Banche Assicurazioni Finanza

Italian Banking Insurance and Finance Federation

Reforming European Financial Markets:

The Case of Italy

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Monday 27 June 2016

Washington, DC

1990 – 2020: The thirty years Revolution of the Italian Financial System

- At the beginning of the 1990's Italian banks were largely state-owned, small and plethoric, with a small number of branches, dominated by local oligopolies, in a market characterised by low insurance penetration, non-existent institutional investors (pension funds), low stock market capitalization, low integration into international markets ("petrified forest")

- In-depth reforms (still underway) have led to liberalization, privatization, separation from political interference, concentration (growing number of international players), competition, openness to foreign intermediaries, development of capital markets, institutional investors, non-bank lending and innovation

- The transition is still underway. It has strongly interacted with the financial crisis, the sovereign debt crisis, the longest stagnation of the Italian economy, European integration processes (EMU, Banking Union, CMU, Brexit, etc..)

  Both virtuous and vicious circles

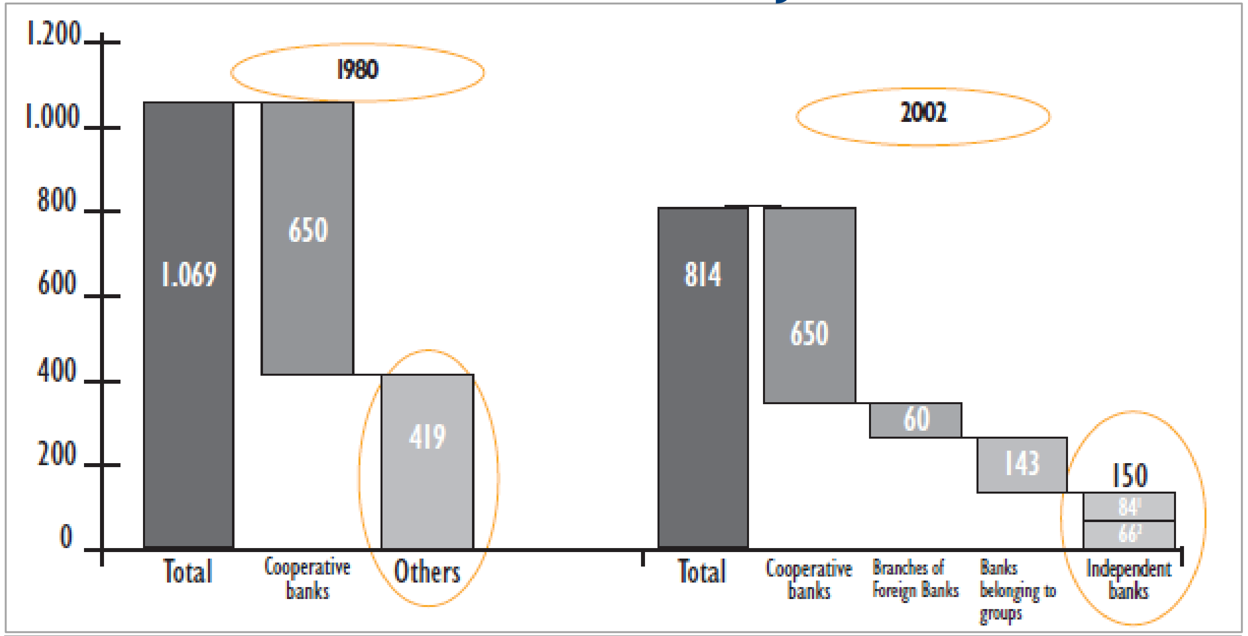
Privatization and Consolidation of Italian and German Banks (1990-2004)

