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Regulatory Developments Affecting the Italian Investment Fund Market

Jeffrey Paul Greenbaum*

Italian regulation of mutual funds and internally managed investment companies has evolved significantly over the past few years. The Consolidated Financial Brokerage Law, Legislative Decree of February 24, 1998, Number 58 (the "Draghi Decree") modified many aspects of Italian corporate law, including provisions of the law applicable to the regulation of mutual funds and other investment companies. Moreover, as a result of changes in the international mutual funds context, Italy has recently adopted additional piecemeal modifications to its regulatory system that have created a far more suitable regulatory environment for foreign mutual funds and investment advisers. Furthermore, changes in the Italian pension fund system have contributed to the already impressive growth in Italian mutual funds.2

Because of these significant developments, the moment is opportune to review Italy's regulation of mutual funds and other investment companies. This article describes the primary entities involved in the operation of Italian mutual funds, the types of funds and other collective investment vehicles that may be offered in Italy, the

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2In February 1997, there were 553 Italian mutual funds with assets under management of Lit. 233,383 billion. Assogestioni, 1999 Fondi comuni di investimento; Guida a dati e statistiche. As of February 29, 2000, there were 832 Italian mutual funds with Lit. 942,553 billion under investment. See Comunicato Stampa (visited March 15, 2000) <http://assogestioni.it dati.comunicatis.isp>.
methods for commencing operations there and permissible methods for marketing or placing of funds. Pension fund developments and provisions governing the offering of funds over the Internet are also discussed.

I. MUTUAL FUND FRAMEWORK

Italian mutual funds operate with three separate components: an investment management company (Società di Gestione del Risparmio, "SGR"); a depositary bank; and the fund itself. The fund is often distributed by a securities firm (Società di Intermediazione Mobiliare, "SIM"). Each of these entities is described below.

A. THE SGR

An SGR is a joint stock company authorized to provide collective investment management services. Its closest equivalent in the United States system is the mutual fund investment adviser. An SGR must have its registered office and head office in Italy. An SGR must have a minimum share capital of 5 million Euro. For an SGR that also intends to undertake clearance and settlement services, the minimum capitalization is 25 million Euro.

Only SGRs and internally managed investment companies may provide collective investment services. An SGR may also provide portfolio management services on a client-by-client basis to third parties and establish and manage pension funds. It may also perform activities related and instrumental to the above services subject to regulations issued by the Bank of Italy after consulting with the Italian equivalent of the United States Securities and Exchange Commission, the Commissione Nazionale per le Società e la Borsa ("CONSOB").

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3 See Draghi Decree, supra note 1, at art. 1, ¶ 0.
4 See Article 4 of Resolution No. 11,768 of Dec. 23, 1998, as modified; Commissione Nazionale per le Società e la Borsa ("CONSOB") Newsletter of Nov. 15, 1999.
An SGR may entrust specific investment plans of a mutual fund to intermediaries authorized to provide portfolio management services in accordance with the investment allocation criteria it defines each time. The SGR sets up the fund and its regulations, and exercises voting rights on behalf of the subscribers.

An SGR may place shares of its own collective investments with the public.

B. THE DEPOSITARY BANK

The depositary bank holds the securities of the mutual fund. It verifies the legitimacy of the operations of issuance and withdrawal of shares from the fund, the calculation of their value and the destination of the profits. It also verifies that the fees relating to the fund are paid to it according to custom. Moreover, it implements the instructions of the investment management company, if such instructions are not contrary to law, regulation or the provisions of the supervisory authority. The separation between the management of the fund assets and the possession thereof adds a layer of protection for the subscribers. For greater certainty and to guaranty the subscribers, the custody of the assets of each mutual fund or division thereof is

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5 See Draghi Decree, supra note 1, at art. 33. An SGR may delegate to a sub-adviser the responsibility of managing a specific portion of the portfolio — a specific plan or program, to be carried out within the limit of the SGR's investment criteria. This delegation may be, but is not necessarily, limited to a certain time period. Some commentators believe that a sub-adviser can be hired to manage the entire portfolio, but such a view is contrary to the specific text of the Draghi Decree and is not the generally accepted view.

6 An SGR may also offer services auxiliary to its management services. For example, an SGR may offer the following services among others:

(i) study, research, analysis in economic and financial areas;
(ii) creation, transmission and communication of economic and financial information and data;
(iii) preparation and management of information services or elaboration of data; and
(iv) management of real property to be used by the SGR.

7 See Draghi Decree, supra note 1, at art. 38 § 1 (noting depositary bank's functions).
entrusted to one depositary bank. Nevertheless, the depositary bank may arrange with, among others, the following to act as a sub-depositary for the fund: Italian or foreign banks; SIMs; or other investment firms that may hold securities and liquid assets of clients.

C. THE FUND

Under Italian law, the mutual fund is an autonomous entity set up by an SGR. In light of the modifications made by a recent decree, the following types of funds are now permitted to be offered in Italy: open mutual funds, closed mutual funds, hedge funds, reserved funds and closed real estate funds. The principal difference between a closed mutual fund and an open mutual fund is that the participants in an open mutual fund have the right to ask at any time for the reimbursement of their holdings according to the procedures set out by the operating rules of the fund. The participants in a closed mutual fund only have the right to withdraw from the fund at predetermined times.

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8 See Pronouncement of the Bank of Italy of July 1, 1998, ch. IV, sec. II, pt. 6 (hereinafter July 1 Pronouncement). With respect to the depositary bank, the relationships between the bank, the promoting company and the investment adviser must be clarified with respect to the procedures regarding the implementation of the advisory and management services. In addition, the offices at which the tasks of issuance and delivery of certificates and withdrawals are to be carried out must be identified. Moreover, the depositary bank must clarify that the role of the depositary bank is for an indefinite term but may be revoked at any time, while the bank may withdraw after giving no less than six months notice. The revocation is not effective until another bank, meeting all the requirements, accepts the position, the consequent amendment to the fund bylaws is accepted by the SGR as well as the Bank of Italy and the securities and cash of the former are transferred and credited at the new depositary bank. Pronouncement of the Bank of Italy of July 1, 1998, ch. IV, sec. II, pt. 6.

