20

Banking in Italy

Elena Beccalli and Claudia Girardone

Introduction

This chapter provides an overview of the evolution of the banking industry in Italy and examines the current structural features, strategic challenges and concerns in the aftermath of the financial crisis of 2007–8. In essence, the Italian banking industry appears to be dominated by polyfunctional groups oriented to relationship lending, and from the 1990s operates according to a banking law allowing banks to act as firms. Such a framework raises new issues such as the large amount of non-performing loans (NPL) affecting Italian banks and the need for further reforms, especially for cooperative banks.

The starting point for our discussion is the 1936 Banking Act, which was in force for over 50 years and officially recognized deposit-taking institutions and credit activities as public services. The process of liberalization started in Italy in the mid-1980s and was substantially influenced by the wide deregulation and harmonization efforts at EU level. It culminated with the enactment

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of a new banking law in 1993 that is still in force today and which essentially allowed banks to operate as firms, subject to prudential supervision. In addition, advances in information technology have proved fundamental driving forces behind the modernization and rationalization of the industry, changing banks' strategic focus towards greater efficiency, cost-effectiveness and innovation (Girardone et al. 2004). The process has been unprecedented and to a large extent it is still ongoing as distribution channels that employ new technologies—such as the remote and mobile banking—are increasingly being used (Bank of Italy 2015). Financial innovation has transformed the dynamics of banking globally; in Italy one of the consequences of the merger waves of the 1990s and early 2000s was the creation of large conglomerates or polyfunctional groups.

Until 2007 the Italian banking sector closely followed a path towards the creation of a European single market in financial services. The process of integration was significantly affected by the global financial crisis and the Eurozone sovereign debt crisis. Currently several challenges have emerged in Italy, as the number of bank branches and employees has dropped (by 5.6 % and 9 % respectively over 2008–14), margins shrunk and NPLs increased steadily. In addition, recent controversial reforms have affected the legal and governance status of the largest cooperative banks (*banche popolari*). Another reform that is also being discussed at the time of writing concerns mutual banks (*banche di credito cooperativo*), which aims to improve the efficiency of their lending process and strengthen their governance and resilience (Barbagallo 2015).

This chapter provides an overview of selected issues that are important to understand the present state of the Italian banking sector and is organized as follows. The section "The Evolution of the Italian Banking Sector" gives a bird's eye view of the evolution and key reforms of the Italian banking sector. Next, "The Structure and Performance Features of the Italian Banking Industry" examines the most fundamental changes in the structure and performance of Italian banks over the past 20 years or so. The section "Current Issues In Italian Banking In the Aftermath of the Crisis" focuses on the current challenges affecting the industry. The final section offers some concluding remarks.

The Evolution of the Italian Banking Sector

The level of transformation experienced by the banking industry in Italy since the 1930s has been remarkable. Banking in the period before the Second World War was essentially an activity undertaken in the public interest, and

even in the post-war years of reconstruction and development helped the government to pursue stability and growth. Among its fundamental principles were structural controls, conduct rules—including branch restrictions and credit quotas—public ownership dominance and the separation between banks and industry. In addition, banking institutions were classified according to their institutional specialization (ordinary and special credit institutions) and maturity (short- and long-term credit). Most of them were state-owned either directly or indirectly via non-profit-making foundations (*fondazioni*) that were themselves government-supervised (Jassaud 2014).

The policies carried out over those years addressed issues that Italy historically has had to tackle: namely, the marked north–south economic gap and the dense fabric of small and medium-sized businesses (SMEs) that characterizes the backbone of the country's industrial structure. In fact, these policies had a substantial role in shaping the structural features of the banking sector. This is because the Italian authorities focused, on one hand, on the need to redistribute savings across regions; and on the other, on creating a sector with small and medium-sized banking institutions that could serve effectively the financial needs of the many local SMEs. Italian banks became a major conduit for the expansion of credit to the economy, although government intervention and controls were extensive. Restrictions on competition in particular affected the efficient allocation of financial resources and banks' ability to grow (Fratianni and Spinelli 1997; Albareto and Trapanese 1999; Guiso et al. 2006). As a result, until the 1970s the Italian banking industry developed as a highly fragmented, overbanked and overspecialized sector.

From the mid-1980s the process of deregulation gradually reduced authorities' discretional powers: credit controls, lending restrictions and bank branches limitations were abolished and entry liberalized. In addition, Italy implemented several European banking directives that were enacted to accelerate the transition towards the creation of a single market for financial services. This programme was part of a larger objective aimed at integrating goods and markets in the European Union. One of its most fundamental aims was to harmonize rules and regulations to create uniform safety and soundness standards; another was to "level the playing field" by creating a comparable competitive environment across member states (see Casu et al. 2015 for more detail).

In this context, public sector banks were allowed to convert into joint-stock companies; bank mergers were encouraged; and the structural separations between short and long-term lending institutions were abolished in favour of a "universal banking" model. However, in Italy the organizational model that prevailed was the so-called polyfunctional group structure that

was preferred to the classical universal bank model that was common, for example, in Germany (see Casu and Girardone 2002 and Chap. 23 in this Handbook). Typically, polyfunctional groups are controlled by a commercial bank (the parent company) and are allowed to offer a wide range of financial services—such as leasing and factoring—that are offered by separate institutions within the same banking group. The main advantages of this model are the greater opportunity of exploiting economies of scale and scope; the capacity of the group to isolate risk from its different activities; organizational flexibility; and facilitation of alliances with other businesses. However, these groups also posed greater concerns for supervisors because of their size and complexities in terms of governance, interconnectedness and too-big-to-fail status.