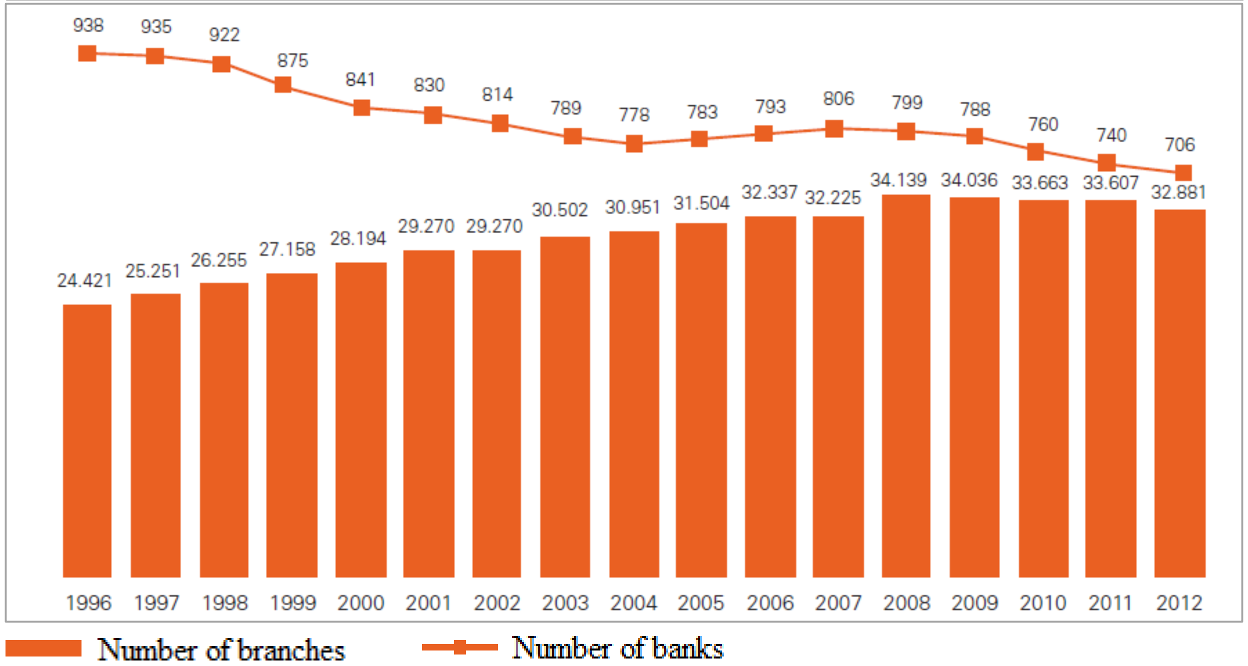
Country	Banking Groups	No. of Banks 1990	No. of Banks 2004	Asset Share 1990	Asset Share 2004
Italy	Public banks	93	-	59.6	-
	Private commercial banks	106	243	20.5	79.3
	Cooperative and mutual banks	823	475	18.5	14.9
	Branches of foreign banks	37	66	1.6	5.80
	Total	1064	784	100	100.00
Germany	Public banks	784	489	34.79	33.30
	Private commercial banks	305	168	27.45	31.99
	Cooperative and mutual banks	3416	1338	14.84	10.42
	Specialized institutions	73	68	21.54	23.00
	Branches of foreign banks	60	84	1.35	1.23
	Total	4638	2147	100	100.00

Source: Bundesbank and Banca d'Italia, Monthly reports.