9 See Communication of Sept. 20, 1999 by the Bank of Italy Issued in implementation of Decree No. 228 of May 24, 1999 of the Ministry of the Treasury, ch. VII, sec. III, art. 1.

10 Ministerial Decree No. 228 of May 24, 1999, Gazz Uff. No. 164 of July 15, 1999 (hereinafter Decree No. 228).

11 See July 1 Pronouncement, supra note 8, at ch. IV, sec. 2, pt. 4.3.
D. THE SIM

A SIM (securities firm) is an entity other than a bank or a financial intermediary that is authorized to provide investment services. It must be listed in a special register held by CONSOB. It must also have its registered office and head office in Italy.

A SIM’s core investment services are dealing for its own account, dealing for customers’ accounts, placement of securities (either with or without underwriting or standby commitment to issuers), management of investment portfolios on a client-by-client basis, and reception and transmission of orders and bringing together two or more investors.

A SIM must apply for and receive authorization from CONSOB to provide each kind of service. SIMs may also provide certain “non-core services.”

Sales made outside of the office of a SIM are carried out through financial salesmen (promotori finanziari). To become a financial salesman, one must pass an examination on the basis of criteria set by CONSOB. Certain persons with similar experience in other European countries are qualified to perform such services in Italy.

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12 CONSOB Resolution No. 11,522 of July 1, 1998, at art. 4.
13 Draghi Decree, supra note 1, at art. 1, § e.
14 See Draghi Decree, supra note 1, at art. 1, § 5.
15 See Draghi Decree, supra note 1, at art. 1, § 6. These include the following:
   (i) safekeeping and administration of financial instruments;
   (ii) rental of safe deposit boxes;
   (iii) lending to investors to carry out transactions in financial instruments where the lender is involved in the transaction;
   (iv) advice to undertakings on capital structure, industrial strategy and related matters as well as advice and services relating to mergers and to the purchase of undertakings;
   (v) services related to the issue and placement of financial instruments, including the organization and the constitution of underwriting and placement syndicates;
   (vi) investment advice concerning financial instruments; and
   (vii) foreign exchange trading where it is connected with the provision of investment services.
16 See Draghi Decree, supra note 1, at art. 31.
17 Id.
II. MUTUAL FUNDS AND OTHER COLLECTIVE VEHICLES THAT MAY BE ESTABLISHED IN ITALY

As noted above, the following types of mutual funds are now permitted in Italy: open mutual funds, closed mutual funds, hedge funds, reserved funds and closed real estate funds formed with publicly owned assets. Internally managed investment companies (Società di Investimento a Capitale Variabile, “SICAVs”) are also permissible vehicles for collective investments. As hedge funds and reserved funds are so new to the Italian market, no such funds were operating as of November 1, 1999. Likewise, since the original limitations on closed funds were so restrictive, few closed funds have been established. It is likely that the recent modifications to the provisions on closed funds (discussed below) will make them a more attractive investment vehicle.

A. OPEN MUTUAL FUNDS

The principal characteristic of an open mutual fund is that its subscribers may withdraw at any time. Open mutual funds may invest in listed securities, deposits of banks in EU member states, shares of Harmonized EU Funds (UCITS), unlisted securities and derivatives (within the limit of 10% of fund assets). Investment in derivatives is permitted on condition that such investment is permitted by the fund bylaws, which must define the

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18 Harmonized EU Funds, used interchangeably with the term UCITS in this article, are funds set up in EU Member States that meet the requirements regarding undertakings for the collective investment of transferable securities (UCITS) as set forth in Directives 85/611/EEC and 88/220/EEC, and as discussed in Section III. B., infra.

criteria of use and the goals sought (that is, risk coverage). In addition, this investment must not alter the risk profile indicated among the objectives of the fund as set out in its bylaws.20

Open mutual funds may not issue loans, go short on the market, invest in financial instruments issued by a controlling SGR or purchase precious metals or precious stones or certificates representing such items.21

Short sales on financial instruments will continue to be prohibited, "except where otherwise established by the Bank of Italy."22 So far, the Bank of Italy has taken no action to permit short sales.

A fund of funds is permitted if it invests in UCITS funds.23 The new rules permit funds to invest 10% of their assets in a UCITS. This limitation is raised to 20% where the latter UCITS invests exclusively in other UCITS. The composition of the portfolio of the fund purchased must be compatible with the investment policy of the purchasing fund. Moreover, if such fund belongs to the same group, the fund bylaw must specifically provide for this possibility.

**B. CLOSED MUTUAL FUNDS**

Closed mutual funds may invest in unlisted securities, real estate and real estate rights, credits and documents representing credits, other assets for which a market exists and which have a value with certainty on at least a six month basis, bank deposits and listed securities.24

A closed mutual fund cannot issue loans, go short on the market, invest in financial instruments issued by a

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20 See ch. II, sec. II, art. 4 of the Sept. 20 Pronouncement.
21 See id., at ch. II, sec. II, art. 1.
22 Article 8, paragraph 2 c. of Decree No. 228 of May 24, 1999 of the Ministry of the Treasury.
23 See Communication of Sept. 20, 1999 by the Bank of Italy issued in implementation of Decree No. 228 of May 24, 1999 of the Ministry of the Treasury.
controlling SGR, invest in unlisted securities issued by companies belonging to the group of its SGR or undertake activities aimed at the construction of real property.\textsuperscript{25}