The Structure and Performance Features of the Italian Banking Industry

The Italian banking industry was highly specialized for many years. The reforms that started in the mid-1980s aimed at providing banks with the structural and organizational models that would allow them to thrive in a more contestable and dynamic market. In 2014 the Italian banking sector included 663 banks, of which 150 belonged to 75 banking groups. As shown in Table 20.1, the segmentation into different types of banks reveals 171 commercial banks (limited company banks accepting short-term funds), 37 cooperative banks (named *banche popolari*), and 376 cooperative mutual banks (named *banche di credito cooperativo*). The cooperative structure is the most common in Italy and comprises over 60 % of all banks.[1]

Focusing on the largest banking sectors in the Eurozone, the Italian banking industry is similar to the French in terms of number of banks although the consolidation trend has been more extensive in France than Italy, as shown in Fig. 20.1. Compared with the years following the implementation of the Second Banking Co-ordination Directive in 1993, the industry has restructured considerably and the total number of banking institutions decreased by over a third. The crisis had a significant impact on the proportion of active banks as the number fell by around 17 % between 2008 and 2015.

[1] It should be noted, however, that while operationally there is no difference between a bank in the form of a company limited by shares and co-operative *popolari* banks, for mutual banks (*banche di credito cooperativo*) there are specific regulations and local and mutual assignments that apply.

Table 20.1 Number of banking institutions, Italy 2014

		Members of banking groups	Not members of banking groups	All banks (No.)	All banks %
Banking groups				75	
Banks	Description	150	513	663	
of which:					
Commercial	*Banche SpA* (limited company banks accepting short-term funds)	120	51	171	*25.8%*
Cooperative *of which:*					
	Banche popolari (cooperative banks)	18	19	37	*5.6%*
	Banche di credito cooperativo (cooperative mutual banks)	11	365	376	*56.7%*
Branches of foreign banks	Foreign-owned banks	1	78	79	*11.9%*

Source: Authors' elaboration on Bank of Italy's data.
[a]Includes former public law banks, banks of national interest, savings and *popolari* banks that changed their legal status since 1990
[b]Includes former rural and artisans' banks

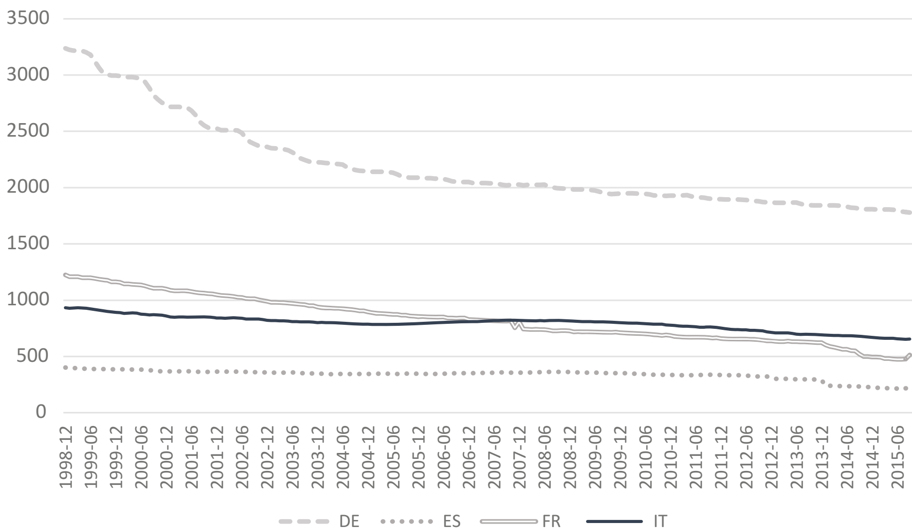

Fig. 20.1 Total number of banks in the four largest banking sectors in the Eurozone (1998q4–2015q2)
Note: *DE* Germany; *FR* France; *IT* Italy; *ES* Spain
Source: Authors' elaboration on ECB Data

Panel (a) of Fig. 20.2 clearly illustrates that in Italy the mutual sector (BCC banks) has experienced the largest decline. The banking industry also underwent wide reorganizations through the rationalization of distribution channels. Over the past 20 years mutual banks have strategically chosen to steadily increase their presence in the country by building up an extensive branch network (panel b). In contrast, the trend in the number of branches of commercial banks follows an inverted u-shape curve thus suggesting a rapid drop post-2007, possibly reflecting a change in strategic focus and cost cutting. Between 2008 and 2014 the number of bank employees was also reduced by 17,900 (5.6 %) (Bank of Italy 2015).

The importance of the Italian banking sector relative to gross domestic product (GDP) has increased significantly since the mid-1980s (Fig. 20.3). From that time the size of the Italian banking industry was slightly above the average of the Eurozone; however, the trend reversed in 2009. In 2014 the Bank of Italy reported that total financial assets were 2.6 times GDP, as against 3.1 in the Eurozone and Germany and 4.0 in France. When compared with its European peers the Italian banking market appears moderately concentrated (Fig. 20.4, panel a). Although concentration has progressively increased over the 1990–2014 period, the consolidation process has not been as prominent as in Germany, Spain and the UK (panel b).

