

Sixth Standing Committee
of the Italian Senate

**Inquiry into matters relating to
the implementation of Law 262/2005
“Measures for the protection of savings
and the regulation of financial markets”**

Testimony of the Governor of the Bank of Italy
Mario Draghi

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1. Introduction

The law on savings (Law no. 262 of 28 December 2005) is a sweeping reform with commendable objectives: to strengthen companies' internal controls and public controls for the protection of savings, enhance the transparency of markets and foster cooperation between authorities by establishing rules to govern their coordination.

Together with many appreciable, necessary changes, the new rules also have several problematic points, chiefly as regards the division of the regulatory framework between laws, administrative rules and self-regulation.

The quality of financial regulation is gauged by its effectiveness in preventing improper conduct, protecting investors against uninformed risk-taking, and averting systemic crises. With today's increasingly complex financial markets and financial products, it would be illusory to pursue these objectives by means of ever-more detailed and pervasive formal constraints and prohibitions. The fact is that constant financial innovation often results in the rapid obsolescence of formally rigorous and detailed rules crystallized in a law, thus imposing unwarranted costs on economic agents and undermining their competitiveness, with counterproductive effects for investor protection. It is important that the fundamental principles the law must establish should fully exploit the potential of mechanisms based on transparency and reputation, the application of self-regulatory codes, and flexible action by the supervisory authorities.

The law on savings takes this course, but only up to a point. On the matter of conflicts of interest within financial intermediaries in particular, it introduces detailed and rigid prescriptions that are not always in line with the rules prevailing at European and international level, which make the most of the self-regulatory capacity of the markets and the flexibility and adaptability to concrete cases characteristic of secondary legislation issued by regulatory authorities.

In the field of corporate governance as well, the reform appears to be torn between measures designed to strengthen internal arrangements and the role of self-discipline, and more *dirigiste* instruments based on meticulous prescriptions.

In coordinating the new rules with existing codified laws and other sectoral legislation, the draft legislative decree under examination introduces many useful elements of rationalization and solves a number of problems. I shall offer some considerations in this regard later, after reporting on the steps the Bank of Italy has taken in recent months to apply the law on savings within its sphere of competence.

I shall treat questions of corporate governance only in passing and concentrate instead on matters relating more directly to the responsibilities of the Bank of Italy. Here let me just mention some of the changes proposed in the draft decree that move in the direction indicated: revised rules on corporate disclosure by companies adhering to codes of conduct that would assign responsibility for the truthfulness of such statements to corporate bodies, without prejudice to Consob's powers to publicize the codes; a new supervisory approach to stock option plans, confirming Consob's duty of guaranteeing complete disclosure to the

market of the working of the plans but eliminating over-detailed rules on matters properly left to the independent management of the company, such as the methods for setting prices and the deadlines for exercising the options; and finally, abolition of the secret ballot requirement for the election of corporate officers, a mandatory norm that is unparalleled in any other system, raises serious problems of opacity in decision-making by the shareholders' meeting, and is not conducive to the transparency of the market for corporate control.

It is necessary to move progressively towards a set of rules allowing sufficient scope for shareholders to perform the controls envisaged by internal corporate mechanisms in a fruitful fashion and make effective use of judicial remedies. This means bringing the efficiency of the civil courts up to a level that has so far proved hard to reach, despite the recent reform of civil procedure. In short, a proper balance between internal mechanisms and public regulation requires that there be effective protection of individuals' contractual positions.

Given the scope of delegated legislation, the draft decree could not deal with all the problems of the legislation on savings. Another opportunity to rationalize the rules, especially on securities, is offered by the transposition of the European directives on offering and listing prospectuses¹ and markets in financial instruments.²

As for the protection of savings, it would appear advisable to start studying forms of crisis management cooperation between the technical authorities and the Government.

2. Implementation of the law on savings

2.1 Cooperation between authorities

The law on savings confirms the independence of the supervisory authorities, reinforces the division of regulatory and control functions by purpose and emphasizes cooperation between the authorities, leaving it largely to their discretion to devise the best forms of collaboration and coordination.

