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MiFID: history and evolution of investor protection regulation and analysis of its application in Banca Generali

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INDEX:

INTRODUCTION 6

CHAPTER 1: PRE-INTODUCTION FINANZIAL-HISTORICAL BACKGROUND OF THE LEGISLATION

1.1 Dot.com bubble 7

1.2 Market consequences of 11/09/2001 12

1.3 Enron collapse 15

1.4 2007-2008 sub-prime mortgage collapse and great recession 2009 19

1.5 Year 2008: Bernard Madoff and the Biggest Ponzi Scheme in History 23

CHAPTER 2: MIFID REGULATION: COMPREHENSION THROUGH PRACTICAL APPLICATION IN BANCA GENERALI

2.1 Definition 26

2.2 The legislative development rationale 26

2.3 The evaluation and review process 32

2.4 Investment advisory services 33

2.5 The importance of regulation from the perspective of the capital markets union and the green paper of September 30, 2015 35

2.6 MiFID regulation objectives 39

2.6.1 The centrality of investor protection 39

2.7 Differences between ISD and MiFID 42

2.8 The organization of markets in the light of legislation 42

2.9 Example of enforcement in customer relations in Banca Generali 43

2.10 Product governance and target market: application in Banca Generali 45

2.11 Cost and charge disclosure: application in Banca Generali 46

2.12 Adequacy, appropriateness, and mere execution of orders: application in Banca Generali 47

2.12.1 Execution only service 48

2.12.2 Appropriateness and adequacy assessment model 49

2.13 Financial instruments valuation: application in Banca Generali 52

2.13.1 The ISR of the advisory perimeter 53

2.13.2 Adequacy control – Appropriateness of the order 53

2.13.3 Control by object type 54

2.13.4 Control by frequency 54

2.13.5 Check by side 55

2.14 Professional clients, retail clients and eligible counterparties: introduction 55
2.15 The organizational requirements of intermediaries 58
2.16 Concluding reflections on current law 58
CHAPTER 3: FOCUS CLASSIFICATION, CUSTOMER MANAGEMENT AND SUSTAINABILITY AT BANCA GENERALI
Introduction 60
3.1 Banca Generali focus on customer classification and management 60
3.1.1 Identification of the levels of protection assigned to each customer category 64
3.1.2 Customer acquisition methods 65
3.1.3 Communication and recording of customer classification in the computerized procedure 66
3.1.4 Change of customer class 67
3.1.4.1 Transition from eligible counterparty to retail or professional client 67
3.1.4.2 Transition from retail customer to professional customer on demand 67
3.1.4.3 Transition from professional to retail customer 69
3.1.4.4 Revision of the classification of professional clients 70
3.1.5 Functions responsible for carrying out checks on classification activity 70
3.1.6 Special ways of classifying customers 70
3.1.7 Customer classification process 73
3.1.8 Classification of new customers 74
3.1.9 Change of classification 76
3.1.10 Network of financial advisors 76
3.1.11 Network of relationship managers 80
3.1.12 MiFID classification alignment of generfid trust mandates 81
3.1.13 Derogation management customer classification 82
3.1.14 Classification review and period checks 83
3.2 Sustainability in the adequacy assessment 83
3.2.1 ESG suitability in MiFID regulation 84
3.2.2 Delegated regulation (EU) 2021/2153 85
3.2.3 The Banca Generali model 86
3.2.4 MiFID questionnaire: subsection sustainability 86
3.2.5 The ESG score of products 87
3.2.6 The ESG adequacy assessment: consistency check 88
3.2.7 Suitability report 88
3.2.8 The ESG guide 89

CHAPTER 4: MIFID IN THE CURRENT CONTEXT AND POSSIBLE FUTURE EVOLUTION

4.1 Current economic and financial context 91

4.1.1 Introduction 91

4.1.2 Cripto: FTX failure 91

4.1.3 Bank crisis 94

4.1.3.1 SVB and the crisis of the regional banks 94

4.1.3.2 Credit Suisse 97

4.1.3.3 Deutsche Bank 100

4.2 Enforcement issues during the crisis 102

4.3 MiFID III 104

4.3.1 MiFID III objectives 106

4.4 Conclusions 112

Bibliography 114

Sitography 115

INTRODUCTION

The condition of the economic environment and historical reality is particularly constraining with respect to the assumptions of choice in the financial market where the user must try his or her hand at investment evaluation.
In the present day, the market changes connotation, opening a new path to information-dominant computer platforms. From the physical place to the digital platform, financial markets are regulated by national regulations and international laws where each economic precept is constantly binding with respect to the possibilities offered for usability. The evolution of the industry offers a wide range of financial products and instruments, but they are not always perceived and chosen in a condition to secure a degree of trust and risk. Before getting to the point of deciding how and what to invest in, regulation has introduced many elements that define a profile with respect to the objectives and the figure of the intermediary. The possibility of being able to interact in a direct way is almost conditioned by relationships with other parties who with other roles become "intermediaries" to whom we entrust our trust.
Having anticipated the great significance of the economic environment of the market in a given period of time, the first chapter of the paper aims to expose and understand the period, and the major events that characterized it, that anticipated and accompanied the introduction of the first form of investor protection legislation.

The second chapter will deal with all aspects of the current version, i.e. MiFID II, of the regulation, and its understanding by illustrating how one of the most important Italian banks, Banca Generali, manages its procedures on the basis of it.

The third chapter delves into the classification and management of customers and compliance with the sustainability standards that financial institutions must meet, among other issues covered by the regulations.

The fourth and final chapter takes stock of the regulation's work by illustrating the current context, characterised by a high degree of uncertainty, and the aspects that will and must be improved or implemented through the upcoming new version, MiFID III.

CHAPTER 1:
PRE-INTODUCTION FINANCIAL-HISTORICAL BACKGROUND OF THE LEGISLATION

The period prior to the introduction of MIFID, the European directive that has as its main objective the protection of the small investor, was characterized by economic-financial events that, because of the importance they represented, still have, or, had until recently, effects on the functioning of the world economic system today.

All of the events that will be described below have several common features, which have made evident the inadequacy of systems for controlling the behavior of financial institutions and the innate tendency of these institutions to continually abuse the small investor.

The study of the events under consideration aims on the one hand to make clear how inherent in the human mind and especially in financial institutions is the idea of prevailing and making a mockery of the small institutional investor, and on the other hand to frame how it was possible for these abuses to happen with a certain frequency.

Precisely because of this, it is possible to understand why it was deemed necessary to introduce an international directive with the sole purpose of protecting the small investor.

Since it was impossible to act and leverage the goodness of man, the institutions opted to act on the economic-financial environment, reducing the possibilities of consumer circumvention through the application of stricter rules in every sphere of the typical financial institution, from accounting to the purely financial market-related, via the social sphere.

Like any introduced rule, however, its mere introduction is not enough; its compliance and proper wording become crucial, as attempts at circumvention are continuous. For this reason, along with the constant change in the economic-financial environments, perhaps the most dynamic ones in existence, the process of investor protection, which began in the early 2000s, has already undergone major changes, with the reformulation of the directive in its new form; the so-called MIFID ii, and will undergo more according to forecasts, there is already talk of a third version.

No one can say for sure whether this will be the last step in this process, what is certain, however, is that it will be yet another sign that continued action to protect investors is imperative and that the topic in question is increasingly relevant and objects of discussion.

The following will look specifically at cases with different origins and consequences but all of equal importance that helped initiate and change the process of protecting the individual investor.

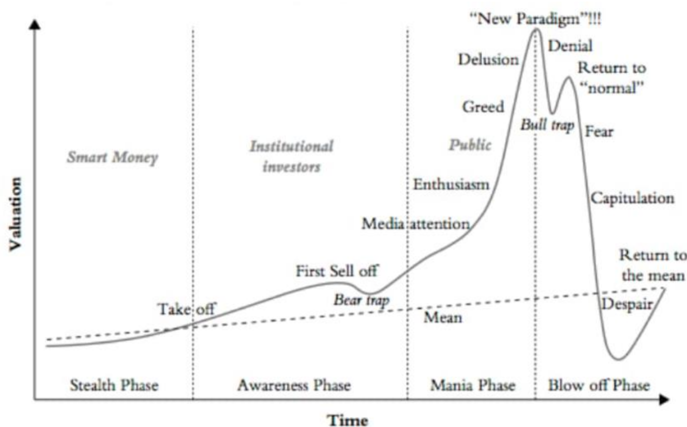
1.1 **DOT.COM BUBBLE**

Also known as the "Internet bubble"[1], the bursting of the dot-com bubble in 2000 represents one of the most important events in recent history.

From 1995 to 2000, the growth and adoption of the Internet[2] drove speculation on the industry's stock. It quintupled in value, in fact, to collapse by more than 80 percent during the last quarter of 2002. The collapse marked the end of many technology companies, most of which had leveraged the Internet to offer shopping, communication and news services.

Like any other crisis generated by a speculative bubble, the Dot.com crisis developed through the classic sequence[3]:

- extreme investor confidence in the potential of a product/company
- rapid growth in the price of the product
- event that shakes expectations of major gains
- high sales flows
- final collapse of the product price.



1.1 Typical Bubble path

In fact, this sequence of events had been observed in the 1840s during the railroad boom, in the 1920s for automobiles and radio, in the 1950s with respect to electronic transistors, and in the 1980s for home computers and biotechnology.

(a) CONTEXT

The World Wide Web was launched in 1989, opening to the public in mid-1991. It was the beginning of a 'new world order,' and Internet adoption accelerated from 1993 through the launch of

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[1] The intelligent investor, Benjamin Graham, 2003 Edition
[2] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition
[3] Anatomy of a Typical Bubble, Jean Paul Rodrigue 2015

publicly available browsers. Of course, soon everyone focused their efforts on commercializing the Internet. Start-ups emerged every other day, and large amounts of capital were allocated within companies that were expected to play a major role in the Information Age.

In 1994, with the listing of Netscape, the company that developed the first commercial Internet browser, a new economic cycle, dubbed the New Economy, began.

The New Economy contrasted with the Old Economy, which was predominantly based on the manufacturing sector. [4]

Within a few years there was the astonishing development of companies operating in the Internet sector or, more generally, in the IT sector, called Dot-com[5] companies (from the '.com' suffix of the sites through which such companies typically operated), also facilitated by the low cost of capital in an environment of low interest rates (between 1995 and 1999 the Central Bank of the United States reduced the official rate from 6 percent to 4.75 percent).

The dot-com bubble was caused by several factors, chief among them the overvaluation of this type of company. Valuations, in fact, were made using high multipliers as well as unreasonable metrics, leaving out some vitally important ones, including cash flow and profit generation, at the expense of which analysts focused instead on matters of little importance, such as web traffic and possible future impact.

The media frenzy and the availability of easy capital in turn contributed to the bubble. An environment where it was easy to obtain credit and a favorable tax regime allowed investors to aggressively speculate on the high-growth sector.

Moreover, there was no pressure to start generating money in the short term: investors were convinced that they were investing to 'change the world.' The media, then, vastly exaggerated the lucrative nature of the Internet, leading investors to have unrealistic expectations about their investments.

In the United States, moreover, it was easy to get money. A 1997 law had cut the capital gains tax liability, prompting investors to make many more speculative bets in the markets. Add to that the so-called FOMO (fear of missing out), the rampant fear of being cut off from the big Internet deal, and investors were opening their portfolios without a second thought.

The bubble continued to accelerate during the beginning of the first millennium, with dot-com companies dominating headlines across the board.

During the 2000 Super Bowl, dot-com companies took up 20 percent of the advertising space (in 1999 they had run only two commercials). The frenzied buying of Internet-based stocks led to a

[4] The intelligent investor, Benjamin Graham, 2003 Edition
[5] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition

bubble peak on March 10 of that year, when Nasdaq stocks reached a total value of more than $6.7 trillion.
The market started to fall on 11 March 2000, and several fundamental problems began to put securities under increasing pressure.

1.2 Graph plotted Trading View

News spread that Japan, where many companies were headquartered, was entering a recession, while in the U.S. a merger between Yahoo and eBay had blown up. Microsoft lost a major legal battle, and investors became increasingly aware of the risks posed by technology stocks. Capital abandoned "bubble stocks" and poured into companies with an established business model. The Nasdaq, just a month after its March peak, lost about $1 trillion.
Finding themselves in the spotlight, dot-com companies[6] began to behave more fiscally responsible, but by then it was too late. Most of the companies declared bankruptcy, and the focal point was the closing of Pets.com in November 2000. The company had been listed only nine months earlier and had enjoyed the support of Amazon. By that time most tech companies had lost more than 75 percent of their value, and the collapse continued into 2001 in which many Dot-com companies closed or were subject to takeover and merger deals.
That year's Super Bowl saw only three commercials from Internet companies[7]. The bear market was made worse by the balance sheet scandals of some large companies that surfaced between mid-2001 and late 2002.
The market hit its lowest point in October 2002, with the Nasdaq marking about 1,100 points-a loss in market capitalization of more than 5 trillion from its peak.

[6] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition
[7] The intelligent investor, Benjamin Graham, 2003 Edition

In 2004, only 50 percent of the companies listed in 2000 were still trading at infinitesimal prices compared to their highs. Few solid companies managed to grow in the following years (Amazon, eBay, Apple).

(b) LESSONS LEARNED

Important lessons can be learned from the dot-com bubble, lessons that investors should treasure to avoid getting caught up in such collapses. In particular, one should always remember that doing the necessary research before investing money in a security is of paramount importance. Instead of falling into the trap and investing in the companies on everyone's lips, investors should analyze the fundamentals of a company and its ability to generate sustainable profits over time. During the dot-com bubble, companies without a solid business model and that had not yet proven themselves capable of generating cash flow were able to access massive bank financing without too much trouble. Investors would later find themselves paying a high price for their recklessness.

The important lesson is that business fundamentals should never be ignored. Investors should also avoid investing based on a company's future prospects and should be careful about investing in sectors they are unfamiliar with. Most investment activities during the dot-com bubble were purely speculative. Many investors did not understand computers, let alone the Internet, and did not take the time to study it.

Most investors were convinced they were taking part in the 'new economy,' but they did not understand how companies would exploit the Internet to make money consistently. In the end, their ignorance was not blissful, and the market punished them mercilessly.

During a market correction, it is the overvalued stocks that suffer the most by prolonging the decline. At the time, it was common sentiment that dot-coms were overvalued, and they had high betas (above 1). To give an example, a company with a beta coefficient of 0.5 would rise a maximum of 50 percent during a boom, or lose half its value during a slump. At the time, Internet stocks had a beta coefficient greater than 1-meaning that they would indeed be profitable during periods of growth, but also that they would lose almost all of their value during a market correction or crash.

(c) CONCLUSION

The dot-com bubble[8] of 2000 shows us how technology can generate a fervor that could quickly turn into a bubble. But when there is something new and trendy and likely to generate major profits, investors should invest knowledgeably, never completely ignoring the fundamentals. In addition, it should not be forgotten that any high-yield opportunity has high risks. Consequently, it is necessary to approach any new or trending opportunity with the appropriate investment criteria that are

[8] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition

applied to other forms of investment. Excitement and buzz should never replace fundamentals and sound business models.

Company	MCap US$bn	Company	MCap US$bn
Microsoft	**473**	Apple	1,533
Cisco	451	**Microsoft**	**1,489**
Intel	**387**	Amazon	1,343
Oracle	202	Alphabet	866
Sun Micro	171	Facebook	520
Worldcom	130	**Intel**	**243**
Dell	110	Nvidia	225
Qualcomm	98	Adobe	205
Applied Mats	71	Netflix	195
Amgen	66	Paypal	201

1.3 Top 10 mkt cap firms 2000 vs 2020

1.2 MARKETS CONSEQUENCES AFTER 11/09/2001

Markets do not like uncertainty. This is the premise for explaining and documenting the performance of stock markets straddling periods of war and geopolitical tension. The widespread volatility that connotes such a period is always brought about by a widespread climate of uncertainty among investors, and historically that climate has always relaxed ending tensions when, indeed, the stock markets return to rally.

When America was attacked by terrorists on September 11, 2001, the entire business community was affected. Stock markets immediately collapsed and almost every sector of the economy suffered extensive economic damage.

The U.S. economy was already going through a moderate recession following the dot-com bubble, and the terrorist attacks added further damage to the already struggling business community.

Almost miraculously, however, the markets and the economy in general recovered in a relatively short time. By the end of the year, U.S. Gross Domestic Product (GDP), the total value of all goods and services, had increased over the previous year by about 1 percent, to over $10 trillion, demonstrating that the economy had not been critically damaged by the September 11 attacks. In particular, decisive was the last quarter of the year, when, according to the Bureau of Economic Analysis (BEA), GDP increased by 2.7 percent.

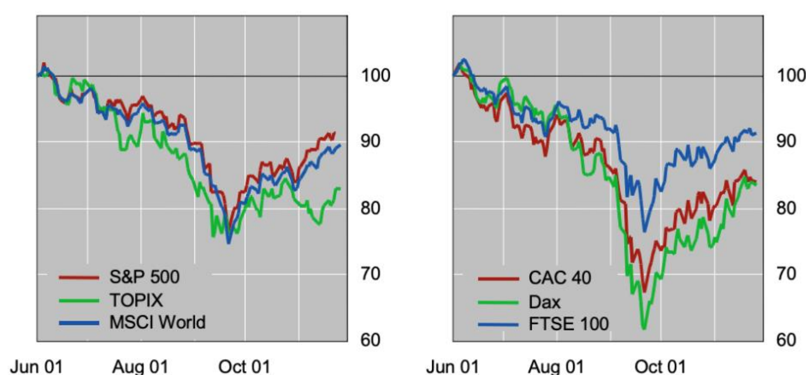
(a) MARKET REACTION

Anticipating market chaos, panic selling and a disastrous loss of value as a result of the attacks, the NYSE and Nasdaq remained closed until September 17, the longest closure since 1933. In addition, many trading, brokerage and other financial companies had offices in the World Trade Center and were unable to operate after the tragic loss of life and the collapse of both towers.

On the NYSE's first trading day after 9/11, the market fell 684 points, down 7.1 percent, setting at the time the record for the largest loss in the history of the exchange for a single trading day (this figure was later eclipsed by the market's reaction during the global coronavirus pandemic).[9]

At the close of trading on that Friday, at the conclusion of a week that saw the largest losses in NYSE history, the Dow Jones, which was down nearly 1,370 points, and the S&P lost 14 percent and 11.6 percent, respectively.[10]

It is estimated that a total value of $1.4 trillion was lost in those five trading days.



1.4 Stock Market Indices – Datastream

As expected, when trading resumed, the biggest declines hit the airline and insurance sectors. Hardest hit were American Airlines and United Airlines, carriers whose planes were hijacked because of the terrorist attacks.

The immediate impact on business was significant, with gold prices jumping from $215.50 an ounce to $287, reflecting the uncertainty and flight to safety of nervous investors.

Oil and gas prices also shot upward on fears of reduced oil imports from the Middle East. Within a week, however, these prices fell back to the approximate pre-attack levels as no new attacks occurred and crude supplies to the United States from the usual sources continued uninterrupted. Gold prices also fell for the same reasons.

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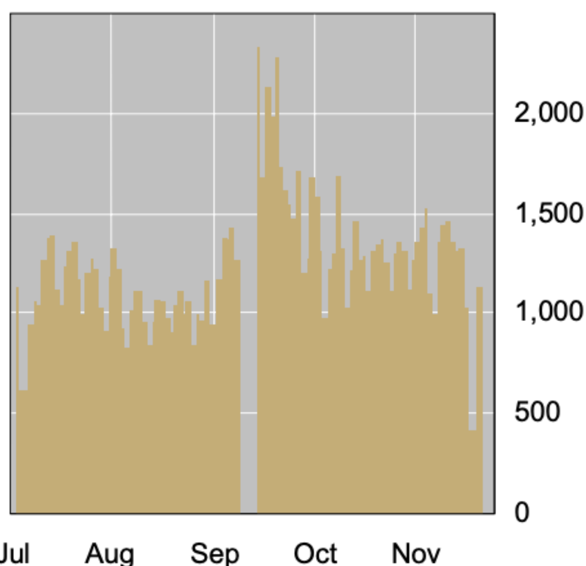
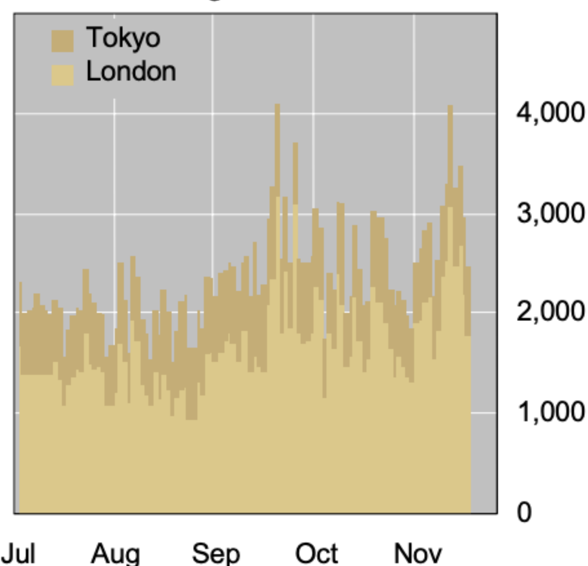
[9] The intelligent investor, Benjamin Graham, 2003 Edition

[10] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition

Some equity sectors, however, posted major gains after the attacks. Some technology companies, as well as weapons and defense suppliers, saw their shares rise. Many of the buyers were investors who expected an increase in government activity as the country prepared for the long war on terror. Share prices also rose for communications and pharmaceutical companies.

On national options exchanges, including the Chicago Board Options Exchange, the world's largest, put and call volume rose accordingly.





1.5 Daily trading volume after the attack - Bloomberg

Put options, which allow the investor to profit if a particular stock falls in price, have been bought in large numbers on airline, bank and insurance stocks. Call options, which allow the investor to profit if a stock goes up in price, were bought on companies in the military and defense sectors. In the short term, many investors who bought these options made money.

The September 11 attack halted the stock market for almost a week and revealed its vulnerability to physical destruction. Although the NYSE building was not damaged, many communication links were disrupted by the fall of the two trade towers. The reopening of the NYSE was hampered by the nearby Ground Zero recovery operation.

In response, the NYSE and other exchanges took drastic measures to strengthen their defenses against a physical disruption, largely switching to electronic trading. While this has made U.S. markets less vulnerable to physical attacks, it has also made them much more vulnerable to a major cyber-attack.

"With the digitization of our lives, which has generally been a great blessing, we have sown the seeds for even greater destruction in terms of our ability to hack our systems," said former Securities and Exchange Commission Chairman Harvey Pitt, who led the agency on Sept. 11, 2001. "It is today's equivalent of a 9/11 attack. There is a potential 'black swan' event every single day," Federal Reserve Chairman Jerome Powell shares a similar view.

In the long run, the stock market and the U.S. economy have experienced strong growth despite the short-term negative impact of the attack. In the nearly 20 years since 9/11, the S&P 500 Index has risen nearly four times, despite periods of sharp declines, including the financial crisis of 2007-2008. [11]

During this period, the U.S. economy has experienced several long expansions, despite severe disruptions, including the Great Recession from December 2007 to June 2009 and the economic consequences of the COVID-19 pandemic.

But the consequences of 9/11 still weigh on the United States today. For decades, taxpayers could pay trillions of dollars in interest on the debt used to finance the wars in Iraq and Afghanistan, weighing on the economy.

Although the government funded the wars with debt, not taxes, taxpayers have already helped pay nearly $1 trillion in interest on the trillions of dollars of debt used to finance the two wars, according to the Watson Institute at Brown University. These interest costs are expected to rise to $2 trillion by 2030 and $6.5 trillion by 2050.

1.3 ENRON COLLAPSE

At the beginning of 2001, Enron was the seventh largest company in the United States. It was only between the following spring and summer that the rest of the world became aware of one of the biggest scams in Wall Street history. A saga of greed, crime and conceit that ended on December 2, 2001, with one of the largest bankruptcies in history. A scandal that led to dozens of convictions, left some 20,000 people out of work and blew billions of dollars in pension funds. [12]

Enron's story had begun 16 years earlier in Houston, with the merger of Houston Natural Gas and InterNorth, two mid-sized energy companies.

The founder, Kenneth Lay, was the son of a Missouri Baptist pastor, whose during the Reagan years had become a prophet of energy market deregulation and one of the industrialists with the most influence in Washington.

[11] The intelligent investor, Benjamin Graham, 2003 Edition

[12] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition

In 1990 Lay chose as his right-hand man Jeff Skilling, a McKinsey consultant with whom he had worked three years earlier. Skilling transformed Enron: from a traditional energy company to a kind of natural gas exchange that treated energy as a financial instrument to be traded, on par with stocks and bonds.

In the 1990s, Enron expanded in short order from natural gas to industries such as electricity, water, even broadband and paper. Its international expansion projects, from water concessions in England and Argentina to the construction of power plants in India and Brazil, helped grow revenues at an average rate of 65 percent annually between 1996 and 2000. Between 1999 and 2000, in particular, revenues rose from $40 billion to $101 billion. Until a few weeks before the bankruptcy, Enron declared itself convinced that it could double that figure by 2001: with sales of about 200 billion, it would be America's second largest company, after Walmart.

The stock followed the same trend on Wall Street, the stock value rising almost uninterruptedly between the second half of the 1990s and the beginning of the 20th century. Even in 2000, the year the dot com bubble burst, the stock rose 87 percent, compared with -10 percent for the Standard & Poor's 500 index average.[13]

($ millions)	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Domestic: Pipelines								
Revenues	$1,466	$976	$831	$806	$1,416	$1,849	$2,032	$2,955
Earnings[a]	382	403	359	570	580	637	685	732
Domestic: Trading & Other								
Revenues	$6,624	$6,977	$7,269	$10,858	$16,659	$23,668	$28,684	$77,031
Earnings[a]	316	359	344	332	766	403	592	2,014
International								
Revenues	$914	$1,380	$1,334	$2,027	$2,945	$6,013	$9,936	$22,898
Earnings[a]	134	189	196	300	(36)	574	722	351
Stock Performance								
Enron	25%	5%	25%	13%	−4%	37%	56%	87%
S&P 500	7%	−2%	34%	20%	31%	27%	20%	−10%
Major Business Events	Teesside opens	Begins electricity trading		Begins construc-tion of Dabhol plant	Acquires Portland General Corp.	Acquires Wessex Water in U.K.	Creates Enron-Online	Trading contracts double Calif. energy crisis

1.6 Firm and stock market performance 1993-2000 , Enron 10-Ks

Yet as early as 1999, journalist Mimi Swartz wrote in Texas Monthly, a rumor began to circulate in Houston that "Enron was nothing but a house of cards." "That phrase was heard at water coolers at downtown banks, or at dinners with guests who worked for the competition. Usually, those who

[13] The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron, Alex Gibney, 2005

uttered those words would shake their heads with the air of someone who knows, but is used to being ignored." [14]

That house of cards, as investigations, books and documentaries on the case have revealed, was based on a number of ploys.

One was called mark-to-market and was an accounting system generally adopted by financial trading firms. In short, it provides that when a contract is signed, the expected revenues are immediately put on the balance sheet. Basically, the executives were saying, 'Ten years from now we will sell the energy from this plant for X dollars a kilowatt.' And there was no way to prove that would really be the case," summarized former Enron executive Mike Muckleroy in the Oscar-nominated documentary Enron - The Economics of Scamming.

Enron invested, for example, in a billion-dollar power plant in India and recorded the revenue it thought it would make in the following years. Money that, in fact, never came: the "smartest guys in the room" had not calculated that Indians could not afford to buy that energy. Overall, the investment lost Enron about $900 million.

Another ploy-the most complicated-was the use of special-purpose entities (s.p.e.), or project companies. Journalist and sociologist Malcolm Gladwell explained it this way in the New Yorker: "Your company is not doing well. If you ask a bank for a $100 million loan, that bank will charge you a very high interest rate, or not at all. However, you hold some oil concessions that will almost certainly yield $100 million over the next five years. So you give them to an s.p.e. that you set up with outside investors. The bank then lends the 100 million to the s.p.e., which turns it over to you." At the time, these transactions did not have to be recorded on the balance sheet. "A company can thus raise capital without incurring debt. And since the bank is almost certain that the concessions will generate the money to repay the debt, it is willing to grant a low interest rate."

Enron adopted the s.p.e. system, which was legal and widespread. But it introduced a couple of variations: it transferred much less reliable assets than oil concessions to these companies and, most importantly, it did not involve outside investors. The s.p.e.'s, on the contrary, were led by executives from the company itself. "Enron was not selling parts of the company to outside entities, but to itself," Gladwell wrote. "A strategy that was not only legally questionable but also extraordinarily risky."

Creative accounting, however, was not always enough to achieve quarterly targets that the U.S. Department of Justice called "unrealistic and unachievable, in line with analysts' expectations and not real or reasonable results." Set, that is, to bolster the image of a booming company. Former employee Max Ebert recalled in Enron - The Economics of Fraud: "It always seemed that achieving

[14] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition

the goals was impossible. Yet, as if by a miracle, we always succeeded. If we asked how it was possible, our boss always answered with one word: 'California.'" [15]

By the late 1990s, Enron had entered the California electricity market, which was deregulated in 1996 under pressure from energy companies. Between 2000 and 2001, the state was hit by dozens of blackouts not justified by the state of the grid. Records that emerged after the bankruptcy revealed that Enron had pressured employees at various power plants to invent maintenance activities and cause outages. Plant shutdowns thus created artificial shortages, which drove up the price of energy. In a recorded conversation during a fire that caused a blackout, which emerged during the investigations, a trader said, "Burn, baby, burn! It's beautiful." Another wished for "a good earthquake" that would "float California over the Pacific."

If Enron had taken 16 years to become one of the world's largest companies, it took only a few months for it to dissolve. Rumors about its accounting intensified, the stock began to fall in the spring and continued throughout the summer.

It did not stop even when, on August 14, Jeff Skilling suddenly resigned. On September 9, 2001, the New York Times paraphrased Shakespeare and headlined, "There's Rot in the State of Enron," while in October the Wall Street Journal published more articles about the company's more opaque dealings. The Securities and exchange commission - the equivalent of Italy's Consob - launched an investigation. In the same days, the accounting firm hired by Enron, Arthur Andersen, shredded a ton of documents.

When even the possibility of a bailout through a sale on balance to another energy company faded in late November, rating agencies reduced Enron's stock rating to 'junk': the shares were now worth pennies.

