



**CONSOB**

COMMISSIONE NAZIONALE  
PER LE SOCIETA' E LA BORSA

*ANNUAL REPORT*  
*2002*

ROME, 31 MARCH 2003

### ***Internet enforcement***

Starting in 2000, the Commission has enforced compliance with securities markets rules on the Internet by systematically controlling the information posted on financial websites. The activity carried out in the three years 2000-03 concerned 191 websites and led to 81 enforcement actions. These included preventive and disciplinary measures adopted or proposed directly by the Commission as well as suspected violations of the law reported to the judicial authorities (Table VII.5).

*In particular the enforcement measures adopted directly by Consob consisted of suspensions and bans on public offerings of financial instruments and alternative trading systems. The illicit activities subject to these measures were carried out using the chain-letter mechanism and therefore involved large numbers of investors.*

*The reports to the judicial authorities, in addition to alleged cases of unauthorized provision of investment services (among which the most frequent were unauthorized asset management and placement of financial instruments), included suspected fraud, unauthorized activities punishable under the Consolidated Law on Banking, and alleged violations of the law on money laundering. The latter cases were also reported to the Bank of Italy, the Ufficio Italiano dei Cambi and the finance police for the matters falling within their sphere of competence. The reports to foreign regulatory authorities under the respective bilateral agreements on the exchange of information concerned illicit activities on the Internet found by Consob which were directed at investors resident in Italy and which potentially or actually also involved other investors.*

TABLE VII.5

## INTERNET ENFORCEMENT

	2000	2001	2002
NUMBER OF WEBSITES EXAMINED	107	35	49
OF WHICH AS A RESULT OF:			
WEB SPIDERING	105	32	21
PRESS CUTTINGS	1	0	2
REPORTS TO OPERATIONAL CONSOB OFFICES	1	3	26
ENFORCEMENT ACTIONS AND REPORTS TO OTHER AUTHORITIES			
CONSOB DISCIPLINARY AND PREVENTIVE MEASURES	9	4	4
REPORTS TO THE JUDICIAL AUTHORITIES	5	6	20
REPORTS TO THE FINANCE POLICE	1	2	2
REPORTS TO THE BANK OF ITALY	2	3	0
REPORTS TO THE UIC	1	3	10
REPORTS TO FOREIGN AUTHORITIES	4	4	2
<i>TOTAL</i>	22	22	38

The experience gained in Internet supervision in the three years 2000-02 has shown the multi-disciplinary nature of this activity with respect to the institutional tasks performed by Consob's various operational divisions. Moreover, the checks and means of investigation for this activity call for the development of solutions adapted to the specific features of the Internet as an instrument for the perpetration of crimes. In particular, Internet enforcement requires the identification of suspicious websites to be examined in more detail. This is done using three sources: periodic web spidering, the reports received from the External Relations Division, the International Relations Office and Consob's other Offices, and analysis of the leading daily newspapers and economic periodicals.

*Web spidering consists in reiteratively searching the Internet for words and phrases by means of an intelligent (neural-network type) algorithm. The set of phrases is updated continuously to take account of the evolution of the initiatives carried out over the Internet that could hide some form of unauthorized activity. It has been found in fact that over time deviant behaviour tends to follow almost predefined formulas in order to reach the investing public effectively. For example, in the year 2000 the most common formula consisted in the setting up of phantom alternative trading systems with companies listed that promised rapid growth and high financial returns. By contrast, in 2001 the unauthorized provision of investment services*

*predominated, while in 2002 many sites adopted a formula that involved the apparent provision of advice, which masked the real aim of providing unauthorized asset management and/or placement of financial instruments and the solicitation of investors.*

Lastly, it should be noted that since the second half of 2002 Consob has participated in a project financed by the European Union known as “FFPOIROT” (Financial Fraud Prevention - Oriented Information Resources using Ontology Technology), the ultimate aim of which is to improve the present web-spidering technique by applying artificial intelligence algorithms based on the notion of ontology (the passage from words to concepts) to the interpretation of the contents of websites.



**CONSOB**

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investigations of websites disseminating cross-border information, thereby making a significant contribution to supervisory interaction between EU authorities.

Last year the Commission adopted 12 enforcement measures (Table aVII.2), consisting mainly of orders suspending or prohibiting offerings of financial instruments and letters of reprimand to the interested parties.

