must be authorized in its home state to provide one or more investment services and activities in relation to certain financial instruments (listed in Annex 1 of MiFID).

As well as removing the need for separate authorization from each host state authority, the passport system aims to provide clarity for investment firms when determining whether the home or host state regulator's rules apply to their business. The general principle of the passport system is that host state regulators should intervene as little as possible. MiFID has increased the extent to which home state rules will govern an investment firm's business when it operates in other Member States.

In respect of prudential regulation, MiFID provides that the rules of an investment firm's home state regulator will apply to all of the firm's business in the EEA, as under the Investment Services Directive; this reflects the success achieved in harmonizing prudential regulation. The organizational requirements which MiFID introduces are also a home state matter.

The most significant change is to conduct of business regulation. Under the Investment Services Directive, this was a host state matter, reflecting the limited harmonisation which the directive achieved. Now, the question of which state's conduct of business rules apply will generally be determined using the "country of origin" approach, focusing on the location from which the services are provided. To the extent that a firm operates from its home state, dealing with customers located within the home state or on a cross-border basis with customers located elsewhere, home state conduct of business rules will generally apply. To the extent that an investment firm operates from a branch outside its home state, it must generally apply host state rules when dealing with customers located in the same state as the branch, and apply home state rules when dealing with customers located outside the state in which the branch is located.

Although this appears to be a more complicated arrangement, it potentially reduces the number of sets of conduct of business rules with which an investment firm that is active in a number of EEA States must comply. It also reflects the greater harmonisation which MiFID has achieved.

3.2 Provision of investment services

A very concise overview of the general rules provided by Italian Consolidated Law on Finance on investment services and activities can

be found below. For a detailed examination of the rules regarding relations between intermediaries and customers, please refer to Chapter 4.

3.2.1 General criteria

3.2.1.1 Client protection

MiFID has the aim to enhance investor protection by setting conduct of business rules for providing investment services to clients and minimum standards for the mandate and powers that national competent authorities must have at their disposal. Many of the specific rules in MiFID relate predominantly to retail clients, as these clients are deemed to be less sophisticated in their knowledge of and expertise in financial markets and financial products. The key measures implemented through the directive were: best execution and order handling practices, categorisation of clients, investment research, conflicts of interest, outsourcing, transaction reporting, pre- and post-trade transparency and regulation of trade-related market infrastructure. The introduction of the directive has resulted in lower trading costs per transaction, reduced bid-ask spreads and faster trading times as envisioned by the European Commission.

However, expected benefits from the new competitive landscape have not flowed equally to all market participants. In particular, it is the opinion of the European Commission that these benefits have not always been passed onto the end investor. The trading environment has become more complex and fragmented and the financial crisis has exposed weaknesses in the regulation of instruments (other than shares) traded mostly between professional investors (e.g. derivatives).

The terms of MiFID mandated the commission to conduct a review of certain provisions of the directive within a specified timeframe. The commission published a paper in 2010 consulting on changes to the directive, followed by formal proposals in October 2011. The commission concluded that innovation and the increasing complexity of financial instruments highlighted the need for updated, enhanced levels of investor protection.

On 13 May 2014, the Council of the European Union formally endorsed a new regulatory regime that will replace the current MiFID. The new legislation, in the form of a recast directive (Directive 2014/65/EU, MiFID II) and Regulation (Regulation (EU) No. 600/2014, MiFIR), was agreed between the Parliament, Council and European Commission after extensive review and consultation, was published on the European Union Official Journal on 12 June 2014 and shall enter into force in the Member States on 3 January 2017, after the end of the European Securities and Markets Authority (ESMA) Consultation on Regulatory

Technical Standards and the implementation into the national legislations of the Member States.

The new regulation represents a significant overhaul of financial services regulation in the European Union: investment firms and banks that provide investment services in financial instruments will be subject to a wide range of new requirements, including enhanced investor protection rules.

In accordance to MiFID, Art. 21 of the Italian Consolidated Law on Finance obliges intermediaries to observe principles and rule of conduct, whose purpose is that of ensuring the correctness of their conduct and of permitting the client informed and aware investment choices in keeping with their needs.

The licensed parties have to observe a number of general principles in providing investment and non-core services and activities, and in particular to: (i) act diligently, fairly and transparently in the interests of customers and the integrity of the market; (ii) acquire the necessary information from customers and operate in such a way that they are always adequately informed; (iii) use publicity and promotional communications which are correct, clear and not misleading; (iv) have resources and procedures, including internal control mechanisms, suitable for ensuring the efficient provision of services and activities.

The final version of MiFID II contains a number of significant changes to the investor protection regime, many of which were introduced in trialogue and differ from the commission's original proposal. The new rules will affect the entire lifecycle of investment products and services. The design, marketing and distribution of products by investment firms must be tailored to the target market. Firms must understand the products they sell and ensure that they are appropriate for the client. Remuneration and sales targets should not incentivise staff to recommend inappropriate financial instruments to retail clients.

3.2.1.2 Client classification

MiFID implements a three-tiered client classification regime:

- Retail clients – defined as customers who are not professionals
- Professional clients – Annex II of the Level 1 Directive sets out which clients are considered as professionals (for example investment firms, credit institutions, insurance companies, etc.); and
- Eligible counterparties – these are the most sophisticated classes of investors and market participants. The client classification as “eligible counterparties” is only applicable to the investment services

of dealing for own account, execution of orders on behalf of clients and reception and transmission of orders. For the other types of investment services, the only client segmentation is between retail and professional clients.

MiFID sets out criteria for classifying clients into one of the three classifications and sets out rules to enable customers to change their initial classification on request. A retail customer may request treatment as a professional customer if the criteria and procedures in MiFID are adhered to. Professional clients may request the protection of retail customers, if they wish. In general, the level of client protection diminishes as the client classification becomes more sophisticated.

3.2.1.3 Information to clients

In general, when making investment decisions, clients need to be adequately informed. Investment firms will need to provide to their customers information relating to the nature and extent of risks inherent in the particular investment services and products. The information to be provided is dependent on the classification of the client from retail to professional to eligible counterparty – for example, it is expected that professional clients can identify for themselves the types of information that they require for assessing an investment service, and hence, the investment firm needs to provide only the information that is requested.

All information must be provided in good time before any investment decision.

In similar ways as set out below for the suitability and appropriateness tests and best execution requirement, investment firms will need to be able to prove that clients have been adequately informed as required by MiFID.

MiFID II will introduce additional information requirements: in particular, when bundling products or services, a firm must tell its clients whether the individual components can be purchased separately and provide evidence of the costs and charges for each component. Firms must also adequately inform retail clients of the different components and how their interaction modifies the risks.

Information regarding costs and associated charges must relate to both investment and ancillary services and include the cost of advice, the cost of the financial instrument and how the client may pay for it, and any third-party payments. Information about costs and charges, including costs and charges in connection with the investment service and the

financial instrument, which are not caused by underlying market risk, must be aggregated, with an itemised breakdown provided upon client request. This information must be provided to the client at least annually during the life of the investment. Firms must also indicate whether they will provide the client with a periodic assessment of the suitability of recommended financial instruments.

3.2.1.4 Conflict of interests

According to Art. 21, para. 2, of the Italian Consolidated Law on Finance, in the provision of investment services and activities and ancillary services, the licensed parties shall adopt all reasonable measures to identify and manage conflict of interest which may arise with the customer or between customers, also by the adoption of appropriate organisational measures, in order to avoid a negative impact on the interests of the customer. Where such measures are not sufficient to ensure, with reasonable certainty, that the risk of damaging the interests of the customer is avoided, licensed parties shall clearly inform customers, prior to acting on their behalf, of the general nature and/or sources of conflict of interest.

3.2.2 Asset protection rules

Art. 22 of the Consolidated Law on Finance provides the principle of the segregation of the clients' assets (financial instruments and funds) held by financial intermediaries, in the provision of investment services and ancillary services. In particular, Art. 22 provides that in providing investment and ancillary services, the financial instruments and funds of individual customers held in whatever capacity by an Italian investment company, asset management company, harmonised asset management company or financial intermediary entered in the register provided for in Art. 106 of the Consolidated Law on Banking and the financial instruments of individual customers held in whatever capacity by a bank shall be separate assets for all intents and purposes from those of the intermediary and from those of other customers. Actions in respect of such assets may not be brought by creditors of the intermediary or on behalf of such creditors nor by creditors of the depositary or the sub-depositary, if any, or on behalf of such creditors. Creditors of individual customers may bring actions up to the amount of the assets owned by such customers.

In addition, legal and court-ordered set-off shall not apply to accounts referring to financial instruments or funds deposited with third parties and agreements may not be made for their set-off against claims of the depositary or the sub-depositary on the intermediary or the depositary.

It is clear that the segregation of assets occurs at two different levels: on the one hand, the intermediary's assets are separated from the clients' assets; on the other hand, the assets of each client are separated from the assets of the other clients of the same intermediary.

The aim of these provisions is to protect the investors from the possible risk of confusion that can arise for the assets held by intermediaries, for the provision of services regulated by the Consolidated Law on Finance. The segregation of assets is mandatory, regardless of the capacity in which the intermediary holds the financial instruments or the funds, and regardless of the type of investment service or ancillary service that the investment firm provides to the client. This principle is not valid for the liquidity held by the banks: in this case, the rules on savings accounts (Art. 1834 of the Italian Civil Code) are applicable, on the basis of which the bank has the ownership of the liquidity deposited by the clients, and it has to give back the same quantity of money when asked by the client.³

The segregation of asset principle is especially relevant when the intermediary is submitted to bankruptcy procedures: in this case, it is especially important to identify the financial instruments and the amount of money owned by each client.

In this hypothesis, no problem will arise if the segregation of assets is effectively observed. There could be the case in which the segregation of assets is not really observed: for instance, there could be a wilful misconduct by the intermediary, or a situation of accounting or administrative disorder, that makes impossible to re-enact the position of each client. In this last case, Art. 91 of the Consolidated Law on Banking (Legislative Decree 385/1993) will apply, by virtue of the reference made by Art. 51 of the Consolidated Law on Finance. For Art. 91 of the Consolidated Law on Banking, there could be two hypotheses: (a) the separation of the bank's assets from those of customers is respected, but the separation by customer of the assets of such customers is not respected; (b) the separation of the bank's assets from those of customers is not respected. In the first case, it is provided that the financial instruments will be returned to the investors "pro rata according to the rights on the basis of which each customer has been admitted to the special section of the statement of liabilities". If it is not possible (for instance, because the financial instruments are not sufficient to effect all the restitutions), the liquidators shall "liquidate the financial instruments belonging to customers and allot the proceeds on the same pro rata basis". Where the separation of the bank's assets from those of customers is not respected, customers entered in the special section of the statement of liabilities

shall participate with unsecured creditors in conformity with Art. 111, para. 1, subparagraph 3 of the Bankruptcy Law.

As a corollary of this regulation, Art. 22, para. 3 of the Consolidated Law on Finance provides that, unless customers have agreed in writing, an investment company, Italian asset management company, harmonised asset management company or financial intermediary entered in the register provided for in Art. 106 of the Consolidated Law on Banking or a bank may not use, on its own behalf or on behalf of third parties, financial instruments belonging to customers which it holds in any capacity. Nor may an investment company, Italian asset management company, harmonised asset management company or financial intermediary entered in the register provided for in Art. 106 of the Consolidated Law on Banking use, on its own behalf or on behalf of third parties, liquid balances belonging to customers which it holds in any capacity. The prohibition to use the client's assets has the aim to strengthen the segregation of assets principle: this prohibition can be disregarded, only for the financial instruments, only if customers have agreed in writing. However, the prohibition is not extended to the liquid balances held by the banks in the provision of investment services. The reason of such limitation is that Art. 1834 of the Italian Civil Code is applicable to banks: this rule provides that the ownership of the liquid balances belongs to the bank, with a significant difference from Art. 22, para. 2 of the Consolidated Law on Finance.

3.2.3 Contracts

According to Art. 23 of the Consolidated Law on Finance, all the investment services, with the exception of investment advice, must be provided on the basis of a written agreement. As specified by Art. 37 of Consob Resolution no. 16190 issued on 29 October 2007 (the Consob Regulation on Intermediaries), the obligation to provide investment services other than investment advice on the basis of a specific contract in writing is only applicable to the relationships between intermediaries and retail customers.

The written form is envisaged for the agreement essentially for two reasons:

- the need to emphasise the importance of the deed and attract the attention of whomever is doing it, requesting them to sign a sheet;
- the need to establish contents of the agreement between the parties in a document, also so as to be able to easily demonstrate them in the future.

It has to be specified that the written form is only required for the agreement used for stipulating the provision of an investment service. Another matter is the orders conferred to the intermediary by way of execution of the agreement which do not necessarily have to be in writing.⁴

The agreement must contain the following elements:

- features of the service and the benefits due;
- validity, amendment and renewal of the agreement;
- methods by means of which the client can impart instructions and orders;
- frequency and content of the reports;
- for certain services (execution of orders, reception and transmission of orders and portfolio management) and in the event of transactions which may determine losses greater than the value of the investment, the loss threshold beyond which the client must be informed;
- the remuneration of the intermediary and the inducements received by the same intermediary;
- the possibility to provide, in association with the services offered, investment advice;
- any settlement and arbitration procedures in the event of disputes.

Failure to comply with the prescribed written form shall render the contract null and void. In addition, according to Art. 23 para. 2 of the Consolidated Law on Finance, any clause which refers to usage for the determination of the fee payable by customers or any other amount charged to them shall be null. In such cases, nothing shall be payable.

The nullity of the contracts or of single clauses provided by the Consolidated Law on Finance is a relative nullity, which can be invoked only by those in whose favour the law has been established: Art. 23 para. 3 provides accordingly that in case of violation of the above mentioned provisions on the written form of the contracts, nullity may be enforced only by the customer.

3.3 “Negotiation” services

3.3.1 Execution of orders on behalf of clients

According to MiFID (Art. 4, para. 1, number 5), the “execution of orders on behalf of clients” is the “[...] activity to conclude agreements to buy or sell one or more financial instruments on behalf of clients”.

After having received the order for the purchase or sale of a security, the intermediary executes it choosing from among several trading venues:

- organized markets;
- multilateral trading facilities;
- internalization of the order.

Organized markets are places for the exchange of securities, admitted beforehand for trading on said markets, where the purchase and sale proposals of several operators come together in an organized manner and on the basis of predetermined rules giving rise to the finalization of contracts. The organized markets are authorized by the Consob and run by a specific management company (for example, Borsa Italiana SpA, the main Italian management company) on the basis of regulations.

The multilateral trading facilities are also places where numerous purchase and sale proposals come together for the finalization of contracts. They can be run by the management company of the organized markets or by asset management and investment firms (SIMs) and banks. The running of these facilities represents a separate investment service and will be described in more details in Chapter G.

The internalizer of the order is a bank or an asset management and investment firm which, upon the request of the client, sells said client its financial instruments or directly acquires them from said client, therefore operating as “direct counterpart”. Systematic internalisation of orders represents a method of performing the investment service of dealing on own account, which will be further described in paragraph 2 of Chapter C.

Art. 21 of MiFID applies the duty of best execution to a firm when executing orders for a client, and takes a broader frame of reference to obtaining the best possible result for the client than simply achieving the best price: the obligation is to take all reasonable steps to achieve the best possible result, taking into account price, costs, speed, likelihood of successful execution and settlement, size, nature and “any other consideration” which is relevant to the execution of the order.

Where best execution applies, the Level 2 Implementing Directive (Art. 44, para. 1) provides that in determining the relevant importance of the factors listed above, a firm should take account of the categorization of the client, the nature of the order and the type of, and venue of execution for, the relevant instrument being traded. Nevertheless, if a

client issues specific instructions in respect of an order, a firm will be required to execute orders in accordance with those instructions.

For retail clients, Art. 45 of Consob Resolution no. 16190 issued on 29 October 2007 (the Consob Regulation on Intermediaries) provides that the “best possible result” will be determined in terms of the total consideration, representing the price of the relevant financial instrument and the cost related to execution.

In order to obtain the best result, the intermediary – as mentioned – has several trading venues at its disposal.

The choice must be made on the basis of precise and predetermined criteria which represent its order execution strategy. The execution strategy determines the trading venues for each category of financial instruments which, according to the intermediary, make it possible to obtain the best possible result on a long-term (and, therefore, not occasional) basis. The strategy then contains the criteria which, as and when, in relation to the individual order, will steer the choice of the specific venue.

According to Art. 46 of the Consob Regulation on Intermediaries, the intermediary must inform the client, in hard copy or via the website, of the main traits of its strategy. Subsequent amendments, if significant, must also be communicated.

It has to be noted that, in response to feedback from investors in different Member States regarding the quality of information they receive in execution policies adopted by firms, MiFID II (Art. 27):

- strengthens the best execution requirements to ensure that firms provide appropriate information to clients on their order execution policy, including explaining clearly, in sufficient detail and in a way that can be understood by clients, how orders will be executed by the firm for the client.
- obliges investment firms to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues where they executed client orders in the preceding year. ESMA will provide technical standards on this.
- requires execution venues to make available to the public data on execution quality of transactions on each venue. ESMA will provide technical standards on this.

The client can also give specific instructions, maybe indicating that the order be executed on an organized market rather than on a multilateral trading facility.

In this case, the intermediary, exclusively for the aspects associated with the instructions received, is released from observing the strategy: it is as if the client takes on responsibility, by means of their choice, for personally pursuing the best possible result, giving up entrusting this task to the intermediary.

In addition to the obligation to provide best execution, Art. 22 of MiFID requires investment firms to implement “procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders on the trading interests of the investment firm”. In other words, a firm must provide timely execution and fair allocation of order priority.

The client may confer the order using the formalities indicated in the contract. Thus, there may be written, verbal or telephone orders or those via internet.

Before executing a purchase order, the investment firm must inform the client of the features of the financial instrument type which it is asking the client to purchase and of the related risks.

According to Art. 19 of MiFID, the investment firm must also assess the “appropriateness” of the transaction for the client. In fact, the appropriateness test is to be applied when a firm provides MiFID investment services which do not involve advice or discretionary portfolio management, including execution services which do not fall within the conditions for execution only business (as explained below): the investment firm must ask the client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered, so as to enable the investment firm to assess whether the service or product envisaged is appropriate for the client.⁵ In assessing the appropriateness of the transaction, the investment firm must in particular take into account:

- the client’s familiarity with the type of transaction requested or proposed;
- the volume, the frequency and the nature of the transactions achieved in the past;
- the client’s level of education;
- the client’s profession.

Perhaps unsurprisingly, the obligations in each case are less onerous when an investment firm deals with professional clients because it is permitted to make certain assumptions about the knowledge and experience of professional clients which it cannot make in respect of retail clients. In

particular, in performing the appropriateness test, an investment firm may assume the necessary experience and knowledge on the part of its professional clients, thus practically confining the test to retail clients only.⁶

If the firm reaches the conclusion that the service or product is not appropriate to its client, it must give a warning to this effect. The warning can be in standardised format. If a client refuses to provide the relevant information (or provide insufficient information) for an assessment of appropriateness, the firm must warn the client that it has not been able properly to assess the appropriateness of the product or service.

There is another case where the intermediary does not assess the appropriateness of the transaction: when the customer requests it to operate as simple order executor. According to Art. 19, para. 6, of MiFID, and to Art. 43 of the Consob Regulation on Intermediaries, execution only services may be provided in the following circumstances:

- the services consist only of the execution and/or the reception and transmission of client orders;
- the services are linked to shares admitted for trading on a regulated market, or equivalent market in another country, money market instruments, bonds or other debt securities (excluding bonds or debt securities with an underlying derivative), harmonised Undertakings for collective investment in transferable securities (UCITS) and other “non-complex financial instruments”;
- the services are provided at the initiative of the client;
- the client has been clearly informed that, in providing said service, the intermediary is not obliged to assess appropriateness and therefore that the investor shall not benefit from the protection offered by related measures. Said advice may be provided in a standardised format;
- the firm complies with conflict of interest obligations.

The term “non-complex financial instruments” is not defined in MiFID, but instead in the Level 2 Implementing Directive (Art. 38); such definition is also included in Art. 44 of the Consob Regulation on Intermediaries. The criteria which determine whether an instrument is non-complex are that:

- the instrument is not one which gives a right to buy or sell another transferable security and is not any other type of derivative instrument;
- there are frequent opportunities to sell, redeem or otherwise obtain repayment of such a financial instrument at prices openly available to market operators. Said prices must be those of the market or those

made available or confirmed by assessment systems other than those adopted by the issuer;

- no actual or potential liability for the client is implied which exceeds the cost of purchase of the instrument;
- sufficient complete information is openly available and the characteristics are sufficiently simple to understand that the average retail customer may make an informed decision regarding whether or not to execute a transaction in relation to said instrument.

The list of financial instruments in MiFID that are covered by the “execution only” regime has been modified by MiFID II. According to Art. 25 of MiFID II, the list of financial instruments that fall within the exempted regime, and in relation to which an appropriateness assessment is not required, now covers:

- Shares admitted to trading on a regulated market, an equivalent third country market or a multilateral trading facility (MTF), where these are shares in companies (except shares in non-UCITS collective investment undertakings and shares that embed a derivative);
- Bonds and other forms of securitised debt admitted to trading on a regulated market, an equivalent third country market or a MTF (except those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved). ESMA will provide technical standards on this;
- Money market instruments (except those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved);
- Shares or units in UCITS (except structured UCITS);
- Structured deposits (except those that incorporate a structure which makes it difficult for the client to understand the risk of return or the cost of exiting the product before its term). ESMA will provide technical standards on this;
- Other non-complex financial instruments. ESMA will provide technical standards on this.

After having executed the order, the intermediary must send the client a communication, in hard copy, where it confirms the execution and indicates:

- the day and hour of execution;
- the type of order;

- the venue of execution;
- the financial instrument being traded;
- the quantity of financial instruments traded, their unit price and the amount paid in total;
- the sum total of the fees and charges paid and, if the client requests, the breakdown of the sum by individual items;
- any fulfilments the client is responsible for so as to be able to settle the transaction (for instance, the consignment of the securities sold or the monetary equivalent value for those purchased);
- the circumstance that the client has had the same intermediary, a company belonging to the same group or another client of the intermediary, as counterpArticle

3.3.2 Dealing on own account

Directive 2004/39/EC-MiFID defines “dealing on own account” as trading “[...] against proprietary capital resulting in the conclusion of transactions in one or more financial instruments” (Art. 4, para. 1, number 6). Hence Art. 1, para. 5-bis, of the Consolidated Law on Finance: “Dealing on own account is defined as the buying and selling of financial instruments, against proprietary capital and in relation to client orders, as well as market-making”.

Dealing on own account is the activity by means of which the intermediary, upon the instructions of the client, sells the latter its own financial instruments or purchases them directly from said client (as a rule, one says that the intermediary operates as “direct counterpart”).

When dealing for its own account, the intermediary:

- commits “own positions” and in other words satisfies the investment or divestment requirements of the clients by means of financial instruments already present in its own portfolio;
- enters into the purchase/sale contract as the direct counterpart of the clients;
- executes the orders of the clients.

This understood, trading on own account activities represents a method of performing another investment service: the execution of orders on behalf of clients described in the previous paragraph 1 of Chapter C.

It follows that the intermediary who trades on own account must not only be authorized for this service but also for the execution of orders on behalf of clients service.

In actual fact, in order to purchase or sell securities, the client has to contact an intermediary authorized to execute orders on behalf of clients. If this intermediary is also authorised to trade on own account, it may internalize the order on condition that this solution is able to obtain the best possible result for the client.

When executing the client's order, the own account transactor will have to observe all the rules laid down for the order execution service described in the previous section.

It has to be clarified that, according to MiFID, market maker activity, if it does not fall into the definition of execution of orders on behalf of clients, however, falls within the definition of dealing on own account given the significant impact it has on the functioning and liquidity of the markets in financial instruments.

A particular way to provide the dealing on own account service is systematic internalization, which implies the need to follow specific organizational rules.

3.3.3 Reception and transmission of orders

The reception and transmission of orders is a service by mean of which the intermediary, having received a purchase or sale order from the client, instead of carrying it out personally, sends it to another intermediary for execution.

Via the order transmission service, the client delegates the investment firm with the choice of another intermediary who will have to execute the order. It will therefore be the transmitter of the order who will have to identify the broker capable of obtaining the best possible result which ensues from the solution which ensures the best overall payment.

In order to identify the most suitable broker, the transmitter of the orders will exploit its experience and professionalism in order to assess the order execution strategies (see paragraph 1 above) of the various intermediaries present on the market.

In turn, so as to choose the order transmitter, the client can assess its transmission strategy, by means of which the intermediary identified the transacting parties to whom the orders will be transmitted for each category of financial instruments.

Apart from these differences, there are many similarities with the order execution service with regard to the order conferral methods, the obligations of the intermediary to correctly inform the client, to assess the appropriateness of the transactions and provide the report on the service provided (for these aspects, see paragraph 1).

3.4 Placement of financial instruments

3.4.1 In general

The companies which issue financial instruments generally offer them to investors via public offers. The offer takes place via intermediaries who contact the investors by means of distribution networks (bank branches, financial advisers, etc.).

In essence, the subscription and/or placement service involves the distribution of financial instruments, as part of a standardized offer, on the basis of an agreement with the issuer (or offeror). Various forms of this service exist.

An initial differentiation concerns the subscription or placement transactions. Subscription takes place when the securities offered are newly issued and are introduced for the first time onto the market. Placement takes place when the securities have already been issued and are subsequently resold.

The placement, or the subscription, can be achieved in public form and therefore targeted at all the investors without distinction or in private form, in other words, targeted at an selected circle of investors, normally professional (banks, insurance companies, etc.).

The placement, or the subscription, can take place “with” or “without” firm commitment underwriting or standby commitments to issuers.

In the case of placement “without”, the intermediary undertakes just the obligation to seek the parties from among the general public interested in subscribing or purchasing the financial instruments to be placed; the risk of failure in the placement encumbers the issuer alone.

By contrast, in the event that the intermediary himself subscribes or purchases the securities beforehand, or in any event provides a guarantee for the success of the transactions, it personally undertakes the risk of the successful outcome of the transaction. If some securities should remain unsold, the intermediary/placer remains the owner thereof if it had purchased them beforehand or would be obliged to purchase them itself if it had undertaken a guarantee in this sense. It is evident that if the intermediary undertakes the risk of the transaction, it has a further interest in placing all the securities offered.

When providing the service, the intermediary must operate in the interests of the client and fulfil all the obligations laid down for the provision of the investment services.

It will therefore have to provide the necessary information to the clients, assess the appropriateness of the transaction, correctly handle any conflicts of interest and operate on the basis of a written agreement.

3.4.2 Door-to-door selling and financial salesmen

A specific method to provide the placement service is door-to-door selling, which – according to Art. 30 of Consolidated Law on Finance – means the promotion and placement with the public of:

- a) financial instruments in a place other than the registered office or the establishments of the issuer, the offeror or the person appointed to carry out the promotion or placement;
- b) investment services and activities in a place other than the registered office or the establishments of the provider, promoter or seller of the service.

According to para. 9 of Art. 30 of Consolidated Law on Finance, the rules regulating door-to-door selling also apply to financial products different from financial instruments and, restricted to authorised persons, to financial products issued by insurance companies.

Consolidated Law on Finance specifies that are not considered door-to-door selling an offer to professional customers or an offer of an issuer's own financial instruments addressed to the members of the board of directors or of the supervisory board, to employees and to collaborators who are not employees of the issuer, of the holding company or of its subsidiaries, made in the respective offices or branches.

Door-to-door selling of financial instruments may be carried on by persons authorised to perform the investment service of placement with or without firm or standby commitment to issuers and by asset management companies, EU management companies, SICAVs, SICAFs, EU and non-EU AIFMs, exclusively for UCI units or shares.

Investment companies, banks, financial intermediaries entered in the special register provided for in Art. 106 of the Consolidated Law on Banking, asset management companies and EU management companies and EU and non-EU AIFMs may engage in door-to-door selling of their own investment services and activities. Where such selling involves services and activities provided by other intermediaries, investment companies and banks must be authorised to perform the investment service of placement with or without firm or standby commitment to issuers.

According to Art. 30, para. 6, of Consolidated Law on Finance, the enforceability of contracts for the placement of financial instruments or the management of individual portfolios concluded outside the registered office or sold using distance marketing techniques shall be suspended for a period of seven days beginning on the date of subscription by the investor. Within that period the investor may notify his

withdrawal from the contract at no expense and without any compensation for the approved person or the authorised person. This possibility shall be mentioned in the forms given to the investor and failure to indicate the right of withdrawal in forms shall result in the nullity of the related contracts, which may be enforced only by the customer.

By way of sentence no. 13905 of 3 June 2013, the United Sections of the Italian Supreme Court took a decision according to which the concept of “contract for the placement of financial instruments” forecast by the above mentioned provision of Art. 30, para. 6, of Consolidated Law on Finance, is comprehensive of every door-to-door selling of financial instruments carried out by the intermediary – and therefore, also when it has taken place in the execution of investment services other than those of “placement of financial instruments” and “management of individual portfolios” explicitly mentioned by the concerned provision – whereas the financial salesman has put in place a solicitation capable of grasping the investor unprepared and causing him to take a trading choice not meditated enough (i.e. “surprise effect”).

Such an extension was likely to endorse a boom of opportunistic behaviours capable of causing several disputes between investors and intermediaries purely based on the new principle of the United Sections. In other words, investors disappointed by the unprofitable transactions – carried out in the execution of any investment service – would have been able to obtain the restitution of the invested sums by invoking the nullity of their subscriptions because of the non-disclosure of “*ius poenitendi*”, also in those cases where the relative legislative provision, and consequently also the related contract forms, were not prescribing its application.

In this scenario, the government, partly as a result of the concerns raised by trade associations, has decided to intervene with a legislative provision considered as “authentic interpretation”: that is Art. 56-quater, Law Decree no. 69 of 21 June 2013, (“Decreto del Fare”), as amended by the conversion Law no. 98 of 9 August 2013, which added a new period to Art. 30, para. 6, of Consolidated Law on Finance, providing that: “Without prejudice to the application of the discipline of the first and second sentence to the investment services referred to in Art. 1, Section 5, letters (c), c-bis and (d), for contracts undersigned as from 1 September 2013, the same discipline also applies to the investment services referred to in Art. 1, Section 5, letter (a)”.

The legislative action has therefore operated on two fronts:

1. with regard to the future scenario, it has adopted – partially – the broad interpretation provided by the United Sections, extending the

prediction of “*ius poenitendi*” to (only one) additional investment service, that of dealing on own account. Therefore, even if the United Sections, investigating the purpose of the provision of, Art. 30, para. 6, of Consolidated Law on Finance, had relied on the need to protect the investor whenever there could have been a “surprise effect”, the law has only mentioned a single new investment service without adopting such a parameter, considering it, rightly, too generic and capable to elicit uncertainty;

2. with regard to the past, the retroactivity of the United Sections’ principle has been expressly excluded by operating an exclusive reference to “contracts signed” – and not, as it should be noted, to “transactions” from 1 September 2013.

According to Art. 31 of Consolidated Law on Finance, for out-of-office offers, investment companies, asset management companies, EU management companies, SICAVs, SICAFs, EU and non-EU AIFMs, financial brokers registered on the list contemplated by Art. 106 of the Consolidated Banking Law and banks can take avail of financial salesmen. A financial salesman shall mean a natural person who, as associate agent pursuant to MiFID, professionally exercises door-to-door selling as an employee, agent or representative. Financial salesman activities shall be performed exclusively in the interests of one person.

The provision of Consolidated Law on Finance expressly make reference to the quality of “tied agent” of the financial salesman, as defined by Art. 23, para. 1 of MiFID.

Financial salesmen used by community and non-community investment companies, EU management companies, EU and non-EU AIFMs, community and non-community banks, shall be equivalent, for the purposes of the application of rules of conduct, to a branch established in Italy.

The authorised person conferring the appointment shall be jointly and severally liable for losses caused to third parties by a financial salesman, including cases where such losses are the consequence of a criminal offence resulting in conviction.

The single register of financial salesmen, divided into territorial sections, has been set up. With Regulation no. 472/1998, the Minister of the Economy and Finance has established the integrity and experience requirements for entry in the register of financial salesmen. The experience requirements for entry in the register shall be verified on the basis of rigorous evaluation criteria that take account of validly documented previous professional experience or on the basis of examinations. From

1 January 2009, the register of financial salesmen is no longer held by the Consob but by the Authority for the Single Register of Financial Salesmen, which is a body composed of members of professional associations representing the financial salesmen and licensed persons, legally established in the form of an association, with organisational and statutory independence, in compliance with the principle of territorial division of departments and activities. Within the scope of its financial independence, the body shall determine and collect fees and other sums payable by members, by registration applicants and by persons wishing to sit the evaluation test, by the amount necessary to guarantee continued performance of its duties. The body shall arrange entry in the register, subject to verification of possession of the necessary requirements, or cancellation from the register in any case contemplated by the Consob Regulation on Intermediaries and shall take all other action necessary for the proper keeping of the register. The body shall operate in compliance with the provisions and criteria of the Consob regulations and under the Consob's supervision.

3.4.3 Distance marketing of investment services and activities and financial instruments

Distance communication techniques, together with door-to-door selling, are the methods to follow to promote and sell financial services outside the registered office of the intermediary. Distance communication techniques are the techniques of contact with customers, other than advertising, which do not involve the simultaneous physical presence of the customer and of the offeror or his agent.

Another fundamental characteristic of this type of offer is that communication must not be mere advertising, which is a communication only suitable to raise awareness and publicise investment opportunities, but communication with contractual nature, leading to the conclusion of a contract.

Finally, the term "contact" mentioned in the previous definition requires a clarification: the contact made by means of distance communication techniques can be established not only when you create an opportunity for dialogue or other forms of fast interaction but can also be established without forms of fast interaction when documents or messages sent through distance communication techniques have a contractual content.

Such techniques have interesting implications related to the new communication technologies: the Consob, with Communication no.

DI/99052838 of 7 July 1999, expressed its position on the promotion and placement via internet, noting that a website – which contains information relating to financial products and investment services, information about how to contact an intermediary in order to receive contractual proposals relating to financial products and investment services, tools with which to establish contact with a broker and receive standardised contract proposals, adhering to which investors can buy or subscribe financial products or establish relationships involving the provision of investment services – is potentially a distance communication technique.

In addition, the Consob found that email, which could be used to send messages and documents with both informative and promotional or contractual content to investors or to dialogue with investors, even with individual communications, potentially falls between the distance communication techniques.

Distance marketing of investment services and activities and financial instruments can be performed by authorised intermediaries, asset management companies and SICAVs, exclusively for units and shares of collective investment undertakings.

The performance of this type of activity is limited by the willingness of investors: according to Art. 80 of the Consob Regulation on Intermediaries, advertising and placement through distance communications techniques shall not be performed and, if undertaken, must be ceased immediately, with respect to customers explicitly objecting to their execution and continuation. For this purpose, the customer's option to object to the future receipt of such communications shall be expressly indicated.

In performing this type of advertising and placement, qualified entities must comply with the provisions regulating investment services, and must provide, in a clear and comprehensible manner appropriate to the characteristics of the distance communication technique used, the information and explanations due to investors.

The documents, which must be delivered to investors or sent by them, can also be transmitted through distance communication techniques, provided that the characteristics of this techniques are compatible with such documents and allow the recipient to acquire the availability of the document on durable support.

After the entry into force of MiFID, it is no longer an obligation for intermediaries to make use of financial salesmen for the distance marketing of investment services and activities and financial instruments.

3.5 Portfolio management

3.5.1 General rules

According to MiFID (Art. 4, para. 1, number 9), the “portfolio management” service means “managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments”. In the provision of such service, the intermediary will decide on behalf of the client which financial instruments will make up the client’s portfolio and will also see to all the transactions necessary for purchasing or selling them.

Before providing the service, the intermediary must assess whether the service offered is suitable for the client, and in other words whether, on the basis of the information acquired by said client, it corresponds to the client’s investment objectives without exposing him or her to risks which he or she cannot bear or comprehend. The suitability assessment will first of all concern the service itself: not all the management schemes (or “lines”) are the same, differing on the basis of the features and the degree of risk. When performing the service, the intermediary will then have to always assess that each individual investment transaction is suitable for the client, thus gauging the management scheme to the specific characteristics and needs of the client.

In order to seriously assess the adequacy, the intermediary shall obtain from the client “the necessary information regarding the client’s...knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives, so as to enable the firm to recommend to the client ...the investment services and financial instruments that are suitable for him” (Art. 19, para. 4, MiFID). If the client refuses to provide the information, the intermediary will have to refrain from providing the service.

According to MiFID II (Art. 25, para. 1 and 5), a firm must also obtain information about the client’s risk tolerance and ability to bear losses in order to ensure that investment services and financial instruments are recommended accordingly. When an investment firm recommends a bundled package of services or products, the overall package must be suitable.

According to Art. 24 of Consolidated Law on Finance, which provides some specific rules for portfolio management service:

- the client may issue binding instructions with regard to transactions to be performed;

- the client may withdraw from the contract at any time, without prejudice to the right of withdrawal by the investment company, asset management company or bank pursuant to Art. 1727 of the Civil Code;
- the power to exercise voting rights in relation to financial instruments under management may be conferred upon an investment company, bank or asset management company by means of proxy granted in writing for each shareholder's meeting in observance of the limits and procedures established by regulation by the Minister of the Economy and Finance, after consulting the Bank of Italy and the Consob.

Agreements in conflict with the provisions of this Art. shall be null and void, nullity may be enforced only by the client.

Art. 24 of the Consolidated Law on Finance provides for the general characteristics of the portfolio management service, which are further specified in Art. 38 of the Consob Regulation on Intermediaries. Such provision indicates in detail the elements that the contract with retail customers relating to portfolio management shall contain, in addition to the general content provided for all investment services. In particular, such contract shall:

- indicate the types of financial instruments that may be included in the customer portfolio and the types of operation that could be performed on such instruments, including any limits;
- indicate the management objectives, the level of risk within which the manager may exercise his discretion and any specific restrictions to said discretion;
- indicate whether the customer portfolio may be characterised by a leverage effect;
- provide the description of the reference parameter against which the customer portfolio yield shall be compared;
- indicate whether the intermediary delegates execution of the assignment to third parties, specifying details of the relevant powers delegated;
- indicate the method and frequency of assessment of the financial instruments contained in the customer portfolio.

The contract shall also specify the intermediary options to invest in financial instruments not admitted for trading on a regulated market, in derivatives or illiquid or highly volatile instruments; or to proceed with

short sales, purchases using borrowed sums of money, financial transactions through securities or any transaction involving the payment of margins, guarantee deposits or exchange risk.

In addition to deciding which securities to purchase or sell, the intermediary must also trade them. It may take steps to do so alone, or transmit the orders to another authorized intermediary. In any event, it will have to apply every measure for achieving the best possible result.

In order to allow the client to check the result of the management activity, the intermediary must send – at least every six months and in hard copy – the report on the management activities. This report indicates:

- the securities contained in the portfolio and their valuation;
- the cash balance at the beginning and at the end of the period;
- the total of the costs payable by the client with indication of the individual items (upon request, the intermediary will have to provide an even more detailed recapitulation);
- the return achieved in the period compared with that of the reference parameter;
- the amount of the dividends, interest and other payments received in the period;
- the details of the transactions carried out in the period. In particular, the day and the time of execution, the type of order, the execution venue, the quantity, the unit price and the total price will have to be communicated. This information, upon the request of the client, can be provided as and when for each individual transaction;
- the rights conferred by the portfolio securities (for example, the right to take part in the general shareholders' meetings in the case of shares, or the right to acquire securities in the case of convertible bonds, etc.).

The rule is that the report should be sent every six months. In some cases, it is by contrast forwarded:

- every three months if the client expressly requests this;
- at least once a month if the contract with the intermediary authorizes the management of a portfolio characterized by leverage;
- at least every twelve months if the client has also asked to receive the information from time to time on the individual transactions carried out by the manager.

According to Art. 25, para. 5 of MiFID II, reporting must be in a durable manner and must include periodic communications taking into account the type and complexity of the financial instruments involved and the nature of the service provided as well as the associated transaction and service costs. In addition, the periodic report for the portfolio management service must contain an updated suitability statement.

3.5.2 Leverage and benchmark

Before the implementation of MiFID in the Italian legislation, the previous Consob Regulation on Intermediaries (the Consob Resolution no. 11522/1998) defined in detail the single elements of portfolio management service (for example, “financial instruments”, the types of “transactions”, etc.) while the matter is now left to the parties’ contractual autonomy.⁷ Such concept and categories can, however, continue to be used but on voluntary basis and provided that the contract contains a definition and a regulation for them.

In particular, this can be useful in order to identify the scope of notions which, also if used in the new legislative framework, are not more specifically defined, as is the case, for example, with reference to “leverage effect”. The concept of “financial leverage”, in the legislative framework prior to the implementation of MiFID, was expressly defined in the Consob Regulation on Intermediaries no. 11522/1998 while the new rules do not give any definition: nothing prevents that the old definition is covered by the portfolio management contract, as well as nothing prevents the contract to provide its own specific definition of that element. In any case, if the portfolio manager can make use of the leverage (and consequently is able to bind the assets managed also for values higher than the equivalent of the assets, thus increasing the portfolio’s exposure to the risk of losses), this element needs to be indicated in the contract.⁸

Compared to the previous rules, a significant change occurred after the implementation of MiFID with reference to the “benchmark”: the abrogated Art. 42 of Consob Regulation no. 11522/98 provided that “for the purpose of defining the characteristics of a management account, the intermediary shall indicate a benchmark to the investor that is consistent with the risks associated with the account against which to compare the results of the account” and that “such benchmark must be based on financial indicators produced by third parties and in common use”. Furthermore, Consob Regulation no. 11522/1998 considered the benchmark a central element in the definition of “management features”.

The wording of the new provisions is different: the benchmark shall only be provided where significant (depending on the characteristics of the portfolio management) and in each case only in order to “compare” the yield of the portfolio.

If provided, it is thus confirmed that the benchmark is an indicator whose function is to allow the investor to compare the activities carried out by the portfolio manager with the performance of an external parameter. It has consequently to be excluded that the indication of the benchmark in the portfolio management contract modifies the nature of the obligations undertaken by the intermediary which provides the portfolio management service: in other words, the benchmark is not a parameter whose trend the manager is required to match or even beat; nor, symmetrically, it may be considered that the manager incurs a liability by the mere circumstance to have achieved, in a given period, a result lower than the benchmark itself. This conclusion, which was already inferred in the legislative system previously in force, *de plano* now descends from the new wording of the provisions on portfolio management service.⁹

3.6 Investment advice

3.6.1 Inclusion of investment advice among investment services

MiFID expanded the scope of regulated investment services by making investment advice one of the core investment services and activities. The significance of this change is that a firm whose sole business is to provide investment advice will need to be authorized as an investment firm. Under the Investment Service Directive (Directive 93/22/EU), investment advice was a non-core service, and it was therefore a matter for each Member State to decide whether to regulate it (for example, in Italy investment advice was not regulated as an investment service). As a result of the changes brought about by MiFID, investment advisers will be better placed to take advantage of the EEA passport.¹⁰

There was debate and a degree of concern for some time about the Level 2 Implementing Measures which would define more precisely the nature of investment advice. In particular, there was much discussion about whether generic recommendations should be included in the definition (for example, a recommendation to invest in shares rather than bonds). However, in its Level 2 Implementing Measures, the commission adopted the advice of Committee of European Securities Regulators (CESR), framing the definition of investment advice in terms of a personal recommendation to deal in a particular financial instruments.

In accordance with CESR and European Commission's guidelines, investing advice service is defined by Art. 1, para. 5-septies, of Consolidated Law on Finance as the "provision of customised recommendations to a customer upon request or as an initiative by the service provider, regarding one or more transaction on an identified financial instrument. The recommendation shall be customised when it is presented as suitable for the customer or is based on consideration of the customer's characteristics. A recommendation shall not be customised if disclosed to the public through distribution channels".

In Italy, until the implementation of MiFID, investment advice was considered an ancillary service and could be exercised without authorization. In fact, the Legislative Decree no. 415 of 23 July 1996 ("Eurosime Decree") and the pre-existing formulation of Consolidated Law on Finance, provided that any natural or legal person could act as an investment adviser without prior authorization. Currently, natural or legal persons who performed investment advice before the implementation of MiFID rules can continue to provide such service without the need of an authorization provided that such service is carried out on an independent basis.

As mentioned, according to MiFID rules, as implemented by Consolidated Law on Finance, investment advice is an investment service where the adviser, upon his or her own initiative or on the request of the client, provides personalized advice or recommendations regarding one or more transactions relating to a specific financial instrument. Personalized advice and recommendations means that these are presented as adapted to the client or based on their characteristics. Recommendations and advice targeted at the public by means of the mass media (newspapers, television, internet, etc.) are therefore not advisory services.

Furthermore, the recommendations and advice must suggest the purchase, sale, exchange or maintenance of a specific financial instrument.

Those suggestions which the intermediaries normally provide that are not associated with a specific financial instrument but a type of financial instrument or the composition of a portfolio do not represent investment advice in a strict sense, but rather general advice. These activities can be a preparatory and instrumental moment for all the investment services (and especially advice in the strict sense) and the intermediaries, in providing them, must observe the rules envisaged for the service which they are offering.

Advice in the strict sense ensures an elevated degree of protection because it places the professionalism of the adviser at the service of the

investor, an adviser who will suggest only transactions deemed suitable, also undertaking responsibility for the same. In addition to assessing the suitability, the adviser will have to provide the client with all the information necessary for avoiding or correctly handling the conflicts of interest.

According to the Consob's view, a link between the provision of the advisory service and the provision of other services (order execution, reception and transmission or placement) can be found, in the sense that whomever, for example, executes the client's order also provides them with the advisory service.

An important aspect of the advice is the relationship that links the adviser to the company that issues the products he or she recommends. In fact, it may occur that the party which provides the advice is the issuer of financial instruments (or other companies in the same group are): for example, a bank belonging to a group which a mutual fund management company also belongs to. It may also occur that the adviser receives incentives (under the form of payments, fees or non-monetary benefits) from the company which issues the advised products.