The Bank of Italy's contacts with other authorities, frequent even before the new law, have been stepped up with a view to agreeing on how to implement the legislative changes. The reflections underlying the draft legislative decree on coordination are the fruit of a joint analysis on the part of the authorities, which participated in the working group chaired by Vice-Minister Pinza.

Together with the Antitrust Authority, we identified the problems with the provision for a "single act" authorizing acquisitions of equity stakes in banks and agreed on appropriate correctives. The Bank's former antitrust powers in banking were handed over without prejudice to proceedings already under way.

¹ Directive 2003/71/EC.

² Directive 2004/39/EC.

A memorandum of understanding will be signed with Consob on the ways the Bank of Italy is to contribute to the examination of prospectuses for bank securities. Another memorandum, also nearing completion, will determine the technical procedures whereby Consob may access Central Credit Register data to verify possible abuses of market power without harm to the confidentiality of the service.

2.2 Bank of Italy administrative and regulatory procedures

The law on savings lays down the principles that are to govern the supervisory authorities' administrative and regulatory action, leaving implementation to regulations to be issued by the authorities themselves.

The law provides expressly for individual proceedings to be subject to the standards of transparency and efficiency laid down by Law 241/1990 on administrative proceedings, insofar as these are compatible with the specificity of control activities. The Bank of Italy has adapted its earlier measures in this field to the new legislation and issued regulations establishing the time limits and persons responsible for administrative proceedings. Regulations governing access to documents and participation in administrative proceedings will follow.

In implementing the principles of the law on savings, the Bank of Italy has also issued measures to separate, within the framework of the administrative sanction procedure, the investigative from the decision-making function. This was made necessary by the direct attribution to the Bank of the power to impose administrative sanctions for violations of the Consolidated Law on Banking.

The law on savings also sets forth principles governing the procedures for approving regulatory and general acts. Their adoption must be preceded by consultations with the financial industry and consumers and by assessments of their impact on the existing regulatory framework, the activities of financial institutions, and the interests of customers. The reasons for measures must be stated and consideration given to the principle of proportionality. Regulations must be reviewed at least every three years. Even before the reform it was standard practice for the Bank of Italy to give the reasons for its regulatory measures and to hold consultations with the financial industry. The new law turns these practices into mandatory requirements, which the Bank will comply with fully.

The quality of regulation is a factor in the efficiency of the financial system. The Bank of Italy is engaged in constant adaptation of its regulations to reduce the costs they entail and to adapt them effectively and promptly to the evolution of the market. The prudential regulation of banks and other intermediaries is undergoing far-reaching change, partly driven by convergence at international and EU level.³ The Bank has issued public consultation documents setting out the regulatory options and policy guidelines for the

³ The New Capital Accord (Basel 2) and Directives 2006/48/EC and 2006/49/EC on the business of credit institutions and the capital adequacy of investment firms and credit institutions, respectively.

implementation of the new prudential rules. The banking and financial industry is called on for comments, suggestions and proposals.

More broadly, a programme of regulatory simplification has been launched to remove constraints and costly formalities that are no longer needed. Most recently the requirement to notify the Bank of Italy of transactions that would entail acquisition of control of a bank even before discussion of the operation by management bodies has been abolished. This change, in line with the standards of transparency confirmed by the reform, abrogates an obligation that the market perceived as an obstacle to domestic and cross-border banking concentrations. Planned concentrations are still subject to authorization, an instrument essential for the Bank of Italy to perform its duty of controlling the quality and soundness of all those intending to acquire control of a bank.

2.3 The institutional structure of the Bank of Italy

The law on savings contains principles that bear on the institutional structure and functioning of the Bank of Italy and serve to protect the independence of the Bank and its governing bodies.⁴ The implementation of some of these principles required revisions of the Bank's Statute.

On 27 July the Board of Directors approved the draft of a new Statute that incorporates the indications of the law. The text was sent to the European Central Bank, which on 25 August issued a broadly positive opinion, suggesting only limited changes. In order to take these suggestions into account, the text will now be submitted to the Board of Directors again and then to the extraordinary shareholders' meeting. Subsequently, the law requires that the Statute be approved with a decree issued by the President of the Republic acting on a proposal from the Prime Minister in concert with the Minister for the Economy and Finance following a decision by the Council of Ministers.