1.7 Enron stock price

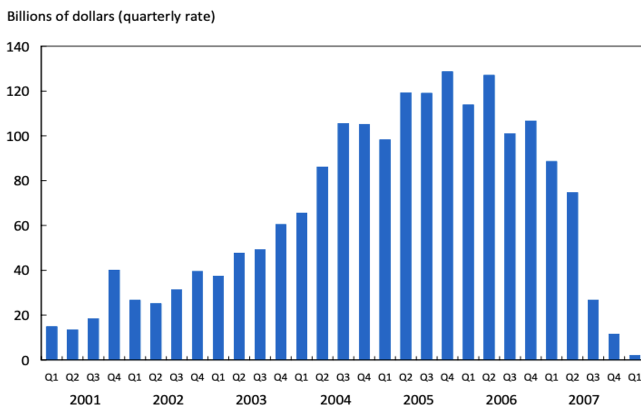
[15] The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron, Alex Gibney, 2005

On December 1, Enron's board of directors voted unanimously to declare bankruptcy. Employees were informed on the morning of December 3. They had 30 minutes to leave the premises.
A year after Enron's collapse, Nobel Prize-winning economist Paul Krugman said that in the future "not the 9/11 massacres, but the Enron scandal would be seen as the great turning point in U.S. history." In 2002, in fact, the U.S. Congress passed a law requiring greater transparency on accounting records. Today it can be said that that regulation was not enough. [16]
In 2001 Enron had $65 billion in assets and its bankruptcy was the largest in American history. As many as six companies later surpassed it. After the nearly $700 billion collapse of Lehman Brothers, Sam Buell, a Duke University law professor who had represented the prosecution in the Enron case, said that "the scams were of the same kind. No one seems to have learned their lesson."

1.4 2007-2008 SUB-PRIME MORTGAGE COLLAPSE AND GREAT RECESSION 2009

The seeds of the financial crisis were planted during years of rock-bottom interest rates and loose lending standards that fueled a housing price bubble in the U.S. and elsewhere.
It began, as usual, with good intentions. Faced with the bursting of the dot-com bubble, a series of corporate accounting scandals, and the September 11 terrorist attacks, the Federal Reserve lowered the federal funds rate from 6.5% in May 2000 to 1% in June 2003.
The aim was to boost the economy by making money available to businesses and consumers at bargain rates.
The result was an upward spiral in home prices as borrowers took advantage of the low mortgage rates. Even subprime borrowers, those with poor or no credit history, were able to realize the dream of buying a home.
Available to them, in fact, were the so-called ninja mortgages: no income no job and assets.
These represented mortgages issued to individuals who offered no collateral whatsoever, which initially featured low interest rates of around 1 percent, later rising to 7 to 8 percent.[17] The banks then decided to sold those loans on to Wall Street banks, which packaged them into what were billed as low-risk financial instruments such as mortgage-backed securities and collateralized debt obligations (CDOs). Soon a big secondary market for originating and distributing subprime loans developed.[18]

[16] The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron, Alex Gibney, 2005
[17] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition
[18] The intelligent investor, Benjamin Graham, 2003 Edition



1.8 Gross issuance of Subprime mortgage-backed securities

This allowed banks to monetize the loans they issued immediately, without waiting years for their payment.

Fueling greater risk-taking among banks, the Securities and Exchange Commission (SEC) in October 2004 relaxed the net capital requirements for five investment banks-Goldman Sachs (NYSE: GS), Merrill Lynch (NYSE: MER), Lehman Brothers, Bear Stearns, and Morgan Stanley (NYSE: MS). That freed them to leverage their initial investments by up to 30 times or even 40 times.

The Fed started raising rates in June 2004, and two years later the Federal funds rate had reached 5.25%, where it remained until August 2007.

This caused real hardship to many Americans. Their homes were worth less than they paid for them. They couldn't sell their houses without owing money to their lenders. If they had adjustable-rate mortgages, their costs were going up as their homes' values were going down. The most vulnerable subprime borrowers were stuck with mortgages they couldn't afford in the first place.

Meanwhile, CDS; credit default swaps began to circulate on Wall street.

They were like insurances from the failure of a borrower, you paid every 3/6 months a counterparty that provided protection from possible credit risk.

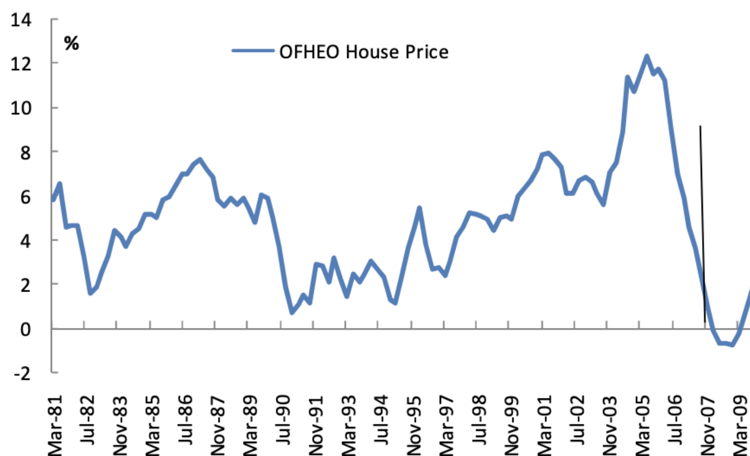
Once it began to become clear that the mortgages contained in CDO's would never be paid off, people began to pounce on buying CDSs, the price of which skyrocketed.

So many American and European banks had not hedged against the risk associated with the CDO's, convinced that the housing market was too solid to collapse, and their balance sheets were full of now worthless subprime mortgages.

Numerous investment banks failed, but despite this, the U.S. government still did not see fit to intervene.

When news began to circulate that Lehman Brothers was failing, the U.S. government declared that it would not intervene in any way to bail it out but, nevertheless, the following day it decided to

intervene by bailing out an insurance company instead: the AIG (american international group) which was deemed "too big to fail," that is, too important to fail.
AIG played a key role in the years leading up to the 2008 financial crisis: they were, in fact, the first to sell CDSs. [19]
It was America's largest insurance company and had relationships with almost every bank in the world and branches in more than 80 countries.
They made immense profits but did not keep the cash on hand to be able to repay these insurances in case the worst happened; they relied as many did on the fact that, at the time, it seemed highly unlikely that the housing market would burst.
Instead, in 2007 the housing market collapses and millions of Americans can no longer pay their mortgages, the CDO's implode into themselves, no longer worth anything.



1.9 Total annual percentage house mkt change

The banks do not lose confidence, at least those that had hedged against the risk, so they come to AIG demanding to be paid, AIG realizes too late perhaps that it has gone too far with CDS missions and realizes that it cannot pay the banks, which begin to collapse. [20]
On September 15, 2008, AIG's coffers are completely empty; on the same day Lemahn Brothers loses 80 percent on the stock market before it even opens.
At this point the U.S. government comes to the conclusion that if AIG had failed, the economy of the whole world would probably have been in jeopardy, having almost every bank and insurance company in the world policies and shares in it.

[19] Random Walk Down Wall Street, Burton G. Malkiel, 2016 Edition
[20] The intelligent investor, Benjamin Graham, 2003 Edition

On Sept. 16, 2008, the Fed bought 80 percent of the insurance company's shares and appointed a new CEO, charged with unraveling the huge skein created in previous years, the total cost of the bailout amounting to more than $150 billion.

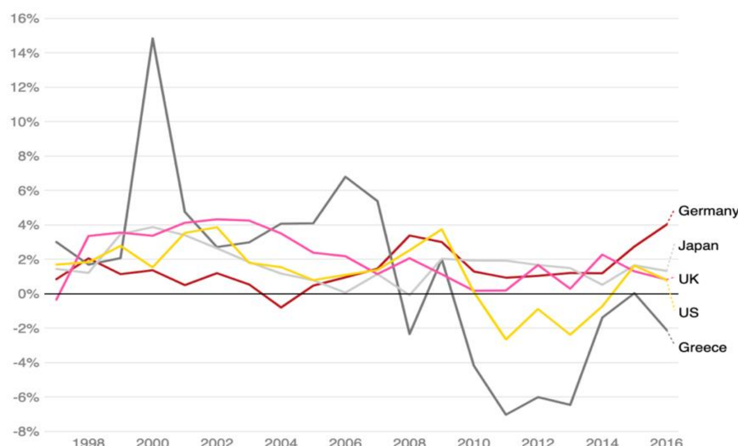
In March 2009, the insurance company posted a loss of $61.7 billion; it was too late for the U.S. economy: the Great Recession began.

Medium-sized businesses had also suffered heavy losses and thus began to spend less and less; lending institutions that until recently had been lending to anyone now lent to almost no one; the U.S. government managed not to derail a train that was already almost off the tracks; with a wave of bailouts and bank mergers it managed to keep the real economy already on its knees from collapsing and the banking system from collapsing for good.

Also in America, there was a series of nationalization and privatization operations, thanks to a plan approved on September 19, 2008: the troubled asset relief program or tarp in Italian.

It consisted of a $700 billion plan, which involved the purchase of all securitized instruments from the balance sheets of troubled banks to revalue them and then sell them back to the market, the U.S. government also bought preferred shares in many of the most important banks, including Wellsfargo, J.P. Morgan and Bank of America, at the same time transforming various investment banks into commercial banks.

Despite this, a systemic crisis was already underway: the effects of the U.S. disaster were also beginning to be felt in Europe, where many banks had securitized instruments on their balance sheets that no longer had any value, member countries that already had imbalances in their balance sheets risked bankruptcy, and only government intervention was able to stop the collapse of countries such as Greece, Portugal, Ireland, Spain and Italy by initiating the period of restraint on member countries' public spending, the famous austerity.



1.10 Government Spending percentage change

Overall the result of the 2008 crisis was bitter: more than 8 million people lost their jobs, unemployment rates reached 10 percent, six million lost their homes, and two and a half million businesses closed, and that was in America alone.

At the end of this difficult period in both America and Europe, new rules were adopted forcing banks to hold more capital to cover the risk of bankruptcy and higher standards for lending money, all in an effort to protect the small investor by making banks as transparent as possible to prevent speculation on the backs of ordinary citizens again in the future.

1.5 YEAR 2008: BERNARD MADOFF AND THE BIGGEST PONZI SCHEME IN HISTORY

Bernie Madoff, the financier who built the largest Ponzi scheme in history.

In 2009, he pleaded guilty to a fraud that affected up to 37,000 people in 136 countries over four decades, until the end of 2008. Among his victims were celebrities such as recording artist Steven Spielberg, actor Kevin Bacon, and Nobel Peace Prize winner Elie Wiesel.

The scam he had concocted was worth over $60 billion, probably one of the largest in the world: he had been running it for years and no one, neither the authorities nor investors, had ever noticed. The $64.8 billion was the figure reported on paper by Madoff in the forged documents to his clients; investors, sometimes celebrities, had entrusted him with at least $17.5 billion over the years, and the judiciary has to date recovered about $13 billion of the ill-gotten gains.[21]

Madoff was chairman of Nasdaq, the technology list, to which he had managed to attract such prominent companies as Apple, Sun Microsystems, Google, and Cisco Systems. The position he held had earned him an excellent reputation and thus an almost unconditional trust, on which he based the scam.

The Wall Street crisis of 2008, however, bent the near-perfect scheme adopted by Madoff, when large funds and other institutional players began rapidly withdrawing capital from accounts opened with Madoff, exposing the scamming scheme and forcing him to confess to his children that the company's fortunes were fake. His scheme, the promise of investments from stellar profits, allows those who start the chain and those first involved to earn high short-term financial returns, but it continually requires new victims willing to pay: in fact, the gains come only from fees paid by new investors, not from productive or financial activities. [22]

[21] Estimating JP Morgan Chase's Profits From The Madoff Deposits, Davis, Louis and Linus Wilson
[22] The Wall street Journal

A Ponzi scheme provides that the returns promised to investors are paid for by the collection of new entrants.
A pyramid structure, the one devised by Maddoff, that began to collapse when investors, faced with markets in the throes of a liquidity and confidence crisis, began to demand repayment of not only the interest but also the invested capital. The situation lends itself to be described with a well-known Warren Buffet aphorism: "it's only when the tide goes out that you see who has been swimming naked." The pyramid structure of the Ponzi scheme, it is well understood, does not always have fraudulent intentions. Just think of the new issues of government bonds, which a country uses to repay interest and maturing debt, as well as to finance new needs; the tool helps to avoid short-term shocks and relies on the "quasi-inexistent" risk of default by a rich country.
It is not certain when Madoff's Ponzi scheme began.
Even less clear is why Madoff carried out the scheme at all. "I had more than enough money to support any of my lifestyle and my family's lifestyle. I didn't need to do this for that," he told Fishman, adding, "I don't know why." The legitimate wings of the business were extremely lucrative, and Madoff could have earned the Wall Street elites' respect solely as a market maker and electronic trading pioneer.
Madoff repeatedly suggested to Fishman that he was not entirely to blame for the fraud. "I just allowed myself to be talked into something and that's my fault," he said, without making it clear who talked him into it. "I thought I could extricate myself after a period of time. I thought it would be a very short period of time, but I just couldn't."
Madoff's apparently ultra-high returns persuaded clients to look the other way. In fact, he simply deposited their funds in an account at Chase Manhattan Bank, which merged to become JPMorgan Chase & Co. in 2000, and let them sit. The bank, according to one estimate, may have made as much as $435 million in after-tax profit from those deposits.[23]
When clients wished to redeem their investments, Madoff funded the payouts with new capital, which he attracted through a reputation for unbelievable returns and grooming his victims by earning their trust. Madoff also cultivated an image of exclusivity, often initially turning clients away. This model allowed roughly half of Madoff's investors to cash out at a profit. These investors have been required to pay into a victims' fund to compensate defrauded investors who lost money.
Madoff created a front of respectability and generosity, wooing investors through his charitable work. He also defrauded a number of nonprofits, and some had their funds nearly wiped out, including the Elie Wiesel Foundation for Peace and the global women's charity Hadassah.

[23] Estimating JP Morgan Chase's Profits From The Madoff Deposits, Davis, Louis and Linus Wilson

He used his friendship with J. Ezra Merkin, an officer at Manhattan's Fifth Avenue Synagogue, to approach congregants. By various accounts, Madoff swindled $2.4 billion from its members.

Madoff's plausibility to investors was based on several factors:

His principal, public portfolio appeared to stick to safe investments in blue-chip stocks.

He claimed to be using a collar strategy, also known as a split-strike conversion. A collar is a way of minimizing risk, whereby the underlying shares are protected by the purchase of an out-of-the-money put option.

His returns were high (10 to 20% per annum), consistent, and not outlandish. As the Wall Street Journal reported in a now-famous interview with Madoff, from 1992:

"[Madoff] insists the returns were really nothing special, given that the Standard & Poor's 500-stock index generated an average annual return of 16.3% between November 1982 and November 1992. 'I would be surprised if anybody thought that matching the S&P over 10 years was anything outstanding,' he says."[24]

[24] The Wall Street Journal

CHAPTER 2:
MIFID REGULATION:
COMPREHENSION THROUGH PRACTICAL APPLICATION IN BANCA GENERALI.

2.1 DEFINITION

MiFID is the English acronym for Markets in Financial Instruments Directive-in Italian "Direttiva sui Mercati degli Strumenti Finanziari" (Directive 2004/39/EC). Approved by the European Parliament in April 2004, MiFID replaces and repeals the previous Investment Services Directive (Directive 93/22/EEC, so-called ISD), radically innovating the EU legal framework on the provision of investment services.

Together with the Market Abuse Directive (so-called Market Abuse or MAD), the Prospectus Directive and the Directive on the Harmonization of Disclosure Requirements of Listed Entities, MiFID forms an integral part of the Financial Services Action Plan (FSAP) adopted by the European Commission in May 1999.[25]

In accordance with the approach proposed by the Lamfalussy Committee, the MiFID regulatory system has three levels:

- the first level, represented by the aforementioned Directive 2004/39/EC, which defines the general principles of regulation;
- the second level, represented by Regulation 1287/2006/EC (relating to market regulation and in particular to pre- and post-trade transparency issues) and Directive 2006/73/EC (laying down provisions on the conduct and organization of intermediaries providing investment services and activities);
- the third level, corresponding to the issuance by the Committee of European Securities Regulators (CESR) of guidelines aimed at ensuring homogeneous reception and application at the national level of all regulatory acts adopted at the first two levels.[26]

2.2 THE LEGISLATIVE DEVELOPMENT RATIONALE

The entry into force in November 2007 of the Markets in Financial Instruments Directive (MiFID I - 2004/39/EC), which intervened to regulate the trading mechanisms of equities in the European Union, marked a new era for the financial markets of the Member States. Indeed, the securities trading rules, contained in the MiFID I Directive, were designed precisely for the purpose of

[25] CONSOB, Regulation n. 20307, 2019
[26] European Banking Authority, Directive (EU) 2019/2034

reshaping the trading market in the European Union to meet the requirements of speed of transactions, market efficiency and investor protection (especially the small one). This is because - as will become clearer in the following paragraphs - while national source regulations have certainly contributed to the fragmentation of securities markets, they have also - thanks in part to the exploitation of innovations in the sector and technological advances - given rise to greater competition among trading venues in the European territory, facilitating convergence toward an increasingly effective regulatory path. MiFID required its transposition in the member states by November 1, 2007, and at that time provided for an initial revision of the text - with reference to certain specific matters - as early as 2008.

The process of transposing MiFID into the Italian legal system began with the approval of Legislative Decree No. 164 of September 17, 2007, which made a number of significant changes to the Consolidated Law on Finance: the Decree came into force on November 1, 2007.[27] Transposition continued on October 29, 2007 with the introduction by Consob - following consultation with the market - of the relevant amendments to the Intermediaries (No.16190) and Markets (No.16191) Regulations, and with the joint publication by Consob and the Bank of Italy of the "Regulations on the organization and procedures of intermediaries providing investment services or collective asset management" (so-called Joint Regulations). In keeping with the objectives of minimizing the risks of fragmentation and ensuring effective equality of treatment for all investment firms operating in the EU market, the national transposition rules show minimal deviations from the dictate of the European legislator.

As is well known, at that very time, the problems that were emerging as a result of the market crisis (which resulted in total losses in the banking system worldwide equivalent to at least one trillion dollars) and made evident mostly in 2008, as well as the need to assess the results to which the provisions of the first draft had led, strongly conditioned the work of revising the Directive, starting with the G20 in Pittsburgh in 2009.[28] In this regard, one of the factors, albeit not purely economic, that inexorably affected the course of the financial crisis was consumer confidence. Indeed, it is now a well-known fact that the lack of transparency about transactions, the lack of information about the risks involved in such transactions, the superficial management of conflicts of interest, to which must be added a legislation that has manifested major flaws in terms of investor protection and, above all, an inability to adapt quickly to the needs of the latter, have meant that consumers in the various countries of the Union have purchased and benefited from financial instruments, as well

[27] CONSOB, Regulation n. 20307, 2019
[28] Il Sole 24 ore, A. CRISCIONE, 2 July 2015

as insurance products and investment services, which should not have been considered appropriate for them.

In this context, the new regulation of the markets in financial instruments referable to MiFID II, Market in financial instruments directive and Regulation (EU) 600/2014 known as MiFIR, Markets in financial instruments regulation, was born, implemented by Italy with the publication in the Official Gazette (OJ) of the Italian Republic on August 25, 2017, of Legislative Decree No. 129 of August 3, 2017, which implemented Directive (EU) No. 65, of May 15, 2014, of the European Parliament and of the Council on markets in financial instruments, which, among other things, also amends previous Directive No. 2002/92/EC and No. 2011/61/EU (as amended by Directive 2016/1034/EU of the European Parliament and of the Council, of June 23, 2016) and adapts national legislation to the provisions of Regulation (EU) No. 648/2012, as updated by Regulation (EU) 2016/1033 of the European Parliament and of the Council, of June 23, 2016.

In this way, MiFID II (2014/65/EU) comes to be part of the process of strengthening the effectiveness of the regulation of the functioning of financial markets, aiming to cover, also and especially, areas that until then had not been the subject of regulation; increased transparency, investor protection and market stability are the main elements to give the (European) financial markets a more secure, stable, resilient and gap-free structure. In other words, in fact, in light of the reduction in the number of cases and subjects exempt from the application of the regulation and the extension of its scope of application - as well as the breadth of enforcement measures - together with the role of national supervisory authorities and ESMA, there should be no more room left for self-regulation. In addition, the revision of the Directive has presented some definitions in a decidedly clearer manner, thus contributing to a more harmonious regulation and to the fact that supervisory practices have become so rigorous and punctual that they can combine the sanctioning and merely deterrent aspects. To this must then be added the consideration that the recent global financial crisis has shown that the interposition of a professional investment adviser between the investor and the issuer in no way guarantees that the former is protected, as moreover the numerous examples of scandals and market collapses demonstrate. Finally, one cannot underestimate the fact that a unified control and regulation could also entail a single collection of data and information regarding the firms subject to said control. Although the objective of such a choice is clearly understandable and worthy of follow-up, a thorny question has been raised in this regard-which to date has not yet been resolved-whether such elements should be reported directly by individual firms to the supervisory authorities or whether financial intermediaries should, instead, procure them.[29] It is good, first of all, to point out that the method of data collection would entail problems

[29] European Banking Authority, Directive (EU) 2019/2034

in both cases: in the former, small and medium-sized companies would be required to incur a significant expense to produce, process and transmit them to the authority; in the latter, it is unthinkable that financial institutions would act as repositories of all the business records of their clients (leaving aside, then, the fact that in this case, not secondary privacy protection problems would also arise). In addition, specific emphasis deserves the fact that the financial crisis of 2008 - as pointed out in the European Commission report concerning the "Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories" of September 15, 2010 - brought over-the-counter (OTC) derivatives to the center of attention of supervisory authorities. [30]

A number of significant events, such as the near-collapse of Bear Sterns in March 2008, the bankruptcy of Lehman Brothers in September 2008, and the bailout of AIG in the same month, exposed the shortcomings of the functioning of this type of market. Considering all these considerations, it is easy to imagine that the debates regarding legislative reforms in the area of securities trading platforms meant that government intervention mainly took the form of restructuring securities and derivatives markets, limiting the scope of self-regulation and - specifically - that of the derivatives segment. In this way, Member States remained free to adopt the procedural discipline deemed most appropriate to achieve their objectives (principle of procedural autonomy), provided, however, that the national procedures were no less effective than those involving similar domestic remedies (principle of equivalence) and did not make it excessively difficult - if not impossible - to exercise the right conferred (principle of effectiveness). It is clear, then, how the revision was not merely an adaptation of provisions to the changing economic environment, but represented a significant opportunity to consolidate the role of the internal market and to regain investor confidence, which had been severely damaged by the crisis itself. Finally, there is also to be said that these new priorities were the result of a debate on the causes of the financial crisis, which imposed itself on both sides of the Atlantic and led to the structuring of new bodies--along with the reorganization of existing ones--to intervene in the markets with a view to monitoring and paying attention to systemic risks. And it was during the crisis years that issuers-but especially investors-became more engaged, including in terms of political pressure, for governments to engage in reforms targeting financial markets (in particular, there was a great deal of pressure for legislative reform targeting derivatives). So, an important number of public consultations were initiated, both at the EU and international level, to respond to the insistent requests, presented by market players, that innovations should not result in circumscribed and targeted interventions that would exclusively benefit certain issuers (and their investors); the

[30] Il Sole 24 ore, A. CRISCIONE, 10 July 2015

objective that, instead, should have accompanied the legislative innovation project was to disincentivize market participants from holding those pre-crisis behaviors, thus avoiding triggering the same mechanisms that had created pathological situations in the market. And, not surprisingly, in the very aftermath of the recent crisis, the sector most targeted in this respect has been structured finance, which has been widely identified as one of the main causes of market meltdowns. Indeed, it has been argued that these types of mechanisms have deprived Eurozone investors of fundamental diversified sources of funding, drastically reducing their ability to properly spread the risks of their investments. This has led, as anticipated, to a new piece of legislation, the MiFID II Directive, and the preparation of the resulting new implementing regulation (the so-called MiFIR Regulation-No. 648/2012).[31]

The former specifically addressed investment services, authorization procedure and requirements, trading rules, internal and external governance requirements of investment firms, and trading venues. As can be seen, the ultimate goal of this revision was to extend the scope of application to additional trading opportunities to encompass an ever-widening range of instruments and venues. The MiFIR Regulation, on the other hand, establishes common rules that are directly applicable in all member states and focuses primarily on the mandatory trading of derivatives, data disclosure, trade transparency, and non-discriminatory access to trading venues.[32] The initial schedule called for the transposition of the Directive within 2 years of its publication in the OJEU, while the Regulation was to be implemented by Member States within 32 months of its entry into force (subject to the adoption of the required implementing measures) and subject to the immediate application of some specific provisions. In 2015, however, several parties (both market participants and national regulators) complained that the timeframe for implementation was decidedly compressed, and, for this reason, they requested, endorsed by ESMA, that the entry into force of the national disciplines transposing the Mifid II Directive should slip by one year (thus to at least 2018). This postponement should have allowed, mainly for issuers, to arrive prepared for the imposition of new rules on the subject especially of client disclosure. In proposing the new texts, the Commission recalled that MiFID had maintained a high level of competition among member states, but ensured deeper integration among them, made investor choice wider, and-not to be underestimated-had ensured a decrease in the cost of each transaction. At the same time, however, the Commission highlighted some difficulties: it was found, in fact, that the benefits of competition were not enjoyed equally by all market players, and, at times, end users did not benefit at all; all this in a situation, in which market fragmentation had made the mechanisms of trading increasingly

[31] European Banking Authority, Directive 2013/36/EU
[32] Il Sole 24 ore, A. CRISCIONE, 10 July 2015

structured and complex. Then, the MiFID directives become the building block of a broader legislative and regulatory framework covering financial intermediation as a whole, an important starting point for ensuring that the MiFID I revision maintains consistency within the context of other relevant laws and regulations to create a comprehensive and harmonized regime for all investment services. In fact, while the initial draft of the revision had limited itself to strengthening conduct of business rules and updating the pillars of the legislative structure, several factors (e.g., increased transparency, investor protection and market stability) have necessitated a broader amendment of the directive; indeed, the need for a single European strategy suitable for addressing market failures, restoring investor confidence, and giving impetus to all the many domestic markets to make them more dynamic and competitive in order to facilitate cross-border transactions as well, has emerged in numerous debates. An attempt by the Commission, then, to provide the European Union with efficient tools to stay abreast of the challenges posed by monetary union and the single integrated market for financial services, given that it was precisely the economic, legal and social barriers between member states (one among them, the different taxation regimes) that slowed down the creation of direct-to-consumer selling in the pan-European financial market). One specific aspect of the debate, which-among others-has emerged, concerns the fact that the investor protection provided for within the legislation not only risks imposing huge costs on the investors themselves-which therefore benefits investment firms-but has also in many cases failed to fulfill the promises of return that a high-risk investment was supposed to fulfill. Indeed, as some have pointed out, the effectiveness of investor protection, while depending primarily on the quality of the implementation of the discipline, comes to be completely called into question in the absence of a decisive reaction to abuses perpetrated during the trading activities of financial instruments.

Successive legislative reforms, being centered on the cardinal concept that an informed investor is also a protected investor, have sought to reduce information asymmetries-between the former and financial intermediaries-as much as possible. At the theoretical level, such a strategy has found much acceptance. Unfortunately, however, practice has shown that--for example--providing a retail investor with a full prospectus and asking him to base his investment decision solely on that document turns out to be an equally ineffective strategy; the prospectus, in fact, requires a specific ability to know how to read and understand it, a challenge that a person not versed in economic and financial disciplines is unable to meet. So, in fact, the small investor must, in any case, rely on the solutions that the intermediary proposes.

2.3 THE EVALUATION AND REVIEW PROCESS

The EU legislature has provided for a periodic review by the European Commission of the contents of MiFID and its implementing provisions. In this regard, see Article 65 (paragraphs 2, 3 and 4) of Directive 2004/39/EC; Articles 44 (paragraph 5) and 51 (paragraph 5) of Directive 2006/73/EC; and Article 40 of Regulation 1287/2006/EC. As early as 2008, CESR initiated a review of certain aspects of the operation of the Directive, with the publication (jointly with the Committee of European Banking Supervisors – CEBS) of "CESR/CEBS's technical advice to the European Commission on the review of commodities business" (CESR/08-752 and CEBS 2008 152 rev., October 15, 2008). This report was followed in June 2009 by a paper "CESR's assessment on the impact of the Directive on the functioning of equity secondary markets" ("CESR's assessment on the impact of the Markets in Financial Instruments Directive – MiFID – on the functioning of equity secondary markets," CESR/09-355) and a second paper on transparency of corporate bond, structured finance product and credit derivatives markets ("Transparency of corporate bond, structured finance product and credit derivatives markets," CESR/09-348). Also in 2009, the Committee began work on revising other aspects of the Directive. In July 2010, a first set of technical papers saw the light of day, relating to the equity market ("CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets," CESR/10-802), non-equity markets transparency ("CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity Markets Transparency," CESR/10-799), transaction reporting requirements ("CESR Technical Advice to the European Commission in the Context of the MiFID Review – Transaction Reporting," CESR/10-808), and investor protection ("CESR Technical Advice to the European Commission in the Context of the MiFID Review – Investor Protection and Intermediaries, CESR/10-859) as well as responses to some questions addressed by the European Commission to the Committee regarding the review process of the Directive ("CESR's Responses to Questions 15-18 and 20-25 of the European Commission Request for Additional Information in Relation to the Review of MiFID" – CESR/10-860). A second set of technical papers was released on October 13, 2010. It addresses issues related to standardization and organization of over-the-counter derivatives trading ("CESR Tecnhical Advice to the European Commission in the Context of the MiFID Review – Standardization and Organized Platform Trading of OTC Derivatives" – CESR/10-1096), post-trade transparency standards for the equity market ("CESR Tecnhical Advice to the European Commission in the Context of the MiFID Review – Equity Markets: Post Trade Transparency Standards" – CESR/10-882) and client categorization ("CESR Tecnhical Advice to the European Commission in the Context of the MiFID

Review – Client Categorization" – CESR/10-10-1040). A second set of responses to questions posed by the Commission closes ("CESR's Responses to Questions 1-14 and 19 of the European Commission Request for Additional Information in Relation to the Review of MiFID" – CESR/10-1254). In 2011, the European Commission is expected to submit a proposal to revise MiFID Level 1 rules.[33]

2.4 INVESTMENT ADVISORY SERVICES

According to Article 37 of the CONSOB Intermediary Regulations, intermediaries provide their investment services, including investment advice that includes conducting a periodic assessment of the suitability of the recommended financial instruments or services, based on a special written contract.