In such situations – which the adviser must handle correctly and which it must inform the client of – the investment advice cannot be deemed to have been provided independently. On the contrary, independent advice is provided when the financial adviser works independently for their clients rather than representing an insurance company, bank or bankassurer.

3.6.2 “Independent” investment advice vs. “non-independent” investment advice: MiFID II provisions

Before the adoption of MiFID II, the European Commission put forward a number of proposals regarding the provision of investment advice. Some of these proposals appeared to pick up themes which were familiar to a UK audience as they were very similar to those which run through the FCA's Retail Distribution Review (RDR) regime.

In particular, under the RDR rules, effective in the UK from 31 December 2012, firms offering financial advice to retail clients on a retail investment product have to:

- stop receiving commission payments from product providers. Instead, they must agree their fees with their clients before providing investment advice. This is to prevent the perception that the adviser could be biased by the amount of commission a product pays and, therefore, recommends this product over another;

- describe their services as either “independent” or “restricted”. Advisers who hold themselves out as independent in the broadest sense have to offer advice on all suitable retail investment products from the whole of the market. Restricted advisers are those who only offer advice on selected products or from selected providers; and
- meet high standards of professionalism and expertise similar to lawyers and accountants. This is achieved through recognised qualifications, continued professional development and a code of ethics, among others.

In October 2011, the European Commission published its proposed amendments to MiFID. Similar to the RDR, these proposals also seek to improve investor protection.

However, the MiFID II proposals differed in one significant respect. Whereas the RDR bans all advisers (i.e. those offering “independent” and “restricted” advice under RDR) from receiving commission or other benefits from third parties, the original MiFID II proposal only sought to apply such a ban on independent advisers. This left open the possibility that non-independent advisers could continue to receive such commissions.

Some Member States argued that a ban on commission from third parties would limit the freedom of choice of ordinary investors and make financial advice unaffordable for those who need it most. Others were pushing for bans similar to those imposed by RDR. These Member States argued that the partial ban on independent advisers only will simply lead to firms ensuring they do not offer independent advice. This will be detrimental to investors and will not overcome the existing problems which these amendments are designed to stamp out. However, with the exception of the Netherlands, which has taken a similar approach to the UK, most other European jurisdictions waited for the publication of the final MiFID II text before proposing any changes to their national legislation.

In a draft report published in March 2012,¹¹ Markus Ferber, the European Parliament rapporteur on MiFID II, said that he was not in favour of distinguishing between investment advice which is “independent” and that which is not. This is in direct opposition to the position under the RDR which labels advice as “independent” or “restricted”. Ferber considers that this distinction could mean that any advice which was not “independent” carried with it a negative connotation. Instead, he opts for more neutral wording and an enhanced disclosure regime.

On 11 October 2012, the European Parliament's Economic and Monetary Affairs Committee (ECON) published a report containing its proposed changes to MiFID II. ECON's report also favours enhanced disclosure to the client, rather than an outright ban on third-party inducements. Its proposal would also allow Member States to prohibit or further restrict the rules on third-party inducements; a process known as "gold plating". This gold plating would also allow Member States to impose obligations on independent advisers which would require them to consider a sufficiently large number of investment products or financial instruments from the market to ensure that the client's investment objectives can be suitably met; a position similar to the RDR rules for "independent" advisers.

The European Council took a different approach to the European Parliament. In its revised draft of MiFID II published on 28 September 2012, the council retained the notion of "independent" advice. Where "independent" advice is given, the firm must assess a range of products and not accept third-party inducements. This position is more in line with the European Commission's original MiFID II proposal and the RDR. However, the council's compromise proposal still leaves open the possibility of non-independent advisers being able to accept third-party inducements.

The final text of MiFID II, published on the Official Journal on 12 June 2014, provides (Art. 24) that when a firm gives investment advice it must inform the client in good time before the advice is provided:

- whether the advice is provided on an independent basis or not;
- whether it is based on a broad or more restricted analysis of different types of financial instruments and, in particular, whether the range is limited to financial instruments issued or provided by entities: (i) having close links with the investment firm; or (ii) any other legal or economic relationships, such as contractual relationships, so close as to pose a risk of impairing the independent basis of the advice provided; and
- whether it will provide the client with a periodic assessment of the suitability of the financial instruments recommended to clients.

In order to strengthen the protection of investors and increase clarity to clients as to the service they receive, MiFID II provides to further restrict the possibility for firms to accept and retain fees, commissions or any monetary and non-monetary benefits from or to third parties, and particularly from issuers or product providers, only when providing the

service of investment advice on an independent basis. However, minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair compliance with the investment firm's duty to act in the best interest of the client should be clearly disclosed and are excluded from this provision.

Finally, MiFID II provides that where an investment firm informs the client that investment advice is provided on an independent basis, the firm shall assess a sufficient range of financial instruments available on the market which should be sufficiently diverse with regard to their type and issuers or product providers to ensure that the client's investment objectives can be suitably met and should not be limited to financial instruments issued or provided (i) by the investment firm itself or by entities having close links with the investment firm or (ii) other entities with which the investment firm has such close legal or economic relationships, such as contractual relationships, as to pose a risk of impairing the independent basis of the advice provided.

3.6.3 Italian rules on independent investment advice

Arts 18-bis and 18-ter of Consolidated Law on Finance provide rules for independent financial advisers and financial consulting companies. In particular, it is provided that "the reservation of activities pursuant to Art. 18 shall not prejudice the opportunity for natural persons in possession of the requirements of professionalism, integrity, independence and equity established by regulation adopted by the Minister of the Economy and Finance, after consulting the Bank of Italy and the Consob, and entered on the register pursuant to subsection 2, to provide advisory services on investment matters, without holding sums of money or financial instruments pertaining to customers" (Art. 18-bis, para. 1) and that "with effect from 1 October 2009, the reservation of activities pursuant to Art. 18 shall not prejudice the opportunity for public limited companies or private limited companies in possession of the requirements of equity and independence established by regulation adopted by the Minister of the Economy and Finance, after consulting the Bank of Italy and the Consob, to offer consultancy services on investment matters, without holding sums of money or financial instruments pertaining to customers" (Art. 18-ter, para. 1).

In addition, the Consolidated Law on Finance provides that the Consob shall determine by regulation the principles and criteria relating to various issues, including "the conduct rules to be followed by persons

registered in their relations with customers, with due regard to the provisions to which licensed parties are subject” (Art. 18-bis, para. 7).

The Minister of the Economy and Finance issued the Ministerial Decree no. 206 of 24 December 2008, implementing Art. 18-bis of Consolidated Law on Finance, which provides the requirements of professionalism, integrity, independence and capital for enrolment of individuals as financial advisers, and Ministerial Decree no. 66 of 5 April 2012, implementing Art. 18-ter of Consolidated Law on Finance, which regulates the capital and independence requirements for financial consulting companies, as well as the requirements of professionalism, integrity and independence for members of government bodies of financial consulting companies.

However, it has not yet been issued the implementing regulations governing the register of independent financial advisers and financial consulting firm and their supervisory body: the Consob published said regulations in draft form in order to submit it to consultation. As a result, the register and the supervisory body of independent financial advisers have not yet been established.

Until the establishment of the register and the supervisory body, the natural or legal persons that, as of 31 October 2007 were providing investment advice may continue to provide such service in an independent way and without holding money or securities belonging to customers.

The conduct rules that the consultant must follow in providing service to his customers and the incompatibilities are indicated in Consob Regulation no. 17130/2010 (Implementing Regulations of Articles 18-bis and 18-ter of Legislative Decree no. 58/1998 relating to financial advisers and financial consulting companies).

Among the important topics of the regulation, we point out:

- the notion of independence;
- the system of technical and administrative requirements which must be observed by the consultant in providing the service.

The principle of independence is explained in a rigorous way by Ministerial Decree no. 206 of 24 December 2008, by Ministerial Decree no. 66 of 5 April 2012 and by Consob Regulation no. 17130/2010. In particular, it is provided that:

- in the provision of investment advice service, financial advisers and financial consulting companies may not receive any form of benefit from anyone other than the client to whom the service is rendered;

- financial advisers and financial consulting companies cannot be registered if they entertain, directly or indirectly, on behalf of third parties, or through third parties, economic, financial, contractual relations or relations of different nature, with issuers and intermediaries, with such companies' subsidiaries, controlling or under common control, with the shareholder or group of shareholders who control those companies or directors or officers of such companies, if such relations may affect the independence in the provision of investment advice; advisers must act in the clients' interest, and when the organisational measures adopted for the management of conflicts of interest with clients or between clients are not sufficient to ensure that the risk to harm the interests of the clients be avoided, they must clearly inform them, before acting on their behalf, of the nature and/or sources of conflicts so that they can take an informed decision on the service provided, taking into account the context in which conflict situations occur;
- the activities of the independent adviser is incompatible with all the financial and insurance activities performed by individuals, as well as with each additional task or activity which is in serious contrast to its orderly conduct.

With reference to the incompatibilities regime, Art. 13 of Consob Regulation no. 17130/2010 states that "the business of an independent financial adviser is incompatible with: (a) the activity of financial salesman; (b) the activity of stockbroker; (c) the activity of insurance brokerage referred to in Art. 109, para. 2, letters (a), (c) and (e) of Legislative Decree no. 209 of 7 December 2005; (d) with the business of agent in financial activity referred to in Art. 3 of Legislative Decree no. 374 of 25 September 1999 and (e) with each additional task or activity which is in serious contrast to its orderly conduct".

With regard to the technical and administrative requirements, Consob Regulation no. 17130/2010 provides that independent financial advisers must, among other things:

- provide customers with a comprehensive pre-contractual information concerning the advisory activity which they intend to provide to customers as well as the characteristics and risks of the financial instruments;
- establish a contractual relationship with customers in writing, to include, *inter alia*: (i) whether or not the customer must notify the adviser the transactions on financial instruments he or she

actually run between those the consultant has recommended; (ii) the frequency and content of the documentation to be provided to the client to report on the activities carried out;

- obtain from the customer information on his or her experience, knowledge, financial situation, investment objectives, in order to recommend suitable investments;
- send to customers a periodic statement of performed activity with the content and the frequency indicated in the contract;
- keep for five years, for all the recommended transactions, adequate and orderly records of his activities, such as to allow the verification of fulfilment of his or her obligations and, in particular, of the conduct rules toward customers.

3.7 Management of multilateral trading systems

3.7.1 General rules

According to MiFID, a multilateral trading facility is a multilateral facility operated and/or managed by an investment firm or market operator “[...] which brings together multiple third-party buying and selling interests in financial instruments [...] in a way that results in a contract in accordance with the provisions of Title II [of Directive 2004/39/EC-MiFID]”. In the same way, the Consolidated Law on Finance defines “management of multilateral trading facilities” as the “[...] management of multilateral facilities that allows, in the system and in accordance with non-discretionary rules, the meeting of multiple third-party buying and selling interests in financial instruments, so as to generate contracts (Art. 1, para. 5-octies)”.

The management of multilateral trading facilities is an investment service which makes it possible to match purchase and sale proposals originating from numerous operators, on the basis of pre-established rules.

The multilateral trading facilities are similar to organised markets with the difference that they can be managed not only by organised market management companies but also by asset management and investment firms and banks authorised to provide this service.

The authorised parties must observe specific requisites and rules in order to guarantee a fair, orderly and transparent trading process vis à vis the users and inform the Consob of a series of information relating to the parties and the instruments admitted for trading, the operating rules of the systems and the supervisory regulations adopted in order to ensure the orderly performance of the trading.

It is, nevertheless, a service which is not normally provided “directly” in favour of the investor (in that it is requested by or proposed to the latter). From the point of view of the investors, the multilateral trading facility is nothing more than one of the trading venues which the intermediary/executor of orders uses for the purpose of achieving the best possible result for the clients.

3.8 Ancillary services

3.8.1 General rules

The parties authorized to provide investment services can also provide the following ancillary services:

- custody and administration of financial instruments;
- rental of safety deposit boxes;
- granting of loans for carrying out transactions relating to financial instruments in which the party who grants the loans takes part;
- advice to businesses concerning financial and industrial structure and regarding the merger and buy-out of businesses;
- services associated with the issue or the placement of financial instruments;
- investment research, financial analysis or other forms of general recommendation regarding financial instruments;
- trading intermediation associated with the provision of investment services.

In order to provide ancillary services without providing investment services no authorization is required, and therefore, parties not authorized to provide investment services can also provide such services. If, however, these services are provided by authorized intermediaries, the latter must observe the rules of conduct envisaged for investment services.

3.8.2 Investment research, financial analysis and general recommendations

MiFID introduced a new ancillary service – investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments.

MiFID provides that a firm solely carrying on these activities (and/or providing other ancillary services) cannot be authorized as an investment firm. Whether any of the activities are regulated in a Member State will be a matter for domestic legislation.

Where an investment firm, authorized to carry on one or more investment service or activity, is also authorised by the home Member State to provide investment research or other general advice, then those ancillary services may be carried on throughout the EEA pursuant to the MiFID passport. This should make it easier for a firm to distribute investment research.

“Investment research” is defined in the Level 2 Implementing Measures as material which, while falling short of constituting investment advice, amounts to a recommendation or suggestion of an investment strategy concerning financial instruments or issuers and is intended for “distribution channels” or for public dissemination (Art. 24, para. 1, Level 2 Implementing Directive).

Where a firm produces investment research, it has to take measures to secure the independence of the financial analysts concerned, and include provisions in relation to personal account trading, inducements, relationships with issuers covered by the research and the partiality of others involved in internal review of the research.

3.9 Conclusion

The final version of MiFID II contains a number of significant changes to the investor protection regime. The new rules will affect the entire lifecycle of investment products and services. The design, marketing and distribution of products by investment firms must be tailored to the target market. Firms must understand the products they sell and ensure that they are appropriate for the client. Remuneration and sales targets should not incentivise staff to recommend inappropriate financial instruments to retail clients.

The post-MiFID II “tuning measures” that will be introduced across EU financial markets will also alter the shape of financial markets in Europe. As well as presenting new and additional responsibilities that will change securities transactions, they are also expected to create new commercial opportunities for financial institutions and service providers. Financial institutions are stating more frequently that, in reality, change will only occur as a result of regulation, and investment firms often propose the need for a regulatory approach to industry change. The operational changes that will result from these regulatory changes will require different services and IT infrastructures to those that many financial institutions rely on today.

We hope that the new operational and procedural framework that investment firms will be required to adopt in accordance with the rules

of MiFID II will lead to an enhancement of the investors' protection as well as to the discovery of new business opportunities for investment firms and service providers.

Notes

1. The Legislative Decree no. 164/2007 amended many parts of the Legislative Decree no. 58 of 24 February 1998 ("Consolidated Financial Act").
2. Such regulation has not yet been issued, so no further ancillary services have to be added to the list provided by the Legislative Decree no. 58/1998.
3. F. Annunziata, "La disciplina del mercato mobiliare", Giappichelli, 2012.
4. The Consob – Divisione Tutela del Consumatore, "I servizi di investimento", October 2012.
5. See Art. 41–42 of the Consob Regulation on Intermediaries.
6. See Art. 42, para. 2, of the Consob Regulation on Intermediaries.
7. R. Costi, "Il mercato mobiliare", Giappichelli, 2012.
8. Financial leverage was defined by previous Consob Regulations on Intermediaries no. 11522/1998 as "the ratio of the market value of the net positions in financial instruments and the value of the assets entrusted for management, calculated using the methods established for the quarterly reports referred to in Annex 5". This definition gave room to various interpretative doubts also with reference to the method to calculate the leverage.
9. F. Annunziata, "La disciplina del mercato mobiliare", Giappichelli, 2012.
10. Under the ISD, investment advice was a non-core service which could be passported only by an investment firm authorized for one of the core ISD investment services.
11. European Parliament – Committee on Economic and Monetary Affairs, *Draft Report on the proposal for a directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (recast)* (COM(2011)0656 – C7–0382/2011 – 2011/0298(COD)), 16 March 2014.

4

Collective Portfolio Management

Valerio Lemma

4.1 Introduction

The interest for a legal analysis of collective portfolio management arises from both the quantity of money which flows in its circuits, and the flexibility of its (European and Italian) regulatory framework.

On an economic base, it is important to highlight that, by managing almost €6 trillion in assets, undertakings for collective investment in transferable securities (UCITS) account for around 75 per cent of all collective investments by small investors in Europe.¹

With regards to legal aspects, the regulatory system provides an advanced system and several criteria for the organization of the management companies (SGR) and for the activity of the investment funds. This is the result of the integration between a clear legislative framework and the wide freedom of self-regulation left to the managers. This is the goal reached by the Legislative Decree no. 44 of 2014, which has clarified some of the most-debated problems.

On these bases, we can analyse the collective portfolio management legal framework having regard not only to the Italian consolidated law on finance (Legislative Decree no. 58 of 1998), but also to the specific rules governing each investment fund. These “fund’s rules”, as we will see, have been set by the asset management company, approved by the supervising authority, and signed by the participants (i.e. the investors who had subscribed the quotes of a fund).

This paper analyses this framework to understand if it aims to protect the savings by also reaching the goal of adding value to financial industry through the activity of a professional manager (the SGR).

4.2 Historical evolution

4.2.1 Development of the regulatory framework

The Italian social and economic evolution shows, since the sixties, the need for a new view in savings' investment. There was the need to go beyond the bank's monopoly in its management.² After more than a decade of vain attempts, the adoption of law no. 77 of 1983 set the rules for managing an open investment fund (i.e. *fondo mobiliare aperto*). The Italian legislation entrusted the management of these funds to a limited company with this only special corporate purpose (*società per azioni ad oggetto sociale esclusivo*).

In this context, the freedom of the individuals is the foundation of the Italian investment model. It allows the free choice of both the management company and the investment policy by any single investor. This is why it is known as "conscious investment".

In particular, the above-mentioned Italian law no. 77 of 1983 applies well-known international models. These models have been developed by Anglo-Saxon capitalism experience. The same is for the European regulation made by Directive no. 85/611/EC on the "coordination of laws, regulations and administrative provisions relating to UCITS".

Afterwards, in the following years, the Italian legislator supported the development of the collective portfolio management industry fixing the paradigms of (i) the specialization of the manager and (ii) the choice of reserving this activity (with laws no. 344 of 1993 and no. 86 of 1994, the first on closed investment funds, *fondi mobiliari chiusi*, and the second on real estate funds, *fondi immobiliari*). There was also a link between the management company (*società di gestione*) and the typology of managed funds.³

In the nineties, the Directive 95/26/EC had strengthened the prudential supervision on the financial markets, going one step further in the regulation of this industry. In fact, there had been the adoption of the Italian consolidated law on finance (Legislative Decree 58 of 1998), where there is a chapter on collective portfolio management. In this text, there is the regulatory framework of a new entity, the *Società di gestione del risparmio* (SGR), described as the only company qualified for providing this special service.

Subjects, activity and management tools are the pillars of the new legislative framework. In particular, the Legislative Decree no. 58 of 1998 confirms that the collective portfolio management shall be reserved only

to the above-mentioned special company (today set by Arts 32 *quater* e 33, Legislative Decree no. 58 of 1998).⁴

There are also legal barriers to enter in this industry: the authorization to the asset management companies to provide the collective asset management service (Art. 34 of Legislative Decree 58 of 1998), the admission to a special register (Art. 35 of Legislative Decree 58 of 1998) and the duty to self-organise the corporate governance to reduce the risk of conflict of interest (among the company and the investors).

To summarize, the Italian consolidated law on finance 1998 since promotes a professional management able to act with diligence, accuracy and transparency. This is aimed to protect the interests of UCITS, their investors and the integrity of the market (according to the provision of Art. 35 *decies* of Legislative Decree 58 of 1998).

We must point out that this legislative framework has been specified by “general criteria” set by the Italian Minister of Economy and Finance, in line with the provisions of Art. 39 of Legislative Decree 58 of 1998.

Under the Legislative Decree 58 of 1998, there are domestic regulations that complete the regulatory framework. These regulations set the technical aspects able to protect the safe and sound management of the money transferred to the above-mentioned asset managers.

This is why it is important to consider the regulation on collective portfolio management made by the Bank of Italy (*Regolamento sulla gestione collettiva del risparmio, Provvedimento della Banca d'Italia*) and the joint regulation made by the Bank of Italy and the Consob (on the organisation of collective investment management service providers).⁵

With regard to the organisational structure of Italian UCITS, we must take into account that the above-mentioned regulations leave to the SGR a wide range of possibilities in choosing the contents of the “fund rules” (i.e. *Regolamento del fondo*), according to the provision of Art. 37, Legislative Decree 58 of 1998. In other words, the management company can set up the organization and the investment policy of the fund. This freedom is the final step of a self-regulation process that – given the authorisation of the Bank of Italy – leads the providing of collective portfolio management service.

Therefore, we deal with a complex regulatory framework. There are externalities that influence the supply and the demand of these services, and then there are effects on the process by which the market price for an asset is determined. This is why the outcome of its legal and economic analysis could be related to both the bilateral relations between manager-investor, and the market flows.

4.2.2 Evolution of the asset management companies and of the investment funds

In the first legal framework set by the above-mentioned law no. 77 of 1983, the differentiation of the asset management companies was an effect of the required exclusivity of the corporate purpose (restricted to the collective portfolio management). Whence, the law provisions on two types of asset management companies: the first specialized in finance (and then in *fondi mobiliari*), the second in real estate investments (and then in *fondi immobiliari*, introduced by law no. 86 of 1994).

Only under the Legislative Decree no. 58 of 1998, in fact, a new type of asset manager had been introduced, the SGR, described as a company able to provide all the services related to collective portfolio management.⁶ Moreover, any choice about its specialization was deferred to the management of the SGR.⁷

At a later stage, the regulatory framework admitted other entities to the collective portfolio management industry. This opening arises from the asymmetric evolution of the European legislation.

Hence, it is important to point out the Italian definition of “EU management company” (*società di gestione UE*), referred to a company authorized according to the provisions of Directive 2009/65/EC in any Member State other than Italy, the regular business of which is the management of UCITS in the form of common funds or of investment companies (collective portfolio management of UCITS).

Furthermore, there is the Italian definition of “EU Alternative Investment Fund Manager”, which is a legal persons whose regular business is managing one or more AIFs under the provisions of Directive 2011/61/EU in a Member State other than Italy, and of “Non-EU Alternative Investment Fund Manager” whereas the company is not incorporated in any EU Member State.

These are the effects of the European response to the financial crisis, taken to prevent a complete collapse of the European internal market of collective portfolio management. In particular, the EU authorities tried to strengthen the supervision on the shadow banking system, where the management of a significant amount of invested assets were placed. Moreover, the EU legislative bodies had understood how the activities of “Alternative Investment Fund Managers” may also serve to spread or amplify risks through the financial system.

However, these regulatory actions must be consolidated into the traditional European legal framework because there is the need of preserving the quality of the regulation governing the financial markets. Hence, we

must expect a general review of the directives concerning the collective portfolio management in order to harmonise (and standardise) the rules concerning the asset management companies.

From another perspective, we must dwell on the instruments useful to provide the collective portfolio management services.

Under the first regulatory framework, the Italian industry was characterised by the open financial funds (*fondi immobiliari aperti*, under the provisions of law no. 77 of 1983) and then other types of closed funds (by law no. 344 of 1993) and real estate investment funds (by law no. 86 of 1994).

Even in this case, the adoption of Legislative Decree no. 58 of 1998 sets the centrality of the fund (UCIT), and so it simplifies the relevant legal framework. It is important to highlight the option for a de-legislative process, which defers to the Ministry of Economic and Finance, the duty (and the power) to set up the available types of funds and their functioning characteristics. Hence, the possibility of open funds (harmonized or not), closed funds, real estate investment funds and reserved, guaranteed or speculative/hedge funds.

Furthermore, the recent evolution of the European legal framework has extended the tools of collective portfolio management, providing – in addition to the above-mentioned Italian funds – UCITS and AIF, besides “EuVECA” (in relation to a qualifying venture capital fund in the union, under the EU Regulation no. 345 of 2013) and the “EuSEF” (on European social entrepreneurship funds, under the EU Regulation no. 346 of 2013).

In another perspective, we must also take into account the “Sicav” and the “Sicaf”, defined by the Italian legislator as open- or closed-ended UCITs, incorporated under the form of a joint stock company, with variable of fix equity and with the exclusive purpose of the collective investment of the assets raised by the offer of their own shares (Art. 1, letter i e i-bis, Legislative Decree 58 of 1998).

In conclusion, there is a multifactorial legal order. As we have seen, it comes from the difficulties in the development of a European regulatory action aimed to face the problems arisen from the financial crisis.

We gather from this the need of a new European action plan to consolidate the above-mentioned EU directives and, more in general, to reorganize the legislative framework. This plan must set up an efficient and rational legal base, because this industry needs to take an economic advantage from a new and more efficient level playing field.

4.2.3 Recent reforms

As aforesaid, the evolution of EU internal market influenced the development of Italian legislation on collective portfolio management industry. In particular, there had been the impact of the European regulatory framework, which was aimed to deliver stable, secure and efficient financial markets and ensure coherence and consistency between the different policy areas, such as banking, insurance, securities and investment funds, financial markets infrastructure, retail financial services and payment systems.⁸

It is helpful to point out the impact of the Directive 2004/39/EC, named MiFID and the new perspectives opened by Directive 2014/65/EU, named MiFID 2. Italian national authorities had to adapt their laws to meet certain end results that must be achieved in every Member State. This had been done firstly by the Legislative Decree no. 167 of 2007, which changed the corporate governance of SGR, launching the duty to adopt “all reasonable measures and implement effective mechanisms to achieve, where orders on financial instruments on behalf of managed UCITS are to be executed, the best possible result”. Obviously, this duty refers to price, cost, speed and probability of execution and settlement, to the size and nature of the order, or any other consideration relevant to its execution (Art. 68, Regulation Consob no. 16190 of 2007).⁹

In this context, it is important to highlight that the Directive 2014/65/EU, acting in accordance with the ordinary legislative procedure, has reviewed and recast the above-mentioned Directive 2004/39/EC to strengthen the weaknesses in the functioning and in the transparency of financial markets. However, this directive did not extend its provision to UCITs or their management companies, but it limits to set up the duty of cooperation between authorities for the supervision of the latters (Arts 11 and 68). Therefore, there is still an open question, regarding the regulatory path to satisfy the need for a competitively set up of the collective portfolio management industry.

Additional changes adapted the Italian regulation to the provision of Directive 2007/16/EC (named “Eligible assets”). Given the variety of financial instruments traded on financial markets (and its considerable increase), there was uncertainty in determining whether certain categories of financial instruments were encompassed by the definitions set by the European regulatory framework. This uncertainty was also in applying the definitions. It gives rise to divergent interpretations of the

European directives given by national authorities. This is why the need for clarification was particularly pressing for investment funds.

Furthermore, we need additional legal certainty with regard to the categorisation, as transferable securities, of financial instruments which are linked to the performance of other assets. Hence, the clarification of the reliable valuation of the risk diversification and its management procedures (with regard also to exposures in financial derivatives, whose risks must be adequately captured by the risk management process of the UCITS, Art. 5, Directive 2007/16/EC).

We must focus our interest on the Directive 2009/65/EU and Directive 2011/61/EU. These pieces of European regulation made a reform taking into account the practical experiences of the financial crisis.

However, these directives do not make only a contingency plan to reduce the impact of the financial losses. On the contrary, they react to the *intrinsic unreliability* of certain financial instruments placed in the European internal market. In fact, there are specific rules on the accuracy of their structure, the transparency of capital market and, more in general, the efficiency in the price setting mechanisms.¹⁰

This is an attempt to adapt the UCITS legal framework to “the financial markets of the twenty-first century” (*Recital no. 2*, Directive 2009/65/EU). Both the directives (no. 2009/65/EU and no. 2011/61/EU), on the one hand, provide “common basic rules” for the authorisation, supervision, structure and activities of European funds and the information that they are required to publish. On the other hand, these directives allows each Member State to draw up rules of conduct which the management companies shall observe.

Furthermore, the Directive 2011/61/EU aims to provide for a harmonised and stringent regulatory and supervisory framework for the activities of all AIFs. This is why its scope should be without prejudice to UCITS, because the latter and AIFs are different both in the investment strategies they follow and in the type of investors for which they are intended. Therefore, the main goal should be the strengthening of the European supervisory mechanisms in order to take into account the systemic risk arising from the activities of all European asset management companies.

It is important to highlight that the Italian legislator adapted its legal framework to these new goals with Legislative Decree no. 44 of 2014, which sets up high standards for the supervision on the investment funds registered in Italy.

4.3 Subjects and tools

4.3.1 Management companies, in general

Asset managers and investors are the subjects that the Italian legislator took into account to regulate the collective portfolio management industry. The firsts promote, arrange and supervise the investments, receiving a payment from the seconds (named management fee). Hence, there is the need to control the organizational structure and supervise the activities of the management companies.

In addition to the above-mentioned subjects, there are other firms (banks, depositary and independent auditors), which perform control functions.

The foundation of the *connection* among these subjects is the investment fund, which must be considered as both the *instrument* to put all the stakes together and the *entity* that owns the assets and liabilities included in the collective portfolio management.

This is the reason why the Italian legislator specifies the concept of “asset manager” by distinguishing among SGR, Sicav and Sicaf (self-managed), EU management company, AIFM (EU or not), manager of a qualifying venture capital fund (for EuVECA) and manager of a qualifying social entrepreneurship fund (for EuSEF). This is not a distinction based on real different functions, but it originates from the above-mentioned, critical asymmetries in the EU regulatory framework.

Therefore, the collective portfolio management has been summarized in a new formula, whereby SGRs manage the equity and risks of the UCITs and they provide for the administration and marketing of the managed UCITs (Art. 33, Legislative Decree no. 58 of 1998). Moreover, on the one hand, the SGRs can both establish an investment fund (setting up its fund regulation) and manage the relations with the investors. On the other, they can invest the money raised accordingly to the fund's rules and policies.

Particular attention, in the outlined context, should be drawn to the previous legal provision about the definition of SGR, which showed very clearly the split between the organization of a collective portfolio and the management of its assets. Despite the above-mentioned Legislative Decree no. 44 of 2014 had rephrased the previous legal provision, this split has been confirmed, together with certain useful clarification on few critical points of this topic (see, paragraph C.3).

That said, we must also consider that the Italian legislation delegate to the secondary regulation the drafting of a legal model for the

management company. This model shall be able to relate all the requirements of a safe manager aimed to comply with the interests of the investors. It can be said, therefore, that the above-mentioned regulation on collective portfolio management made by Bank of Italy limits the autonomy of the persons who wants to establish an asset management company, providing them with a scheme that shows the business activity, its development guidelines, strategy and goals. In addition, other *conditionings* result from the authorization procedure and the close examination of the required report on the organizational structure (required by the Bank of Italy to authorise the SGR).

Then, comes into consideration the supervision activity, which is not a mere initial control, but it aims to verify – time to time – the presence of the conditions required for the initial authorization.¹¹

There is no doubt that the target of the provided service (i.e. the savings) and the area of business (i.e. the financial market) are the key elements of a pervasive regulation of the collective portfolio management. This is related to the well-known duty of protection that the Italian legal order charges to the Republic (Art. 47 of the Italian Constitution), but it refers also to the possibility that the law shall provide for appropriate programmes and controls so that public and private-sector economic activity may be oriented and coordinated for social purposes (Art. 41 of the Italian Constitution).

Finally, it is clear that the Italian regulatory framework does not aim to reduce the competition for raising private savings, but it tries to guide the investment process to a model which complies with the safeguard of the capitals, stability of the financial markets, and so with the maximization of social wellness.

4.3.2 Equity, capital adequacy and ownership of the management companies

In the Italian regulatory framework, the presence of the SGR is important to put in place the investment policies set by the “fund’s rules”. This is why there are specific rules concerning the capital adequacy of this company. In other words, the initial capital and an additional amount of own funds are required to ensure that these management companies will be able to fulfil any obligation arising from its activities.

It is clear that, also in the collective portfolio management industry, the setting of the equity of the SGR can be a form of selective safeguard, able to verify the economic relevance of the people willing to ask for the authorization to provide the above-mentioned services.¹² This provision is in line with the idea that equity can guarantee the companies’ stability and then financial markets’ safety.¹³

That said, we must consider that, underlying this system, there is also the qualifying examination of the shareholders, verifying if they can guarantee the safe and sound management of the SGR, given the *endowment* of an adequate capital. Hence, there are specific controls on the ownership, having regard both to the personal features of the shareholders and their group.¹⁴

In the context of prudential supervision, the balance sheet is the *unit of measure* of the business authorised to the SGR. In particular, the amount of the manageable funds and the possibility to run other risks are *multi- ples* of its financial position, in line with the Italian standard measure provided to reduce the risks in the capital markets. This is related both to the collective portfolio management and other services provided by the SGR in connection to it.

The European Authorities confirm the efficiency of this regulatory system with the adoption of the Directive 2009/65/EC. As we have already mentioned, the framework of the new European approach to collective portfolio management aims to ensure investor protection and the solvency of management companies, with a view to contributing to the stability of the financial system (*Recital no. 8*).¹⁵

After all, the Italian regulation of the collective portfolio management does not require that the initial capital and an additional amount of own funds will guarantee the performance of the managed investment funds. This regulation will ensure that the management company has a sufficient amount of money to perform its programme of operations and to set out, at least, its organisational structure.

Significant is, therefore, the calculation of the additional amount of own funds required to the SGR. That is the 0.02 per cent of the managed funds' volume (based on their accounting reports) and the 25 per cent of the SGR's fix costs (based on its P&L statement). Hence, these documents have a centrality in detecting the conformity of the capital adequacy to the business as well as in verifying the performance of the collective portfolio management.

Finally, it should be pointed out that the Italian regulatory system admits also an SGR with reduced-initial capital (named "SGR con capitale ridotto"). This is an option related to the possibility that the majority of the SGR's shareholders are entities qualified for their social relevance (i.e. universities, research centres, etc.). Furthermore, this kind of SGR shall perform a limited business, related to the management of closed-end funds (with initial asset value lower than Euro 25 millions).¹⁶ It is clear that the provision of a SGR with reduced-initial capital is an exception to the standard regulatory approach to the stability of the investment companies.¹⁷ In this case, the reduction of the amount of

initial own funds is related to the cost of the capital (higher than the one affordable by the above-mentioned shareholders).¹⁸

In this case, there is another opportunity for the collective portfolio management, whereby the application of its investment model will be able to support new firms that perform research activity or try to apply the result of the research to the production of goods.

4.3.3 Organizational structure: governance and internal controls

Going further in the analysis of the collective portfolio management, we must take into account the regulation and control on the strategy that the SGR will apply to manage its investment funds. The Italian regulatory framework requires that the shareholders choose a corporate governance model able to ensure the safe and sound management, following the interests of the participants.¹⁹

Going deep into the question, we must consider that the Italian legal order is based on the positive link between the need of high-quality corporate governance and the goal to safeguard the money invested in a bank, a corporation or any other special investment vehicle.

We must focus on the provision of Art. 36, Legislative Decree no. 58 of 1998, as it results after its modify made by the above-mentioned Legislative Decree no. 44 of 2014. The new text provided that the investment fund is managed by SGR in compliance with law and regulations, and that the SGR acts independently from the participants' will but in their interest. This is the reason why the law provides that the SGR assumes – towards these latters – the same obligations and responsibilities which arises from a mandate contract.

We can assume, then, that the body of directors of the SGR will be entrusted of enacting the investment and disinvestment policies of the managed funds, according to the provisions of the applicable fund's rules. This is the reason why there is a liability of the managers which can be actioned both by the shareholders (of the SGR) and the participants (to the funds).

Accordingly to this, we understand the importance of the internal control functions of the SGR, which performs audits both on the assets of the managed funds (and on the safety of the IT systems) and then on the flows of information (to the financial market and the supervising authorities). These audits will also verify the compliance of the SGR performance to the obligations owed to participants.

We must also take into account the question the allocation of the liabilities (and then how to find the money to repay the damages). It is

difficult to accept the following Italian precedent made by the Corte di Cassazione: the creditors of any obligation undertaken in the interest of a fund can get their money back from the SGR if the fund's asset are not sufficient to satisfy their request.²⁰

In fact, today, there are new and clear law provisions which states that the SGR can satisfy the obligations undertaken in the interest of a fund only with the fund's asset (Art. 36 of Legislative Decree no. 58 of 1998). This statement does not deny the possibility that there are obligation that the SGR must satisfy with its own assets, especially if there is an unfair management of the investment funds.

Undoubtedly, there is a greater involvement, than in the past, of corporate governance in the management of the risk and the sustainability of the way the SGR applies the funds' investment policies.

In that logic, it is justified the intervention of moral suasion indicated by the supervisory authority, which has suggested a scheme that SGR must fill in to show their statutory choices on its business venture, organisational structure (of the management and the account systems) and internal control function.

This scheme also advises the shareholders on the *desiderata* of the supervising authority. There is no doubt that we are in the presence of a piece of soft law aimed at supporting the transparency and the safety of management companies, and therefore the evolution of their business model towards more efficient organizational structures.

4.3.4 Participants

There are many reasons that can lead a person to turn to an SGR for the management of his assets (which, therefore, are given in a fund), trusting the peculiar professionalism of the action of the latter (which will have to manage it according to the guidelines set out in the fund's rules). If, originally, they appeared related to the interest of the participants (for the investment of their savings in conscious ways and in coherence with the policies established in the regulation), today other reasons come into consideration.

We are referring, in particular, to the possibility to assign a given set of assets (including through the establishment of a "family fund") to use the investment fund to separate a mass of assets from the participant's estate (in the case of fund vehicles) or to take advantage of the mechanisms under consideration to finance the development of companies with high potential or with social impact (in the case of EuVECA and EuSEF); this, of course, with the awareness of being able to benefit from a favourable tax regime.²¹

It is clear that, in the system outlined by the existing legislation, will and interests are summed up in such a specific role of the participants, which – as we shall see – is between investment and management (although, if we consider, the legislation establishes the prevalence of first profile, limiting the administrative activities allowed to participants).

In addition, it should be considered that the participation to the fund identifies a complex legal situation, in which a unique interaction between the asset and liability positions (which are part of the participants) is determined, arising from the specifications contained in the regulation of each fund (Arts 36 and 37, Legislative Decree no. 58 of 1998).

Hence, there is an organizational flexibility that, if on the one hand, appears to be in line with the requirements of the financial market; on the other hand, it is suitable for a distorted application of the most advanced financial technologies (often projected toward the purposes of private speculation).

To the moment of fund units underwriting, corresponds a connection that is summarized in a bilateral relationship with the pro tempore manager and in another relationship – of participatory nature – with the organs of the fund (referring, in particular, to the assembly of participants, of which Art. 37 of Legislative Decree no. 58 of 1998).

It is good to keep in mind the distinction between the various categories of investors entitled to participate in an investment fund; this because the secondary regulation graduates, on the relative levels of experience and professionalism, the reduction of the safeguards placed in a general way at risk protection. This applies, in particular, to the possibility of restricting participation to qualified investors.

From another perspective, it is necessary to highlight the problematic nature of the separation between ownership and management that comes from the qualification of an investment fund as “independent estates” (“patrimoni autonomi”). And this, despite the recent legislative clarification on the legal nature of that body, that the Italian regulator has considered as an *intermediary* in the relationship between the participants and the assets of the fund (as a result of the aforementioned Legislative Decree no. 44 of 2014). Thus, on an owner’s perspective, we can now clearly say that the rights of participants concern the fund units only, where the SGR exercises every power over the assets that make up the fund’s estate, in accordance with the requirements of the relevant fund’s rules.

It goes without saying that, in the current regulatory framework, the management powers of the participants – mentioned at the beginning of this paragraph – remain limited to accepting the investment policy contained in the regulation of the fund that they want to join. However, similar limitations are placed on to the SGR, which only in the initial stage of preparation of the fund's rules shall be free to determine investment policies and strategies.

This explains the praxis relating to the negotiation of the contents of the fund's rules (that the SGR will have to place under the examination of the participants prior to their subscription) and the charge of responsibility to the SGR, in case of violation of the agreements entered before the authorization of the fund. Hence, that in the initial phase of establishment of the fund, the management powers find application, both on the part of the participants (who may influence the drafting of the regulation) and on the part of the SGR (in predetermining the policies of investment and disinvestment that, in future, will guide its management).

It is hardly necessary to point out that the relationship of participation to an investment fund is established through the subscription of its units,²² an act that represents the assumption of the obligation for the whole provision – in cash or in kind – of the resources intended to form the initial assets of the fund. In terms of negotiations, it appears that the initial offering of the units is the act through which the SGR proceeds to collect savings from the public. Therefore, the regular closing of this procedure is also the fact in which it is identified, the conclusion of the contract for the provision of the service of collective portfolio management (being understood the applicability of the special legislation provided by the applicable financial framework and, in particular, the provisions of Art. 42 et seq., Legislative Decree no. 58 of 1998).

From another perspective, it points out the coherence which should qualify the relationship between the application process and the characteristic features of the fund, so that the nature of the assets used for the assignment and the temporality of the contributions must be functional to the pursuit of the purpose explained in the fund's rules (in accordance with the investment object and policy therein).

Hence, the "call for the investments" (*richiamo degli impegni*) must be in functional mode to the dynamics of cash flow management, the distribution of incomes and, more generally, to the investment project authorized by the supervising authority. Of course, in the interests of the participants, the SGR will not be able to interpret its role the same way as a mere placement activity, but must proceed according to the dictates of a preordained strategy to create value.

Conversely, the application form to participate to the fund is an act of private autonomy that is left to the free determination of the participant, obviously within the limits provided for by the general regulatory framework (being such a request one of the initial elements of the participatory relationship at the basis of collective management). In other words, the preparation of the application by the subscriber – or the filling in, if prepared on the basis of a pre-existing form – will have to follow the verification of its conformity with the fund's rules, prior to acceptance by the SGR.

As mentioned above, the discipline of capital structures that occurs in the collective management is not freely provided by the parties, but it is defined by the act of approval (of the fund's rules) assumed by the Bank of Italy. There is, therefore, an objective definition to the negotiating skills of the parties, which cannot modify the contents of the service. Thus, the subscription demand is resolved in adherence to the requirements contained in the fund's rules.

From the foregoing, it can be inferred that the application (for membership) does not affect the regulation, even in the case in which these can be considered objectively advantageous for the saver/subscriber. This is because the supervision on the collective portfolio management does not end in "investor protection", extending itself to the research for the "trust safeguarding" of the operators as a condition for "the stability and proper functioning" of the financial system (oriented, consequently, toward increasing levels of competition). They are quite evident, also, the implications – in terms of competitive equality – that derive from a discrepancy of relations between SGR and individual subscribers (although derived from the formation of the participation relationship).

This study must then dwell on the obligation imposed to the closed-end funds to set a duration for the subscription collection stage, which must be no longer than 18 months from the date of publication of the prospectus (according to Art. 94, third paragraph, Legislative Decree no. 58 of 1998) or, if the fund's units are not offered to the public, from the date of approval of the regulation by the Bank of Italy.²³

The expiration of this term, in fact, affects the morphological characteristics of the fund; and indeed, in the presence of subscriptions that represent a value lower than expected, but enough to operate, the management company can continue its promotional activities, subject to specific authorization by the supervising authority. This "down-sizing", however, is not free from consequences, since the latter should

be regarded as a fact likely to give the promisor subscriber the faculty to exercise the right of withdrawal.

Conversely, in view of the collection of subscriptions for an amount greater than the offered one, there is the possibility to increase the assets of the fund, where this is laid down in the fund's rules, after informing the Bank of Italy.²⁴ Alternatively, the allocation of the units will occur in a selective way (between all the names of the promisor subscribers). In both cases, it is clear that a different size can significantly affect the asset management activity and then the collective portfolio management services; it appears, therefore, appropriate that the SGR would proceed to the adoption of any regulatory change that may be necessary to ensure the safe and sound management of the raised money, so that the new size would not be an obstacle to the proper functioning of the fund.

Finally, it is useful to underline a disciplinary section that characterizes this matter. We are referring to the provision of law under which the term of the subscription procedure establishes the participation relationship (giving course to the potestative complex which reports to the SGR and investors who, thanks to this act, acquire the status of participant). It is clear how, only following this moment, the collective portfolio management is enabled, to which corresponds the execution of the necessary contributions for the formation of the fund's holdings.

4.3.5 Funds

In light of the foregoing, it is understandable that, in the system outlined by the Italian regulation, the assets are a precondition necessary to start the management of a fund; it is, as we have previously highlighted, a set of resource contributions, underlying the subscription of its units.

Also, regarding this disciplinary aspect, the matter under consideration has an "open" framework, in which self-regulation has specific value (contained in the programmes of activities of the SGR and in the rules approved for the management of funds), not only for its ability to follow the evolution of the market dynamics, but also because it also allows the SGR to keep into consideration the guidelines issued by industry associations.

Moreover, the legislator clearly orientates in this sense, which identifies the role that a fund plays in respect to the SGR and the participants (and indeed, as written in the provisions of Art. 36 Legislative Decree no. 58 of 1998, while the participation relationship is disciplined by the fund's rules, the SGR acts in an independent way and in the interest of the participants to the fund).

Hence, the centrality of the issue regarding the allocation of the assets (acquired with the revenue from the money raised from participants at a specified fund). We understand the reason why while the fund (under Italian law) has been defined as the UCIT established in the form of autonomous assets, divided into units, established and managed by a manager (Art. 1 Legislative Decree no. 58 of 1998, as amended by the aforementioned legislative decree 44 of 2014).

It is appreciable this new approach to the matter. After it has been detected for a long time, even in judicial rulings, the new regulation will override the ambiguity of the previous dispositive formulas. These had revealed to be, at the proof of facts, unsuitable to bring in unique ways the ownership rights of the assets in which the raised money is invested to the fund's holdings (and not to the SGR holdings).²⁵

On this point, it should be noted that the regulatory option to anchor the investment fund to the form of the independent estate (*patrimoni autonomi*, as specified in Art. 36 Legislative Decree no. 58 of 1998), rather than considering it a constitutive element of a legal personality, does not imply a simplification in the management of the business relationships and, in particular, of the imputation to the fund of the real estate.

It goes without saying that, in this hypothesis, it would be possible to admit a regulation scheme in which the establishment of the fund is a prerequisite for the assignment of administrative rights to the SGR, where the subscription of units would give the economic rights to the participants.