One of the major innovations introduced by Law 262/2005 is the principle of collegiality, whereby the Directorate is required to adopt measures of external significance that were previously within the scope of the Governor's authority. The new rule was promptly applied in decision-making. Some delicate problems nevertheless emerged during the rule's initial application, as the law lends itself to a diversity of interpretations. In transposing the principle of collegiality into the Statute, an effort has been made to define the scope of the measures to be adopted by the Directorate more precisely.

Other changes concerned the procedural rules for appointing and removing the Governor and the other members of the Directorate and their term of office. These rules have been rewritten in full conformity with the new legislation and the principles of the European System of Central Banks.

The law also required the Statute to be amended with regard to the powers of the Board of Directors, which was to be expressly entrusted with functions of supervision and

⁴ Article 19 of Law 262/2005.

control within the Bank. With the amendments accordingly made to the Statute, the system of controls will involve three actors: the Board of Directors is charged with overseeing operations in accordance with the responsibilities of the administrative body; the Board of Auditors is charged not only with ensuring conformity with the law but also with exercising accounting control; and, as required by the Statute of the ESCB, the Bank's accounts will be examined by external auditors.

The law also lays down that the Government is to issue a regulation revising the Bank of Italy's ownership structure and governing the procedures for the transfer of those of its shares held by persons other than the State or other public entities.⁵

The ownership of the Bank of Italy has been a topic of debate and analysis of late. It is not up to the Bank of Italy to choose its owners, but it is appropriate to reflect on some general principles that should guide regulation of the ownership of a modern central bank, in the light of European rules, international standards and the experience of other major countries.

This comparison shows a variety of arrangements. The model of exclusively public ownership, though widespread (France, Germany), is not the only solution; there are examples of public and private-sector shareholders both being present (Austria, Belgium) as well as the totally private ownership structure of the Federal Reserve System of the United States, where the capital of the central bank is held by the privately-owned banks belonging to the System.

But the findings are far more uniform in other respects, reflecting common principles serving to safeguard the central bank's institutional and operational independence. The owners must in no way interfere in the institutional functions.

As for the monetary functions, the principles are codified in the Treaty. They include financial independence, meaning the possibility for the central bank to allocate sufficient resources to the performance of its tasks without being influenced by other public authorities. On more than one occasion the European Central Bank has drawn the attention of the national parliament to the need to establish adequate guarantees for the autonomy of the central bank in legislation on the ownership of the Bank of Italy.⁶ The presence of multiple shareholders is important in the light of this principle. Under the new Statute⁷ there must be a "balanced" distribution of shares among the shareholders and the power exercised in voting cannot exceed certain limits; the task of ascertaining whether potential purchasers satisfy the requirements is assigned to the Directorate and the Board of Directors, in conformity with the opinion of the ECB, as an additional guarantee of the Bank's independence.

⁵ Article 19.10 of Law 262/2005.

⁶ See, in particular, the opinions issued with regard to the law on savings (CON/2005/34 and CON/2005/58) and the Statute of the Bank of Italy (CON/2006/44).

⁷ Article 3.2.

An international consensus is also found in the approach taken to the area of banking and financial supervision. Here the independence rule must hold at two levels. The first, essential for every supervisory authority, is that of impermeability to the interests of the institutions subject to supervision. It is based on solid institutional safeguards. The argument, sometimes made, that there is a conflict of interest between some supervised entities (the shareholder banks) and the supervisor (the Bank of Italy) is without foundation. Not only does the Board of Directors, elected by the shareholders' meeting, not have the power to intervene in questions of monetary policy, but it is also explicitly excluded by law⁸ from all tasks relating to banking supervision. The law on savings (and the new Statute) assign these tasks to the Directorate. Pursuant to the law, the Governor is now appointed by the Government.⁹ It should also be borne in mind that the votes any one shareholder may cast in a shareholders' meeting are limited by the Statute¹⁰ to a maximum of 50 (out of a total of 665 today), regardless of the number of shares held, in order to prevent individual shareholders from exerting a preponderant influence on the Bank's decision-making even in the restricted scope of the matters in which the shareholders intervene.