It stipulates that the written contract is mandatory for placement and investment advisory services.[34]

The intermediary is thus bound to the client by an ongoing relationship that frames all the activity that he or she will then perform on behalf of that client. The agreement governs the rights and duties of both the intermediary and the client.

Under MiFID II (Art. 4(4)), in line with the previous Directive, the activity of investment advice is defined as:

- the provision of personalized recommendations to a client at his or her request or at the initiative of the investment firm;
- recommendations relate to one or more transactions in financial instruments.

A recommendation is personalized when it is presented as suitable for the client or is based on consideration of the client's characteristics; it is not personalized if it is disseminated to the public through distribution channels.

It follows that recommendations that are not presented as "suitable" or "based" on the client's characteristics, as well as those intended for the public (gross mass marketing) disseminated only through mass distribution channels such as the Internet, television, radio, etc., are devoid of the element of personalization, and therefore do not fall within the definition of advice for MiFID purposes.

The recommendation made to the client relates to one or more transactions related to financial instruments.

[33] CONSOB, Regulation n. 20307, 2019

[34] European Banking Authority, Directive 2013/36/EU

It is not sufficient that the recommendation refers, more generically, to types of financial instruments: the activity of asset allocation or financial planning does not fall within the scope of investment advice when the advice given does not relate to a specific financial instrument but to a type of instruments.

To be specified is the difference between investment advice and generic advice.

The service of "advice" (product advice) is confidential and regulated, the advice must be appropriate.[35]

Generic advice (advice on type) is not regulated and is limited to strategic asset allocation by indicating only the types of products and services.

It is not advice, understood as an investment service, to present the characteristics of individual products to clients (at least two from which the client must choose).

In accordance with the general principles dictated by MiFID (and implemented in Articles 40 and 41 of the RI) there is an obligation to obtain the information necessary to make the suitability assessment:

- to investment knowledge and experience regarding the specific type of instrument or service;
- To the financial situation, including the ability to sustain losses;
- to investment objectives, including risk tolerance;

the obligation to make the judgment of "suitability" and not merely the judgment of appropriateness; the prohibition of giving advice where the client has not provided the information necessary for the assessment of suitability; and the obligation to advise only investments that are appropriate to the client's profile.

Article 167(2) RI regulates advice to professional clients: when the service is provided to a professional client it is presumed that the client has the necessary level of experience and knowledge to understand the risks associated with the recommended investment, and where the client is a professional client by right that he or she is also financially capable of bearing the risk associated with the investment consistent with his or her investment objectives.

Incentive for advice is the receipt by the intermediary of a fee paid in connection with investment advice or general recommendations, in circumstances where the advice or recommendations are not distorted because of the receipt of the fee, shall be deemed to enhance the quality of advice given to the client.

Investment firms shall maintain and implement effective organizational and administrative arrangements to take all reasonable measures designed to prevent any conflicts of interest from adversely affecting the interests of clients.

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[35] LE GUIDE DELLA BANCA D'ITALIA, 2013

In developing a conflict-of-interest policy that identifies the circumstances that constitute or may give rise to a conflict of interest, intermediaries should pay particular attention to investment advice.
The investment advice service may have different operational characteristics with regard to: range of products covered by the service, periodicity (continuous or episodic) of advice, possible provision of the service in conjunction with other investment services.
Regarding the applicable regulations, the first two aspects indicated do not generally present particularly significant impacts.
The provision of the advisory service in association with other investment services may present some critical profiles about the application of the regulatory discipline. In particular, it could be difficult to prove that the advisory service has not been provided to clients or regarding a possible reversal of the burden of proof (Art. 23 TUF)
Major problems exist where orders are communicated by the customer to the broker's employee or financial adviser without the aid of remote means of communication. [36]

2.5 THE IMPORTANCE OF REGULATION FROM THE PERSPECTIVE OF THE CAPITAL MARKETS UNION AND THE GREEN PAPER OF SEPTEMBER 30, 2015

From the perspective of the project to realize the Capital Markets Union (CMU), which is one of the main items on European Commission President Juncker's agenda, the goal of having clear and investor-protecting regulation brought forward by MiFID Regulation takes on even more relevance.[37]
The Capital Markets Union perspective has reinvigorated and provided a fresh perspective across financial markets. Different reasons have prompted different actors to support such a type of structural integration of investment platforms: to obtain easier access to financing for small and medium-sized enterprises and – conversely – to disengage from a corporate model still strictly dependent on the granting of financing by banks, the most widespread in Europe; to implement a tool to overcome the fragmentation typical of European capital markets; seize the opportunity to harmonize certain institutions and legislative cases, the standardization of which has not yet been addressed at the European level (such as, for example, securitization); finally, there is no shortage of those who see in this project an opportunity for the creation of a supervisory authority with functions similar to those of the U.S. "Securities and Exchange Commission" for securities markets

[36] CONSOB, Regulation n. 20307, 2019
[37] European Banking Authority, Directive 2014/65/EU

and which could come to play a role similar to that of the European Central Bank for the Banking Union.[38]

It cannot, however, fail to point out that despite years of legislative innovations aimed at harmonizing regulation and endowing member countries with a single currency, to date European capital markets still appear fragmented. Certainly, the recent financial crisis has adversely affected the path to standardization, but this does not detract from the fact that – for example – many market participants continue to be embedded in an exclusively vertical, rather than cross-cutting, integration mechanism, this is probably also due to the fact that legitimate coordinating bodies at the European level have emerged only in the last decade and that the most powerful financial intermediaries are often linked to the United States of America (thus subject to a regulatory discipline that differs greatly from the European one and operating in an economic environment, the structure and functioning of which – especially in terms of economic policies and tax rules – are not comparable to those of European states). It should be remembered, however, that the CMU, in order to become fully operational, requires the structuring of a very complex organization, and it is likely that it will take several years before the various relevant bodies manage to become fully functional and work efficiently, but above all, in a coordinated manner (it is, in fact, immediately apparent how the malfunctioning of one link in the chain can easily affect all the rest). The most optimistic forecasts, indeed, report that most of the regulations contained in the framework envisaged by the CMU will manage to come into force – at least on paper – in 2019; however, the great challenge in the field will be to succeed in ensuring the simultaneous existence – both horizontally and vertically – of institutional bodies and financial intermediaries (which implies integrating public law and private law regulations), so as to get to the point of reducing the dependence of small and medium-sized enterprises on exclusive bank financing. Finally, the scope of the undertaking is well illustrated by the fact that fragmentation affects financial centers of different sizes and organizations, not all of which are capable of reacting homogeneously to the same calls for legislative innovation. There are then numerous authors, who stress the importance of coordination of the European system's own rules with those of the United States of America (mainly between the DoddFrank Act and the EMIR Regulations). Certainly open at this point remains the question of monitoring the functioning of the CMU and the role that the European Single Rulebook has in this regard. The latter instrument, in fact, has the main objective of issuing a set of prudential rules on banking legislation, with which all issuers operating in the territory of the Union must comply; moreover, it is widely agreed that it alone is not sufficient to ensure the monitoring of the mechanisms of integration of financing services (which at the European level can act as an

[38] Il Sole 24 ore, M. MARI, 14 July 2015

alternative to banking and contribute, thus, to supporting businesses by ensuring an appropriate flow of credit and thus reducing the vulnerability of the economic structure to financial shocks). This particular aspect, in different historical periods, has perhaps not been given due attention, to the point that in recent years we have come to have an organization, not only uncoordinated among the various supervisory bodies (both horizontally and vertically), but above all with very few powers at the central (European) level and many, instead, devolved to national authorities. Such conducts have, at times, even led to the establishment of a competitive mechanism among the different jurisdictions of the member countries; a mechanism that, as it is easy to imagine, frequently tends to ensure greater autonomy and streamlining of powers and competences in the hands of national supervisory authorities, with obvious possible negative repercussions on the perception by (especially small) investors of the safety of the market in general and of cross-border investments in particular. To make up for this kind of risk, for example, the structure of the Banking Union introduced a supervisory system known as the "Single Supervisory Mechanism" (SSM) in order to strengthen the prudential supervision of credit institutions in the Eurozone; thus, the essential tasks of prudential supervision of the European banking sector are now for the first time carried out, on a transnational level, by the European Central Bank. It is interesting, then, to note how, in contrast to the clearly stated policy objective in Banking Union, the recent Green Paper suggests, instead, a broader, more complex and articulated response, pandering to the trend of the markets themselves. Finally, for the sake of completeness, it should be noted that, unlike, however, the Banking Union, the CMU will find application in all member states and-at least on paper-does not necessarily imply a push toward centralized and institutionally coordinated supervision of capital markets. Also on the side of banking legislation, the Bank Recovery and Resolution Directive (BRRD) constituted a further tool for the development (which has now become an essential pillar) of the Single Market, which followed precisely the entry into force of the Euro. The rationale behind this framework is that from a national legislation perspective, the loss of banking sovereignty should ensure the concrete possibility for banks and firms to access the entire European capital market, precisely within the framework of the Capital Markets Union. In fact, the increased integration of capital markets, as indicated by the European Commission in the recent Green Paper, aims to expand access to long-term financing, particularly for small businesses. At this point, therefore, the role of national supervisory authorities assumes an even more central position, as they are entrusted with the task of assisting the ECB in the preparation, but above all in the implementation of all activities related to the exercise of its powers, including – for example – the periodic assessment of the performance of credit institutions carrying out their activities in the

territory of that state. In other words, after the first necessary authorization of the ECB to carry out banking activities, most of the supervisory tasks remain with the national supervisory bodies. [39]
This, of course, does not detract from the fact that the ECB may at any time decide to assume and exercise all powers relevant to one or more particular institutions in question. The discussion takes on even greater weight with reference to institutions of smaller size (and accumulation of assets); in such environments, in fact, the tasks and the degree of autonomy of national supervisory authorities extend decidedly further, becoming more pregnant and carrying out substantially targeted and direct control. Moreover, all of the above should also be considered in the light of additional factors that may be able to affect the positive outcomes that diversification of sources of financing for firms can produce. Some of these sources (e.g., some institutional investors or retail investor groups) may perhaps tend to provide highly volatile financing, subject to high turnaround risk, early exits, and the like. Such volatility is likely to produce, in the long run, several possible consequences: in periods, when there is great liquidity in the markets, retail investors (as well as probably some institutional investors) will tend to support long-term investments; however, when markets begin to fluctuate, the same investors, since their risk aversion will tend to increase, will likely lean strongly toward increasing the productivity of their investments in the short run, in order to extricate themselves from the relationship and exit as soon as possible. [40]
Thus, if alternative sources to the banking system were to become a widely used instrument by small and medium-sized enterprises and if these operations were considered in large numbers, they could also lead to repeated fluctuations in market trends, which, in the long run, could lead to small investors even becoming wary of such alternative sources and, therefore, to a reduced willingness to make use of them precisely when they had become necessary on a par with banking sources. It is, however, considered appropriate to emphasize that alternative sources of market financing for small and medium-sized enterprises should complement, not completely replace, the role of banks in this area. In particular, banks will certainly continue to play a key role in terms of, for example, financial advice for medium-sized mortgage applicants, as well as investment opportunities for institutional and retail investors.
Ensuring a healthy and robust banking system that can provide credit and support economic growth will, therefore, remain the primary focus, despite a strong push toward diversification of funding sources expected from the implementation of the CMU. In addition, banks will naturally continue to play a key role in the capital market as issuers, investors and intermediaries. They were considered vital in the design of the CMU structure and must themselves help support the development of other

[39] Il Sole 24 ore, M. MARI, 14 July 2015
[40] CONSOB, Regulation n. 20249/2017

forms of financing. The establishment of the SSM was, in fact, also envisaged to support the role that banks can and should play in the CMU context, in order to build a healthy banking system, from which typical protectionist practices peculiar to national territories can be eradicated and such a structure can contribute to the provision of cross-border financial services.

2.6 MiFID REGULATION OBJECTIVES.

Despite the complexity and variety of the topics addressed, certain underlying objectives emerge in MiFID and its implementing measures: [41]

-Stimulating competition by abolishing requirements for concentration of trading in regulated markets and facilitating cross-border provision of investment services (freedom to provide services across member countries, otherwise known as the “single passport”);

-Enhancing the integrity, efficiency and transparency of markets by establishing detailed trade execution rules;

-Ensure investor protection and standardize rules of conduct in relations between intermediaries and clients;

-Introduce uniform minimum general requirements for the organization and control of intermediaries.

-Provide clearer and more appropriate Classification of customers.

-Depthening the issues of the Advisory and Placement Agreement.

-Increase the number and clarity of Information provided by the client

-Identify the Target Market accurately.

-Illustrate the discipline on Equivalent Products.

-Accurate Assessment of Costs and Benefits.

-Depth treatment of Conflicts of Interest.

-Increasing Transparency of pre- and post-trade trading information, extended by MiFIR Regulation to non-equity instruments as well

-Provide specific Rules for Systematic Internalizers.

-Reinforcing rules related to Best Execution.

[41] CENTER for ECONOMIC and SOCIAL RIGHTS, 16 November 2018

2.6.1 THE CENTRALITY OF INVESTOR PROTECTION

As is well known, the financial intermediation contract constitutes an example of asymmetrical bargaining, in which there is a physiologically weak party (the investor), insofar as he is unaware of the information and lacks the expertise available to the other contracting party (the intermediary): the legislator, therefore, in order to remedy the de facto inequality, introduced de jure a series of specific information obligations on intermediaries, currently regulated in the TUF (Legislative Decree Legislative Decree 58/1998) and in Consob Intermediary Regulation No. 11522/1998.
The problematic aspe0t of the regulations in question consists, however, not in the definition of the obligations of intermediaries-already identified in a definite and punctual manner by the provisions of the regulations-but in the identification of the remedies that the client can avail himself of following an investment transaction that is improperly managed by the intermediary. In other words, the legislative framework is incomplete: it clarifies the obligations that the intermediary has towards the client, but it does not indicate what remedies the client can avail himself of in the face of an illicit financial transaction (uninformed, incorrect, negligent, obscure, etc.). From the foregoing, it can be seen that the legislature has been very analytical and precise in identifying the intermediary's obligations, not leaving them to the common civil law framework, but specifying and further enhancing them in the context of a financial relationship; however, we do not see equal clarity regarding the identification of remedies available to investors in the face of a violation by intermediaries of any of the rules of conduct identified in the legal provisions. In fact, the only remedy positively identified is compensation for damages: Art. 23, c. 6, TUF stipulates that, in judgments of compensation for damages caused to the client by financial transactions conducted unlawfully, it is the intermediary's burden to prove that he or she has exercised the specific diligence required by the performance of his or her professional activity. As can be imagined, such a remedy cannot cover the full range of cases that can be brought to the attention of the courts; for these reasons, for some time now, jurisprudence has been trying to provide answers that are both satisfactory on a substantive level and logical on a legal level. For what is of interest here, there have been several legal reconstructions of financial transactions: the difficulties arise because it is a question of qualifying not a single contractual relationship, but an original relationship, which is followed by several and multiple executive acts.
In the past, one doctrinal opinion was expressed in terms of a unitary mandate contract: in other words, there would be an original and analytical contract between the intermediary bank and the investor client, within which the criteria are indicated and directions provided for future investments, and subsequent executive acts of the original mandate.

Another opinion in the literature has pronounced in terms of an ordinary professional work contract, with the consequent possibility of the bond also arising on the basis of mere "social contact" between the intermediary and the client: in this view, it becomes irrelevant to verify the presence and analyze the structure of the original financial intermediation contract.

Finally, the currently prevailing view in both literature and jurisprudence reconstructs financial intermediation in terms of a negotiated link between an original and indispensable predicate contract (framework contract) and subsequent investment orders.

The most accomplished expression of this strand turns out to be a 2009 Supreme Court decision,[42] which deals with the causal link and its proof, where it is stated that it is an indispensable condition for the compensability of damages that there is a causal link between the violation of the behavioral rule by the intermediary and the damage suffered by the investor and that, in the case of conflict of interest or inappropriate investment, it is not the plaintiff's burden to provide the relevant proof, since the causal link at that point is in re ipsa and always entails full compensation for the damage.[43]

Hence, from these rulings emerges the close and inseparable link between the assessment of the adequacy of a transaction and the verification of the existence of the causal link between information omissions and the damage suffered by the investor, with the consequence that, once the inadequacy of an investment has been established, this causal link cannot but be declared to exist. The novelty of the decision under comment lies in the fact that it has sanctioned that said causal link always entails full compensation for the damage, as opposed to the admission of mere partial compensation (of a percentage of the damage). It follows that, at that point, the damage must necessarily coincide with the entire loss suffered, even in the deniable hypothesis that - for example - it emerges that the investor would have invested in securities of lesser value. This is in continuity with what has already been ruled by the Supreme Court in Joint Sections in 2007, in the well-known rulings Nos. 26724 and 26725.[44] Jurisprudence, in such cases, has rejected the thesis of the nullity of the contract - which had also taken hold in previous years - affirming that in our legal system there are effective remedies available to the weaker party, the saver, who wants to obtain immediate compensation for damages. In fact, as anticipated, Article 23, c. 6, TUF stipulates that in judgments of compensation for damages caused to the client in the performance of investment and ancillary services, the burden of proof of having acted with the specific diligence required lies with the qualified parties. This provision, in procedural terms, translates into an evidentiary facilitation in favor of the plaintiff (i.e., the investor) in liability suits for damages brought against the intermediary. The aim of the provision is, evidently, to benefit the contracting party that comes into

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[42] Corte di Cassazione, Sentenza n 41 2009

[43] European Banking Authority, Directive 2013/36/EU

[44] CONSOB, Regulation n. 20249/2017

a clearly weak position when entering into contracts involving financial instruments. In other words, the onus will be on the bank to prove that it has not harmed savers by first proving that it has adequately informed the customer and, then, that it has acted with the specific diligence required.

2.7 DIFFERECES BETWEEN ISD E MIFID

The difference in approach of MiFID compared to the ISD appears clear. Whereas the ISD aimed to harmonize only "...initial authorization and operating requirements for investment firms, including conduct of business rules ..." as well as "...certain conditions regarding the operation of regulated markets ...", MiFID aims to ensure " ... the degree of harmonization necessary to be able to offer investors a high level of protection and enable investment firms to provide services throughout the Community ... on the basis of home Member State supervision ..." (Directive 2004/39/EC, Recitals 1 and 2). In other words, if ISD appeared to be inspired by principles of "minimum harmonization," MiFID and its implementing measures mark the transition to a very broad harmonization discipline, identified as the instrument to give birth to a truly integrated and single financial market. Even when legislative intervention takes the form of the Directive, the rules appear to be very detailed: this severely limits the possibility for member states to introduce any additional rules when transposing them.[45]

2.8 THE ORGANIZATION OF MARKETS IN THE LIGHT OF LEGISLATION

As early as November 2002, when first proposing the new framework, the European Commission pointed out that "...since the adoption of ISD, the EU financial market has become more complex and the boundary between markets and intermediaries has become less precise..." Traditional trading and order collection systems and regulated markets had in fact been joined by alternative systems of transaction execution: the so-called alternative trading systems (ATS), known in Italian law as Sistemi di Scambi Organizzati (SSO). On the line between intermediaries and markets MiFID intervened, with ambitious and highly innovative choices. "It is necessary," recites Recital 5 of Directive 2004/39/EC, "to establish a comprehensive regime governing the execution of transactions in financial instruments, regardless of the methods of organization used, so as to ensure a high quality of execution ... as well as the integrity and overall efficiency of the financial system ... It is necessary to take note of the emergence, alongside regulated markets, of a new generation of

[45] European Banking Authority, Directive 2013/36/EU

organized trading systems, which should be subject to obligations to preserve the efficient and orderly functioning of financial markets".[46]

To achieve the stated objectives, the action of the EU legislature has developed along several lines:

- the elimination of the power, previously given to member states, to impose concentration requirements on regulated markets of exchanges of listed securities;
- the opening to the internalization of orders, that is, to in-house trading by the intermediary (so-called systematic internalizer) in direct counterparty with the client;
- the inclusion of the operation of multilateral trading facilities, or MTFs, among investment services and activities;
- the provision - to be borne by systematic internalizers, MTF operators and regulated markets - of pre- and post-trade transparency rules in order to avoid the negative effects associated with the fragmentation of execution venues.

The removal of trade concentration requirements means that orders to buy and sell financial instruments can now be executed using three different (competing) trading venues: regulated markets, MTFs and systematic internalisers. An updated list of authorized trading venues can be found on CESR's website.[47]

2.9 EXAMPLE OF ENFORCEMENT IN CUSTOMER RELATIONS IN BANCA GENERALI

An example of the application of Mi FID regulations in customer relations can be found in Banca Generali. In fact, for all clients (new and existing), the CRC must be collected. Its signature by the client allows the bank to fulfill all obligations under the regulations.[48]

Banca Generali provides for the signing of the Basic Consulting contract as an integral part of the CRC.

[46] CENTER for ECONOMIC and SOCIAL RIGHTS, 16 November 2018

[47] CONSOB, Regulation n. 20249/2017

[48] Circular 00308 Banca Generali Version 001

2.1 The RCC (relationships with the clients' card)

It is structured as a single document that consists of 4 sections (A,B,C,D) :

-Data Sheet and Application for Activation of the Placement and Investment Advisory Service (A)

-General Information Document (B)

-Contract for the Regulation of Investment Advisory and Placement Services (C)

-Contract for the regulation of the Evolved Advisory Service "BG Personal Advisory" (D)

Within the Client Relationship Charter, the Master Data Sheet (A) collects the personal information provided by the client: Personal Data, Appropriateness/Appropriate Questionnaire, Tax Status, Adequate Client Verification, Additional Client Information (by the Advisor).

CARTA DELLA RELAZIONE CON IL CLIENTE - PARTE A

SPAZIO BARCODE GIC

CDG

BANCA GENERALI PRIVATE

SCHEDA ANAGRAFICA CLIENTE

La Carta della Relazione con il Cliente è composta dai seguenti documenti:

PARTE A
- Richiesta di attivazione del Servizio di Consulenza in materia di investimenti e del Servizio di Collocamento (da compilare)
- **Scheda Anagrafica Cliente** (da compilare per ogni intestatario solo in caso di primo censimento)

PARTE B
Documento Informativo Generale

PARTE C
Contratto per la disciplina dei Servizi di Consulenza in materia di investimenti e di Collocamento

PARTE D
Contratto per la disciplina del Servizio di Consulenza Evoluta "BG Personal Advisory"

2.2 Biographical data sheet

The relationship between intermediary and client is regulated by MiFID through:

- the definition of a more complex set of rules for knowing the client and assessing his or her arrangements, leveraging the notions of "suitability" (suitability), "appropriateness" (appropriateness) and "mere execution of orders" (execution only);
- the introduction of a different classification of clients, broken down into the two general levels of retail and professional clients and the new category of "eligible counterparties";
- the obligation for intermediaries to have a procedure capable of routing orders to the trading venue that offers the best execution conditions, "...taking into account price, costs, speed and likelihood of execution and settlement ..." (so-called best execution, Art. 21(1) of Directive 2004/39/EC);
- a stringent regulation of the intermediary's duties of information to clients;
- the prohibition for banks and investment firms to receive compensation, commissions or nonmonetary benefits (inducement) in connection with the provision of an investment service, unless special conditions are met;
- the extension of the notion of financial instruments and the broadening of the scope of investment services, with the inclusion among them of investment advice.[49]

2.10 PRODUCT GOVERNANCE AND TARGET MARKET: APPLICATION IN BANCA GENERALI

Distributor intermediaries shall take appropriate measures and procedures to ensure that the instruments and services they intend to offer or recommend are compatible with the needs, characteristics and objectives of a given target market and that the intended distribution strategy is consistent with that market (Article 72 of the Intermediaries Regulation).
The transposition of the information provided by the producer and the identification of the actual target market is carried out on the basis of the information provided to the Bank by the client as part of the MiFID questionnaire and its financial profile (table below).
For all distribution services, prior to confirmation of the transaction, disclosure is provided to customers - within the order form - in case of sale out of TM (so-called gray area) or in TM Negative (Network Communication 50096 of 23/08/2018).

[49] Circular 00308 Banca Generali Version 001

MIFID 2 (Guidelines ESMA)	MANUFACTURER (European MiFID II Template)	BANCA GENERALI
Tipologia di clientela	Retail/Professionale/Controparte qualificata	Retail/Professionale/Controparte qualificata
Conoscenza ed esperienza	Basic Investor/ Informed Investor/ Advanced Investor	Da questionario MiFID in base a risposte su conoscenza ed esperienza
Situazione finanziaria e capacità di sostenere le perdite	No capital loss/ Limited capital loss / No capital guarantee / Loss beyond capital	In base al profilo finanziario complessivo del cliente
Tolleranza al rischio	✓ SRI o SRRI ✓ Metodologia interna (no PRIPs/no UCITS: LOW, MEDIUM, HIGH)	Da questionario MiFID in base a risposta su capacità di sostenere le perdite
Obiettivi e bisogni del cliente	✓ Preservation/Income/Growth/... ✓ Orizzonte temporale	✓ Questionario: finalità investimenti ✓ Questionario: orizzonte temporale

2.3 Target market identification template

2.11 COST AND CHARGE DISCLOSURE: APPLICATION IN BANCA GENERALI

The Mifid II Directive requires that information on all costs and associated charges, together with inducements received by the intermediary, must be made available to the client in aggregate form to enable the client to know the total cost and its overall effect on performance and, if the client so requests, in analytical form.

This information should be provided to the client ex-ante, at the time of the sale of each product, so that he or she can make investment decisions with greater awareness of the cost.[50]

Banca Generali has prepared an ex-ante cost and charge information sheet that must be given to the client prior to the subscription or purchase of each financial instrument.

The representation of costs in absolute and percentage terms, inducements and the overall effect of costs on performance is rendered assuming:

- a fixed investment amount of 10,000.00 euros
- an investment horizon of 1 year
- a hypothetical return of 0%.

The details of the individual costs applied according to the type of transaction are represented below:

- Management fees
- Distribution fees

[50] CONSOB, Regulation n. 20307/2018

- Underwriting fees
- Redemption fees
- Transaction fees
- Fixed redemption fees
- Fixed underwriting fees
- Fixed coupon fees
- Switch fees
- Fixed subsequent subscription fees
- Fixed switch expenses (buy/sell)
- Ongoing expenses

INFORMAZIONI SULL'INVESTIMENTO

Gentile Cliente,

nel rispetto di quanto previsto dall'art. 50 del Regolamento Delegato (UE) 2017/565, di seguito forniamo indicazione dei costi ed oneri che sosterrà a fronte dell'acquisto o sottoscrizione del seguente strumento finanziario:

DENOMINAZIONE STRUMENTO FINANZIARIO	ISIN
Lux Im - Income Coupon DL	LU0255288671

Di seguito trova quindi indicazione:

a) dei costi totali connessi all'operazione, stimati sulla base di un importo di **investimento ipotetico pari ad euro 10.000,00;**

b) della quota parte dei costi totali riconducibile agli inducement riconosciuti al distributore;

c) dell'impatto sulla redditività del prodotto determinato ipotizzando un rendimento pari a zero e un **orizzonte di investimento pari a un anno**;

ACQUISTO/SOTTOSCRIZIONE	€	%
COSTI TOTALI*	617,50	6,175%
di cui inducement	401,00	4,01%
IMPATTO DEI COSTI SUL RENDIMENTO	617,50	6,175%

*Di cui commissioni di sottoscrizione € 300,00 (3%)
Tale valore non include i costi eventuali, ove applicabili, rappresentati dalle commissione di performance .

Banca Generali S.p.A.

2.4 Investment's cost disclodure

In case of purchase and sale of listed stocks, bonds and certificates, the total costs are represented by the trading fees charged for the type of transaction.

In case of purchase of PRIIPs products by retail customers, the relevant KID must also be delivered to the customer.[51]

[51] Circular 00308 Banca Generali Version 001

2.12 ADEQUACY, APPROPRIATENESS AND MERE EXECUTION OF ORDERS: APPLICATION IN BANCA GENERALI

The assistance offered by the intermediary to the client takes on different gradations in the MiFID approach depending on the nature of the service provided (see Article 19 of Directive 2004/39/EC and its implementing provisions). In the case of the more complex and higher-value-added services-i.e., portfolio management and advice-the intermediary is required to have a thorough knowledge of the client and an assessment of the "appropriateness" of the transactions recommended or investments made on his or her behalf.[52]

The intermediary should gather information that is useful in assessing the client's investment experience, financial situation, and goals. Thereafter, he will check that the proposed service actually corresponds to the client's stated objectives and does not place on him risks that he is unable to understand or bear. In the event that he does not obtain the information necessary to assess suitability, he will have to refrain from providing the advisory and management services. For financial services other than advice and management, the intermediary is required to make an assessment of "appropriateness." That is, he or she must judge whether the client has sufficient knowledge and experience to understand the risks inherent in the specific product or service proposed/requested, gathering information about the financial instruments with which he or she is most familiar, the frequency of transactions carried out in the past, the level of education, and the profession held. In the event that the client decides not to provide sufficient information to carry out the appropriateness assessment, the intermediary will warn him that he is unable to determine whether the service or product requested conforms to its characteristics; however, he may proceed to provide it, once this warning has been carried out. Finally, in the case of "mere execution of orders" (Execution only), the intermediary has no obligation to assess whether the transaction is appropriate to the client's characteristics: it is therefore not required to collect any information. The mode of mere order execution can be applied only when the service offered relates to shares listed on a regulated market, money market instruments, bonds and other debt securities, harmonized funds and other non-complex financial instruments.

[52] Circular 00175 Banca Generali Version 005

2.12.1. EXECUTION ONLY SERVICE

EXECUTION ONLY refers to the ability of investment firms, which perform execution and/or order receipt and transmission services, to provide these services without the need to conduct appropriateness assessments, all other operating methods (Order Execution, Inducement, Conflicts of Interest) remaining unchanged.

The intermediary receives, transmits and executes the client's order without the need to perform the appropriateness test.[53]

This possibility is applicable if ALL of the following conditions are met.