In conclusion, a further step forward in the regulation about the matter is desired, so as to coordinate (or rather, integrate), at European level, the two systems of UCITS and AIF, as the frequent interactions of their components make the presence of unjustified regulatory barriers (which appear mainly rooted in the contingencies posed by the financial crisis).

4.4 Perspectives

The analysis of the development of the collective portfolio management highlights the correlation of the latter with the evolution of the capitals' circulation and, in particular to those alternative to the banking sector. Based on these trends, there is, in fact, a system grounded on the professionalism of SGR, responsible of both the *investment* (made by the participants) and the *management* (of the assets of the UCITS or AIFs).

All this takes place within a complex regulatory framework, which was affected by the process of harmonisation promoted by the EU.

It is possible, in fact, to find a parallelism between the formation of the internal capital market and the revision of the above-mentioned legislation.

To this date, the fund's rules incorporate the essence of the regulatory framework marked by the Italian authorities. In them, the objectives of the investment and, more in general, the policies that will guide the operator are disciplined. To it, all the results of the service and, therefore, the evaluation of the responsibility profile of the manager should be parameterized.

In this context, it should be noted that the current design of the European Bank Union does not include within the perimeter of the Single Supervisory Mechanisms the collective portfolio management or other forms of investment that are achieved with the instruments aforementioned.

This suggests a backwardness of the supervision exercised upon the sector under examination, in comparison to the one that characterizes the banking sector; so that it can be said that, to the present, it is not yet fully aligned with the process of European integration, whence the hope of an intervention that covers under the supervision of the ECB also funds and managers of systemic importance, so as to avoid asymmetries that might affect the financial market negatively.

Notes

1. See EC, *Greater protection for retail investors: Commission welcomes European Parliament adoption of strengthened European rules on UCITS*, Brussels, 15 April 2014.
2. See Capriglione, *Intervento pubblico e ordinamento del credito*, Milano, 1978, p. 3 et seq. for a view of the first regulatory changes in the financial market.
3. See Rabitti Bedogni, *Commento sub Art. 33 l.u.f.*, in Aa.Vv., *Commentario al testo unico delle disposizioni in materia di intermediazione finanziaria*, edited by Capriglione, Padova, 2001, I, p. 351.
4. Because of this reserve, the SGR can run only certain other business, referable or linked to the cpm.
5. Before the Italian legislative activity required for fulfilling Directive 2011/61/EU, there had been a joint communication by the Bank of Italy and the Consob of 26 July 2013, on the regulation applicable to AIFMs.
6. In this context, it should be noted that *Principi sui rapporti tra gli investitori istituzionali e gli amministratori indipendenti e sindaci delle società quotate e Principi in materia di remunerazione degli amministratori esecutivi*, edited by Assogestioni, November 2008.

There are also documents on *Standardization off und processing in Europe*, edited by Efama, September 2008; *Modelli operativi* edited by National Market Practice Group, 7 November 2006, reperibili sul sito, www.assogestioni.it.

See, on this point, Annunziata, *Gestione collettiva del risparmio e nuove tipologie di fondi comuni di investimento*, in *Rivista delle società*, 2000, p. 350 et seq. and later, Id., *La disciplina del mercato mobiliare*, Torino, 2008.

7. See Carosio, *Fondi comuni e crisi dei mercati*, Speech of the Vicedirettore Generale della Banca d'Italia to the Annual Assembly of Assogestioni, Milano, 18 March 2009, p. 9.
8. See EC Commission, Financial Services – General Policy, 9 July 2014.
9. See *Regolamento intermediari*, Consob doc no. 16190 of 29 October 2007; see also Assogestioni, *MiFID e linee guida assogestioni*, draft between 5 May 2008 and 6 August 2009, on www.assogestioni.it.
10. See Lemma, *Crisi finanziaria e stabilità dei fondi immobiliari*, in Aa.Vv., *Scritti in onore di Francesco Capriglione*, Padova, 2010, II, p. 1227 et seq.
11. Moreover, there are other prudential rules to be followed, see Art. 10 of Directive 2009/65/EC on the requirements for the collective portfolio management service.
12. This choice is higher than the value set in the; Art. 7, letter a, of Directive 2009/65/EC provides that *la società di gestione dispone di un capitale iniziale pari almeno a 125 000 EUR*.
13. See Portale, *Capitale sociale e società per azioni sottocapitalizzata*, in *Riv. Soc.*, 1991, p. 3 ss. where the idea of “minimum equity” as a selective tool.
14. See Provvedimento 8 maggio 2012, cit., p. II.1.8.
15. In particular, see Art. 7, letter a, i, of Directive 2009/65/EC.
16. See Provvedimento 8 maggio 2012, cit., p. II.1.3.
17. Please note that Art. 8, Directive 2009/65/EC requires the “comunicazione dell’identità degli azionisti o dei soci, diretti o indiretti, persone fisiche o giuridiche, che vi detengono una partecipazione qualificata nonché dell’entità della medesima”.
18. See Lemma, *Società di gestione del risparmio*, in Aa.Vv., *L’ordinamento finanziario italiano*, cit., II, p. 679 and Amorosino, *Funzioni e poteri della CONSOB nouvelle* in *Banca borsa e titoli di credito*, 2008 I, p. 137 et seq.
19. See Provvedimento, 8 maggio 2012, cit., p. II.1.9 ss.
20. See Corte di Cassazione, Section I civ., 15 July 2010, n. 16605, in *Banca borsa e titoli di credito*, 2011, II, p. 417 ss.
21. See Barbagelata – Piazza, *La “leva fiscale” per i fondi immobiliari*, in *Corriere tributario*, 2012, p. 893 et seq.; Gagliardi – Vozzi, *Il trattamento fiscale delle principali novità introdotte dalla direttiva UCITS IV. Parte prima: le fusioni tra fondi stabiliti negli Stati membri*, in *Bollettino tributario d’informazioni*, 2012, p. 97 et seq.; Trivellin, *Il regime di tassazione dei fondi immobiliari, con particolare riguardo ai partecipanti “non istituzionali” titolari di quote qualificate* – [The Italian Real Estate Investment Fund tax regime, with a particular focus on “non-institutional” investors holding a qualified shares], in *Riv. dir. trib.*, 2013, I, p. 157 et seq.
22. See Arts 10 and 14 of d.m. 228 of 1999.
23. See Art. 14, d.m. 228 of 1999.
24. See Art. 14, para. 4, d.m. 228 of 1999.
25. See Corte di Cassazione, Section I civ. 15 July 2010, no. 16605, cit.

5

Italy's Supplementary Pension System

Raffaele Capuano

5.1 Introduction

Since 1993, Italy's policy makers have favoured the development of funded supplementary pension pillars in order to compensate retrenchment interventions within the public pension system. Introduced upon a voluntary basis, supplementary pillars are fully funded and provide almost exclusively Defined Contribution (DC) pension systems.

Following the 1993 reform and its subsequent revisions, supplementary pension pillars are now organised as Contractual or Closed Pension Funds (CPFs), Open Pension Funds (OPFs) and Personal Pension Plans (*Piani Pensionistici Individuali*, PIP).¹ Closed Funds are set up within the frame of collective bargaining between employers and trade unions and are not suited for profit institutions. They can be established at several levels – company or group(s) of companies, industrial or economic sectors (job category), geographical areas and so forth. Self-employed associations can also set up closed pensions. Italy's regulatory framework does not allow CPFs to manage assets; except for some specific securities, they have to contract with financial institutions such as banks, insurance companies, investment firms or asset management companies.

Open Funds are promoted and managed by banks, insurance and investment companies, and can offer both personal and occupational (i.e. based on collective enrolment) plans. It is worth underlining OPFs are hybrid institutions, covering both second and third pillar forms depending on affiliation modes: consequently, within Italy's system, actual difference between occupational and personal schemes (i.e. second and third pillars) does not depend on the type of pension fund (Closed or Open), but rather on affiliation modes (collective or individual). Since the year 2000, personal pension plans can be offered also

through life insurance contracts, as long as benefits are paid compliantly with the same rules applied to pension funds – that is, subject to the same tax treatment and incentives as pension funds. The 2005 Reform introduced some new rules for PIPs, mainly concerning the kinds of administrative costs they can impose on buyers.

However, prior to the main 1993 Reform, hundreds and hundreds of pension funds (so-called pre-existing funds) were operating, usually sponsored by banks and insurance companies in favour of their own employees (i.e. sort of fringe benefits). At present, approximately 330 pre-existing funds still exist, encompassing about 650,000 members. With some adaptation to new rules, they can continue to operate in their original forms (no longer subject to 1993 rules), have different investment limits to the new kinds of funds and offer defined benefits. Nevertheless, following the 1993 Reform, Defined Benefit (DB) pension plans were closed to new members. Therefore, the new pension architecture presents a public pillar and complex system of private pension schemes, although the latter are still underdeveloped in terms of actual coverage and take-up rates.

Most recent data indicate the take-up rate in private supplementary schemes is still not satisfactory: about 2,950,000 individuals were members of Closed and Open Pension Funds (2,000,000 and 950,000, respectively), and the enrolment growth rate in both types of funds has not been significant since 2008. Conversely, PIPs appear more appealing, in light of 2.1 million individuals currently enrolled within supplementary schemes. If we include pre-existent funds (about 650,000 individuals) and PIPs established before 2007 (about 500,000 individuals), the total amount is equal to approximately 6.2 million out of slightly fewer than 23 million employed.²

Currently, the take-up rate of Closed and Open Funds is equal to 32.2 per cent among private employees, 4.8 per cent among public employees due to the late starting of supplementary schemes in the public sector and other constraints and 30.6 per cent among self-employed people. Prior to the reform concerning TFR devolution (2007), the take-up rate among private employees was much lower (around 15 per cent). However, the weak development of private pillars and their modest role in increasing future pensioners' prospects is due to lack of confidence in supplementary schemes rather than to low contribution to such schemes by participants (i.e. TFR, employer and employees contributions pay about 9.5 per cent of salaries). In particular, the enrolment rate is very low among young generations, although their future replacement rates have been massively reduced by NDC introduction and pension funds are usually

considered the main tool available for younger workers to increase their replacement rates. Pension funds members' average age is in fact very high (about 44 years old versus 40 years old among employees), and only as many as 20 per cent are younger than 35 (32 per cent among employees).

Pension funds provide old age pensions, whereby the worker has cumulated at least five years of seniority in the fund and has reached the age required for old age pension within the public scheme.

The tax regime for all private schemes (Closed and Open Funds, and new PIPs) is a sort of hybrid³ exemption taxation (ETT): contributions are exempted until a EUR 5,165 threshold each year. Investment returns are subject to 11.5 per cent (for 2014) proportional rate taxation. Prior to 2007, benefits used to be taxed as per progressive personal income tax rates; since 2007, a 9 per cent to 15 per cent proportional rate has been applied, depending on the seniority within the fund and exempting; nevertheless, the share on which the tax on investment returns has already been paid. These fiscal rules appear very controversial, especially on equity grounds. Apart from the costs on public budget of such tax expenditure (which will materialise only in the future), deep incoherence arises between a public scheme in which taxes benefit in a progressive way and a private scheme in which taxes benefit less and proportionally. Furthermore, such fiscal rules are substantially regressive as the proportional rate applies to a system whose membership probability increases along with income.

5.2 The three pillars of Italy's pension system

As follows the three pillars of Italy's overall pension system, and their related features.

1) Public, compulsory and unfunded pay-as-you-go (PAYG) systems

The first pillar represented almost the unique retirement annuity until mid-1990s and was based on an earnings-related system – the pension level of each retired employee resulted from the amount of salaries earned within (the last years of) one's own working life. Consequently, the replacement rate between pensions and salaries amounted up to 80 per cent.

The reforms introduced in the second half of the 1990s kept up the PAYG system; however, the current reformed system definitely mimics a funded system – the pension level of each retired employee will be based on the amount of contributions poured into the public pension scheme

during own working life. In particular, the individual pension level will result from the sum of the individual amount of contributions and its capitalisation at the rate of change of nominal GNP. Therefore, within the current public pension scheme, the mean replacement rate between pensions and salaries will decrease, entailing different effects on the various categories of employees. At first, the new scheme will be applied gradually, so as to avoid affecting older classes of employees, and self-employees will severely affect the replacement rate of younger classes of employees. Furthermore, due to progressive changes in the workforce contracts, the continuity of paid contributions within the first pillar is not likely to be regular. Nowadays, more and more frequently young workers find a job at an older age than in the past, and as such, they do not enjoy long-lasting contracts.

2) Private, voluntary and “collective” funded systems

The second pillar was extended theoretically to all workers early 1990s. In 1993, Italy's legislation introduced *Pension Funds* with significant improvement at the beginning of the new century.⁴ Italy's pension funds can be broken down in two broad subsets: (i) the so-called Occupational or Closed Pension Funds, mainly established by employers' associations as well as trade unions on the basis of occupational schemes, geographic areas or individual big firms, although they can also be the result of direct agreements among self-employed people; and (ii) the so-called Open Pension Funds, established by banks, insurance companies and savings management companies.

At present, “Occupational” or “Closed” Pension Funds (CPFs) are the core of the second pillar of Italy's pension system. Conversely, “Open” Pension Funds (OPFs) play a role within the second pillar whereby they offer a social security product to a given class of employees, but operate within the third pillar whereby they offer a standardised or peculiar social security product to individual employees and other savers. Assuming that a comprehensive regulation for all relevant actors and efficient competition among all market participants are essential, all pension funds have common features – they generally require given contribution rates and do not guarantee predetermined revenues. In this regard, Italy's Pension Funds act as institutional investors within the domestic and international capital markets; they choose an asset allocation for their financial portfolios based on given benchmarks and entrust their wealth to asset management companies. The employees enrolled in a given pension fund will be able to collect the social security revenues

depending on several factors: gross return rates linked to the fund's financial investments, operational costs, tax regime for social security, life expectancy of retired employees, institutional and operative setting of salary payments and so forth.

3) Private, voluntary and individual social security schemes

Within the third pillar of Italy's pension framework, financial products provided by OPFs to individual employees do compete with the more traditional social security assets offered by insurance companies (PIPs), resulting in a significant growth of the number of subscriptions within individual pension schemes.

5.3 Italy's "pre-existing" Pension Funds

Private voluntary pension funds were established before the legislation on pension schemes was first enacted in 1993.⁵ Some private employers (i.e. mostly banks and insurance companies) established internal programmes for the benefit of their employees, although no special directive on pension funds was in force then, and such schemes operated semi-autonomously. Nevertheless, since 1993, a number of initiatives have been undertaken so as to provide such funds with regulations harmonised with the new forms of pension systems.

Pre-existing funds are most numerous among private pension schemes and are still regulated by specific directives with respect to new pension schemes regarding financial management and corporate governance requirements.

5.4 Complementary Pension Funds system of rules

Italy's Legislative Decree no. 124/1993 introduced a systematic legal framework for complementary pension schemes, followed by new rules on benefits, taxation and individual schemes aimed at fostering their development. The main reform was then introduced by Italy's Legislative Decree no. 252/2005, in force to date.

Early 2007, Law no. 296/2006 widely amended the regulation, involving the devolution of current retirement benefits (known as TFR – *Trattamento di Fine Rapporto*), establishing that employees can transfer their TFR annual allocations to a given pension scheme or, alternatively, maintain them within their employer company. In the latter case, whereby the firm hires more than 49 employees, flows are diverted

to a specific treasury fund maintained by INPS (Italy's National Social Security Institute). Should the employee not express any decision, the *tacit consent* principle shall apply, and flows shall be transferred to a collective pension scheme, whereby contractually identified for that specific professional category. In the absence of an eligible contractual scheme, flows shall be transferred to a pension scheme specifically established within INPS. In 2007, TFR devolution strongly raised the number of accessions and assets under management by the complementary pension industry.

Key principles regulating complementary pension schemes lie in: voluntary affiliation; adequate pension fund schemes; financial management assigned to institutional managers: banks, management and investment companies (mainly equivalent to UCITS and security brokerage/dealing companies), insurance companies; *ad hoc* supervisory authority (i.e. Covip). Due to individual will relevance, old pension funds (either classified as second pillar or third pillar) have to provide the so-called *progetto esemplificativo*, a kind of provision annuity they will enjoy – also potential members are entitled to it within a stabilised version. Covip has established the prudential requirement for such provision (assets of returns, salary growth, discount interest rate).

Whether Occupational/Closed Pension Funds, Open Pension Funds with collective or individual membership, or Individual Pension Plans (PIPs), any types of pension schemes shall be authorised by Covip and are subject to its supervisory powers and to the same regulatory and supervisory treatment (i.e. tax regimes and/or benefits), although they operate with different legal status, governance and operating models, in accordance with their respective specific nature.

5.5 The supplementary pension market

The characteristics of the supplementary pensions market are such as to differentiate it from other financial market sectors in the broad sense (i.e. banking, insurance and proper financial market).

In the first place, system actors, appointed to offer supplementary pension schemes, are numerous and non-homogeneous – social parties with their collective agreements; public entities (e.g. regions); banking, financial and insurance operators; and so forth. Pension funds can be established and provided by all these subjects, with consistent characteristics.

In this context, Defined Contribution (DC) pension systems (i.e. the parties taking part in a fund provide their savings and expect an

ultimate final benefit resulting from optimal management) coexist with DB pension systems (i.e. the fund makes a commitment to a particular benefit at the expiry date of the accumulation period).

At the same time, the mentioned management models are implemented through different types of funds: Pension Funds (NGOs obliged to entrust their resources to specialised managers); Open-Ended Funds set up by financial, banking and insurance traders, directly managed by such operators; Individual Pension Plans implemented by individual insurance contracts.

The common feature of all such models lies in the welfare purpose of the function performed. As such, all participants shall respect fundamental principles such as optimisation of prudential risk management, member participation in the fund's life through representativeness mechanisms and constant reference to the evolution of the mandatory pension system in order to measure additional benefits adequacy.

Despite the common purpose, supplementary pensions are characterised by individuals acting in competition with each other and are, at the same time, organised and structured in different ways (pension funds or brokers) consistently with the different ultimate purposes of their activities (profit or non-profit) and the structural characteristics of such activities.

Last but not least, it should be noted that the entire field of supplementary pensions is characterised by the principle of voluntariness and freedom of choice. As a matter of fact, workers need to individually express their own willingness to join a given fund, even whereby agreements exist at collective or company level providing for establishment of a supplementary pension fund. Even in the case of automatic enrolment, individuals need confirm their participation within six months of hiring in the workplace that also provides for membership of a fund.

Funds can freely organise themselves according to relevant laws and implementing regulations. Even funds financial management takes place according to free market rules upon free choice, with competitive bidding from the individual(s) in charge of fund management.

5.6 Closed Pension Funds

"Occupational Pension Funds" are also known as "Closed Funds" because only specific groups of people can join them – employees can subscribe whereby their contracts foresee a complementary pension fund. Self-employed workers can subscribe a Complementary Fund whereby allowed by their working category, usually prompted by a professional

association. Funds for self-employed workers represent a minority. These types of funds for employees may be established on a territorial or a company basis and/or connected to any other kind of labour organisations. The pension scheme can be established at national, regional, local or company level.

All complementary pension funds are independent legal entities with their own capital and organisational structure, and their corporate governance is based on the principle of equal representation – usually members representing employees equally institute the Board of Directors and other collective bodies (e.g. Audit Committee) and are required to fulfil specific ethic and professional requirements.

The assembly shall approve budgets, annual reports, amendments to by-laws, procedures for liquidating assets and elects the Board of Directors and Supervisory Board. The General Director or head of the fund plays an important role, executing the board decisions, and is responsible for the fund, supervising that all the operations are carried out exclusively in the interest of fund members.

Workers can join the scheme and become affiliated members only whereby they meet specific requirements established in the fund by-laws.

The fund charter initially sets a membership rate target to be achieved within a timeframe defined by the supervisor. Once the threshold has been attained, the supervisor shall authorise the fund to set up its own operations – the fund can start collecting contributions from its own members. However, contributions cannot be invested until the pool reaches a minimum amount and a financial intermediary is instructed so as to manage the fund resources.

The business model of Occupational or Closed Funds is based on a close relationship between stakeholders and potential members. No fee or commission is due for this process. Affiliation is at hand if the fund's reference sector is concentrated, as contacts with employees are easier to be attained and managed.

Currently, all pension funds are based upon Defined Contribution (DC) schemes – the amount is set by the fund's by-laws. Usually funds are financed by contributions both from employees and employers and through TFR. Supplementary contributions are also envisaged.

Contributions flow into the individual account of each member and are invested by financial managers appointed by the fund and selected exclusively among banks, management and investment companies or insurance companies. Based on the pension needs of its potential members, the fund defines the strategic asset allocation of its investment

portfolio; structures mandates and establishes their duration; and defines the number of financial managers and selects them according to a process regulated and controlled by the supervisor. The process begins with an invitation to tender in which the fund defines the selection criteria consistently with specific requirements – that is, capital amount; assets under management consistent with the mandate asset class; past experience in pension fund management; composition, stability and structure of the management team responsible for interacting with the fund; required fees; reporting quality. Upon conclusion of the process, one or more financial managers are selected and sign a contract defining the conditions that regulate their respective obligations. The contract can allow sub-delegation to another asset manager.

The fund is required by law to be aware of the risks to which its member are exposed – that is, financial managers shall comply with the risk profile defined by the fund with an *ex ante* approach. As most mandates are based on a specific benchmark, the agreement states *ex ante* a given level of risk to be respected in terms of Tracking Error Volatility (TEV). Some mandates have risk profiles expressed in terms of Value at Risk (VaR).

Occupational Funds receive flows from contributions and TFR devolution; as such, they shall have a specifically established sub-fund guaranteeing at least the capital repayment. Additional yield giving an annual performance in line with the one prescribed by TFR law should be achieved on a best-effort basis.

The fund can offer other guaranteed sub-funds. The common feature of every guaranteed sub-fund is given on a one-event basis. Events that can trigger the guarantee usually do not depend on members' free will, such as retirement date, death, severe disability, long-term unemployment. Rarely does the guarantee apply when members switch to another fund or when the financial managers' contracts end.

As funds typically have a very simple structure and limited financial management knowledge (except for some board members), external advisers often support the selection and supervision of financial managers.

As it is essential to the relationship with members and important to board renewal, fund and financial managers are in close contact and meet periodically in order to discuss results, prospects and possible new tactical asset allocation.

The fund needs report at least on an annual basis, but fund websites can provide information to members more frequently. It is essential to consider that frequent reports might cause bias on investment processes

that should be long-term oriented. Recently, the office term has been extended: from three years to five years or even longer in specific asset classes. A depositary bank performs actual trading.

Due to the small structure of its business model, Occupational Funds typically outscore the administration process in order to reduce the investments required for their establishment.

The administration role is of key importance, as it manages all the information on cash flows coming from fund members and their employers, and links it with information and cash flows coming from investment, benefits and processes to provide annuities. Therefore, administration tasks include: registering new members; collecting contributions; selecting investment strategies and similar data; calculating the value of individual positions and the amount of benefits; paying dues to pensioners and members; supplying the fund with book-keeping activity; and providing the scheme with information necessary to draft annual reports.

As mentioned, Italy's law requires that a depositary bank keep the assets in custody and carry out trading activities ordered by financial managers. Therefore, trading is actually conducted by an entity other than financial managers, which is in charge of verifying their activities and carrying out their instructions only whereby compliant with relevant legislation, supervisor regulation, fund's by-laws and appointment agreements. Regulation does not strictly forbid the depositary bank and financial managers from belonging to the same group; nevertheless, several Occupational Funds do require such independence. The fund shall select a depositary bank through an invitation to tender, as mentioned for other external entities.

Pension fund costs mainly consist of administrative and financial fees due to institutions in charge of asset management, custody services and administrative activity. Overheads are generally low, as board members usually receive token compensation. No fee is due for gathering memberships, yet the fund bears the costs of training representatives, organising assemblies and communicating with potential members. Financial fees are directly deducted from schemes' assets while administrative costs and overheads are covered by charging a periodic membership fee (usually directly from contributions). Moreover, new members are required to pay an entry fee, and members are charged a modest forfeit to exercise specific options (e.g. switching to a different sub-fund, redeeming their individual positions or transferring their balance to another scheme, etc.).

As funds are non-profit organisations, whereby administrative costs are lower than the fees collected to cover them, the difference shall be accredited

to members' single positions. As such the business model of contractual funds is efficient whereby a certain number of members sign on.

Cost impact on member balances is measured via Italy's ISC index (*Indicatore Sintetico di Costo – Cost Impact Index*) – the calculation methodology is established by the supervisor. Funds shall also compute the TER (Total Expense Ratio) index, namely the ratio of total assets at year-end. While the ISC is an *ex ante* evaluation of future costs, TER is computed on an *ex post* basis and as such reflects the past impact of costs upon members. Both ISC and TER shall be regularly disclosed to members.

5.7 Complementary Open Funds

Open Funds are potentially addressed to all categories of workers – “open” shall mean that membership is not restricted to a specific group, unlike Closed Funds.

Open Funds are established by the same organisations managing pension funds' financial resources: banks, *management* and investment companies and insurance companies.

The boards of directors of such institutions shall establish the fund according to a specific set of rules allowing it to operate similarly to Closed Funds, pursuant to Covip authorisation.

Open Funds are not independent legal entities; rather they are established within an organisation, although the fund resources are legally separated from the managing entity and as such cannot be executed by sponsor company creditors (Art. 2117 of Italy's Civil Code). Consequently, the fund does not have its own administrative bodies but has its own governance system.

The fund can be established either for a collective or an individual membership or both. Collective membership is based upon an agreement among stakeholders (usually at company level), stating fund's membership rules. Unlike Closed Funds, Open Funds have no stakeholders' representatives within their governance bodies. Furthermore, these funds are not limited to the group that signs the agreement, as other communities can also join. Therefore, Open Funds can represent an opportunity for small or medium sized groups of workers – that is, as the same fund can receive both collective and individual memberships, members may belong to more than one organisation.

Governance rules try to balance the power between the sponsoring institution and members. In fact, within both collective and individual membership schemes, the person appointed responsible for the fund shall be independent from the establishing institution and fulfil ethic

and professional requirements. This individual shall supervise all the fund's activities and ensure the fund is operating in the sole interest of its members.

Within collective membership funds, governance rules also require the presence of another supervisory body, made up of at least two individuals. In the case of collective membership of more than 500 workers belonging to the same company or group, two additional members, one appointed by the employer and the other by the employees, shall integrate the supervisory body. Clearly, this is an attempt to replicate the typical collective bargaining criteria, with reference to a different legal structure.

No requirement is established for individual membership; while collective membership requires employment by the employer who signed the agreement.

Due to the fund's specific nature, the sales force of the sponsoring institution is primarily responsible for recruiting new members. Specialists at corporate level propose collective memberships, while individual memberships are task of the retail sales force, disseminated throughout the territory.

Collective membership is funded with contributions from employer, employees and retirement benefits (TFR). In order to collect the TFR of workers who failed to express a choice (*tacit consent*), the fund is required to have an established *ad hoc* sub-fund, as for Closed Funds. Individual membership is voluntary.

Each plan offers various investment options. Whereby the fund allows for collective membership targeting workers who fulfil specific requirements and is willing to gather contributions coming from the tacit consent principle, one of the investment alternatives offered shall give a guarantee for the capital linked to specific events. Contributions can be split among different sub-funds if the scheme thus allows members.

As Open Funds are managed by financial intermediaries, the asset management process is directly handled by the institution creating the scheme. However, fund management can be assigned to a third party appointed to conduct specific operations. The administrative process can be outsourced. A depositary bank is required as with Closed Funds.

Costs may be charged at membership start and/or levied each year so as to cover administrative expenses and also to pay the sales force. Such costs and the relative incentive to sell represent the main differences between Open Funds and Closed Funds. The strong link between banks and employer, reinforced by credit needs, can give banks a competitive advantage in signing collective agreements. Costs impact is measured via ISC and TER indexes, periodically disclosed to members.

5.8 Individual Pension Plans (PIPs)

Operating exclusively upon an individual basis, Individual Pension Plans consist of an insurance contract compliant with rules on complementary pension schemes – related to benefits, fiscal treatment, portability, supervision and so forth.

Likewise, Open Funds, the insurance company board shall establish the scheme and apply for Covip authorisation in order to become operational. Since 2007, a new type of insurance contract has been issued, fully compliant with the new regulation in force.

Two types of insurance contracts are currently offered – with-profits and unit-linked. In some cases, a combination of both types is possible in order to attain a more flexible risk profile. Usually with-profit policies provide a minimum annual interest rate, guaranteed and consolidated in the company accounts, besides a financial performance quota as recorded at year-end. Unit-linked policies usually have no guarantee, and their performance depends on the value of the unit in which contributions are invested. PIPs can offer additional coverage in case of death, long-term care or disability, sometimes as a bundled package.

Likewise Open Funds, PIPs are not independent legal entities and the resources provided by members have a special status as they constitute a separate fund from the establishing entity and cannot be executed by sponsor company creditors.

An independent person shall be appointed responsible for the scheme and entrusted with the same powers and requirements as for Open Funds.

No requirements apply in order to qualify for accession to insurance policies besides premium payment. Likewise, Open Funds, membership is mainly driven by sales force commitment.

Contribution is flexible. In most cases, premiums may be paid either at any time or on a monthly basis. Within limits agreed upon with the insurance company, the insured party chooses the amount of premiums, which can also be inflation indexed so that the money accrued during the accumulation phase keeps its real value. Subordinate employees may pay into the scheme both with their own money and their annual share of retirement benefits. PIPs are individual accession pension plans; hence, there is no contractual agreement with the member's employer governing additional contributions.

Investment is carried out directly by the insurance company offering the policy, and no intervention by a depositary institution is required. Investment shall comply with the same rules regulating insurance

policies – with partly different limitations versus Closed and Open Funds. Investment activity is primarily regulated by Italy's Private Insurance Code (*Codice delle Assicurazioni Private* (CAP), namely Legislative Decree no. 209/2005), which governs insurance activities in general. The insurance company may delegate the investment process to a third party. The insurer shall handle all phases of the process, ranging from selling to paying benefits.

Costs are similar to OPFs costs and are influenced by guarantees and insurance coverage offered. The sales force impact can be relevant, but the service level provided to customers by insurance specialists can be appreciable as well. Cost impact is measured via ISC and TER indexes, periodically disclosed to members.

5.9 Rules on management and efforts to achieve long-term investment strategies

The pension funds' market now appears as a mature market. Consequently, there is increasing interest in developing sounder strategies for investing pension funds' assets. To date, the existing strategies have mainly relied upon a passive approach. The use of prudent and commonly adopted benchmarks has thus reduced the opportunity for significantly investing in assets other than government or bank bonds. It is now time to introduce more proactive approaches to investment so as to ensure better returns to funds' participants. It is true that this prudent approach has limited the effects of the recent financial crisis on funds' assets; nevertheless, the expected low interest ratio-incoming scenario pushes for a different behaviour of fund managers.

A new regulation is expected to enter into force on pension funds asset management by the end of 2014. It is Covip's opinion that the regulation on the way to be adopted by Italy's Ministry of Economy and Finance and Ministry of Labour will provide fund managers with a set of qualitative rules aimed at enhancing coherence between fund participants' expectations and asset management targets.

To some extent, Covip anticipated the principles that inspired the above Ministries' Regulation to adopt rules on the Investment Policy Assessment to be provided by pension funds in order to put in place an ordered investment strategy as well as correct execution of investment policy. In March 2012, Covip instructed Italy's Pension Funds to implement their investment strategy.

Both Covip instructions and Ministries' Regulation aim to obtain from pension funds the definition of their strategies according to

specific investment targets related to the goals demanded by their members. Pension funds are also required to measure their risk budgets and identify asset classes compatible with the defined risk limits when they decide about their investments. They obviously have to define risk control measures and regularly verify investments results. Finally, funds governance needs be adequate to the number of asset classes in their respective portfolios and to the level of risk accepted by managers.

The rationale behind the new investment regulation seeks to obtain more diversified funds' portfolios aiming to create both better returns for pension funds members and a stronger role of pension funds as institutional investors within the economic system.

5.10 Conclusions: supplementary pensions within a new welfare model

The field of supplementary pensions reveals the convergence of a number of interests, rights and obligations expressed within activities and functions having diverse and complex characteristics.

In the first place, supplementary pension systems represent an efficient blend of individuals' pension needs combined with social partners and financial market operators' capacity to provide welfare coverage. As such, supplementary pensions reveal public interest in building a sustainable, adequate and safe pension system and converge with the need to involve individuals in the creation of their own welfare. In fact, the increasing difficulty experienced by the mandatory pension system in ensuring the levels of insurance coverage required in the past does require integrating state pension mechanisms with individual savings. This is an important step – if not the main step – leading to a new “welfare state” structure, which involves individuals with their own resources and savings to build up the security they need. Individuals' participation also entails the use of market instruments, as private interventions play a central role.

Supplementary pension schemes are primarily based on the establishment of private institutions managed by the representatives of those who provide their savings in order to receive pension benefits, as well as on the provision of pension tools developed by the market, albeit characterised by mechanisms of representativeness of the parties concerned. It is no longer the state directly in charge of providing pensions; rather the funds are required to comply with the engagements taken by means of optimal management of resources.

Thus, the state's role lies in guaranteeing that contributions and operational mechanisms of the systems operate efficiently in the interest of participants. Hence, the supervisory authority in charge of such control function does play an essential role.

Notes

1. R. Pessi, *Lezioni di diritto della Previdenza Sociale* (Padova: CEDAM), 2008.
2. Source: Covip 2013 *Annual Report*, Rome, 28 May 2014.
3. F. Marchetti and M. Marè, *Previdenza Complementare e disciplina fiscale* (Bologna: Il Mulino), 2009.
4. M. Messori, *La Previdenza Complementare in Italia* (Bologna: Il Mulino), 2006.
5. M. Bessone, *Previdenza Complementare* (Torino: Giappichelli), 2000.

6

Rules Regarding Relations Between Intermediaries and Customers

Diego Rossano

6.1 Introduction

The rules that regulate the relationship between intermediaries and customers are based on transparency and proper conduct. A system based on these, aims mainly at protecting the interest of the customer but also, more generally, the stability of the market. It goes without saying, in fact, that the establishment of a relationship of trust between the contracting parties involved favours the adoption of cautious investment choices and, in this way, helps to ensure stability of economic transactions.¹

It is no coincidence, then, that the techniques adopted to achieve these objectives in terms of concreteness are summarized in the imposition, by the contractors, of considerable informational duties, in the belief that the complexity of trade dynamics requires a continuous exchange of information between stakeholders. In this order, the acquisition of further details about the steps to be taken, represents the vehicle to re-establish credibility of the relationships in question.

The original Italian regulatory framework (1942) only covers the situation in which the determination of the content of the agreement is referred to one of the contracting parties; we are referring to Art. 1341 c.c. in which the general conditions of the agreement are effective against one of the parties, only if the contractor “has got to know or should have known them by ordinary diligence”. The result is the commitment made by the predisposing part to provide clear information in an understandable manner.²

The outlined model did not fit properly in the negotiation dynamics in which, facing a (so-called strong) professional negotiation party, there was another (so-called weak) not equipped with adequate knowledge

to understand the contractual settlement because of inexperience.³ It should be added, moreover, that the absence of rules on the procedure that allows the circulation of information – to which was associated the simple, hardly useful written approval of the so-called unfair contract terms (sometimes there to ensure its effectiveness)⁴ – has certainly not helped the success of the original disciplinary system.

With the adoption of the 93/13/ECC Directive, adopted in Italy with the Law no. 52 of 6 February 1996, a new chapter (XIV bis) was added to the Civil Code whose articles then transmigrated toward the current Consumer's Code.⁵ The attention paid, in the contracts with the consumer, to the exchange of information within the negotiation relationships has justified the introduction of a specific part dedicated to "education, information, business practices, and advertising".⁶ The same importance has been paid to the possibility that the weaker contracting part could be victim of abuses by the counterpart; hence, the invalidity of unfair contract terms unless they are individually negotiated, but still subject to the invalidity of specific provisions (Art. 36, Consumer's Code).⁷

We are in the presence of a system that intends to leave plenty of space for the consumer's autonomy, imposing on the professional contractor specific communicational duties; in this perspective, the legislative action is not just a function of protection of the individual, it is intended to also achieve general purposes.⁸ Moreover, the recognition that the market is not self-sufficient does not mean reducing the contracting freedom of the subjects involved; the identification of tools able to ensure conscious choices allows, in fact, these to orientate themselves in the complex commercial dynamics.⁹ In this perspective, the provisions that provide for the expansion of the informational duties in the pre-contractual phase in the contracts made at a distance or off premises must be, therefore, interpreted.¹⁰

The need to aim at these objectives has been felt in the banking and financial sector; an area in which, in fact, the disciplinary evolution (which will be described in the next section) shows that the increase of information data was the way that, even at a community level, was intended to be taken to compensate operators' knowledge deficiency. This is because the reference to the transparency rules of contractual conditions, as well as the correctness of the behaviour assumed, seemed essential in areas in which we are witnessing an objective volatility and uncertainty of the object of the contract itself.¹¹

It is no coincidence, therefore, that the MiFID Directive has promoted these principles to fundamental elements of the regulation of financial

markets, imposing disclosure requirements also by investors, so as to be able to make a precise profiling of risk; so that, clear, fair and not misleading information is summed up in the thoroughness of its content becoming prerequisite of the negotiating relationships in question. The data flow is constant, in fact, in a bidirectional way (intermediary/customer and vice versa); a particular that allows you to ascribe the cognitive moment to basic criteria of the legal system of markets.¹²

However, it is now a known fact that the MiFID Directive has not given great account of itself in the recent crisis events that have affected the majority of the countries of the entire globe¹³; that is why it is necessary to find new instruments that can ensure more strength to contractual relations.¹⁴ Regarding this matter, the community legislation proposal reveals evaluation limits in terms of adequacy (for counselling services in the investment field or portfolio management) and appropriateness (for other investment services); this discipline, while pivoting on the “knowledge” of the financial experience of the customer and his inclination to invest, does not offer, in fact, appropriate mechanisms to make such predictions.

Regarding the possible adoption of procedures able to appreciate the actual risk inclination of investors, please refer to the continuation of this discussion. However, it has to be pointed out that the community rules, contrary to its premises, have not ensured a fully harmonized European framework specification. Nevertheless, the second recital of the Directive no. 2004/39/EC qualifies as “necessary to provide for the degree of harmonization needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community, being a Single Market, on the basis of home country supervision”. Moreover, as highlighted in the seventh recital of Directive 2006/73/EC, which underlined the “necessary to establish a harmonized set of organizational requirements and operating conditions for investment firms. Consequently, Member States and competent authorities should not add supplementary binding rules when transposing and applying the rules specified in this Directive, save where this Directive makes express provision to this effect”.

It should be emphasized, moreover, that the transposing provisions¹⁵ have not always shown coherence with that purpose; and this, despite the motivation found in literature regarding the presence of certain gaps in the disciplinary community system. In this sense, the choice to give local legislations the capacity to give actionable remedies in cases of violation of behaviour rules is regrettable; in fact, the overall picture that is painted, as we shall see later, is characterized by considerable

heterogeneity. The analysis of the aspects that we reported earlier will be preceded by a short historical excursus about the evolution of Italian financial and banking rules in terms of transparency, so we can better appreciate the novelty of the current dispositive model considering the various stages of the Italian disciplinary process.

6.2 Italian regulations on banking and financial transparency: historical evolution ...

The analysis of the historical process of national and community legislation concerning financial matters reveals a gradual awareness of the need to ascribe an increasingly decisive role to transparency and fairness.¹⁶ That intention, as will be seen, is found mainly in the banking sector in which the adoption of measures inspired by the logic of clarity and honesty of the work of lenders has been an essential element in relations of negotiability since the early nineties. The importance of the exchange of data in the relationships in question can be deduced by Art. 18 of Law no. 216 of 1974 in which the task of exposing the ways that had to be implemented on the purchase, sale of shares or convertible bonds through a public offer was assigned to the Consob; hence, the practice adopted by the Consob was to help the diffusion of information by means of a document. This formality was recognised officially in Art. 12 of Law no. 77, 1983; a measure that extended the application of this operation mode to every hypothesis of solicitation of public savings and any other securities.¹⁷

The rules in question confirm the significant role of information in the field. However, for the construction of a model containing these initial rules of behaviour, we will have to wait for the Italian Law no. 1 of 1991 (so-called Sim Law). The disciplinary scheme was based on the standardisation of behaviour and the recognition of the relevant regulatory function and also of other authorities. It required the brokers to act "with diligence, fairness, and professionalism for the care of their client" (Art. 6, 1st co., letter a) and at the same time imposed on them various obligations to provide information which was related to a corresponding burden of disclosure on the part of the customer.¹⁸

In an effort to encourage greater harmonisation between the disciplines of the Member States, Directive 93/22 / EEC of 10 May 1993, relative to investment services in the securities field, cd Directive ISD (Investment Services Directive) was then adopted at EU level. In this law, the logic aiming at predetermining uniform behavioural patterns was abandoned in favour of systems aiming at preserving "different

requirements for protection of various categories of investors and of their levels of professional expertise", (recital 32), subject to the need that the investment firm act honestly and fairly in conducting "its business activities in the best interests of its clients and the integrity of the market" and "with due skill, care and diligence" (Art. 11), giving attention to make adequate disclosure of relevant material information.¹⁹

These principles were transposed into the legislative Decree no. 415 of 1996 (the cd. Decree Eurosime). In particular, in line with EU guidelines, the national legislator identified, in diligence and correctness of the directives, the criteria that are at the base of the discipline; and this objective was not already limited to the mere interest of the individual transaction but rather extended to ensure the integrity of the entire market. Moreover, the relevant replacement of the principle of professionalism with the principle of transparency must be inspired by the behaviour of intermediaries.²⁰

Therefore, it was clear that there was an awareness in the need of basic rules as we already said before, and this should finally be ascribed to the guidelines in these commercial relations, trying to protect the community and not only the individual investor.²¹ From this point of view, Art. 17 of the Decree Eurosime is significant in which it was expected that investment firms should be organized in such a way to minimize the risk of conflicts of interest, provided that, in similar circumstances, they would have to act in order to ensure transparency to customers and equitable treatment.

In the already mentioned context, particular importance should be ascribed to the Legislative Decree no. 58 of 1998 establishing the Uniform Financial Code, in which we witness the replacement of the term "securities" with that of "financial product" and the distinction between "solicitation" and "takeover bid or exchange". This measure is then followed by the Consob Regulation no. 11522 of 1998, adopting a logic of clarification of the general criteria set out in Art. 21 of TUF (according to which the provision of services and the activities of investment and non-authorized persons must behave with "diligence, fairness and transparency").

Taking count of the provision of information obligations imposed on the parties involved, the defined system represented an evolution of the previous one. The distinction between the category of retail investors and professional traders is, in fact, significant, and corresponds to the application or otherwise of the detailed rules introduced. This, however, concerned people because they thought there was the possibility that the membership of one or other type of patronage would depend on a mere

declaration of party; this possibility, plus the one in which the operation was carried out, with the written consent of the investor (even though it was considered inadequate by the investment firm), has contributed to the phenomenon of the so-called betrayed saving.²²

In this sense, they laid the provisions contained in Art. 31 of the former Consob Regulation no. 11522, which included in the category of qualified individuals who also had documented "possession of the professional requirements set forth in the *Testo Unico* for persons who function in administrative, managerial or control securities firms, banking foundations and any company or legal person in possession of a specific expertise and experience in the field of transactions in financial instruments expressly declared in writing by the legal representative".

It is also important to say that some operators subscribed their customers (inexperienced) with statements in which they renounced to produce the requested clarification of the regulations regarding the personal financial situation and investment objectives. This practice is the basis of the judicial ruling according to which the intermediary still has to judge the appropriateness of the transaction even if the customer refuses to provide the necessary information.²³ This approach shows a will directed to prevent unscrupulous conduct by certain investment firms. On this point, Communication no. 30396 of 21 April 2000 was decisive where the Consob recommended that intermediaries must not encourage such conduct; so that, in the event that the customer had not provided the information necessary to carry out the provisions in question, the operator would have to adhere to the information already in his/her possession (such as the investor's past operations).²⁴ Therefore, under the force of the previous legislation, the intermediary, in the presence of an investor's refusal to provide the requested information, should not proceed to make their own estimates, although they, inevitably, turn out to be approximate as based on information inferred at random; assessments, in fact, had to be based on previous investment choices and, more generally, the antecedent behaviour held by the investor.

As regards to the banking sector, however, the disciplinary system (of which we reported earlier) did not ensure adequate protection to customers; so, to grant them tools to protect their own interests, at first, they thought it could be appropriate to be identified by a system based on self-regulation. Significant in this regard, the initiatives that were found in the "interbank agreement" for the publicity and transparency of the terms offered to customers of banks stipulated in 1988 (which is after the one of 1978 concerning the advertising of services offered as well as the elements contained in the statements). It was a

clear desire, on the one hand, to avoid legislative measures aimed to restrict banking activities and, on the other hand, to create relations for a greater transparency; objectives which, according to the doctrine,²⁵ were not achieved.

The failure of the model based on autonomy to regulate the banking system, made the legislator's need for further intervention clear. The so-called Transparency Act of 17 February 1992, no. 154, followed by that of 19 February 1992, no. 142, established a governing consumer credit.²⁶ With the Legislative Decree no. 385 of 1993, the Consolidated Law on Banking was then introduced, which is the regulatory system for reference on the subject. It is necessary to point out that the original framework of the system specification gave special importance to the pre-negotiation phase (Art. 116) and the agreement conclusion (Art. 117); which, in any case, must be in writing under penalty of nullity and pursuant to Art. 127, can be claimed only by the weaker party; it shows, however, as evidenced by the doctrine according to which the discipline of the duties of information covers only the economic conditions of the "overall offer" omitting certain crucial aspects (such as the regulatory conditions prepared by the bank) for which the customer asked for protection in the general clause of good faith.²⁷ It should be pointed out that the original discipline only contained "conditions" to the proposed services, although the doctrine had no doubt about the scope of the restrictive provision in question.²⁸

6.3 ...and recent reforms

Chapter I of Title VI of the Consolidated Law on Banking, had been reformed several times until the recent Legislative Decree no. 14 as of 13 August 2010 and subsequent amendments. Changes are an expression of a progressive tendency, also felt in this kind of area, to make a deregulation of the relevant legislation by delegating the government sector to identify in detail the operational instruments. This approach, indeed, is justified, as just evidenced in a careful doctrine, in the will to ensure "a high degree of timeliness and responsiveness of the judicial system to follow the evolution of the products offered, trying to pursue the maximum protection of bank customers".²⁹

Moreover, the reference made in Art. 116 is significant regarding the bank's obligation to disclose, in a clear way, the economic conditions "relative to the operations and the services offered". This clarification confirms (the legislative) disciplinary orientation in the past expressed by the doctrine; however, it does not resolve concerns related to the

restriction of the range of the legislation. In this regard, it seems there are elements to preclude the disclosure, in terms of concreteness, which can also be related to not strictly economic conditions. In other words, although rule legislation would seem to limit the regulative range as outlined above, it is more precise to think that it does not preclude in any way the possibility that the expenses in advertising may relate to other conditions than economic ones. It argues, in this sense, the absence of an express prohibition in this kind of discipline; on this point, the known sentence according to which everything that is not forbidden is allowed.