Whereas initially the percentage and types of permitted investments for closed mutual funds were strictly circumscribed,\textsuperscript{26} two major limitations have been removed from these funds. No longer are they limited to a 30% holding in a company. Moreover, the 80% limitation regarding investments in non-listed companies has also been eliminated. These were two of the principal limitations making such funds less attractive as venture capital vehicles. Moreover, the listing obligation has been substantially reduced (as long as the minimum investment is at least 25,000 Euro).\textsuperscript{27} If the investment of the closed mutual fund is to be principally in unlisted securities, the minimum subscription may not be less than 50,000 Euro.\textsuperscript{28} In principal, a closed mutual fund may not have a duration of longer than 30 years, though the Bank of Italy may grant extensions for three years.\textsuperscript{29}

C. HEDGE FUNDS

Hedge funds may now be offered in Italy, in either an open or closed form. Although there are no limits as to the types of investments they may make,\textsuperscript{30} there are certain limits on their operations. First, there is a minimum investment requirement for each investor of one million Euro. Second, no more than 100 investors may participate in a hedge fund. Third, hedge funds may not be the subject of solicitation for investment. Fourth, the fund bylaws must indicate the risky nature of the investment and that it does not follow the rules of prudential investment and sharing of risk as established by the Bank of Italy. Hedge

\textsuperscript{25} See id. at ch. II, sec. III, art. 2.
\textsuperscript{26} Id. at art. 10.
\textsuperscript{27} See Decree No. 228, supra note 10, at art. 5.
\textsuperscript{28} Id. at art. 12.
\textsuperscript{29} Id. at art. 6.
\textsuperscript{30} See Sept. 20 Pronouncement, supra note 19, ch. II, at sec. I, art. 1 D.
funds may only be established by SGRs that have as their exclusive purpose the establishment or management of hedge funds. Thus, in order to establish a hedge fund in Italy, a specific SGR must first be organized. This requirement may, in effect, double the time necessary for establishing a hedge fund.

D. RESERVED FUNDS

An SGR may set up either an open or closed mutual fund reserved for "qualified investors", specifying the types of investors to which the fund is reserved. There is no limitation on the number of investors in a reserved fund. Moreover, the bylaws of a reserved fund may set norms of prudence different from those established generally for Italian mutual funds. The shares of reserved funds may not be placed, or resold, to persons different from those indicated in the fund bylaws. Qualified investors are deemed to be banks, investment firms, SGRs, SICAVs, pension funds, insurance companies, bank holding companies and physical or legal persons having specific capabilities and experience in operations involving financial instruments as expressly declared in writing by the person or its legal representative.

E. CLOSED REAL ESTATE FUNDS FORMED WITH PUBLICLY OWNED ASSETS

With the very recent introduction of the new rules liberalizing permitted investments by closed mutual funds in real estate, the old rules regarding real estate investment trusts were abrogated. The only prior rules still in force in this area apply to real estate funds formed by a contribution of at least 51% of publicly owned assets.

31 Id.
Even these funds, however, are subject to the general rules regarding closed mutual funds investing in real estate.\textsuperscript{34}

F. SICAVs

A SICAV is a joint stock company (società per azioni) that deals solely with the collective investment of funds raised by offering its own shares to the public. It also must have its registered office and head office in Italy.\textsuperscript{35} The sole business purpose that may be specified in the bylaws of a SICAV is the collective investment of assets raised by offering shares to the investing public. A SICAV may delegate the power to manage its assets to an SGR. In the case of a multi-fund SICAV, each fund must be autonomous and separate from other funds for all purposes.\textsuperscript{36}

III. METHODS BY WHICH A FUND CAN COMMENCE OPERATIONS IN ITALY

A. ESTABLISHMENT OF ITALIAN MUTUAL FUNDS AND SICAVS

The procedures for the authorization of open and closed mutual funds are quite similar and set out in summary form below. The funds are established by the Board of Directors of the SGR.\textsuperscript{37} The fund bylaws (as well as any changes thereof) must be approved by the Bank of Italy. The bylaws are deemed to be approved if they have not been rejected within four months from their date of filing with the Bank of Italy.\textsuperscript{38}

\textsuperscript{34} See Decree No. 228, supra note 10, at art. 13.
\textsuperscript{35} Draghi Decree, supra note 1, at art. 1, ¶ 1.
\textsuperscript{36} See id. at art. 43. In this context, the word “multi-fund” means that the SICAV is a type of umbrella fund offering more than one sub-fund.
\textsuperscript{37} See id. at art. 36.
\textsuperscript{38} See id. at art. 39, ¶ 3.
1. Open and Closed Mutual Funds

The bylaws of an open mutual fund must include the following:

(i) the name and duration of the fund;
(ii) the name of the depositary bank;
(iii) the procedures for subscribing to the fund and the terms and procedures for issuance of subscription certificates;
(iv) the names of the bodies responsible for choosing the securities and the criteria for the division of assets;
(v) the type of assets, securities and other goods in which it is possible for the fund to invest;
(vi) the criteria for determining the determination of profits;
(vii) a specific indication of which expenses are to be borne by the fund and which expenses are to be borne by the managing company;
(viii) the amount or criteria for determining the commissions of the investment management company and the charges to the subscribers for subscription and withdrawal; and
(ix) the means of publicizing the net asset value of the shares of the fund.\(^3^9\)

As a result of the recent regulations,\(^4^0\) closed mutual funds are now established in essentially the same manner as open mutual funds.