The other level regards the possible influence of politics on the technical decisions of banking supervision. The principle of the supervisory authority's independence is affirmed by international organizations and is a value incorporated into the Bank's de facto constitution. Clearly enunciated in the *Core principles for effective banking supervision* prepared by the Basel Committee on Banking Supervision,¹¹ it is now sanctioned in domestic legislation by Article 19.3 of the law on savings, which establishes the independence of the Bank of Italy's governing bodies. Consistently, the Bank's new Statute¹² prohibits the Bank's decision-making bodies from accepting instructions from other public or private-sector entities.

The comparative picture, the approaches adopted in national and Community legislation, and the long-standing orientations of international organizations suggest the usefulness of reflecting further on the possible configurations of the Bank's ownership and comparing the principles referred to above with the solution chosen by Law 262/2005.

3. Implementation of the enabling clause on legislative coordination

The Bank of Italy participated in the work at the Ministry for the Economy and Finance to implement the mandate to coordinate the consolidated laws on banking and finance and other sectoral laws with the changes introduced by the law on savings.¹³ The work was carried out in a climate of full cooperation among the authorities concerned and between them and the representatives of the Executive. The draft decree as a whole is

⁸ Article 5.1 of Legislative Decree 691/1947 issued by the Provisional Head of State.

⁹ Article 19.8 of Law 262/2005.

¹⁰ Article 8 of the Statute now in force, Article 9.3 of the new Statute.

¹¹ See the recent consultation documents of April 2006.

¹² Article 1.2.

¹³ Article 43 of Law 262/2005.

consistent with a rational interpretation of the mandate: it accomplishes coordination between the new legislative text and pre-existing financial legislation and allows selective corrections to some critical aspects of the law on savings.

To begin with, the text contains some provisions on the Interministerial Committee for Credit and Savings. It formalizes the practice, established in recent years, of involving the chairmen of the other financial sector authorities in the work of the Committee on the basis of an invitation decided by the Minister for the Economy and Finance from time to time for topics “relevant to the matters assigned to them by law and pertaining to aspects of the overall stability, transparency and efficiency of the financial system”.

For the aspects directly bearing on the tasks of the Bank of Italy, the dropping of the rule that requires the Bank and the Antitrust Authority to adopt their respective measures authorizing bank acquisitions in a “single act” is commendable. Besides involving problems of implementation, the provision is asystemic and does not serve the objectives pursued. It would be superseded by one in which the two authorities are required to adopt their respective measures within 60 days of the time the application, accompanied by all the necessary documentation, is filed. The draft decree appropriately specifies that only acquisitions giving control of a bank fall within the scope of the new rule.

Consistently with the new division of tasks, the Antitrust Authority, acting on a request from the Bank of Italy, may authorize agreements and concentrations that restrict competition, on grounds of the functionality of the payment system or the stability of the banks concerned.

By enlarging the tasks with which the authorities are charged and rendering them more complex, the law on savings makes it necessary for the authorities to enjoy a form of legal protection for good-faith conduct in the exercise of their institutional functions, in order to safeguard the independent and impartial performance of supervision. The draft decree inserts into the part of Law 262/2005 governing administrative procedures a provision that limits the liability of the authorities (the Bank of Italy, Consob, Isvap and Covip), the members of their respective decision-making bodies and their employees to cases of bad faith or gross negligence. This rule is in line with the most advanced international standards¹⁴ and with what the International Monetary Fund has suggested on more than one occasion.

The draft decree addresses the question of conflicts of interest in banking and amends the provisions of the Consolidated Law on Banking concerned with connected lending¹⁵ and the obligations of banks’ corporate officers.¹⁶

¹⁴ *Core principles for effective banking supervision*, Basel Committee, 1997.

¹⁵ Article 53 of Legislative Decree 385/1993 (the Consolidated Law on Banking).

¹⁶ Article 136 of the Consolidated Law on Banking.

On connected lending, the draft decree introduces general principles and eliminates excessively detailed prescriptions. Flexibility is restored to the prudential rules by referring to sources of secondary legislation and specific measures adopted by the credit authorities. The guidelines recently established by the Interministerial Committee for Credit and Savings in conformity with the indications of the law on savings establish a very stringent discipline, in view of both the broad definition of related parties and the quantitative limits set on risk assets. The amendments provided for in the draft decree will require the Committee to re-examine the matter. Work is already under way on the secondary legislation that the Bank of Italy must issue, based in part on solutions adopted in other leading countries. Great care is needed, not least in view of the potentially significant impact on the relationship between banking and industry.