The consequences of the violation of the written form provided for by Art. 117 has also aroused particular interest. In particular the law of 1992 no. 154 sanctioned the nullity of the agreement negotiations, invalidity that could be relied on by anyone who had an interest in accordance with the general principles. The original text of the act, however, provided a specific case of relative nullity, which could only be brought by the customer. It should be highlighted that an orientation according to which the mentioned defect could have been detected *ex officio* by the court, despite the absence of an express law.³⁰ Echoing instances of the doctrine and jurisprudence, the Italian legislator amended Art. 127 of the *Testo Unico* in which nullity only can operate for the benefit of the client even if the court can intervene.³¹

Even in financial matters, the recent actions confirm the willingness to regulate the intermediary/customer relations in accordance with the principles of fairness, diligence and transparency. The intent of creating a single and integrated market inspired by these criteria also implies the need to give due importance to the peculiarities of the specific case. From this point of view, it is significant to the classification of customers (retail, professionals and eligible counterparties); hence, the lowering of the threshold of protection in the presence of experts, which corresponds to the increase of the same if the investor is in retail.

More generally, Directive 2004/39/EC (MiFID first level) determines the general criteria that govern this subject while the identification details of the operational tools are entrusted to the Regulation no. 1287 of 2006 (in order to “pre-trade and post-trade transparency” operations) and Directive 2006/73/EC (MiFID second level) with specific regard to the rules of behaviour that can be followed by the action of those who perform services or investment activities. To this, we must add the important role played by Cers and ESC (European Securities Committee), involved in coordination with operators of financial markets.

The community framework was implemented by the Italian legislator by September 2007, no. 164 Decree, which was modified with the TUF contained in part in Title II, entitled “services and investment activities”, in the chapter “Performance of services and activities”. By the power to make regulations established by Art. 6, 2nd co., TUF, a Consob Regulation 29 October 2007, no. 16190 was also adopted that, in terms of concreteness, identifies the methods used to regulate the dynamics between intermediaries and customers.

In 2007, most European countries transposed community legislation. In particular, Spain with the 19 November 2007, no. 47 and the *Real Decreto* to 15 February 2008, no. 217, amended the *Ley del Mercado de Valores* (Law of 28 July 1988, no. 24).³² In France, however, the process was initiated in 2005, but in practice, the legislation was adopted in 2007; it refers to the many measures³³ that have integrated the “*monétaire et financier*” code. As regards Germany, the formal procedures were marked by the decision of 14 September 2006 (*Referenterzhwurf* of the German Ministry of Finance), then picked up by the law of 16 July 2007 that came into force fully only in 2008. The “Finanzmarktrichtlinie-Umsetzungsgesetz” (frug) has, therefore, made changes to laws already existing; this refers to Wertpapierhandelsgesetz (WpHG) and the Börsengesetz (BörsG), as well as to Kreditwesengesetz (KWG).³⁴

6.4 The consequences of the violation of the rules of conduct in a comparative perspective

As already mentioned, the community legislator did not consider operated to provide a remedy in the event of breach of the rules of conduct in contractual relationships under investigation, attributing its task on the jurisdiction. It is just necessary to point out that, with regard to the matter of distance marketing of financial products, the decision taken at the supranational level was different. In this case, in fact, the legislation makes specific reference to the severe sanction of nullity in case of failure to comply with disclosure requirements. It is in this action, therefore, the precise choice to establish at the community level, the possible consequences arising from breach of duties imposed on the trader; a choice that was not intended to be followed with MiFID discipline.

It is also significant to disclose a further exception that can be found in the provision of Art. 100 bis of the TUF that the case of a public offer of financial products (reserved for qualified investors, but later resold to

non-qualified investors) requires the invalidity of the agreement if the prospectus has not been published.

In the transposition of MiFID, the Italian legislator has decided not to predetermine the consequences of failure to disclosure of charges billed to the intermediary. This has contributed to a general climate of uncertainty in the matter.³⁵ However, the traditional distinction between validity rules and rules of conduct³⁶ (as opposed to the theory that intends to qualify them the same way as general rules of contract³⁷) was endorsed by the judgements in the United Sections of the Supreme Court of 19 December 2007, no. 26725 and no. 2674, which, depending on the stage of negotiation, decide to give to the act a liability incurred by the of pre-contractual or contractual type. From here, the amenability of the breach of the obligations in question by rules of conduct.³⁸

However, the lack of harmonization existing at the European level should be highlighted; absence that comes, in fact, from the decision to refer the resolution of problems relating to the individual national legal systems. In this regard, we must note, for example, the widespread orientation in Spain to trace the consequences arising from the breach of information duties in vices of the free expression of the will of investors; so the nullity of the contract is the penalty to be applied. In this regard, a recent decision of case law³⁹ is symptomatic in that, after the stages of regulations that preceded the transposition of MiFID rules (with the law no. 47 of 2007), recalls the principles contained in prior case law measures, so as to justify the application of Art. 1265 Spanish Civil Code according to which *“será nulo el consentimiento prestado por error, violencia, intimidación o dolo”*.

The Iberian judges, therefore, refer to the judgement of the Court of Valencia on 12 July 2012⁴⁰ (sharing its findings) that in the event of failure of duty to inform, billed to the intermediary, the customer is not able to express a valid consent; more precisely, the client *“no esté con conocimiento de causa exigido legalmente para tomar la decisión en el campo del mercado de valores”* showing, therefore, a *“consentimiento no informado ...”* Properly understood, then, is *“esa falta de información la que vicia el consentimiento y por ende el contrato”*. So the considerations expressed by the court according to which, in this case, a severe sanction of nullity should be applied.

The model adopted in France, however, appears to be similar (at least in financial matters) to the Italian one; the use of the professional's liability and the resulting payment of damages, it is how we should try to satisfy the expectations of injured investors by the negligent conduct of intermediaries.⁴¹ It is necessary to point out that, instead, on consumer

affairs, there is a tendency to ascribe the absence of adequate information to the client to a mere error, which can influence the validity of the agreement.⁴²

It is significant also to note that, prior to the implementation of the MiFID Directive, in France, the identification of cognitive behaviour to profiles commensurate with the peculiarities of individual investors were assigned to doctrine and jurisprudence, where, however, in Italy, the Consob resorted to a specific provision: Art. 13 of the Consob Regulation 2 July 1991, no. 5387.⁴³ This approach, followed by the Italian Surveillance, is in tune with an orientation, more generally, that the secondary legislation, although they cannot have remedies available to investors, has the duty to specify in detail the content of the disclosure requirements.⁴⁴

In the period prior to the current legislation, therefore, in the absence of regulatory guidance, there was an orientation by the French judicial authorities directed to give special prominence to some personal investors, so as to determine the level of protection chosen to recognize them. From this point of view, we must note the reference to the “*homme d'affaires avisé, habitué aux placements financiers et s'intéressant à la bourse est créancier d'une information moindre que celle due à un profane, même s'il n'a pas de compétence particulière en gestion de fortune*”⁴⁵ but also to “*celui qui est aguerri à la problématique des taux de change parce qu'il a passé des ordres en bourse contre des devises étrangères et qui est un habitué des marchés à risque, est un investisseur averti*”.⁴⁶ Moreover, it is important to note the reference to “*he*” who “*est habituée des marchés et qui ne confie à un intermédiaire qu'un mandat limité est un investisseur averti*”.⁴⁷ It must be highlighted that despite the fact that the national legislation transposed the client classification criteria introduced by the MiFID Directive, the more recent case law confirms a tendency to give importance to some personal qualities of the client, deducible from the concrete circumstance. In fact, the “*Cour d'appel de Mons*” faced with a controversy concerning the failure of a bank to provide the correct information on risks associated with a share option, quickly pointed out how the client “*n'était pas ignorant des services qui pouvaient être apportés par un gestionnaire de fortune et des risques inhérents aux investissements financiers*”, which means “*il est diplômé de l'ICHEC, a assumé personnellement la gestion des placements financiers et était mieux informé qu'un investisseur 'lambda', du fait de sa formation universitaire, du fonctionnement des marchés boursiers et des risques qui sont inhérents aux investissements financiers*”.⁴⁸

It is hardly necessary to point out that a similar attitude, outside of the Union, is also taken by the Swiss courts. In Switzerland, however, a categorization of customers, as in the community scheme, is not provided. It follows that the identification of the conditions that justify the application of the regulations to protect the customer will be determined from time to time. Properly understood, the mechanism in question does not provide adequate protection of the investors' interest. This is confirmed by the willingness of the FINMA (the Swiss Financial Market Supervisory Authority Swiss Financial Market) to adapt a more rigid model established by MiFID; this, however, would be desirable also in view of coordinating disciplines between states that are different.⁴⁹

6.5 The lack of information and the obligation to abstain

The MiFID Directive introduced the novel discipline on the assessment of appropriateness (contained in Article detail, the Consob Resolution 42 by 29 October 2007, no. 16190). In fact, the Italian legal system until then only knew the judgement of adequacy. However, it is properly understood that there are elements of differentiation that in the past could have been found even in the latter procedure. Among the most important, it is appropriate to indicate the one specified in Art. 35 of Directive 2006/73/EC, para. 5, which states as part of the advisory functions relating to investment or portfolio management, if the firm does not obtain the information requested from the customer, it does not recommend the service nor the financial instruments.

It is significant to note that, in the transposition of the relevant regulations, the Spanish legislator has expressed the terminology offered by the community rules; in particular, the Art. 72 of the Royal Decree no. 217 of 2008, which governs the "evaluación de la idoneidad" which states that, in that case, "la entidad...no podrá recomendar servicios de inversión o instrumentos financieros al cliente". French and German legislators also think in the same way; the first stating that, in the absence of information, the intermediary "s'abstient de recommander au client ou client potentiel concerne des services d'investissement" and the second stating that, in the same situation, the company "nicht darf es im Zusammenhang mit einer Anlageberatung kein Finanzinstrument empfehlen oder im Zusammenhang mit einer Finanzportfolioverwaltung keine Empfehlung abgeben".

The Italian regulator, on this precise point, was much more robust. Art. 39, para. 6, of Consob Resolution no. 16190 of 2007, in fact,

specifies that when brokers who provide the service of investment advice or portfolio management do not get the necessary information, they shall refrain from providing the aforementioned services. It is in the presence, therefore, of a formula that leaves no room for misinterpretation: a possible written authorisation from the customer who intends to proceed with the transaction is not covered. This possibility was, however, used in the past in the provision of Art. 29 of Consob Resolution of 1 July no. 11522; a circumstance that has encouraged the spread of the phenomenon, which we have already spoken of and is called “betrayed saving”.

The recent judgement of the Court of Barcelona is significant (2 September 2013, no. 108⁵⁰) in respect of a dispute in which a bank “no efectuó al cliente ni el test de idoneidad ni el de conveniencia antes de suscribir la operación, llegando a afirmar en las condiciones impresas que el cliente se había negado a proporcionar la información necesaria para elaborar dichos”. The rulemaking process resulted in the Royal Decree no. 217 of 2008 (and amendments made to Art. 79a of LVM), the court concluded that, in this case, there had been a violation of “normas de protección de la inversionistas minorista, aunque este en una norma como la Ley del Mercado de valores”. That is the reason for “la sanción mas grave prevista en el derecho civil” or the invalidity of the agreement.

Properly understood, the new disciplinary provision concerns only the case in which the firm does not obtain the required information and not the one in which they, although present, do not allow the intermediary to make a judgement of adequacy. It should be noted, however, that, on this point, as an authoritative doctrine argues the obligation also exists in this case.⁵¹ It is necessary to point out that, instead, the community legislator has explicitly provided for it in the corresponding hypothesis with regard to the procedure for the assessment of appropriateness. That is why, it has the option that in the past the Italian legislation granted to the customer in accordance with Art. 29 (Consob Regulation no. 11522).

More precisely, in the provision of services other than investment advice and portfolio management, if the operation is inappropriate, the customer must, first, be warned by the intermediary. The latter, however, is exempt from liability if, in spite of the warning, commences operation after obtaining the express written permission from the investor.

In other words, according to the current disciplinary system, when the firm undertakes an assessment of appropriateness and considers the service for the customer inadequate, it can still carry out the transaction

(if there is consent from the person concerned). In the context of advisory services and portfolio management, the broker either considers it adequate or necessarily has to refrain from providing services (regardless, therefore, of the fact that the inability stems from the fact that the customer has not provided the requested information). They saw the considerations expressed by the doctrine⁵² that realize the information mentioned above, the free decision-making ability of the parties to self-determination has been replaced by the need to protect savings; this involves, therefore, the sacrifice of personal instances in a perspective that takes into account the need to overcome “superare con modalità certe lo squilibrio... dei diritti e degli obblighi derivanti dal contratto”.⁵³

Therefore, in the presence of a system that, in the context of the individual evaluation processes, imposes not only factors of an objective nature but also subjective requirements (such as, for example, the experience of the investor); in this sense, however, the Court of Appeal in Oviedo (no. 219 of 2013⁵⁴) has expressed a recent judgement according to which, “las previsiones reseñadas tienen su importancia en orden a conseguir que la información prestada reúna unas condiciones objetivas de corrección (información clara, precisa, suficiente y tempestiva) y otras que podían calificarse de de ‘subjetivas’ por atender a circunstancias concretas del cliente (experiencia, estudios, contratación previa de otros productos...)”. To this, we must add the need to provide greater market stability; an objective pursued through the sacrifice of personal instances on the basis of a more general protection of savings. In this perspective, however, there is the need to define more precisely the scope of the discipline in question; we refer, for example, to the so-called advice that is incidental to the consultative work that can be carried out in the course of another investment service.

In these circumstances, there are, in fact, those who wonder if the discipline adequacy is applicable and, therefore, if the profile of the intermediary liability should be limited strictly because of the “type” of activity.⁵⁵ The issue becomes more interesting by virtue of the Consob Communication of 2 March 2009, no. 9019104⁵⁶ which, with respect to illiquid products, points out that the assistance given to the client in the structuring phase of these operations creates (or at least presents as) being “tailored” for the client, even if in partial standardisation, presupposes intrinsically that the product is presented as suitable for the client and thus makes the application of the regime of adequacy necessary, this is foreseen in cases of providing investment services.

6.6 Future prospects

The framework outlined in the financial and banking areas is heavily anchored on the necessities to ensure adequate levels of awareness on the part of customers so that the resolution of the issue of the so-called “information asymmetry” is addressed through a significant transmission of data between professionals and the consumers (especially if) inexperienced. It is no coincidence that the MiFID Directive provides for a classification of customers by lowering the threshold of protection in front of a prepared counterpart and not in need of further information.

It is, however, obvious to everyone that the disciplinary system as proposed has not borne up before the recent crises; hence, the need by the jurist to propose new operating modes able to ensure greater stability to the system. Indeed, it is now common opinion that the same test of adequacy and appropriateness has proved absolutely incapable of delineating the precise risk profiling of customers⁵⁷; at the same time, the persistent and unresolved issue of conflict of interest, of course, did not favour the establishment of the necessary confidence between broker and client.

The implementation of financial education is not the way to pursue in view of an improvement in the subjects’ ability to make really conscious choices; in fact, the same increase of information gives rise to phenomena of overload (or excess data) harbingers, most of the time, and of judgement errors (bias).⁵⁸ In this critical context, the identification of eligible instruments to overcome the fallacy decision of individuals (experts or not) is the objective that, in the near future, should engage scholars of the subject.⁵⁹

It is the view in this regard that legislation to regulate the relationship in question on the basis, primarily, of the exchange of clear and not misleading information (in order to ensure rational choices by investors) cannot be separated from the contributions of those who study the processes of data processing on the part of individuals. The reference to the work of cognitive psychology, and in particular the complex dynamics of decision-making of investors, which is an aspect of the legislator (community and national) cannot but take into account the definition of a disciplinary system that involves a cognitive investigation.

From this point of view, it is confirmed, also supported by medical studies,⁶⁰ that decision-making individuals tend to give undue prominence to the rational and emotional components rather than enhance, for the resolution of a complex problem, some data, even if unnecessary, merely because they have been highlighted in a manner appropriate

to attract this attention,⁶¹ and this cannot be neglected. The same test of adequacy and appropriateness implies, in our view, a psychological investigation. The exact definition of investor risk profiling requires, therefore, a deepening of the intricate subjective decision-making processes; a study that may help identify the most appropriate instruments (compared to typical questionnaires prepared by intermediaries) to pursue their aims by the MiFID Directive.

Properly understood, the realization that individuals, faced with difficult situations, prefer the use of simplified mental processes to make decisions is something that requires you to search *aliunde* for the direct means to facilitate decisions that are as rational as possible. To this, add how the contributions of scholars in the field have shown that even experienced individuals (and, therefore, also the interlocutors of the same customers) can fall victim to cognitive errors⁶²; hence, the need to further identify, even in this respect, means able to warn the negotiating parties of the possibility of erroneous decision-making processes.

In this context of course, the provision in Art. 42 last paragraph. of the Consob 29 October 2007, no. 16190 can be criticized; a provision which takes its origin from the EU directive. It recalls a sterile standardized format, the warning of the intermediary to the customer that the service or the instrument is inappropriate for him or her. Indeed, the danger that lurks behind forms of communication, the default is the possibility that intermediaries enjoy exemption from liability arising from an informed consent expressed by the customer which, in practice, signs a pre-printed form without adequate attention. In this regard, the recent circular of the National Commission of the Spanish securities market⁶³ in which a standardized model is contained to which the intermediary must refer to situations is significant: “en el proceso de evaluación de la Conveniencia”. In particular, in a separate document, it should be specified that in the event that the customer does not provide the information, the broker will not be in possession of “datos necesarios para realizar Dicha evaluación”; hence, the impossibility of “formarse a opinión respecto a esta operación es o no conveniente para usted”. If the investor intends, in every case, to approve the transaction, a document must be signed with the following wording: “no he sido en esta operación asesorado”.

It is evident that similar pre-printed forms if, on the one hand, have the merit of removing responsibility of the company from any damages that may arise as part of the operations to be carried out; on the other hand, they show a declaration system capable of conferring too much power to authorized persons, to the detriment of the effectiveness of the

mechanism of investor protection.⁶⁴ More generally, it should be noted that studies of the psychology of financial markets have shown that the most effective circulation of information is not based on a written form.⁶⁵ From this point of view, therefore, the oral communication mode should be favoured. However, there is the need, in this context, for the expansion of the skill levels of people, who in terms of concreteness, direct the investment choices of subjects (particularly those less experienced).

The identification of mechanisms able to determine the actual skill possessed by those who enter into direct contact with clients, requires the need to ensure that these can operate without any conditioning. In this respect, therefore, the problems associated with the potential conflict of interest that exists on the part of intermediaries has to be resolved; a conflict that is able to undermine the relationship of trust between the intermediaries and the client and, in this way, the stability of the market. From this point of view, the strengthening of independent counselling services as is stipulated in the so-called MiFID review is, of course, an important step toward strengthening the solidity of commercial relations, without prejudice, in any case, the opportunity to ensure appropriate quality standards in the conduct of these operations.

It is, therefore, in this context, a goal that cannot be ignored any longer is the use in the evaluation of adequacy and appropriateness of questionnaires able to find any cognitive errors committed by the clients, so as to warn them about the possibility that personal decision-making can be influenced by them. We have to that, prospectively, the opportunity to use specific software to identify, as precisely as possible, the tendency risk of individuals⁶⁶; to reduce, in the processes of judgment in question, the discretion of authorized persons. It is clear that a similar approach goes through the decision to act, in the preparation of rules aimed at regulating the matter, in collaboration with researchers in cognitive psychology; this is because legislation that seeks to impose a variety of informational burdens on the parties and to make a survey of subjective inclinations at risk from clients, cannot be separated from the scientific contributions concerning the study of the intimate subjective dynamics processing data.

Notes

1. As concerns the normative evolution of the so-called *informative asymmetry* of the Italian framework, cf. M. De Poli, *Asimmetrie informative e rapporti contrattuali*, 2002, in *Collana del Dipartimento di Scienze Giuridiche degli Studi Ca' Foscari – Venezia*, Padova Cedam, ed.

2. For all, V. Roppo, *Il contratto*, 2001, in G. Iudica and P. Zatti, eds., in *Trattato dir. priv.*, Milano Giuffrè ed., p. 906.
3. The disposition mentioned, in fact, is applied every time the contract settlement is arranged for one party only regardless of the existence of an information gap. On this subject, cf., for all, F. Capriglione, *Intermediari finanziari Investitori Mercati. Il recepimento della MiFID. Profili sistematici*, in F. Capriglione, ed., 2008; *Saggi e monografie di diritto dell'economia*, Padova Cedam, ed., 23, note 56; V. Roppo, *Il contratto*, 2001, cit., 911; S. Patti, *Le condizioni generali di contratto e i contratti del consumatore*, 1999, in P. Rescigno, ed., *Trattato dei contratti*, Torino Utet, ed., 295; G. Tassoni, *Condizioni generali di contratto e dolo del predisponente*, 1994, in *Contratti*, 2, 124; M. Costanza, *Condizioni generali di contratto e contratti stipulati dai consumatori*, 1994, in *Giust. civ.*, 3, 543.
4. About the subject, cf., for all, G. Capozzi, *Il contratto in generale*, 2002, Milano Giuffrè, ed., 264, according to which the praxis shows that the formalism resolves itself in the simple apposition, on the contractual document, of a second signature by the participant with the same distraction with which he or she subscribes, accepting in a passive way and in block, the form prepared by the enterprise.
5. On the subject, cf. F. Rossi, art. 142, in G. Alpa and L. Rossi Carleo, eds., in *Commentario al Codice del Consumo*, 2005, Napoli Esi, ed., 873 ss., and also for the reasons of legislative politics that led to this decision.
6. Regarding this matter, cf., L. Rossi Carleo, art. 5, in G. Alpa and L. Rossi Carleo, eds., in *Commentario al Codice del Consumo*, 2005.
7. For a study on the relevance of the restrictive clauses in the contracts concerning financing services, please refer to M. Sepe, *Clausole vessatorie e abusive nei contratti relativi ai "servizi finanziari"*; *il regime di specialità*, 2010, in *Scritti in onore di Francesco Capriglione*, Tomo II, Padova Cedam, ed., 787 ss.
8. For all, cf. R. Caterina, *Paternalismo e antipaternalismo nel diritto privato*, 2005, in *Riv. dir. civ.*, 6, 779 ss.
9. With regard to the importance of the public intervention in the economy, please refer to L. Zingales, *The Costs and Benefits of Financial Market Regulation*, 2004, April, ECGI – Law Working Paper, 21, consultable on <http://ssrn.com/abstract>; E. Rock, *Securities Regulations Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 2002, in *Cardozo Law Review*, 23, 675 ss.; S.M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis* 2000, in *U. Chi. Law Review*, 68, 1023.
10. We are referring to the recent modification to the Consumer Code contained in the D. Lgs. No. 21/2014 that transposes the European directive 2011/83/EU.
11. On this point, see M. De Poli, *Asimmetrie informative e rapporti contrattuali*, cit., 168 ss. For a study on the relationship between ethics and professionalism in banking, please refer to V. Lemma, *Etica e professionalità bancaria*, 2013, in Sabbatelli I., ed., *Banche ed etica*, in Capriglione F., ed., *Saggi e monografie di diritto dell'economia*, Padova Cedam ed., 129 ss.
12. Thus, for all, see F. Capriglione, *Intermediari finanziari Investitori Mercati*, cit., 13, according to which the rules of transparency are basic criteria of the legal market (which results in the recognized strengthening of specific ethical importance).

13. Reasons for which it is found widely in the literature. Please refer to F. Capriglione, *Crisi a confronto*, 1929 and 2009. *Il caso italiano*, 2009, Padova Cedam and J.C. Trichet, *The ECB's response to the crisis*, 20 February 2009, available on the official website of the European Central Bank; R. Schiattarella, *La crisi economica: cause, dimensione e prospettive*, 2008, *Dem. e dir.*, 2, 83 ss.
14. On this subject, see R. Rordorf, *La tutela del risparmiatore: norme nuove, problemi vecchi*, 2008, in *Soc.*, 3, 270 for which the serious and negative crisis events are derived from infringement, plus or minus a license, rules that the existing legislation already expressed and which, however, have not been able to ensure effective and timely compliance with.
15. With regard to implementing provisions of MiFID in Italy, please refer to F. Capriglione, *Intermediari finanziari Investitori Mercati*, cit.; Aa.Vv., *Strumenti finanziari e regole MiFID*, 2009, F. del Bene, Giuffrè Milano, eds.; E. Guerinoni, *La nuova disciplina dei contratti di investimento*, 2008, Giuffrè Milano ed., V. Roppo, *Sui contratti del mercato finanziario, prima e dopo la MiFID*, 2008, in *Riv. dir. priv.*, 485 ss.; S. Bastianon, *L'integrazione dei mercati finanziari in Europa: la MiFID e la recente normativa italiana di recepimento*, 2008, in *Il Diritto dell'Unione Europea*, 2, 255 ss.; F. Durante, *Con il nuovo regolamento intermediari, regole di condotta "flessibili" per la prestazione dei servizi di investimento*, 2008, in *Giur. mer.*, 3, 628 ss.; A. Rinaldi, *Il decreto MiFID e i regolamenti attuativi: principali cambiamenti*, 2008, in *Soc.*, 1, 12 ss.; V. Sangiovanni, *La nuova disciplina dei contratti di investimento dopo l'attuazione della MiFID* 2008, in *Contratti*, 2, 173 ss.; ID., *Gli obblighi informativi delle imprese di investimento nella più recente normativa comunitaria*, 2007, in *Dir. comm. degli scambi internaz.*, 2, 363 ss.
16. On the matter, see M. Pellegrini, *Etica e regole di condotta degli intermediari finanziari*, in I. Sabatelli, ed., *Banche ed etica*, in F. Capriglione, *Saggi e monografie di diritto dell'economia*, Padova Cedam, ed., 65, such as the rule of conduct must be considered a provision that is made in the code of ethics of the financial intermediary that constitute significant part of the disciplinary system.
17. On the subject, see M. De Poli, *Asimmetrie informative e rapporti contrattuali*, cit., 181 s.
18. For a review of the rules of conduct in the validity of the l. Sim, please refer to F. Capriglione, *Evoluzione del sistema finanziario italiano e riforme legislative, (prime riflessioni sulla legge "Amato")*, 1991, (Report to the seminar organized by the Industrial Credit Sardinian on the theme: "the transformation of the public sector bank in the predictions of the law 218/90 and decrees", Cagliari-chia Bay 24 November 1990), in *Banca, borsa, tit. cred.*, 1, 42 ss.; ID., *Le gestioni patrimoniali: prime riflessioni sulla disciplina contenuta nella legge sulle S.i.m.*, 1991, in *Bancaria*, 4, 7 ss.; G. Alpa, *La legge sulle s.i.m. e i contratti con i clienti* 1991, in *Giur. it.*, 5, 177 ss.; M. Sepe, *Tutela concorsuale del fiduciante e separatezza patrimoniale nel regime della legge sulle Sim*, 1992, (note to Trib. Torino 28 February 1991), in *Banca, borsa, tit. cred.*, 4, 484 ss.; R. Costi, *Prime note esegetiche in tema di società di intermediazione mobiliare*, 1992, in *Dir. banca e mercato fin.*, 2, 149 ss.; V. Di Cataldo, *Lo "statuto speciale" delle Sim*, 1992, (Speech at the conference on the theme: "Supervision and fairness in stockbroking activities," Trapani, 29–30 May 1992) in *Banca, borsa, tit. cred.*, 6, 149 ss. In a comparative perspective, please refer to M. Lobuono, *Le regole di comportamento degli intermediari*

mobiliari tra istanze professionali e disciplina del mercato: l'esperienza inglese e francese, 1991, in *Riv. dir. civ.*, 99 ss.

19. On the topic, it can be found, even for references to foreign literature, in M.S. Carboni and F. Munari, *Enforcement of the European regime for investment services in the member states and its impact on national conflict of laws*, 1997. (Speech at the conference on the theme: "European investment markets implementation of the ISD and national law reforms", Santa Margherita, 8–9 November 1996), in *Dir. un. europ.*, 1–2, 31 ss.; F. Annunziata, *Il "Wertpapierhandelsgesetz" e la riforma del mercato mobiliare in Germania*, 1996, in *Banca, borsa, tit. cred.*, 2, 226 ss.; E. Wymeersch, *Il recepimento delle Direttive europee sui servizi di investimento nell'ordinamento degli Stati membri*, 1997, in *Riv. soc.*, 2–3, 400 ss.; G. Ferrarini, *Novità e problemi del decreto Eurosim*, 1996, in *Banca, borsa, tit. cred.*, 6, 883 ss. The need to promote harmonization between the various disciplines in the field was also motivated by the intensification of the relations between the various states that has facilitated new investment opportunities as well as the use of intermediaries dedicated to asset management. On this point, see M. Sepe, *Il risparmio gestito*, 2000, Bari Cacucci, ed.
20. With regard to the rules of conduct in the validity of the Eurosim decree, see F. Annunziata, *I primi regolamenti di attuazione del decreto Eurosim*, 1997, in *Riv. soc.*, 2–3, 450 ss.; G. Alpa and P. Gaggero, *I servizi di investimento in valori mobiliari nel decreto Eurosim*, 1997, Milano Giuffrè, ed., 47 ss.
21. On the subject, cf. C. Rabitti Bedogni, *Il testo unico della intermediazione finanziaria*, 1998, Milano Giuffrè, ed., 171 ss. Recently, even for a historical reconstruction of the legislation in question, cf., P. Lucantoni, *Le regole di condotta degli intermediari finanziari* (2010), in E. Gabrielli and R. Lener, *I contratti del mercato finanziario*, Part I, cap. V, Torino Utet, ed., 242 ss.
22. On the subject, cf., for all, M. Pellegrini, *Le regole di condotte degli intermediari finanziari nella prestazione dei servizi di investimento*, 2010, in F. Capriglione (ed.), *L'ordinamento finanziario italiano*, Tomo II, Padova Cedam, eds., 809 ss. which (818) highlights the close link between the dispute relating to the financial services and the default of large enterprises; I. Sabbatelli, *La supervisione sulle banche. Profili evolutivi*, 2009, Padova Cedam, ed., 42 ss.; F. Durante, *Intermediari finanziari e tutela degli investitori*, 2009, in C. Riviezzo, ed., "Orientamenti di merito", Milano Giuffrè, ed., F. Greco, *Risparmio tradito e tutela: il "subbuglio" giurisprudenziale*, 2007, note to App. Milano sez. I, 19 December 2006, No. 3070; Trib. Brindisi 21 July 2006, No. 701; Trib. Lecce section II, 12 June 2006, No. 1105, in *Danno e resp.*, 5, 569 ss.; M. Sciuto, *Il danno dell'investitore (dove sta andando la giurisprudenza sul "risparmio tradito")*, 2009, Lecture given at the conference "La tutela del denaro degli altri. Dove sta andando la Giurisprudenza" held in Florence, on 7 November 2008, in *Riv. dir. impr.*, 1, 49 ss.
23. Cf., for all, Trib. Law, 12 June 2006, No. 1105.
24. On this subject, cf., among others, Trib. Catania, 19 June 2008, No. 2820 (with a note by F. Savasta, *L'adeguatezza informativa ed operativa a fronte del rifiuto di fornire informazioni*, 2009, in *Le soc.*, 8, 1000 ss.) that despite recognising how the intermediary has been failing toward the client regarding the informational duty concerning the investment characteristics, it does not grant to the latter compensatory protection; this is because the investment was adequate on the basis of a presumptive assessment conducted by the

- Technical Consultant. See also Trib. Milano, 26 April 2006, No. 4882; Trib. Milan, 20 March 2006, No. 3575; Trib. Genova, 22 February 2006, No. 625; Trib. Novara, 17 November 2005, No. 819, with notes by V. Sangiovanni, *Scandali finanziari: profili di responsabilità dell'intermediario*, 2006, in *Danno e resp.*, 8–9, 884 ss.; Trib. Turin, 16 February 2006, with notes by C. Marchiandi, *La responsabilità degli intermediari nei confronti dell'investitore: il quadro giurisprudenziale*, 2009, in *Giur. comm.*, 2, 363 ss.
25. Among others, see M. Porzio, *L'accordo interbancario sulla trasparenza* (1990), *Dir. banca e merc. fin.*, 374 ss. On this point, please refer to V. Piccinini, *I rapporti tra banca e cliente. Asimmetrie e condotte abusive*, 2008, Padova Cedam, ed., 22.
 26. For a discussion of the discipline, see G. Alpa, *La "trasparenza" del contratto nei settori bancario, finanziario e assicurativo*, 1992, in *Giur. it.*, 10, 411 ss.; F. Maimeri, *La legge sulla trasparenza delle operazioni bancarie*, 1992, in *Bancaria*, 5, 57 ss.; A. A. Dolmetta, *Per l'equilibrio e la trasparenza nelle operazioni bancarie: chiose critiche alla legge No. 154/1992*, 1992, in *Banca, borsa, tit. cred.*, 3, 375 ss.
 27. M. De Poli, *Asimmetrie informative e rapporti contrattuali*, cit., 209 s.
 28. Cf., for all, R. Costi, *L'ordinamento bancario* (1994), Bologna Il Mulino, ed., 477.
 29. A. Urbani, art. 116, in F. Capriglione, ed., *Commentario al Testo Unico delle leggi in materia bancaria e creditizia*, 2012, Padova Cedam, ed., Vol. 3, 1676.
 30. In this regard, see the judgement of the Court of Justice of 4 October 2007 (case C-429/05), available on the website <http://curia.europa.eu>.
 31. On this subject, see A. Baldassare, Art. 126-octies, in F. Capriglione, ed., *Commentario al Testo Unico delle leggi in materia bancaria e creditizia* (2012), Padova Cedam, ed., Vol. 4, 2018 ss.
 32. For a reconstruction of the Spanish law aimed at transposing the MiFID Directive, see M. Di Sarli, *Recepita in Spagna la direttiva MiFID*, 2008, in *Riv. soc.*, 2–3, 2008, 626 ss.
 33. *Ordonnance numéro 2007–544 du 12 avril 2007, publiée au JO du 13 avril 2007; Décret en Conseil d'état numéro 2007–901 du 15 mai 2007 publié au JO du 16 mai 2007; Décret numéro 2007–904 du 15 mai 2007 publié au JO du 16 mai 2007; Arrête du 15 mai 2007 portant l'homologation de modifications du règlement général de l'AMF*. For a first comment, see F. Buisson, *La transposition de la directive européenne Marchés d'Instruments Financiers (MIF) en droit français* (2007), in *Rev. trim. droit. fin.*, 2, 2007, 6 ss.
 34. For a review of the measures transposing the MiFID Directive into German law, see P. Beltrami, *Attuazione della direttiva MiFID nell'ordinamento tedesco* (2007), in *Riv. soc.*, 5, 1183 ss.
 35. In particular, the doctrine states that the violation of the rules of conduct and, in particular, the duties of information, involve the nullity of the contract. Among others, see G. Alpa, *La legge sul risparmio e la tutela contrattuale degli investitori* (2006), in *Contratti*, 10, 930; G. Piazza, *La responsabilità della banca per acquisizione e collocamento di prodotti finanziari "inadeguati" al profilo del risparmiatore*, 2005, in *Corr. giur.*, 1, 1029 ss.

Contra, ex multis, V. Mariconda. Regole di comportamento nella trattativa e nullità dei contratti: la criticabile ordinanza di rimessione della questione alle sezioni unite, 2007, in *Corr. giur.*, 5, 635 ss., which (640) states that, among

other things, does not mean at all that the assertion of invalidity of contracts where one party has behaved improperly, applies to better protect the other party; M. Ambrosoli, *Doveri di informazione dell'intermediario finanziario e sanzioni*, 2005, in *Contratti*, 12, 1110; M. Pellegrini, *Brevi note sulla vexata quaestio dei bonds argentini*, 2005, in *Banca, borsa, tit. cred.*, pt. 2, 6, 682 which sees (688) in a jurisprudential attempt to the appeal on the subject for the invalidity for the violation of mandatory rules of a culture that disregards the rules of the market disregarding the possible liability of the investor.

36. It is just necessary to point out that the sanction of invalidity related to the violation of the rules of behavior is configured in Germany, in relation to the principle of *Treu und Glauben*. On this point, see Bundesverfassungsgericht (Constitutional German Court), 19 October 1993, in *Nuova giur. civ. comm.*, 1995, I, 197, with notes by A. Barengi, *Una pura formalità. A proposito di limiti e di garanzie dell'autonomia privata in diritto tedesco*. In dottrina, cf. F. Galgano, *Squilibrio contrattuale e mala fede del contraente forte*, 1997, in *Contratto e impr.*, 418 ss. With respect to the relationship between the framework contract for the discipline of the service and the individual shops with which it is implemented to the relationship that agreement draws its source, please refer to V. Troiano, *Violazione delle regole di condotta degli intermediari nello svolgimento dei servizi di investimento e tutela giudiziale*, 2005, in *Mondo banc.*, 5, 33 ss.
37. See, G. Alpa, *Gli obblighi informativi precontrattuali di investimento finanziario. Per l'armonizzazione dei modelli regolatori e per l'uniformazione delle regole di diritto comune*, 2009, in *Ec. dir. terziario*, 3, 396 ss.
38. For a comment on the judgements of the Supreme Court of 19 December 2007, No. 26724 and No. 26725 please refer, for all, to G. Vettori, *Regole di validità e di responsabilità di fronte alle Sezioni Unite. La buona fede come rimedio risarcitorio*, 2008, in *Obb. e contr.*, 2, 104 ss.; D. Maffei, *Discipline preventive nei servizi di investimento: le Sezioni Unite e la notte (degli investitori) in cui tutte le vacche sono nere*, 2008, in *Contratti*, 4, 403 ss.; V. Sangiovanni, *Inosservanza delle norme di comportamento: la Cassazione esclude la nullità*, 2008, in *Contratti*, 3 221 ss. On the subject, see also A. Tucci, *La violazione delle regole di condotta degli intermediari tra nullità virtuale, culpa in contrahendo e inadempimento contrattuale*, 2007, in *Banca, borsa, tit. cred.*, 648 ss. With regard to the case law, cf. Cass., 29 September 2005, No. 19024, in *Contratti*, 8, 2006, 897 ss.; in *Giur. it.*, 8–9, 2006, 1602 ss., with notes by G. Sicchiero, *Un buon ripensamento della S. C. sulla asserita nullità del contratto per inadempimento*; e in *Danno e resp.*, 2006, 1, 25 ss., with notes by V. Roppo and G. Afferni, *Dai contratti finanziari al contratto in genere: due punti fermi della cassazione su nullità virtuale e responsabilità pre-contrattuale*.
39. Referring to the Judgement by the Tribunal of Valencia No. 778, 11 June 2013, available on the website <http://asuapedefin.com/>.
40. Available on the website <http://asuapedefin.com/>.
41. Bruxelles, 23 septembre 2010, in *Rev. des contrats*, 2012, 57, with notes by O. Stevens; Justice de Paix de Molembeek-Saint-Jean, 10 May 2012; Mons, 24 October 2012, 1; Trib. Comm. Bruxelles, 2 mars 2011, in *Rev. des contrats*, 2012, 378; Trib. comm. Bruxelles, 25 October 2010, in *Rev. des contrats*, 2012, p. 367, B. Caulier, *De la nature des titres perpétuels*; S. Bonfils, *Les obligations de mise en garde au profit des investisseurs et des emprunteurs face aux risques*

- de pertes et de déloyauté*, 2008, in *Droit bancaire et financier. Mélanges AEDBF-France*, Paris, Revue Banque édition, 61.
42. See in Jurisprudence, for all, Cass. civ., 13 November 2002, Bull. civ., No. 267, 208 ff. And in doctrine, for all, D. Fenouillet, *Formalisme informatif*, 2005, in *Rev. des contrats*, 2, 323 ss.; V. Magnier, *Les sanctions du formalisme informatif*, 2004, in *La Semaine juridique – Edition générale*, 106. With regard to a reform of the Contract Legislation, please refer to D. Fenouillet, *Regards sur un projet en quête de nouveaux équilibres: présentation des dispositions du projet de réforme du droit des contrats relatives à la formation et à la validité du contrat*, 2009, in *Rev. des contrats*, 1, 279 ss. See also V. Crescimanno, *Obblighi di informazione del fornitore di servizi finanziari e nullità del contratto: la disciplina francese tra Code de la consommation e Code civil*, 2008, in *Europa dir. priv.*, 503.
 43. On the subject, cf. F. Grasselli, *Derivati: la Cassazione si pronuncia sulla nozione di operatore qualificato*, 2011, in *Obbl. contr.*, 5, 507 ss., notes to Cass. civ. 16 May 2009, No. 12138.
 44. On the matter, cf. G. Alpa, *Gli obblighi informativi precontrattuali di investimento finanziario. Per l'armonizzazione dei modelli regolatori e per l'uniformazione delle regole di diritto comune*, 2009, cit., 407.
 45. Trib. Comm. Bruxelles, 5 May 2006.
 46. Trib. Comm. Mons, 22 February 2001, in *Rev. des contrats*, 2003, 63 with notes by P. Buyle e M. Delierneux.
 47. Trib. Comm. Mons, 22 February 2001, cit.
 48. Cour d'appel de Mons, 24 October 2012, No. 401.
 49. See the document of 24 February 2012 in which the FINMA (the Federal Authority for Financial Market Supervisory Authority) expressed its orientation; document entitled: "Regolamentazione sulla produzione e la distribuzione di prodotti finanziari" available on the website www.finma.ch.
 50. Available on the website <http://asuapedefin.com/>.
 51. F. Capriglione, *La problematica relativa al recepimento della MiFID*, in M. De Poli, ed., in *La nuova normativa MiFID*, 2009, in F. Capriglione, *Saggi e monografie di diritto dell'economia*, Padova Cedam, ed., 23. Cf., and, L. Frumento, *La valutazione di adeguatezza e di appropriatezza delle operazioni di investimento nella direttiva MiFID*, 2007, in *Contr.*, 583 ss.
 52. Referring to F. Sartori, *Le regole di adeguatezza e i contratti di borsa: tecniche normative, tutele e prospettive MiFID*, 2008, in *Riv. dir. priv.*, 1, 42.
 53. F. Capriglione, *La problematica relativa al recepimento della MiFID*, cit., 23.
 54. Available on the website <http://asuapedefin.com/>.
 55. On the subject, see V. Santocchi, *Le valutazioni di adeguatezza e appropriatezza nei rapporti contrattuali fra intermediario cliente*, in E. Gabrielli and R. Lener, eds., *I contratti del mercato finanziario*, 2010, Torino Utet, ed., Part I, cap. VI., 217.
 56. Available on the official website www.consob.it. On the matter, see also M. Rescigno, *Il prodotto è tossico: tenere lontano dalla portata dei bambini*, 2009, in *AGE*, 1, 159, who asks if it would not be more convenient evaluation regulatory choices that concentrate mainly on the products subject to the investment, without affecting the opportunity to raise the rate of paternalism in the law of the financial markets in order to defend it from itself.
 57. See N. Linciano, *La consulenza finanziaria tra errori di comportamento e conflitti di interesse*, 2012, in *AGE*, 1, 136 s. that suggests a refinement of the instruments (i.e. questionnaires) commonly used by consultants for the detection

of relevant information to define the risk profile of the client; so they should distinguish part of the process of profiling preferences towards risk (objective) from the emotional ability and financial capacity to assume risk and having to use, for each of these components, suitable measures (also methodological) designed to ensure a reliable detection.

58. See Ackert, Church, Tkac, *An Experimental Examination of Heuristic-Based Decision Making in a Financial Setting*, 2010, in *The J. Behav. Fin.*, Vol. 11, 135 ss.; J.M. Lacko and J.K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, 2004, in Federal Trade Commission Bureau of Economics Staff Report, February; A. Bastardi and E. Shafir, *On the Pursuit and Misuse of Useless Information*, in *J. Pers. soc. Psyc.*, 1998, Vol. 75, No. 1, 19 ss. In the Italian doctrine refers to P. Legrenzi, *Psicologia e investimenti finanziari*, 2006, Milano Giuffrè, ed., 76 ss.
59. On the subject, refer to D. Rossano, *Le tecniche cognitive nei contratti di intermediazione finanziaria. Valutazione dei rischi finanziari ed indicazioni delle neuroscienze*, 2011, in Collana del Dipartimento giuridico dell'Università degli Studi di Napoli "Parthenope", Napoli Esi, ed.
60. See the study of G. Sanfey, G. Loewenstein, S.M. McClure and J.D. Cohen, *Neuroeconomics: cross-currents in research on decision-making*, 2006, in *TRENDS in Cognitive Sciences*, 10, 2006, 108 ss.; A.G. Sanfey, J.A. Aronson, L.E. Nystrom and J.D. Cohen, *The neural correlates of theory of mind within interpersonal interactions* Rilling (2004), in *Neuroimage*, Vol. 22, No. 4, 1694 ss.
61. D.G. MacGregor, P. Slovic, D. Dreman and M. Berry, *Imagery, Affect, and Financial Judgment*, in *J. Psyc. and Fin. Markets*, 2000, Vol. 1, No. 2, 104 ss.
62. On the subject, see R.J. Shiller, *Euforia irrazionale. Alti e bassi di Borsa*, 2009, translated by Lucia Scardapane, Bologna Il Mulino, ed., 214 ss.
63. Circular 3/2013, de 12 de junio, de la comisión nacional del mercado de valores: consultable at www.boe.es.
64. On the subject, see P. Lucantoni, *Le regole di condotta degli intermediari finanziari*, cit., 195.
65. See R.J. Shiller, *Euforia irrazionale. Alti e bassi di Borsa*, cit., 217, which shows that the mainstream media, print, television and radio have a deep capacity for the dissemination of ideas, but their ability to generate active behaviour is still limited. Interpersonal communications and interactive, especially face-to-face or word of mouth, still have the most powerful impact on our behaviour.
66. For a listing of possible tests and software to use, please refer to D. Rossano, *Tecniche cognitive, tutela del risparmiatore ed etica comportamentale degli intermediari*, in I. Sabatelli, ed., *Banche ed etica*, in F. Capriglione, *Saggi e monografie di diritto dell'economia*, Padova Cedam, ed., 215; ID. *Il contributo delle scienze cognitive nella valutazione della propensione al rischio*, 2012, in *AGE*, 1, 85 ss.; No. Linciano, *Errori cognitivi e instabilità delle preferenze nelle scelte di investimento dei risparmiatori retail*, 2010, in *Quaderni finanza della Consob*, 1, 38.