2. SICAVs

In implementation of European Economic Community Directives 85/11/EEC and 88/220/EEC, upon authorization from the Ministry of the Treasury, and after consultation with the Bank of Italy, a SICAV may be

\(^{39}\) See id. at art. 39, ¶ 2.
\(^{40}\) See Decree No. 228, supra note 10.
established. Many of the rules applicable to open mutual funds also apply to the establishment of SICAVs. 41

The capital of a SICAV must be entirely paid in. Moreover, a request for authorization must be filed with the Bank of Italy, including:

(i) the name, registered offices and the directorate of the company to be incorporated;

(ii) complete information on the subscribing shareholders; and

(iii) the following attached documents — a list of founding members and their respective shareholdings, a list of directors, documentation showing that the founders meet the requirements of honorability 42 and documentation regarding the shareholders. 43

The Bank of Italy is free to ask for additional documentation and is to issue the authorization within 90 days from the date of receipt of documentation. 44

B. Notification or Authorization of Foreign Funds

Issuance of the Draghi Decree, among other things, was intended to rationalize Italian regulation of foreign mutual funds, UCITS or otherwise. Primarily, the innovations were aimed at accelerating the procedures for the introduction of these funds into the Italian market. Under prior law, the Ministry of the Treasury was identified as the center of investigation regarding foreign funds. CONSOB and the Bank of Italy, however, in fact carried out the investigations themselves. Thus, this process effectively imposed a double layer of bureaucracy. While the involvement of the Treasury was deemed necessary for an

43 July 1 Pronouncement, supra note 8, at ch. V, sec. VI, pt. 1.
44 Id. at ch. V, sec. VI, pt. 2.
initial authorization, no such authorization was really needed for these funds, as they had already been examined and subject to home country control. The Draghi Decree therefore removed the Ministry of the Treasury from this process.

The Draghi Decree, like prior Italian law, set out separate procedures for the offering of foreign mutual funds established in an EU Member State and complying with the provisions of Directives 85/611/EEC and 88/220/EEC (hereinafter UCITS or “Harmonized EU Funds”) and for foreign funds not established in an EU Member State or funds established in an EU Member State which do not comply substantially with the structural requirements of the Directives (hereinafter “Non-Harmonized EU Funds”).

The most significant difference in treatment between Harmonized EU Funds and Non-Harmonized EU Funds under the Draghi Decree is that a notice regime applies to Harmonized EU Funds, while Non-Harmonized EU Funds must undergo a more rigorous authorization procedure. Thus, for Harmonized EU Funds, notice must be given to the Bank of Italy and CONSOB (with notice no longer being given to the Ministry of the Treasury). As for Non-Harmonized EU Funds, the Bank of Italy, after consulting CONSOB, must authorize them. During this process, the Bank of Italy must evaluate whether these funds are compatible with the Italian system.

1. Notification of UCITS

As noted above, in order to market its quotas in Italy, a Harmonized EU Fund must give prior notice to the Bank of Italy and to CONSOB accompanied by the following documentation, together with a translation into Italian:

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45 Draghi Decree, supra note 1, at art. 42.
(i) a certificate issued by the appropriate authority of the place where the fund is located ("Home State Authority") certifying that the fund meets the requirements of the above mentioned EU Directives;

(ii) the fund rules, or the investment company's instruments of incorporation, together with a certificate of the Home State Authority certifying that such documents are currently in force and effect;

(iii) the latest prospectus transmitted to the Home State Authority, together with a certificate of said Authority to the effect that this document is the latest prospectus received, or the last prospectus approved where this is subject to approval or prior review;

(iv) an informational document to provide to the public containing the information contained in the regulation to be issued by CONSOB in accordance with Article 42, paragraph 3 of the Draghi Decree;

(v) the latest annual report of the EU Fund and the subsequent six-month report, if published;

(vi) information as to the organizational system adopted by the fund to insure the exercise of the participants' rights in Italy;

(vii) the list of persons or entities charged with placement in Italy of the quotas of the fund and the indication of the correspondent bank (or the correspondent banks, where more than one bank is to be used) together with a copy of any agreements signed; and

(viii) detailed information as to the procedures adopted to render public the price of issue, sales, repurchase or reimbursement of the parties as well as providing to the public the other information identified by CONSOB in its regulation issued pursuant to Article 42, paragraph 3 of the Draghi Decree.\(^{46}\)

\(^{46}\) See July 1 Pronouncement, supra note 8, at ch. IX issued pursuant to art. 42, ¶ 2, sec. a and b of the Draghi Decree.
A fund may be prohibited from marketing in Italy if (i) the organizational scheme does not insure the exercise of the participants’ rights in Italy, (ii) there is a failure to comply with the provisions issued by CONSOB pursuant to Article 42, paragraph 3 of the Draghi Decree or (iii) there is a failure to comply with the provisions of Article 44, paragraph 1 of Directive 85/611/EEC.

If the Bank of Italy or CONSOB makes observations or asks clarifications in this period, the two-month term is interrupted. In such case, a new two-month period (one time only) runs from the date of receipt of the response.

The unauthorized offering of a UCITS in Italy is punishable by imprisonment for up to four years and with a fine from Lit. 4 million to Lit. 20 million.47

2. Authorization of Non-Harmonized EU Funds

As noted above, a Non-Harmonized EU Fund may be marketed in Italy after authorization by the Bank of Italy, on the condition that its operation is compatible with a type of recognized Italian fund.48

New rules governing the offer of Non-Harmonized EU Funds have not yet been issued, even though they were expected to be issued by January 31, 1999. In the absence of new rules, existing rules remain in effect.