The size of the "typical" Italian bank has also increased over time, particularly during the 2007–8 financial crisis (Fig. 20.5). The number of large (assets>€860m) and medium-sized banks (assets between €250m and €860m), has grown substantially as they acquired many smaller banks (assets

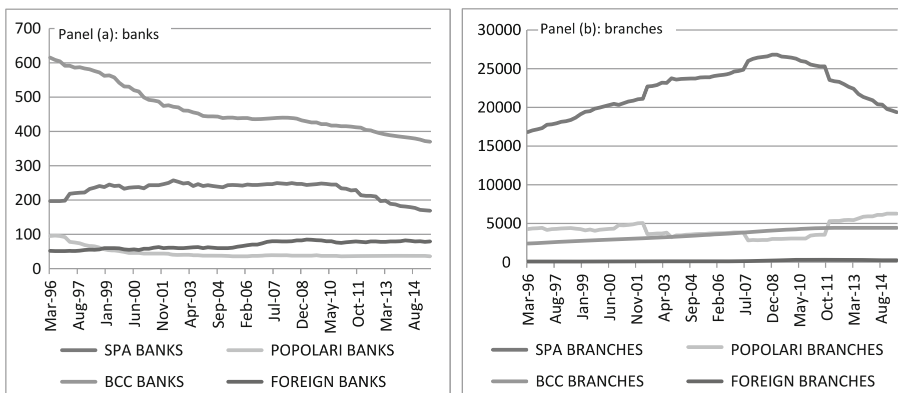

Fig. 20.2 Number of banks and branches in Italy by ownership type (1996–2014)
Note: Commercial banks are referred to as SPA; cooperative banks are the *popolari* banks, and cooperative mutual banks are *banche di credito cooperativo (BCC)*
Source: Authors' elaboration on Bank of Italy's data

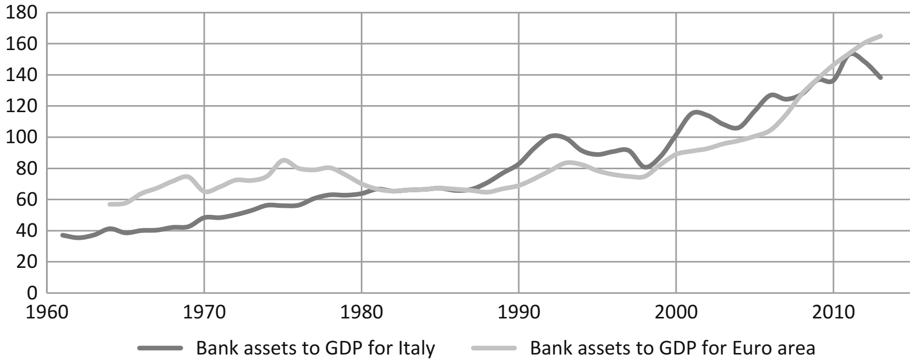

Fig. 20.3 Deposit money to bank assets to GDP: Italy v Euro area
Source: Authors' elaboration on World Bank data

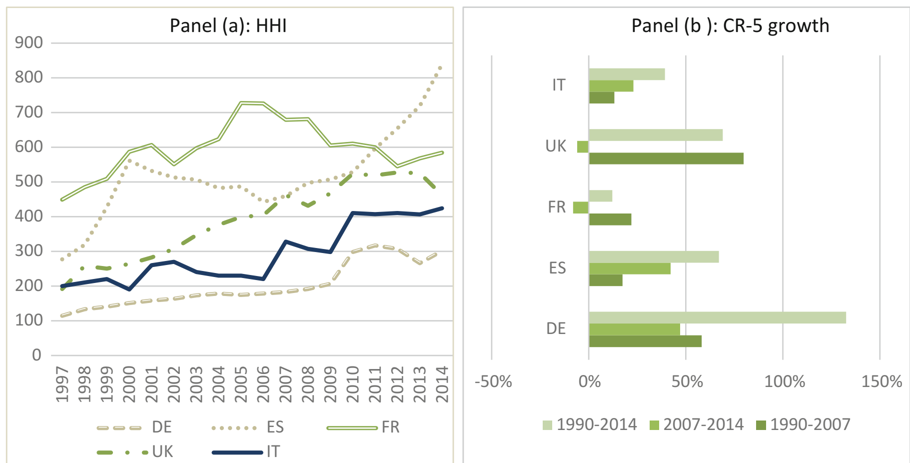

Fig. 20.4 Herfindahl–Hirshmann Index and CR-5 growth in five selected EU countries
Note: *HHI* Herfindahl–Hirshman Index of concentration; *CR-5* = Concentration ratio calculated on the first five banks. *DE* Germany; *FR* France; *IT* Italy; *ES* Spain; *UK* United Kingdom
Source: Authors' elaboration on ECB data.

<€250m), as further explained later in this chapter. Interestingly, in 2010 the number of small and medium banks was equal to the number of medium banks, although over time they show opposite time trends (i.e. increasing trend for medium banks, decreasing trend for small banks). Interpreting these three time series, one could infer that medium and large Italian banks are looking for scale economies deriving from the increase in their size.