*The unauthorized offerings targeted by these measures generally took the form of Ponzi schemes. Typically, the owner of the website promotes an activity, based on investment in financial instruments, that promises each investor a chance to make money depending on the number of other investors he or she is able to bring in. Obviously, this type of pyramidal remuneration scheme works as long as the rate of growth of new investors ensures the inflow of cash needed to pay the first investors and, above all, the person who began the activity (the site owner). When the inflow of fresh cash from new investors is no longer sufficient, the mechanism collapses, leading to a loss of all the capital invested by the last persons enrolled in the scheme. Some of these schemes, whose nature is such that they can involve a large number of savers, entailed suspected criminal offences or violations of the law on money-laundering and were duly reported to the judicial authorities or the Italian Foreign Exchange Office.*

*Another scheme commonly used on the Internet consists in presenting what appears to be a consulting service but actually involves unauthorized asset management and placement of financial instruments. These cases were also reported to the judicial authorities.*

Over and above the above-mentioned cases, the reports to the judicial authorities regarded alleged cases of unauthorized activities punishable under the Consolidated Law on Banking, which were also reported to the Bank of Italy for the matters falling within the scope of its authority. Furthermore, the Commission provided support to the judicial authorities in a criminal trial that arose

### **Internet enforcement**

In the four years 2000-04 that the Commission has supervised compliance with market rules on the Internet it has examined more than 250 websites and taken more than 100 enforcement actions. The fact that irregularities were found in such a large percentage of the sites examined indicates the need for the utmost attention in supervisory action to combat widespread illegality in financial websites.

The Commission's four-year experience of Internet supervision shows the impossibility of identifying a priori the types of irregularities characteristic of activity carried out on websites. Supervisory action, performed using specific innovative instruments of investigation, benefits from a statistical refinement of web spidering.

Consob has presented its supervisory procedure to the Committee of European Securities Regulators along with the results of some of its

from a report by Consob in the preceding years in connection with its Internet supervision. In addition, Consob cooperated with the Finance Police in a number of instances. Lastly, the Commission found what it suspected were irregularities in the provision of insurance services and reported them to Isvap, the supervisory authority for the insurance industry, for the matters falling within the scope of its authority.

The reports the Commission made to foreign supervisory authorities pursuant to the respective memoranda of understanding concerned illicit

activities on the Internet aimed at Italian investors that potentially or actually also involved investors not resident in Italy.

Lastly, Consob began the technical and juridical review of Legislative Decree 70/2003 implementing Directive 2003/31/EC on electronic commerce. Among its other provisions, the decree empowers Consob to order Internet service providers to shut down websites in order to prevent the protraction of violations. Some of the provisions of the decree were already applied in the first few months of 2004.



**CONSOB**  
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and reported 16 cases of unlawful activities to other authorities (Table aVII.2).

The number of Internet irregularities that are such as to warrant enforcement action not only highlights the effectiveness of the supervisory tools developed by Consob but is also an indication of widespread illegality in financial websites. The experience gained over the last five years has evidenced some special features of this area of supervision.

In particular it has emerged that this field has nothing to do with the Internet activities of authorized persons (intermediaries, issuers and markets) in terms of the checks, aims and investigative tools involved. Moreover, it is impossible to identify a priori the types of irregularities characteristic of activity carried out on websites. Action may require inputs from any number of Consob departments and very often from various other authorities as well.

In the last few years Internet supervision and enforcement has grown in importance, not least because Consob has been participating since 2002 in an EU-financed programme called "FFPOIROT" (Financial Fraud Prevention Oriented Information Resources using Ontology Technology) with a view to improving web spidering through the application of artificial intelligence algorithms based on the concept of ontology as a method of interpreting the contents of websites.

The supervisory experience gained shows that the effectiveness of Consob's supervision must be backed up by the possibility of blocking savers' access to the websites used for illegal activities. This need

### ***Internet enforcement***

Last year was Consob's fifth year of supervising investment services on the Internet and in that time it has analyzed about 600 websites, of which around 350 have had enforcement action taken against them.

In 2004 the Commission adopted 97 disciplinary and precautionary measures in connection with its supervision of websites

was addressed in July 2003 with the enactment of Legislative Decree 70/2003 implementing Directive 2000/31/EC on electronic commerce. This legislation has granted specific powers to Consob within the framework of its supervision of websites. For example, it may demand that internet service providers disable access to the offending internet addresses (known as “shutting down” the site) – including storage, caching and transmission – in order to prevent the protraction of violations and it may request information from such providers in various ways.