Thus, an authorization must be sought from the Ministry of Treasury in conjunction with the Ministry for Foreign Trade. In order to obtain authorization, the Non-Harmonized EU Fund, among other things, must comply with the following requirements:

(i) it must have structural and operative characteristics similar to those of Italian mutual funds;

47 Article 166 of the Draghi Decree.
48 See Draghi Decree, supra note 1, at art. 42, § 5.
(ii) it must be subject, in the country where it has its statutory or administrative principal office, to adequate control by a public authority similar in nature to the comparable Italian authorities;

(iii) it must have a permanent office in Italy (or a representative office which may be that of a securities broker, a fiduciary company, an investment management company or other company established in Italy or authorized pursuant to Law No. 77 of March 23, 1983);

(iv) it must give the task of handling all the subscriptions and repayments in Italy to a bank;

(v) it must give the custody of part of its assets (corresponding to the shares or units which are placed in Italy) to a bank, which is responsible as a depositary, it may, however, also sub-deposit all or part of the above mentioned assets in other entities, in Italy or abroad;

(vi) the managers of the fund responsible for investments must meet certain moral background requirements (for example, they must not have a criminal record) specified for managers of Italian mutual funds;

(vii) the same requirements must be met by the managers who represent the fund in Italy; and

(viii) the Home State Authority must cooperate with the Bank of Italy, where appropriate.

The Ministry of Treasury can reject the application for authorization within two months from the filing of the application. The authorization may also be denied or revoked if any of the above requirements cease to apply.49

The placement of Non-Harmonized EU Funds in Italy is also subject to prior notice to CONSOB. This notice must set out the quantity and characteristics of the offered securities, and the terms and conditions of the placement

49 The details of the terms of the authorization procedure (including a specific list of documents and required translations into Italian, to be filed with the Treasury) are contained in the Decree of the Ministry of Treasury of July 27, 1993.
activity. In addition, an information prospectus must also be provided. When the placement targets institutional investors, exemption from public offering requirements is available. Prior notice must be sent, however, to the Bank of Italy for placements in an amount in excess of 100 billion lire.

If a Non-Harmonized EU Fund enters the Italian market without authorization, this may result in administrative fines or imprisonment of up to three years.

To date, no mutual funds organized in the United States have sought authorization from the Ministry of the Treasury. This is attributable to the Italian taxation rules. Investing in a United States fund authorized in Italy would, in most cases, be far more costly tax-wise to the investor than investment in a comparable Italian mutual fund, SICAV or notified UCITS.  

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IV. MARKETING OR PLACEMENT OF MUTUAL FUNDS

A. MARKETING TO THE PUBLIC

Once a UCITS fund has been notified into Italy, an authorized intermediary may sell shares of such fund in Italy. An authorized intermediary, in this sense, means an Italian SIM with placement authorization, an Italian bank, a foreign bank authorized in Italy or an EU investment firm passported into Italy.

Financial salesmen, however, must be used for out of office selling (for example, door-to-door or Internet sales). The activity of a financial salesman may be exercised on behalf of only one subject. The authorized subject using the financial salesman is jointly and severally liable for injury caused to third parties by the financial salesman, even where such injury arises from a criminal offense for which the financial salesman has been convicted.

B. PRIVATE PLACEMENT OF MUTUAL FUNDS IN ITALY

Many United States firms are not interested in the retail side of the Italian market; they are instead only interested in Italian institutional investors. Italian law does not provide private placement exemptions for the offer of foreign mutual funds (UCITS or otherwise) in Italy. As noted above, all foreign funds must be either notified or authorized by the Italian regulatory authorities before they can be offered on the Italian market. Likewise, there are no simplified notification or authorization procedures for mutual funds that are to be offered solely to institutions.

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52 Article 31 of the Draghi Decree.

53 See Section VI B, infra.
Once a mutual fund has been authorized, however, the solicitation of investors in such fund is simplified for private placements. Under prior and current Italian law, if an offer of securities is exempted as a private placement, no formal offering circular is required for such exempted transactions.

In general, solicitations of public savings are subject, among other things, to prior communication to CONSOB with the prospectus attached. The general requirements of the contents of the prospectus are set forth in the Draghi Decree.

Article 100 of the Draghi Decree, however, carves out an exception to the above requirements in certain circumstances. Thus, it provides that these requirements are not applicable to solicitations where one or more of the following conditions exist:

(i) the solicitation is aimed only at professional investors pursuant to Article 30, paragraph 2;
(ii) it is addressed to a number of subjects not exceeding the number established by CONSOB in a regulation;
(iii) the amount of the solicitation does not exceed the amount established by CONSOB in a regulation;
(iv) the solicitation involves financial instruments issued or guaranteed by the Italian government, by an EU member state or by international public bodies comprising one or more EU member states;
(v) it involves financial instruments issued by the European Central Bank or by the national central banks of EU member states; and
(vi) it involves insurance products issued by insurance companies or financial products issued by banks other than shares or financial instruments that allow the purchase or subscription of shares.

Article 100 also provides that CONSOB may identify other types of soliciting operations to which all or some of the provisions regarding the solicitation of public savings do not apply.
The regulations issued pursuant to Article 100 fill in many of the blanks left by Article 100. As to the exception of Article 100 paragraph a, the regulations define institutional investors to include the following entities: authorized intermediaries, SGRs, SICAVs, pension funds, insurance companies, foreign entities authorized by their Home State Authority to carry out the above, companies and entities issuing financial products traded on regulated markets, companies registered under the Banking Law, physical persons possessing the requirements of professionalism set for people carrying out management, direction or supervisory roles with investment companies, banking foundations, and any other company or legal person possessing a specific competence and experience in transactions in financial products expressly declared in writing by its legal representative.

Moreover, Article 33 of the Regulation, with an eye to Directive 89/298/EEC, specifies that the Draghi Decree provisions regarding public solicitations do not apply when the solicitation:

(i) is aimed at a number of persons not greater than 200;
(ii) concerns financial products whose total value is not greater than 40,000 Euro;
(iii) seeks a minimum investment amount which is not less than 250,000 Euro;
(iv) is aimed at replacement of sums for undertaking non-profit activities;
(v) is carried out in the context of forced sales connected to proceedings envisaged by law;
(vi) concerns the purchase of all, or a controlling portion, of the shares by one party or a number of parties in concert;

(vii) is aimed at members of corporate bodies or executives of the issuer, or of the company controlling the issuer or of the companies controlled by and/or affiliated to the issuer; or
(viii) concerns financial products offered as an option to shareholders of an issuer that does not have listed or widely held shares or convertible bonds.