7

Public Offer

Paola Fico

7.1 Introduction

The main aim of the legislation on public offer (also known as solicitation) is to have a safeguard of the “unaware savings” that are not necessarily coming from professionals, through the transparency of the proposed transactions.

The transparency of the proposed transactions has to be intended as the availability of information that, by quantity and quality, can be considered adequate in order to formulate a valid opinion on the risk-return profile of the proposed investment.

The tool concretely used to this end is the diffusion of a prospectus that contains some information on the party proposing the transaction and the execution modalities of the operation itself.

It is therefore included in the concept of solicitation any offer of public underwriting, having as an object financial products of a new issue; any proposal through an offer to the public, to buy or to sell (or even to exchange) financial products already issued; any invitation to the public to present offers for the underwriting or the acquisition of financial products; any message, even if advertising, aimed at promoting (and also if preparatory or preliminary) placement of financial products.

These activities on financial investments can be done “in any way”, and that is by any means (by proposals of an offer or by an invitation to offer, at the domicile of the investors, or through newsletters or through the use of mass communication means: television, electronics means and so on). The concept of investment solicitation is quite broad and as such includes any form of distribution among the public of financial products, even though with unknown modalities, or not adequately developed, at the moment of the publication of the legislation.

7.2 The historical evolution

In the Italian legal system, the provisions on public offers have been gradually introduced since the mid-1970s, according to a path that has followed in part the developments of the Italian securities market, but that has also been strongly incentivised by the action of the European Legislator, which has used the experience of foreign legislative systems, especially of the American one, as examples.¹

Up to the 1970s, the legislation on financial intermediation in Italy used to basically coincide with the legislation on the banking law of 1930s.²

The complex process of the regulatory production of the legislation of the securities market starts essentially in 1974 with the creation of the National Commission for the Companies and the Stock Exchange (the Consob).

A significant change takes place in 1983 with the approval of the law of 23 March 1983, no. 77 which marks the extension of the authority of the Consob over activities not necessarily related with the Stock Exchange.

This means the creation of a first legislation addressed to the securities market as such. The law no. 77/1983 not only introduces for the first time in Italy a legislation on the controls over the activities of collection of non-bank savings, defined as “investment solicitation”, but it also intervenes on the notion of security, as of law no. 216/1974, meaning by it: “any document or certificate that directly or indirectly represents rights in companies, associations, enterprises or entities of any kind, here included Italian or foreign investment funds; any document or certificate representing a credit or an interest negotiable or not; any document or certificate representing rights related to material goods or real estate properties, as well as any document or certificate apt at conferring rights issued by trustees entities...” (Art. 1\18-*bis* law no. 216/1974). The broad range of such a definition marks the extension of the Consob controls to all the securities market, without prejudice to the legislation concerning banks and insurances that are not included in these provisions.

The solicitation had to be anticipated by the publication of a prospectus. With the entry into force of the TUF, D.L. 24 February 1998, No. 58, it has been reinstated the notion of solicitation: “every offer or incentive, invitation to offer or promotional message, in whatsoever form addressed to the public, whose objective is the sale or subscription of financial products”. Also, the obligation to publish a prospectus had been reproduced.

In 2007, such a framework had been revised to implement the Prospectus Directive No. 2003/71/EC. The Prospectus Directive is among the measures of juridical harmonisation aimed at the implementation of the Financial Service Action Plan (FSAP) approved by the European Union with the aim of enhancing the free movement of capitals within the European Union and to incentivise the development of a pan-European securities market able to compete at international level. On such basis, the Prospectus Directive joins the provisions of the directives 80/390/EEC and 89/298/EEC and harmonises the procedures for the approval and the publication of a prospectus to be published respectively for the admission to listing and for the public offer of securities.³ The even more ambitious objective of the European legislation is the uniform regulation of the contents of the prospectus implemented with the European Community Regulation of 29 of April 2004 no. 809, containing the prospectus schemes redacted according to the standardization and simplification principles in order to enhance the safeguard of investors and the efficiency of the market. The Prospectus Directive came into force on 31 December 2003 by its publication in the EU Official Journal. Member States were required to implement it in their jurisdictions no later than 1 July 2005.

With the Legislative Decree of the 28 of March 2007, No. 51, the directive has been implemented in Italy. The ambitious objective of the directive has been to facilitate the access to the European markets by the companies in the European Union and to uniform the level of the information addressed to the investors.

Art. 31 of the Prospectus Directive required the European Commission to assess the application of the directive five years after its entry into force and to present, where appropriate, proposals for its review.

Moreover, in January 2007, the European Commission launched the Action Programme for reducing administrative burdens in the European Union to measure administrative costs arising from legislation in the EU, by reducing administrative burdens by 25 per cent by 2012. The Prospectus Directive has been identified as one area that contains a number of burdensome obligations for companies, some of which can be alleviated. At the same time, in the light of the current financial crisis, it has been considered appropriate to review certain provisions of the Prospectus Directive in order to increase its efficiency as well as upgrade investor protection. To this effect and in line with the "Better Regulation" principles, the European Commission set up a public consultation process.

Some of the obligations provided for in the Prospectus Directive had been identified by the commission as appearing to be excessively burdensome on companies. Those obligations had been reviewed by Directive no. 2010/73/EU in order to reduce the burdens weighing on companies within the union to the necessary minimum without compromising the protection of investors and the proper functioning of the securities markets in the union. The TUF had been amended accordingly.

7.3 The Italian legal framework on public offers

7.3.1 Notes on the general provisions

The legislation on public offers refers to the identification of the activities relevant for the application of the legislation itself and to the definition of financial products.

“Those who intend to do a public offering...shall previously communicate it to Consob. The prospectus shall not be published before being approved by Consob”. The law provides for two different documents (the communication and the prospectus) of which only the second one (the prospectus) is intended for the publication and for the knowledge by the public. The communication has to specify the subjects that intend to proceed to the solicitation activity with the indication of the role of each of them, the fundamental characteristics and the amount of securities object of the offer (of sale, of underwriting) and the modalities and terms foreseen for the execution of the operation. It has to be subscribed, as it is obvious, by the offeror but also by the responsible of the placement defined by the Consob Regulation as the “subject that organises and constitutes the underwriting syndicate, the coordinator or the sole investment dealer”. The prospectus shall contain “in a form easy to analyse and to understand, the information that, depending on the characteristics of the financial products and of the issuer, is necessary for investors to make an informed assessment of the issuer’s assets and liabilities, profits and losses, financial position and prospects and of the financial products and related rights. The prospectus also contains a securities note indicating the risks and the fundamental characteristics of the offer”. For the approval, the Consob verifies the completeness of the prospectus as well as the coherence and the understandability of the provided information. The approval procedure, if positively concluded, ends with the prospectus approval. The prospectus can then be published. Those financial products with an overall amount less than 5 million euros and those addressed to a number of subjects less than 150, as well as those addressed to qualified investors are not considered offers to the public. Nonetheless,

the TUF foresees other cases of non-applicability of these provisions and gives the Consob the power to identify "by regulation other types of public offering of financial products" to which such provisions do not apply totally or partially. The TUF, taking into account the nature of the issuer, exempts from the application of the above provisions investment solicitations having as object "(a) financial instruments issued or guaranteed by the Italian State, by a Member State of the European Union or issued by international organisations with public relevance to which belong one or more Member State of the European Union; (b) financial instruments issued by the European Central Bank or by the national central banks of the member state of the European Union". The Consob, according to what stated in the EC Regulation no. 809/2004, has introduced new cases for the exemptions from the application of the provisions on solicitation, subordinating such an exemption to the existence of information instruments that, taking into account the quality of the oblates, can be considered anyway sufficient in order to guarantee the necessary information. The Consob Issuers Regulation exempts from the provisions foreseen for the offer to the public of financial products those offers that: have as object shares issued in substitution of other shares already issued, if the issue of these new shares does not entail an increase of the issued capital; have as object financial products offered in the occasion of an acquisition through a public offering of exchange, providing that it is available a document including the information considered by the competent authority equivalent to that of the prospectus, taking into account the requirements of the European legislation; have as object financial products offered, assigned or to be assigned in the occasion of a merger providing that it is available a document including the information considered by the competent authority equivalent to that of the prospectus, taking into account the requirements of the European legislation; have as object shares offered, assigned or to be assigned free of charge to the existing shareholders and dividends paid as shares of the same class of those for which such dividends are paid, providing that it is available a document containing the information on the number and the nature of the shares, on the reasons and the details of the offer; have as object financial instruments offered, assigned or to be assigned to directors or previous directors or employees or previous employees by the issuer that has financial instruments already admitted to trading on a regulated market or by the controlling company, the controlled company, connected or in any way under its control, providing that such financial instruments are of the same class as those already admitted to trading on the same market and that it is available a document containing all the

information on the number and the nature of financial instruments, on the reasons and the details of the offer. According to Art. 98, para. 1 of the TUF, "The prospectus and any supplements approved by Consob shall be valid for the purpose of the offering of EU financial instruments in other EU member states", meaning for European financial instruments securities and quotes of closed funds. The necessary condition for the validity of a prospectus in another Member State is simply that the Consob, upon request of the issuer or of the offeror, communicates, within three days from the request to the authorities of the country where the offer will take place a statement of compliance with the Prospectus Directive, as well as copy of it, translated if needed. On the other side, "when the offer of European financial instruments is foreseen in Italy, as host Member State, the prospectus and the potential supplement approved by the home Member State authority can be published in Italy, as long as are respected the notification procedures foreseen by the European provisions". In those cases where the issuer has its registered office in a country outside of the European Union and the offer takes place in Italy, the "Consob can approve a prospectus written according to the legislation of the country outside of the European Union if the project has been done according to the international standards defined by the international organizations of the Markets Surveillance Commissions" and "the requested information, including information of financial nature, is equivalent to the provisions stated in the European rules".

The Consob's surveillance in relation to public offers is not limited to the analysis and the evaluation of the communication and of the informative prospectus, but it is extended to the subjects (the issuer, the proponent and the subject appointed for the placement) involved in the offer; transparency and correctness obligations are imposed to these subjects. More exactly – at the date of the communication to the Consob of the offer, the issuers, the offerors and the intermediaries responsible for the placement shall (if required by the Consob) disseminate on the market the news, related to the offer, considered necessary for the information of the public.

Starting from the same date, they are also subject to the information obligations toward the Consob foreseen for listed companies, meaning that the Consob can request them such information and inspect them in order to monitor on the correctness of the information given to the public and can do it up to one year from the end of the offer. The issuers, moreover, submit to auditing the annual accounts and the consolidated accounts if they have been approved or redacted during the offer; the TUF has then given to the Consob the duty to establish the "the

implementation methods for the offering, also to guarantee equal treatment of the addressees” as well as to identify “the conduct-of-business rules to be observed by the offeror, the issuer and the person placing the financial products, as well as by the persons in a control relationship with or related to such persons”. For this reason, the Consob Issuers Regulation, besides fixing the rules for correctness that the different categories of subjects involved in the offer shall respect, has established that the offer is revocable only in those cases foreseen by the informative prospectus and that the distribution criteria shall ensure an equal treatment among the participants. According to the provision of Art. 100, para. 1, (a) the offers addressed only to qualified investors are not subject to the provisions foreseen for the offers to the public of financial products and more in specific to the obligation of previously publishing an informative prospect. Art. 100-bis of the TUF after having stated that “The subsequent resale of financial products which have become the subject matter of a public offering which is exempt from the obligation to publish a prospectus forms to all effects a distinct and autonomous investment incentive in the case where there occur the conditions specified in the definition provided for in Art. 1, Subsection 1, paragraph (t) and there are not any cases of inapplicability provided for by Art. 100”, states that “An investment incentive occurs also whenever the financial products which formed the subject matter in Italy or abroad of an allocation reserved for qualified investors are, during the following twelve months, systematically resold to people who are not qualified investors and this resale does not fall within any of the cases of inapplicability provided for in Art. 100”.

The Consob has been given the “cognitive” and “prohibitive” powers in order to ensure the respect of the provisions stated for the offer to the public of financial products. From the moment of the communication, the Consob has the power to request from the issuer all the information foreseen (for listed companies) as of Art. 115 of the TUF, and it also has analogous power toward the other subjects involved in the solicitation. Not only that, but when there is a reasonable suspicion of a violation of the legislative and regulatory provisions related to the solicitation, the Consob “can request, up to one year from the purchase or the subscription, the communication of data and news and the transmission of acts and documents to the buyers or the underwriters of the financial products” and such a power exists “also against those subjects for whom there is a grounded suspicious that are performing an offer to the public in violation” of the said provisions. Art. 191 of the TUF foresees that any subject doing an offer to the public of financial products without having previously informed the Consob or publishing a prospectus not

approved by the Consob “shall be punished by a pecuniary administrative sanction of an amount not less than one fourth of the offered value and up to two times the value itself”. Moreover, according to Art. 173-bis of the TUF, “Any person who, with a view to obtaining an undue profit for himself or for others, in prospectuses required for public offerings or for admission to trading on regulated markets, with the intention of deceiving the recipients of the prospectus, includes false information or conceals data or news in a way that is likely to mislead such recipients, shall be punished by imprisonment for between one and five years.”

7.3.2 Notion of offer

The constitutive elements of the definition of public offer can be summarised as follows:

- the circumstances that the activity has as object “financial products” (meaning, as of Art. 1, para. 1, (u) TUF, “financial instruments and every other form of investment of a financial nature”);
- the existence of a communication aimed at making acquiring or underwriting a specific financial product and containing, consequently, the representation of the characteristics and of the essential conditions of it;
- the circumstance that such offer is addressed to a public resident in Italy.

The Consob, during the years, has clarified the scope of the definition; in particular the commission has highlighted how “in order to be considered as ‘public offering’ as of Art. 1, para. 1, (t) of the TUF, as such subject to the obligation of redacting and publishing an information prospectus, the operation under consideration shall have specific characteristics as, basically, the existence of contractual conditions standardised and the related impossibility by the potential participant, to pact conditions different from the ones originally foreseen.

The intervention of the jurisprudence that has correctly resumed the position of Consob has been remarkable, by stating that: “To this regard according to Consob an offer is public when it is characterised by terms of the offer standardised and is done *ad incertam personam*. However, it is not necessarily true that the offers addressed to specific individuals are private. According to the ‘formalistic’ orientation an offer is public when it is directed to more than 200 individuals, as suggested by Art. 33 of the Issuers Regulation. According to the ‘substantial’ orientation an offer can be qualified as ‘public’ if it is *ad incertam personam*, with the consequence that an offer addressed to more than 200 individuals would

not be a 'public' offer and therefore would not consist in an investment solicitation when the addressee are defined".

7.3.3 Concept of public

Another theme discussed in relation to the notion of solicitation has then be the definition of the concept of "public".

To this regard, the Consob has affirmed more than once that: "the fact that the user of the service...is or not qualified is not relevant in order to establish whether such a service is or not provided toward the public" and that "the notion of public, on the other hand, can be identified even when a financial activity is addressed to a plurality of individuals that can be identified only because of their appurtenance to a specific category of subjects".

In the doctrine, it has been highlighted how the notion of "public" has not been identified directly by the legislator but had to be deduced basically at an interpretative level.

To this regard, also on the basis of a praxis by the Consob, it has to be considered that the "public" character appears when the operation is addressed to a plurality of subjects that are not exactly identifiable before. To this end, it has to be understood the reference, deliberately generic, to the "individuals" present in the definition.

Today, the Prospectus Directive has introduced the definition of the offer to the public of financial products as: "every communication addressed to individuals, in whatsoever form and with whatsoever mean, that presents sufficient information on the conditions of the offering and of the financial products offered, so to enable an investor to decide to purchase or subscribe such financial products, including the placement through authorised people".

The definition implement the one of "offer to the public of financial instruments" foreseen by Art. 2, para. 1, (b) of the Prospectus Directive.

On the scope of the European notion, the European Legislator has observed that: "The definition of an 'offer of securities to the public' refers to a communication which presents sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities. If sufficient information is not provided, a communication will not constitute a public offer for the purposes of the PD. The definition is intended to be broad".

7.3.4 Procedures

With reference to the modalities of the offer, Art. 1, para. 1 (t) of the TUF defines the offer to the public as "every communication addressed to individuals, in whatsoever form and with whatsoever mean, that

presents sufficient information on the conditions of the offering and of the financial products offered, so to enable an investor to decide to purchase or subscribe such financial products, including the placement through authorised people”.

The definition identifies the notion of offer independently from the means used; in this sense, it is substantially in line with notion (previous to the TUF) of “solicitation”.

It derives that – in an analogous way to what was considered with reference to the notion of solicitation – the provision in discussion apply independently from the fact that the operation presents the characteristics of an offer to the public, as defined by Art. 1336 of the civil code.

The aim is indeed to realise a form of safeguard of the “unaware” or “uninformed” saver, independently from the fact that the operation presents all the characteristics of the civil provision.⁴

Any operation aimed at realizing a “diffused” form of collection of savings is then included in the definition, including the offers on the Stock Exchange, the indirect offers, the offers at the domicile, the offers at distance or the invitations to offer.

With respect to the previous definition, the new definition of offer to the public of financial products, requires that the message presents “sufficient information” so to put the investor in the condition to decide whether to participate or not to the operation. In this sense, we note a difference from the previous definition of investment solicitation that entails also the simple “promotional messages” and that look to include “advertising messages”.

On the basis of the new definition, on the contrary, these last ones can represent a real offer to the public, only if they present the specific characteristics indicated in the provision. It is confirmed, however, that for advertising messages on operation of offer to the public, Art. 101 of the TUF foresees specific rules.

7.4 Some peculiar features of the Italian financial legal system about the notion of financial product

7.4.1 General remarks

With reference to the notion of “financial products” – a category that entails both the types already foreseen by the legislator of “financial instruments” and “any other form of investment of a financial nature” – the Consob, in the past, has provided some indications to the market, in particular by clarifying that for “any other form of investment of

financial nature” it has to be intended the investment proposals that imply the joint presence of the following elements: (i) use of capital, (ii) expectation of a return of a financial nature and (iii) undertaking of a risk linked to the use of capital.

We will focus on some orientations by the Consob that can be considered emblematic for the identification of the reference scope of the notion of financial product and for how it has changed in the course of time ensuring a substantial continuity in the fundamental elements of the definition. Notwithstanding, the important revisions intervened following the implementation of broad and complex European rules, the pre-existent national system has indeed demonstrated a significant alignment with international practices.

7.4.2 Some thoughts on the different types of financial products

Below we have analysed a set of guidelines provided by the Consob starting from 1997 until 2012 on the notion of financial product in order to give a flavour of the regulator’s approach and of its substantial consistency, in spite of time and of the very diverse characteristics of each product considered.

7.4.2.1 Starting from gold

The Consob Communication of 4 October 2012, no. 12079227, has been recently published following a request for an opinion on the compliance of specific products included in the context of the professional trade of gold. In particular, it questioned the possible existence of solicitation profiles in relation to a programme of acquisition of “physical gold for investment” that was intended to be offered to the clients. In particular, it has been requested to the Consob to indicate whether, according to its opinion, the plan for the acquisition of gold according to a defined timing and the offer to the clients could be qualified as an “offer to the public of financial products”.

The acquisition plan foresaw a series, with a defined timing, of acquisitions of a specified quantity of gold until reaching a defined final quantity, useful for the transformation in certified ingots. Against such purchases, noted in specific accounting, “metal accounts” in the name of each client to the client was recognised a correspondent joint-property right on an ingot specify identified as property of the offeror, through the provision of a “receipt (certificate)” not transferable. The purchase – even if fractioned in time – of gold was directed to the acquisition of the good, given that the buyer is granted the enjoyment of the physical

gold, receiving in exchange of the single fractioned purchases, the right of joint-proprietary – for the quote of the acquired gold – of a specific ingot of the company or at the end of the plan of fractioned purchases or in the case of an anticipated exit from the plan – always possible without any condition – the exclusive property of a different ingot specifically produced for the client and concretely given to him. Any form of return by the proponent different and/or linked to the value of the purchased good was not foreseen; nor, can it be qualified as “return of financial nature”, the potential appreciation (or depreciation) of the material *thing* object of the sale (gold), and it has to be excluded, in this case, the taking of a risk of a capital loss.

In light of the above elements, the Consob considered that it seems that there are not the minimum and necessary elements to qualify it within the scope of the notion of “public solicitation in financial products”. In this context, the commission has specified that are not included in the notion of solicitation “the investment transactions in material activities or of consumption, that is the operation of purchase of goods and of provision of services that, even if concluded with the aim of investing his own capital, are basically directed at providing to the investor the possession of the good, to transform its resources in material goods apt at satisfying in a direct way the non-financial needs of the saver himself” and that “we are in presence of a financial investment, in contrast with a consumption investment, every time when the saver [...] gives his money with an expectation of return, that is of increase of the resources invested”.

7.4.2.2 Mortgage contracts

In the Consob Communication no. DIN/82717, the Consob responded to a request for clarification concerning the activity of the offer not on-site of mortgage contracts and the obligation to use promoters. To this regard, that the mortgage contract is not included in the categories of financial instruments and of investment services, listed, respectively, in para. 2 and 5 of Art. 1 of the TUF that identify the individual typologies of instruments and services. Equally, the mortgage is not included either among the financial products as Art. 1, para. 1, (u) of the TUF, according to which are financial instruments “financial instruments and any other investment form of financial nature “. The context of this last category can be included – as already observed by the Consob (please see the Consob Communication no. DI/98021215) – only the financial products of “collection” and not those of “issuing”, to which, according to the common opinion, belongs the mortgage. Indeed, the mortgage

for the purchase of real estate for residential use is not, for the borrowed, an investment form, as the money received is not invested directly with the aim of an income or an economic “return”. Nor does it represent an investment of financial nature, as it is not aimed, directly or indirectly, at financing the issuer company, for which, on the contrary, such an activity represents an “expense commitment”.

It is possible, therefore, to consider that the mortgage, even if it is a bank product, is not a financial product.

7.4.2.3 even breeding farms...

The Consob Communication no. 97006082 responded to a question on the performing of an activity that can be briefly described as follows:

- an Australian company specialising in a breeding farm would like to promote and propose to the public of Italian investors the stipulation of buying and selling contracts having as object the transfer of the ownership of big-size animals;
- such animals would be bred by the company itself with the agreement that, when adults, they would be bought by it at a predefined price or sold to third parties through the company that guaranteed the sale or maintained in breeding in order to allow their reproduction;
- in this last hypothesis, half of the offspring of the animals owned by the investors would automatically be of this last one;
- all the rights and obligations arising from the contract would be regulated by the Australian legislation; in particular, the price of the transfer and the monthly payment for the animal breeding would be paid in Australia, as would the payment for the restitution of the animals or the proceeds from their sale on the market.

With reference to the case described, it has been questioned whether it consists in a hypothesis of solicitation according to law no. 216/1974 and whether it is included in the application scope of law no. 1/1991.

In order to resolve the question proposed, the Consob had verified whether the buying and selling contract that was intended to be proposed to the public could be qualified as a security as the activity of investment solicitation necessarily supposes that the transaction has as object securities.

At that time, the notion of securities was given by Art. 18-bis of the law no. 216/1974 according to which a security is any document or certificate that directly or indirectly represents rights in companies, insurances or entities of any type, here included Italian or foreign investments funds,

any document or certificate representing rights related to material goods or real estate properties, as well as any document or certificate apt to give a right of purchase of one of the securities indicated above.

The type of contract that, in the prospected transaction, is intended to be proposed to the public of the Italian investors would seem to belong to the category of "documents or certificates representative of rights related to material goods".

This statement, however, does not necessarily lead to the application of the provisions as of Art. 18 and following of the law no. 216/1974 as the broad scope of Art. 18-bis does not allow to identify a valid discretionary criteria for those hypothesis that, as the one under consideration, are on the border between the investment in financial activities and the consumption of good or the investment in real activities.

In order to delimitate the application scope of the provisions on solicitation, the commission, sustained also by the best doctrine,⁵ has detailed that the notion of solicitation specifying that the relevant cases for the application of the provisions under consideration shall be individuated in the investment transactions in financial activities.

Such transactions as those where the collection of funds takes place against a return recognised directly by the proponent or anyway previewed by him or her, that is those transactions where the saver that has been solicited gives his or her money to thirds with the aim of receiving a profit increasing the invested assets, are considered.

Not included in the notion of solicitation investments transactions in real or consumption activities is the transactions of purchase of goods and services that, even if concluded with the aim of investing his own assets, are basically directed at proving to the investor the enjoyment of the good, at transforming the resources in real goods apt at satisfying in a direct way the non-financial needs of the saver itself.

In light of the considerations exposed, the Consob concluded that in the case under exam, there was a case of offer to the public of securities, relevant according to Art. 18 of the law no. 216/1974 as the transaction prospected has for sure a financial content.

The buying and selling contracts that were intended to be placed, as a matter of fact, even if they had as an object the purchase of the ownership of animals, were absolutely not aimed at providing to the buyer the immediate enjoyment of the benefits deriving from it but rather at providing to the investor a financial profit.

This can be implied by the content of the agreement itself, as described in the question, whose agreements foresee that the management of the investments demanded to the proponent company itself that commits

itself at repurchasing the animals sold at a fixed price (which will surely take into account the buying price more the amounts monthly paid for the breeding) or at reselling them to thirds or using them in reproduction.

In any case, the interest of the investor is aimed at obtaining, through the management of the transaction by the purchase proponent, an increase in the assets used in the business. Therefore, under the substantial profile, it can be said that the object of the contract that is intended to be proposed consists not in the animals whose ownership is transferred but rather "by the service that has as its content the promise of a return direct or mediated on the capital collected or managed".

7.4.2.4 Bond loans

Another interesting question is the one described in the Consob Communication no. DAL/RM/97000658 concerning the placement to the public of a product defined as "security".

In particular, reference was made to a multi-year bond loan with an issue price and refund value at par. It was supposedly a return for the bonds, payable in annual coupons.

At the underwriting, the loan was linked to a right for the underwriter of purchasing quotes of hotel joint ownership owned by the company itself. The exercise of the right was regulated by the introduction of a warrant in the rules on the issue of the loan.

The underwriter exercising the warrant will become the buyer of quotes of the hotel joint ownership, at discounted prices compared to the price list in force, and will have the opportunity of paying them by ten annual payments through compensation of part of the value of the interest's coupon.

To this regard, in the mentioned note, it is clarified that the amount of the purchase agreement will be determined so that to the underwriter is guaranteed a monetary return equal to a percentage of the prospected return every year.

It is highlighted that the stipulation of the deed for the purchase of the joint ownership will ensure to the buyers the access to a secondary market of the quotes of the hotel joint ownership already under deed (that will be established and managed by a controlled company) and that the value of the resell of the purchased quote could represent in the future a "further element of the revenue for the underwriter-buyer".

With regard to the prospected transaction, it is highlighted that the remunerated bond loan that this company would intend to place represents the security as of Art. 1/18 bis of law no. 216 of 1974, and therefore,

the offer of it for underwriting to the public represents a transaction relevant according to the provisions on investment solicitation, as of Art. 1/18 and following of the same law.

The financial nature of the transaction is definitely not changed by the existence of the mentioned warrant. This is because, notwithstanding the close link existing between the bonds offered in underwriting and the warrant, the last one is not able to affect the reason for the business proposed to the public, which is characterised by the aim of getting a financial return and not of getting the enjoyment of material good.

The Consob confirmed that the product belongs to the list of financial instruments, as it belongs to the category of “bonds, Government bonds and other debt securities tradable on the capital market” (Art. 1, para. 1, (b) of the Legislative Decree no. 415/1996.

7.5 Financial innovation

Financial innovation and IT developments are strictly related and interconnected as the recent debate on the High Frequency Trading issue demonstrates. Also, the notion of public offer and its modalities can be affected by technical innovation. The current work focuses on two recent examples.

7.5.1 Direct offers on the exchange

With the Notice no. 16832, Borsa Italiana SpA (Borsa Italiana) has introduced a new modality for the distribution of financial instruments (the Distribution on Borsa Italiana) in order to ease their spreading on the market.

In particular, the Distribution on Borsa Italiana replies the scheme adopted for the distribution of the BTP on the MOT and referring to which the Ministry of Economy and Finances – Treasury Department has concluded that it is (i) a case of primary market and that it (ii) uses a platform for a secondary market (that is a market regulated managed by Borsa Italiana) for the related distribution.

According to the new procedure foreseen by Art. 2.4.3 of the Exchange Rules, in the context of the process of admission to listing, the issuer/offeree can use the Borsa Italiana markets for the distribution of financial instruments. Borsa Italiana, once verified the admission requirements of the issuer/offeree and of the financial instruments, admits to listing the financial instrument and starts the sale on the market. At the end of the sale period, in case of positive result and conditionally to the respect of the requirements foreseen by the Exchange Rules, the

admission becomes definitive, and Borsa Italiana establishes the date for the start of transactions on Borsa Italiana.

The modalities of execution of the distribution through the market are established from time to time by Borsa Italiana with a specific notice. To this end, the issuer/offeror communicates to Borsa Italiana the intermediary responsible (so-called dealer) to make the proposals for the sale of the financial instruments that will be issued, where is not done directly. The issuer/offeror also communicates the days when the distribution will take place, the price, the day when the issue is reserved, as well as the only date when the contracts concluded are settled that usually coincides with the date of issue and payment of the financial instruments. The contracts concluded during the distribution phase through the informatics structures supporting the trading cannot be cancelled.

The new procedures introduce a market phase during which the issuer/offeror, directly or through a subject appointed by him or her (the so-called dealer), sells the financial instruments object of the prospect issue. Simultaneously to the admission to listing, Borsa Italiana starts the sale phase on the market that takes place in the days established by the issuer/offeror. In this phase, all the participants to the market, without the possibility of exclusion by the issuer/offeror, can buy on the market the securities object of the prospect issue.

The distribution of the financial instrument takes place on a regulated market. Focusing on this aspect, we should wonder whether such a modality of trading can be assumed under the provision of the Art. 205 the TUF that foresees that the buying and selling offers of financial products done on regulated markets do not represent offer to the public of financial products. Art. 205 of the TUF provides that: "The offers for the purchase and sale of financial products on regulated markets, in multilateral trading systems and, if the conditions indicated by Consob by regulation are fulfilled, by systematic internalisers, do not represent the offer to the public of financial products or purchase or swap offers to the public", and it has found an historic justification in the fact that in the absence of the provision as of Art. 205 TUF, all the orders done on a regulated market that usually lead to typical transactions on a secondary market would be qualified as offers to the public as addressed to a undefined public of investors. Nonetheless, we note that following the evolution of the functioning mechanisms of the market, there have been cases introduced to which the provisions of Art. 205 of the TUF have been deemed applicable, such as the issue procedure of covered warrants and the direct listing, that present continuity profiles with the Distribution on Borsa Italiana, such as the use of a platform of the secondary market

with a distribution aim, as well as elements of discontinuity with it. In particular, the issue procedure of covered warrants constitutes a case of primary market, having as object securities not yet issued but that will be issued on tap, at conditions of price and time different each time and determined by transactions in direct exchange with the investors that have entered their buying proposals. The direct listing is a transaction of simple listing of securities issued but not yet diffused (among qualified investors or among the public) and that once traded on the regulated market become the object of normal buying and selling in direct exchange through which is reached the aim of distribution of the security (typical of the primary market). On the other side, the issuer does not put in place the solicitation activity and the investments take place at market conditions.

Coherently with this theme, the provision on the investment solicitation has no reason to be applied and vice versa do apply the rules proper of the regulated market.

In the case regulated by Art. 2.4.3, para. 7 of the Rules of the Exchange, it is noticed that financial instruments to be issued object of buying and selling contracts are admitted to listing on the MOT regulated market and that the transactions in the distribution period take place in the related platform typically of secondary market through the enter, on one side, of irrevocable selling proposals of financial instruments to be issued by the issuer/offeror of the securities or by the dealers and, on the other side, of irrevocable buying proposals by the investors through the intermediaries, according to the Exchange Rules.

The connection, where there are the prerequisites, in relation to which is demanded to the Consob the possible identification *ex ante* of the factual elements and of the related relevance in order to qualify the operation, of the case under consideration to the application scope of Art. 205 of the TUF would have as a consequence the obligation to publish a prospectus for the admission to listing of the financial instruments to be issued according to Art. 113, para. 1 of the TUF.

On this point, the Consob published the Communication no. DIN/DSR/CLE/0049126 of 11 June 2014. The Consob expressed its evaluations with reference to the qualification of the operation as “offer to the public” according to Arts 94 and 113 of the TUF, with consequent obligation to publish a prospectus – given that they are primary market operations, having as object financial instruments still to be issued, as well as taken into account of the specific modalities for selling securities on the market, that provide for a predefined and fixed price (and single) and the final admission to listing only after the closing of the distribution phases.

However, in the communication, it has illustrated and defined different modalities of explication of the role of the participants involved in the distribution of the securities that open the way to new modalities of interaction among participants in the transactions involving the risk capital.

Extremely innovative is indeed the examination done by the Consob with regard to the activity undertaken by the so-called Operator Appointed for the analysis of the activities done by those subjects that establish direct relationships with the final investors.

The activity of the Appointed Operator is, without doubts, ascribable to an investment service – subject therefore to the law reserve as of Art. 18 of the TUF – whose exact configuration is not, however, exactly identified.

The said activity, being part of a phase “substantially” of primary market and having as prerequisite an agreement with the issuer aimed at realising the offer of securities on the market, could seem at a first glance a case ascribable to the “placement” service – without the direct underwriting nor the assumption of a warrant – as of Art. 1, para. 5, c-bis), of the TUF.

The same activity, however, could be ascribable also to the “execution of orders on behalf of clients” service foreseen by Art. 1, para. 5, and (b) of the TUF. Such service, thanks to the definition contained in Art. 4, para. 1, no. 5 of the Directive 2004/39/EC (so-called MiFID), consists in the “conclusion of buying or selling agreements of one or more financial instruments on behalf of clients”.

In particular, examining the activity of the Appointed Operator, the service of execution of orders, done against the issuer, can be identified.

As a matter of fact, the act of the operator of exposing, on the trading platform, selling proposals of securities to be issued is indeed the performance of the (selling) order received by the issuer. Moreover, as typically happens in the execution of orders, the activity of the operator stops at the “threshold” of the (regulated) market as venue, designed by the issuer, for the execution, according to the market rules, its interests (and orders) of sale.

The investment service, from this perspective, is done by the Appointed Operator only for the issuer that assumes, in this context, the part of the client on behalf of which the execution is done. On the other hand, the Appointed Operator does not carry out any investment service and – in fact does not have any direct relationship – with the investor, final buyer of the securities issued.

Precisely the lack of an intermediary relationship between the Appointed Operator and the investor (toward whom deem applicable the relevant conduct rules), leads to an interpretation of the activity undertaken in terms of service of execution of orders. An automatic connection to the context of the placement service opening the way to new considerations with regard to the direct offer of financial instruments on the exchange is therefore excluded.

7.5.2 Crowdfunding

The 2012 “Growth Decree bis” introduced, among other things, Arts 50-quinquies and 100-ter into the Consolidated Law on Finance – respectively entitled “Management of portals to collect capital for innovative start-ups” and “Offers through portals to collect capital” – and delegated to the Consob the power to adopt the related implementing rules. The primary law governs the phenomenon known also as “equity crowdfunding”, which indicates the possibility for companies (normally start-ups) to collect risk capital (funding) via the internet, thus making an appeal for public savings aimed at a large number of addressees (crowd), which in practice make investments of a modest amount.

Italy is the first country in Europe to adopt such legislation. The regulations were adopted by the Consob following a preliminary investigation for the collection of data and information, followed by an open hearing. The draft regulations were submitted for consultation on 29 March 2013.

In order to enable the development of a first stage of “testing” capital collection via online portals, for the purpose of encouraging the development and growth of the country, the primary law made a series of choices that orient and guide the definition of implementing rules. In particular, among other things, the decree introduced the possibility for risk capital to be collected by innovative start-ups through an online portal managed not only by banks and investment firms but also by subjects entered in a register held by the Consob to which the special rules laid down by the Consob and not the rules of the Consolidated Law on Finance on the subject of performance of investment services apply.

Offers made via online portals can regard only the subscription of financial instruments issued by innovative start-ups and must have a total price less than that entailing the applicability of the rules on prospectuses (a threshold of 5 million euros).

This is a new phenomenon, the governance of which requires particular attention above all as regards to the preparation of adequate

measures to protect retail investors, who will be able to decide to invest their savings in offers made by innovative start-ups via an online portal. As of today, in fact, 307 companies are entered in the special section of the companies register relating to innovative start-ups (96 per cent of them have adopted the legal form of a limited company).

For the purposes of issuing secondary regulations – in line with the best practices of better regulation – on 21 January 2013, the commission began a preliminary consultation stage to gather the data and information necessary to define regulatory options on the subject of crowd-funding. The preliminary investigation, in which 59 subjects took part, was completed on 8 February 2013.

The responses received from retail investors revealed, among other things, that the risks considered most significant were identified (84 per cent of replies) as the risk of losing the capital and as a lack of information after the offering with reference to investment in innovative start-ups. Regarding the risks connected with the fact that the offering is made online, investors were worried about the probability of being defrauded (72 per cent) and, also with reference to the offering, the lack of information (50 per cent).

In keeping with the findings, the new regulation provides for: (i) establishment of the register and registration methods; (ii) definition of the requisites of professionalism and honourability of company officials and shareholders; (iii) definition of the rules of conduct; (iv) the template for the distribution of information on the single offerings of innovative start-ups; (v) the introduction of instruments to protect retail investors in the event that controlling interests are sold.

In line with the reasoning of the primary legislation and taking account also of the experience gained in other countries, the proposed regulations are intended to facilitate the activity of online portals in order to encourage risk capital collection by innovative start-ups, guaranteeing, however, to small investors, who take part in crowd-funding initiatives, a level of protection substantially equivalent to that provided to the retail customers of brokers authorised to provide investment services.

In this sense, the regulation provides for specific disclosure obligations on the manager in relation to the public as regards to offerings relating to individual start-ups in order to enable the knowledgeable investment decisions to be taken. The new regulation governs the measures that managers must take in the stage of collecting orders from investors and of subsequent transmission to authorized brokers. The regulatory proposal states that to protect investors, MiFID monitoring

must be applied to the stage in which brokers (banks and investment firms) execute the orders transmitted to them by portal managers.

As regards retail customers, the regulation states that at least 5 per cent of the offer must be subscribed by particular categories of professional investors, but in the event of a change in control over a start-up, the minority subscribers must, for a period identified in the articles of association, have a right to recede from the company or have the right to sell their shares at the same conditions at which the controlling interest is transferred to third parties.

The new regulation provides for complete dematerialization of the documentation, authorization procedures and communication of the information flows through the establishment of a specific Certified Electronic Mail (CEM) address, also for the purpose of reducing the administrative costs borne by the supervisory bodies.

7.6 Conclusions

Long-term data shows that IPO markets across the world are actually contracting by number and volume. During 1993–2000, the OECD area had an annual average of about 1170 IPOs. During 2001–2011, this number fell to about 670. During the “recovery” period before the financial crisis, the annual number of IPOs never reached the average number of IPOs during the 1990s. The decrease in the number of new listings in OECD markets was accompanied by a decrease in the amount of equity that companies raised. The total value of capital raise decreased from an annual average of USD 132.7 billion during 1993–2000 to an annual average of USD 69.9 billion during 2001–2011. According to the OECD, preliminary data for the first half of 2012 indicated modest results that remained below the average for the period 2001–2011.

European companies will need to raise more funding via market finance, as bank finance is being constrained. It is of paramount importance to make it easier for companies to get additional funding simplifying the current regime, where needed and/or stimulating new policies and models to gain this goal

Notes

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2. Costi R., *Il mercato mobiliare* (2008), Torino, p. 24 ss.

3. Ferrarini G., *La direttiva comunitaria sul prospetto di offerta pubblica*, in Banca, borsa tit. cred., 1990, I, p. 827 ss.; Id., *La proposta di direttiva sui prospetti informativi per l'offerta al pubblico e per l'ammissione a quotazione di valori mobiliari – prime considerazioni*, in Marchetti P.G (ed.), Banca, borsa tit. cred., 2001, p. 270 ss; *I controlli sull'informazione finanziaria*, in Balzarini P., Carcano G., Ventoruzzo M (ed.), *La società per azioni oggi: tradizione, attualità e prospettive*, Milano, 2007, p. 143 ss.
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5. Carbonetti "Che cos'è un valore mobiliare" in Giur. comm. 1989, p. 280 ss. and Visentini, "I valori mobiliari", in Tratt. di dir. priv. diretto da P. Rescigno, Torino 1985, Vol. 16, II, p. 705 ss.

8

Public Takeover Bids: The Legal Framework

Gioacchino Amato and Stefano Torregiani

8.1 Introduction

The Italian regulatory framework for listed companies is oriented at the compliance with two principles, both having constitutional relevance: the protection of shareholders (descending from the protection of savings, laid down by Art. 47 of the Italian Constitution) and the efficiency and transparency of the market in corporate control and the capital market (in this respect, the freedom to conduct private businesses, protected by Art. 41 of the Italian Constitution is applied in a broader sense – in the light of the modern reinterpretation of the provision oriented at implementing EU regulatory directives – as the need to create efficient and competitive markets).¹

In the light of the above, the regulatory framework for public takeover bids focuses on a very specific market segment, that is the market of corporate and company control, where supply and demand meet not over generic company participations or a given quantity of financial instruments, but rather over participation quotas significant enough to access the control of the company – hence, generally speaking, said participations have a value higher than the arithmetic sum of the price of shares being traded. To pursue said goals, the Italian legislation aims at matching the need for contestability of listed companies (based on the principle that a financial market is more efficient the more contestable listed companies are) and the urge to protect minority shareholder, that is small investors who, holding limited share quantities, would not benefit from changes of control if no defensive measures were created to this end. The goal of protecting investors – or constitutionally speaking, protecting savings in the field of public takeover bids can be pursued by granting equality of consideration to all shareholders and transparency

of any bid terms and conditions (whereas in the past said extraordinary operations had too often been conducted with scant transparency of information that inevitably penalised minority shareholders).²

8.2 Evolution of the regulatory framework³

Takeover bids and/or tender offerings in Italy were first regulated by law no. 149/1992. Since its earliest cases of application, quite a few significant critical points emerged that the legislator tried to remove by passing Legislative Decree no. 58/1998, containing the *Testo Unico della Finanza* (Consolidated Law on Finance, hereinafter CLF).

The first regulatory act on the EU side for what concerns public takeover bids was Directive 2004/25/CE, transposed in Italy by Legislative Decree no. 229 of 19 November 2007, which tried to address the profoundly diverse nature of existing legal framework across the various EU Member States jurisdictions.

Over the years, a continuous legislative fine-tuning activity has been performed to eventually reach what provided for in Legislative Decree no. 91 of 24 June 2014, no. 91, converted into law no. 116 of 21 August 2014.

8.3 Various types of public takeover bids

Takeover bids may be classified as voluntary or mandatory depending on whether the decision to launch the bid is spontaneous or pursuant to a specific obligation prescribed by law.

Depending on the nature of the consideration agreed upon, takeover bids can be defined as public tender offering; or public exchange offerings⁴ or public mixed offerings, blending tender with exchange. In the first case, consideration is represented by money; in the second, by other financial instruments, whereas in the third (“mixed”) by a blend of money and other financial instruments.

Public takeover bids differ from Initial Public Offerings (hereinafter, IPOs) in that the former are aimed at divestment, hence, bids made to existing shareholders of the target company with the goal of acquiring their shares, whereas the latter aim at having new investors acquire shares of the company.

8.4 Public takeover bids: definition

The CLF defines takeover bids as “any public offer, invitation to offer or promotional message, in whatsoever form effected, whose

objective is the purchase or exchange of securities, addressed to a number of people and of a total amount greater than that indicated in the regulation pursuant to Art. 100, Subsection 1, paras (b) and (c); an offering of securities issued by the central banks of EU Member States shall not constitute a mandatory takeover bid or exchange tender offering".⁵

The legal framework of voluntary public takeover bids (unlike that of the mandatory public takeover bids) applies to non-listed as well as listed issuers.

Some cases of inapplicability are provided; as a matter of fact, *Directive 2004/25 sets out that*, "in view of the public-interest purposes served by the central banks of the Member States, it seems inconceivable that they should be the targets of takeover bids. Since, for historical reasons, the securities of some of those central banks are listed on regulated markets in Member States, it is necessary to exclude them explicitly from the scope of this Directive".

Moreover, the Consob has provided, upon delegation by the Italian legislator, two quantitative limitations to the applicability of the legislation regarding takeover bids: (a) that the bid be extended to at least 150 shareholders, other than the so-called *qualified investors*; (b) that the amount exceed €5million. To this end, several offers concerning the same security, made by the same issuer or offeror in a 12-month period shall be considered together.