The exercise of the new powers envisaged in the Decree has led to the updating of the Internet supervisory procedures and the broadening of the duties of the Internet task force that applies them.

Experience has shown, however, that the owners of websites which have been shut down tend to transfer the site to non-EU internet service providers in order to escape Consob action.

*This trend raised the need to examine the clauses contained in private contracts for the provision of international services mainly based on the standard forms drawn up by ICANN (Internet Corporation for Assigned Names and Numbers). This examination showed that the contracts governing the provision of various services that can be offered on the Internet envisage that unfair terms must be specifically acknowledged in writing. Among other things, such clauses allow the persons providing the service to interrupt it unilaterally and unappealably if they become aware of unequivocal evidence to the effect that the*

*provision of the service facilitates the carrying out of unlawful activities through the Internet.*

*Such clauses have de facto given Consob the possibility of interacting with non-EU internet service providers as well. In this regard the first shutting down of websites hosted by foreign Internet service providers was achieved in the second half of 2004.*

With reference to the supervision of financial information disseminated through the Internet, 2004 witnessed the rapid growth of blogs with specifically financial contents through which investors report and spread stock exchange news and rumours or specify their own investment strategies, sometimes even mentioning the securities portfolio held by the author. Those sites have been included in the database of websites, fora, newsgroups and on-line information channels that are regularly monitored in view of the ease and rapidity with which such information can be posted on the Internet.

*Special attention is paid to examining the operating advice contained in such blogs in light of the risks associated with the spreading of investment strategies which are not sufficiently well-founded, accurate or updated or which in any event could potentially modify share prices in line with the expectations of the author of the strategy, especially where securities that are not readily marketable are involved.*

*Because of its particular investigative worth, the information gathered during 2004 as a result of Internet supervision constituted an integral part of the documentation forwarded to the judicial authorities pursuant to Article 186 of the Consolidated Law on Finance.*



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**Lamberto CARDIA**

*Members of the Commission*

**Enrico CERVONE**

**Carla RABITTI BEDOGNI**

**Paolo DI BENEDETTO**

*Director General*

**Massimo TEZZON**

*The growing use of internet as a means for promoting the supply of financial instruments and investment services or as a means for accessing financial instrument markets, on the one hand, and the specificities of the web supervisory checks with regards to technicality and instrumentation required, on the other hand, have made constant streamlining of the supervisory procedure necessary, in addition to intense collaboration with regards to other supervisory authorities, Italian and foreign. The supervisory procedure envisages a web spidering model which is based on artificial intelligence algorithms capable of scanning the web site on the basis of specific semantic training criteria and, therefore, seeking the information concerning the case being assessed on the internet.*

During 2005, supervision concerning the examination of 432 internet sites gave rise to 498 enforcement measures, in addition to 264 reports to the judicial authorities and 523 reports to other authorities (Table 57).

Enforcement action involved precautionary/disqualification measures which concerned cases of offerings and irregularities in the functioning of alternative trading systems, followed by measures for blacking-out the web sites involved (measures achieved, for the web sites maintained on the internet by EU service providers, in accordance with Italian Legislative Decree No. 70 dated 9 April 2003 and, for those maintained by non-EU service providers, via private law clauses which discipline the web service provision contracts envisaged by the ICANN formats).

### **3. Internet enforcement activities**

During 2005, supervision of the activities on the internet was intense; moreover the quantitative methods for identifying anomalies were further improved.

Table 57

Internet supervisory activities

	No. of web sites examined for:				Enforcement actions	Reports to other authorities						
	Web Spidering	Press reviews	Reports to Consob operational offices	Total	Precautionary/disqualification measures <sup>1</sup>	Judicial authorities	Guardia di Finanza	Bank of Italy	Uic	Isvap	Foreign authorities	Total
2000	105	1	1	107	9	5	1	2	1	--	4	13
2001	32	--	3	35	4	6	2	3	3	--	4	18
2002	21	2	26	49	4	20	2	0	10	--	2	34
2003	27	1	42	70	12	6	3	1	2	2	2	16
2004	297	2	18	317	97	42	30	35	30	1	11	149
2005	406	3	23	432	498	264	164	169	163	1	26	787

<sup>1</sup> The figures for 2004 and 2005 include the measures for blacking out websites adopted in compliance with Italian Legislative Decree No. 70/2003.