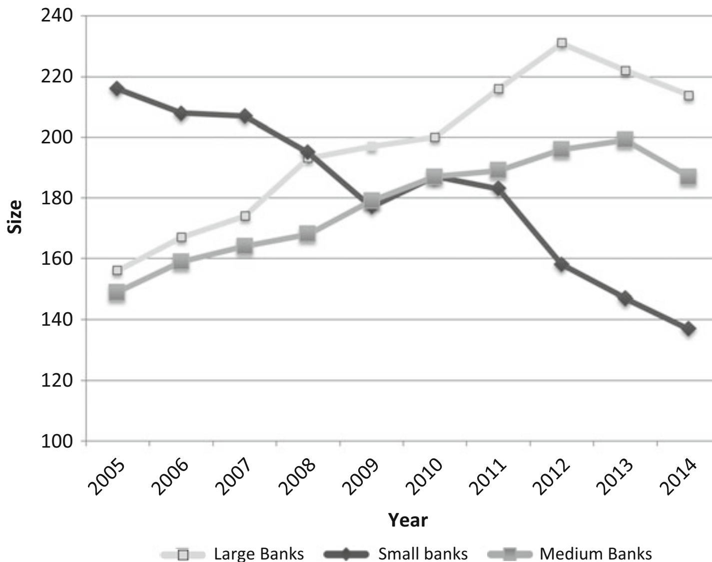

Fig. 20.5 Distribution of Italian banks by size (2002–2014)
Source: Authors' elaboration on Bankscope data

The global financial and sovereign debt crises have severely affected the performance of Italian banks, that have suffered low margins, rising regulatory costs, weak loan demand and high cost of credit (see also Cosma and Gualandri 2012; IMF 2014). The relatively low performance after the outbreak of the 2007–08 crisis is clearly shown in Fig. 20.6 by the trend in Return on Assets (ROA) and the rising cost-to-income ratios. From Fig. 20.7 it is also possible to note how dramatically the income sources of Italian banks have changed over the past 25 years, with non-interest income growing rapidly particularly in the period 1990–2006.

Current Issues in Italian Banking in the Aftermath of the Crisis

The global financial and sovereign debt crises have caused and exacerbated several aspects of the Italian banking system. First, the crises have led to a sharp rise in NPLs, whose incidence has increased to record levels compared with European counterparts. A second result has been the dominance of relationship banking over transaction banking, and its implications for firm financing. Third, the downsizing of the market for bank mergers and acquisitions, nowadays mainly motivated by the need to restructure the target or by reasons

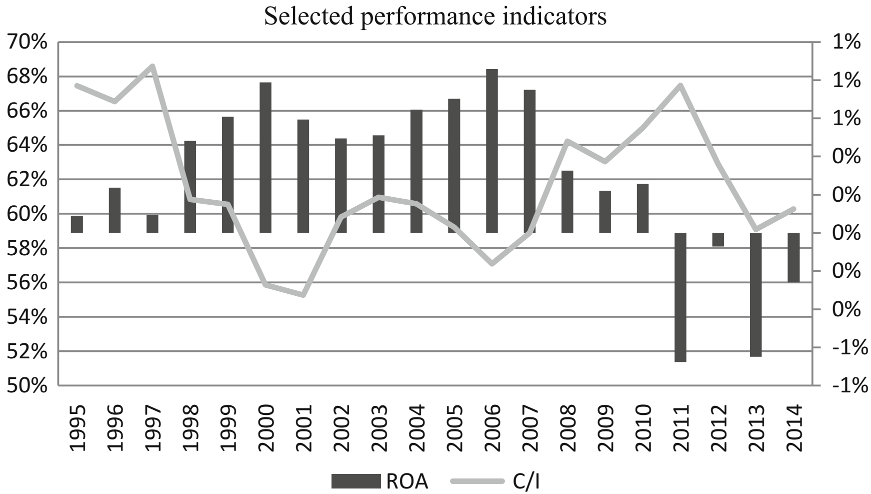

Fig. 20.6 Selected performance indicators
Note: *ROA* Return On Assets; *C/I* Cost-to-Income ratio
Source: Authors' elaboration on Bank of Italy's data

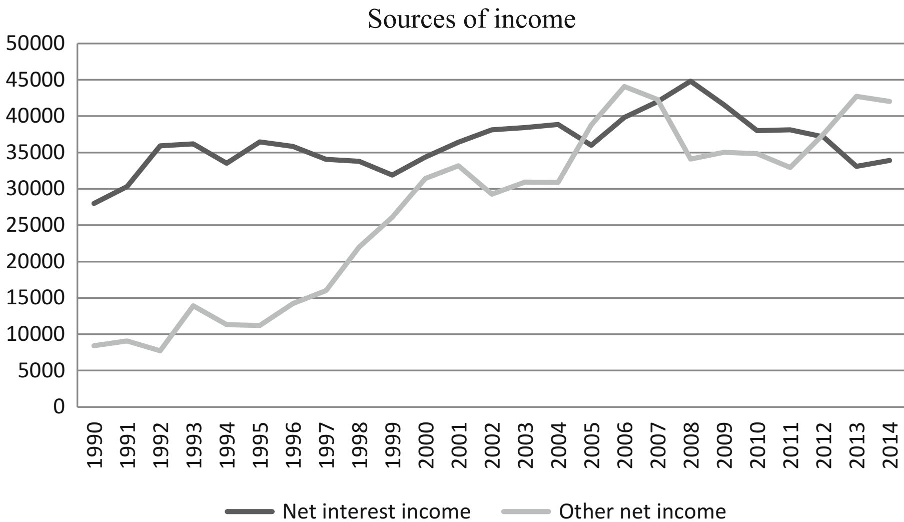

Fig. 20.7 Sources of income
Source: Authors' elaboration on Bank of Italy's data

of defensive nature. Fourth, the need to enhance competition in the system, by introducing a new legal and governance framework for *banche popolari*, leading to a considerable ferment in the sector. These issues are discussed in detail in the following sections.