8.5 Supervisory authority and applicable law

The EU legislator has deemed it appropriate to clearly entrust the relevant national authority with carrying out proper surveillance activities on transactional takeover bids, to avoid conflicting claims between authorities from different Member States.⁶

Particularly, the CLF⁷ provides that the Consob shall supervise takeover bids or exchange tender offerings with regard to takeover bids or exchange tender offerings: (a) involving securities issued by a company with registered office in Italy and admitted to trading on one or more Italian regulation markets; (b) involving securities issued by a company with registered office in an EU Member State other than Italy and admitted to trading solely on Italian regulation markets; (c) involving securities issued by a company with registered office in an EU Member State other than Italy and admitted to trading on regulated markets in Italy and in EU Member States other than that in which the company is registered, if said securities were first admitted to trading on an Italian

regulated market or, if the securities were simultaneously first admitted to trading on regulated markets in Italy and in other EU Member States, where the issuer adopts the Consob as the competent supervisory authority, informing the aforementioned markets and their supervisory authorities on the first day of trading.

Where the Consob is the competent supervisory authority matters concerning the price, procedure, with particular reference to reporting obligations on the decision of the bidder to proceed with the bid, content of the takeover bid document and disclosure of the bid shall be governed by Italian law. In matters relating to the information to be provided to employees of the issuer, matters relating to company law, in particular with regard to the threshold exceeded which a takeover bid becomes mandatory, to any derogation from such an obligation and the conditions under which the board of the issuer may undertake any action which might result in the frustration of the bid, the applicable rules and the competent authority shall be those of the Member State in which the issuer has its registered office.

Where the takeover bid involves securities issued by companies with a registered office in Italy and admitted to trading solely on one or more regulated markets of other EU Member States, the matters above indicated shall be governed under Italian law and the relevant supervisory authority shall be the Consob.

8.6 Bidder obligations

The first bidder obligation is that the decision or occasion giving rise to the mandatorily promote a takeover bid or exchange tender offering shall be notified to the Consob without delay and at the same time disclosed to the public.⁸

As soon as the bid has been made public, the boards or control bodies of the issuer and of the bidder shall inform the representatives of their respective employees or, where there are no such representatives, the employees themselves.

The bidder shall take immediate action to make the bid, and in any event no later than 20 days from the above mentioned notice and submit the takeover bid document for publication to the Consob. Should said deadline not be met, the takeover bid document shall be declared inadmissible, and the bidder may not make a further bid on the same security in the 12 months thereafter.

The short of the term available to the bidder to issue the takeover bid document is motivated by the high speed of response of financial

markets and the legislator's intention to remove all elements of uncertainty right after the will to launch a takeover bid is made public.

When the document is made public, the boards or controlling bodies of the issuer and of the bidder shall circulate the document to the representatives of their respective employees or, where there are no such representatives, to the employees themselves.

The board of directors of the issuer shall issue a notice containing all information useful to evaluating the bid and its own evaluation of the bid. The notice shall also contain an evaluation of the effects of eventual success of the takeover bid on the interests of the company and on the employment conditions and location of business premises. At the same time as its disclosure, the notice shall be issued to representatives of the company's employees or, where there are no such representatives, directly to the employees. If received in time, the opinion of employee representatives regarding repercussions on employment conditions, shall be attached to the notice.

The notice issued by the issuer's board of directors is crucial to allow shareholders to decide properly not only in consideration of the economic convenience of the bid, but also of other criteria such as the impact of a change of control on employment levels and/or decisions to delocalise production or otherwise alter the productive process (if applicable). In the case where the overall directors' opinions is negative, a hostile takeover bid is underway.

8.6.1 The issuer statement

The Consob⁹ adopted some implementing rules in order to decide the content of the issuer statement.

In particular, the issuer's statement shall:

- a) indicate the names of the members of the board of directors and control body present during the meeting for assessing the offer, as well as the names of those absent;
- b) indicate any members of the board of directors or the supervisory board who have notified the fact that they have a possible conflict of interest, their own or of third parties, relating to the offer, specifying the nature, terms, origin and scope thereof;
- c) contain all the information serving to evaluate the offer together with the reasoned opinion on the offer and the fairness of the price by the board of directors and the supervisory board, with an indication, where applicable, of its approval by majority vote and the names of those dissenting and abstaining, specifying the reasons for

any dissent or abstention. The statement shall also specify, positively or negatively, any participation by any title of the members of the administrative body and supervisory board in negotiations to define the transaction;

- d) indicate whether, in forming their opinion on the offer, the issuer made use of independent expert opinions or specific assessment documents. In these latter cases, the methods used and the results of each criteria applied shall be indicated;
- e) provide information on material matters not covered in the latest annual report or the latest interim report published;
- f) provide information on the issuer's recent performance and prospects if they are not reported in the bid document;
- g) contain, for bids on securities an assessment of the effects that a successful bid would have on the company's interests, as well as on employment and the location of production sites;
- h) where a merger is envisaged that involves an increase in the debt of the issuer, supplies information on the company's debt resulting from the merger; in this case, it also indicates the effects of the transaction on the loan agreements in place and on the related guarantees as well as on the need to stipulate new loan agreements.¹⁰

8.6.2 Independent director opinions

Before approving the issuer's statement, independent directors who are not related parties of the bidder, where existing, shall draw up a motivated opinion containing their assessment of the bid and the fairness of the price, with the right to engage the aid of an independent expert of their choice, at the cost of the issuer. This opinion, where not entirely incorporated by the administrative body and the opinion of the independent expert where applicable are disclosed in the same way of the issuer's statement.

8.7 Implementation of the bid

One of the key principles that regulate takeover bids is their irrevocability. Any clause stating the contrary is void. The offer shall be made at the same conditions to all the holders of the securities that are the object thereof.

Obviously enough, the irrevocability of the bid allows for certain conditions to apply (i.e. a minimum threshold of shareholders' acceptance), provided that said conditions are properly illustrated in the bid document and said conditions are not merely arbitrary.

The Consob has also set precise limits regarding the maximum duration of the public takeover bid, to prevent uncertainties related to the outcome of the bid which may impair the market trend of securities being targeted by the bid.

For what concerns competing bids, the Consob¹¹ has regulated in the direction of balancing the urge to admit revised bids in the interest of the shareholders being targeted by the bids with that of preventing an indefinite extension of the bid's duration, also to avoid inconvenient disturbances (such as the launch of revised bids that do not significantly improve the value of the offer, aimed solely at procrastinating the terms). Indeed, the Consob has provided that competing bids shall be published up to five days before the date set for the close of the preceding subscription period, even if extended. *Inoltre le*, increased bids and other amendments to bids, shall be made by publishing a statement specifying the nature and size of the increased bid and attesting the issue of the supplementary guarantees. In the case of increased bids, the quantity requested may not be reduced. Increased bids and other amendments must be made within five days of the publication of the competing bid or an earlier increased bid or amendment by another bidder. Increased bids may not be made beyond the fifth day preceding the close of the preceding subscription period. Following publication of a competing bid or an increased bid, acceptances of the other bids shall be revocable. In the five days following the publication of the results of the winning bid, such bid may be accepted, following revocation of the acceptance, for securities for which other bids had been accepted.

Lastly, from the date of notification of competing bids until the close of the subscription period bidders may not acquire, directly or indirectly or through nominees, the securities that are the subject of the bid or the right to acquire them at a later date at prices higher than the highest price of the bids notified.

8.8 Passivity rule¹²

Given the case of hostile takeover bids, the target company may adopt a set of defensive actions aimed at sabotaging the bid or at least bring the bidder to revise/improve it.¹³

As for what defensive measures can be considered admissible, legislations differ widely across EU Member States. Extreme orientations may be found that tend either to forbid or to admit any such measure, whereas other tend to admit defensive measures under certain conditions. The legislator's attitude with regards to the passivity rule reflects

the ideological approach to either favour the contestability of companies and change of control or rather protecting the existing ownership interests, pursuing continuity and conservation. In the light of the profound divergences among EU Member States, Directive 2004/25/CE failed to achieve the goal of regulatory harmonisation.

In particular, with reference to defensive measures, the CLF provides that unless approved by the ordinary or extraordinary shareholders' meeting, depending on the attributed level of decision-making powers, Italian listed companies whose securities are involved in the offering shall abstain from action or transactions that could counteract achievement of the aims of the offering. This abstention obligation shall apply from the date of notice until closure of the offering or until the offering expires. Mere research into other offerings shall not constitute an act or transaction in conflict with the aims of the offering. The liability of directors, members of the management board, supervisory board and general managers for action taken or transactions executed shall remain unchanged.

The by-law of the company may differ, wholly or in part, from the above mentioned provision. The company shall notify any difference approved to the Consob and to supervisory authorities for takeover bids in member countries in which their securities are admitted to listing on a regulated market or in which admission to listing has been requested. Such differences shall also be promptly disclosed to the public in accordance with said provisions.

Given the inherent differences in existing legislations of various EU Member States, Directive 2004/25/CE has provided for the reciprocity clause that asserts that the option to adopt defensive measures shall not apply to takeover bids or exchange tender offerings by entities not subject to such provisions or equivalent provisions or by a company or entity controlled by such entities. Where launched by persons acting in concert, it is sufficient that such provisions do not apply to just one of the bidders involved.

At the request of the bidder or issuer and within 20 days of submission of the request, the Consob shall decide whether the provisions applicable to the bidder are equivalent to provisions to which the issuer is subject.

8.9 Breakthrough rule

By the same token, the CLF has also provided for the so-called breakthrough rule, that is the creation, on behalf of the target company, of

barriers that might hinder the success of the bid; the latter can include – but are not limited to – limitations on the transfer of securities or limitation on the voting rights envisaged in the company's bylaw or special rules regarding the appointment or removal of the directors.¹⁴

Also in this case, the EU Directive fails to meet the goal of harmonising the regulatory frameworks existing in various Member States, given that their adoption of the breakthrough rule has been configured as a simple option; to this, Italy ranks among the few states that decided to take this regulatory option.

Particularly, the CLF¹⁵ provides that in the takeover bid period, limitations on the transfer of securities as envisaged in the by-law shall have no effect on the bidder. Likewise, limitations on voting rights envisaged in the articles of association or shareholders' agreement in cases where a shareholders' meeting is called to resolve upon the actions and transactions, shall have no effect on the bidder. At the same shareholders' meetings, the multiple-voting shares confer only one vote and the voting rights are not counted.¹⁶

Furthermore, if as a result of a takeover bid the bidder comes into possession of at least 75 per cent of the share capital with voting rights in relation to resolutions on the appointment or removal of directors or members of the controlling body or supervisory council, at the first shareholders' meeting following close of the bid, called to amend the bylaw or to remove or appoint directors or members of the controlling body or supervisory council, the multiple-voting shares confer only one vote and the following have no effect:

- a) limitations on voting rights as envisaged in the bylaw or shareholders' agreements;
- b) any special right in relation to the appointment or removal of directors or members of the control body or supervisory council as envisaged in the bylaw;
- b-bis) the additional votes in the multiple-voting shares.

If the result of the bid pursuant proves positive, the bidder shall be obliged to pay a fair indemnity for any prejudice to share capital suffered by holders of rights the exercise of which is rendered void by application of the above mentioned provisions, provided that provisions of the bylaw or contractual provisions constituting such rights were in force prior to issue of the notice. The claim for indemnity must be submitted to the bidder, on penalty of lapse, within 90 days of the close of the bid or within 90 days of the date of the shareholders' meeting. Should no

agreement be reached, the amount of the indemnity shall be decided by the court as a discretionary assessment with regard, *inter alia*, to a comparison between the average market price of the security in the 12 months prior to issue of the first notice concerning the bid and the price performance following the positive conclusion of the bid.

8.10 Mandatory takeover bid¹⁷

The CLF provides for two distinct types of mandatory takeover bids: global takeover bids prior and partial bids. A third type was provided – residual takeover bids – renamed into commitments to squeeze-out in the light of Directive 2004/25/CE.

As stated above, mandatory takeover bids apply solely to Italian companies with securities admitted for trading on Italian regulated markets.¹⁸

8.10.1 Global takeover bid

The CLF¹⁹ provides that anyone who, following acquisitions or increased voting rights, holds a stake greater than the 30 per cent threshold or holds more than 30 per cent of the voting rights of the same, promotes a takeover bid addressed to all security holders for the totality of the securities admitted for trading on a regulated market in their possession.²⁰

For each class of securities, the takeover bid shall be made within 20 days at a price no less than the highest price paid by the bidder, and by persons acting in concert with the bidder, in the 12 months prior to issue of the notice to launch a takeover bid, to acquire securities of the same class. If no purchase against payment of securities of the same class was made in the period indicated, the takeover bid is implemented for that class of securities at a price no less than the weighted market average over the previous 12 months or shorter available period. The same price applies, in the absence of purchases at a higher price, if the threshold relative to voting rights is exceeded by effect of the additional voting rights.²¹

For the purpose of this regulation, a participation or stake shall mean a portion, held directly or indirectly through trust companies or nominees, of the securities issued by a company pursuant to subsection 1 that give the right to vote in shareholders' meetings on resolutions concerning the appointment, removal or liability of directors or members of the supervisory board. The above implies that, from the standpoint of enacting the relevant provisions, no limitations shall apply to any category of actions. What is more relevant to the obligation to launch a takeover bid

is that the shares held by the bidder qualify his voting rights for general meetings decisions deemed crucial for company operations.

Nonetheless, the CLF has invested the Italian supervisory authority (hereinafter, the Consob) with considerable power in broadening the category of relevant actions. In particular, the Consob may issue a regulation whereby the relevant capital shall include security categories in the equity investment that give the right to vote on one or more different matters taking into account the nature of the influence their exercise, jointly or severally, may have on the management of the company. By regulation, the Consob shall also decide upon the investment calculation criteria if the securities referred to therein are, as a result of legal or regulatory provisions, without voting rights or if the bylaw contemplate increased voting rights. By the same token, the CLF²² provides that by regulation the Consob shall establish the cases and methods by which derivatives held are counted in the investment. The common element to the scenarios dealt with above is that these shareholders still have the possibility of impacting on the company's management. Rather than acting on a case-by-case basis that would imply considering particular elements of a given situation, the Consob can provide providing general guidelines, thus, exerting its powers from a strictly regulatory standpoint.

As mentioned above, exceeding the 30 per cent threshold might occur by direct and/or indirect actions. One of the most frequent cases occur when a subject acquires control over a company that, in turn, holds a participation exceeding 30 per cent of the capital of a listed company. This sort of "*matrioska effect*" must then be limited, especially in cases where the acquisition of control over a listed company implies the obligation to launch a takeover bid not only on the company itself, but rather on all listed companies controlled by the company being acquired. The CLF²³ provides delegates the Consob to regulate on the matter. In turn, the Consob has decided²⁴ that given the case of indirect takeover the acquisition, singly or in concert, of an equity investment that allows more than 30 per cent of the shares of a listed company which grant voting rights to be held or that gives control of an unlisted company shall determine the obligation to make a tender offer, where the purchaser comes to hold, indirectly or as a result of the sum of direct and indirect equity investments, more than 30 per cent of the securities of a listed company which grant voting rights. Moreover, an indirect equity investment exists where the assets of the company whose securities are held consist prevalently of equity investments in listed companies or in companies that prevalently have equity investments

in listed companies. And prevalence shall exist where at least one of the following conditions is met:

- a) the book value of the equity investments represents more than one third of the balance sheet assets and exceeds that of every other fixed asset shown in the balance sheet of the investor company;
- b) the value attributed to the equity investments represents more than one third and constitutes the principal component of the purchase price of the securities of the investor company.

Where the assets of the company referred to consist prevalently of equity investments in a plurality of listed companies, the obligation to make a takeover bid only regards the securities of the companies whose value represents at least 30 per cent of the total of such participation.

A further particular case is configured when a shareholder holding a stake higher than 30 per cent without holding the majority of voting rights in the ordinary shareholders' meeting. Also in the above cases, the Consob has been invested with the regulatory power to decide under which circumstances arise the duty to make a takeover bid following acquisitions higher than five per cent or the increase in voting rights of more than five per cent of the same. To this, the Consob²⁵ has provided that the bid obligation shall arise from the acquisition, including indirect acquisition of more than five per cent of the capital represented by securities that grant voting rights for matters specified in Art. 105 of the Consolidated Law as a result of purchases made in the 12 months.

The Consob is also in charge of decisions in cases where any takeover bid is promoted at a price lower than the highest price paid, establishing criteria to determine said price and provided one of the following circumstances exists:

- 1) the market prices were influenced by exceptional events or there are grounds to suspect they were subjected to manipulation;
- 2) the highest price paid by the bidder, or persons acting in concert with the bidder is either the buy-sell price for the securities involved in the takeover bid applied under market conditions and as part of the normal business practices or is the price of buy-sell transactions that would have benefited from one of the exemptions.

To this, it is relevant to observe that for what concerns the obligation to launch a mandatory takeover bid, exceeding the threshold shall only occur as a result of the purchase of securities and no other causes.

Mandatory takeover bids shall have the object of securities attributing voting rights in the ordinary or extraordinary shareholders' meeting, even for limited issues. Moreover, the price of the mandatory takeover bid is set to match a value that is no less than the highest price paid by the bidder, and by persons acting in concert with the bidder, in the 12 months prior to issue of the notice, to acquire securities of the same class.

By regulation, the Consob shall establish cases whereby exceeding the mentioned threshold a takeover bid will not be considered mandatory if implemented in the presence of one or more majority shareholders or results from:

- a) transactions to bail out a company in crisis;
- b) transfer of the securities among parties linked by significant investment relationships;
- c) causes not dependent upon the wishes of the buyer;
- d) transactions, or rather, where the temporary threshold is exceeded;
- e) mergers or spin-offs;
- f) purchases free of charge.

In any event, by provision with just cause, the Consob may establish that a takeover bid shall not be considered mandatory on exceeding the threshold in cases attributable to the situations above mentioned but which are not expressly indicated in the regulation.

There is one last case in which no obligation to launch a mandatory takeover bid arises. The CLF²⁶ provides that a takeover bid shall not be considered mandatory where the participation over the threshold is held as a result of a takeover bid or exchange tender offering involving all the holders of securities and for the total quantity of securities in their possession, provided that, in the case of an exchange tender offering, the securities offered in exchange are listed on a regulated market in an EU Member State or a cash payment is offered as an alternative.

8.10.2 Prior partial bid

The CLF²⁷ provides for a second type of mandatory takeover bid which actually configures a further exception to the obligation of promoting a global takeover bid.

Indeed, the provisions regarding mandatory takeover bids shall not apply where the participation is owned as a result of a takeover bid or exchange tender offering on at least 60 per cent of the securities in each category and all the following conditions are satisfied:

- a) the bidder and persons acting in concert with the bidder, have not acquired participations exceeding one per cent, including shares purchased under forward contracts maturing at a later date, in the 12 months preceding the notice to the Consob nor during the bid period;
- b) the validity of the bid is subject to approval of a number of shareholders which together hold the majority of the securities concerned, excluding securities held by the bidder, the major shareholder, also in relative terms, if that participation exceeds ten per cent, and by persons acting in concert with the bidder;
- c) the Consob shall grant the exemption after verifying satisfaction of the conditions specified in paragraphs (a) and (b).

The underlying rationale of the exemption to the obligation to launch a global takeover bid can be retrieved in the overall will to protect existing minority shareholders both in consideration of the value of the bid (equal to at least 60 per cent of securities) and of the approval on behalf of the general assembly (in which the controlling shareholders other than the bidder hold no voting rights).

To prevent using a prior partial bid from dodging the obligation to launch a global takeover bid, the CLF provides that the bidder is required to launch a global takeover bid where, in the 12 months subsequent to the close of the unsolicited bid:

- a) the bidder, or persons acting in concert with the bidder, have acquired participations exceeding one per cent, also by means of forward contracts maturing at a later date;
- b) the issuing company has approved a merger or a spin-off. In this latter case, it appears evident that if after the prior partial bid a merger or a spin-off should be deliberated whose exchange rate would be deemed unfavourable to existing shareholders of the target company, an elusion of the mandatory takeover bid provision would clearly be configured. In fact, the target company's shareholders who failed to accept the prior partial bid would be strongly penalised as a result of the merger or spin-off decision adopted after the launch of the prior partial bid.

8.11 Mandatory squeeze-out

If as a result of a global takeover bid, the bidder becomes holder of at least 95 per cent of the share capital represented by securities in an Italian listed company, the bidder shall mandatorily squeeze-out

of the remaining securities at mere request by any other shareholder. Where more than one class of securities is issued, the commitment to squeeze-out shall subsist only for classes of securities for which the 95 per cent threshold is reached.

The aim of the above provision is to protect the interests of a shareholder, who declined the mandatory takeover bid relying on the wrong forecast that many other shareholders would do the same and would now hold a lowly liquid asset, which may be difficult to sell.

The CLF also provides for a second scenario, that is when any party becoming holder of a quota exceeding 90 per cent of capital represented by securities admitted to trading on a regulated market shall be committed to squeeze-out the remaining securities admitted to trading on a regulated market by any holder thereof unless a float sufficient to ensure regular trading performance is not restored within 90 days. Where more than one class of security is issued, the commitment to squeeze-out shall subsist only for classes of securities for which said 90 per cent threshold is reached.

Given the latter case, the squeeze-out threshold is set at 90 per cent rather than 95 per cent in that it can be reached independently from causes related to the takeover bid launch. Thus, in the former case the threshold gets heightened to 95 per cent because the shareholder had just received an offer to sell his or her shares and declined. In the latter case, the shareholder holds a less liquid asset without having been given the option of selling it.

As to price determination, in cases where the threshold has been reached further to a global takeover bid, the consideration equals the price provided in the global takeover bid.

Over and beyond the cases above mentioned, the price shall be established by the Consob, also taking into account any previous price bid or the market price in the half-year prior to announcement of the bid or prior to the acquisition giving rise to the commitment.

8.12 Right to squeeze-out

A bidder coming into possession following a global takeover bid of a holding of at least 95 per cent of the capital represented by securities in an Italian listed company shall have the right to squeeze-out on remaining securities within three months of expiry of the time limit for bid acceptance, if the intention to exercise said right was declared in the takeover bid document. Where more than one class of securities is issued, the right to squeeze-out shall subsist only for classes of securities for which the 95 per cent threshold is reached.

This is a typical case of mandatory purchase by the bidder, and in fact, the transfer shall be effective from the moment notice of the deposit of the consideration with a bank is given to the issuing company, which shall make the consequent entries in the shareholders' register.

The rationale of this mandatory purchase is that the bidder declared in the takeover bid document that he or she would have reached the 95 per cent threshold. The shareholder knew in advance that if he or she would have not accepted the bid and the bidder reached the threshold, he or she would have risked being forced to sell the shares without prejudice as far as the price of the purchase is concerned because the price is equal to that of the previous global takeover bid. In this case, the legislator aims at neutralising the influence of minority shareholders and also at protecting the bidder, who has already embarked on significant investments to acquire the total share capital of a listed company and might eventually hold a nearly total participation while still being exposed to decisional limitations enacted by minority shareholders (who had even been given the option of selling their participations to the bidder at a fair price). After all, the bidder's quota exceeding 95 per cent is proof enough that the vast majority of shareholders had deemed the bid favourable – hence, their massive acceptance has dramatically lowered the liquidity of the remaining shares, which is ultimately unfavourable for the shareholders who declined the bid.

In light of the above, the right to squeeze-out is one of those measures within the regulatory framework of takeover bids aimed at pursuing the highest possible efficiency of both the capital and the corporate/company control markets *finalizzato ad attribuire rilevanza all'efficienza del mercato dei capitali e del mercato del controllo societario*, in accordance with Art. no. 41 of the Italian Constitution. The capital market cannot be deemed efficient when securities that are no longer liquid still remain listed. By the same token, the corporate/company control market is not efficient when it fails to reward (in the applicable case, the right to squeeze-out) a bidder that embarked in the significant effort to launch a takeover bid only to be impaired by a restricted group of shareholders that could hinder the delisting procedures for the company acquired (with consequent additional financial burdens that would render).

8.13 Squeeze-out in concert²⁸

Parties acting in concert shall be jointly obliged to launch a global takeover bid or a mandatory squeeze-out when, as a result of purchases made even by one only of the parties, they come into possession of a total holding exceeding the percentages indicated under the above articles.

The same obligations exist for those who act in concert, subsequent to an increase in voting rights, also in favour of only one of the same, if they then hold voting rights greater than the threshold of 30 per cent of the share capital of a listed company.

TUF²⁹ defines the category of “People acting in concert” as people cooperating together on the basis of a specific or implicit agreement, verbal or in writing, albeit invalid or without effect, for the purpose of acquiring, maintaining or strengthening control over the issuer or to counteract achievement of the aims of a takeover bid or exchange tender offering.

In any event, persons considered to be acting in concert are: (a) parties to a shareholder’s agreement, even if void; (b) an entity, its parent company and its subsidiaries; (c) companies subject to joint control; (d) a company and its directors, members of the management board, supervisory board or general managers.

8.14 Failure to comply with obligations and sanctions

In the event of a violation of the obligations of the takeover bid section of CLF³⁰, the voting rights attached to the whole participation owned shall not be exercisable, and the securities exceeding the percentages specified the global takeover bid and the mandatory squeeze-out must be sold within 12 months. Where the voting rights are exercised, the shareholders’ meeting adopted with the decisive vote of the shareholder that exceeded the threshold may be challenged also by the Italian supervisory authority, the Consob.

Moreover, the Consob may, by provision with just cause and considering, *inter alia*, the reasons for failure to comply with obligations, the probable effects of the sale and any changes in the ownership structure, impose implementation of the global takeover bid at the price established by the Consob taking into account the market price of the securities.

8.15 New amendments in the takeover bid regulation

Law no. 116 of 11 August 2014³¹ has heavily impacted on Italian Corporate law, traditionally based – for what concerns share-based corporate participations – on the “one share one vote” principle. The above provision has thus removed a key principle that had resisted any previous regulatory amendments by introducing the option of statutorily established increased voting shares³² for listed companies, as well as multiple-voting shares for non-listed companies.

In the light of the new legislation, modifications have been introduced to match the set of rules for global takeover bids with the options made available to listed companies to issue this new type of shares with the aim of protecting their share capital from takeover attempts. As a matter of fact, the underlying rationale of increased voting rights is diametrically opposite to that of takeover bids. Whereas the latter is instrumental to favouring the change of control of listed companies' shares, hinging on the fact that a capital and company control based market is most efficient when controlling interests and changes of control are easiest to achieve, the newly introduced set of provisions regarding increased voting rights is aimed at protecting existing shareholders from third parties' takeover attempts. Hence, the recent legislative change of orientation has heavily impacted on the Italian legislation on takeover bids, by making the system – at the option of existing shareholders – more or less vulnerable to takeover attempts from third parties wanting to achieve a controlling interest.

To this, the legislator provides that exceeding the 30 per cent threshold that generates the obligation to launch a global takeover bid might occur, not only by means of purchasing shares, but also further to the availability of increased voting rights. Given the case of a subject holding a 20 per cent share – hence, not legally bound to launch a global takeover bid – if the company chooses to issue increased voting rights as provided for by the newly introduced legislative provisions, said shareholder might continue to hold a 20 per cent participation to the operating results, that nevertheless accounts for a 40 per cent share from the voting rights standpoint, thus, exceeding the relevant threshold and generating the obligation to launch a global takeover bid.

The above legislative provision has also introduced the concept of Small and Medium Enterprises (hereinafter, SMEs) in the Italian legal system. SMEs are small and medium listed enterprises which, on the basis of the approved financial statements for the last financial year, also prior to the admission of their own shares for trading, have turnover of up to Euro 300 million or average market capitalisation in the last calendar year of below Euro 500 million. Issuers of listed shares which have exceeded both the aforesaid limits for three consecutive financial, or rather calendar, years are not considered SMEs.

To this, the legislator provided that in companies other than SMEs, the global takeover bid shall be promoted also by anyone who, subsequent to acquisitions, comes to hold a stake higher than the threshold value of 25 per cent, provided that no other subject holds a higher stake.

The bylaws of SMEs may contemplate a threshold different from 30 per cent, in any case no less than 25 per cent nor higher than 40 per

cent. If the bylaws are amended after the start of trading of the securities on a regulated market, the shareholders who have not participated in the relative resolution have the right to withdraw for all or part of their securities. Hence, SMEs are allowed to independently set the degree of contestability they deem more appropriate to their own growth goals and corporate governance. What is more, modifying the degree of contestability of a company after its listing – hence, has become public and participated in its capital by retail investors – allows an exit way to all previously existing shareholders.

8.16 Conclusion

The recent amendments were aimed at approximating Italy's legislation to that of many other EU Member States, particularly with the intent of favouring the listing of new companies on Italy's regulated market. These new regulations have impacted on the very concept of efficiency on the capital market and corporate governance side amply dealt with above and might end up producing more radical changes in regulatory strategies than what we might have envisioned so far.

The new rules, however, have a great advantage that is the enhancement of a great level of flexibility that listed company may use with an amendment of their bylaws so adapting their corporate governance to the specific needs of the company or their controlling shareholders in order to reach the level of openness deemed as optimal on a case-by-case approach.

Notes

1. Art. 91 of the Legislative Decree D.Lgs. no. 58 del 24 febbraio 1998, hereinafter CLF provides indeed that the "Consob shall exercise the powers provided for in this part having regard to the protection of investors and the efficiency and transparency of the market in corporate control and the capital market".
2. AA.VV., *La disciplina delle società quotate nel Testo Unico della Finanza*, d.lgs. 24 febbraio 1998, no. 58, Commentario a cura di P. Marchetti – L.A. Bianchi, Milano, 1999; AA.VV., *Testo Unico della Finanza*, Commentario diretto da G.F. Campobasso, Torino, 2002; AA.VV., *Il nuovo diritto societario*, Commentario diretto da G. Cottino e G. Bonfante, O. Cagnasso, P. Montalenti, Bologna, 2004; AA.VV., *Società di capitali*, Commentario a cura di G. Niccolini e A. Stagno d'Alcontres, Napoli, 2004; AA.VV., *Commentario alla riforma delle società*, diretto da P. Marchetti e L.A. Bianchi, F. Ghezzi, M. Notari, Milano, 2005; AA.VV., *Il nuovo diritto delle società. Liber amicorum Gian Franco Campobasso*, diretto da P. Abbadesse e G.B. Portale, Torino 2006; AA.VV., *Le offerte pubbliche di acquisto* a cura di M. Stella Richter jr., Torino, 2011; Angelici, C., *La riforma*

- delle società di capitali, *Lezioni di diritto Commerciale*, Padova, 2003; Bebchuk, L.A., *Efficient and Inefficient Sales of control*, in *Quarterly Journal of Economics*, 1994, 957 ss.; Bianchi, M. and Bianco, M., *Italian Corporate Governance in the last 15 years: from pyramids to coalition?*, ECGI Working Paper Series in Finance, 2006, www.ecgi.org/wp; Bianchi, M., Bianco, M., Giacomelli, S., Paces, A.M. and Trento, S., *Proprietà e controllo delle imprese in Italia*, Bologna, 2005; Costi, R. and Enriques, L., *Il mercato mobiliare*, in *Trattato di diritto commerciale* diretto da G. Cottino, Padova, vol. VIII, 2004; Dyck, A. and Zingales, L., *Private Benefits of Control: an International Comparison*, in *Journal of Finance*, 2004, 59, 2, 537 ss.; Ferrarini, G., *Share Ownership, Takeover Law and the Contestability of Corporate Control in Company Law Reform in OECD Countries. A comparative Outlook of Current Trends*, ECGI Working Paper, http://papers.ssrn.com/abstract_id=265429; Venturuzzo, M., *La disciplina delle misure difensive negli Stati Uniti d'America*, in *Governo dell'impresa e mercato delle regole. Scritti giuridici per Guido Rossi*, Milano, 2002, 495 ss.
3. Chiappetta, F. and D'Ambrosio, R., *OPA e disciplina del procedimento*, in *Rivista delle Società*, 2001, 449 ss.
 4. Although public exchange offerings inherently contain both the solicitations to invest and to divest, the Italian legislation in this respect inherits the provisions for public takeover bids rather than those for public sale or subscription offerings.
 5. Art. 1, comma 1, letter (v) of the CLF.
 6. Gatti, M., *Scelte opzionali e reciprocità nella direttiva in materia di offerte pubbliche di acquisto*, in *La Nuova Giurisprudenza Civile Commentata*, 2005, II, 416 ss.
 7. Art. 101-ter of the CFL.
 8. Pagano, M., Panunzi, F. and Zingales, L., *Osservazioni sulla riforma della disciplina dell'opa, degli obblighi di comunicazione del possesso azionario e dei limiti agli incroci azionari*, in *Rivista delle Società*, 2007, 1095 ss.; Miola, M. and Picardi, L., Art. 102, in *Testo Unico della Finanza*, Commentario diretto da G.F. Campobasso, Torino, 2002, II, 859 ss.
 9. Art. 39 and 39-bis of the Issuer Regulation.
 10. Chiappetta, F. and Ristuccia, R., *Ma quando inizia il gioco dell'opa?* in *Giurisprudenza Commerciale*, 2000, II, 18 ss.
 11. Art. 44 of the Regulation implementing Italian Legislative Decree No. 58 of 24 February 1998, concerning the discipline of Issuers no. 119871 of 14 May 1999 (Regulation Issuer).
 12. Chiappetta, F., Art. 104, in *Commentario al testo unico delle disposizioni in materia di intermediazione finanziaria*, a cura di G. Alpa e F. Capriglione, Padova, 1998, 967 ss.
 13. Vella, F., *La nuova passivity rule nella disciplina delle offerte pubbliche di acquisto: alla ricerca di un difficile equilibrio*, in *Banca, Impresa e Società*, 2000, 176 ss.
 14. Ferrarini, G., *Le difese contro le o.p.a. ostili, analisi economica e comparazione*, in *Rivista delle Società*, 2002, 737 ss.
 15. Art. 104-bis of the CLF.
 16. Vella, F., Art. 104, in *Testo Unico della Finanza*, Commentario diretto da G.F. Campobasso, Torino, 2002, II, 887 ss.
 17. Enriques, L., *Mercato del controllo societario e tutela degli investitori. La disciplina dell'opa obbligatoria*, Bologna, 2002; Enriques, L., *The mandatory bid rule in the*

- takeover directive: harmonization without foundation?* in *European company and financial law review*, 2004, 449, nt. 17.
18. Guizzi, G., *Notarelle in tema di OPA obbligatoria, violazione dell'obbligo di offerta e interessi protetti*, in *Rivista del Diritto Commerciale*, 2005, 251 ss.
 19. Art. 106 of the CFL.
 20. Cannella, F., Art. 106, in *La disciplina delle società quotate nel Testo Unico della Finanza, d.lgs. 24 febbraio 1998, no. 58*, Commentario a cura di P. Marchetti – L.A. Bianchi, Milano, 1999, I, 325 ss.
 21. Enriques, L., *The Mandatory Bid Rule in the Proposed EC Takeover Directive: Harmonization as a Rent Seeking*, in *Reforming Company and Takeover Law in Europe*, a cura di G. Ferrarini, K.J. Hopt, J. Winter and E. Wymeersch, Oxford, 2004.
 22. Art. 105 of the CFL.
 23. Art. 106, par. 3, CFL.
 24. Art. 45, Regulation of the Issuer.
 25. Art. 46, Regulation of the Issuer.
 26. Art. 106, par. 4, TUF
 27. Art. 10, CFL.
 28. Bianchi, L.A., Art. 109, in *La disciplina delle società quotate nel Testo Unico della Finanza, d.lgs. 24 febbraio 1998, no. 58*, Commentario a cura di P. Marchetti – L.A. Bianchi, Milano, 1999, I, 429 ss.
 29. Art. 101-bis, par. 4, CLF.
 30. Art. 110, CLF.
 31. Converted into law, the Legislative Decree no. 91 of 24 June 2014.
 32. Increased-voting rights shares attribute two voting rights for each share held, whereas multiple-voting rights shares account for three votes per share. The exceptional case exists of listed companies having issued multiple-voting rights shares – this case occurring when a company issues this sort of shares before its listing. In this particular case, the legislator allows this company to keep multiple voting rights shares within its corporate governance – given that this sort of shares have been conceived also as an incentive to undergo the listing procedure and to favour potential IPOs in future times.

9

Listed Companies

Simone Alvaro

9.1 Rules governing listed companies: sources of regulation and ambit of application

Italy introduced a specific regulation for listed companies in its legal system for the first time with Law no. 216 of 7 June 1974, a law which (also) determined the establishment of the Commissione Nazionale per le Società e la Borsa (the Consob), the public authority responsible for regulating the Italian securities markets.¹ These “primordial” rules laid down exclusively the transparency duties of listed companies toward the Consob and the markets.

In subsequent years, the regulation was greatly enriched and enlarged, undergoing a profound change. Today, the regulation encompasses a kaleidoscope of constantly evolving provisions ranging from rules of European origin to rules originating from Italian primary or secondary law, including soft regulations introduced by the Supervisory Authority on financial markets (recommendations, advice and communications) as well as self-regulation from contractual sources.²

Today, the Italian regulations (both primary and secondary) applicable to listed companies are, on the whole, structured as follows:

- a) one part is contained in the Italian Civil Code³ (Book V, Title V), which sets down the rules concerning all companies (both listed and unlisted);
- b) a second part, specifically dedicated to listed companies, is contained in the Consolidated Law on Finance (“*Testo Unico della Finanza*” or simply the TUF).⁴ This stipulates (see Part IV, Title III, headed “*Issuers*”) the rules regarding company information, ownership structures, information on the adoption of codes of conduct,

- shareholders' rights, cooperatives, proxies and solicitation of proxies, savings shares and other classes of shares, administration bodies, internal control bodies, financial information, statutory audit and relations with foreign companies having their registered office in countries where corporate transparency is not ensured;
- c) the final part is contained in the Consob's Regulation implementing Italian Legislative Decree no. 58 of 24 February 1998 ("*Issuers Regulation*"), concerning the discipline of listed issuers.⁵

The regulation of listed companies contained in the TUF (as specified by Art. 119) applies, unless specified otherwise: to Italian companies⁶ with shares listed⁷ on regulated markets in Italy or other EU countries.

Having the *status* of a listed company affects, as indicated above, the corporate governance discipline of the company (both administration and internal control bodies), shareholders' rights, representation at the shareholders' meeting, solicitation of proxies, statutory audit and financial instruments that the company may use for raising funds on financial markets. For this reason, Italian legal doctrine in the past considered whether a listed company should be treated as a different and ulterior company model compared to those of the unlisted companies outlined in Art. 2249 of the Italian Civil Code⁸ (hereafter CC). This is not simply a theoretical issue, as the answer to this can, for example, also affect the question of the competence of the shareholders' meeting on listing and unlisting admission on regulated market matters (as well as the shareholders' right of withdrawal in such situations).⁹

The ambit of application of rules set down in the TUF concerning the corporate governance of listed companies (again under Art. 119 TUF) is narrower than the ambit of application of rules regarding information to be provided to the public (as identified by Art. 114 and 116 of the TUF), as will be seen in greater detail later. The latter rules, in fact, apply to both Italian and foreign listed companies that issue financial instruments (also different from shares), listed in regulated markets or widely distributed among the public.¹⁰ A listed "*società per azioni*" (company limited by shares) and companies that issue shares, which are unlisted but widely distributed among the public, together constitute the category of "*open*" companies – companies that resort to the risk capital market (Art. 2325-*bis* CC).

9.2 General principles governing the regulation of listed companies

Given that financial markets are influenced by physiological economic information asymmetry, the Italian regulation of listed companies

allows a public intervention in the sector, through the emanation of rules aimed at the protection of investors and, more generally, in order to guarantee the safeguarding of faith in the financial system (Art. 5, Subsection 1, letter a, TUF).¹¹

As a result, Art. 92 of the TUF introduced a rule which affirmed the principle of equal treatment for all holders of listed financial instruments and by which listed issuers (including listed issuers with Italy as their home Member State) must guarantee:

- a) the same treatment, with identical terms and conditions to all holders of listed financial instruments;
- b) the instruments and information necessary for the exercise of rights to all holders of listed financial instruments.

This principle does not aim to govern purely the internal aspects of company organization but also (and especially) to protect all holders (both actual and potential) of listed financial instruments.

9.3 Transparency of ownership structures

Italian law requires transparency in the ownership structures of Italian companies with shares listed on regulated markets in Italy or in other EU countries. This transparency is due in favour not only of the investee listed company, but also toward the Consob and the markets.¹²

Notification requirements do not concern all forms of participation, but only “major shareholdings”, that is a participation that may have some influence on the company’s management power.

Major shareholdings are taken to mean: (a) shares, capital parts and other financial instruments that confer administrative rights or in any case those provided for by the final subsections of Art. 2351 of the Civil Code (see Art. 1, Subsection 6-*bis*, of TUF) and in Art. 127-*quinquies* of TUF; (b) over two per cent of the capital of a listed issuer with Italy as home Member State.¹³

The Consolidated Law on Finance (Art. 120, Subsection 4) conferred the Consob with the task of setting down a regulation covering both the variations in the holdings and the methods for calculating holdings, including indirect holdings and those where voting rights belong or have been assigned to a person other than the shareholder as well as those to which the companies’ bylaw recognises an increased vote.¹⁴

The Consob has, therefore, stated (see Issuers Regulation, Art. 117) that “Those who hold the share capital of a listed company must notify the investee company and Consob in the case that:

- a) the 2 per cent threshold is exceeded;
- b) the thresholds of 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 30 per cent, 50 per cent, 66.6 per cent, 90 per cent and 95 per cent are reached or exceeded;
- c) the reduction of the investment to below the thresholds specified in cases (a) and (b) above”.

The Consob’s Issuers Regulation requires transparency also for potential investments, meaning “shares comprising the underlying capital of derivative financial instruments listed under Art. 1, para. 3 of the TUF and all other financial instruments or contracts, which, by virtue of a legally binding agreement, attributes the holder, on its exclusive initiative, the unconditional right to purchase, by physical delivery, the underlying shares or the discretion to buy, by means of physical delivery, the underlying shares” (Art. 116-*terdecies*, Subsection 1, letter d, Issuers Regulation).

Declarations of holdings (even potential ones) must be made without delay and in any event within five trading days of the date of the transaction leading to the obligation.

9.4 Rules governing cross-holdings

Cross-holdings between two companies are allowed in Italy unless:

- a) there is a control relationship between the companies concerned, as defined by Art. 2359-*bis* of the Civil Code (in this case the company under control shall not get a participation above 10 per cent of the capital of the controlling company and shall not vote in the shareholders’ meetings of the controlling company);
- b) the companies concerned are listed companies (Italian companies with shares listed on regulated markets in Italy or other EU countries).

In this second case, limitations set down by the law are not aimed at protecting the company’s capital (as in the first case) but both to favour a sufficient circulation of the share’s holdings of companies that resort to the risk capital market and to prevent a situation occurring in which the reciprocal participation would lead to the subtraction from the

market of the power to govern the company and place it in the “mutual” cooperation between controlling shareholders’ groups and company’s managers involved.¹⁵

Art. 121 TUF stipulates that in the case of reciprocal participation between listed companies and in excess of two per cent (or five per cent for SMEs)¹⁶, the company that was last to exceed the limit cannot exercise its right to vote relative to the surplus shares and must dispose of them within 12 months from the date on which it exceeded the limit. In the event of the failure to undertake this disposal within such a time limit, the suspension of voting rights applies to the entire shareholding. Where it is not possible to ascertain which of the two companies was the last to exceed the limit, the suspension of voting rights and the disposal requirement applies to both, unless they have agreed otherwise.

Given that in the past this rule has been used as a poison pill against takeovers, the TUF (in Art. 121, Subsection 5) stated that the limits indicated in the aforementioned Art. 121 Subsection 1 and 2, shall not apply where the limits are exceeded following a takeover bid or exchange tender offering aimed at the acquisition of at least 60 per cent of the ordinary shares.

9.5 Shareholders’ agreements

Considering the fact that the existence of a shareholders’ agreement can deeply affect ownership structures, both under the profile of the circulation of share holdings (*blockade agreements*) and from that of the effective relevance of the management (*vote agreements* or *consultation agreements*), the TUF has guaranteed their transparency and some limits to their contents.¹⁷

Under Art. 122 TUF, agreements regarding the exercise of voting rights in companies with listed shares and their parent companies, in whatever format they may be stipulated (with the exception only for those regarding shareholdings totalling less than the threshold of two per cent), within five days of stipulation must be:

- a) notified to the Consob;
- b) published in abstract form in the Italian daily press;
- c) filed with the Register of Companies in which the company office is registered;
- d) notified to the companies with listed shares.

Following Art. 122, Subsection 2 TUF, the Consob must lay down a regulation for the contents of the notification, the abstract and its publication, together with the related procedures.¹⁸

In the event of non-compliance with the requirements, the above-mentioned agreements are to be considered null and void and voting rights attached to listed shares may not be exercised.

The same rules apply to agreements (see Art. 122, Subsection 5), in whatsoever form concluded, that:

- create obligations of consultation prior to the exercise of voting rights in companies with listed shares or companies that control them;
- set limits on the transfer of the related shares or of financial instruments that entitle holders to buy or subscribe for them;
- provide for the purchase of shares or of financial instruments that entitle holders to buy or subscribe for them;
- have as their object or effect the exercise, jointly or otherwise, of a dominant influence on such companies;
- aim to encourage or frustrate a takeover bid or exchange tender offering, including commitments relating to non-participation in a takeover bid.

9.6 Corporate governance of listed companies

The internal organization of a listed company may change significantly depending on the specific options chosen by this same company. Listed companies, in fact, may decide to adopt any of three juridical structures: (1) a “società per azioni” (stock company)¹⁹, (2) a “società in accomandita per azioni” (limited share partnership)²⁰ or (3) a “società cooperativa per azioni” (cooperatives with share capital)²¹. Thanks to the “Organic reform of company and cooperatives” law of 2003,²² the company can also opt for a traditional Italian management and control system (i.e. the “horizontal” two-tier model)²³ or, in some cases, the “vertical” two-tier²⁴ or one-tier²⁵ management and control system. It is interesting to observe here, however, that in the vast majority of cases, Italian listed companies (mainly organised as *società per azioni*) choose to follow the traditional management and control system. In fact, at the end of 2012, only 8 out of 251 companies adopted an alternative system.²⁶

Listed companies, finally, can also decide to adopt or not to adopt a code of conduct.²⁷ On this matter, Art. 124-ter of the TUF states that “To the extent of its powers, Consob shall establish the disclosure formats for codes of conduct regarding corporate governance issued by stock exchange companies or trade associations.”²⁸

Regardless of the choices mentioned above, the TUF imposed several rules which are valid for all listed companies on the subject matters of: administration (Art. 147-ter et seq.) and internal control bodies

(Art. 148 et seq.), shareholders' rights (Art. 125 et seq.), representation at the shareholders' meeting (Art. 135-*novies* et seq.), solicitation of proxies (Art. 136 et seq.), statutory audit (Art. 155 et seq.), financial instruments (Art. 145 et seq.) and additionally, for information which the company is required to give to the markets and to Consob (Art. 113 et seq.).