More specifically, the obligation to give prior communication to CONSOB attaching a copy of the prospectus no longer applies when the solicitation:

(i) involves listed financial products offered as an option to shareholders of an issuer that does have listed shares or convertible bonds;
(ii) involves financial products offered as an option to shareholders of an issuer that does have widely held shares or convertible bonds;
(iii) concerns financial products with a total value not greater than 5,000,000 Euro; or
(iv) is aimed at employees, retirees and agents of the issuer, or of the company controlling the issuer or of the companies controlled by and/or affiliated to the issuer as well as persons working with them on a continuous and coordinated basis.

**IV. DEVELOPMENTS REGARDING PENSION FUNDS**

**A. BACKGROUND**

In August of 1995, Italy significantly revised its pension system, providing for a change from a defined benefit to a defined contribution approach. It is expected that the change from a defined benefit to a defined contribution system will lead to overall greater

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development in the Italian equities market and consequently growth in the mutual funds area.\textsuperscript{56}

In accordance with the new Pension Law, implementing decrees allowed pension funds to be created to invest in debt, equities, open and closed mutual funds.\textsuperscript{57} Moreover, they set out the procedures for establishing a pension fund for certain work categories (closed pension funds) as well as requirements for open pension funds.\textsuperscript{58}

Changes in the requirements governing pension funds have been issued in piecemeal form. The Treasury Ministry issued two decrees in November 1996. The first set out the requirements applicable to management companies;\textsuperscript{59} the second provided the management criteria and investment limitations.\textsuperscript{60} The Ministry of Labor issued a decree in January 1997, modified by the Pension Fund Supervisory Commission (\textit{Commissione di Vigilanza dei Fondi Pensione}) in January 1998,\textsuperscript{61} relating to the authorization procedure for pension funds. In July 1998, the Pension Fund Supervisory Commission issued accounting rules for pension funds. The final regulations regarding the setting of benchmarks were issued on December 30, 1998.

\textsuperscript{56} See, for example, \textit{I fondi pensione e il mercato mobiliare italiano. Le prospettive aperte dalla recente normativa sulla previdenza complementare}, a speech by Angelo Porta at the Conference Ricerche sull'industria dei servizi mobiliari in Italia, organized by CONSOB in Rome on Nov. 15, 1995.


\textsuperscript{60} See Decree No. 703 of Nov. 21, 1996.

B. Delegation of Management Responsibilities

Under the new rules, both closed and open pension funds can, among other things, invest in one or more mutual funds, or contract with a management services group. The rules governing the delegation of advisory services by pension funds, are more restrictive than the comparable restrictions applicable to normal mutual funds under the Draghi Decree; however, this more restrictive position is being reconsidered by the Pension Fund Supervisory Commission. A pension fund is permitted to undertake an agreement with a SIM, or an entity that undertakes the same activity, if the entity has a registered office in one of the EU Member States. Indeed, the Pension Fund Supervisory Commission has stated informally that management of pension funds may be delegated to a foreign management company authorized to undertake asset management by its Home State Authority. If the authorized company is domiciled within the EU, then it may provide such services in Italy, on a passportable basis, without establishing a branch in Italy, upon notice by the Home State Authority to CONSOB that the authorized company wishes to undertake such management or advisory services in Italy.

Pension funds, regardless of whether they are open or closed, may delegate management or advisory functions to an American entity only if it opens a branch in Italy (or in another EU Member State passported into Italy). Delegation of advisory or management functions to an American entity may not be for the entire portfolio, but rather only for a portion thereof, for example a market segment. There is no set rule as to percentage limitation. Thus, the possibility remains that a delegation of more

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63 Compare Legislative Decree 124/93, effective Apr. 28, 1993 with Article 33 of the Draghi Decree. The latter permits delegations to "authorized intermediaries", a term that can be, and has been, broadly interpreted.
than 50% of the portfolio (but less than 100%) might be questioned.

C. RESTRICTIONS APPLICABLE TO THE SELECTION OF PENSION FUND ADVISERS

The Pension Fund Supervisory Commission adopted the Resolution of December 9, 1999 regulating the selection of pension fund advisers. \(^{64}\) The purpose of the Resolution is to ensure that the selection process for a pension fund adviser guarantees transparency and compatibility between the fund’s objectives and management procedures — as previously decided by its directors — and the criteria for choosing the adviser.

Before the selection process may begin, the objectives for the pension fund and the desired advisory style for its adviser must be defined. The fund’s objectives and desired advisory style may refer to investment time horizons, types of investments (including classes of financial activities, geographic areas and issuer categories), advisory styles, benchmarks, any guarantees of results and any other elements related to risk and return that would be useful in characterizing advisory services. The fund must also define the quantitative and qualitative requisites of the potential advisers, the duration of the assignment, any possibility for engaging sub-advisers and any other items to be considered in evaluating potential advisers. These items may include the following:

(i) general information on the candidate, with particular attention to the shareholders and the structure of the group to which it belongs;
(ii) the organization of the advisory activities, also with reference to relationships with other companies of the group;
(iii) the net assets of the candidate and the consolidated net assets of the group;

(iv) the asset amount for which advisory services are being carried out;
(v) the type of clientele and its stability;
(vi) the coverage of Italian and foreign markets, with specific reference as to how assets would be invested;
(vii) returns attained in performing advisory services for portfolios compatible with the type to be assigned by the fund;
(viii) advisory styles prevalently followed for portfolios compatible with the type to be assigned by the fund;
(ix) the organizational structure for the specific group to carry out the advisory services;
(x) methods of reporting aimed at insuring the transparency of results; and
(xi) manner of managing conflicts of interest.