Doubtful and Non-Performing Loans of Italian Banks

The long crisis which since 2007 has affected financial systems and the real economy has resulted in, among other things, a large amount of NPLs in the balance sheets of European banks, and particularly of Italian banks. The banking system as a whole meets the capital requirements, but at the end of 2014, the stock of NPLs amounts to €350 billion, a level that is four times the European average. The issue concerns primarily the extent of the exposure and the related flows, and especially the presence of such a large amount "freezing" bank balance sheets. The primary challenge connected to the large amount of NPLs in banks' balance sheet lies in greater difficulties to have the necessary flows for lending to customers (that turn into the so-called credit crunch).

The evolution of the phenomenon is very diverse across European countries (Beccalli et al. 2015). A clear segmentation exists between banking systems that have suffered a sharp rise in NPLs and banking systems where the phenomenon has remained very low, showing no particular tightening in recent years (Fig. 20.8). The countries most affected are Greece, Ireland, Italy and Spain, whereas there are no signs of deterioration in France, the Netherlands and Germany (that even shows a decline in the share of doubtful and NPLs).

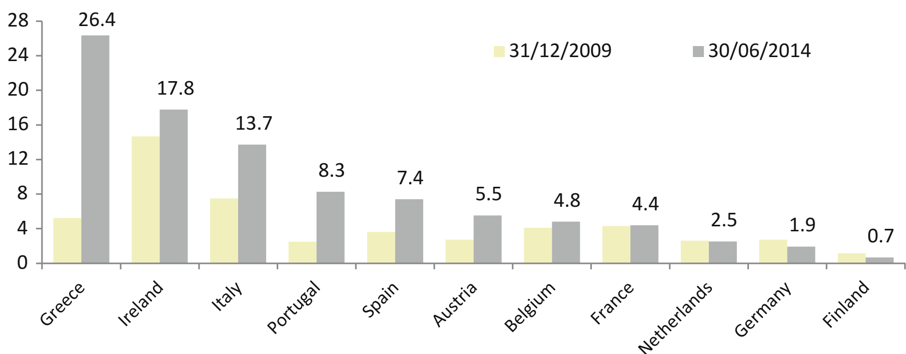

Fig. 20.8 Gross total doubtful and NPLs as a percentage of total debt instruments and total loans and advances (2009 and 2014)
Source: Authors' elaboration on ECB data

Note, however, that in the absence of harmonized statistics on the phenomenon, the European comparison should be conducted with caution, being distorted by differences existing between various countries: the main differences being in terms of definition (Barisitz 2013) as discussed later in this section.

In addition, we observe different behaviours even within the countries most affected by the decline in credit quality. In particular, in Spain and Ireland, the phenomenon has emerged with the private debt crisis and the real estate market crisis and has significantly affected residential mortgages to families and to the construction sector (Bank of Italy 2013). In Italy, on the other hand, the continuous and sustained emergence of NPLs slightly affected families and mostly interested business loans. Changes in the rate of new NPLs of households showed no particular problems, despite the very unfavourable employment context. The relative resilience of Italian households was favoured by their limited level of debt and the very low level of interest rates, as well as initiatives by the banking industry in favour of debt sustainability.

In Italy, as a result of the 2007 financial crisis, the default rate has risen to nearly the highs reached following the 1992–3 recession. However, the current phase is longer than the past one, with the quarterly decay rate of non-financial companies consistently higher than the threshold of 1 % for nine consecutive quarters from the end of 2012 to the end of 2014.[2] With the recession 1992–3, this threshold was exceeded for six consecutive quarters. In the current crisis, the peak of the phenomenon seems to have been reached in 2013 and also in 2014, driven by the outcome of the ECB Asset Quality Review and an unsatisfactory performance of the economy.

The continuous and sustained increase in the default rate has fuelled the growth of the stock of doubtful and NPL (known as *sofferenze*), that has reached 10 % of the total gross loans for the entire Italian banking industry. Such a value is four times higher than that registered at end 2008/early 2009 and is the highest since mid-1998. The average figure comes in a value close to 17 % for non-financial firms and to 7 % for households, with respectively, an increase of nearly 14 percentage points and 4.7 percentage points from the end of 2008, when the incidence of doubtful and NPLs of the two segments was about the same (3 % for non-financial firms and 2.5 % for households). Interestingly within non-financial firms, doubtful and NPLs of the construction industry exceeded a quarter of all loans.