As for the obligations of banks' corporate officers, problems emerged in applying the new rules as soon as the reform came into force. As is well known, under Article 136 of the Consolidated Law on Banking banks' lending to their corporate officers and other business dealings with them are subject to a special procedure and non-compliance is a penal offence. The law on savings has extended the scope of the provision to such a broad range of "relevant" persons and made their identification so complex that they risk committing violations unwittingly. The problem is aggravated by the large number of intragroup transactions to which the provision applies, since for the most part they have no bearing on the provision's objective.

Although useful, the changes that the coordination decree would make to Article 136 do not solve all the problems this provision of the law on savings has created, especially as regards the broad range of persons falling within its scope. If the limits of the legislative mandate are deemed not to permit any other solution, addressing the question as soon as possible in a different legislative form should be considered. Rather than multiply constraints and prohibitions, it would be better to fully exploit the strengthening of transparency obligations as the means of limiting conflicts of interest.

The draft decree also contains provisions intended to coordinate the innovations introduced by the law on savings concerning the transparency of financial products issued by banks with the Consolidated Law on Banking and the Consolidated Law on Finance. The law on savings establishes that all investment contracts, including those of banks (and insurance companies), fall within the scope of the Consolidated Law on Finance and are subject to Consob controls. The draft decree explicitly clarifies that such contracts are no longer covered by the Consolidated Law on Banking or subject to Bank of Italy controls; it also provides for the same rules to apply to "mixed" products with banking, securities and insurance components. On the other hand it clarifies that the "financial products" defined in the Consolidated Law on Finance do not include bank or postal deposits that are not represented by financial instruments, since such deposits normally serve a purpose other than investment. This eliminates interpretative doubts and the overlapping of some border areas.

The draft decree also radically revises Article 129 of the Consolidated Law on Banking, which, as it stands, grants the Bank of Italy powers of prior control on issues of securities. The amendments eliminate the Bank of Italy's ex ante control and introduce a system of ex post notifications intended to permit the monitoring of markets and financial instruments. The change is consistent with the purpose-based allocation of tasks among the regulatory authorities and is therefore welcome.

Lastly, the draft decree addresses the question of the circulation among the public of financial products originally placed with professional investors. The law on savings added a provision to the Consolidated Law on Finance¹⁷ requiring professional investors who transfer financial products to the public either to make information available or to guarantee the issuer's solvency. The aim of the provision is to protect investors more effectively and to prevent elusive and opportunistic behaviour on the part of intermediaries. The objective is commendable; if achieved, it will also help to safeguard the stability of intermediaries by reducing the reputational risks associated with improper behaviour towards clients. However, as currently formulated, the provision involves serious problems of interpretation and enforcement.

The draft decree seeks to overcome the difficulties by introducing a different system for the protection of non-professional investors. It establishes that there is a public offering, and a consequent obligation to publish a prospectus, when financial products that were the subject of a placement reserved to professional investors are systematically sold on to non-professional clients in the twelve following months. Failure to comply with the rules would be punished by the annulment of the contracts and be subject to civil action. In view of the purpose of the provision, these sanctions should apply only to intermediaries that sell the products to small investors in the retail market; there is no reason to extend their application to other professional investors that had traded the securities among themselves benefiting from their exemption from information requirements. A revision of the Consolidated Law on Finance along these lines would be desirable.

4. Transposition of EU financial directives

The matters covered by the law on savings will shortly be affected by the implementation of some important EU directives.

The transposition of the directive on offering and listing prospectuses will be completed with the exercise of the delegated legislative powers provided for in the law on savings. The Bank of Italy has been consulted by the Ministry for the Economy and Finance on a preliminary draft of the legislative decree and has submitted some observations concerning matters bearing on the banking sector. In particular, it has drawn attention to the need for a more flexible regime for the exemption of bank securities, where many of the rules do not have to be laid down by law but could be left to Consob.

¹⁷ Article 100-bis.