9.7 Report on corporate governance and ownership structures

Art. 123-*bis* TUF stipulates that all issuers with securities admitted to trading on regulated markets must give the markets a general and complete overview both of the corporate governance system adopted and of ownership structures of the company.

The management report on corporate governance and ownership structures must contain a specific section providing detailed information which has to include:

- the capital structure of the company (including securities not traded on a regulated market in an EU Member State, with an indication of the different classes of shares);
- any restriction on the transfer of securities (e.g. limitations in the possession of securities or the need to obtain consent from part of the company or other securities holders);
- significant direct and indirect holdings (e.g. through pyramid structures and cross-holdings);
- the holders of any securities with special control rights and a description of such rights, if known;
- the mechanism for the exercise of voting rights in any employee share scheme where voting rights are not exercised directly by the employees;
- any restrictions on voting rights;
- shareholders' agreements known to the company;
- adoption of a corporate governance code of conduct issued by regulated stock exchange companies or trade associations (giving reasons for any decision not to adopt one or more provisions);
- the operating mechanisms of the shareholders' meeting, its main powers, shareholder rights and their terms of exercise, if different from those envisaged by legal and regulatory provisions applicable as supplementary measures;
- the composition and duties of the administrative and control bodies and their committees.

9.8 The shareholders' meeting

The Consolidated Law on Finance recognizes the shareholders' meeting as the moment and the place where "minorities", and especially institutional investors, may raise their voice and carry out a positive monitoring activity on management decisions.²⁹

It is from this perspective, therefore, that the rules should be interpreted. These stipulate: (a) that the control body (board of auditors, supervisory board and management control committee) report to the shareholder's meeting on "the supervisory activity performed and on any omission and censurable facts found" (Art. 153, Subsection 1); (b) that the management body submit to the shareholders' meeting the authorisation of management acts and transactions that may contrast a takeover bid (Art. 104, Subsection 1) as well as the assumption of cross-holdings in excess of the limit of two per cent (or five per cent for SMEs) of the capital (Art. 121, Subsection 1 and 2); (c) the approval of an extraordinary shareholders' meeting for the request that their own financial instruments may be excluded from trading on a regulated market (Art. 133, Subsection 1, TUF).³⁰

The shareholders' meeting is to be convened through the publication of a notice on the company's website no later than 30 days prior to the date of the meeting or by other means and within the terms established by the Consob (Art. 125-*bis*, Subsection 1, TUF). Alternatively, it can be convened by the board of auditors (or by at least two of its members) after having notified the chairman of the board of directors (Art. 151, Subsection 2, TUF).

Shareholders must be informed on each of the items of the agenda before the meeting takes place in the following ways: (a) through the content of the agenda (analytically regulated by Art. 125-*bis* TUF), (b) through the report made by the board of directors available to the public at the company's registered office, on the company website and by other means envisaged by the Consob regulation (Art. 125-*ter* TUF) or (c) by exercising the right to consult all the documents filed at the company's registered office for shareholders' meetings that have already been called and, in this case, obtaining a copy thereof at their own expense (Art. 130 TUF).

Shareholders with voting rights may also submit questions on the items on the agenda before the shareholders' meeting (Art. 127-*ter* TUF) and those who, either individually or jointly, account for one fortieth of the share capital may ask (within ten days of the publication of the notice calling the shareholders' meeting, or within five days in the event

of the meeting being called in accordance with Art. 125-*bis*, Subsection 3 or Art. 104, Subsection 2) for the integration of the list of items on the agenda, specifying in the request the additional items they propose or presenting proposed resolutions on items already on the agenda (Art. 126-*bis*, Subsection 1, TUF).

Concerning the right to attend shareholders' meetings and the exercise of voting rights, Art. 83-*sexies* TUF states that the legitimate attendance of shareholders' meetings and the exercise of voting rights is confirmed by a statement to the issuer from the intermediary, in compliance with intermediary accounting records, on behalf of the person with the right to vote.

For meetings of holders of financial instruments admitted for trading with the issuer's consent on regulated markets or in the Italian multilateral trading systems or those of other EU countries, the aforementioned communication is made by the intermediary on the basis of the evidence of the accounts contemplated by Art. 83-*quater*, Subsection 3, TUF, relative to the term of the accounting day of the seventh market business day prior to the date established for the meeting ("record date").

In terms of voting, listed companies can permit votes cast either by post or through electronic means (Art. 127 TUF).

The correspondence vote can be exercised, in accordance with the provisions provided in the notice convening the shareholders' meeting, by sending a ballot card prepared so as to ensure the secrecy of the vote until the counting begins and containing the indication of the issuing company, the details of the meeting, the identity of the person entitled to exercise voting rights and specifying the number of shares held, the motion proposals, the vote cast, the date and the signature (Art. 140, Subsection 2, Issuers Regulation).

Correspondence votes must be exercised directly by the owner and expressed separately for each of the motion proposals and the ballot has to be received by the company by the day prior to the meeting (Art. 141, Subsection 1 and 2, Issuers Regulation).

9.9 Proxies

Any person with the right to vote may indicate one representative for each shareholders' meeting, without prejudicing their right to specify one or more replacements.

The TUF allows promoters (i.e. the person or persons, including the issuer, acting in concert to promote the solicitation) to perform a solicitation through the dissemination of a statement and a proxy form (Art.

138 TUF). At the same time, it defines “solicitation” as a request to more than 200 shareholders for proxy to be conferred in relation to specific voting proposals or accompanied by recommendations, statements or other indications capable of influencing the vote (Art. 136 TUF).

Proxies have to be signed by the givers and may be revoked. They may be given only for one shareholders’ meeting that has already been called, remaining effective for subsequent calls where applicable; they may not be given blank and must be dated, show the name of the appointee and the voting instructions. The proxy may also be conferred for only a number of the voting proposals indicated in the proxy form or for only certain items on the agenda (Art. 142 TUF).

9.10 The Board of Directors

Italy has special voting arrangements for the election of board members (which are in fact quite uncommon in the international panorama) in order to facilitate the effective participation of minority shareholders.³¹

Directors are drawn from a list of candidates (“slates”) to be submitted ahead of the shareholders’ meeting.

Company bylaws establish the mechanisms according to which board seats are distributed among the slates presented and defines the minimum participation share required for their presentation, to a limit not above a fortieth of the share capital (or at a different level established by the Consob, with the regulation taking into account capitalisation, floating funds and ownership structures of listed companies).³²

The lists indicate which directors hold the independent requisites established by law and by the statute. The statute may also provide that, regarding the section for directors to be elected, the lists which have not reached a percentage of votes at least equal to half of the one required by the statute for the presentation of same are not to be taken into account (Art. 147-ter TUF).

Lists are deposited with the issuer by the twenty-fifth day prior to the date of the meeting called to resolve on the appointment of the members of the board of directors and made available to the public at the company’s headquarters, on the company’s website and in the other ways envisaged by the Consob by regulation, at least 21 days prior to the date of the shareholders’ meeting.

The statute also lays down that the division of directors to be elected has to be made on the basis of a criterion that ensures a balance between genders. The less-represented gender must obtain at least one third of the directors elected.

Companies almost always grant a majority premium to the slate receiving the highest number of votes, which takes all board seats except the *quota* reserved to candidates chosen from minority slates. Minority shareholders can in any case nominate candidates to their own slate, given that at least one board member must be elected from the minority slate that received the largest number of votes and which is not linked in any way – even indirectly – to the shareholders who presented or voted for the list that came first by number of votes (Art. 147-ter, Subsection 1 and 3, TUF).

Attributing the votes received by a slate to individual candidates is commonly done using the quotient method: the votes received by each candidate are the result of the ratio between the total number of votes received by the relevant slate and the ordinal number associated to the candidate (the first candidate receives the total number of the slate's votes; the second candidate receives one half of total slate's votes; the third candidate receives one third of total slate's votes, etc.). The quotients resulting from these calculations are progressively attributed to the candidates and those with the highest quotients are appointed, with a possible exception in order to meet legal or regulatory requirements for board composition.

Some companies, such as privatised ones, have reserved a higher number of board places for the minority slate (a fifth of the board).³³

In addition to the before, at least one of the members of the board of directors, or two if the board of directors is composed of more than seven members, should satisfy the independence requirements established for members of the board of auditors in Art. 148, Subsection 3 of the TUF and, if provided for in the Articles of Association, the additional requirements established in codes of conduct drawn up by regulated stock exchange companies or by trade associations (Art. 147-ter TUF).

Moreover, persons who perform an administrative or management role must satisfy the integrity requirements established for members of internal control bodies in the regulation issued by the Minister of Justice pursuant to Art. 148, Subsection 4, of the TUF (Art. 147-quinquies TUF).

9.11 Internal control bodies

In the aforementioned Italian traditional management and control system (the horizontal two-tier model) the "*collegio sindacale*" (the internal independent auditors committee) is appointed by shareholders' meeting. It is composed of three (or, but less frequently, five) independent members (who have a background in law or accounting), who

are responsible for attending board meetings and monitoring compliance with the law and with the company charter, as well as the adequacy of the company's organisational structure and of the internal control, administrative and accounting system.³⁴

The Articles of Association of the company state, moreover, that the division of members of *collegio sindacale* shall be done in such a way that the less-represented gender shall obtain at least one third of the regular members of the board of auditors (Art. 148, Subsection 1-*bis*, TUF).

For the election of *collegio sindacale*, Italy also has special voting arrangements, again to facilitate the effective participation of minority shareholders.

Art. 148, Subsection 2, of the TUF lays down that the Consob shall establish the rules for the election procedure by a list vote of a member of the *collegio sindacale* by minority shareholders that are not directly or indirectly associated with the shareholders that submitted or voted for the list qualifying as first for the number of votes received.

Italy also has a special regulation on the subject of limits on the accumulation of positions that members of the internal control bodies may hold in others (capital-based) companies.

According to Art. 148-*bis* of the TUF, the Consob shall stipulate in a regulation the limits to the accumulation of management and control positions, establishing such limits taking into account the onerousness and complexity of each type of position, including in relation to the size of the company, the number and size of the firms included in the consolidation and the extension and articulation of its organisational structure.³⁵ The Consob shall also declare the disqualification from positions taken on after the maximum number provided for in the regulation referred to in the first subsection has been reached (Art. 148-*bis*, TUF).

A number of regulations of the TUF confer some particular power on the *collegio sindacale* inside the company such as:

- 1) members of the *collegio sindacale*, jointly or separately, may at any time carry out inspections and controls and require the directors to supply information, *inter alia* with reference to subsidiaries, on the performance of the business or on particular transactions or make the same requests for information directly to the management and control bodies of subsidiaries (Art. 151, Subsection 1);
- 2) the *collegio sindacale* may exchange information with the corresponding bodies of subsidiaries concerning management and control systems and the general performance of the business. After notifying

the chairman of the board of directors, it may also call the shareholders' meeting and meetings of the board of directors or the executive committee and use employees of the company in performing its duties (Art. 151, Subsection 2, TUF);

- 3) where it has a well-founded suspicion that the directors, in violation of their duties, have committed serious irregularities in transactions that may injure the company or one or more of its subsidiaries, the *collegio sindacale* may report the facts to the courts pursuant to Art. 2409 of the Civil Code. In such case, the costs of the inspection shall be borne by the company and the court may also remove the directors (Art. 152, Subsection 1, TUF);
- 4) the *collegio sindacale* shall report on the supervisory activity performed and on any omissions and censurable facts found to the shareholders' meeting called to approve the annual accounts or pursuant to Art. 2364-bis, Subsection 2, of the Civil Code (Art. 153, Subsection 1, TUF);
- 5) the *collegio sindacale* shall notify the Consob without delay of irregularities found in the performance of its oversight activity and shall transmit the related minutes of the meetings and investigations conducted with all other relevant documentation (Art. 149, Subsection 3, TUF).

9.12 Financial structure of listed companies

On the whole, it can be said that the basic financial structure of a listed company is quite similar to that of unlisted *società per azioni*.

The only important basic difference is that: Law no. 216/1974 allows listed company to issue non-voting shares ("saving shares"), Art. 127-*quinquies* of the TUF³⁶ allows listed companies to recognise an increased vote (up to a maximum of two votes per share) to members who possess the shares for an uninterrupted period of no less than 24 months³⁷ and Art. 2351, Subsection 4, CC allows unlisted companies' bylaw to create multiple-voting shares.³⁸

Art. 145, Subsection 1 of TUF, today stipulates that Italian companies with ordinary shares listed on regulated markets in Italy (or other EU countries) may issue non-voting shares with preferential rights with regards to the payment of dividends and the liquidation of assets. The Articles of Association shall specify the substance of such preferential rights and the conditions and time and other limits for their exercise; they shall also establish the rights of holders of savings shares where ordinary or savings shares are excluded from trading.

An organisation of holders of savings shares divided into a special meeting and in a “common representative” is mandatory (Art. 146 TUF).

However, it should be mentioned that over the last 20 years, the use of non-voting shares (preference and savings shares) declined so much that in 2012, the number of Italian firms issuing non-voting shares were only 32, compared to 120 in 1992.³⁹

It is also important to observe that the “Organic reform of the company and cooperatives law” of 2003 allowed Italian companies (both listed and not listed) to issue financial instruments different from shares and bonds, even though always referable, respectively, to equity capital (“equity-like instruments”) and to debenture capital (“bond-like instruments”).

Obviously, listed companies may issue financial instruments different from shares and bonds in as far as they shall be listed on regulated markets or, more generally, exchanged on others trading venues. It is also for this reason that Art. 95, Subsection 4, of TUF prescribes that the “Consob shall determine which financial instruments or products, admitted for trading on regulated markets or widely distributed among the public pursuant to Art. 116 and identified by a particular denomination or on the basis of specific qualifying criteria, must have a typical determined content”.

The most important difference between listed and unlisted shares is that listed shares shall be dematerialised and managed by central depository.

The TUF sets down specific regulation regarding: option rights (Art. 134 TUF and Art. 2442, Subsection 4, CC), the valuation of the part of the capital to liquidate to shareholders in case of withdrawal (Art. 2437-ter CC), the acquisition of own shares (Art. 132 TUF), limitations to voting rights toward a certain amount of shares owned (Art. 2351, Subsection 3, CC) and the possibility for the Articles of Association to “order that each share held by the same shareholder for a continuous period indicated in the Article, in any case of no less than one year or the lesser period running between two consecutive payment dates of the annual dividend, shall assign the right to an increase of no more than ten per cent of the dividend distributed to the other shares” (Art. 127-quater, Subsection 1, TUF).

The Italian Civil Code gives listed companies wider power in the issuing of bonds than it does to unlisted companies given that for listed companies on regulated markets on which bonds are traded there are a

multiplicity of controls that give the bond holders a stronger guarantee than the one given by the capital of the company (see Art. 2412 CC).

9.13 Related Party Transactions

Art. 2391-*bis* of the Italian Civil Code, lay down that “administration bodies of companies that turn to risk capital shall adopt, in accordance with the general principles indicated by Consob, rules that guarantee the substantial and procedural transparency and correctness of related party transactions and disclose them in the management report”.

Hence, in March 2010 Consob enacted a Regulation containing specific provisions regarding Related Party Transactions (hereinafter RPTs) covering both approval and disclosure requirements to be followed by listed companies when dealing with insiders. Such requirements are graduated according to the magnitude of the transaction (i.e. its materiality, following the result of a significance test set forth in the regulation), the risk of minority exploitation and the size of the company.⁴⁰

The regulation allows companies to set up their own procedures with a certain degree of flexibility in the identification of RPTs, in particular with regards to the definition of material RPTs⁴¹, which are subject to increased approval and disclosure requirements on the one side, and of small transactions, which are to be exempted from all requirements, on the other.

Furthermore, the regulation grants companies some degrees of freedom in the definition of the approval requirements to be followed when entering into RPTs, in particular with regard to the possibility of overcoming a (negative) binding opinion by independent directors on material RPTs, to the approval exemptions in case of urgency and to the setting-up of budget limits to the external advice that independent directors may seek on transactions below the materiality threshold.

9.14 Company information⁴²

Information regarding the trends of a listed company as well as its future prospects is never distributed in a completely uniform way between *insiders* e *outsiders*, resulting in a rather asymmetric situation where there is a bias toward the *insiders*.⁴³

According to economic theory a financial system is efficient and competitive when it achieves a level playing field – a “parity of information” – for all market participants (issuers, intermediaries, institutional investors, savings, etc.). This occurs when the market provides

participants (especially those able to bear the costs necessary to collect, analyse and verify data) with all the information upon which to make conscious and efficient choices.⁴⁴

Economic theory also assigns regulation (including supervisory authorities) with the task of preventing and mitigating the consequences of “market failures”. These failures can be defined as the market’s inability to self-generate – through the supply and demand mechanism – satisfactory conditions of efficiency, consistency and stability.

In this sense, financial regulation enters into the wider sphere of public intervention in the economy with more general objectives which are commonly established as those of preserving stability, fairness in resource distribution, free competition and the efficient use of resources.

The obligation for listed companies to provide information to the public is the tool adopted to ensure this in all legal systems of countries with advanced economies.

This form of “disclosure philosophy”, that characterized the United States federal rules since the 1930s⁴⁵, is summed up in a famous aphorism of Louis Brandeis: “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman”.⁴⁶ It was following the principles of this theory that the Commissione Nazionale per le Società e la Borsa (the Consob), the public authority responsible for regulating the Italian financial markets, was set up in Italy in 1974.

In Europe, Directive no. 2004/109/CE (the “Transparency Directive”) lay down the basis for: (a) a uniform regulation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and (b) a set of rules concerning the disclosure system of all available information to the public.

In particular, the Transparency Directive (introduced in Italy with Legislative Decree no.195/2007) sets down: (a) periodic information requirements (the issuer must make public its annual financial report at the latest four months after the end of each financial year, half-yearly financial report covering the first six months of the financial year and interim management statements during the first and the second six-month period of the financial year); (b) ongoing information requirements (the disclosure of accurate, comprehensive and timely information about issuers and about their securities); (c) obligations for the publishing and storing of regulated disclosure requirements.⁴⁷

Today, both primary and secondary Italian regulations concerning transparency requirements for security issuers and investors acquiring or disposing of major holdings in issuers whose shares are admitted to trading on a regulated market, are structured as follows:

- a) one part is contained in the TUF (Arts 113 to 118-*bis*); this aims to increase disclosure by listed companies especially toward the market (Arts 113, 114 and 114-*bis*) and the Consob (Art. 115);
- b) a second part is contained in the Issuers Regulation (Arts 65 to 116-*duodecies*).

The two most important articles of the TUF are Art. 114 (headed “Information to be provided to the public”) and Art. 115 (headed “Information to be disclosed to Consob”).

Art. 114 TUF states that (a) listed issuers shall make available to the public, without delay, any inside information (referred to in Art. 181) that directly concerns such issuers and their subsidiaries and (b) the Consob shall establish the terms and conditions for the disclosure of information and dictate measures to coordinate duties attributed to stock exchange companies with their own communication means.

Art. 115 TUF states that “for the purposes of monitoring the accuracy of information provided to the public, the Consob, on a general basis or otherwise, may:

- a) require listed issuers, listed issuers with Italy as home Member State, the persons that control them and companies controlled by them to provide information and documents, establishing the related procedures;
- b) gather information, including by means of hearings, from members of governing bodies, general managers, managers charged with preparing companies’ financial reports and other managers, statutory auditors, independent statutory auditors and companies and persons referred to in paragraph (a);
- c) carry out inspections at the offices of persons referred to in paragraphs (a) and (b) to check company documents and obtain copies thereof;
- c-*bis*) exercise the other powers provided by Art. 187-*octies*.

9.15 Problems, perspectives and potential evolution of the governance and internal controls of listed companies

In order to consider how governance in Italian listed companies could evolve in the next few years, it is important firstly to reflect on the historical evolution that has been seen up until this time and the problems currently related to the regulation of this area in Italy.

In particular, it should be highlighted that the regulation of internal governance and specifically of the board of directors of listed companies remained substantially unchanged for over 60 years (at least until 2005⁴⁸) following the rules laid down in the Civil Code of 1942.⁴⁹ In fact, neither the so-called “mini-reform” of 1974 (L. no. 261/1974) with which the Consob was established, nor the original version of the TUF, which instead contained norms regarding the *collegio sindacale* (the internal independent auditors committee), addressed any specific provisions to the board of directors – either in its functions or its structure.⁵⁰

In the last 11 years, the entire internal governance of listed companies in Italy has evolved significantly and become far more complex as a result of three factors: (a) the Reform of Company Law in 2003, which introduced the vertical two-tier model and the one-tier model (the so-called alternative models) alongside that of the traditional Italian management and control system (i.e. the horizontal two-tier model), in order to allow companies greater organisational flexibility⁵¹; (b) the Savings Law of 2005 (as well as various laws subsequent to this), which noticeably enriched the regulation of the administrative body (both regarding its structure and composition as well as its functions); (c) the fact that over the years the internal control system has been the focus of numerous interventions by the legislator which have made the system fragmented and over abundant.⁵²

This complex and layered regulation resulted in a number of problems.

With regards to the alternative management and control systems, the norms introduced in 2003 (which are not actually perfectly in line with the models developed in the countries of origin) are essentially norms derived from the traditional system through means of an extensive recourse to referred norms and as such are particularly stifling.⁵³ This is one of the main reasons why the alternative models have been used very rarely by listed companies in Italy⁵⁴; in fact only three per cent of companies, as mentioned above, have opted for an alternative administration and control model over that of the traditional Italian management and control system (i.e. the horizontal two-tier model). There is no doubt, however, that operators have preferred to maintain the traditional Italian system also in virtue of the fact that with respect to certain corporate issues related to this matter, jurisprudential and doctrinal interpretation guidelines are often well defined and fairly stable.

The traditional Italian system, moreover, is characterised today by the greater distance that exists between the administrative and control functions compared to that found in the other two models. In fact, while in

the two-tier system, the supervisory board watches over the operations of the administrators more closely and above all more actively, in the one-tier system there is a higher circulation of information between the administrative body and that which is responsible for control, a feature which leads not only to cost and time savings, but also to a higher level of transparency between the administration and control functions.⁵⁵

Concerning the regulation of the board of directors, it should be mentioned that since 2005, the state regulation of this body has undergone a rapid change which has resulted in a layered regulation which is disorganic and unique in the world, and which effectively overlaps with that laid down by the Italian Corporate Governance Code of 1999. This means that:

- a) regarding the question of the composition of the administrative body, today the TUF establishes that within the board of directors (or the supervisory and management boards) it is necessary to have members with “integrity” (Art. 147-*quinquies*), independence (Art. 147-*ter*, comma 4), originating from a certain sector of the company shareholders (the “majority” or the “minority”, Art. 147-*ter*, comma 3)⁵⁶ or of a certain gender (Art. 147-*ter*, Subsection 1-*ter*) but with no particular professional characteristics.⁵⁷ Such norms must be coordinated with the provisions of the Corporate Governance Code that, above all based on the experience of the United Kingdom and the United States of America, provides for the presence on the board of an adequate number of non-executive independent directors (chosen with a partially different method from that found in the Civil Code), the establishment of committees with proposing and consultative functions, etc. All these rules have resulted in the creation of a necessary dialectic between the executive and non-executive members within the administrative body with as well as the creation of internal subdivisions with functional or inquiry roles. This demonstrates also the tendency in Italian law to make the board of directors of listed companies above all a place where the various interests and multiple visions of the interests of the company converge.⁵⁸
- b) in terms of functions, it is particularly interesting to look at the norms which have attributed the administrative body with the strategic supervision of the area of risk, which aims to impose stricter control over the management also through the setting down of protection measures against company risks (Art. 2381 and 2391-*bis* Civil Code). According to this, the board of directors “shall define the guidelines of the internal control and risk management system,

so that the main risks concerning the issuer and its subsidiaries are correctly identified and adequately measured, managed and monitored, determining, moreover, the level of compatibility of such risks with the management of the company in a manner consistent with its strategic objectives".⁵⁹

Finally, concerning the internal control and risk management system, the Italian internal control system of listed companies (in line with many other countries with advanced economies), is today affected by the phenomenon of normative and regulation "overshooting".⁶⁰ This calls for the involvement of an excess of bodies, committees and other elements: (1) the board of directors, (2) the *collegio sindacale*, (3) the internal committees of the board of directors – particularly the control and risk committee (see Art. 7 of the Italian Corporate Governance Code⁶¹), (4) the surveillance and control body pursuant to Legislative Decree 231/2001 (which has the responsibility of monitoring organisation and control models that enable companies to avoid the burden of administrative responsibility), (5) the manager responsible for preparing a company's financial reports (Art. 154-*bis* TUF, introduced by Art. 14, L.no.262/2005), (6) independent directors, (7) the head of internal audit (entrusted with the task of verifying the functioning and adequacy of the internal control and risk management system) and the many other roles and business functions who have specific tasks connected to internal control, risk management, compliance and internal audit (see the Bank of Italy and the Consob joint regulation of 29 October 2007).

From what has been outlined so far, it seems possible to envisage that in the near future, the Italian Legislator could decide to improve the regulation of the one-tier and two-tier models in order to make it clearer, more autonomous and consequently more attractive for Italian companies. This could happen firstly by dedicating an autonomous regulation to each model and above all one which is closer to that of the more mature models developed in other countries (the two-tier model in Germany and the one-tier version in the United Kingdom).

Secondly, it is possible to argue that Italy – where internal controls appear to be more of a network (or grid) – must look toward a simplification of the internal control system.

Although clearly no internal control system can be valid for all historical periods or all types of company (the success of a control system is closely related to the context in which it is set and the aims for which it was drawn up),⁶² there is obviously a need to simplify the Italian control system, in particular by: reducing the number of elements involved;

regulating the flow of information between the different parts; attributing the control body with the function of coordinating all the instances of internal control in the company; ruling that the procedures and the means of coordination between the different people who are responsible for internal control are regulated with a specific measure adopted by the board of directors; establishing an obligation for the internal control body to report periodically (every quarter) to the board on the functioning of the control systems and the results of controls carried out, as well as to decide on any modifications that need to be made on the part of the internal control body itself.⁶³

From this point of view – despite being aware of the fact that no administrative or control model has proved to be better than any others in the past – the questions should anyway be asked of the traditional Italian model (in which the *collegio sindacale* has greater independence from the board of directors in addition to incisive individual inspection powers⁶⁴) whether: a) it is still today a model which allows Italian companies to compete on a level playing field with those of other countries, given both the fact that it is so rare and almost unknown in the rest of the world,⁶⁵ but also that there are a significant number of companies ruled under foreign law on the Italian markets; b) it is a model which adapts itself perfectly to the new concept of internal control such as Enterprise Risk Management – ERM, which aims to protect the company resources, as well as create value for all the shareholders.⁶⁶ In consideration firstly of the fact that (at least in theory) with respect to the one-tier model, the circulation of information between the administrative body and the body responsible for control is more complex and costly and secondly that, compared to the two-tier system, it appears to be less capable of close and active supervision of the operations of the administrators.

From an alternative point of view, it could also be said that after many years characterised by the excessive and complex process of “state regulation” of the governance system in Italian listed companies, it would seem opportune to enter into a period of strong deregulation. The Italian system is too tightly regulated for the diverse and ever more rapidly evolving environment – as is that of the companies listed under Italian law – and where many companies with very different capitalisation and number of partners coexist.

As has been correctly observed,⁶⁷ it is likely that such a set of strict rules should only be applicable to companies with very high capitalisation, the blue chips or the companies quoted on the FTSE-Mib, whereas greater space for statutory autonomy needs to be given to medium and small companies. This change needs to take place through a gradual

process (and possibly through transitional norms) in order to maintain the trust of those who have invested in certain companies putting their faith in one particular system of company governance.

Notes

The ideas and position in the article are personal views of the author and cannot be attributed to the Consob.

1. For a comment to Law no. 216/1974, see: G. Sbisà, *I controlli della Consob*, in *Commentario Scialoja-Branca*, Bologna-Rome, 1999; A. Mignoli, *Nuove leggi e nuova Consob*, in *Riv. Soc.*, 1991, p. 953 et seq.; F. Carbonetti, *Consob*, in *Enc. giur. it.*, VII, Rome, 1988; G. Minervini, *L'istituzione del controllo pubblico sulle società per azioni. Prime valutazioni*, in *Giur. comm.*, I, 1974, 439.
2. On the general theme of the evolution of Italian regulation of financial markets and listed companies, see: R. Costi, *Il mercato mobiliare*, Turin, VIII, ed., 2013; M. Fratini, *Diritto dei mercati finanziari*, Bari, 2013; F. Annunziata, *La disciplina del mercato mobiliare*, VII, ed., Turin, 2014; E. Galanti, R. D'Ambrosio and V. Guccione, *Storia della legislazione bancaria, finanziaria e assicurativa*, Bank of Italy, Rome, 2012; M. Onado, *Economia e regolamentazione del mercato finanziario*, Bologna, 2008; P. Abbadessa and F. Cesarini (edited by), *La legge per la tutela del risparmio*, Bologna, 2007; AA.VV., *La riforma delle società quotate*, Atti del convegno di studio. S. Margherita Ligure, 13–14 June 1998, Milan, 1998. On the specific theme of self-regulation, see: M. Stella Richter jr, *Il nuovo codice di autodisciplina delle società quotate e le novità legislative in materia di autoregolamentazione*, in *La società quotata dalla riforma del diritto societario alla legge sul risparmio* (edited by U. Tombari), Turin, 2008, p. 95 et seq.; S. Alvaro, P. Ciccaglioni and G. Siciliano, *L'autodisciplina in materia di corporate governance – Un'analisi dell'esperienza italiana*, Quaderni Giuridici Consob, no. 2, 2013.
3. R.D. 16 March 1942, no. 262 (as subsequently amended).
4. Legislative Decree no. 58 of 24 February 1998 (published in the Ordinary Supplement of *Official Gazette* no. 71 of 26.3.1998) subsequently amended by many decrees and laws and especially by Law no. 262 of 28.12.2005 also known as the “Savings Law” (Published in the Ordinary Supplement, *Official Gazette* no. 301 of 28 December 2005). An English version of Legislative Decree no. 58 of 24 February 1998 is available on the Consob's website at: http://www.consob.it/mainen/documenti/english/laws/fr_decree58_1998.htm.
5. Adopted by the Consob under Resolution No. 11971 of 14 May 1999 and subsequently amended by many others resolutions. “Listed issuers” shall mean Italian or foreign issuers of financial instruments listed in Italian regulated markets (Art. 1, Subsection 1, TUF).
6. On this matter, see: A. Toffoletto and G. Labianca, Art. 119 in *Il Testo Unico della Finanza* (edited by M. Fratini and G. Gasparri), Tome II, Turin, 2012, p. 1608 e 1609; M. Notari, Art. 119 in *La disciplina delle società quotate nel testo Unico della Finanza. D.lgs. 24 febbraio 1998, no.58*, edited by P. Marchetti and L.A. Bianchi, Milan, 1999, p. 762.
7. These could be not only “società per azioni” (joint-stock companies), but also “società in accomandita per azioni” (limited share partnership) and “società cooperative per azioni” (cooperatives with share capital).

8. On legal doctrine, see: R. Costi, *Il mercato mobiliare*, VIII ed., Turin, 2013, p. 290 et seq.; A. Toffoletto and G. Labianca, in *Il Testo Unico della Finanza* (edited by di M. Fratini and G. Gasparri), Tome II, sub Art. 119, Turin, 2012, p. 1606; U. Tombari (edited by), *La società quotata dalla riforma del diritto societario alla legge sul risparmio*, Turin, 2008; P. Montalenti, *La società quotata*, in Trattato di dir. Comm. directed by G. Cottino, Vol. IV, Padua, 2004, p. 57 et seq.; P. Spada, *Tipologia delle società e società per azioni quotata*, in Riv. dir. civ., 2000, II, 211; G. Oppo, *Sulla 'tipicità' delle società quotate*, in Riv. dir. civ., 1999, II, 432.
9. P. Montalenti and S. Balzola, *La società per azioni quotata*, Bologna, 2010; P. Montalenti, *La società quotata*, cit., p. 57 et seq.; G. Zanarone, *Il ruolo del tipo societario dopo la riforma*, in *Il nuovo diritto delle società*, Liber amicorum G.F. Campobasso, 1, Turin, 2007, p. 69 et seq.; P. Spada, *Tipologia delle società e società per azioni quotate*, cit., p. 215; G. Grippo, *Il recesso del socio*, in *Trattato delle società per azioni*, directed by G.E. Colombo e G.B. Portale, Vol. VI, Tome 1, Turin, 1993, p. 139.
10. The definition of issuers of financial instruments widely distributed among the public is contained in Art. 2-bis of the Consob's Regulation implementing Italian Legislative Decree no. 58 of 24 February 1998 ("Issuers Regulation").
11. Cfr. M. Fratini, *Diritto dei mercati finanziari*, cit., p. 367.
12. Art. 122 of Issuers Regulation establishes that "In place of the listed issuers, Consob shall make public the information it acquires within three trading days of the receipt of declarations".
13. See also Art. 20 of Decree Law 24 June 2014, no. 91 (passed, with amendments, into Law 11 August 2014, no. 116) that establishes the different threshold of 5 per cent for small and medium enterprises (SMEs).
14. See Law Decree 24 June 2014, no. 91 passed, with amendments, into Law 11 August 2014, no. 116.
15. R. Costi, *Il mercato mobiliare*, cit., p. 306.
16. See Art. 20 of Law Decree 24 June 2014, no. 91 passed, with amendments, into Law 11 August 2014, no. 116.
17. In legal doctrine, an analysis of the discipline of shareholders' agreements in the Consolidated Law on Finance can be found in: M. Pinnarò, Art. 122 e 123, in *Il Testo Unico della Finanza* (edited by M. Fratini and G. Gasparri), Turin, 2012, p. 1661 et seq.; V. Chionna, *La pubblicità dei patti parasociali*, Milan, 2008; G.F. Campobasso, *Voto di lista e patti parasociali nelle società quotate*, in *Banca borsa e titoli di cred.*, 2003, I, 125 et seq.; D. Caterino, *Patti parasociali*, in *Codice commentato delle società* (edited by N. Abriani and M. Stella Richter jr), 2010, II, sub artt. 122, 123, 123-bis, 124 TUF; R. Costi, *I patti parasociali e il collegamento negoziale*, in *Giur. comm.*, 2004, I, 200 et seq.; C. Fois, *Sindacati di voto e corporate governance: un problema tra ordinamento e sistema della società per azioni*, in AA.VV., *Mercato e governo dell'impresa*, Scritti giuridici per Guido Rossi, Tome 1, Milan, 2002, p. 235; G. Santoni, Artt. 122 et seq., in *Testo Unico della Finanza. Commentario* (edited by G.F. Campobasso), Turin 2002, Tome 2, p. 1001 et seq.; V. Furfaro, Art. 122, in AA.VV., *La legge Draghi e le società quotate in borsa* (directed by G. Cottino), Turin, 1999, p. 115; M. Pinnarò, *I patti parasociali*, in AA.VV., *Intermediari finanziari, mercati e società quotate* (edited by A. Patroni Griffi, M. Sandulli and V. Santoro), Turin, 1999, p. 771 et seq.; A. Picciau, *Patti parasociali*, in *La*

- disciplina delle società quotate*, Commentario (edited by P.G. Marchetti and L. A. Bianchi), Tome I, Milan, 1999; L.A. Bianchi, Art. 109, in *La disciplina delle società quotate*, Commentario (edited by P.G. Marchetti and L. A. Bianchi), cit., Tome I, p. 442 et seq.; E. Kustermann, *Osservazioni sui patti parasociali dopo la "riforma Draghi"*, in *Società*, 1998, p. 910; R. Costi, *I patti parasociali*, in AA.VV., *La riforma delle società quotate*, Atti del convegno di studio. S. Margherita Ligure, 13–14 giugno 1998, Milan, 1998, p. 113.
18. See Arts 127–131 of the Consob's Issuers' Regulation.
 19. See Italian Civil Code: Art. 2325 et seq.
 20. See Italian Civil Code: Art. 2452 et seq.
 21. See Italian Civil Code: Art. 2511 et seq.
 22. Legislative Decree no. 6 of 17 January 2003.
 23. The horizontal two-tier model envisages a board of directors ("*consiglio di amministrazione*") and a board of statutory auditors ("*collegio sindacale*") both appointed by shareholders' meeting.
 24. The vertical two-tier model envisages a supervisory board appointed by shareholders' meeting and a management board appointed by the supervisory board.
 25. The one-tier model envisages a board of director appointed by shareholders' meeting and a management control committee made up of non-executive independent members of the board.
 26. See N. Linciano, A. Ciavarella, V. Novembre and R. Signoretti, *2013 Report on corporate governance of Italian listed companies*, Consob, Statistic and Analyses, 2013, p. 12. On the reason of this "failure", see the Consob, *Documento di consultazione 25 luglio 2011 – Proposte di interventi legislativi. Disciplina dei modelli di amministrazione e controllo monistico e dualistico*, Section II, par. 3; V. Cariello, *Il sistema dualistico*, 2012, Turin, p. 31 e ss.; P. Montalenti, *Il sistema dualistico*, in N. Abriani, S. Ambrosini, O. Cagnasso and P. Montalenti, *Le società per azioni*, in Trattato di diritto commerciale, directed by Cottino, Padua, 2010, p. 853; N. Abriani, *Il sistema monistico*, in N. Abriani, S. Ambrosini, O. Cagnasso and P. Montalenti, cit., pp. 873–883.
 27. Italian Corporate Governance Code for listed companies of July 2014 (an English version is at: <http://www.borsaitaliana.it/comitato-corporate-governance/codice/2014cleaneng.en.pdf>).
 28. See: Corporate Governance Committee, *1st report on compliance with the Italian Corporate Governance Code*, in http://www.borsaitaliana.it/borsaitaliana/regolamenti/corporategovernance/annualreport2013.en_pdf.htm; S. Alvaro, P. Ciccagliani and G. Siciliano, *L'autodisciplina in materia di corporate governance – Un'analisi dell'esperienza italiana*, Quaderni Giuridici Consob, no. 2, 2013; M. Bianchi, A. Ciavarella, V. Novembre and R. Signoretti, *Comply or Explain? Investor protection through Corporate Governance Codes*, ECGI Finance Working Paper, no. 278/201; M. Bianchi, L. Enriques, *Corporate governance in Italy after the 1998 reform: What role for institutional investors?* Quaderni di finanza Consob, no. 43, 2001. An analysis of internal controls in (non-financial) listed companies can be found in: G. Gasparri, *I controlli interni nelle società quotate*, Quaderni Giuridici Consob, no. 4, 2013.
 29. R. Costi, *Il mercato mobiliare*, cit., p. 332.
 30. R. Costi, *op.loc.ult.cit.*

31. On the election system based on lists of candidates, see M. Belcredi, S. Bozzi and C. Di Noia, *Board elections and shareholder activism: The Italian experiment*, in M. Belcredi and G. Ferrarini, G. (eds.), *Boards and shareholders in European listed companies. Facts, context and post-crisis reforms*, Cambridge University Press, Cambridge, 2013, pp. 365 et seq.; S. Alvaro, G. Mollo and G. Siciliano, *Il voto di lista per la rappresentanza di azionisti di minoranza nell'organo di amministrazione delle società quotate*, the Consob, Quaderni Giuridici, no. 1, 2012, p. 24; M. Stella Richter Jr., *Sulla composizione e sulla elezione dell'organo amministrativo di una società quotata*, in *Riv. dir. comm.*, 2012, I, pp. 51–78; M. Ventoruzzo, *Empowering shareholders in directors' elections: A revolution in the making*, ECGI Law Working Paper, 147/2010; M. Stella Richter Jr., *Voto di lista per la elezione delle cariche sociali e legittimazione dell'organo amministrativo alla presentazione di candidati*, in AA.VV., *Studi per F. Di Sabato*, ESI, Naples, 2009, p. 9 et seq.; G. Guizzi, *Il voto di lista per la nomina degli amministratori di minoranza nelle società quotate: spunti per una riflessione*, in *Corr. giur.*, 2007, p. 301. See also: European Commission, *Feedback Statement – Summary of Responses to the Commission Green Paper on the EU Corporate Governance Framework*, 15 November 2011, p. 16, sub Question 21, in http://ec.europa.eu/internal_market/company/docs/modern/20111115-feedback-statement_en.pdf.
32. See Art. 144-ter et seq. of the Consob's Issuers Regulation.
33. OECD – Directorate for Financial and Enterprise Affairs – Corporate Government Committee, *Peer review 4: Board Nomination and Election*, April 2012.
34. In these terms, M. Belcredi, S. Bozzi and C. Di Noia, *Board elections and shareholder activism: The Italian experiment*, *cit.*, p. 378, footnote 1.
35. See Art. 144-duodecies et seq. of the Consob's Issuers Regulation.
36. Introduced by Art. 20, Subsection 1, of Law Decree no. 91/2014 passed, with amendments, into Law 11 August 2014, no. 116.
37. See S. Alvaro, A. Ciavarella, D. D'Eramo e N. Linciano, *La deviazione dal principio "un'azione – un voto" e le azioni a voto multiplo (Deviation from the "one share-one vote" principle and multiple-voting shares)*, the Consob, Quaderni Giuridici, 2014.
38. For listed companies, see Art. 127-sexies of the TUF.
39. See N. Linciano, A. Ciavarella, V. Novembre and R. Signoretti, *2013 Report on corporate governance of Italian listed companies*, the Consob, Statistic and Analyses, 2013, p. 2.
40. Cf. N. Linciano, A. Ciavarella, V. Novembre and R. Signoretti, *2013 Report on the corporate governance of Italian listed companies*, *cit.*, p. 27.
41. Material transactions are identified as a result of three materiality indices defined in Annex 3 of the regulation. The default threshold above which a transaction is to be considered as material is 5 per cent (or 2.5 per cent in case of transactions with the parent company in pyramidal groups); however, companies may define lower materiality thresholds in their procedures.
42. On company information, see M. Cera e G. Presti, *L'informazione societaria*, in AGE, 2013; F. Annunziata, *Sub artt. 113-ter – 115*, in M. Fratini e G. Gasparri (edited by), *Il Testo Unico della Finanza*, Turin, 2012; F. Vella (edited by), *E' la*

- stampa, bellezza! – Regole e interessi nell'informazione economica*, in AGE, no.2, 2006; G. Ferrarini, *Informazione societaria: quale riforma dopo gli scandali?* in Banca impr. soc., 2004, p. 411 et seq.; A. Perrone, *Informazione al mercato e tutele dell'investitore*, Milan, 2003; C. Angelici, *Diritto Commerciale*, Bari-Rome, 2002, p. 129; R. Lener, *La diffusione delle informazioni 'price sensitive' fra informazione societaria e informazione riservata*, in Soc., 1999, p. 142; P. Sfameni, *Sub Art. 114*, in *La disciplina delle società quotate nel Tuf. Commentario al d.lgs. 24 febbraio 1998, no.58* (edited by P.G. Marchetti e L.A. Bianchi), 1999, p. 509; C. Angelici, *Note in tema di informazione societaria*, in AA.VV., *La riforma delle società quotate*, Atti del convegno di studio. S. Margherita Ligure, 13–14 June 1998, Milan, 1998, p. 249 et seq.; F. Annunziata, *La nuova disciplina delle comunicazioni societarie al pubblico e alla Consob*, in Soc., 1999, p. 398 et seq.; F. Chiappetta and M. Tofanelli, *Informazione societaria e mercato mobiliare*, Milan, 1993; G. Ferrarini, *La responsabilità da prospetto*, Milan, 1986; AA.VV., *L'informazione societaria – Atti del convegno internazionale di studi*, Venice 5–6–7 November 1981, Milan, 1982.
43. A. Perrone, *Informazione al mercato e tutele dell'investitore*, Milan, 2003, p. 2. On the vast subject of company information in the capital markets, see F. Easterbrook and D. Fischel, *The Economic Structure of Corporate Law*, Cambridge-London, 1991; M. Belcredi, *Economia dell'informazione*, Turin, 1993.
 44. C. Angelici, *Note in tema di informazione societaria*, in AA.VV., *La riforma delle società quotate*, Milan, 1998, p. 251.
 45. A. Perrone, *Informazione al mercato e tutele dell'investitore*, cit., 2003, p. 12.
 46. L. Brandeis, *Other People's Money and How the Bankers Use It*, 1014, New York, p. 92.
 47. M. Fratini, *Diritto dei mercati finanziari*, Bari, 2013, p. 453. Art. 113-ter TUF establishes that: "Regulated disclosures shall mean disclosures published by listed issuers, listed issuers for which Italy is the home member State or their controlling bodies, pursuant to the provisions of this Title, Chapters I and II, Sections 1, I-bis, and V-bis, and to related enactment regulations or provisions established by non-EU country authorities considered the equivalent of Consob".
 48. The *Organic reform of company and cooperatives law* of 2003 (Legislative Decree No. 6 of 17 January 2003) introduced in Italy the possibility for listed companies to choose among three different management and control systems (the traditional Italian horizontal two-tier model, the vertical two-tier model and the one-tier model); two years later "Savings Law" of 2005 (Law No. 262 of 28 December 2005) introduced a specific new Session inside the TUF dedicated to the "Administration bodies" containing norms regarding: the election and composition of the Board of Directors (147-ter), the composition of the management board (147-quater) and Integrity requirements (Art. 147-quinquies).
 49. For this reason the Corporate Governance Code of listed companies – adopted in Italy for the first time in 1999 – tried in some way to fill the gap in the legislation by dedicating 7 articles out of 13 in the Code to the administrative body.
 50. See M. Stella Richter jr, *Appunti sulla evoluzione della disciplina dell'amministrazione delle società quotate e sulle sue prospettive di riforma*, to be published in the Consob volume bringing together the proceedings of the

- first seminar celebrated on the occasion of the 40 year anniversary of the Consob, held in Rome on 6 June 2014.
51. See M. Vietti, *Nuove società per un nuovo mercato – La riforma delle società commerciali*, Rome, 2003, p. 35 and also V. Calandra Buonauro, *I modelli di amministrazione e controllo nella riforma del diritto societario*, in *Giur. comm.*, 2003, I, 535 ss.
 52. Cfr. P. Montalenti, *Società per azioni, corporate governance, mercati finanziari*, Milan, 2011, p. 114 et seq. M. Irrera, *Dall'adeguatezza degli assetti organizzativi al sistema monistico quale "assetto organizzativo adeguato?"* to be published in the Consob volume bringing together the proceedings of the first seminar celebrated on the occasion of 40 year anniversary of Consob, held in Rome on 6 June 2014.
 53. See the Consob, *Documento di consultazione 25 luglio 2011 – Proposte di interventi legislativi. Disciplina dei modelli di amministrazione e controllo monistico e dualistico*, Section II, par. 3, cit.; V. Cariello, *Il sistema dualistico*, cit., p. 31 et seq.; P. Montalenti, *Il sistema dualistico*, cit.; N. Abriani, *Il sistema monistico*, cit.
 54. On this subject, see V. Cariello, *Il Sistema dualistico – Vincoli tipologici e autonomia statutaria*, Milan, 2009, p. 9 et seq.
 55. See: M. Vietti, *Nuove società per un nuovo mercato – La riforma delle società commerciali*, cit., p. 36 et seq.
 56. See above, paragraph 10.
 57. On this matter, see M. Stella Richter jr, *Appunti sulla evoluzione della disciplina dell'amministrazione delle società quotate e sulle sue prospettive di riforma*, cit.
 58. M. Stella Richter jr, *Appunti sulla evoluzione della disciplina dell'amministrazione delle società quotate e sulle sue prospettive di riforma*, cit.
 59. See: Italian Corporate Governance Code, *Criterium* 7.C.1.
 60. G. Vegas, *Annual speech by the Chairman of Consob to the financial markets*, 5 May 2014, pp. 11 e 15.
 61. An English version of the Italian Corporate Governance Code is available at: <http://www.borsaitaliana.it/comitato-corporate-governance/codice/2014cleaneng.en.pdf>.
 62. See F. Denozza, *Conflitti e controlli in una società per azioni 'complessa'*, in *Il sistema dei controlli interni nelle società quotate: i risultati di una ricerca*, Sole 24 Ore Group ed. and Chamber of Commerce of Milan, 2010.
 63. In these terms: P. Montalenti, *Amministrazione e controllo nella società per azioni: riflessioni sistematiche e proposte di riforma*, in *Riv. Soc.*, 2013, p. 42 et ss.; Id., *Sistemi di controllo interno e corporate governance: dalla tutela delle minoranze alla tutela della correttezza gestoria*, in *Riv. Dir. Comm.*, 2012, II, 243 ss.
 64. no. Abriani, *Verso una riforma della disciplina dei controlli interni*, to be published in the Consob volume bringing together the proceedings of the first Seminar celebrated on the occasion of the 40 year anniversary of Consob, held in Rome on the 6th June 2014.
 65. Apart from Italy, the *collegio sindacale* exists only in Japan and Portugal.
 66. On this matter see: G. Ferrarini, *Controlli interni e strutture di governo societario*, in AA.Vv. (cured by Abbadesse e Portale), *Il nuovo diritto delle società – Liber Amicorum Gian Franco Campobasso*, Turin, 2007, III, 5 et seq.; P. Ferro Luzzi, *Riflessioni in materia di controllo*, in *Diritto dei mercati ed etica. Dopo la crisi, Omaggio a Piergatan Marchetti*, Milan, 201, p. 309 et seq.; G. Presti, *Di cosa parliamo quando parliamo di controllo?*, in AA.Vv. *I controlli societari. Molte regole*

- nessun sistema* (M. Bianchini – C. Di Noia), p. 143; M. Stella Richter jr, *La funzione di controllo del consiglio di amministrazione nelle società per azioni*, in *Riv. Soc.*, 2012, p. 663 et seq.; C. Angelici, *Su mercato finanziario, amministratori e responsabilità*, in *Riv. Dir. Comm.*, 2010, I, 1 et seq. G. Gasparri, *I controlli interni nelle società quotate*, Quaderno Giuridico Consob, no.4, 2013, p. 15; P. Montalenti, *Amministrazione e controllo nella società per azioni: riflessioni sistematiche e proposte di riforma*, in *Riv. Soc.*, 2013, 52; F. Chiappetta, *Il sistema di controllo interno tra compliance normativa ed attività gestionale*, in *Riv. Soc.*, 2013, p. 555.
67. M. Stella Richter jr, *Appunti sulla evoluzione della disciplina dell'amministrazione delle società quotate e sulle sue prospettive di riforma*, cit.