An adviser wishing to be considered for the position must present the performance attained by clients of its advisory services. The candidate advisers must present such results in accordance with the following criteria:

(i) for portfolios for which it has investment discretion and on behalf of third parties compatible with the objectives predetermined by the fund and with the type to be assigned by the fund;
(ii) evaluating the portfolios at market price;
(iii) from a sufficiently ample multi-year time horizon, taking into account the assigned type specified in the tender;
(iv) utilizing a time-weighted calculation of return to neutralize the effects of liquidity flows on the portfolios;
(v) providing gross and net of management commissions and tax charges;
(vi) for each portfolio group, the median of results attained for each single portfolio weighed by the value of each portfolio, indicating the measure of the dispersion of the results of the single portfolios with respect to the median.
Advisory candidates must also provide a list of the portfolios for which the results are presented and those, if any, excluded, indicating the value, and in summary fashion, the type of portfolio. For portfolio groups for which results have been presented, information must also be presented about their composition (type of instruments, geographic area), use of derivative instruments and coverage of exchange risks, and volatility and level of risk. The Resolution also notes that it may be useful for the pension fund to require a comparison between the results presented and benchmarks compatible with the characteristics of the portfolio for which results are presented.

The pension fund must publish a tender for the role of adviser in at least two national newspapers. The text of the tender must include the following information:

(i) the name of the pension fund;
(ii) the asset amount for which advisory services are sought;
(iii) the fund’s objectives and desired advisory style;
(iv) the requisites for the adviser;
(v) the number of advisers sought with respect to each appointment;
(vi) the duration of the appointment;
(vii) the possibility of appointing sub-advisers;
(viii) a summary of the items contained in the questionnaire that will be used to evaluate candidates;
(ix) candidate selection procedures; and
(x) procedures and deadlines for filing the questionnaire.

The pension fund must prepare a questionnaire to collect the relevant information for the selection process. On the basis of the criteria set out in its the preliminary resolutions, the fund will evaluate the questionnaires. After the questionnaires have been examined, the pension fund will, by apposite resolution, identify the most highly qualified candidates and ask them to make an offer for the
tender. For every type of appointment, the number of candidates who are to be asked to make such offers is to be set so that a comparison may be made between a number of candidates appropriate for the number of advisers to be chosen.

The fund must evaluate the offers both from a quality as well as a price perspective. The price must be qualified with reference to all the cost elements relating to the advisory services.

The Pension Fund Supervisory Commission retains the right to ask for more information and documentation regarding the selection process.

As soon as the tender is published, the pension fund must provide the Pension Fund Supervisory Commission with a report, approved by its Board of Directors, regarding decisions made up to that point. The report must contain a copy of the tender and the questionnaire.

In filing the request for authorization of its choice of adviser, the pension fund must provide a follow up report on developments during the selection process.

VI. RULES REGARDING THE SALE OF FINANCIAL PRODUCTS VIA THE INTERNET

While answering certain specific questions, CONSOB set out a general position regarding the problem of promotion and placement of financial products and services through the Internet in a form of no-action letter (the “Communication”).65 CONSOB distinguished its analysis of Internet communications with respect to the use of an Internet site and electronic mail in support of an Internet site. The Communication clarified where an Internet site is deemed to be an instrument for the offering of investment services or products, such as mutual funds, in Italy. It also discussed certain requirements concerning the use of

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electronic mail with respect to financial services and products.

The Communication did not enter into a detailed discussion of the regulatory requirements for the offer or sale of financial services and products in Italy. However, strict requirements exist in Italy and these must be discussed to understand the framework of Italian regulations in this area. As discussed above, financial services and products cannot be offered in Italy without authorization from the Italian authorities, or notice to them as the case may be. Thus, with respect to mutual funds, the Draghi Decree, like prior Italian law, set out separate procedures for the offering of UCITS funds and non-UCITS funds, providing a notice regime for UCITS funds and an authorization regime for non-UCITS.

Once a UCITS fund has been notified into Italy, an authorized intermediary may sell such fund in Italy. An authorized intermediary, in this sense, means an Italian SIM with placement authorization, an Italian bank, a foreign bank authorized in Italy or an EU investment firm passported into Italy.

In determining the procedures by which such sales are permitted, Italy modified its existing legislation. The Investment Services Directive, 93/22/EEC, which explicitly excluded from its sphere of application door-to-door selling of transferable securities (Eighth Recital), permitted Member States to regulate this area autonomously. As a result, in implementing this Directive, Italy deemed out of office sales not as an autonomous activity of securities intermediation, but rather as one particular way of providing such investment services. As out of office sales was not an activity subject to mutual recognition and given the need for regulation to protect consumers in this area, Italy established special rules for this area, requiring that out of office sales be carried out by authorized financial salesmen. The Draghi Decree (Article 30), as implemented, sets out the rules governing out of office sales. These are deemed to be the promotion and
placement with the public of financial instruments in a location different from the registered offices or the offices of the issuer, of the person proposing the investment or the person charged with promotion or placement.

Similarly, with respect to distance selling, Article 32 of the Draghi Decree defined it as a technique of contact with the client, different from publicity, which does not involve the simultaneous and physical presence of the client and the offering person or his representative. Paragraph 2 of this Article gave CONSOB the power to regulate, in conformity with the principles set down in Article 30 of the Draghi Decree discussed above, the promotion and distance selling of financial services and products (apart from financial products issued by banks, different from shares or financial products permitting acquisition or subscription of shares or insurance products issued by insurance companies). Pursuant to this paragraph, CONSOB was also to indicate the cases in which persons authorized to provide financial services were to use financial promoters.