The transposition of the MiFID directive could be an opportunity to re-examine the question of conflicts of interest in the securities industry. The law on savings has introduced solutions intended to prevent conflicts of interest by imposing stringent constraints on intermediaries' organizational and operational freedom.¹⁸ This choice diverges from the line followed by the Community. According to the MiFID directive, intermediaries are required to identify conflicts of interest themselves and adopt organizational arrangements capable of preventing them; the regulatory authorities are controlling the effectiveness of the measures adopted and establishing appropriate transparency obligations.

The Minister for the Economy and Finance has recently consulted the Bank of Italy on draft criteria for the mandate to transpose the MiFID directive. The document envisages solutions consistent with the orientation of the Community. In line with the purpose-based allocation of functions, secondary legislation and controls concerning conflicts of interest would be entrusted to Consob. This will require close coordination with the Bank of Italy, which would remain responsible for all the prudential aspects concerning intermediaries' organization and internal controls.

5. Configuration and coordination of the regulatory authorities

The configuration of supervision defined by law essentially reflects a purpose-based allocation of tasks. The Bank of Italy is entrusted with ensuring the stability of the financial system and with the controls on intermediaries' sound and prudent management, Consob with the controls on transparency and proper behaviour for the protection of investors. The law on savings removed some exceptions to this approach, for example by bringing financial products issued by banks within the scope of the rules on investment services and public offerings. The same logic governed the transfer to the Antitrust Authority of responsibility for safeguarding competition in the banking sector.

The purpose-based criterion for the allocation of tasks meets the needs deriving from the growing integration of the different segments of the financial market and makes the identification of the responsibilities of each regulatory authority clearer.

The law provides, pragmatically and flexibly, for the authorities themselves to manage the boundaries between their responsibilities and identify the necessary forms of coordination and information sharing. I have described the steps already taken in this respect and the initiatives under way. Apart from any technical improvements required, this model appears to be decidedly preferable to the creation of complex and rigid entities. It makes it possible to perform coordination more efficiently, to adapt the latter's forms and content to the evolution of the market with the necessary rapidity, and not to impinge on the authorities technical independence.

¹⁸ Articles 9 and 10 of Law 262/2005.

The introduction into the banking industry of the system for legislating and providing supervisory coordination and cooperation known as the Lamfalussy system,¹⁹ with the creation of the European Banking Committee and the Committee of European Banking Supervisors, has eroded the scope for autonomous regulation by the member states and shifted both legislative choices and the process of establishing uniform supervisory practices to Community level. There thus appears to be a decline in the importance of the Interministerial Committee for Credit and Savings, whose function of providing legislative guidelines has shrunk considerably as a consequence of the integration of European financial regulation, not infrequently by way of maximum harmonization solutions, in both primary and secondary legislation.

On the other hand new coordination needs are emerging that involve the political as well as the technical sphere and make it desirable to find ways of linking up the Ministry for the Economy and Finance and the supervisory authorities. These needs primarily concern the prevention and management of financial crises with potentially systemic effects. The problem has not only a national but also a European dimension. The necessity of tackling it was referred to in the proposals put forward by the EU Economic and Financial Committee in March 2006 on the basis of the indications expressed by the informal Scheveningen ECOFIN meeting. The Minister for the Economy and Finance also mentioned this point when he reported to Parliament on the ministry's policy guidelines.

These matters need to be studied, including by reference to the best solutions adopted in other legal systems and the experience being gained with crisis simulations coordinated at European level. It is necessary to find forms and methods of coordination that distinguish properly between the responsibilities of the regulatory and political authorities. The former include the identification, on the basis of technical evaluations, of a state of crisis. On the other hand, the management of crises that have been declared, when they are of a systemic nature and have their origin in defaults, must necessarily involve not only the technical authorities but also the political authorities because they may require interventions that, directly or indirectly, have a cost for the public purse.

Modern and efficient regulation provides protection for the weak and at the same time fosters competition. It is an essential instrument for promoting the growth of the economy. Partly in response to traumatic events, Parliament and the Government have laid the foundations for a far-reaching reform that will affect basic aspects of the framework of rules governing finance. The work must be completed. Legislation in the pipeline will provide an opportunity to do so. The Bank of Italy's collaboration is unstinting.

¹⁹ Commission Decisions of 5 November 2003, 2004/5/EC and 2004/10/EC.