10

Reinsurance Business

Andrea Miglionico

10.1 The discipline of reinsurance

Nowadays, it is commonly considered that the reinsurance transfers the risk from an insurer to another party (reinsurer), the primary object being to indemnify the reinsured against loss.¹ Reinsurance can be defined the “insurance of insurance” or the “insurance of insurers”: an insurer buys protection against the costs of the claims it may have to meet under the policies of insurance it has itself issued.² As a result, reinsurers absorb losses that are not retained by primary insurers, and in so doing, they limit the earnings volatility of primary insurers.³ If the function of an insurance firm is to provide protection to the original insured against potential heavy losses, the reinsurer provides similar protection to the insurance company. In this way, reinsurance business plays an important role in the insurance market by providing capacity, creating stability and strengthening finances.⁴

Art. 1928 of the Italian Civil Code provides a broad definition of the contract of reinsurance by regulating some aspects of the transaction: in particular, the provision states that the reinsurance is the contract by which an insurer (reinsurer) is obliged to other insurers to cover partly or totally a risk which he has taken upon himself.⁵ Art. 1929 of the Civil Code states that reinsurance involves a legal obligation between firms only, so there is no contractual relationship between the insurer and insured party.⁶

The Italian Insurance Code (Legislative Decree No. 209 of 7 September 2005) – hereinafter “Insurance Code” – defines reinsurance business as “the taking up and management of the risks ceded by an insurance undertaking or retroceded by a reinsurance undertaking” (Art. 1, letter d).⁷ According to Art. 57, para. 1 of the Insurance Code, reinsurance

business consists in accepting risks ceded by an insurance undertaking or by another reinsurance undertaking and shall be reserved to reinsurance undertakings. However, the Italian legislator limits the objects of such activity to "the pursuit of reinsurance business and related or instrumental operations" (Art. 57, para. 2).⁸ The definition provided by the code reflects the discipline enshrined by the European legislation and the international commercial practice of reinsurance (in particular the British mercantile transactions).⁹ On this point, it can be argued that the international contours of reinsurance have showed the difficulty for domestic legislators to identify a single, unique regulatory framework for this business activity.¹⁰

A reinsurance agreement may be expressed so as to constitute a further insurance on the original risk; in order to establish liability against a reinsurer, the reinsured must establish that loss is within the risk assumed under the underlying insurance contract and that the relevant risk has been assumed under the reinsurance contract.¹¹

A contract of reinsurance may insure a single direct contract,¹² in which case it is referred to as "facultative", or it may reinsure a class of direct risks accepted by the reinsured, in which case it is referred to as "treaty" reinsurance.¹³ For the treaty reinsurance, the Italian Civil Code requires the written form *ad probationem* (Art. 1928, para. 1);¹⁴ this provision aims to regulate the object of contractual relationship and its clauses, which means the quality and quantity of risk that the reinsurer has taken.¹⁵

As has been already indicated, the contract of reinsurance is distinguished from the direct contract as there is no contractual relationship between reinsurer and insured. Thus, if the reinsured has become insolvent, the insured has no cause of action against the reinsurer, and the reinsurer is required to pay the whole amount of the loss to the reinsured's liquidator. If the reinsurance contract covers a reinsured that is not authorized to carry on insurance business of the class in question, the reinsurance contract remains enforceable against the reinsurer.¹⁶ Therefore, reinsurance business concerns an activity displayed by insurance companies where the transfer of risk and its redistribution mitigate the harmful consequences that the event may produce to the principal insurer creating an indirect benefit between insured parties.¹⁷ In this light, it should be observed that the reinsurance business plays an important role of ensuring the market stabilization.¹⁸

Therefore, it is claimed that the outstanding feature of the reinsurance activity is that it reduces the reputational risk of enterprise and improves investment protection.¹⁹ To achieve this goal, the firm not only must be

ensured by high standards of disclosure, but it must also be enabled to comprehend the appropriate operation of reinsurance.²⁰

In this context, integrity and ethical conduct assume a central role in the reinsurance activity if measured by the reputational risk; as a result, the principles of good faith, trust and fairness must be embodied in reinsurance companies' behaviours.²¹ For this reason, reinsurance business aims to avoid the risk of market failures that means legal risks and, hence, reputational risk.²² Therefore, legitimate and accountable reinsurance business prevents the potential risk of confidence failure and promotes a clear understanding of consumer protection. By improving effective fairness in respect of business conducts represents the main goal of reinsurers.

After providing a brief overview of the reinsurance discipline, the next section analyses the main features of reinsurance activity by taking into account the regulatory tools and supervisory regime implemented in the Italian legal system. The following section examines the EU normative framework of reinsurance by looking at the Directive 2005/68/EC and its core provisions: a critical appraisal of the rationale adopted by the EU legislator will be taken into consideration. Then, the accountability of reinsurance practice will be discussed by tackling the questions of transparency, integrity and market fairness. The last section provides some concluding observations.

10.2 The activity of reinsurance

10.2.1 Function of reinsurance

The reinsurance activity consists in accepting risks ceded by an insurance undertaking or by another reinsurance undertaking. Although there is no statutory definition of reinsurance in the Italian legal system (because most of the provisions come from the European legislation), the recent insurance practice at the international level has shed light into the features of discipline. In order to examine the terms of reinsurance activity, it should be cleared that the original or direct insurer who reinsures with a reinsurer is known as the "reinsured" or "reassured". Where a reinsurer buys reinsurance for the risks it is itself reinsuring, this type of reinsurance is called "retrocession".²³ In these terms, reinsurance is often used to protect reinsurers from variations in the risks against which they provide insurance. It also provides a means whereby an insurer can avoid wide fluctuations in its results from one year to another.²⁴ As already mentioned in the preceding section, reinsurance

acts as instrument to absorb the risks of financial market; more precisely, it can be said that reinsurance is an insurance mechanism to neutralize the wide spread of unforeseen events among firms.²⁵ It has been noted that “reinsurance is often used to increase the underwriting capacity of direct insurers by providing a means whereby an insurer can avoid being solely responsible for claims of such a size as might endanger its financial stability.”²⁶

By using the reinsurance, the risks derived from macro-economic imbalances (e.g. fraudulent claims arising out of recession or economic factors such as escalating inflation or interest rates) may be reduced. For instance, an increasing in professional indemnity claims or temporary fluctuations in basic probabilities (e.g. a severe winter) or geographical risks (e.g. natural disasters, social disturbances like riots or government collapse) may be retained through specific reinsurance agreements.²⁷ As has been observed, “the liability incurred by an insurer towards its policyholder remains entirely and exclusively with that insurer; reinsurance does not constitute any form of assignment to the reinsurer by the insurer of any interest it has in a given policy”.²⁸ Therefore, reinsurance business can be intended as an instrument directed to facilitate internal schemes of financial control, risk management and to strengthen the capacity of companies to deal with extreme challenges. For this reason, the importance of reinsurance comes from its role to deal with market risks in the global financial system; its function is not only confined to the absorption of losses from natural events, but it covers investments and liquidity, economic capital requirements and corporate governance.²⁹ In this light, reinsurance activity is evolved from pure insurance business to mechanism of financial stability that means market confidence and consumer protection.³⁰

10.2.2 Forms of reinsurance

Reinsurance underpins the insurance industry: basically, it is a way in which insurers can lay off their own accumulated risk to third party specialist reinsurance companies.³¹ As has been already indicated, reinsurance may be arranged on an individual basis with the reinsurance of each direct policy being individually negotiated (“facultative reinsurance”) or by means of a general agreement (“treaty reinsurance”) covering certain types of policies written by the insurer (e.g. the insurer, who becomes the reinsured, will cede all the fire policies it writes).³² Facultative reinsurance may be “proportional” while treaty reinsurance may be classified as “proportional”, “quota share”, “surplus” and “facultative obligatory”.

In doctrine, facultative reinsurance has been identified as a contract “which consists of the reinsurance of a single risk reinsured on a proportional basis, in that the reinsured retains an agreed proportion of the risk and passes some or all of the remainder to the reinsurers”.³³ A facultative agreement reinsures a single risk accepted by the reinsured: in other words, a single risk is insured and then reinsured. Facultative reinsurance is generally stated in “proportional form”, so that the sum reinsured in excess of the stated deductible (if any) will be shared between the reinsured and the reinsurers in the proportions laid down in the policy.³⁴ In facultative reinsurance, there is a presumption that the reinsurance reproduces the direct insurance (back-to-back with the insurance) – so the reinsurer’s obligation arises when the insurer’s obligation is triggered under the insurance.

The second type of agreement – treaty reinsurance – entails the placement of a series of direct risks with the reinsurers. The risks may be limited to specific classes of business or specific perils, or the reinsured may reinsure some or all of its whole account. A treaty may be proportional or non-proportional. Forms of proportional treaty are “surplus” and “quota share”, in which the reinsured’s capacity is increased because of the reinsured ceding a fixed proportion of all risks accepted by him. In case of non-proportional treaty, it should be mentioned the “excess of loss” that aims to protect the reinsured against substantial aggregate losses arising from a specified event or occurrence. In practice, the reinsured cedes to the reinsurers all sums – subject to the maximum amount reinsured – above the reinsured’s own retention, defined as its “ultimate net loss”, arising from any one event or series of events. Another form of non-proportional treaty is “stop loss reinsurance” that ensures protection in respect of aggregate losses from all sources in respect of all or a particular class of business.

A treaty may be obligatory on both sides so that the reinsured is required to cede accepted risks to the reinsurer and the reinsurer is required to accept them; it may be facultative on both sides so that there is no obligation to cede and no obligation to accept risks which are proposed to be ceded; or it may be facultative obligatory so that the reinsured is not required to cede risks, but the reinsurer is required to accept such risks as are ceded.³⁵

The obligatory treaty is generally considered a contract of utmost good faith: any risk accepted by the reinsured which falls within the scope of the treaty is automatically ceded to the treaty, with neither party having an option not to cede or accept. The reinsured is not required to disclose to the reinsurers material facts relating to any risk accepted by him.

In case of facultative treaty, the reinsured is given an option to declare risks and the reinsurers are given the option to accept or reject any proposals made to them so that a duty of disclosure attaches to each of them. In the facultative obligatory treaty, the reinsured has the discretion whether or not to make a declaration, but the reinsurers are bound to accept any declaration which the reinsured chooses to make. A declaration under facultative obligatory treaty may be made at any time before the reinsured has become aware that a loss has been suffered.

10.2.3 Contracts of reinsurance

In the reinsurance there are two separate contracts: one between the assured and the insurer, and another between the insurer (reinsured) and the reinsurer. It has been rightly noted that "where the insurance is effectively a fronting operation for the placement of the risk with the reinsurers, so that the reinsured retains little or none of the risk but merely lends its name to the process to satisfy regulatory rules or the demands of the assured, then in practice any claim will be handled by the reinsurers and the reinsured drops out of the process".³⁶

In practice, contracts of reinsurance commonly include a term under which the reinsured promises only to make disclosure to the best of its knowledge and belief. The contract of reinsurance may be classified under the following categories: (a) proportional or contributing reinsurance; and, (b) non-proportional reinsurance that is categorized into "Stop Loss" reinsurance or "Excess Aggregate" reinsurance and "Excess of Loss" reinsurance. Under the proportional or contributing reinsurance, the reinsurer accepts a predetermined proportion of the business recognized by the ceding company in return for an equivalent proportion of the premium after deduction of various commissions (these usually reflect the cost to the ceding companies of acquiring the business).

The non-proportional reinsurance, particularly "Stop Loss" reinsurance or "Excess Aggregate" reinsurance, is characterized by the fact that reinsures losses are above stipulated amounts and is normally fixed by the reinsured's loss ratio (the claims; premiums ratio). Under the "Excess of Loss" reinsurance, the reinsurer is liable to the extent that amounts paid under direct policies exceed a stipulated amount (known as a priority, excess, retention or deductible). This type of reinsurance includes three basic forms: (a) "Per Risk Excess of Loss"; (b) "Per Occurrence Excess of Loss" or "Per Event Excess of Loss"; and, (c) "Aggregate Excess of Loss".³⁷

The contract of reinsurance may contain a clause, "Subject to the same terms and conditions as the original policy" or, simply, "As original";

or the reinsurance slip may be attached to a copy of the direct policy and “re” inserted before every appearance of “insure” or “insurance” in that copy. By examining the express terms generally found in the contract of reinsurance, it should be noted that like ordinary insurance, a reinsurance may define cover in one of two basic forms: (a) cover is defined broadly (“fire”) and then limited by a number of conditions and exclusions which mean there is no liability if the fire is caused in certain ways (e.g. as a result of bringing explosives on to the premises) or certain circumstances exist (e.g. no fire alarm); and, (b) cover is defined narrowly so that there is less need for other terms and exclusions.³⁸

With regard to the “leading underwriter clause”, the ability to persuade a leading underwriter to sign for a substantial part of the risk is likely to be crucial in persuading other underwriters to sign. Typically, the slip contains a leading underwriter clause, which incorporates by reference the terms under which the leading underwriter is authorized to bind the following market. However, the ability of the following market to challenge the reinsurance for non-disclosure or misrepresentation in the relationship between the reinsured and the leading underwriter may be undermined by things said or done in relation to a particular underwriter.

Regarding the “errors and omission clause”, in proportional treaties, it was originally designed to allow the remedy of errors or omissions in information about the ceded risks provided by the reinsured to the reinsurer, but it has been extended to require record keeping by the reinsured and the supply of information to the reinsurer. It may also cover delay and may require the reinsured to take steps to remedy the failure.

With regard to the “inspection clause”, reinsurance contracts do not necessarily require the reinsured to supply any information about the direct policies or details about claims made under those policies. In “facultative reinsurance”, such information will be provided in order to persuade the reinsurer to take on the risk and may be part of the duty of disclosure; but in treaty reinsurance, this information is not the basis of the contract. The express right to inspect the records of the reinsured enables the reinsurer to monitor the underwriting practice of the reinsured and its claims handling procedures. The reinsurer may, of course, use this power not for its original purpose but as a means of delaying payment or discovering reasons for not paying. Contracts of reinsurance typically run for one to three years with a provision for review (e.g. allowing increase in premium in the event of a material change of circumstances) or cancellation on each anniversary. Typically, review or cancellation can only be exercised if notice has been given and reinsurers routinely give provisional notice to keep their options open.

10.3 The EU normative framework

10.3.1 Background of the reinsurance legislation

Regulation of reinsurance in the EU has developed through the approval of Directive 64/225/EC on “abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession”.³⁹ The 1964 Directive was an early attempt to remove national barriers to the creation of single, unique set of rules for reinsurance services.⁴⁰ However, although the directive’s main goal was market liberalisation by removing restrictions to the transaction of reinsurance, the EU legislation did not seek to establish a common regulatory framework for the supervision of reinsurance within the European Economic Community.⁴¹ In substance, the 1964 Directive did not harmonise the regulation of reinsurance that remained essentially limited to national laws.

As a result, the directive failed to create a mutual recognition of domestic regulations for reinsurers and reinsurance market. Therefore, obstacles to the free exercise of reinsurance services were not removed, and only after years of consultation between the EU institutions and Member States, it was reached an agreement that culminated in 2005 with the proposal on a “reinsurance directive”. In doctrine, it has been noted that such a long period before to set out legislation for reinsurance sector is explained by the need to establish first a single market for direct insurance.⁴² Clearly, the EU legislator primarily focused to remove internal barriers on insurance trade because of the benefits that European citizens would be perceived by more competitive range of products and prices among insurers (in the view that such benefits would be more attractive than the regulation of reinsurance transactions).

10.3.2 The “Reinsurance Directive”

After the experience of 1964 EC Regulation, the European Union adopted in December 2005 the “Reinsurance Directive” that established a coherent regulatory framework for reinsurers sector while avoided the fragmentation among Member States.⁴³ The Reinsurance Directive, which entered into force in 2007, harmonized the authorization and regulation of pure reinsurers and introduced the single passport system for pure insurers. In particular, the directive carries out “harmonization which is essential, necessary and sufficient to ensure the mutual recognition of authorizations and prudential control systems”.⁴⁴ The directive recognized the nature of reinsurance as a financial activity and a mechanism for the covering of risk globally. In implementing the

directive, Member States were stimulated to abandon local rules and dismantle normative barriers. Principally, the EU legislator intended to improve consumer protection, cross-border operation and foster competition among reinsurer companies. Although the reinsurance activity originated as an international business for its well-recognized role and importance in the global financial system, the 2005 Directive strengthened the European regime of direct insurers by providing a legal platform for reinsurance arrangements.⁴⁵

In substance, the Reinsurance Directive impacts to: (a) “pure reinsurers” (insurers that only carry on reinsurance business); (b) “mixed insurers” (insurers covering direct insurers who also write a significant amount of reinsurance business); and (c) “direct insurers” (insurance special purpose vehicles and financial reinsurance).⁴⁶ It also applies to pure reinsurers, captive reinsurers and special purpose vehicles.

A reinsurer authorized in one member state has a right of establishment in all others, subject to authorization by the home state in accordance with prescribed standards.⁴⁷ Regarding the single passport system and home state authorization, it does apply for both cross-border services business and for branches in other EEA States. The directive establishes minimum necessary conditions for the official authorization: (1) the reinsurance undertakings have a specific legal form; (2) the reinsurance undertakings submit a scheme of operations with essential information on their business plans; (3) the reinsurance undertakings possess a minimum guarantee fund (Art. 29 of the directive); (4) the reinsurance undertakings effectively run by managers who have adequate technical qualifications or experience; (5) the reinsurance undertakings limit their objects to the business of reinsurance and related operations; and (6) the reinsurance undertakings possess sound administrative and accounting procedures as well as adequate internal control mechanisms which ensure an orderly and financially stable pursuit of their activities. However, the competent authorities grant the authorization after careful consideration of the identity and suitability of the members or shareholders with a qualifying participation in the reinsurance undertakings.⁴⁸

It should be noted that the directive does not reflect the procedural requirements for cross-border notifications in the regime for direct insurers.⁴⁹ The directive also (a) provides a definition of “finite” reinsurance (i.e. financial reinsurance) and allows Member States to regulate it (Art. 2.1(q) and Art. 45); (b) introduces Insurance Special Purpose Vehicles (ISPVs) which are special purpose vehicles that accept risks from insurers or reinsurers and are funded by debt issuance subordinated to the SPVs’ reinsurance obligations (Art. 2.1(p) and Art. 46); and (c) completes the

system for EU wide portfolio transfers (Art. 18).⁵⁰ Clearly, the outstanding feature of the directive is that it improves transparency for insurers and reinsurers and consumer protection.

The “Reinsurance Directive” was transposed into the Italian legal system through further reforms of the Code of Insurance 2005 which had already introduced a set of rules to govern the reinsurance business (Art. 57 of the Code). The Code of Insurance mandated the Italian insurance regulator ISVAP (today IVASS) high supervisory powers with respect to all the objective set by the directive. In particular, the ISVAP was responsible for granting authorisation and could furthermore impose additional strict requirements to be met, such as patrimonial adequacy or the sound and prudent management requirements.⁵¹

As has been previously pointed out, one of the Reinsurance Directive’s fundamental goals is harmonisation as between Member States and the introduction of an enhanced single framework of provisions. However, it can be observed that the directive on reinsurance has created a single system for cross-border transactions with an efficient integration of insurance services in which reinsurers are clearly accountable for their acts.

The Reinsurance Directive established minimum common standards for the regulation of reinsurers and imposed a legal platform where the monitoring function of reinsurer companies is strengthened through a need for reputational protection. Although one of the main purposes of the directive was to incorporate reinsurance into EU’s supervisory system of the insurance sector, the legislation delegated to the domestic authorities the function of monitoring reinsurance activities. However, a more explicit reference to the single European supervisory body would have been desirable. The impact of EU legislation on reinsurance business may certainly be seen as a step forward in the regulation of insurance industry and in line with the literature, “the Directive is an interim measure that introduced the idea of harmonised prudential supervision of reinsurance in the European Union, in advance of Solvency II, and materialised the need for a European-wide consistent regulatory regime for reinsurance”.⁵²

10.3.3 The supervisory regime

The reinsurance companies have generally not been subject to supervision or to particularly intensive market scrutiny.⁵³ At the global level, the International Association of Insurance Supervisors (IAIS) issued a set of standards providing guidance for supervision of the reinsurance industry in order to improve the transparency of the industry.⁵⁴ This supervisory approach reflected a “principles-based regime” where insurance market

relied more on high-level, broadly stated rules or principles. But the principles-based regime needs internal controls to enhance its enforcement and must be accepted by market participants as a voluntary, yet, nonetheless, binding, legal regime.⁵⁵ The most important aspect had to do with the legitimacy of this regime as a regulatory strategy: a principle itself does not ensure correct application of rules because, often, it is synonymous with escaping enforcement and lack of certainty.⁵⁶ It is arguable that principles represent a form of soft law, albeit not readily translatable into a legal paradigm of reference.⁵⁷

In this regard, the 2005 Reinsurance Directive provided a coherent and structured system of controls: it introduced prudential rules for the supervision of reinsurance companies by requiring all firms to be licensed and by increasing transparency through the establishment of principles for solvency requirements, risk management and firm governance.⁵⁸ Also, the Reinsurance Directive improved the increased cooperation between different supervisory authorities with the aim to enhance oversight on reinsurance business. In this light, it has been noted that “state supervisory regimes should be compatible with each other, create a level playing field for market players and prevent regulatory arbitrage”.⁵⁹

In the Italian legal system, Art. 3 of the Insurance Code regulates the purposes of supervision through the sound and prudent management of insurance and reinsurance undertakings; the provision establishes that supervisory regime aims to ensure fairness in the behaviour of undertakings, intermediaries and the other insurance market participants with regard to stability, efficiency, competitiveness and the smooth operation of the insurance system. Clearly, the Italian legislation followed the Community Law and, precisely, the provisions enshrined in the Reinsurance Directive by pursuing two main objectives: the stability of insurance sector and the transparency of activities. By defining the purpose of supervision, Art. 3 determines the conditions and limits of its intervention for ensuring the soundness of insurers and reinsurers. It is arguable that the domestic discipline on reinsurance business is characterized by detailed rules that reflect the intent of EU legislator to establish an adequate protection of market participants. In this regard, Art. 63 of the Insurance Code regulates the organisational requirements that reinsurance companies must be observed in order to guarantee a consistent internal control system and appropriate risk monitoring procedures. The effectiveness of internal controls can allow action to be taken against behaviours amounting to misconduct and can permit a sound system of risk management to be applied.

It should be noted that the role of insurance regulators in the EU financial markets has assumed formidable dimensions in terms of supervision and regulation; furthermore, regulatory body such as the European Insurance and Occupational Pensions Authority (EIOPA)⁶⁰ has a significant role to play. In particular, under the new financial architecture implemented by the *de Larosière* reform this authority plays a huge role in ensuring supervisory convergence by laying down best practices, guidance, standards and non-legally binding principles.⁶¹ European supervisors can provide a more independent and objective assessment of the problems identified in the course of the supervisory process than national supervisors. At the institutional level, the existence of European regulators should facilitate the adoption of EU measures based on a single insurance regulatory strategy; on these lines, the creation of a single European supervisor to control the national supervisors' could well come in to being.

Recently, the EU Solvency II Directive established stricter regulatory standards namely quantitative requirements (for instance, the amount of capital an insurer should hold), insurers' governance and risk management requirements, disclosure and transparency requirements, as well as supervision of insurers.⁶² In substance, the "Solvency II" imposed higher capital requirements and stricter standards for collateral: compliance with these requirements may be an issue to reinsurance market. For instance, the existing floating charge arrangements which have been entered into to secure reinsurance exposures in favour of insurers might not satisfy the proposed requirement that the secured assets "can only be changed or substituted with the consent of the [insurer]".⁶³ As a result, the reinsurance market became heavily regulated. The EU reforms, which would have characteristics of its own, would reflect the main purposes of the supervision function: prudential supervision, ensuring the financial stability of whole reinsurance sector and the conduct of business supervision, combined with disclosure and investor protection systems incorporated in the internal management controls. At this point, it is arguable that a strong improvement of reinsurance risk management, together with the enforcement of internal compliant behaviours, should be implemented when tackling the new challenge of the reform of insurance supervision.

10.4 The accountability of reinsurance

In the light of the above considerations, reinsurance is a transfer of risks from an insurer to a reinsurer. Insurance companies purchase reinsurance

in order to cover any losses they may incur as a result of the insurance contracts they have issued. As indicated, the reinsurance contract is formed by two different and separate agreements that highlight separate insurable interest for the assured and the reinsured.⁶⁴

The reinsurer is under the duty to provide indemnity to the reinsured only within the limits of the reinsured's contractual liability under the original policy. The reinsurer owes a duty of utmost good faith to the reinsured, but even if there is a breach by the reinsurer, is it unlikely that the reinsured will have a remedy.⁶⁵

Once the contract has been entered into the duty to disclose ceases and the reinsured is under no obligation to notify of things that render representations false (absent an express term providing for a continuing obligation to disclose). However, post-contractual events may alter the nature of the risk to the extent that the contract is discharged because the risk is not that which the reinsurer agreed to run. This depends on what it is that the parties have agreed the contract should cover, and reinsurers will not be allowed to escape their obligations merely because it is more likely that claims will be made.

The duty to disclose revives when the reinsurance contract is renewed since this constitutes a new contract. Where a long-term reinsurance treaty is made subject to "Notice of Cancellation at Anniversary Date" clause, which gives the reinsurer the right to cancel on that date, it is unclear whether at that date the reinsured comes under the duty of disclosure and a duty to correct any representations rendered false since the last contract date. In most reinsurance agreements, the reinsurer is dependent on decisions made by the reinsured as to the risks involved in the underlying insurance that are then ceded to the reinsurance.

It has been observed that the insurance and reinsurance contracts are presumed to provide "back-to-back cover", although that presumption is ousted if the reinsurance is clearly expressed in different terms or if the circumstances show that the reinsurers intended the contract to be governed by the principles of its applicable law rather than the law applicable to the direct insurance.⁶⁶

10.5 Conclusions

10.5.1 Managing the systemic risk of reinsurance market

The reinsurance business has recently become subject to intensive regulation following the implementation of the EU Reinsurance and Solvency II Directives. However, after the experience of the 2007–2009

global financial crisis, the role of reinsurance industry has come under scrutiny. The default events – such as the fall of AIG, the collapse of Reliance Group Holdings and the downgrade of Swiss Re – that hit the integrity of insurance markets brought to light manifest shortcomings in the activities of reinsurance players in carrying out adequate protection to investors and firm risk management. Significant concerns were raised as to the reliability of reinsurance companies particularly with respect to their impact on measuring counterparty risk.⁶⁷ Also, the financial crisis has showed the lack of reinsurance regulation to reduce the prospect that “insurance-related shocks could systemically threaten the larger financial system and the real economy”.⁶⁸ In addition, the concentration of reinsurance industry in a few large companies (for instance, Swiss Re, Munich Re and Berkshire Hathaway) creates evident interconnections that might increase the systemic risk in the whole market.⁶⁹ This means that the collapse of one big reinsurer could simultaneously impact the overall insurance sector at once. Another issue concerns the lack of uniformity about the ways in which reinsurance companies are governed as they are mainly located in offshore centres (for example, Bermuda) with different supervisory regimes:⁷⁰ an issue that could incentives the phenomenon of regulatory arbitrage. Also, the fact that reinsurance is an international business makes it difficult to acquire financial information about the firms and, most importantly, to reduce the default risk poses by reinsurance activities.⁷¹

Although the insurance regulatory reforms adopted at EU level introduced pervasive controls in terms of capital requirements and internal risk models, the issue about lack of transparency, inaccuracy and absence of adequate information on reinsurance companies financial health remain unresolved. Regulators exhibited deficiencies in addressing the opaqueness to which the reinsurance firms are subject: in particular, they showed weaknesses in protecting the whole industry from large losses provoked by potential shocks on assets or liabilities.⁷² It has been noted that “the relevance of reinsurance in the regulatory context is to note that reinsurance is only bought by other insurance companies who should be experts in what they are buying”.⁷³ In this regard, market discipline might represent an incentive in creating an effective and efficient reinsurance industry. By enhancing availability of insurer financial information and by increasing transparency, market should pressure on reinsurers to maintain an appropriate level of risk.⁷⁴

With these considerations in mind, it is possible to argue that reinsurance companies could face potential systemic risk because of the scant incentive to perform their screening accurately and because of

the equally negligible incentive for policymakers, institutional investors and global regulators to address the potential threats stemming from reinsurance market.

Notes

1. C. Russo, *Comment to Art. 57 of the Italian Code of Insurance*, 2007, in F. Capriglione, ed., *Commentary to the Legislative Decree 7 September 2005 No. 209*, Padua Cedam, ed., Vol. 1, p. 5.
2. The purpose of reinsurance is to spread the risk of loss among multiple insurance companies. The original or direct insurer who reinsures with a reinsurer is known as the “reinsured” or “reassured”.
3. International Association of Insurance Supervisors, *Reinsurance and Financial Stability*, 19 July 2012, p. 6.
4. On this view, R.P. Bellerose, *Reinsurance*, 2003, Witherby Publishers, London. The author observes that reinsurance is a form of financing and a form to minimize the risk of insurance exposures.
5. A. Donati and G. Volpe Putzolu, *Manuale di diritto delle assicurazioni*, 2006, Milan Giuffrè, ed., p. 253.
6. L. Farenga, *Diritto delle assicurazioni private*, 2006, Turin Giappichelli, ed., p. 225.
7. The Code identifies reinsurance undertaking as an “undertaking exclusively authorised to the pursuit of reinsurance, other than an insurance undertaking or a non-EU insurance undertaking, the main business of which consists in accepting risks ceded by an insurance undertaking, an insurance undertaking with head office in a third State or other reinsurance undertakings”.
8. E. Bellizzi, “Accesso ed esercizio dell’attività di riassicurazione [Arts 57–67]”, in S. Amoroso and L. Desiderio, eds., *Il nuovo codice delle assicurazioni*, Milan Giuffrè, ed., 195 ss. The Insurance Code follows the discipline contained in the European Parliament and Council Directive 2005/68/EC, the so-called “Reinsurance Directive”.
9. On this matter, R. Merkin, “Tort and Insurance: some insurance law perspectives”, 2010, 26 *Professional Negligence* 4, p. 198.
10. B. De Mori, “Orientamenti della riassicurazione nel campo internazionale”, in Aa.Vv., *Problemi attuali delle assicurazioni private e della previdenza sociale*, 1960, Vol. 1, Milan Giuffrè, 37 ss.
11. The recent case *Astrazeneca Insurance Co Ltd v XL Insurance (Bermuda) Ltd* [2013] EWHC 349 (Comm), [2013] 2 All ER (Comm) 97 has showed indemnification where actual liability established.
12. The reinsurance typically can be classified into one of three categories: (a) facultative reinsurance, where an insurer reinsures an individual insurance with any reinsurer who is prepared to accept it; (b) obligatory, or treaty reinsurance, as it is more commonly called, where the reinsurer enters into an agreement under which it has to accept and the insurer has to reinsure specified categories or types of insurance written by the latter such as marine or property business; and (c) facultative or obligatory reinsurance, where the reinsurer agrees to reinsure such specified insurance business as the ceding company, at its discretion, may care to offer to the reinsurer.

13. On this matter, J. Gilman, R. Merkin, C. Blanchard and M. Templeman, *Arnould: Law of Marine Insurance and Average*, 2013, Sweet & Maxwell Ltd 18th edn., chapter 33.
14. For the "treaty" reinsurance do not apply Arts 1341–1342 of the Italian Civil Code regarding the discipline of contracts terminated by standard forms.
15. V. M. Prosperetti and A. Apicella, *La riassicurazione*, 1994, Milan Giuffrè, ed., pp. 19–20.
16. A. Fenton, "The nature and extent of a reinsurer's liability and the effect of 'follow settlements' clauses", 2013, *Dir. fisc. ass.* 4, 530.
17. O. Cagnasso, *Riassicurazione*, in *Dig. disc. priv., sez. comm.*, 1996, Turin Utet ed., Vol. 12, 487 ss.
18. R. Capotosti, "Riassicurazione: il completamento comunitario dell'ordinamento assicurativo", 2006, *Ass.* 1, p. 33.
19. A. Dreassi and S. Miani, "Market conduct in the insurance industry and convergence of international supervision", 2008, 12 *Journal of Risk Management and Insurance* 8, pp. 20–21.
20. A. Dreassi and S. Miani, "Operational risk capital requirement: comparison of proposed Solvency II methodologies for the Italian insurance market", 2009, *Dir. ec. ass.* 8, pp. 728–729.
21. International Monetary Fund, "The financial market activities of insurance and reinsurance companies", *Global Financial Stability Report. A Quarterly Report on Market Developments and Issues*, June 2002, p. 30.
22. G. Plantin, "Does reinsurance need reinsurers?" 2006, 73 *The Journal of Risk and Insurance* 1, pp. 167–168.
23. R. Capotosti, *La riassicurazione. Il contratto e l'impresa*, 1991, Turin Utet ed., p. 11.
24. On this point, see Barlow Lyde and Gilbert, *Reinsurance Practice and the Law*, 2009, Informa Publishing Group Limited ed., para. 1.14.
25. M. Prosperetti, "Il trattato di riassicurazione a scopo di finanziamento", in *Studi in memoria di Cicala*, 2003, Naples Jovene, ed., 1024 ss.
26. Clyde & Co LLP, *Reinsurance Practice and the Law*, 2014, Informa Professional ed. (Charter one).
27. G. Fanelli, "Le assicurazioni", in *Trattato dir. civ.comm.*, 1973, A. Cicu and F. Messineo, eds., Vol. XXXVI, Milan Giuffrè, p. 285.
28. Barlow Lyde and Gilbert, *Reinsurance Practice and the Law*, para. 1.16.
29. J.D. Cummins and P. Trainar, "Securitization, Insurance, and Reinsurance", 2009, 76 *The Journal of Risk and Insurance* 3, p. 464.
30. International Association of Insurance Supervisors, *Reinsurance and Financial Stability*, p. 14; P. Falush, "Development of Reinsurance Markets in the Economies in Transition", 1997, *Insurance regulation and supervision in economies in transition*, Second East-West Conference on Insurance Systems in Economies in Transition, OECD Proceedings, 239 ss.
31. The largest global reinsurance companies are: Munich Re, Swiss Re, Hannover Ruckversicherung AG and Lloyd's of London. These global firms have international presence and offer similar products, fostering a strong level of rivalry within the global market.
32. Generally, "treaty reinsurance" involves two stages: (1) the parties enter into the treaty; and (2) the reinsured makes declarations to the treaty (cedes business).

33. R. M. Merkin, *Colinvaux's Law of Insurance* (2013) Sweet & Maxwell ed., para. 17–01.
34. See O. Gurses, "Insurance, reinsurance and the Titanic", 2012, *Journal of Business Law* 4, p. 340.
35. A. Dreassi and S. Miani, "Requisiti di vigilanza e crediti da riassicurazione: analisi teorica delle implicazioni per la solvibilità assicurativa", 2011 *Dir. ec. ass.* 1, p. 51.
36. O. Gurses, "Insurance, reinsurance and the Titanic", p. 341.
37. On this matter, see J. S. Butler, "The use of aggregate extension clauses in excess of loss reinsurance agreements", 1999, 13 *Lloyds Maritime and Commercial Law Quarterly* 3, 380 ss.
38. J. Lowry, P. Rawlings and R. Merkin, *Insurance Law: Doctrines and Principles*, 2011, Oxford Hart Publishing 3rd edn., 503 ss.
39. Council Directive 64/225/EEC of 25 February 1964 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession (OJ 56, 4.4.1964, p. 878/64).
40. The main purpose of 1964 Directive was to prohibit the discrimination against in coming reinsurers; however, the legislation did not require Member States to authorise or regulate insurers which only underwrite reinsurance and retrocession.
41. A.M. Evans, "The EU Reinsurance Directive", 2007, 32 *The Geneva Papers*, p. 96.
42. Ibid.
43. Directive 2005/68/EC of the European Parliament and of the Council of 16 November 2005 on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC as well as Directives 98/78/EC and 2002/83/EC.
44. The Reinsurance Directive provides for an EU reinsurer to provide services or to establish on the basis of their home Member State's authorisation without any further requirements.
45. See P. Edmondson, "Insurance Regulation", in *Financial Services Law*, 2009, M. Blair, G. Walker and R. Purves, eds., Oxford University Press 2nd edn., p. 793.
46. The Reinsurance Directive applies only to reinsurers which carry out reinsurance to the exclusion of direct insurance business and therefore does not apply to mixed insurers.
47. The directive requires authorisation of pure reinsurers and imposes conditions such as the form of reinsurance undertakings, close links and controllers and a scheme of operations.
48. On this matter, see K. Noussia, "The impact of the Reinsurance Directive 2005/68: so far so good?" 2008, 5 *Journal of Business Law*, p. 418.
49. Pure reinsurers incorporated outside the EEA are subject to separate authorization in each EEA State.
50. Art. 18 of the Reinsurance Directive requires Member States to authorise reinsurance transfers (under conditions laid down in national law) by a reinsurance undertaking, including of business carried out under the freedom of establishment or to provide services in other Member States. Such a transfer is subject to the home State regulator of the transferee providing a certificate of the necessary solvency margin (taking the transfer into account).
51. With regard to the licensing system, the application of the home country control principle embodied in the Reinsurance Directive was not able to

- operate under the Italian Code of Insurance 2005 because it was only the ISVAP who had the authority to grant licenses for reinsurance companies wanting to operate in Italy.
52. K. Noussia, "The impact of the Reinsurance Directive 2005/68: so far so good?" p. 431.
 53. On this point, see I. Van Lelyveld, F. Liedorp and M. Kampman, "An empirical assessment of reinsurance risk", 2009, *De Nederlandsche Bank Working Paper No. 201*, p. 2.
 54. IAIS, "Supervisory Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers" (IAIS Supervisory Standard No. 7), January 2002; "Principles on Minimum Requirements for Supervision of Reinsurers" (Principles Paper No. 6) October 2002; see also "Standard on Supervision of Reinsurers" (IAIS Supervisory Standard No. 8), October 2003.
 55. J. Black, "Forms and Paradoxes of Principles Based Regulation", 2008, *LSE Law, Society and Economy Working Papers* 13, pp. 4–5.
 56. See J. Black, "Using Rules Effectively", in Christopher McCrudden, ed., *Regulation and Deregulation*, 1998, Oxford University Press, p. 101.
 57. Soft law signifies a form of non-binding rules constituted by legal opinions, statements, guides, protocols, and commentaries.
 58. Under the Reinsurance Directive, the supervisory rules applicable in the country in which the head office of a reinsurance company is situated are (mutually) recognised by the other member states. See I Riva, "La Direttiva 2005/68/CE in materia di riassicurazione", 2006, 11 *Contr. impr. Europa* 1, 534 ss.
 59. R. Vogelgesang and M. Kubicek, "Towards a Global Approach to Reinsurance Regulation", 2007, 32 *The Geneva Papers*, p. 413.
 60. EIOPA, the successor of CEIOPS, based in Frankfurt, was established by the Regulation (EU) No. 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/79/EC, [2010] OJ L331/48 (EIOPA Regulation).
 61. However, under this supervisory architecture the unconvincing regulatory structure of authorities implemented by the *de Larosière* is evidenced by an insufficient level of control with regard to the responsibility of members.
 62. In this regard, see MarketLine Industry Profile, "Global Reinsurance", October 2013, p. 16.
 63. S. McEwan, "Future-proofing insurance transactions pending the implementation of Solvency II", 2013, 28 *Journal of International Banking and Financial Law* 9, p. 579.
 64. K. Noussia, "Reinsurance Contracts and the Myth of "Automatically" Guaranteed Coverage", 2008, 29 *Business Law Review* 4, p. 164. By commenting the case *Wasa International Insurance Co Ltd v Lexington Insurance Co*, AGF *Insurance Ltd v Lexington Insurance Co* [2007] EWHC 896 (Comm), the author underlines the judgment held by the Court according to which "the direct incorporation of terms and conditions from an original insurance contract into a reinsurance contract does not alter their separate nature".
 65. For instance, the English law provides that a reinsurer is not obliged to indemnify the reassured unless the loss falls within the scope of the cover

of the insurance contract and within the scope of the cover created by the reinsurance contract.

66. O. Gurses, "Insurance, reinsurance and the Titanic", p. 341.
67. M. Gatumel and L. De Forges, "Understanding and monitoring reinsurance counterparty risk", 2013, 13 *Bulletin Francais D'Actuariat* 26, p. 122.
68. D. Schwarcz and S.L. Schwarcz, "Macroprudential Insurance Regulation: Anticipating New Sources of Systemic Risk", in *Systemic Risk and the Future of Insurance Regulation*, 2015, A. Georgosouli and M. Goldby, eds., Routledge
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72. S.E. Harrington, "Capital Adequacy in Insurance and Reinsurance", in *Capital Adequacy Beyond Basel: Banking, Securities, and Insurance*, 2005, H.S. Scott, ed., Oxford University Press ed., p. 87.
73. J. Burling and K. Lazarus, "An Introduction to Insurance Regulation in the United Kingdom", mimeo, 10. On this matter, see R. Merkin and M. Mendelowitz, "Reinsurance: finding the balance between reinsurers' and reinsureds' interests", in *Research Handbook On International Insurance Law And Regulation*, 2011, J. Burling and K. Lazarus, eds., Edward Elgar, 146 ss.
74. M. Eling, H. Schmeiser and J.T. Schmit, "The Solvency II Process: Overview and Critical Analysis", 2007, 10 *Risk Management and Insurance Review* 1, p. 81.

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