Notwithstanding the birth and tremendous growth of the offer of financial services and products via the Internet, CONSOB had not set out its views on whether an Internet site relating to mutual funds constituted an offer of such funds until the Communication and Newsletter.

A. INTERNET SITE

In the Newsletter, CONSOB declared that an Internet site would be deemed to be an out of office sales technique, governed by CONSOB Regulation 11,522/98, notwithstanding the inability of the manager of the site to contact the investor autonomously. As such, an Internet site may be deemed to make an offer aimed at Italian investors where its contents and the connected circumstances lead

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\(^{66}\) CONSOB Newsletter of July 12, 1999.
one to presume that the activities of promotion and placement have as their objective — even on a non-exclusive basis — persons residing in Italy.

With respect to the contents of the site, aspects of it that may indicate that the site is aimed at Italian residents include, but are not limited to, the following:

(i) the presence on a site of references to facts and circumstances relating to Italy (for example, economic and financial trends, tax regime, returns of financial products and investment services);
(ii) use of the Italian language; or
(iii) indications of prices and amounts in Italian Lire.

Otherwise, aspects of the site that may indicate that it offers products to Italian residents include, among other things, the following:

(i) operation in Italy of broker-dealers (or other non-authorized persons) through which it is possible to follow up or accept promotions or placements;
(ii) the dissemination of information, by information or publicity campaigns in Italy or otherwise, whether on an individual or mass market basis, having a purpose analogous to the site contents, whether or not the different means of communication are classifiable as distance selling techniques; or
(iii) the availability of the site through Italian research engines or research engines specializing in Italy and which in any case permit research to be carried out on sites of interest to Italian residents.

CONSOB, however, reserved the right to examine the specifics in each case to establish whether a site was aimed at Italian residents and to adopt all the necessary actions of supervision on the activities carried out.

Notwithstanding the above, the Communication noted that a site would not be deemed to be aimed at Italian residents if the site did not make it possible for Italian resident investors to follow up promotions or proposals presented on the site. Thus, one indication that the site is
not aimed at Italian residents might be the inclusion of an explicit, adequately highlighted warning clarifying that the content of the site is directed only to residents in states different from Italy because the site is not in conformity with the provisions in force in Italy. In this regard, the manager of the site must utilize procedures permitting it to effectively refuse acceptances or requests from investors residing in Italy or the site manager must effectively refuse every acceptance from investors residing in Italy.

The validity of contracts entered into through distance sales is suspended for a term of seven days from the date of signature by the investor. During this time, the investor may notify the manager of the site of his withdrawal at no cost or payment to anyone.

Administrative fines and criminal sanctions may be imposed for operating an Internet site with the goal of offering mutual funds to Italian residents without the proper authorization or notification, although from a practical matter this would not necessarily have a great impact on someone offering such services or products offshore.

CONSOB may also act pursuant to Article 54 of the Draghi Decree to prohibit the unauthorized offer of mutual funds over the Internet. CONSOB has recently issued a resolution (No. 12,410, not yet published) in which it prohibited the offer of a Non-Harmonized UCITS over the Internet. In this case, Tricalpa Finance Inc., with offices in the British Virgin Islands, offered a series of services to Italian clients, including collective management of savings, through a Non-Harmonized Fund called the "Millennium Bug International Fund." The fund was not authorized in Italy so CONSOB found a violation of Italian law.

Finally, in a recent case not yet published, where unauthorized services were provided, CONSOB turned the question over to judicial authorities, which, on their own initiative, blacked out the site in Italy.

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67 See Draghi Decree, supra note 1, at arts. 166, 191.
B. Electronic Mail

The Communication also noted the requirement to use financial promoters if the distance selling technique permits individualized communication and rapid interaction. This obligation does not exist if the activity is carried out on the initiative of the investor, unless this initiative has been solicited with messages personally addressed to the investor.

While the mere use of an Internet site does not require the use of financial promoters, CONSOB treats the use of electronic mail more rigorously than the mere presentation of a web site: contact through electronic mail is deemed to be far more direct. Accordingly, where electronic mail is used the persons interacting between the investment firm and the investor must be financial promoters authorized in Italy.

Financial promoters are not required to send messages confirming orders given or to send documents, even contractual documents, upon request of the investor if the request was not solicited by the employee, necessary for the purchase and selling of financial products or for the commencement of relationships regarding the providing of investment services with the investment company or other investment companies or information describing the offer or investment services or financial product offered.

An employee who is not a financial promoter must refrain from using electronic mail to send proposals of promotional content.

As with the improper use of an Internet site, if electronic mail is used other than as set out above, administrative fines and criminal sanctions may be imposed. 69

The investment firm has the burden of setting up procedures that permit verification of whether the investor

68 CONSOB Resolution No. 11,522 of July 1, 1998.
69 See Draghi Decree, supra note 1, at arts. 166, 191.
has received proposals or offers from the personnel corresponding with the investors by electronic mail.

Electronic mail is considered to be carried out in Italy if the addressee of the message resides in Italy.

VII. CONCLUSION

With the recent growth in investments in mutual funds in Italy (growth that is likely to continue, particularly in light of the changes in the pensions system), Italy has become an increasingly attractive market for foreign mutual funds and investment advisers. Given the recent regulatory changes and the increasing ease and speed of foreign entry into the Italian investment company market, it should become apparent by the end of the year 2000 whether the regulatory improvements are only illusory or instead will enable a real sea change in the Italian funds market.
Non-Compete Obligations of Departing Star Partners and the Right of Clients to Their Continued Services

Tamar Frankel

The Investment Company Act of 1940: Why the Time Has Come to Revive Section 3(b)(1)

Brian J. Lane and Gillian McPhee
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