- The services are related to NON-complex financial instruments;
- The service is provided at the initiative of the client or potential client;
- The investment firm complies with its obligations regarding conflicts of interest;
- The client has been clearly informed that in providing this service the investment firm is not required to assess the suitability of the instrument or service provided.

A specific Execution Only contract must be signed for all clients (new and old), who wish to operate in this mode, in which the client acknowledges that for the activity performed under this regime, the bank will not do any testing of either appropriateness or suitability.

Execution Only is also compatible with advice, provided it is done in compliance with the above rules.

2.12.2 APPROPRIATENESS AND ADEQUACY ASSESSMENT MODEL

The cornerstones of the new model adopted by Banca Generali are several:

- Single mode of adequacy/appropriateness verification applicable to all areas of the bank's operations (assets under administration, asset management and insurance) and to all device channels usable by customers.[54]
- Order eligibility verification is carried out on all investment transactions (securities purchase, subscription, additional deposits and switches on asset management products).
- For insurance investment products (so-called IBIPS), the customer protection safeguards provided for in compliance with the IDD Directive apply and include product governance controls related also to the Target Market, customer demand & needs verification, and product suitability assessment (for details see Network Communication ID No. 50269 of 09/28/2018).[55]

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[53] European Banking Authority, Directive 2013/36/EU

[54] Circular 00175 Banca Generali Version 005

[55] CONSOB, Regulation n. 20307/2018

- 6 financial profiles for customers.

- A synthetic risk indicator (isr) for each individual product being placed or order taken, provided daily by an external company (Prometeia).

The isr "incorporates" information on:

- market risks
- counterparty risks
- liquidity risks

Of each financial instrument being assessed

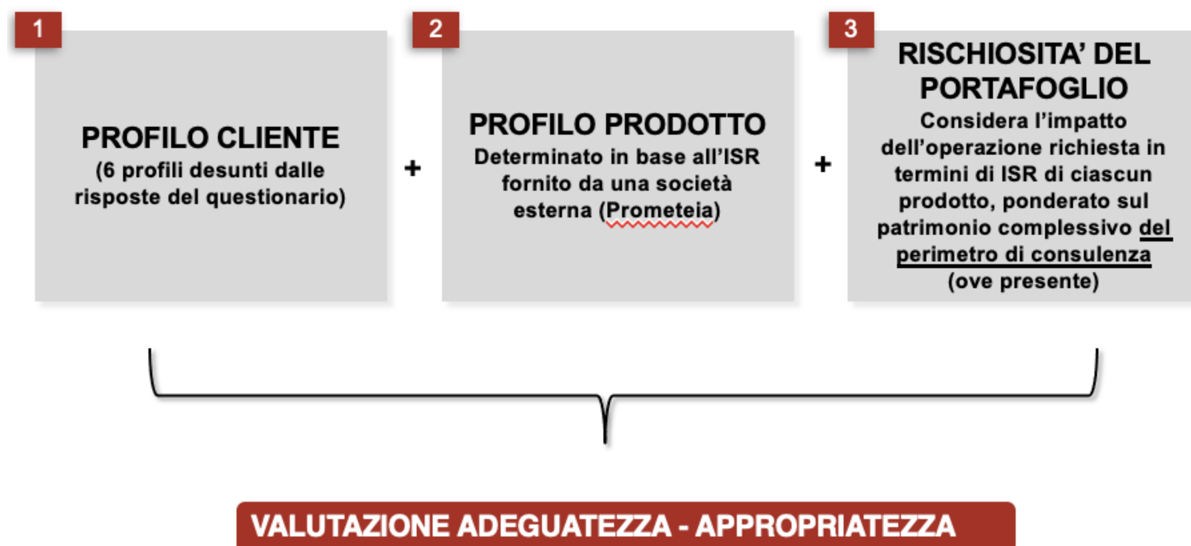
- Average portfolio SRI calculated on the perimeter of relationships defined by the advisory contract

- 3 parameters related to the adequacy assessment:

- type/object
- frequency
- size

Automated support tools to verify "ex ante" the actual adequacy/appropriateness:

- with the planning tool available on the BGPA platform, it is possible to simulate all transactions related to the selected individual advisory contract and simultaneously verify all related suitability checks.
- for only the transactions on managed (funds & sicavs, single-line gp), insurance and administered securities under placement arrangements, on the other hand, it is possible to use the simulators available on promoters front end.



2.5 Adequacy and appropriateness assessment scheme

The Bank has automated the additional controls required by the regulations with reference to the assessment of appropriateness and/or adequacy in the context of the distribution of illiquid products (ref. Communication to the Network BGMKWM011 dated 11/04/2011).[56]

- illiquid products distributed by the Bank are automatically identified through the appropriate indicator provided by Prometeia within the following types of products: (i) debt securities; (ii) class III and V insurance products; (iii) derivatives (including warrants and cw).
- to measure the degree of risk of illiquid products, the "unmediated" SRI determined by separately considering the different risk components (issuer/counterparty risk, market risk, and liquidity risk) is used. The unmediated SRI is determined by adjusting the SRI in consideration of the component that shows the highest risk.
- automation of the point comparison between the type of illiquid product to be purchased and the knowledge/experience declared by the client through the MiFID questionnaire
- automation of the punctual comparison between the time horizon (holding period) declared by the client (so-called "prevailing" time horizon indicated in the MiFID questionnaire) and the master/remaining life of the product to be purchased (as determinable on the basis of the master information of the financial instrument).

In Communication No. 0097996 of 12/22/2014 Consob intervened on the distribution of complex financial products to retail customers, highlighting that high levels of complexity increase the difficulties in understanding the characteristics of the proposed investments and are therefore likely to impair the ability to make informed investment decisions.

- Banca Generali, with a view to maximum client protection, has decided at the moment not to proceed with the distribution to retail clients of very high complexity products that Consob normally considers unsuitable for retail clients (products on the "black list")

- With regard to other very high complexity ("grey list") financial products, the Bank has defined specific "enhanced attention" safeguards in line with the provisions of the communication

Banca Generali has defined the introduction of concentration limits for complex products on the client's assets included in the scope of the advisory contract. In this context, a logic of gradualness has been defined in the control in question, which provides for increasing percentage limits of assets that can be invested in complex financial products according to the client's financial profile.

In this regard, please note that in order to trade in complex products, the client must answer in the affirmative regarding knowledge and/or experience to questions No. 9 and No. 10 of the MiFID

[56] Circular 00175 Banca Generali Version 005

questionnaire and provide a correct answer to both questions No. 14 and No. 15 of the "Complex Financial Products Subsection.". [57]

2.13 FINANCIAL INSTRUMENTS VALUATION: APPLICATION IN BANCA GENERALI

The following financial instruments are subject to evaluation (and related assignment of the synthetic risk indicator, SRI):[58]

- administered savings instruments
- bond placements (based on information in the prospectus)
- repos
- Funds and Sicavs surveyed in the Bank's securities registry
- GPFs and GPMs (based on the information in the mandate contract and the relevant benchmark)
- Class III and V insurance products (through an assessment of the underlyings, not a "global" assessment of the policy)

As part of the appropriateness and/or adequacy assessment, the "unmediated" SRI determined by separately considering the different risk components (issuer/counterparty risk, market risk, and liquidity risk) is used to measure the degree of risk of illiquid products. The unmediated SRI is determined by adjusting the SRI in consideration of the component that shows the highest risk.

Each financial instrument, on the basis of the assigned SRI, is placed in one of six risk classes, the significant changes during 2007/08 regarding especially instruments with equity components suggested the consideration of changes in procedural settings.

[57] CONSOB, Regulation n. 20307/2018
[58] Circular 00308 Banca Generali Version 001

	Rischio	Punteggio
1	Rischio 1	0 - 1,0009999
2	Rischio 2	1,0010000 - 2,5009999
3	Rischio 3	2,5010000 – 4,5009999
4	Rischio 4	4,5010000 - **10,0009999**
5	Rischio 5	**10,0010000 - 20,0009999**
6	Rischio 6	**≥20,0010000**

2.6 ISR Valuation

The proposed change affected the ranges of the highest risk classes (4, 5 and 6), containing products reserved for customers with higher profiles (medium-high, high and very high). In this regard:

- the 3 highest risk-product classes are those containing the largest number of products
- the 3 highest customer profiles represent the majority of customers.

Regarding the control by frequency is performed only for the adequacy assessment, A parametric facility has been set up that allows setting, for each customer profile and for each financial product risk class, a "maximum number of transactions that can be carried out" within a predefined time period (set at 7 days) beyond which the transaction will be considered unsuitable.
The time frame used to control the maximum number of transactions that can be executed is a fixed 7 days (Communication BGMKAM029 dated 29/05/09).

2.13.1 THE ISR OF THE ADVISORY PERIMETER

The SRI is also used to define the overall portfolio risk associated with a given advisory contract, in order to assess the appropriateness/appropriateness of orders also through comparison with the risk profile of the portfolio.
The overall riskiness of the portfolio is determined through the assignment of a score that considers the impact, in terms of SRI, of each financial product present, evaluated in relation to the corresponding percentage weight on the portfolio itself.
The weighting will be by the countervalue of the financial product present in the portfolio, updated daily.[59]

2.13.2 ADEQUACY CONTROL - APPROPRIATENESS OF THE ORDER

[59] European Banking Autorithy, Directive 2013/36/EU

The control is organized by successive levels: the first level is the comparison between the Customer's risk profile and the product's riskiness category.
If the riskiness category of the product is less than or equal to the Client's risk profile, the order results:

- under Placement, appropriate (and no further checks are provided);
- under Placement and full questionnaire (Sections A and B), appropriateness check, proceed with the second level of control (by frequency and size)
- under Advisory, adequacy check proceed with the second level of control (by frequency and size)

If the product risk category is higher than the Client's risk profile:
- one proceeds to the second level of control, which involves comparison with the average portfolio SRI (synthetic risk index) modified by the new investment. Comparisons are made by "category" (low, medium-low, etc.).
- the mechanism of operation of the second level of assessment of adequacy/appropriateness through the use of SRI requires that, for each order the impact, in terms of SRI of each financial instrument on the risk score of the portfolio associated with the scope of advice (if any) is assessed.

2.13.3 CONTROL BY OBJECT TYPE

Each portfolio is classified, based on its average SRI, into six classes, corresponding to the six types of Client profile. This check verifies the adequacy of the order by comparing the Client profile with the profile of your Portfolio.
The portfolio riskiness, including the marginal risk* contributed by the order the client intends to place, will be compared with the Client profile.
In case the portfolio riskiness (including the order being checked) is still less than or equal to that of the client profile, the order will be considered:
- Under Placement = appropriate (without further checks)
- Under Advisory or Comprehensive Questionnaire = go to the next checks (frequency and size).

2.13.4 CONTROL BY FREQUENCY

It is carried out only for the adequacy assessment, a parametric facility has been set up to set, for each customer profile and for each risk class of financial product, a "maximum number of

transactions that can be carried out" within a predefined time period (currently set at 7 days) beyond which the transaction will be considered unsuitable.

VALUTAZIONE FREQUENZA							
	7 gg	**Classe 1**	**Classe 2**	**Classe 3**	**Classe 4**	**Classe 5**	**Classe 6**
	Cauto	10	10	5	3	2	1
	Prudente	12	10	8	5	3	1
	Moderato	15	12	10	7	4	3
	Bilanciato	17	14	12	10	9	7
	Dinamico	20	18	15	13	12	10
	Avanzato	25	25	20	20	15	12

2.7 Maximum number of expected transactions per risk profile

For example: for a customer with a "LOW" risk profile, a maximum number of 10 transactions over 7 days in products belonging to risk class 2 is considered adequate. Upon exceeding the 10th transaction, the 11th order would be "not adequate."
The maximum number is currently calculated on the total number of transactions during the period, regardless of product classification.

2.13.5 CHECK BY SIZE

It is performed only for the adequacy assessment.
To enable the procedure to be applied correctly, the reference assets - updated with daily batches - is obtained by summing the C/C liquidity and the countervalue of Securities, Managed Savings, and Insurance Savings falling within the CONSULTANCY PERIMETER.
For each combination of client profile/risk class of financial product, a maximum percentage of "assets" that can be invested with a single provision has been defined.
Below is the current table showing the parameters set for size control. In other words, a client with a low profile will not be allowed to invest in the purchase of a class 4 security more than 10 percent of their assets.

Percentuale massima del controvalore dell'ordine rispetto al patrimonio						
profilo cliente / rischio prodotto	**Rischio 1**	**Rischio 2**	**Rischio 3**	**Rischio 4**	**Rischio 5**	**Rischio 6**
Profilo 1 – Cauto	95%	80%	40%	10%	7%	5%
Profilo 2 – Prudente	95%	90%	50%	15%	10%	7%
Profilo 3 – Moderato	95%	95%	60%	20%	15%	10%
Profilo 4 - Bilanciato	95%	95%	70%	60%	20%	15%
Profilo 5 – Dinamico	**100%**	**100%**	**90%**	**75%**	**35%**	**25%**
Profilo 6 – Avanzato	**100%**	**100%**	**95%**	**85%**	**45%**	**30%**

2.8 Maximum percentage of the order's CTV in relation to assets

2.14 PROFESSIONAL CLIENTS, RETAIL CLIENTS AND ELIGIBLE COUNTERPARTIES: INTRODUCTION

The levels of protection offered by MiFID also appear to be articulated in relation to the category to which the client belongs. A "professional" within the meaning of Directive 2004/39/EC is defined as a client "...who possesses the necessary experience, knowledge and expertise to make his or her own investment decisions and properly assess the risks he or she takes ..." (Annex II). The category rightfully includes credit institutions, investment firms, insurance companies, UCITS, asset management companies, pension funds, other institutional investors, national and regional governments, entities in charge of public debt management, entities dedicated to asset securitization, central banks, and international and supranational institutions (World Bank, IMF, ECB, EIB, etc.). The following may also be classified as professional clients: a) large enterprises, under certain conditions [60]; (b) clients not included in the types previously mentioned, provided that they make an explicit request to the investment firm (so-called "professional clients on request") and that the cases, conditions and procedures described in Annex II, Section II, of Directive 2004/39/EC are met [61]. "Eligible counterparties" are configured in MiFID as a subset of the

[60] Professional clients are large companies that meet at least two of the following size criteria: 1) balance sheet total, EUR 20 million; 2) net turnover, EUR 40 million; 3) equity, EUR 2 million.

[61] The recognition on request of the status of professional client presupposes that the intermediary carries out "...an appropriate assessment of the expertise, experience and knowledge of the client..." which reasonably enables him to consider "...having regard to the nature of the transactions and services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved" (Directive 2004/39/EC, Annex II, Section II, point II.1). In the course of the assessment, at least two of the following criteria should be fulfilled: 1) that the client has carried out transactions of a significant size on the market in question at an average frequency of ten per quarter over the previous four quarters; 2) that the value of the client's financial portfolio exceeds the EUR 500,000 threshold; 3) that the client works or has worked in the financial sector for at least one year, in a position that requires knowledge of the transactions or services envisaged. The request must be made by the customer in writing and may be made either generally or in respect of a particular service, transaction or investment product.

professional client category [62]. The granting of eligible counterparty status is relevant only with reference to the provision of specific investment services and related ancillary services [63]: proprietary trading, execution of orders on behalf of clients, and reception and transmission of orders. Finally, the category of "retail clients" includes all persons not included among professional clients and eligible counterparties; it also includes all those who request to be treated as such, either generally or for individual transactions. Classification as an eligible counterparty or as a professional client does not, in fact, affect the client's ability to enjoy more protective treatment, either generally or on a transaction-by-transaction basis; obtaining the different status is subject to the intermediary's consent. It is precisely the retail client who enjoys the highest level of protection under MiFID.[64] Directive 2004/39/EC specifies that, in good time prior to the provision of the service, all terms of the service must be made clear to the client, together with a range of information about the investment firm and its services, the nature and risks of the financial products, the instruments provided to safeguard client instruments or funds, the costs and all charges associated with the provision.[65] Instead, the professional client should be provided with information exclusively in relation to the nature and risks of the products or services offered, the safeguarding of client financial instruments and funds, and the existence and terms of any security rights or privileges that the investment firm holds or may hold over its financial instruments or funds. Before providing advisory and asset management services, the intermediary will acquire from the retail client all information that is useful to enable it to make an assessment of suitability; where the service is for services other than advice or management, it will only request information

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[62] The definition of eligible counterparty is transposed into Italian law by Article 58(1) and (2) of the Intermediaries Regulation. This Regulation identifies as eligible counterparties 1) investment firms, banks, insurance companies, OICRs, SGRs, harmonised management companies, pension funds, financial intermediaries registered in the lists referred to in Articles 106, 107 and 113 of the Consolidated Banking Act (TUB), the companies referred to in Article 18 of the TUB, electronic money institutions, banking foundations, national governments and their corresponding offices, including public bodies in charge of managing the public debt, central banks and supranational organisations of a public nature; 2) undertakings whose main business consists of dealing on own account in commodities and commodity derivatives; 3) undertakings whose exclusive business consists of dealing on own account in derivatives markets and - for hedging purposes only - in spot markets, provided that they are guaranteed by members who are members of the clearing organisation of these markets; 4) entities as listed above, resident in non-EU countries. Professional clients referred to in Annex 3 of the Intermediary Regulations, Section I, points (1) and (2), not included in the previous list, may be treated as eligible counterparties: these include stockbrokers and large companies.

[63] In accordance with Annex I to Directive 2004/39/EC, 'investment services and activities' include the reception and transmission of orders; the execution of orders on behalf of clients; dealing on own account; portfolio management; investment advice; underwriting of financial instruments and/or their placement on a firm commitment basis; the placement of financial instruments without a firm commitment; and the operation of multilateral trading facilities (Section A). On the other hand, 'ancillary services' (Section B) include: the renting of safe-deposit boxes and the administration of financial instruments on behalf of clients; the granting of finance to investors to carry out a transaction in one or more financial instruments; advice on capital, industrial strategy and related matters, and advice and services relating to mergers and the purchase of undertakings; foreign exchange services where these are connected to investment services; investment research and financial analysis; and underwriting services.

[64] Compliance e Anti Money Laundering Department, Banca Generali, 2018

[65] CONSOB, Regulation n. 20307/2018

from the client regarding his or her knowledge and experience about the specific product or service proposed/requested (appropriateness assessment). When the counterparty is represented by a professional client, there is a presumption in MiFID that the latter has the necessary level of knowledge and experience to understand the risks inherent in the products, transactions and services in relation to which he is classified as a professional client; with respect to such services, the appropriateness assessment may therefore be omitted. Where the financial service in question consists of the provision of investment advice, the investment firm has the right to assume that the professional client is financially capable of bearing any risk associated with it and compatible with its own investment objectives: the assessment of appropriateness will therefore be simplified compared with that to be made with respect to retail clients.[66] Some of the rules set by the European legislator to protect retail and professional clients do not apply to relationships with eligible counterparties. In particular, when providing the services of dealing on own account and on behalf of third parties and/or receiving and transmitting orders to such counterparties, investment firms are not required to comply with the obligations set out in Articles 19, 21 and 22 paragraph 1 of Directive 2004/39/EC - relating to general rules of conduct to be observed when providing services; the obligation to execute orders on the most favorable terms; and the obligation to apply procedures that ensure prompt and efficient execution of orders.

2.15 THE ORGANIZATIONAL REQUIREMENTS OF INTERMEDIARIES

As already mentioned, the objectives of MiFID include the introduction of uniform standards of organization and control of intermediaries. This issue is addressed by the Directive by resorting to a principle-based approach: that is, the legislator merely indicates objectives and minimum requirements, leaving intermediaries free to structure their organizational and management models independently. Moreover, the organizational structure and controls must be proportionate to the nature, size and complexity of the activity carried out by the intermediary, as well as to the type and range of services provided (so-called principle of proportionality). The provisions on the organization and control of intermediaries are dictated by Article 13 of Directive 2004/39/EC and detailed in Chapter II of Directive 2006/73/EC. In a nutshell, these sources define the obligations of intermediaries regarding general organizational requirements; business continuity; administrative and accounting organization, including the establishment of the regulatory compliance function; business risk management; and internal audit. Guidelines are also outlined for the establishment of procedures, including internal control procedures, for the proper and transparent provision of

[66] Circular 00175 Banca Generali Version 005

services; for compliance control; for the receipt and payment of incentives; for the handling of complaints; and for personal transactions. Finally, the conditions for the outsourcing of essential or important operational functions and the mitigation of related risks are established.[67]

2.16 CONCLUDING REFLECTIONS ON CURRENT LAW

In light of what has been said and argued above, it is clear that, with reference to contract regulation and contractual remedies, society has transformed in a neurotic and - at least to some extent - unpredictable manner, but the law has struggled to meet the new demands of market efficiency, particularly in terms of transparency and protection of small investors. For decades, it has been the prerogative of the law to ensure the formal equality of the parties during contract negotiations, and in this way, the very contract has become a symbol of the legal equality of subjects within our legal system. In recent years, however, it has been realized that the formal equality of the parties is no longer sufficient, since in numerous cases it translates into de facto inequality - in terms of culture, experience in the field and economic possibilities - between subjects who are only formally equal and that, therefore, the intervention of the law must be directed at attributing protections in favor of physiologically weak subjects, in order to bring the negotiating relationships back into effective balance. The latest version of the CMU contains provisions aimed at reinvigorating the securitization sector, making medium- and long-term investments more dynamic and decoupling them from the banking sector. As is well known, the Italian business environment (but, in fact, that of much of Southern Europe) is rich in medium-sized enterprises that, especially in recent years, are encountering increasing problems in accessing bank financing. It can be understood, then, how a mechanism - in which banks, which are the largest source of financing, are becoming increasingly reluctant to provide it, creating no small amount of concern in public and supervisory authorities (state and supranational) - is bound to lead to a slowdown in productive activities, with consequent repercussions on the economies of individual countries. It is here, therefore, that the need arises for a single capital market, that is, one that is integrated and coordinated at the European level also in terms of taxation, and that manages to transcend the specific traditional disciplines of individual member countries, with rules - among others - specifically aimed at favoring small and medium-sized enterprises. Discipline that takes on even greater significance if one considers it as a means of giving full and complete implementation to the Banking Union discipline as well.

[67] Circular 00175 Banca Generali Version 005

CHAPTER 3:
FOCUS CLASSIFICATION, CUSTOMER MANAGEMENT AND SUSTAINABILITY AT BANCA GENERALI.

INTRODUCTION

Having had the opportunity during the curricular internship at Banca Generali to examine the concrete application of MiFID regulations, this chapter will examine, in particular, the aspect of client classification and management, only introduced in the previous chapter of the paper.
Along with this, an increasingly predominant aspect in the policies of every company, including those of the financial sector, will be examined in depth; that of sustainability, in particular the application and integration of sustainability principles in investment processes will be addressed.

3.1 BANCA GENERALI FOCUS ON CUSTOMER CLASSIFICATION AND MANAGEMENT

The directive and its various "topics" are constantly evolving, and a practical example of how each financial institution transposes and, consequently, applies the regulation is provided to us by Banca Generali's internal circular on the directive published in September 2021.[68]
It highlights, in particular, the elements that concern, in the provision of investment services to clients, the activity of classifying them.
This classification is necessary and connected to the identification of the greater or lesser protection, which the Bank must grant to customers, both when opening investment relationships and when managing investment orders.
The purpose of the aforementioned circular is to define the operating procedures to be followed by staff when classifying customers for the first time or when changing/updating the classification.
The reference documents are:
- TUF - Consolidated Law on Finance (Legislative Decree 58/98) and subsequent amendments and additions.
- Consob Intermediaries Regulation 20307/2018 and subsequent amendments and supplements.
- Ministry of Economy and Finance Decree No. 236 of 11 November 2011.
- Banca Generali's Customer Classification Policy. [69]

68 Circular CR-B-00308, Banca generali, Version 002

[69] CONSOB, Regulation n. 24910, 2019

In particular, Article 35 of CONSOB Intermediary Regulation No. 20307 states that, when opening investment relationships, intermediaries shall inform customers of their classification as

1. retail client,
2. professional client,
3. eligible counterparty.

The determination of the class to which clients belong is reflected in a whole series of behaviours, outlined below, that the bank must adopt in the provision of investment services, and results in greater or lesser protection for those clients.

	Dettaglio	Professionali	Controparti qualificate
Valutazione appropriatezza ordini	Sì	NO	NO
Valutazione adeguatezza GPI e Consulenza	Sì completa	Sì completa	N/A
Best Execution negli ordini	Sì	Sì	NO
Consegna policy conflitto di interessi	Sì	Si	NO
Informativa sui conflitti di interessi	Sì	Sì	Sì

3.1 Clients' Class determination criteria

A "Retail Customer", pursuant to Article 35(1)(e) of the CONSOB Regulation

CONSOB Intermediaries Regulation, a client who is not a professional client or an eligible counterparty.

Professional clients are distinguished, according to their legal nature, into

- public professional clients
- private professional clients.

Professional clients also distinguish between those:

- "as of right": placed in this category on the basis of specific criteria identified by the legislator;
- "on request", i.e. those who may request to be considered by the intermediary as professional if they meet specific requirements; the classification "on request" provides for a preliminary assessment of the client's characteristics and its eligibility to be classified as a "professional client"; the classification may also be made for individual services or instruments.

For all investment services and instruments, private professional clients are defined as

(1) entities that are required to be authorised or regulated to operate in the financial markets, whether Italian or foreign such as:[70]

(a) banks;

(b) investment firms;

(c) other authorised or regulated financial institutions;

(d) insurance companies

(e) collective investment undertakings and management companies of such undertakings

(f) pension funds and management companies of such funds;

(g) dealers in commodities and commodity derivatives on own account

(h) entities engaged exclusively in dealing on own account on markets in financial instruments and which participate indirectly in the clearing service and the clearing and guarantee system (locals);

(i) other institutional investors;

(j) stockbrokers;

(2) large companies that have at least two of the following size requirements at the individual company level

- balance sheet total: Euro 20.000.000
- net turnover: Euro 40.000.000,
- own funds: Euro 2.000.000.

(3) Institutional investors whose main activity is investing in financial instruments, including entities engaged in asset securitisation or other financial transactions.

Professional public clients as of right for all investment services are exclusively

- The Government of the Republic;
- the Bank of Italy.

The criteria for identifying "private" professional clients and the persons considered as such by right (clients who possess the experience, knowledge and competence necessary to make their own informed investment decisions and to correctly assess the risks they assume) are identified by CONSOB in Annex 3 of the Intermediaries Regulations, while as regards "public" professional clients and the persons considered as such by right, it is the Minister of Economy and Finance who has identified the identification criteria with Ministerial Decree 236/2011.

The identification criteria are also set out in the Customer Classification Policy (available on the company intranet).

Eligible counterparties are defined as:

[70] Circular CR-B-00308, Banca generali, Version 002

(1) investment firms, banks, insurance companies, OICRs, SGRs, harmonised management companies, pension funds, financial intermediaries registered in the lists envisaged by Articles 106, 107 (carrying out, vis-à-vis the public, the activity of taking equity investments, granting loans, providing payment services and foreign exchange intermediation) and 113 (activity not vis-à-vis the public) of the Consolidated Banking Act, the companies referred to in Article 18 of the T.U.B. (financial companies admitted to mutual recognition), electronic money institutions, banking foundations, national governments and their corresponding offices, including public bodies in charge of managing the public debt, central banks and supranational organisations of a public nature; [71]

(2) undertakings whose principal activity consists in dealing on own account in commodities and commodity derivatives;

(3) undertakings whose exclusive business consists of dealing on own account in financial derivatives markets and, for hedging purposes only, in spot markets, provided that they are guaranteed by members who are members of the clearing organisation for those markets, where responsibility for the performance of contracts entered into by such undertakings lies with members who are members of the clearing organisation for those markets

(4) the categories corresponding to those in the preceding numbers of entities from outside the European Union.

Eligible counterparties are so defined only in relation to the specific services of order execution and/or dealing on own account and/or order reception and transmission, while for other investment services they are considered professional clients. They are subject to the minimum level of protection and safeguards provided by the regulations.

They are also eligible counterparties:

- entities that are required to be authorised or regulated to operate in the Italian or foreign financial markets (referred to in point 1) of the de jure professional clients) and large companies (referred to in point 2) of the de jure professional clients)
- firms that are qualified as such, pursuant to the Mifid II Directive, by the legislation of the EU State in which they are established or that are subject to identical conditions and requirements in the non-EU State in which they are established.

The Bank must obtain explicit confirmation from such counterparties, either generally or in relation to individual transactions, that they agree to be treated as eligible counterparties.

Articles 36 (General Information Requirements), 51(3) (Publication of Orders with Price Limits), 60 (Reporting to Clients), and the provisions of Title VIII of Book III and Book IV. of the

[71] Circular CR-B-00308, Banca generali, Version 002

Intermediary Regulations apply to the provision of investment and related ancillary services to eligible counterparties. With regard to disclosure requirements concerning the execution of orders not falling within the scope of portfolio management, the requirements applicable to disclosures to retail and professional clients apply, unless agreements are entered into with eligible counterparties to determine the content and timing of the disclosures.

Classification as an eligible counterparty is without prejudice to the client's right to request, either generally or on a transaction-by-transaction basis, to be treated as a professional client or, expressly, as a retail client. The request is subject to the Bank's consent.

Retail customers are defined as all customers who do not fall into the other two categories. This category enjoys the highest level of protection and safeguards granted by the Consob Intermediary Regulations to clients.[72]

3.1.1 IDENTIFICATION OF THE LEVELS OF PROTECTION ASSIGNED TO EACH CUSTOMER CATEGORY

The regulatory client categories are accorded different degrees of professional experience, which are correspondingly associated with different levels of protection. The category of "Eligible Counterparties" is accorded a minimum level of regulatory protection. In the provision of investment services and related ancillary services, Articles 36, 51(3) and 60, as well as the provisions of Title VIII of Book III and Book IV of the CONSOB Intermediary Regulations (concerning: advertising and promotional information and communications, suitability statements in the investment advisory service, client order management, client reporting, governance of financial instruments, procedures for the correct and transparent provision of services, regulatory compliance monitoring, complaint handling, personal transactions, conflict of interest management, record keeping).

In any case, classification as an eligible counterparty does not affect the subject's right to request to be treated as a professional client or, expressly, as a retail client. Pursuant to Article 61 of the EU Delegated Regulation 2017/565, the requirements for disclosures to retail and professional clients generally apply, except where the Bank enters into agreements with eligible counterparties to determine the content and timing of disclosures.