As discussed in Beccalli et al. (2015), there are several factors which influence the level and trend of doubtful and NPLs, primarily the economic cycle,

[2] The decay rate is computed as the flow of doubtful and non-performing loans in a given quarter divided by the stock of loans.

the characteristics of borrowers, the lending policies of banks and other bank-specific characteristics. Then there are factors concerning bank regulation and supervision, standards and accounting practices, taxation, the legal system and the efficiency of the judicial system. While the last two categories of factors have typically a national dimension, what concerns the bank regulation and accounting rules strictly speaking should have a high degree of harmonization at European level. However, at least until the start of the single supervision and adoption of standards on non-performing exposures and forbearance issued by the EBA, there remained significant national differences in terms of regulatory and accounting practices with respect to: (i) classification of loans between performing and the various categories of NPLs; (ii) value adjustments; (iii) disclosure on NPLs. As a consequence, with the increasing deterioration of the loans observed in recent years, it is difficult to compare the credit quality of different European banking systems and, in some jurisdictions, even among banks in the same country. Specifically, the Italian case was distinguished in comparison to the European framework as for: (i) the high degree of disclosure on doubtful and NPLs and the harmonization of the definitions among banks; (ii) the consistency between accounting and supervisory definitions; (iii) the segmentation into distinct categories for increasing abnormality of the credit including, among other things, the class of restructured loans (often considered to be performing in other jurisdictions); (iv) the extensive approach to the borrower rather than for individual positions in default; (v) the reporting including guaranteed non-performing exposures, differently from other jurisdictions considering NPLs net of those secured by collateral. Nevertheless, as said, the latest developments (i.e. the Single Supervisory Mechanism and the adoption of EBA technical standards) go in the direction of overcoming national peculiarities and improve the comparability of data. However, the timing of the adoption of the EBA reporting standards does not yet enables us to have harmonized data on NPLs at European level.[3]

The high level of Italian NPLs, as explained in Beccalli et al. (2015), is also determined by factors external to the banking sector, linked to the characteristics of the tax system, the procedures for settlement of corporate crises, and the functioning of the judiciary system. In particular, in Italy, the stock of bad loans is a result also of the slow procedures for debt recovery, that force banks to keep NPLs in their financial statements longer than in other countries. The relationship between the stock of bad debts to total loans depends not only on

[3] The Asset Quality Review (AQR) conducted by ECB in 2014 saw the implementation of a simplified version of the EBA standard.

the rate of entry in distress, but also on the rate of extinction (defined as the ratio of doubtful and NPLs extinction and the overall total). Between 2007 and 2011 such rate of extinction was reduced by 11 %, from 27 % to 16 %, corresponding to a lengthening of extinction from four to six years (Bank of Italy 2013). Due to the longer timing of debt recovery and insolvency procedures than the EU average, other conditions being equal, the ratio of bad debts is higher in Italy than in jurisdictions where debt recovery is quicker (Bank of Italy 2013). Recently, the International Monetary Fund (IMF) has focused on the slow pace of derecognition of loans in Italy, highlighting the determinants and the negative implications and suggesting a strategy for the development of a market for NPLs in Italy (Jassaud and Kang 2015).

Relationship vs. Transaction-Based Lending

The Italian banking system, like other bank-oriented systems, is typically based on relationship lending (see Angelini et al. 1998). This feature is especially relevant in Italy because SMEs, which are highly bank-dependent for their funding, account for a larger share of output than in most comparable countries.

Several advantages characterize relationship banking: lower financial constraints and better credit terms and conditions are documented for firms that borrow from a small number of banks, or concentrate the bulk of their funding in one relation with a bank, and preserve their relation for a relatively long period (Elsas 2005). Nevertheless, the stability and the efficiency of relationship lending appear vulnerable to several factors: higher switching costs due to the relevance of soft information; the risk that competition in credit markets might limit the incentives for banks to engage in close relationships; and the fact that the efficiency in collecting and processing soft information depends on the internal organization of banks, with small banks usually having a comparative advantage over larger ones.

Recent studies devote attention to the impact of the crisis in Italy with regard to relationship vs. transaction lending. Gambacorta and Mistrulli (2014) investigate how the bank–firm relationship has influenced interest rate setting since the 2008 collapse of Lehman Brothers. Their evidence shows that interest rate spreads increased by less for those borrowers having closer lending relationships. Bolton et al. (2013), using detailed information for Italian banks before and again after the Lehman Brothers' collapse, study how relationship vs. transaction banks responded to the crisis. Their empirical analysis shows that relationship banks charged a higher spread before

the crisis, offered more favourable continuation-lending terms in response to the crisis, and suffered fewer defaults, thus confirming the informational advantage of relationship banking. De Mitri et al. (2010) investigate whether relationship lending has had a significant effect in mitigating the credit contraction that followed Lehman's default. Their empirical findings document that firms borrowing from a higher number of banks (or firms diversifying their borrowing, and concentrating a smaller proportion with the main bank) suffered on average a larger contraction in bank credit and a higher probability of experiencing a reduction in outstanding bank debt. The duration of the bank–firm relationship also contributed to mitigate the credit restriction. Finally, if there was a contraction in credit, the decrease was mitigated by the intensity of the relationship (i.e. a lower number of financial institutions from which the firm borrows), the concentration of lending and the duration of the relationship.

Mergers and Acquisitions

There were many mergers and acquisitions (M&As) in the Italian banking system before the global financial crisis. A sharp turnaround was recorded during the financial crisis, however, when M&As slowed down considerably, especially when cross-border (Fig. 20.9).