With regards to unauthorized solicitation, the recurrent pattern continues to be that typical of the so-called “chain letter”, as in previous years. What is more, in 2005 a new phenomenon involving solicitation via internet emerged, associated with the formation of credit societies via committee’s of financial salesmen.

The measures for blacking out websites involved in cases of unauthorized solicitation and irregularities in the functioning of organized trading concerned websites, as in previous years and, for the first time in 2005, messaging forwarded from electronic mail boxes or that present on discussion forums.

With reference to website backing out measures, collaboration with the body responsible for assigning “.it” domain names was particularly useful (the Register of ccTLD “.it”) as was that with the main service providers.

In relation to black-out measures regarding messaging, besides acquiring the contents of the same via the afore-mentioned collaboration for the purpose of fully

reconstructing the case subject to verification, complex reverse lookup procedures have been activated which have made it possible to trace back to the owners of the mail boxes and the users registered in discussion forums, via which the messaging was forwarded onto the internet. Moreover, the reverse lookup procedures made it possible to comply with requests for co-operation made by foreign supervisory authorities, within the sphere of the memorandums of association stipulated with the Consob.

The reports to the judicial authorities mainly concerned alleged unauthorized provision of investment services.

In detail, with regards to the unauthorized provision of investments services, as in previous years the most common scheme on the internet involves the presentation of apparent advisory activities which, in reality, involve the unauthorized provision of financial instrument management and/or placement services.

When carrying out internet supervision, alleged illicit conduct not falling under Consob's responsibility was also detected, and reported to the competent authorities.

Within the international sphere, besides the presentation to other supervisory authorities of the aforementioned web supervisory procedure, the

three-year European research project concerning detection methods on the internet was completed; the project was entitled FFPOIROT (Financial Fraud Prevention Oriented Information Resources using Ontology Technology), and has made it possible to streamline the web spidering model used by Consob even further.



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*Chairman*

**Lamberto CARDIA**

*Members of the Commission*

**Carla RABITTI BEDOGNI**

**Paolo DI BENEDETTO**

**Vittorio CONTI**

**Michele PEZZINGA**

*Director General*

**Massimo TEZZON**

### 3. Internet enforcement activities

During 2006, supervision activities on the Internet were intense; moreover the quantitative methods for identifying anomalies were further improved. Supervision involved the examination of 83 internet sites (432 in 2005) and gave rise to 27 enforcement measures (498 in 2005), in addition to 7 reports to the legal authorities (264 in the previous year). Overall, in the period 2000-2006, supervision has involved approximately 1,100 web sites and led to over 650 enforcement measures (Table 42).

Table 42

	No. of web sites examined for:			Enforcement measures		Reports to other authorities						
	Web Spidering	Press reviews	Reports to Consob operations units	Total	Precautionary measures/prohibition orders <sup>1</sup>	Legal authorities	Guardia di Finanza	Bank of Italy	Uic	Isvap	Foreign authorities	Total
2000	105	1	1	107	9	5	1	2	1	--	4	13
2001	32	--	3	35	4	6	2	3	3	--	4	18
2002	21	2	26	49	4	20	2	0	10	--	2	34
2003	27	1	42	70	12	6	3	1	2	2	2	16
2004	297	2	18	317	97	42	30	35	30	1	11	149
2005	406	3	23	432	498	264	164	169	163	1	26	787
2006	49	1	33	83	27	7	--	--	--	--	5	12

<sup>1</sup> The figures for 2004 and 2005 include the measures for blacking out websites adopted in compliance with Italian Legislative Decree No. 70/2003.



Among the enforcement measures triggered by the Internet supervision activity, there were a number of suspensions and prohibition orders for public offers to invest in financial instruments organised without authorisation to publish the related prospectus (see paragraph 2 above). As is normal, following the adoption of these measures the web sites involved in the offences were shut down.

The reports to the Legal Authorities regarding possible criminal offences mainly concerned allegedly illegal investment services and/or promotions and fraud, as in previous years.

In particular, one report to the Legal Authorities regarding a web site suspected as being used for illegal provision of investment services led to the arrest of the webmaster and confiscation of funds illegally managed on behalf of unwitting investors.

Another report to the Legal Authorities concerned an alleged manipulation of unlisted securities on an ATS already suspended indefinitely by Consob. Specifically, manipulative conduct was repeatedly employed by a number of strongly interrelated persons to wilfully steer prices upwards on certain issuers' shares, also with the aim of obtaining financing from banks which were to accept those shares as guarantee.