The category of "Professional Clients" is accorded an average level of regulatory protection, considering that the professional client ("as of right" and "on request") already possesses the necessary knowledge and experience to understand the risks inherent in the types of financial

[72] Circular CR-B-00308, Banca generali, Version 002

instruments or financial products or investment services for which he is classified in the category of professional clients.[73]

The category of 'Retail Customers' is accorded the highest level of protection.

3.1.2 CUSTOMER ACQUISITION METHODS

The acquisition of a new Customer understood as a natural or legal person to whom the Bank provides investment or ancillary services generally takes place through: o the Private Relationship Manager networks; o the Financial Planner, Financial Planning Agent, Private Banker and Wealth Advisor networks; o the Branch network.

- On the basis of CONSOB regulations, natural persons, with the exception of the category of Exchange Agents, fall into the class of "Retail Clients".

Individuals who come into contact with such customers must request from them the necessary documentation for the correct census and classification in the "General Register" procedure. In the case of a Stockbroker, the documentation necessary to ascertain his activity must be requested. Natural persons may be classified as professional clients upon explicit request and only if they meet specific requirements indicated in the following paragraphs

- With regard to legal persons, the person coming into contact with them must verify the documentation necessary to identify the existence of the requirements provided for by the regulations for proper classification.

Below is a synoptic overview of the different classification categories of a legal entity:

	Tipo CDG	Descrizione	Cliente al Dettaglio	Cliente Professionale	Controparte Qualificata
Banche	BA	Banca		√	√
Banca d'Italia	BI	Banca Centrale		√	√
Governo della Repubblica	TS	Tesoro Stato		√	√
Sim e Imprese di Investimento UE	SC	Società di capitali		√	√
Altri Istituti finanziari autorizzati o regolamentati	AS	Assicurazioni e Fin. Private		√	√
Imprese di Assicurazione	AS	Assicurazioni e Fin. Private		√	√
Organismi di investimento collettivo e società di gestione di tali organismi	SC	Società di capitali		√	√
Fondi pensione e società di gestione di tali fondi	SC	Società di capitali		√	√
I negoziatori per conto proprio di merci e strumenti derivati su merci	SC	Società di capitali		√	√
Soggetti che svolgono solamente la negoziazione per conto proprio su mercati di strumenti finanziari e che aderiscono indirettamente al servizio di liquidazione nonché al sistema di compensazione e garanzia	SC	Società di capitali		√	√
Altri Investitori Istituzionali	MT, DP, PT	Monte titoli, Cassa DD PP Poste,		√	√
Imprese	SC		Altri casi rispetto a quelli della colonna "cliente professionale"	Se rispettano almeno 2 dei seguenti requisiti a) totale bilancio 20.000.000 Euro b) fatturato netto 40.000.000 Euro c) fondi propri 2.000.000 Euro	
Intermediari finanziari iscritti nell'albo previsto dall'art. 106 del Testo Unico Bancario	SC			√	√

3.2 Legal Enterprise categories

[73] Clients Classification Policy PY005, Banca Generali, Versione 006

3.1.3 COMMUNICATION AND RECORDING OF CUSTOMER CLASSIFICATION IN THE COMPUTERISED PROCEDURE

Article 45(1) of EU Delegated Regulation 2017/565 requires the Bank to notify new customers, and existing customers who have been reclassified, of their classification as a retail customer, professional customer or eligible counterparty. In this regard, it is necessary to collect the customer's complete personal data and send the complete documentation to the Organisational Unit in charge of the customer census and the opening of relations. [74]

Upon completion of the customer census and the opening of relations, the CSE procedure prints a communication indicating, in addition to the customer's financial profile and acceptance of the advisory and placement contract, the classification assigned to the customer. [75]

Each communication also contains the information for clients, expressly provided for by Article 45, paragraph 2, of the EU Delegated Regulation 2017/565, on the possible right to request a different classification and on any limits that would result from this in terms of protection. It should be noted that, pursuant to Article 61(2) of the CONSOB Intermediary Regulations, the eligible counterparty is required to notify the Bank of its acceptance of classification in the "Eligible Counterparties" category.

When the client is a large firm, as defined in Appendix 3 of the CONSOB Intermediary Regulations, the Bank must inform it, prior to any provision of services, that, on the basis of the information available to it, it is considered by right a professional client and will be treated as such unless the Bank and the firm agree otherwise. It is the duty of the Operator of the Organisational Unit in charge to enter into the "General Registry" procedure, by means of the appropriate transactions, the data relating to the Customer and to the classification assigned, so as to enable the Information System to be updated immediately. Each time there is a change in classification, it is the duty of the said Operator to update the status of the customer in the procedure.

3.1.4 CHANGE OF CUSTOMER CLASS

The CONSOB Intermediary Regulations allow customers to request a different classification. The following transitions from one class to another are therefore permitted, subject to the existence of the necessary requirements: - from eligible counterparty to retail client; - from eligible counterparty to professional client; - from retail client to professional client on request; - from professional client

[74] Clients Classification Policy PY005, Banca Generali, Versione 006

[75] Circular CR-B-00419, Banca generali, Version 001

by right to retail client. It is made clear that there are no further transitions from one category to another.

3.1.4.1 TRANSITION FROM ELIGIBLE COUNTERPARTY TO RETAIL OR PROFESSIONAL CLIENT

The Bank, pursuant to Article 45(3) of EU Delegated Regulation 2017/565, acting on its own initiative or at the request of the customer concerned, may treat as a retail or professional customer a customer who might otherwise be classified as an eligible counterparty (see Section 2.1). In such a case, the person in contact with the customer must collect the customer's written request and forward it to the appropriate Organisational Unit, which must - assess whether or not to accept the customer's request; - file the customer's request; - update the customer's classification in CSE's General Registry procedure accordingly. The change to the new category of "retail customer" or "professional customer" entails the assignment of greater protection. To this end, the Bank will send the customer written notice of acceptance of the request for change of classification.

3.1.4.2 TRANSITION FROM RETAIL CUSTOMER TO PROFESSIONAL CUSTOMER ON DEMAND

The Bank may treat a retail customer, whether natural or legal person, as a professional customer, subject to the express written request of the latter. In such a case, the person handling the contact with the customer must

- give the customer the appropriate request form, which differs according to the type of customer (natural person, private legal entity or public body);
- have the customer complete and sign the form in its entirety;
- acquire from the customer any documentation necessary for examination of the request;
- forward the request to the Organisational Unit responsible for assessment.[76]

The Bank must warn customers, in a clear written communication, of what protections and indemnification rights they may lose; and customers, in turn, must state in writing, in a separate document from the contract, that they are aware of the consequences of losing those protections.[77]
The competent Organisational Unit examines the customer's request, verifying the presence and completeness of the customer's declaration that he meets the requirements (and, where appropriate,

[76] Circular CR-B-00419, Banca generali, Version 001
[77] Clients Classification Policy PY005, Banca Generali, Versione 006

the documentation provided by the customer or obtained through archives and public records). The disapplication of rules of conduct laid down for the provision of services to non-professional customers is permitted when, after carrying out an adequate assessment of the Customer's competence, experience and knowledge, the Bank may reasonably believe, taking into account the nature of the transactions or services envisaged, that the Customer is capable of making his own investment decisions in an informed manner and of understanding the risks he is taking. In the absence of anomalies, the Bank accepts the request to change to 'professional client' status. With reference to private customers, pursuant to Appendix 3, Part II of the CONSOB Intermediary Regulations, the existence of at least two of the following requirements is required (the so-called competence test) - the client has carried out transactions of a significant size (amounting to more than EUR 10,000 and whose average countervalue is more than EUR 30,000) on the market in question with an average frequency of 10 transactions per quarter in the previous four quarters; - the value of the client's portfolio of financial instruments, including cash deposits, must exceed EUR 500,000; - the client works or has worked in the financial sector for at least one year in a professional position that presupposes knowledge of the transactions or services envisaged. In the case of legal persons, the above assessment is conducted with regard to the person authorised to carry out transactions on their behalf and/or the legal person itself. With regard to public customers, the Regions, the Autonomous Provinces of Trento and Bolzano, the local authorities referred to in Article 2 of Legislative Decree No. 2671 of 18 August 2000, as well as national and regional public bodies, may apply to the Bank to be treated as professional customers, provided that they jointly meet the following requirements (the so-called competence test):

a) final revenue ascertained in the last approved management statement in excess of EUR 40 million;

b) having carried out transactions on the financial market with a total nominal or notional value exceeding €100 million during the three-year period preceding the conclusion of the contract

c) the presence on the staff of financial management personnel who have acquired adequate skills, knowledge and experience in investment services, including those of collective management, and financial instruments. The non-application of the rules of conduct laid down for the provision of investment services to retail clients is permitted if, after conducting an adequate assessment of the skills, experience and knowledge of the financial manager at the entities indicated above, the Bank can reasonably believe, taking into account the nature of the transactions or services envisaged, that the public client is actually capable of making informed investment decisions and understanding the risks he assumes. Public clients referred to above may waive conduct of business protections only if:

(a) the application form is accompanied by a declaration by the financial manager that he/she has appropriate professional qualifications in financial matters, indicating his/her experience in the financial sector;
(b) the clients declare in writing that they are aware of the consequences of the loss of protection and the risks assumed. Public clients shall inform the Bank of any changes that could affect their classification; in any event, the Bank shall take appropriate action if it finds that the client no longer meets the conditions necessary for professional client treatment. At the end of the proficiency test, if successfully completed, the Bank shall notify the client of the acceptance of the request for a different classification. To this end, the Organisational Unit in charge thereof:
- sends the customer the appropriate written notice of change of classification;
- updates the customer's classification in the procedure.[78]

3.1.4.3 TRANSITION FROM PROFESSIONAL TO RETAIL CUSTOMER

Persons listed in Appendix 3 of the CONSOB Intermediary Regulations, and considered as professional clients, may request treatment as retail clients from the Bank, which may agree to provide them with a higher level of protection. It is up to the client considered to be a professional by right to request, in writing, a higher level of protection if he considers that he is unable to properly assess or manage the risks assumed. In such a case, the person handling the contact with the client must - have the appropriate form filled out in full and signed by the customer; - forward the request to the Organizational Unit in charge of assessment, which must proceed to update the customer's class in the procedure. The Bank shall send the client a written notice of acceptance of the request.

3.1.4.4 REVISION OF THE CLASSIFICATION OF PROFESSIONAL CLIENTS

It is the responsibility of professional clients to inform the Bank of any changes that might affect their current classification. However, the Bank is obliged to reclassify professional clients as retail clients if it finds that they no longer meet the necessary conditions to be treated as professional.

3.1.5 FUNCTIONS RESPONSIBLE FOR CARRYING OUT CHECKS ON CLASSIFICATION ACTIVITY

[78] Clients Classification Policy PY005, Banca Generali, Versione 006

Different levels of control are foreseen on the classification activity carried out by Financial Advisors, Private Relationship Managers and Addiction Operators. In particular: - a line control carried out by the Heads of the Departments and/or the Functions of the Finance Department in charge of classification, aimed at verifying the correctness of the procedures adopted on the subject of classification (requesting requirements, sending/delivering documentation, etc.); - a second-level control carried out by the Compliance Department on classified customers. a second-level control performed by the Compliance Department on customers classified as "Professional Customers" and "Qualified Counterparties", with the aim of assessing the adequacy and effectiveness of the overall customer classification process; - a third-level control performed by the Internal Audit Department, with the task of validating, on a sample basis and periodically, the entire customer classification process. Any classification errors must be promptly notified to the competent Organisational Units, which shall take the appropriate steps to remedy the anomaly detected.[79]

3.1.6 SPECIAL WAYS OF CLASSIFYING CUSTOMERS

Banca Generali is obliged to inform clients of any right to request a different classification and of any limits to client protection that would result.

Therefore, the Bank may, on its own initiative or at the client's request:

(a) treat as a professional or retail client a client who might otherwise be classified as an eligible counterparty;

(b) treat as a retail client a client who is considered to be a professional client by right.[80]

The persons listed above may request Banca Generali to treat them as retail clients and the Bank may agree to provide them with a higher level of protection (so-called downgrade).

Where the client is a company, classified as a professional client, the Bank must inform it, prior to any provision of services, that, on the basis of the information available to it, it is considered by law to be a professional client and will be treated as such unless the Bank and the client agree otherwise. The Bank must also inform the client that he may request a modification of the terms of the agreement in order to obtain a higher level of protection.

It is up to the client who is considered to be a professional as of right to request a higher level of protection if he feels that he is unable to properly assess or manage the risks assumed with regard to investments. To this end, clients considered to be professionals as of right must request in writing to be treated as retail clients.

[79] Clients Classification Policy PY005, Banca Generali, Versione 006

[80] Circular CR-B-00419, Banca generali, Version 001

Conversely, the Bank may treat retail clients, who expressly request to be treated as professional clients (professional clients on request), provided that the criteria and procedures mentioned below are complied with (so-called upgrade).
However, the Bank is not permitted to assume that such customers possess market knowledge and experience comparable to that of the categories listed as professional by right.
The non-application of the rules of conduct laid down in the provision of investment services for the protection of retail clients is permitted if the Bank, having made an adequate assessment of the client's expertise, experience and knowledge in accordance with the criteria set out below, can reasonably assume that the client is capable of making informed investment decisions and understanding the risks involved.
Therefore, a retail client (natural or legal person) may be treated as a professional if he meets at least two of the following requirements
1. has carried out transactions of a significant size with a minimum frequency of 10 transactions per quarter[81] in the preceding four quarters (all transactions arranged with Banca Generali and those carried out with a third institution are considered as such in the scope of the 10 transactions, to be attested by the presentation of an appropriate supporting document[82] on the last available date);
2. the value of the customer's portfolio, including cash, is greater than €500,000.00 (the customer's portfolio may also consist of assets held with a third party institution. This must be certified by the presentation of an appropriate supporting document[83] at the latest available date);
3. has at least one year's professional experience in the financial sector in a position requiring knowledge of the transactions and services provided.
The possession by the private client, requesting to be treated as professional, of the requirements of professionalism laid down for managers and directors of entities authorised in the financial sector in accordance with Community directives (as a rule, firms registered with the registers of the supervisory authorities) may legitimately be taken as a reference for assessing the client's competence and knowledge.
In the case of legal persons, the assessment referred to in the last requirement above is conducted with regard to the person authorised to carry out transactions on their behalf and/or the legal person itself. In this regard, it should be noted that, in the event of changes in the Company's staff classified as professional with reference to the person authorised to carry out transactions, it is verified that the successor person meets the requirements of knowledge and experience. [84]

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[81] At least 10 transactions for each quarter in the previous four quarters.
[82] For example: Account statement, securities account statement on the first available date.
[83] E.g.: Account statement, securities account statement on the first available date.
[84] Circular CR-B-00308, Banca generali, Version 002

In this regard (change of the legal representative of a company classified as professional) and in order to monitor these master changes, the operator of the O.U. Middle Office Operations - Team Research and Queries quarterly runs a Query that extracts all 'Legal Person' customers classified as professional who have changed the Legal Representative - RL within the reference period.
The operator verifies that in the NOTE field of the client's classification there is the wording: 'Requirement regarding RL knowledge and experience'.
In such cases, the Research and Query Team shall classify the legal entity from Professional to Retail (downgrade) and inform the Financial Advisor of the need to acquire, if possible, a new classification request to Professional, subject to the usual assessment.
With regard to public customers, the following may request the Bank to treat them as professional customers:
- the Regions
- the Autonomous Provinces of Trento and Bolzano,
- the local authorities referred to in Article 2 of Legislative Decree No. 2675 of 18 August 2000,
- national and regional public bodies, provided they jointly meet the following requirements (so-called accrual test)
- final revenues ascertained in the last approved management statement in excess of EUR 40 million
- having carried out transactions on the financial market with a total nominal or notional value exceeding €100 million during the three-year period preceding the conclusion of the contract
- the presence of financial management personnel having acquired adequate skills, knowledge and experience in investment services, including those of collective management, and financial instruments.
The non-application of some or all of the rules of conduct envisaged for the provision of investment services for the protection of retail customers is allowed if, after carrying out an adequate assessment of the skills, experience and knowledge of the financial management personnel at the entities indicated above, Banca Generali can reasonably believe, taking into account the nature of the transactions or services envisaged, that the public customer is actually capable of making informed investment decisions and understanding the risks he/she is assuming.
Public clients referred to above may waive the protections afforded by the conduct of business rules only if:
- the clients declare in writing that they are aware of the consequences of losing the protections and the risks assumed.

- The form "Request for change from retail client to professional on request - public body" is accompanied by a declaration from the financial manager stating that he/she has adequate professional qualifications in financial matters, indicating experience in the financial sector.
It is the responsibility of professional clients, whether public or private, to inform the Bank of any changes that might affect their current classification. If, however, the Bank discovers over time that the client no longer fulfils the conditions necessary for professional client treatment, it must take appropriate measures by reclassifying the client as a retail client.[85]

3.1.7 CUSTOMER CLASSIFICATION PROCESS

The Intermediary Regulation requires intermediaries to adopt in writing appropriate internal measures to classify clients. To this end, Banca Generali has prepared the Client Classification Policy to which reference should be made. This Policy is valid for the classification of all new clients who have signed an investment services contract since 1 November 2007.[86]
MIFID regulations also require that new clients must receive written notice of their classification.
The transactions relating to client classification, with particular reference to the tables containing this classification, are contained in the AOX menu - Functions for MiFID, within the AO procedure in Host CSE and are as follows:

✓ general parameters for client classification;

✓ tables for entering or displaying the proposed client classification;

✓ tables for entering or displaying the actual classification of customers;

✓ tables for entering or displaying exceptions to the classification of customers.

This operation is preparatory to the opening of any investment relationship (e.g. a placement or custody contract) and, as such, must be carried out prior to contract opening transactions.

3.1.8 CLASSIFICATION OF NEW CUSTOMERS

The MiFID classification of new clients takes place at the stage of the master census of the client and their relationships.[87]

[85] Circular CR-B-00419, Banca generali, Version 001
[86] Circular CR-B-00308, Banca generali, Version 002
[87] Clients Classification Policy PY005, Banca Generali, Versione 006

This phase is carried out by different units depending on whether the customer is a natural person or a legal person (in the latter case, the Legal Entities Opening Team within the Customer Acquisition Administered Savings Unit).

The CSE procedure has been appropriately parameterised so that, depending on the type of CDG and the economic sector, it classifies customers correctly. As also stated in the Classification Policy, it has been provided by Banca General that natural persons are all classified by the procedure as retail customers, while legal persons, depending on the type of CDG or SAE will be classified in one of three categories.

The procedure recognises all legal persons included in specific SAEs, such as banks, SGRs and SIMs, as eligible counterparties.

For prudential purposes, Banca Generali has decided to classify large companies, which are considered professional clients by law, as retail clients, unless there is an express request from the client to change the classification. In this regard, the Legal Representative must issue an attestation, in which he certifies that he meets the requirements necessary for his company to be considered a large company.

The operator then proceeds to classify the newly registered customer in one of the three categories provided for. In particular

- if it is a "natural person", the functionalities of the FER application - "Front End Networks" and, if it is not available, the transaction Host AXCS - Management of MIFID classification proposal must be used;
- if instead it is a "legal person", the only functionalities available are those of the AXCS transaction mentioned above.

During the census of new customers, the classification, only if different from that provided for by default by the procedure, must be approved by the Bank in order to become definitive.

Similarly, in the case of changing the classification of existing customers (not managed by the FER application but only by Host), approval by the Bank is required. Only then can the classification proposal become a final classification and be recorded in AXFS. For approval there is a specific functionality, available only to Host, in the AXCS transaction.[88]

At present, customer classification information is only available and searchable in the AO procedure archives, and cannot be viewed by the FF file management procedure transactions (with the exception of the FFOS order management transaction).

The FFDS transaction when opening deposits, however, checks for the presence of a customer classification, and if there is not a definite one, displays a blocking error.

[88] Circular CR-B-00419, Banca generali, Version 001

Without prejudice to the above, the specific operations provided for the Financial Planners, Financial Planning Agents, Wealth Advisors and Private Bankers network and the Relationship Managers network are described below:

- Financial Advisor Network.

The assessment of the classification of clients in a manner different from that established by the ordinary procedure (including approval) is reserved exclusively for the Head of the Legal Entities Opening Team / Individuals Opening Team, to whom requests from clients to be classified differently will be forwarded already at the initial census stage.[89]

- Relationship Manager Network.

With regard to customers under the Relationship Managers' responsibility, their relationships must only be opened on the Private Centres' branch codes. Accordingly, operations in this regard are reserved for the Private Centre Manager, to whom requests from customers to be classified differently must be submitted as early as the initial census stage. The Head of the Private Centre, after assessing, on the basis of the criteria set out in the Customer Classification Policy, the admissibility of requests, will, if favourable to the request, authorise the change of classification in the Host procedure.[90]

The Private Branches forward requests to open relationships to the relevant Private Branch Office, which carries out the necessary activities also in respect of customer classification.

Having described the specific features outlined above for the Financial Advisor network and the Relationship Manager network, operations for Financial Advisors and Relationship Managers proceed jointly as detailed below.

The CSE procedure, upon completion of the correct entry of all data and upon opening of the relationships, automatically sends clients the communication regarding their classification, which will vary depending on whether they have been classified as retail or professional clients or eligible counterparties.

The confirmation of classification is sent to the client together with the acceptance of the placement contract and any financial profile determined on the basis of the Mifid suitability score.

[89] Clients Classification Policy PY005, Banca Generali, Versione 006

[90] Circular CR-B-00419, Banca generali, Version 001

3.1.9 CHANGE OF CLASSIFICATION

The regulations provide that customers may request to be classified, in the presence of pre-determined requirements, in the category above the one they belong to (upgrading) or in the category(ies) below (downgrading).
As already stated in the Classification Policy, the Bank must assess any requests by customers for upgrading on the basis of predetermined criteria, the details of which are set out in the Policy.
In relation to downgrading requests, the Bank does not have to verify any prerequisites and, unless there are particular cases in which the management of the client would be negatively affected by downgrading (e.g. qualified counterparties managed directly by the Finance Department whose operations could be limited by the new classification), it will always accept the client's request, with a view to meeting the client's needs.
Operationally, the request for new classification signed by the client can only be collected by the distribution networks (Financial Advisor / Relationship Manager / Branches). It is not possible to request a new classification through the Contact Centre.
The only exception envisaged concerns institutional clients (banks, SGRs, SIMs, etc.) accredited with the Finance Department, which will directly collect, on the relevant forms attached to the circular, the request for new classification of the same and will forward it to the U.O. Middle Office Operations - Research and Reconciliation Team.

3.1.10 NETWORK OF FINANCIAL ADVISORS

The Financial Adviser and the Branches will collect the customer's request on the special forms for upgrading requests from natural persons and legal persons - also available at FEP - and for downgrading requests and send it via electronic bill to the Middle Office Operations - Research and Quarters Team.[91]
Professional clients in law:
With reference to:
- large companies
- entities that are required to be authorised or regulated to operate in the financial markets, whether Italian or foreign

[91] Circular CR-B-00419, Banca generali, Version 001

- institutional investors whose main activity is to invest in financial instruments, including entities engaged in securitisation of assets or other financial transactions, the team member.

1) receives the legal entity customer's attestation and verifies that the form is correctly completed and signed;

2) verifies that at least two of the following parameters are met (in the case of large companies)

- balance sheet total: Euro 20,000,000[92],

a. accesses the "Cerved Services" application available in the SR Web application menu and requests the latest available financial statements of the legal entity

b. consults the balance sheet and verifies that at least two of the three requirements are met:

- net turnover: Euro 40,000,000
- own funds: Euro 2,000,000;

in the following manner:

3) if positive, and after having obtained the opinion of its Manager on any complex cases, it accepts the request by entering the new classification in CSE with the AXCS transaction and, with the FUPS transaction function P, it adds to the customer's CDG the records relating to classification policies for professional customers and smart order routing systems

4) in the negative, rejects the request by sending the specific rejection form to the customer while giving evidence of it by e-mail to the Financial Advisor / Relationship Manager.

Professional customers on demand and downgrading:

Given that the professional client is "a client who possesses the necessary experience, knowledge and expertise to make informed investment decisions and to correctly assess the risks he/she assumes", the operator of the Middle Office Operations O.U. (Research and Reclassification Team) upon receipt of the upgrade request - shall verify

- the correct and complete completion of the reclassification request form;
- the client's knowledge of all the financial products/services/transactions listed in Section A - APPROPRIATENESS/ADAPPROPRIATENESS of the MIFID Questionnaire (in the absence of this preliminary requirement, the operator will not be able to proceed with the upgrade)
- that the client has correctly answered questions 11-12-13 of the Complex Products subsection of the Mifid Questionnaire:

11: There is a direct relationship between the return and the risk of a financial product: the higher the expected return, the higher the risk.

12: Investment in the share of a single company is typically less risky than investment in a broad spectrum of securities

[92] Balance sheet total means total assets.

13: 'Credit risk' is the risk that the issuer of a bond is unable to pay coupons and/or repay principal at maturity

- that there is also consistency between what the client indicates in section B - suitability - of the Mifid Questionnaire on the size of his assets and his possible declaration in the upgrade request that he has assets in excess of EUR 500,000.

- Assets declared entirely with Banca Generali: the operator verifies that an amount greater than 500,000 Euro is present on the client's position at the date of the check and
  - if positive, it verifies that assets in excess of 500,000 Euro have been indicated in the Mifid questionnaire and if not, it informs the Financial Advisor by e-mail that the client must update the Mifid Questionnaire and proceeds to reject the request for upgrading
  - otherwise, deems that the assets requirement is not met and informs the Financial Adviser and rejects the upgrading request if two other of the requirements are not confirmed.
- Part of the declared assets held with a third party institution: the Financial Advisor verifies that the sum of the assets held with Banca Generali and the assets deposited with the third party institution is greater than 500,000 euro and that appropriate documentation is present to confirm that the assets are held with the third party intermediary[93] e:
  - in the positive case, verifies that the client has declared in the Mifid Questionnaire assets of 500,000 Euro and in the event that this has not been indicated, informs the Financial Advisor by e-mail that the client must update the Mifid Questionnaire and proceeds to refuse the request for upgrading ;
  - in the event that, even taking into account assets held with third parties, the minimum asset requirement is not met, inform the Financial Adviser and refuse the upgrading request.[94]

The verification of the client's assets takes into account all the accounts held in his name and/or jointly held.

If the client declares that he/she has carried out the required transactions with Banca Generali (the average value of which must exceed 30,000 euros with a minimum amount greater than 10,000 euros and a minimum frequency of 10 transactions per quarter in the four preceding quarters), in order to carry out the appropriate checks, the operator performs the inquiry of the transactions[95] both on the ordinary dossier (cat. 005 [96]) either on the technical file of funds (cat. 013). Movements made on client management mandates (cat. 055) are not taken into account, without prejudice to any specific instructions given by the client[97].

[93] E.g. account statement, securities account statement, etc. dating back no more than the last three months.

[94] Circular CR-B-00419, Banca generali, Version 001

[95] Transactions related to: purchases/sales, subscriptions/redemptions..

[96] This also includes any purchase/sale transactions carried out within the scope of BG Saxo Sim's executive service.

[97] To verify the presence of any specific instructions on portfolio management, the operator, using the FEP application, checks whether there are any movements marked with the symbol D - Dispositions in the past year..

In the event that the customer declares that he/she has carried out the transactions envisaged by the rule with a third party intermediary, the trader verifies that the form is correctly filled out with the indication of the third party intermediary in question and that appropriate documentation is attached to confirm the requirement[98]. Where the intermediary indicated is BG Saxo SIM, the Bank verifies the correspondence with the evidence (number of transactions of significant size in the last four quarters) in the IT procedures.

As regards the requirement of professional experience in the financial sector, the customer is required to include in the upgrade request a brief description of the role and position held that have enabled him to acquire the necessary professional experience. It should be noted that qualification as a Financial Advisor (verified through access to the Financial Advisors' Register) is considered a sufficient requirement.

In general, if the client declares to have developed at least one year of professional experience in the financial sector in an appropriate position at an Italian company, it is always necessary to verify through CERVED visura that such position was actually held and what is the economic sector of the company. In particular:

1) if the customer declares to have held offices as manager or director in companies registered in a register kept by the (Italian or Community) Supervisory Authorities, the requirement of professionalism is fulfilled; it is however necessary to verify through inquiries on the sites of the Supervisory Authorities that the company is actually registered in the register

2) if the customer declares to have held a position as manager or director in a large enterprise classified as a professional customer by right, where such role presupposes knowledge of the instruments/services for which the upgrade is requested (e.g. financial manager, treasury manager and the like), the requirement is deemed to have been met

3) the mere position of manager or director in a company not belonging to the financial sector is not a sufficient condition to consider the requirement of professionalism fulfilled, without prejudice to the possibility for the customer to supplement the request with the necessary evidence to allow the Bank to assess whether the requirement is fulfilled.

Please note that at least two of the three requirements (assets, number of significant quarterly transactions, professional experience in the financial sector) must be met on the basis of the information declared in the application form or of the data in the Bank's possession.

If the operator detects that at least two of the three requirements are met without finding any anomalies, he accepts the request, gathering the opinion of his Manager for any doubtful / complex cases, and enters the new classification in CSE with the AXCS transaction.

[98] E.g.: securities dossier statement containing the movement, list of orders placed produced by the third party intermediary, etc. useful for recording the movement over the last 4 quarters.

In the event that the operator finds anomalies in the completion of the application form or in the fulfilment of the requirements he will request the Financial Advisor concerned to rectify them if possible.[99]
In caso di rifiuto di *upgrading* l'operatore darà comunicazione al Consulente Finanziario del cliente tramite e-mail, segnalando le motivazioni alla base del rifiuto.
In the case of a downgrading request, the operator accepts the request by entering the new classification in CSE with the AXCS transaction.
In the case of both downgrading and upgrading, the operator, with the transaction FUPS function P, adds the classification policy records for the assigned customer category and smart order routing systems to the CDG of the customer.
Each time the customer is reclassified, a new record is inserted into the AXCS transaction. If the record is the same as the previous one, the new record is automatically confirmed, otherwise a new acceptance by the operator and a new communication to the customer will be required.
Finally, in the case of downgrading or acceptance of upgrading, a communication will be produced in the procedure and sent to the customer by regular mail.
The forms are signed by a person authorised to sign on behalf of the Bank.
The customer's request and the Bank's copies of the reply forms will then be filed in the usual manner.