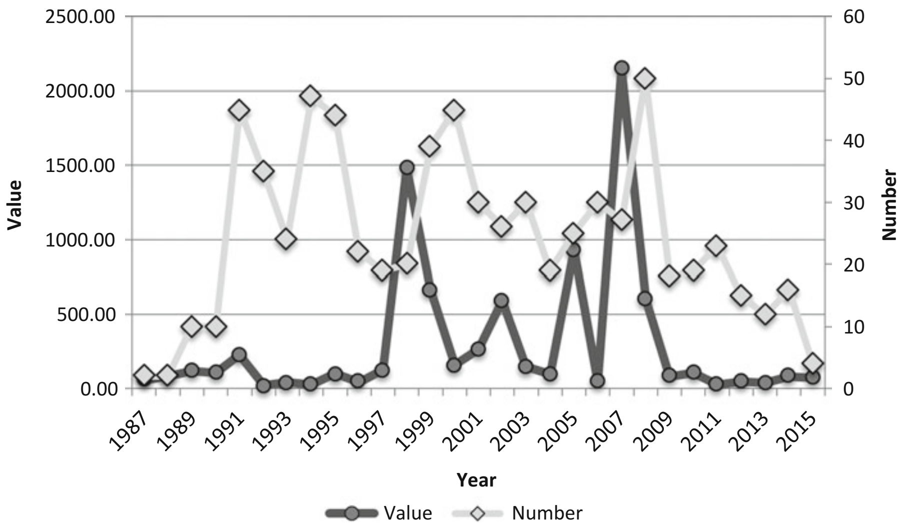

Fig. 20.9 M&A deals (number and value by Italian banks (1987–2015))
Source: Authors' elaboration on Thomson One Banker data

By classifying deals on the basis of the location of the target, cross-border deals have become less frequent since 2007, to the point that there has been no operation with foreign targets in the years 2009–2014. The value of these cross-border deals increased between 2005 and 2008 compared with the 2002–4 period. This indicates that, in the years before the crisis, Italian banks planned fewer cross-border transactions but of greater size. Moreover, during the period 1987–2015, cross-border deals include more frequently targets located in Germany, France and Spain than in other European countries. It is also interesting to note that Serbia, Russia and Hungary were typical countries involved in cross-border deals with Italian banks. Moreover, some 76.4 % of the targets were located in Eastern Europe.

Domestic deals, in contrast to cross-border operations, have been relatively constant over the entire period with a peak in 2008, as well as a higher average size from that same year (when the average value per transaction equals €108 million, i.e. 4,113 billion in total). This indicates that, although Italian banks contined the process of aggregation even during the crisis, the process is mainly focused on domestic deals rather than cross-border deals.

Evidence of the ability of M&As to create value ex post remains uncertain (DeYoung et al. 2008). Recently more attention is devoted to the investigation of the determinants of M&A deals (Beccalli and Frantz 2013). The management of banks is interested in the characteristics that make a business combination more likely in order to identify both potential targets in relation to the strategic choices of expansion and potential acquirer with regard either to integration strategies or defence. Moreover, institutional investors are interested to know the characteristics that can predict the target banks, with reference to choices of composition of their portfolio. Finally, regulators and supervision authorities are interested in the determinants of business combinations, especially among larger banks, for any consequences that they may determine in terms of creating banks too-big-to-fail rather than in terms of supervision in the context of the Banking Union.

As documented in Beccalli and Lenoci (2014), the characteristics of Italian banks that make them more likely to become an acquirer in a cross-border deal are their larger size, lower specialization in traditional lending activity, higher capitalization and the better quality of loan portfolio. Foreign banks that are most likely to become targets are smaller banks, with higher liquidity, better quality of loan portfolio and a history of low growth. The determinants of domestic deals are very different. Only the larger banks are likely to become acquirers along with those banks with a better quality of loan portfolio, whereas banks with lower operating efficiency and a worst funding gap are likely to become targets. Whilst domestic deals appear to be primarily

motivated by the need to restructure the target or by reasons of defensive nature such as maximizing the size, cross-border deals seem to be strategic operations motivated by expansion into new markets (i.e. expansion of the client base into new markets and support to Italian companies in their international business needs).

During the crisis, however, given the sharp downsizing in cross-border deals and the strong differences in the determinants of the operations, the main motivation for cross-border transactions appears to have been size maximization pursued via M&As. Consequently, Italian acquirers favoured larger foreign targets, perhaps also seeking the status of too-big-to-fail. This change in the motivation for M&As welcomes the transfer of banking supervision within the Banking Union: the presence of large banks, which tend to become bigger and bigger through cross-border deals, shows that it is appropriate that these banks have a single supervisory authority rather than a plurality of national supervisors.

The Reform of *Banche Popolari*

The reform of *banche popolari* has modified several provisions included in the 1993 Banking Act,[4] that is, the pillar of the regulation of the modern Italian banking system, as discussed in the section "The Evolution of the Italian Banking Sector". This reform aims at strengthening the ability of *popolari* to thrive in a fast-changing banking market, by introducing a new framework of regulation and supervision based on high capital requirements, severe periodic stress tests and the early involvement of shareholders and creditors in any losses.

The reform, as implemented by primary legislation mentioned above, gives the Bank of Italy the task of issuing the secondary legislation. The secondary legislation is intended to complete the arrangements applicable to the *popolari* allowing these banks to adapt to the new reform within18 months (that is by July 2016).[5] Interestingly, the framework in which the Bank of Italy is operating follows the entry into force of the single supervisory mechanism

[4] Decree (*Decreto legge*) issued on 24 January 2015 (no. 3 published in the *Gazzetta Ufficiale*), and approved into law on 24 March 2015.