3.1.11 NETWORK OF RELATIONSHIP MANAGERS

The Relationship Manager and/or Counter Operator of the Centre / Private Branch collects the customer's request on the appropriate forms and:
1. If employed by a Private Centre, they will carry out the necessary activities autonomously and forward the request to the Private Centre Manager, who will authorise the change of classification, if favourable to the request;
2. if they are employed by a Private Branch, they shall send the request to the Research and Quarters Team for the necessary procedural activities.

3.1.12 MIFID CLASSIFICATION ALIGNMENT OF GENERFID TRUST MANDATES

On a six-monthly basis, the operator of the Searches and Reconciliations Team proceeds to extract, by means of Various Queries, the list of clients who, in the previous six months, have requested an

[99] Circular CR-B-00419, Banca generali, Version 001

upgrade/downgrade of their position and who, at the same time, hold a GENERFID mandate with Banca Generali.[100]

Following this extraction, the operator sends by e-mail to each Financial Advisor/Relationship Manager involved the list of his clients in order to assess with them the possibility of requesting a variation of the Mifid classification also for the GENERFID mandate and the related securities relationships opened with the Bank.

The Financial Advisor/Relationship Manager contacts each client he follows to submit the possibility. If the client so decides, the Financial Advisor / Relationship Manager shall have the client complete and sign a request for reclassification of the mandate and forward it to GENERFID in the usual manner.

If the client declines this proposal, the Financial Advisor/Relationship Manager shall notify the Research and Quotations Team by e-mail.

On receipt of the customer's request to upgrade/downgrade the fiduciary mandate, GENERFID signs it and forwards it to the Middle Office Operations Unit (Research and Reporting Team) so that it can also reclassify the CDG of the fiduciary mandate.

After 30 days from the sending of the list, the operator of the U.O. Middle Office Operations shall verify that he has received the request for variation of the classification of the fiduciary mandate or the communication by e-mail that the client has declined the proposal from each Financial Advisor / Relationship Manager and, in case some requests / communications are missing, he shall solicit by e-mail the Advisor / Relationship Manager concerned.

If a Client who is the holder of a GENERFID fiduciary mandate requests an upgrade/downgrade of the Mifid classification of the fiduciary mandate, the Financial Advisor/Relationship Manager receives the upgrade/downgrade request from the client in the usual way and sends it to GENERFID.

GENERFID, after verifying and signing the form, forwards the request to the U.O. Middle Office Operations - Research and Reporting Team to perform the CDG upgrade / downgrade of the fiduciary mandate.

The operator of the Research and Reconciliation Team, in addition to the usual checks, checks whether the CDG of the mandator fiduciary at the Bank has the same Mifid classification as the CDG of the mandate, and in case of misalignment informs the Financial Advisor / Relationship Manager by e-mail so that he can contact his client to assess the possibility of changing the classification also in relation to the relationships directly held at the Bank.

[100] Clients Classification Policy PY005, Banca Generali, Version 006

The Financial Advisor, if the client wishes to request a change of his Mifid classification, shall forward the request to the Research and Reporting Team in accordance with the procedures set out in paragraph 4.2.1. If the client is the responsibility of a Relationship Manager, the latter shall proceed with the upgrade/downgrade of the Mifid classification and inform the Research and Reporting Team thereof.
If the client does not wish to change his classification, the Financial Advisor / Relationship Manager shall inform the Research and Reconciliation Team by e-mail.
In the absence of feedback from the Financial Advisor / Relationship Manager on the client's willingness, the Team Research and Reconciliation operator shall, after 30 days, proceed to solicit them.

3.1.13 DEROGATION MANAGEMENT CUSTOMER CLASSIFICATION

It is possible to enter a derogation from the standard classification for each client.
As provided for in the MIFID directive, the classification of a client can be:
1. at a general level (for all services, products and transactions performed),
2. at the level of:
a. individual services,
b. type of products - shares, bonds etc. etc., linked to geographical area,
c. type of transactions - spot trades, derivatives, repos, etc. etc,
3. individual transaction level.
The types of derogations envisaged for each customer classification must be entered in the Derogation Level field, and which instruments or which types of transactions fall within the indicated derogation level are deduced from the parameters present in the procedure.
To date, the derogations that Banca Generali agrees to make are only at a general level (for all services, products and transactions carried out), while for the other types of derogations it will consider whether to issue operating instructions on the matter in the future. Therefore, the operating procedure for entering any exceptions, which are equivalent to a client moving from one category to another, is used.

3.1.14 CLASSIFICATION REVIEW AND PERIODIC CHECKS

Revision of the classification is only due for customers classified as professional, whereas, for example, it is not necessary for retail customers who are already offered the highest degree of protection under the regulations.

In this regard, the Client Relationship Charter stipulates that it is up to professional clients to inform the Bank of any changes that might affect their current classification.

However, the Bank carries out periodic ex-post checks (normally annual) to ensure compliance with the conditions (capital requirement and minimum frequency of transactions) for maintaining classification as a professional client on request. The verification of the maintenance of the requirements provided for by the regulations is carried out by way of exception and/or on a sample basis by the Middle Office Operations Unit (Research and Reconciliation Team) with the support of the Compliance Service for the identification of the criteria for identifying the customers to be monitored (e.g. on the basis of the products distributed in the reference period, particular concentrations on Financial Advisors....).

After having drawn up the list of customers to be audited, the operator verifies that the requirements are met by inquiry of the IT procedures and, where necessary, by consulting the initial request for upgrade; if not, the operator involves the Financial Advisor / Relationship Manager by e-mail so that he may acquire the necessary additional information from the customer and the relevant documentation.

If the Bank finds that the client no longer meets the necessary conditions for classification as a professional client, it must take appropriate action by classifying him/her as a retail client.

With regard to Eligible Counterparties clients, it is the responsibility of the Finance Department to communicate any changes in the status of the eligible counterparties with which it deals.[101]

3.2 SUSTAINABILITY IN THE ADEQUACY ASSESSMENT

Proof of Banca Generali's strong commitment to ESG (Environmental, Social and Governance) principles is its inclusion among the 40 companies in the new MIB index designed by Euronext and Borsa Italiana, which, by combining the measurement of economic performance with assessments

[101] Clients Classification Policy PY005, Banca Generali, Versione 006

in line with the principles of the 2030 Agenda defined by the United Nations, identifies listed companies with the best ESG practices.[102]

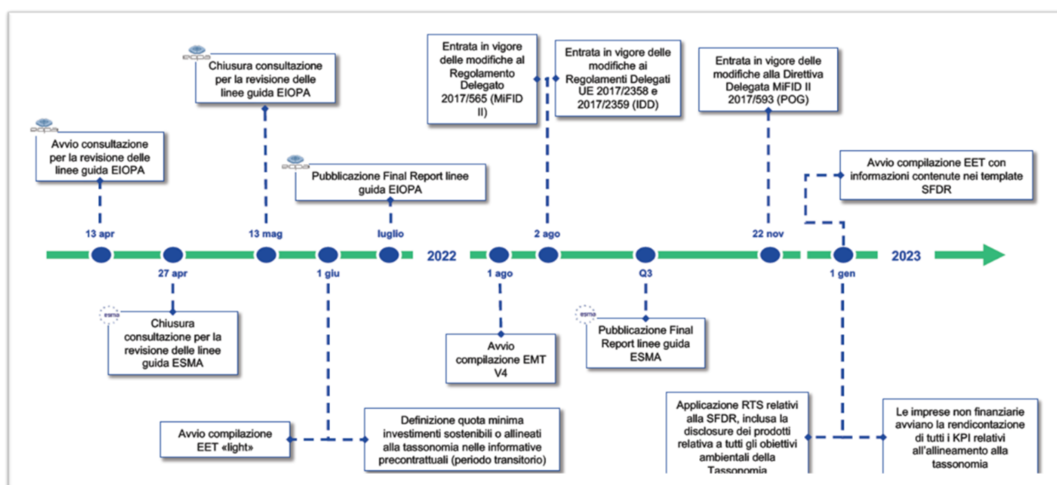
The selection rewards the path taken by the company, which for years now has placed sustainability and sustainable investments at the heart of its business model, not only with a dedicated product offering for customers, but also with good corporate governance practices that are among the factors most appreciated by investors and that are giving the stock confidence.

3.2.1 ESG SUITABILITY IN MIFID REGULATION

In **March 2018**, the Commission publishes the Action Plan for Financing Sustainable Growth in which it sets out a comprehensive strategy on sustainable finance. One of the objectives set out in the Action Plan is to redirect capital flows towards sustainable investments to enable sustainable and inclusive growth. In this context, the need was highlighted to clarify that investment firms must take sustainability factors into account when fulfilling their duties towards clients and potential clients to whom they provide advice.

In **August 2021**, the European Commission intervenes with some structural changes to the MiFID II body of law to ensure that investors' sustainability preferences are, inter alia, taken into account when providing the investment advisory service and the portfolio management service.

On **2 August 2021**, Delegated Regulation (EU) 2021/1253 on 'the integration of sustainability factors, sustainability risks and sustainability preferences into certain organisational requirements and operating conditions for the activities of investment firms' is published in the Official Journal of the European Union.



[102] Compliance Services Division, Banca Generali 2021

From the graph above, it can be seen that the regulatory environment is complex and constantly evolving.[103]

3.2.2 DELEGATED REGULATION (EU) 2021/2153

Delegated Regulation (EU) 2021/1253 amended Delegated Regulation 2017/565 with regard to the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions of investment firms' activities.
Pursuant to the amendments introduced by Delegated Regulation (EU) 2021/1253, with particular reference to the amendment of Article 54(2) of Delegated Regulation (EU) 2017/565, it is provided that, as of 2 August 2022, investment firms providing the advisory and portfolio management services must consider sustainability issues in each of their spheres of activity and, in particular, by:
1. the collection of client sustainability preferences;
2. updating the models for assessing suitability and profiling the risk associated with each client, providing for additional checks to verify the correspondence between the sustainability preferences collected and the products recommended
3. the precise definition of the catalogue of financial instruments proposed to clients, with particular regard to those financial products marked by ESG characteristics.
Investment firms are therefore required to integrate sustainability 'factors' and 'risks' in the provision of their services and in their internal organisational processes. In addition, they must collect the information they need from clients or potential clients in order to understand their essential characteristics and have a sufficient information set to assess whether the proposed service or financial instrument corresponds to the client's 'investment objectives' and 'risk tolerance', including from an ESG perspective.
The qualitative non-financial ESG factor is in addition to the financial risk factors already used in the suitability assessment process.
Delegated Regulation (EU) 2021/1253 also requires (recital no. 6) investment firms to explain in a clear and comprehensible manner - without using 'technical' language - the distinction between financial instruments that pursue sustainable investments and other instruments without such specific characteristics.

[103] Compliance Services Division, Banca Generali 2021

3.2.3 THE BANCA GENERALI MODEL

As of 2 August 2022, the adequacy assessment carried out by Banca Generali also included a consistency check between the sustainability preferences expressed by the client in the MiFID questionnaire (ref. subsection sustainability) and the financial product being purchased.

It should be noted that:

- - the check is non-blocking: the outcome of the check is specifically disclosed to the client;
- - clients who have not yet expressed their preferences in terms of sustainability will be 'non-assessable' and will have to update the questionnaire at the earliest opportunity.[104]

As of July 2021, the Bank has integrated the Mifid questionnaire to collect customer preferences regarding sustainability*.

Specifically, the 'Sustainability Subsection' consists of four questions:

- Two questions to define the client's level of knowledge in ESG products
- One question to define the client's level of interest in ESG investments
- One question to define the client's preference, if any, towards ESG products with specific characteristics related to the investment strategy i.e. thematic or generalist products

3.2.4 MIFID QUESTIONNAIRE: SUBSECTION SUSTAINABILITY

SOTTOSEZIONE SOSTENIBILITA'

1. Il suo livello di conoscenza delle tematiche di sostenibilità

1.a. Cosa si intende per investimento sostenibile? *(una sola risposta ammessa)*

- Un approccio di investimento che mira ad incrementare la performance ☐
- Un approccio di investimento che mira a integrare fattori ambientali, sociali e di governance nelle decisioni di investimento ☐
- Non so rispondere a questa domanda ☐

1.b. Un investimento che non contribuisce ad almeno un obiettivo ambientale, sociale e/o di governance può essere definito sostenibile? *(una sola risposta ammessa)*

- Sì ☐
- No ☐
- Non so rispondere a questa domanda ☐

2. Quanto è interessato/a ad investire parte del portafoglio in prodotti che tengono conto di fattori di sostenibilità *(una sola risposta ammessa)*

- Poco ☐
- Molto ☐

3. Nell'ambito della sostenibilità, in quali prodotti preferisce investire?

- Mi interessano prevalentemente prodotti ESG ad ampio spettro che tengano conto delle tematiche di sostenibilità nel loro complesso ☐
- Mi interessano prevalentemente prodotti ESG che si focalizzano su specifiche tematiche di sostenibilità ☐
- Non ho preferenze rispetto alle tipologie di prodotti ESG indicate alle risposte precedenti ☐

3.4 MiFID questionnaire, sustainability part

[104] Compliance Services Division, Banca Generali 2021

- Questions 1a and 1b are aimed at surveying the customer's level of knowledge in the area of sustainability. In this first phase, the Bank has provided for the delivery of an info-formative guide on sustainability issues known as the 'ESG Guide' to all clients who will fill in and update the questionnaire independently of their answers. This question is not relevant for the ESG suitability assessment.

- Question 2 determines the client's level of ESG interest and the resulting suitability assessment between the client's ESG preference and the level of sustainability, as measured by the score, of the individual product/service.

- Question 3 aims to detect the possible preference for thematic or generalist products.

The question is not relevant for the adequacy assessment. [105]

3.2.5 THE ESG SCORE OF PRODUCTS

The ESG score of products, expressed on a numerical scale from 1 to 5, is currently calculated and provided to the Bank by a third party (Mainstreet Partners).

A product is considered sustainable if it has an ESG score greater than or equal to 3.

Special cases:

- Portfolio Management: a synthetic ESG score is provided for all lines, calculated as a weighted average of the scores of the underlying assets (consistently with the previous control logic, the adequacy assessment is carried out at mandate level on the basis of the weighted average of the scores of the individual lines) ;
- BG Stile Libero/BG Insieme Progetti di Vita/ LUX Protection Life: the ESG score of the product is calculated on the weighted average of the ESG scores of the underlying instruments. NB the class I component (Separate Account) is not considered ESG and is therefore given a score of less than 3;
- BG Beyond: given the nature of the product, the ESG score will always be greater than or equal to 3.

3.2.6 THE ESG ADEQUACY ASSESSMENT: CONSISTENCY CHECK

The ESG adequacy assessment covers all advisory transactions carried out both through BG and BG Saxo SIM and as part of the BG International Advisory service.

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[105] Compliance Services Division, Banca Generali 2021

As part of the consistency check, the answer to question 2 of the MiFID questionnaire (How interested are you in investing part of your portfolio in products that take sustainability factors into account) is compared with the product's ESG Score - on a scale of 1 to 5 - currently provided by Mainstreet Partners.

3.2.7 SUITABILITY REPORT

Following each transaction subject to suitability check Banca Generali provides for the delivery to the client of a suitability report in which the client will be given evidence of the consistency between the characteristics of the product and the sustainability preferences expressed in the MIFID questionnaire.

Interesse Cliente	Score Prodotto	Esito controllo	Testo informativa al cliente
Cliente poco interessato	Score ESG < 3	Adeguato	*L'ordine effettuato risulta coerente con le preferenze da lei espresse in materia di sostenibilità*
Cliente poco interessato	Score ESG >= 3	Adeguato	*L'ordine effettuato risulta coerente con le preferenze da lei espresse in materia di sostenibilità*
Cliente molto interessato	Score ESG < 3	Non adeguato	*L'ordine effettuato risulta non pienamente coerente/non coerente con le preferenze da lei espresse in materia di sostenibilità pur essendo finanziariamente adeguato.*
Cliente molto interessato	Score ESG >= 3	Adeguato	*L'ordine effettuato risulta coerente con le preferenze da lei espresse in materia di sostenibilità*
Cliente che non ha ancora risposto alle domande ESG	Non applicabile	Non valutabile	*Sulla base delle informazioni in nostro possesso non è stato possibile valutare la coerenza del prodotto rispetto alle sue preferenze in materia di sostenibilità*

For transactions carried out through Front Ends all disclosures to the client are automatically integrated within the contractual forms of the product being invested in.[106]

3.2.8 THE ESG GUIDE

In order to facilitate advisory activities with a view to sustainability and to foster clients' awareness of ESG issues, the Bank has prepared an 'ESG Guide' to be given to all clients who complete or update the MIFID questionnaire.

The ESG Guide is an informative document aimed at enabling clients to make informed decisions in terms of sustainability. Within it, the following topics are explained clearly and without recourse to technical language

[106] Compliance Services Division, Banca Generali 2021

- sustainability, also with reference to the financial sector;
- sustainable and responsible investment;
- the difference between thematic and generalist products;
- the role of sustainability in Banca Generali's strategy.

La sostenibilità e gli investimenti sostenibili: introduzione all'approccio ESG

Che cos'è la sostenibilità?

"E' uno sviluppo che soddisfa le necessità delle attuali generazioni senza compromettere la capacità delle future generazioni di soddisfare le proprie"[1].

Il motivo principale per cui oggi si parla di sostenibilità è connesso alla **scarsità di risorse** indispensabili alle attività umane. A livello aziendale, risultano necessarie delle scelte strategiche volte, ad esempio, a ridurre gli sprechi, utilizzare energia pulita, ma anche a **rendere più sostenibile la vita delle persone** che, ogni giorno, contribuiscono alla crescita dell'impresa con il loro lavoro.

La sostenibilità nel settore finanziario

Parlare di sostenibilità diventa imprescindibile in un dialogo tra aziende, gestori e investitori in cui finanza, economia e rispetto per l'ambiente si intrecciano e si rinforzano a vicenda. Fare **finanza sostenibile** significa realizzare, accanto a un **rendimento economico finanziario**, anche un **vantaggio socialmente condiviso**, grazie alla riduzione dei rischi ambientali e delle disuguaglianze.

La sostenibilità di una banca è riscontrabile nei suoi diversi ambiti di attività e caratterizza anche una gestione dei risparmi della clientela in grado di favorire comportamenti e consumi sostenibili e di impattare positivamente sull'ambiente e la società, contribuendo così alla stabilità complessiva e all'efficienza del sistema finanziario. Uno degli strumenti della finanza sostenibile è l'investimento sostenibile e responsabile.

Che cos'è l'investimento sostenibile e responsabile?

L'investimento sostenibile e responsabile (abbreviato con l'acronimo SRI, dall'inglese *Sustainable and Responsible Investment*) **mira a creare valore per l'investitore e per la società nel suo complesso**, attraverso strategie di investimento orientate al medio-lungo periodo che, nella valutazione di imprese e istituzioni, integrano l'analisi finanziaria con quella ambientale, sociale e di buon governo (abbreviato con l'acronimo ESG, dall'inglese *Environmental, Social, Governance*). A titolo esemplificativo, gli operatori finanziari possono integrare le analisi tradizionali con le seguenti valutazioni legate ai singoli fattori ESG:

- **Fattore E:** considera gli aspetti ambientali quali, ad esempio, il consumo di energia, la produzione di rifiuti, le emissioni di CO2, la tutela della biodiversità, la gestione delle risorse naturali, la deforestazione e la posizione dell'azienda verso il cambiamento climatico.
- **Fattore S:** valuta le condizioni di lavoro dei dipendenti, l'impegno per l'inclusione e la riduzione delle disuguaglianze, la formazione, i rapporti con la comunità locale ed il territorio.
- **Fattore G:** considera gli aspetti quali la strategia della Governance, la composizione del Consiglio di Amministrazione, la remunerazione del personale, la gestione dei conflitti di interesse, la trasparenza e l'anticorruzione.

A livello globale le tematiche ESG hanno trovato specifica declinazione in un programma d'azione per le persone, il pianeta e la prosperità sottoscritto nel settembre 2015 dai governi dei 193 Paesi membri dell'ONU, la c.d. "**Agenda 2030**". L'Agenda 2030, con i **17** Obiettivi di Sviluppo Sostenibile (*Sustainable Development Goals* - **SDGs**), individua possibili azioni da mettere in campo per favorire un modello di sviluppo più sostenibile.

[1] Secondo la prima definizione della Commissione mondiale sull'ambiente e lo sviluppo dell'ONU del 1987

A livello europeo è in corso un'intensa **attività di regolamentazione**, ad entrata in vigore progressiva, che ha portato alla pubblicazione di provvedimenti normativi finalizzati ad indirizzare gli operatori finanziari verso un'**integrazione dei criteri ESG** al fine di considerare il rischio di sostenibilità[2] all'interno dei loro **processi d'investimento e di consulenza**. Tra questi si considerino ad esempio il Regolamento Tassonomia, che introduce il concetto di Tassonomia Europea delle attività economiche eco-compatibili, prevedendo una classificazione di tutti gli investimenti considerati sostenibili dal punto di vista ambientale, e la *Sustainable Finance Disclosure Regulation* (c.d. SFDR), che richiede a tutte le società di garantire nei confronti degli investitori una maggior trasparenza sul livello di sostenibilità dei prodotti offerti.

Qual è la differenza tra prodotti ESG generalisti e tematici?

Nell'ambito dell'investimento in strumenti collettivi, quali ad esempio i Fondi Comuni ESG, si distinguono due macro-categorie: **Fondi Generalisti** e **Fondi Tematici**.

I **Fondi Generalisti** tengono conto degli ambiti **E, S e G nel loro complesso**, componendo portafogli molto diversificati per settore ed area geografica e valutando gli impatti di sostenibilità a livello globale.

I **Fondi Tematici** prevedono di norma l'investimento in aziende che, in considerazione dell'attività svolta, contribuiscono ad affrontare **specifiche sfide legate a tematiche ambientali, sociali e di buon governo**. In particolare, tra le tematiche che assumono maggiore rilevanza si annoverano: la crescita demografica, la crescita sostenibile dei paesi in via di sviluppo, la corretta gestione delle risorse naturali, la transizione energetica e il cambiamento climatico.

Banca Generali e la sostenibilità

Il ruolo della finanza nei sistemi economici e il suo impatto nella vita quotidiana non possono più prescindere dal rispetto per l'ambiente e per gli aspetti sociali.

Il **modello di business di Banca Generali è rivolto ad uno sviluppo sostenibile**, che si ispira a **principi di integrità, responsabilità sociale e innovazione**. Il focus della banca e delle sue persone è quello di adoperarsi con correttezza, passione e dedizione alla protezione dei patrimoni delle famiglie guardando ad **obiettivi di lungo periodo**. In linea con questi obiettivi, Banca Generali promuove gli investimenti sostenibili e grazie anche ai suoi consulenti finanziari è al fianco dei clienti per la costruzione di investimenti che possano tenere conto delle loro diverse preferenze in tema ESG.

Per approfondimenti in merito alla sostenibilità in Banca Generali la invitiamo a consultare la sezione "Sostenibilità" del sito http://www.bancagenerali.com. Le ricordiamo che il suo Consulente è sempre a disposizione per fornirle ulteriori chiarimenti e dettagli.

[2] **Rischio di sostenibilità** (Art. 2 SFDR): un evento o una condizione di tipo ambientale, sociale o di governance che, se si verifica, potrebbe provocare un significativo impatto negativo effettivo o potenziale sul valore dell'investimento.

CHAPTER 4
MIFID IN THE CURRENT CONTEXT AND POSSIBLE FUTURE EVOLUTION

4.1 CURRENT ECONOMIC AND FINANCIAL CONTEXT

4.1.1 INTRODUCTION

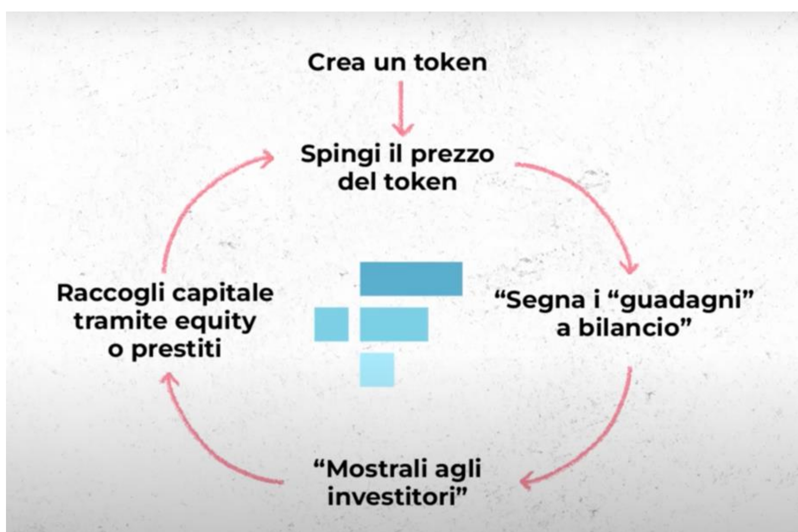
Despite the constant changes, updates and corrections introduced in the regulations aimed at protecting the individual investor, events that have moral-hazard activities on the part of prominent individuals at some of the world's largest financial institutions behind their occurrence continue, unfortunately, to be extremely topical issues. The major crises and collapses that characterised the end of 2022 and the beginning of 2023 did not spare any type of company, ranging from those in the crypto world to traditional banks, perhaps proving conclusively that the security of investors in a financial institution does not depend directly on whether the latter is centralised or decentralised.
In this chapter, we will attempt to analyse these current issues.

4.1.2 CRIPTO: FTX FAILURE

There is an earthquake in the crypto world and the reasons are various. The market collapsed after one of the main exchanges exploded, while the other main exchange announced that it would intervene, without having taken any concrete action.
Changpeng Zhao, the ceo of Binance, one of the main cryptocurrency exchanges, tweeted in mid-November 2022 that he would sell all the FTTs that Binance had in its portfolio, in order to avoid risks and not to support those who lobbied behind competitors' backs, referring to Alameda Research the first trading company of Sam Bankman-Fried. FTTs are the tokens of FTX, an exchange founded in 2019 by Sam Bankman-Fried, at the time of the tweet binance's FTTs were worth around $530 million.[107]
Alameda Research, according to Changpeng Zhao Alameda, and thus also FTX, was negotiating with the US Congress on a package of legislation that would give it an advantage over its competitors. Not only that: according to some rumours, Alameda had liquidity problems, which was later also confirmed, hence Changpeng Zhao's decision to sell everything.

[107] CNBC, 17 January 2023

The immediate effect was the collapse of the FT token price, on the one hand because investors, especially smaller ones, got scared and started to withdraw funds, and on the other hand because Alameda started to sell to raise liquidity.
On two days in mid-November 2022, and as a surprise, Changpeng Zhao announced that he would buy FT to help cover the liquidity crisis. Too bad he then, again surprisingly, backed out saying that the problems were beyond their capacity.
The rumours were true: FTX really did have financial problems.
The news shocked everyone a little. In short, it was lightning in a bottle, and according to Bloomberg FTX was even close to bankruptcy and had a deficit of $8 billion.[108]
To understand the impact these dynamics have had on the prices of the crypto sector, one needs to understand how Bankman-Fried managed to raise so much investor capital by inflating the value of its companies.[109]



4.1 Bankman-Fried Fraud cycle

It all starts with the creation of an FT token, in this case, which FTX used to raise capital from investors.
Investors help you raise the money you need and in return you give them shares in your company via the FT token, similar to how you do with shares.
The problem in this is that Alameda is, or rather was at this point, a big market maker, which has the ability to move the market and also the ability to induce small investors to buy crypto. It did

[108] CNBC, 17 January 2023
[109] BBC, 18 December 2022

exactly that with the FT token, so it inflated its value and got smaller investors to buy it in order to support its price over the last few years.

As a result, the price went up and Sam Bankman-Fried was able to show investors the good balance sheets of his companies, FTX and Alameda Research, which owned a large part of the FT token, which had been inflated in price. This allowed him to raise further capital and continue this cycle of inflating the price and raising money. In September alone, he was in the process of raising additional capital in the amount of $32 billion.[110]

The impact this fraud has had on the entire crypto sector is incredibly significant, proving, if proof were needed, the impressive volatility of this sector.

4.2 CMI Index path in November 2022

Bitcoin touched $15,500, prices not seen since November 2020 the FT token lost the most from about $26 to $2, losing about 90% of its value. Even the sol token, i.e. the native of the Solana ecosystem, which was financed by Alameda and FTX lost more than 70% of its value to $12. During the bull run of 2021, it was worth $260 for a capitalisation of around $70 billion, more or less the same as Intesa Sanpaolo and Unicredit combined.

Among the factors responsible for the collapse we can certainly identify the fear of investors, who have seen one of the largest and most emblazoned exchanges in the sector collapse and have therefore sold their crypto holdings; secondly, there have been people who, seeing in this drama a possibility of speculation, have opened short positions, i.e. bearish, on Bitcoin, FTT, Solana.

Those who might be impacted now or in the future by this domino effect are surely all those unfortunate people who had funds on FTX, who will struggle to see them again, at least in the short term, secondly all the crypto projects that had Alameda and or FTX as investors will struggle to

[110] BBC, 18 December 2022

carry out their plans as their main lines of credit suddenly vanished, and last but not least all those other major market players who had lent to Alameda on the confidence of apparent good financial results.

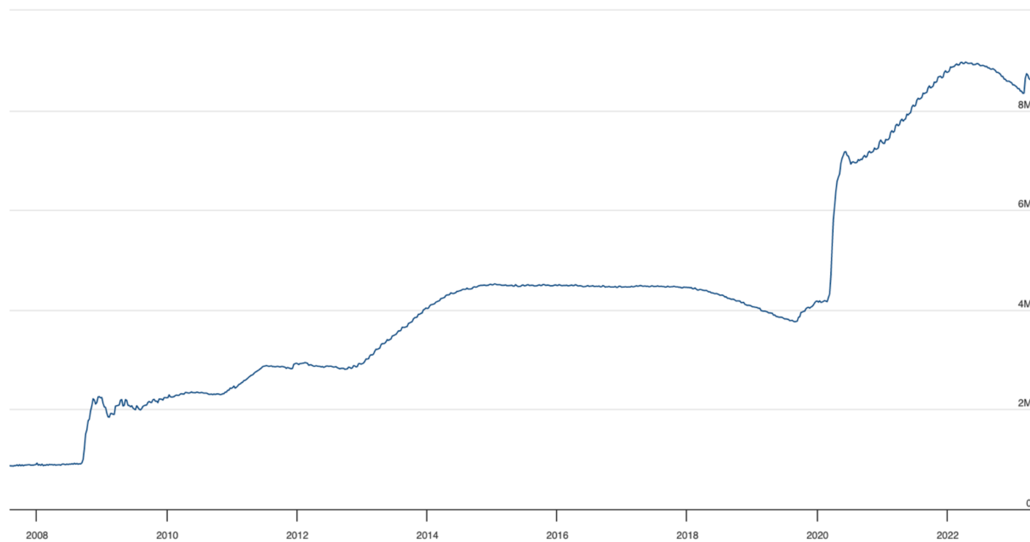
4.1.3 BANK CRISIS

The most rapid rise in interest rates by central banks in history has also contributed to putting traditional financial institutions in crisis, whose bad balance sheet and financial situations are leading more and more people to make comparisons with the 2008 crisis, but which, as we shall see, originated from completely different economic and financial phenomena and contexts than the current ones.
We will then analyse the causes of the collapses or deep downward speculations of some of the most critical American and European banks.

4.1.3.1 SVB AND THE CRISIS OF THE REGIONAL BANKS

The Silicon Valley Bank went bankrupt and to fully understand the reasons why, it is necessary to take a few steps back. First of all, we need to understand what the Silicon Valley Bank did, and an initial indication is given by its name. It is the bank of Silicon Valley, of the tech startup founders we all know, but also of the startups themselves, multi-million dollar accounts of both individuals and companies.[111]
A rumour had started to circulate that the bank might run out of cash and this rumour triggered the bank-run.
To understand why this rumour started to circulate, we need to take another step back a few years; in recent years, tech and pharmaceutical start-ups have been growing at a dizzying pace, and the abundance of liquidity in the market resulting from the accommodative policy supported to counter the Covid-19 pandemic by the Federal Reserve, the US central bank, has created a lot of money in just two years between March 2020 and April 2022.

[111] REUTERS, 11 May 2023



4.3 Total Fed Assets (milions of dollars)

The increase in currency in circulation also implies a lot of investment and a lot of this has ended up in Silicon Valley startups, billions invested in startups and with every signing and every investment round this money ends up in the account of some bank, in particular the Silicon Valley Bank.

To give you some numbers; at the end of 2016 SVB had just under $50 billion on its balance sheets, by 2022 it had an average of around $180 billion in deposits, almost four times of which more than half came from the tech world, making it among the top banks in America.

SVB invested the deposits in US government bonds, an asset class considered to be risk-free, but having selected long-dated securities, if sold ahead of time the yield is lower and not only did the bank invest $80 billion, but the securities in question were backed by mortgages similar to those that triggered the 2008 crisis.

The yield on those securities was 1.5%, nothing exciting but when rates are at zero they are not so bad.

The economy in 2022 also runs too fast and inflation starts to rise and at the same time the war in Ukraine breaks out, the price increase explodes further due to the cost of gas and oil. Central banks raise interest rates to cool the US economy, making the cost of money more expensive.

With higher interest rates, old government bonds issued before the increase lose value, being sold by investors who now have more profitable alternatives. As a consequence of the mechanism just illustrated, the bonds in which Silicon Valley Bank had invested depreciate in value, meanwhile the start-ups also receive less money, as the cost of money has risen and given their poor credit rating, deposits do not grow and, on the contrary, begin to fall, and money from current accounts is needed to run the start-ups' operations.

Silicon Valley Bank finds itself with two problems: deposits are being withdrawn and its investments are worth less and less, so in order to repay depositors it would have to divest part of its assets, but is forced to do so at a loss. It sells 21 billion securities, including US Treasury bonds, and loses about two billion of them, then announces that it wants to cover these losses with a capital increase, asking the market for funding through new investors.[112]
In the meantime, however, word spreads; the venture capitalists, the start-up investors, warn the various founders that SVB is going through a liquidity crisis and to withdraw deposits as soon as possible. The situation then worsens; a run on the banks is triggered, the market does not take it well, Moody's on Wednesday downgrades it to just above junk bond level, the 'junk' bonds characterised by higher yields but also greater risks.
Investors arrive, word gets around and in just two days shareholders sell enough shares to cause the price to plummet by 60%, a disaster. On Friday, 10 March, the Federal Deposit Insurance Corporation (Fdic) closed and commissioned the SVB.[113]
Practically at the same time as SVB's failure came that of Signature bank, the third largest in US history. Depositors of the New York-based bank will have access to their money under "a systemic risk exception similar" to the one that will allow customers of Silicon Valley Bank to get their money back as the Treasury Department, the Federal Reserve, and the Federal Insurance Deposit Corp. stated in a joint statement. "All depositors of this institution will be compensated," the regulators said. "As with the Silicon Valley Bank resolution, no losses will be borne by the taxpayer."
The decision to put Signature Bank into receivership came as a surprise to its executives, who discovered it shortly before the public announcement, said a person familiar with the company's operations. The bank has been facing a flood of deposit outflows.
Concern about the health of other smaller banks focused on the venture capital and startup communities is prompting regulators to consider extraordinary measures to protect financial institutions and their depositors.
Signature Bank came into the spotlight with the collapse of cryptocurrency exchange FTX late last year. FTX had accounts with Signature Bank, which according to the company accounted for less than 0.1 per cent of its total deposits. In December, after FTX's bankruptcy, Signature said it planned to remove up to $10 billion in deposits from digital asset customers. This would bring cryptocurrency-related deposits to around 15-20% of the total, and the bank said it plans to limit the share of deposits from each individual digital asset customer. Silvergate Capital Corp., another bank

[112] REUTERS, 11 May 2023
[113] The Guardian, 10 March 2023

hit hard by the FTX implosion that has spent the last few weeks bombarded by short sellers, abandoned by depositors, and shunned by business partners, declared last week that it would close its doors, just days before the failure of Silicon Valley Bank.[114]

4.1.3.2 CREDIT SUISSE

Withdrawals amounting to tens of billions in a few days, a stock market valuation plummeting, gone from being one of the strongest and most powerful banks in the world Credit Suisse has become the worst headache for the world economy, the weakest link in the chain, which could trigger a new financial crisis that reminds one of 2008.

Before the bankruptcy Credit Suisse recorded its worst stock market loss since 2008, in just five days it lost about 75% of its value and was forced to be acquired by its direct rival UBS for $3.3 billion. [115]

To understand how Switzerland's second largest and one of the world's most renowned banks ended up in this situation, it is necessary to look at who Credit Suisse is and what it does.

This was in fact one of the world's largest investment banks, a financial institution headquartered in Zurich, which at the beginning of 2023 managed more than CHF 1,000 billion (about EUR 1,300 billion), operated in 50 countries around the world and had more than 45,000 employees.

The bank mainly offered private banking services, i.e. financial services dedicated to very wealthy clients with enormous capital to manage, the driving force of their business being the Wealth Management section: the consulting and management of very large assets on behalf of individuals or families, an activity worth about 40% of total revenues linked to this activity there is then the section of the bank dedicated to the support of investment banking activities, which on the other hand weighs only about 10% of the bank, with the carrying out of this activity is intended to help clients by providing all the necessary tools to carry out their businesses, make loans available, assist in finding financing, act as a guarantor to have their companies listed on the stock exchange.

The description of the bank's activities and the consequent identification of their target represented for the most part by the wealthiest customers, serves to understand how important its reputation is for retaining such customers. Damage to such, therefore, can have very serious effects and it is precisely because of these that Credit Suisse ended up in trouble.

In fact, today's problems are not only caused by the panic in the banking sector caused by Silicon Valley Bank; the crisis of the Swiss financial giant stems from a series of mistakes that have been

[114] The Guardian, 10 March 2023
[115] CNN, 24 March 2023

going on for several years, mistakes that were not always in good faith. The bank has ended up involved in many, too many, financial crime trials, which has undermined its once impeccable reputation in no small measure.

As evidence of its great and historic solidity, suffice it to note that in 2008 Credit Suisse was one of the healthiest banks in the world, so much so that it withstood the effects of the crisis very well, to give an example UBS the largest Swiss bank in the same period had to be saved from bankruptcy with a bailout from the Swiss state.

After 2008, however, the situation began to change, partly due to international pressure to abolish Switzerland's banking secrecy law, a law that was in fact weakened until it was repealed altogether in 2014.[116]

It is no coincidence that the first problems emerged that very year in 2014, when Credit Swiss was prosecuted and fined no less than USD 2.6 billion for helping some wealthy US citizens evade taxes. Only two years later the Swiss bank had to go to court again, this time in Italy in 2016, it settled for a €109 million fine again for helping some of their clients, this time Italian, evade tax.

In 2018 the bank also ends up under indictment for its activities in Chinese territory, the trial however will always be in the United States, American investigators in fact discover that between 2007 and 2013 Credit Suisse was involved in cases of bribery of Chinese officials. For this affair the Swiss bank will be fined $47 million, but the biggest problem, as we have seen, is not the money from the fines but the damage to its image and reputation.

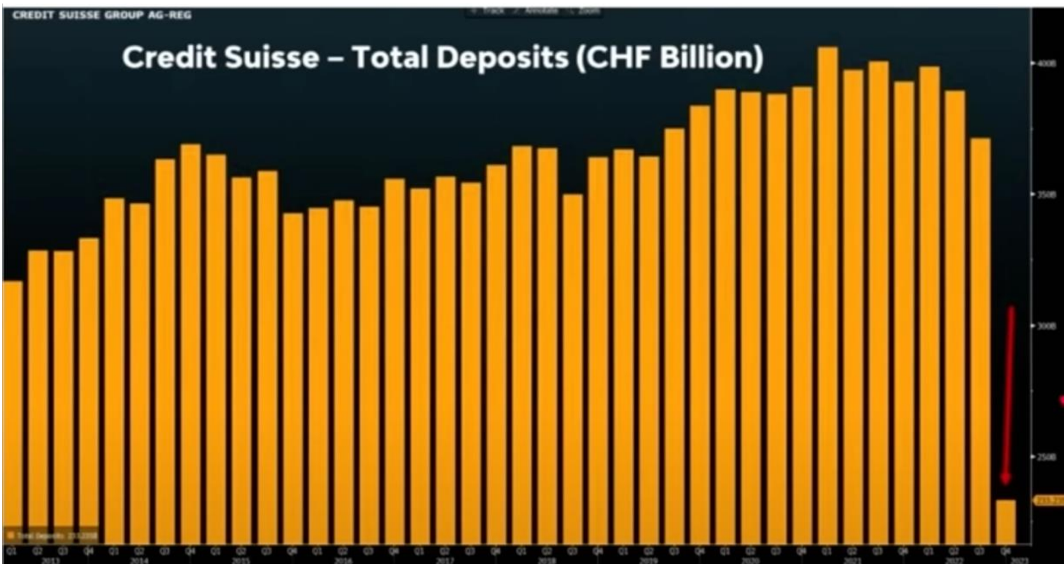
Credit Suisse's reputation, perhaps tilted, still remains solid but only until 2019.

The first of the new problems consists of an absurd story that started with personal disagreements between two of Credit Suisse's most important executives: they are Tidjane Thiam, the bank's CEO at the time, and Iqbal Khan, head of the International Web Management division. Khan was unhappy because the CEO was giving him less and less freedom of action, despite his excellent results, as if his superior was trying to hinder him so that he would not be overshadowed. About six months later, Khan left Credit Suisse to go to his historic rival UBS, but here something anomalous happened. the non-compete obligations in particular the interval of months or even years that is normally imposed on top executives before they can go to work for other people is to avoid industrial espionage Cannes exploiting the clauses of his contract manages to skip the period of forced hiatus Credit Suisse then hires a detective agency to tail him, Khan however realises he is being followed by someone so he goes to the police who start an investigation. Not only does it turn out that Credit Suisse is having Khan watched, it turns out that he is having several of his employees and former employees followed. The scandal is such a sensation that several executives

[116] Financial Times, 28 March 2023

resign, including the CEO himself, although only the bank's then chief operating officer Pierre Olivier Bouée will be held legally responsible.
Thomas Gottstein was appointed as the new CEO, but he was not going to have an easy time of it: it was with him that the most serious financial scandals emerged.
In 2020, Credit Suisse executives were investigated for money laundering, having laundered at least 146 million dollars between 2004 and 2008 on behalf of a Bulgarian drug trafficker. In 2021, the first real lethal blow to Credit Suisse's reputation came in the form of the bankruptcy of the now famous British financing company Greensil Capital.
Credite Suisse had offered several investment funds linked to Greensil's activities to its major clients, thus raising $10 billion, all the while presenting the deal as a profitable investment is completely safe. In March 2021, however, Greensil Capital went into receivership due to a series of financial and governance problems suffice it to say that in this investment. Approximately three of the 10 billion initially invested was lost and this for a company like Credit Suisse is a very serious image loss.
During 2021 Credit Suisse will be further fined 275 million by the American regulators and 47 million by the British authorities all for having taken part in serious cases of corruption in Mozambique before 2018, the bank seems to have been one of the main protagonists of corruption in the country, corruption that had led Mozambique to economic disaster.
With all these scandals one after the other, the trust of the clients is lacking and Credit Suisse is really starting to be in trouble, although it is not really at risk yet, or at least it does not seem to be. The final straw came in March 2023, with the bankruptcy of the Californian Silicon Valley bank, after which several other American regional banks collapsed in a chain effect, as we have said clients, especially those typical of Credit Suisse are very sensitive to market trends and it takes very little to trigger a run on the branches. [117]
The bank goes into a liquidity crisis, its value on the markets falls even further, triggering a vicious circle, so the bank ends up at risk of insolvency.

[117] CNN, 24 March 2023



4.4 Credit Suisse Total Deposits - Bloomberg

Its bankruptcy would have repercussions on the entire world economy, but fortunately here the Swiss state steps in with a credit line of more than 100 billion dollars, providing the liquidity needed to avert any risk. In addition, it obliges UBS to buy Credit Suisse for CHF 3 billion, thus trying to stop the rescue effort. [118]

4.5 Credit Suisse share price path – Bloomberg

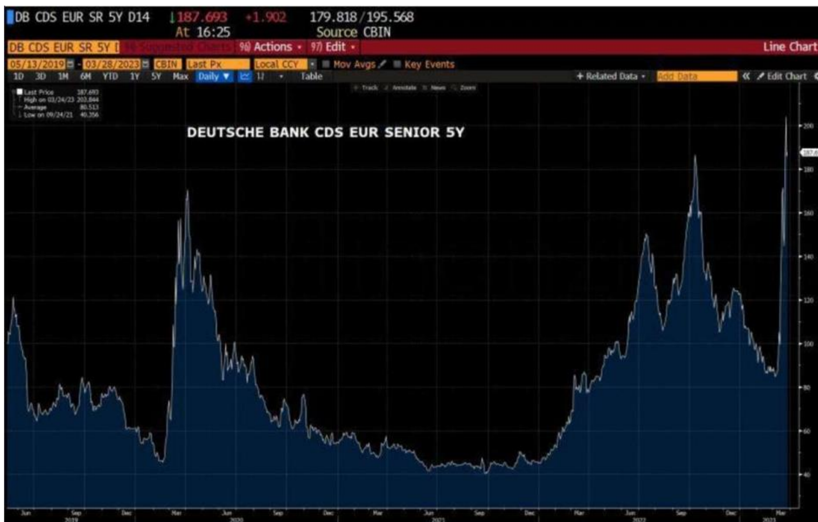
4.1.3.3 DEUTSCHE BANK

As DB, Deutsche Bank, is Germany's largest bank, understanding the reason for its recent serious problems is not immediate and trivial. Its balance sheet in 2022 was exciting: a profit of EUR 5.6

[118] CNN, 24 March 2023

billion, the best result in 15 years. The record profit had been 8.7 billion in 2007. But the global crisis of 2008 had left deep wounds to heal and losses for five consecutive years until 2019.[119]
As of 2019, the management claimed to have tried to carry out a profound renewal of the group by reducing its investment banking activities, i.e. the business that seeks high profits from the riskiest speculations. Hence, less exotic business and fewer hedge fund clients. The idea, at least on paper, was to return to being a more European bank and 'for entrepreneurs'. The Db also went ahead with the integration of the Postbank, which, like our BancoPosta, has a very large number of customers, families and small to medium-sized businesses.
The turnaround in interest rates increased the bank's assets to EUR 27.2 billion, an increase of more than 7% compared to 2021. Despite inflation and economic slowdowns, there were no fears of loan defaults. In 2022, the bank had set aside no less than EUR 1.2 billion against this risk, more than twice as much as in 2021.All was rosy in 2022 and should have been even more so in 2023. Better ratings from the rating agencies after their downgrades in previous years had also contributed to the success.
Not all voices, however, were in such agreement. The bank's internal supervisory board complained that planned improvements and sustainability targets had not been fully achieved, so it decided to reduce the millionaire bonuses for executives by five per cent. In particular, in February it had raised serious concerns about the management of derivatives.
The bank's history matters and should never be forgotten. Last April, the German police had visited its Frankfurt headquarters in the course of a money laundering investigation. In past years his name had appeared in almost every investigation into various international financial scams and embezzlement. In 2016, remember, he had paid a $7.2 billion fine for fraudulent transactions with mortgage-related derivatives, in return for closing the investigation.
Something was wrong with Db if the cost of its credit default swaps, the derivative securities that hedge the risk of bankruptcy, rose sharply. Since the beginning of the year, its shares have lost about a quarter of their value.

[119] CNBC, 28 March 2023



4.6 Deutsche Bank CDS price path - Bloomberg

It is true that the entire European and international banking system is under pressure, but Deutsche bank seems to be affected more than the other banks. It cannot be compared to Credit Suisse, which was saved from bankruptcy, except for the fact that they are two of the largest European banks considered systemic.

ECB President Christine Lagarde and all European governments are competing to affirm the soundness of the European banking system, "helped by the banking regulatory reforms initiated in the wake of the global financial crisis". Perhaps these reforms are lacking.

One of these serious shortcomings is revealed by DB's 2022 balance sheet: the total notional value of financial derivatives is EUR 42,500 billion, almost all of them of the very risky type, the Otc, over the counter. An increase of 6 per cent in one year. That's a bit less than the peak of 48 trillion in 2018, but the situation hasn't really changed. Almost 80% are derivatives entered into on interest rate movements.[120]

Not only the Db but all the too big to fail banks are involved in these speculative interest rate transactions. It is precisely the volatile behaviour of central banks that makes them highly inflammable.

Even if one were to admit that the Db has tried to reduce its exposure in the riskiest otc derivatives, one has to recognise that it is a difficult process alone. Just as it is for a drug addict who would like to free himself from addiction, but continues to frequent drug dealing circles.

The problem of financial speculation is global, but unless real reform is addressed internationally, banking crises will become more frequent and intense. We expect European authorities and governments to make the first move: eliminate speculation in order to defend the real interests of citizens, starting with economic stability and social welfare.

[120] CNBC, 28 March 2023

4.2 ENFORCEMENT ISSUES DURING THE CRISIS

The current banking crisis has exposed several weaknesses of MiFID, which was introduced in the European Union in 2007 to regulate financial markets and protect investors. Although MiFID has undoubtedly brought positive changes to the financial sector, it has also been criticised for its shortcomings.

Here are some explanations of MiFID's weaknesses in the current banking crisis:

A) Lack of transparency: one of the main weaknesses of MiFID is its inability to ensure sufficient transparency in financial markets. Although the directive aimed to increase transparency through mandatory pre- and post-trade transparency, there are still significant gaps. Complex financial products and over-the-counter transactions are not adequately covered by MiFID, allowing the proliferation of opaque trading practices that have contributed to the current crisis.

B) Inadequate investor protection: MiFID intended to improve investor protection by introducing stricter rules for investment firms and promoting the concept of 'best execution'. However, the directive's approach was deficient in some areas. For example, the sale of complex financial products to retail investors without proper assessment of their suitability and risk profile has led to numerous cases of mis-selling and losses for investors.

C) Insufficient market surveillance: MiFID's framework for market surveillance and control has proven to be inadequate. It relies heavily on self-disclosure by firms, which creates a potential conflict of interest. Regulators have struggled to effectively monitor and detect market abuse, such as insider trading and market manipulation, causing an erosion of market integrity and contributing to the current crisis.

D) Regulatory arbitrage: The implementation of MiFID has inadvertently led to regulatory arbitrage, where financial firms exploit regulatory gaps or differences between jurisdictions to gain a competitive advantage. This has led to regulatory fragmentation, making consistent and coordinated supervision of financial markets difficult. The crisis revealed cases where some jurisdictions had lax regulatory standards, which allowed risky behaviour to flourish, ultimately impacting the stability of the entire banking system.

E) Inadequate risk management: MiFID did not place sufficient emphasis on risk management practices within financial institutions. The crisis revealed that many banks and investment firms underestimated or did not adequately assess the risks associated with complex financial products and trading strategies. This lack of awareness and risk management contributed to significant losses and failures in the banking sector.

F) Incomplete coverage of financial instruments: MiFID's regulatory scope did not cover all financial instruments, leaving some market segments outside its regulatory framework. For example, some derivative products, such as credit default swaps, were not subject to the same level of supervision, allowing excessive risk-taking and contributing to the instability observed during the crisis.

G) Fragmented regulatory framework: MiFID operates within a broader regulatory framework comprising multiple directives, regulations and agencies. This fragmented structure has led to coordination, harmonisation and enforcement problems in EU Member States. The crisis has highlighted the limitations of this fragmented approach, as regulatory responses and actions have differed across jurisdictions, hampering effective system-wide crisis management.

These MiFID weaknesses have contributed to exacerbating the current banking crisis. Recognising these shortcomings, regulators and policymakers are now working to close the loopholes and strengthen the regulatory framework in order to prevent future crises and better protect investors and financial market stability.

4.3 MiFID III

There are many changes to be expected as MiFID evolves. Some are of a regulatory nature, with the amendment of the MiFID directive or regulations, others are changes introduced gradually with the adaptation of Q&A, ESMA and local guidelines (e.g. ESMA's Complaints Management Document).

The most important development will be the changes that will occur between MiFID II and the planned MiFID III. [121]

There are three areas that should demand our attention: the creation of a new investor category, the lost causes in MiFID II negotiations regarding the inclusion of spot FX, and custody under MiFID.

These would result in some big changes for some institutions that, until now, have been able to circumvent the scope of this regulation. Finally, there will be some changes in the market structure, particularly with the forced introduction of established tape providers.

The most likely and important change in terms of organisation will be the creation of new categories of investors.

With the approximation of the regime for professionals and eligible counterparties starting next year (EU/2021/338), the possibility will open up for the introduction of a new 'super retail' category.

[121] Bloomberg, 17 September 2022

This category will probably have less protection than the current retail, but will gain more opportunities to invest in products in such a way that these investors support the EU economy by using alternative investment funds (AIFs) or European longterm investment funds (ELTIFs), which, until now, have been closed to retail investors. Conceptually, the 'qualified investor' regime as we know it in Luxembourg could be a potential model. The problem is that clients who for years have been classified as retail investors will now have to be reclassified.[122]

The second set of changes could also be operationally complex to introduce. Indeed, if spot FX (currently excluded) and custody become MiFID services in their own right, this will result in the need to include a full range of new clients within the scope of MiFID.

FX-only or custody-only clients will need to receive profiles, reports and potentially be included in product governance. Some of this will be static information, so once done it will be available for future changes. However, if the inclusion of custody and spot FX applies to all clients (including retail clients), it will be necessary to include FX transaction reporting and the application of best execution, price transparency and reporting to authorities in MiFID reporting. This would represent a real technical and operational challenge.

The third pillar to be addressed concerns changes in market structure with adaptations to commodity trading and trading, in particular the 'merging' of the EMIR and MiFID obligation with mandatory cleared derivatives trading. At this stage, the EU Commission is keen to push for a consolidated tape, a central and single place, at least per asset class, where trading prices will converge, in real time. This could lead to some interesting insights into the concept of a single EU market if all prices converge in one place. Furthermore, a consolidated tape could be a huge improvement for compliance and reconciliation of transaction prices, but it needs to be fully developed. In this last part of the market, in addition to this trend, at the market price level, we could anticipate the arrival of a broader consolidation of information at ESMA level on products, service providers to be provided to investors and, more generally, provide MiFID stakeholders with a consolidated view of the market across all Member States.

This last MiFID stream is definitely more anticipation of changes to be introduced than material changes. Changes do not happen quickly. After all, the timeline (a first draft released by the EU Commission) now seems set for Q4 or later. Add to this the fact that discussions between the EU institutions will most likely continue for 18 months and that the changes themselves will have to be followed by a transition period of 18-24 months, all leading to the changes actually coming into force around 2025.

[122] Bloomberg, 17 September 2022

To conclude and put things in perspective, we have seen MiFID changes impact the industry every seven to eight years, from the pre-history of the Investment Services Directive (ISD) (pre-2000, to MiFID I in 2007 and MiFID II in 2014 (2018 for implementation); it is therefore not unreasonable for the text and its profound changes to come into effect around 2025. In the meantime, and contrary to what has been experienced in the past, other continuous evolutions are on the horizon, which will act as intermediate steps (ESG, Quick fix) but will make the challenge of complying with MiFID even more complex by setting different start dates, with overlapping demands or requirements. Therefore, anticipation is key.[123]

4.3.1 MiFID III OBJECTIVES

On 16 December 2022, the EU Council and Parliament published a proposal for the revision of the main sources of regulation, namely the MiFIR (EU Reg. 600/2014) and MiFID II (EU Reg. 65/2014).

Wanting to briefly summarise the content of the 16 December 2022 proposal, the future MiFID III will intervene (or, at least, should intervene) essentially along three lines of action: i) encouraging a level playing field between execution venues (regulated markets, multilateral trading facilities, organised trading facilities); ii) increasing the competitiveness of market infrastructures internationally; iii) enhancing the transparency and availability of market data.

The latter seems, in particular, to be the objective to which the legislator devotes most attention.

First of all, in fact, the proposal suggests the creation of a centralised database in order to allow access to market data of trading venues and systematic internalisers.

Next, it is proposed that the providers of a consolidated publication system report near real-time, reliable data on executed trades and best bids and offers at the time of the specific trade, as far as Euro-unified and most competitive markets are concerned.

The proposal also provides some simplification proposals on the application of the dark pool discipline. This is an alternative trading system in which institutional investors can place large orders anonymously, without the need to publicly disclose their intentions when searching for buyers or sellers. This prevents the triggering of adverse price movements.

Currently, however, the volume limits within which this system is permitted are determined by applying various calculation criteria, which make monitoring complex. The proposal aims to bring these criteria down to unity by adopting a single ceiling.

[123] Bloomberg, 17 September 2022

It is also proposed to support the provision of liquidity to the market even under stress conditions by strengthening a number of obligations for investment firms trading on their own account.
Whispers of an overhaul of European trading and transparency rules almost two years ago have become a real talking point. Concern among dealers and buyers about the provision of data on new bonds and derivatives is fuelling calls for change. The much-vaunted transparency of Mifid is more of a fog. Few, however, agree on how to solve the problems. Some are pushing for a revision of the main legislation to change the type of trading activity that has to be reported. Others argue for only minor technical changes to make the currently available data more usable. "If you look at the goals of transparency, [Mifid II] is missing the mark and not providing meaningful and useful data," says Matthew Coupe, director of market structure at Barclays. "The Mifid II review must answer the question: how can we achieve effective transparency from Mifid II? What changes and adjustments might be needed?"
The second Markets in Financial Instruments Directive extends its tentacles into almost all corners of Europe's financial markets. The law, and its accompanying Mifir regulation, aim to help investors compare pre-trade data, compare executed prices with others, and assess market liquidity. The rules impose far-reaching obligations on buyers and sellers to report the price and quantity of trades, including some derivatives that are traded outside official venues. But there is confusion about which over-the-counter transactions fall into this category. To remedy this problem, some propose that only the most standard instruments be reported. Others propose that the list should include all over-the-counter derivatives, as in the United States. A similar debate concerns the rule allowing participants to delay reporting certain transactions. Given the large number of trades that enjoy this delay, in many cases by as much as four weeks, users are sceptical about the value of the data attached. "There is a perception in the market that some of the objectives in terms of transparency and accessibility of data are still difficult to achieve for many market participants, both buy side and sell side," says Stephane Malrait, head of market structure and innovation at ING. "So there is definitely room for improvement, not a drastic change in regulation, but improvement."[124]
A smaller 'targeted' revision will be published next year to address immediate problems with the rules, while a longer revision is planned thereafter to address issues that require more in-depth analysis. It is not yet clear whether corrections to post-trade data for derivatives and bonds will be included in the first revision or in the next, longer one. A regulatory expert at a large hedge fund suspects that EU regulators want to prioritise transparency changes, as this was the subject of a recent consultation paper by the securities regulator, the European Securities and Markets Authority. Esma published a report on 5 December 2022 outlining the results of the consultation. "I

[124] Bloomberg, 13 October 2022

don't think it is clear at this point what the content of the review will be, but I certainly think the order of the reports shows that the transparency framework is a key area of focus," says the expert. Two sources say they have been informed that Esma will issue a second consultation later this year to assess the functioning of the transparency framework for non-equity instruments. However, a third industry source says it expects the publication to take place towards the end of February and that Esma will produce a consultation for the European Commission by July 2020. Esma would not comment. The German Finance Ministry, according to an August position paper, wants the European authorities to review many of the issues surrounding transparency - including the cost of market data - in the 'medium term' rather than the 'short term'. Many of the changes desired by market participants are far-reaching and require a legislative rewrite that might be difficult to negotiate through the labyrinthine work of the European Parliament and the Council. It is easy to see why the Commission might be tempted to opt for small changes to Mifid rather than a total change. Apples with apples Mifid II requires dealers to report OTC derivatives using an equivalence indicator known as TOTV, or 'traded on a trading venue'. In short, if an OTC instrument is similar to an instrument traded on a trading venue, the reporting obligation applies. TOTV has been hampered by different interpretations of what is equivalent, leading to complaints of inaccurate reporting. Some argue that trades are under-reported and that the data do not give a complete picture of activity in a derivative. Others argue that activity is over-reported, potentially creating more noise for data scientists to sift through and exclude.