[5] In view of the urgency of implementing the reform, the Bank of Italy issued the document in a very short time after the entry into force of the law converting the Decree. The outcome of the consultation takes on the guise of an update of the "Supervisory Provisions for Banks" contained in the Circular of the Bank of Italy No. 285 of 17 December 2013 (Bank of Italy 2015) and enters into force on the day following its publication on the website of the Bank of Italy, although a transitional regime has been provided.

(SSM) and of the legal transposition in Italy of Directive 2013/36/EU (the "CRD IV"). At the same time, the regulatory intervention of the Bank of Italy fits into the legal framework defined by the banking crisis on the European Directive on the recovery and resolution of banks. In this context, if capital needs are not met in a short time, they may come to set the conditions for the "resolution" of the bank and shareholders and creditors (other than depositors) would be called to participate in the losses (the so-called "bail-in").

As for the recipients of this reform and how they are identified, the banks under the new framework are the ten *popolari* banks with assets exceeding €8 billion, including seven listed banks and three banks with shares widely distributed among the public (excluding those *popolari* banks whose parent company is itself a *popolari* bank).[6] These entities account for over 90 % of total assets of *popolari* banks. The reform is clearly across-the-board in that it takes as a reference the level of bank assets regardless of how it is distributed among investors and regardless of whether listed or not.

The reform introduces primarily the obligation for banks with assets of over €8 billion to transform into joint-stock company (*Società per Azioni*, SpA) or approve the voluntary liquidation, unless the bank opts for the reduction of capital within twelve months after the threshold is exceeded. The choice is left to the assembly and the lack of a decision of the latter would result in the application of surveillance measures by the Bank of Italy. Moreover, the criteria for calculating the threshold of €8 billion are delegated to the secondary regulations.

Banks that fall within the parameter of assets exceeding €8 billion will have to abandon the principle of the "vote" system (so that in the assembly of shareholders every member can express a single vote regardless of the number of shares he owns or represents). This determines a change of great importance for the governance structure of *banche popolari* because they have always been marked by the importance of per capita voting for the equal participation of members in decisions; in fact, it means that an individual or a bank, Italian or foreign, might come to have an absolute majority in their company. And that *popolari* banks, some of which are in crisis and are looking for new capital, could also be included in the process of merger or acquisition exactly like other lenders. Institutions, in the same meeting that launched the transformation in a joint-stock company, could introduce in the statute a limit of 5

[6] The system of *popolari* banks comprises 70 institutions, but only the top ten are involved (from the largest to smallest: Banco Popolare, UBI Banca, Banca Popolare dell'Emilia Romagna, Banca Popolare Milano, Banca Popolare di Vicenza, Veneto Banca, Banca Popolare di Sondrio, Credito Valtellinese, Banca Popolare Etruria and Lazio, Banca Popolare di Bari). The reform does not apply to credit co-operative banks or small *popolari* banks (that is, those with assets less than €8 billion).

% to the exercise of voting rights. This is a clause that allows defensive protection from the risk of climbing. The cap will be introduced with this majority; however, it is limited to a maximum of 24 months.

The new regime that substantially affects the legal and governance aspects of *popolari* banks has created a considerable ferment in the sector, given that aggregation among the recipients of the new discipline is seen as the only possibility of avoiding possible hostile takeovers and given that it may result in a more competitive banking system after the application of the reform. In fact, one of the consequences of the new rules may be to make easier rising the competition in the system and the attractiveness of Italian banks. Moreover, many observers have seen the risk that the new regime could endanger the lending policies of popolari, because of the concern of exceeding the threshold imposed for maintaining the popolari status. Others have called for a rethinking of the reform to avoid, with the transformation into "joint-stock company", the loss of the participatory democracy principle and relatedly the link with local communities (Barbanti 2015).

Conclusions

From many decades banking in Italy was essentially an activity undertaken in the public interest. A process of liberalization began in the mid- 1980s and culminated in the enactment of a new banking law in 1993 that is still in force today and which allowed banks to operate as firms, subject to prudential supervision. This chapter has offered a synopsis of the recent evolution of the Italian banking sector and has focused on its structural and performance features and current strategic challenges and concerns.

There is no doubt that the performance of domestic banks has been affected significantly by the recent financial crises. Because of the international nature of these events, many of the difficulties that have arisen for Italian banks in recent years are common to other developed countries in the Western world. However, in Italy, as illustrated in this chapter, the crises have caused a sharp rise in bad loans, whose incidence has risen to record levels. Although the deterioration in credit quality affected European countries with different intensity, the Italian banking system appears among those most affected, with a ratio of NPLs among the highest.

One of the most controversial reforms in recent years is that relating to the *banche popolari* that will transform them into joint-stock companies in an effort to make them more competitive and more likely to survive in the fast-changing banking and financial marketplace. Another reform that is cur-

rently ongoing and causing considerable ferment in the sector is that relating to cooperative mutual banks (*banche di credito coooperativo*). Stability and efficiency motives are behind these reforms and will no doubt trigger many mergers and acquisitions. As discussed in this chapter, empirical evidence for the ability of bank M&As to create value is not unambiguous. Nonetheless, the organizational structures that are likely to result from these reforms are expected to be better equipped to withstand the pressures of the markets and the increasingly demanding regulatory requirements at the European level.

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