An Esma opinion paper published in May 2017, prior to the launch of Mifid II in January 2018, hoped to define the scope of the TOTV by stating that off-venue trades should be considered equivalent to on-venue trades if they share the same data field characteristics used in reference data reporting. Participants are unsure whether the correspondence between on-venue and off-venue trades also extends to the unique codes used to label generic derivatives, known as Isins (International Securities Identification Numbers). The inclusion of Isins could significantly narrow the scope of transparency obligations, as the codes use a more granular set of fields to distinguish individual instruments.[125]

A further source of confusion arises from the lists that operators and data publishers use to determine the types of instruments that are traded on venues. One source is Esma's Financial Instruments Reference Database, which lists all instruments traded or admitted to trading on EU venues. Esma has privately told market participants not to use this database as a 'gold source', which has led companies to use different lists offered by various providers. Simplification may be in order and some regulators are in favour of re-evaluating the TOTV concept to determine the scope of

[125] Bloomberg, 13 October 2022

transparency requirements for OTC derivatives. "The basis of TOTV is good, to provide more information to the market, but sometimes we wonder whether it is entirely satisfactory to extend TOTV to OTC derivatives," said Patrice Aguesse, head of the market regulation division at the French supervisory authority, the Autorité des Marchés Financiers, at a conference in Paris in October. "I am not saying that we should not do this, but that we should evaluate the result of this implementation after one and a half years. And, in particular, we should balance the results and the costs'.

Ideas on how to change the TOTV span a wide spectrum. One suggestion is to define a number of asset classes as being subject to the transparency requirements of Mifid II based on their standardisation and the frequency with which they are traded on venues. "If I have a very complicated derivative that is presented for trading on a venue and it is unlikely to be used for transparency, should it be reported?" asks Coupe of Barclays. "Perhaps we should consider whether the type of instrument is suitable for transparency." Trade associations argue that reporting non-standardised OTC derivatives could make Mifid II post-trade data misleading, as the data of a non-standardised transaction may be indistinguishable from that of a standardised transaction, but the instrument may have additional terms that significantly change the product and price. A regulatory expert from a second European investment bank states: 'It would be better to focus more closely on what is liquid and frequently traded around a few core asset classes and cut away the broader scope. In non-equity sectors, it is more difficult to derive useful comparative data from complex and thinly traded derivatives'. From a practical point of view, some suggest that it may take a long time for legislators, regulators and the industry to agree on a definition of standardised derivatives. "You could say that forex forwards are all traded in one location, but perhaps the long end is never. So there would be years of discussion about which parameters are or are not standardised,' says Ben Scofield, foreign exchange content manager at data provider Refinitiv. There are cases, however, where EU regulators have been able to determine 'liquid' and 'standardised' products in a matter of months, thanks to tests and consultations conducted to determine which OTC derivatives should be cleared through central counterparties or traded on venues, known as clearing and trading obligations, respectively.

The large hedge fund's regulatory expert suggests a radically different approach, under which all derivatives would be subject to transparency requirements, regardless of whether they are standardised or traded on a venue. This is similar to the approach taken in the United States, where banks labelled as swap dealers, or non-banks labelled as major swap participants, must report all their traded derivatives to the swap data repository. This approach could provide a much cleaner solution, as it would put to rest any debate on the scope of transparency requirements and level the

playing field between on-venue and off-venue trading. But the inclusion of thinly traded derivatives in the data would dilute their value, users complain. "It is not practical to try to monitor this data on an infrequent basis. All it does is increase the volume of market data in circulation, essentially creating noise,' says the regulatory expert at Europe's second-largest investment bank. This approach would also require a change in the primary legislation of Mifid II, as the definition of TOTV would be overbroad if non-traded derivatives were interpreted as TOTV.[126]

"Trading on a trading venue was a top-level concept and is incorporated into the criteria for many obligations, such as post-trade transparency," says Tim Cant, partner at law firm Ashurst. "Therefore, it is not possible to amend the opinion to say that all derivatives fall within the scope of the TOTV."

One change to the transparency framework that could be the subject of a targeted review concerns the delay in reporting illiquid or oversized transactions. The size rule is twofold: a 'large size' (LIS) referral is granted to transactions that are larger than the average transaction size within that asset class. An 'instrument specific size' (SSTI) deferral is granted if a transaction is above a minimum size threshold for dealers using their own capital while trading off-site or on trading venues on a quote request basis. Deferrals can last two days or four weeks, depending on the national supervisory authority. For instance, in Sweden and Denmark, two-day deferrals are sometimes used, while in the UK and most of Germany, four-week deferrals are granted in all cases. Industry experts say that since the vast majority of instruments receive four-week deferrals, the use cases are limited. "We found that 89 per cent of interest rate swaps are deferred by four weeks," says Chris Barnes, senior vice president for Europe at data provider Clarus FT. "So we are discarding the delayed data that is not accessible and realistically we don't get the data until four weeks after the trade." The amount of referrals could change once Esma stops using its 'transitional' transparency calculation to assess OTC derivatives liquidity and average trade size. The regulator was supposed to measure derivatives liquidity in April this year, but decided to postpone the test due to data quality issues and uncertainty surrounding the UK's exit from the EU. Esma has stated that it will carry out the full transparency test for derivatives in April next year, but in an announcement published on 30 October 2022 hinted that the calculations may have to be further delayed for some derivatives categories. In the meantime, Esma carries out liquidity tests on bonds every quarter and in the latest results, published on 6 November, 611 bonds were identified as liquid. Refinitiv estimates a possible universe of 500,000 bonds. Esma is currently in the first phase of four liquidity thresholds, which will gradually lower to the final one, bringing more bonds into the scope. Esma

[126] Bloomberg, 13 October 2022

has yet to move to the second phase due to the uncertainty of Brexit. Under the fourth phase, it is estimated that 22% of bonds will be considered liquid.

It is widely believed that a high number of deferrals reduces the usefulness of the data. The 15-minute deferred data could be used for a number of purposes, including intraday snapshots of market prices and trading volumes, end-of-day instrument valuations or to help feed pricing and hedging algorithms. John Mason, global head of middle and back office business at Refinitiv, says there are still some use cases for the data from four weeks ago, including a test to show that risk factors are modelled as part of the upcoming trading book capital rules. ING's Malrait says the data can also be used in macroeconomic analysis and to model the historical performance of instruments and portfolios in backtesting. However, many are calling for changes in primary or secondary legislation to reduce the number of referrals or shorten the timeframe. "The data is so stale in terms of relevance after four weeks," says the regulatory expert from a large hedge fund. "We believe that the length of the deferral period should be drastically reduced." The specialist suggests that Esma amend Mifid II secondary legislation to ensure that OTC derivatives defined as liquid in other rules - such as clearing and trading obligations - are also considered liquid for transparency purposes.

However, dealers are cautious about any changes to the deferral regime that could affect their ability to cover a client's order before the market can anticipate its execution. "The deferral regime exists for a good reason: we can still trade illiquid or large instruments with limited impact on the market," says ING's Malrait. "The thresholds started high, but over time they will lower, which means that eventually more instruments will be subject to real-time transparency. This is the right approach." Wider concerns may diminish as Esma completes the Mifid II liquidity calculations for derivatives and reaches the final stage of liquidity thresholds for bonds. However, participants will prepare for regime changes: it is not yet clear whether this will be Mifid 2.2 or Mifid 3.[127]

The problems affecting the quality of reported data are manifold. For example, the industry has long questioned the use of maturity date in reference data and Isins for interest rate swaps. Since swaps mature on a different date from one day to the next, this has led to a proliferation of Isins assigned to swap contracts. As a result, it is difficult to aggregate the trading volumes of interest rate swaps. Other data quality problems are that counterparties communicate information to each other in different formats, forcing data aggregators to convert the information to match. "It is possible to report the price of a bond as a percentage of par value, in cash or in basis points," says Ben Scofield of Refinitiv. "If a bond is traded on three venues and has off-site trading, not only do you need to aggregate the data, you need to harmonise it. There are also real mistakes made by traders, such as reporting currency pairs in foreign exchange derivatives incorrectly. There are two possible

[127] Bloomberg, 13 October 2022

remedies to these problems, which require the intervention of legislators and regulators. Either secondary legislation could be amended to reduce the choice of reporting fields, or Esma could publish additional Q&As to harmonise the interpretation of fields. Industry groups are also trying to solve some of these data quality problems without any legislative changes. Working groups have been set up at various associations, including the International Capital Market Association, the FIX trading community and the International Swaps and Derivatives Association, to address some of the problems.

4.4 CONCLUSIONS

The analysis in this paper shows that the evolution of the Markets in Financial Instruments Directive (MiFID) has played a crucial role in shaping the European financial landscape since its inception. MiFID I, introduced in 2007, aimed to promote competition and improve investor protection in the financial markets. This legislation has achieved important milestones, introducing new trading platforms, promoting transparency and increasing market access for investors.

However, the financial landscape has evolved rapidly since the implementation of MiFID I and new critical issues have emerged. MiFID II, implemented in 2018, addressed some of these by introducing stricter rules on transparency, market structure and investor protection. It broadened the scope of regulated instruments, improved transaction reporting and introduced rules on high-frequency trading.

Despite the progress made, MiFID II faced some challenges and limitations in its implementation. The complexity of the regulation and high compliance costs have created difficulties for market participants, particularly smaller firms. In addition, technological advances and the emergence of new trading practices have highlighted the need for further regulatory measures.

Looking forward, the proposed MiFID III has the potential to fill these gaps and improve the existing framework. It is expected to focus on areas such as algorithmic trading, market data, sustainable finance and investor protection. By incorporating emerging technologies and market developments, MiFID III can provide more comprehensive regulation for the evolving financial landscape.

One of the main improvements MiFID III could bring is a more streamlined and simplified regulatory framework. This would address the complexity and high compliance costs associated with MiFID II. Furthermore, strengthening the provisions on algorithmic trading can help mitigate the risks associated with automated systems and ensure fair and orderly markets. Furthermore, by emphasising sustainable finance, MiFID III can facilitate the transition towards a more environmentally and socially responsible financial system.

However, the successful implementation of MiFID III will require careful consideration of lessons learned from previous iterations. Cooperation between regulators, market participants and industry stakeholders will be essential to strike the right balance between regulatory requirements and market efficiency. Furthermore, continuous monitoring and regular review of regulation will be crucial to adapt to future market developments.
In conclusion, the evolution of MiFID has been instrumental in shaping European financial markets. MiFID III offers the opportunity to build on the achievements of its predecessors and address the challenges of the modern financial landscape. By embracing technological advances, simplifying regulation and focusing on sustainability and investor protection, MiFID III can contribute to a more resilient, transparent and efficient European financial market ecosystem.

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EXECUTIVE SUMMARY

This paper highlights the importance of the introduction of MiFID (Markets in Financial Instruments Directive) in Europe, which aims to protect small investors. It states that prior to MiFID, there were significant economic and financial events that had a lasting impact on the global economic system. These events revealed the inadequacy of controlling financial institutions and their tendency to exploit small investors. The passage emphasizes the need for investor protection and the introduction of international directives to address these issues.
While it acknowledges that regulating the behavior of financial institutions cannot rely solely on human goodwill, it emphasizes the importance of strict rules and their enforcement to prevent circumvention. The passage mentions the evolution of investor protection, from the initial MiFID to its reformulation as MiFID II and the potential for a third version in the future.

In the analysis of the historical pre-introduction period, five of the most significant economic and financial events of the period were analysed: The Dot.com bubble, the market consequences of 11/09/2001, the Enron collapse, the 2007-2008 sub-prime mortgage collapse and great recession of 2009 and the Year 2008 Bernard Madoff Biggest Ponzi Scheme in History.

The Dot-com bubble refers to a period of excessive speculation and investment in internet-based companies during the late 1990s and early 2000s. This economic phenomenon was fueled by the rapid growth of the internet and the belief that any company with an online presence could achieve significant financial success.
During this time, investors poured large sums of money into internet startups, often without thoroughly evaluating their business models or profitability. Stock prices of these companies soared to unprecedented levels, despite many of them lacking sustainable revenue streams or clear paths to profitability.
However, the bubble eventually burst in the early 2000s. Investors began to realize that many of these dot-com companies were overvalued and unlikely to deliver the promised returns. As a result, stock prices plummeted, causing significant financial losses for investors and leading to the bankruptcy and closure of numerous dot-com companies.
The bursting of the Dot-com bubble had far-reaching consequences, including a decline in market confidence, widespread job losses, and the reevaluation of internet-based business models. It exposed the risks associated with speculative investing and highlighted the importance of conducting thorough due diligence and assessing fundamental business viability.

Nevertheless, the Dot-com bubble also played a role in paving the way for future internet-based success stories, as it forced companies to focus on developing sustainable business models and led to the evolution of the internet economy.

The terrorist attacks that occurred on September 11, 2001, had significant consequences for global markets. The immediate aftermath of the attacks saw a sharp decline in stock markets worldwide, as investors reacted to the uncertainty and fear surrounding the events.
In the United States, the stock market remained closed for several days following the attacks. When it reopened, there was a substantial sell-off, with the Dow Jones Industrial Average experiencing its largest point drop in history. This decline in stock prices reflected concerns about the impact of the attacks on the economy, particularly in industries such as airlines, insurance, and tourism.
Furthermore, the attacks prompted a heightened sense of risk aversion among investors, leading to increased demand for safe-haven assets such as gold and U.S. Treasury bonds. The Federal Reserve responded by cutting interest rates and implementing measures to stabilize financial markets and support economic recovery.
In addition to the immediate market reactions, the events of 9/11 had long-term implications for various sectors. The airline industry, in particular, faced significant challenges due to increased security measures, a decline in air travel, and rising fuel costs. Insurance companies also experienced significant losses due to the large number of claims resulting from the attacks.
Furthermore, the attacks prompted increased geopolitical tensions and military interventions, particularly in the Middle East. These factors contributed to volatility in energy markets, as concerns about oil supply disruptions and political instability influenced oil prices.
Overall, the consequences of the September 11 attacks on global markets were characterized by initial market shocks, a period of heightened risk aversion, and long-term effects on specific industries. The attacks served as a reminder of the vulnerability of global markets to unexpected events and highlighted the need for resilience and adaptability in the face of such challenges.

The Enron collapse refers to the scandalous downfall of Enron Corporation, one of the largest energy companies in the United States, which occurred in 2001. The collapse of Enron was primarily due to widespread accounting fraud and unethical practices, revealing major flaws in corporate governance and financial reporting.
Enron, once hailed as a highly innovative and successful company, engaged in deceptive accounting techniques to hide its mounting debts and losses. The company created off-balance sheet entities

and used complex financial structures to manipulate its financial statements, presenting a false image of profitability and financial health.

Enron's fraudulent activities involved inflating revenues, understating liabilities, and artificially boosting the value of its stock. These practices were facilitated by complicit auditors and a corporate culture that prioritized short-term financial gains over ethical conduct.

As the truth about Enron's financial mismanagement started to emerge, investor confidence plummeted, and the company's stock price collapsed. Enron filed for bankruptcy in December 2001, resulting in significant financial losses for shareholders, employees, and pension funds.

The Enron collapse had far-reaching consequences beyond the company itself. It led to the dissolution of one of the largest accounting firms at the time, Arthur Andersen, due to its role in the auditing failures. The scandal also prompted a wave of regulatory reforms, including the passage of the Sarbanes-Oxley Act, aimed at enhancing corporate governance, financial transparency, and accountability.

The Enron collapse served as a wake-up call for the need to improve corporate governance practices and strengthen regulations in the corporate sector. It exposed the dangers of unchecked greed, unethical behavior, and inadequate oversight, underscoring the importance of transparency, accountability, and integrity in business practices.

Overall, the Enron collapse remains a significant symbol of corporate fraud and serves as a cautionary tale about the risks of unchecked corporate power and the importance of maintaining ethical standards in business.

The 2007-2008 subprime mortgage collapse and the subsequent Great Recession of 2009 were intertwined events that had a profound impact on the global economy. The subprime mortgage collapse began with the bursting of the housing bubble in the United States, leading to widespread defaults and foreclosures on subprime mortgages. This caused significant losses for financial institutions that held mortgage-backed securities tied to these risky loans.

The collapse quickly spread throughout the financial system, resulting in a loss of confidence and liquidity problems. Major banks and financial institutions faced insolvency, requiring government interventions and bailouts to prevent a complete collapse of the financial system.

The crisis then triggered the Great Recession, which was a severe global economic downturn. The recession was characterized by a contraction in economic activity, high unemployment rates, and a decline in consumer spending. It had ripple effects across various sectors, including housing, manufacturing, and finance, leading to widespread job losses, business closures, and a decline in stock markets worldwide.

Governments and central banks implemented various measures to combat the crisis and stimulate economic recovery. These included fiscal stimulus packages, monetary policy interventions, and regulatory reforms aimed at strengthening financial oversight and improving risk management.
The 2007-2008 subprime mortgage collapse and the subsequent Great Recession exposed fundamental weaknesses in the financial system, including lax lending practices, excessive risk-taking, and inadequate regulation. The crisis prompted significant reforms in financial regulations, such as the Dodd-Frank Act in the United States, to enhance transparency, accountability, and stability in the banking and financial sectors.
The impact of the subprime mortgage collapse and the Great Recession was felt globally, highlighting the interconnectedness of economies and the need for coordinated international efforts to mitigate the effects of future crises. The events served as a stark reminder of the importance of responsible lending, prudent risk management, and robust regulatory frameworks to safeguard the stability of the global economy.

In 2008, Bernard Madoff, a prominent American financier and former chairman of the NASDAQ stock exchange, was exposed for running the largest Ponzi scheme in history. Madoff's scheme was a massive fraud that involved using new investors' funds to pay off earlier investors, creating the illusion of consistent high returns. However, in reality, no legitimate investments were made, and the entire operation was sustained through the influx of new funds.
Madoff's scheme unraveled when the financial crisis hit in 2008, causing a significant number of investors to request withdrawals. Unable to meet these demands, Madoff confessed to his sons that his investment advisory business was a fraud. They subsequently reported him to the authorities.
The revelation shocked the financial world, as Madoff's reputation and connections had led many to trust him implicitly. The scheme's total estimated losses were approximately $65 billion, making it the largest Ponzi scheme in history.
The fallout from the Madoff scandal was extensive. Many individuals, charities, and institutional investors suffered severe financial losses, including prominent figures and well-known organizations. The Securities Investor Protection Corporation (SIPC) was tasked with liquidating Madoff's firm, and attempts were made to recover funds for the victims.
The scandal highlighted significant failures in regulatory oversight and due diligence, as Madoff had operated his scheme for decades without detection. It prompted calls for increased transparency and stricter regulation in the financial industry to prevent similar frauds from occurring in the future.

Bernard Madoff was eventually arrested and charged with multiple counts of securities fraud, investment advisor fraud, and other offenses. In 2009, he pleaded guilty to these charges and was sentenced to 150 years in prison.
The Madoff Ponzi scheme serves as a cautionary tale, reminding investors and regulators of the importance of skepticism, independent audits, and robust oversight to protect against fraudulent schemes in the financial world.

In the second chapter of the paper, the regulations in force were analysed in all their aspects, from definition to objectives, and their application in Banca Generali in order to better understand.
MiFID II, implemented in 2018, is a comprehensive regulatory framework in the European Union (EU) that builds upon the original MiFID directive from 2007. It aims to enhance transparency, investor protection, and the functioning of financial markets within the EU.
One of the key objectives of MiFID II is to strengthen investor protection. It requires financial firms to act in the best interests of their clients and introduces stricter rules for product governance, ensuring investment products are designed and distributed appropriately. It also mandates clearer disclosure of costs and charges associated with investment services and products.
MiFID II emphasizes market transparency by introducing standardized trade reporting requirements, including for over-the-counter transactions. It aims to increase pre- and post-trade transparency, making more information available to market participants. Additionally, it mandates the publication of data on trading venues and introduces rules on the systematic internalization of trades by investment firms.
The regulation addresses trading activities and market structure by imposing regulations on algorithmic trading and high-frequency trading. Firms engaged in these activities must meet specific requirements, such as implementing risk controls and testing. MiFID II also seeks to improve the functioning of trading venues and introduces new categories of trading platforms, such as organized trading facilities (OTFs), which must comply with transparency and trading rules.
MiFID II aims to enhance investor access to a wider range of financial instruments and venues, promoting competition and innovation. It facilitates access to trading venues and central counterparties. The regulation also establishes rules to ensure fair treatment of investors in primary market issuance and provides guidelines for the provision of investment research to clients.
Harmonization and consistency across EU member states are crucial aspects of MiFID II. It introduces common rules for investment services, activities, and financial instruments, reducing regulatory arbitrage and ensuring consistent application of regulations.

MiFID II strengthens the supervisory and enforcement framework by enhancing the powers and responsibilities of national competent authorities. It promotes cooperation and information exchange among regulators to detect and prevent market abuse. The regulation also sets rules for the authorization and operation of trading venues and data reporting services.
The implementation of MiFID II has ensured that Banca Generali operates in the best interests of its clients, with a strong emphasis on investor protection.
Through the regulation's requirements for product governance and disclosure of costs, Banca Generali has improved its practices in designing and distributing investment products that are suitable for different types of clients. The clearer disclosure of costs and charges associated with investment services and products has empowered clients to make more informed decisions.
MiFID II's focus on market transparency has prompted Banca Generali to adhere to standardized trade reporting and pre- and post-trade transparency requirements. By providing more information to market participants, Banca Generali has contributed to a fairer and more efficient financial market environment.
The regulation's impact on trading activities and market structure has influenced Banca Generali's operations.
Banca Generali has also aligned its practices with MiFID II's emphasis on investor access to markets. Fair treatment in primary market issuance and the provision of investment research guidelines have contributed to a more inclusive and accessible market for clients.
Overall, the application of the MiFID II regulation in Banca Generali has been instrumental in strengthening investor protection, enhancing market transparency, promoting fair and efficient markets, and fostering harmonization. It has played a crucial role in shaping Banca Generali's practices and ensuring compliance with the regulatory framework, ultimately benefiting its clients and contributing to the integrity of the financial markets in which it operates.

In the third chapter, two pivotal aspects of the directive such as the classification and management of customers and compliance with ESG standards under the directive are discussed in depth.
The circular issued by Banca Generali in September 2021 provides practical insights into the application of the MiFID II regulation, specifically regarding the classification of clients. The classification of clients is crucial as it determines the level of protection and treatment they receive when engaging in investment services with the bank.
The circular outlines the legal framework, including the TUF (Consolidated Law on Finance), Consob Intermediaries Regulation, Ministry of Economy and Finance Decree, and Banca Generali's Customer Classification Policy. According to CONSOB Intermediaries Regulation No. 20307,

clients are classified into three categories: retail clients, professional clients, and eligible counterparties.
Retail customers are those who do not fall into the categories of professional clients or eligible counterparties. They enjoy the highest level of protection and safeguards provided by the Consob Intermediary Regulations.
Professional clients are further divided into public professional clients and private professional clients. Private professional clients are entities authorized or regulated to operate in financial markets, such as banks, investment firms, insurance companies, and pension funds. They are also large companies that meet specific size requirements. Public professional clients include the Government of the Republic and the Bank of Italy.
The classification of clients influences the bank's behaviors and obligations when providing investment services. MiFID II requires the bank to inform clients of their classification and implement appropriate measures based on the level of protection required for each category.
Eligible counterparties are specific entities, including investment firms, banks, insurance companies, and other financial institutions, that are eligible for certain services but subject to minimum levels of protection.
Banca Generali's internal circular aims to establish operational procedures for client classification and to ensure compliance with the regulatory requirements. By adhering to these guidelines, the bank strives to provide appropriate treatment and protection to its clients based on their classification.
Overall, the circular demonstrates Banca Generali's commitment to implementing the MiFID II regulation, specifically in terms of client classification and the corresponding obligations and protections associated with each category. This ensures transparency, fairness, and consistency in the bank's interactions with its clients in accordance with the regulatory framework.
Banca Generali has implemented an adequacy assessment process that includes a consistency check between clients' sustainability preferences and the financial products they purchase. Starting from August 2, 2022, clients' preferences expressed in the MiFID questionnaire are compared with the sustainability characteristics of the product being bought.
Important points to note are: the consistency check is non-blocking, meaning it does not prevent the client from making the purchase, but the outcome is disclosed to him, clients who have not yet expressed their sustainability preferences will be marked as "non-assessable" and will need to update the questionnaire as soon as possible.

Since July 2021, Banca Generali has integrated the MiFID questionnaire to collect customer preferences regarding sustainability. The questionnaire includes four questions related to ESG (Environmental, Social, and Governance) products and investments:

- Two questions assess the client's knowledge level in ESG products.
- One question measures the client's interest in ESG investments.
- One question captures the client's preference for thematic or generalist ESG products.

Question 1a and 1b aim to gauge the client's knowledge level in sustainability, and all clients receive an informative guide called the "ESG Guide" regardless of their answers. Question 2 determines the client's interest in ESG and compares it to the ESG score of the product/service, provided by a third-party called Mainstreet Partners. Question 3 identifies the client's preference for thematic or generalist ESG products.
The ESG score, ranging from 1 to 5, determines the product's sustainability level, with 3 or higher indicating sustainability.
After each suitability-checked transaction, Banca Generali provides clients with a suitability report demonstrating the consistency between the product's characteristics and the sustainability preferences expressed in the MiFID questionnaire.
To facilitate advisory activities and raise clients' awareness of ESG matters, Banca Generali has prepared an "ESG Guide" that explains sustainability, sustainable and responsible investment, thematic and generalist products, and Banca Generali's sustainability strategy.
Overall, Banca Generali's integration of sustainability preferences in the adequacy assessment process and the provision of informative materials demonstrate their commitment to sustainable investing and ensuring transparency for clients.

The fourth and final chapter deals with the banking crisis that plagued first America and then Europe between late 2022 and 2023, analysing the shortcomings of the directive and the improvements that must and will be made by the upcoming third version.
The global banking crisis of 2023 was triggered by a combination of factors, including rising inflation due to the COVID-19 pandemic, the Russian invasion of Ukraine, the global energy crisis, COVID lockdowns in China, and supply bottlenecks. Advanced economies such as the US and UK experienced historically high inflation rates, leading to concerns of a global recession.

To combat inflation, central banks raised interest rates, which increased borrowing costs and slowed economic growth. However, the rate hikes also exposed vulnerabilities within the banking sector. Several banks failed during the crisis:
Silicon Valley Bank (SVB): SVB's collapse resulted from a poor investment strategy during the tech boom of 2020-2021 and the US Federal Reserve's decision to raise interest rates. SVB had invested in long-term treasury bonds when rates were low, but the value of these bonds plummeted when rates increased, leading to significant losses. Deposit withdrawals and a liquidity crisis ultimately caused the bank's collapse.
Signature Bank: Although Signature Bank had exposure to the crypto sector and high uninsured deposits, its collapse was primarily a result of panic following SVB's failure. Concerns over contagion effects and potential bank runs led the FDIC to seize and shut down Signature Bank.
Credit Suisse: Designated as a "global systemically important bank," Credit Suisse faced ongoing scandals, litigations, and financial losses stemming from the 2008 sub-prime mortgage crisis. The failure of SVB and Signature Bank triggered a selloff in banks worldwide, including Credit Suisse.
Unable to raise additional capital, Credit Suisse faced significant distress and had to seek support from the Swiss Central Bank. It was ultimately acquired by UBS to avoid collapse.
The crisis highlighted the risks of rising interest rates and exposed vulnerabilities within banks, emphasizing the need for better risk management strategies and regulatory oversight.
Deutsche Bank (DB), Germany's largest bank, has faced significant challenges despite its strong profit of EUR 5.6 billion in 2022. The bank had aimed to shift its focus towards more European and entrepreneurial banking, while also integrating Postbank. However, internal concerns arose regarding unmet sustainability targets and derivatives management. DB's history of involvement in investigations and financial scams further added to its troubles.
The cost of credit default swaps for DB increased, and its shares lost around 25% of their value, indicating a greater impact compared to other banks. The bank's balance sheet revealed a substantial exposure to risky derivatives, particularly those related to interest rate movements. The presence of speculative interest rate transactions, influenced by volatile central bank behavior, poses a significant risk.
The global issue of financial speculation requires international reform to prevent more frequent and intense banking crises. European authorities and governments are urged to take the lead in eliminating speculation to safeguard economic stability and social welfare.
Summary:
The current banking crisis has exposed weaknesses in the Directive, these include a lack of transparency, inadequate investor protection, insufficient market surveillance, regulatory arbitrage,

inadequate risk management, incomplete coverage of financial instruments, and a fragmented regulatory framework. These weaknesses have contributed to the current crisis by allowing opaque trading practices, mis-selling of complex products, erosion of market integrity, regulatory fragmentation, and inadequate risk assessment. Regulators and policymakers are now striving to address these weaknesses and strengthen the regulatory framework to prevent future crises and enhance investor protection and market stability.

The European Union (EU) Council and Parliament have proposed a revision of the MiFIR and MiFID II regulations, known as MiFID III, focusing on three key areas: creating a level playing field between execution venues, increasing competitiveness of market infrastructures internationally, and enhancing market data transparency. The proposal suggests the establishment of a centralised database for access to market data, near real-time reporting of trade data, and simplification of dark pool trading rules. Concerns have been raised about the transparency and usefulness of data under MiFID II, leading to calls for changes. There are debates on the scope of transparency requirements for over-the-counter (OTC) transactions and the inclusion of non-standardized derivatives. Some propose reporting only standardized instruments, while others advocate for reporting all derivatives. The review also addresses issues with post-trade data for derivatives and bonds and the delay in reporting illiquid or oversized transactions. Changes to the deferral regime are being considered, but there are concerns about impacting market liquidity and execution. The revision aims to improve transparency and address the challenges faced under MiFID II, with further targeted revisions and a longer-term review planned. The exact content and timing of the revision are still being determined, and discussions are ongoing among regulators, industry participants, and policymakers.

The paper highlights the significant role of the Markets in Financial Instruments Directive (MiFID) in shaping the European financial landscape. MiFID I, implemented in 2007, aimed to enhance competition and investor protection, leading to the introduction of new trading platforms, increased transparency, and improved market access. MiFID II, implemented in 2018, addressed emerging issues by imposing stricter rules on transparency, market structure, and investor protection. However, it faced challenges in implementation, such as complexity and high compliance costs. The proposed MiFID III aims to fill these gaps by streamlining the regulatory framework, addressing algorithmic trading risks, emphasizing sustainable finance, and improving investor protection. Successful implementation will require cooperation, monitoring, and continuous adaptation to future market developments, with the goal of creating a resilient, transparent, and efficient European financial market ecosystem.