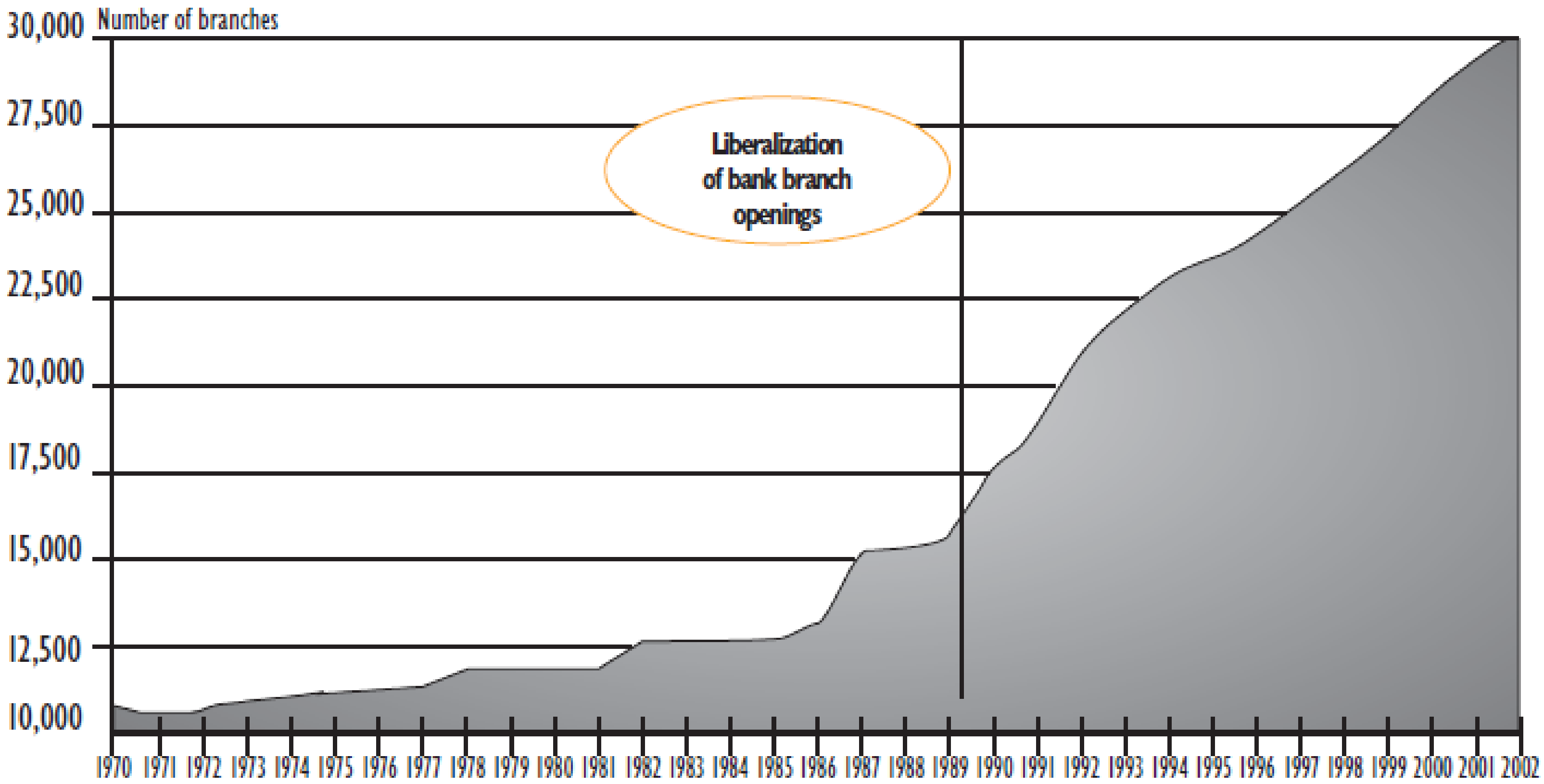
Banks in Italy

[1]Independent banks
[2]banks heading a group



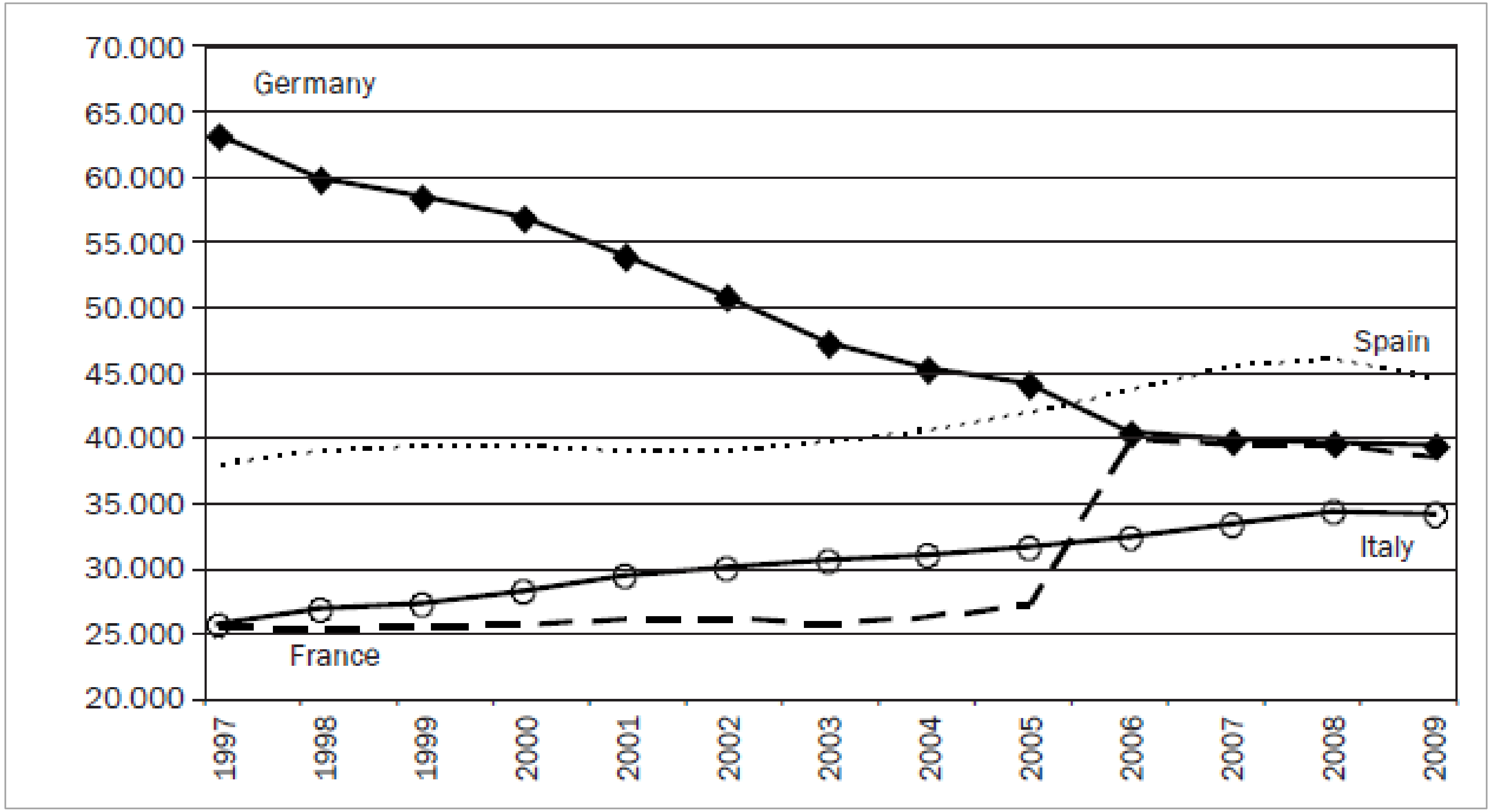


Bank branches in Italy



- Since bank branches were liberalized in March 1990, the overall number of branches almost doubled. From the end of 1989 to the end of 2002, the network grew to 30,000 from 15,577

Bank branches in the large euro-area countries



Source: ECB –EU banking structures, various years

The Europeanization of the Regulatory Framework

- In 1993 Italy codified its banking legislation in the so-called ‘Testo Unico bancario’ (Tub). The outcome was a major break from the past, being the first major overhaul of Italy’s banking legislation to have taken place since 1936. Until then, banks could either operate as a short-term credit institutes or as entities specializing in long-term lending. The new legislation removed the barriers between short-term and medium/long-term credit banks

- In addition, it abolished the legal difference between banks of national interest, public law banks, popular, savings and rural banks as well as special credit institutions

- In 1998 the regulatory framework was completed with the socalled ‘Testo Unico della finanza’

CHANGES IN ITALIAN REGULATION	
1980-90	Implementation of European banking directives (Directive 77/780 → Law 74/1985 Directive 89/646 → Law 481/1992)
1990	Liberalization of bank branch openings
1990	New regulation aimed at boosting competition in the banking sector
1990	Law encouraging the transformation of savings banks into joint-stock companies and incentivating mergers (Amato law)
1993	Testo Unico bancario
1998	Testo Unico della finanza

- Later the regulatory framework was driven by the adoption of international standards and European norms

The Structure of Banking and Finance

- The Italian banking system is relatively small. At the end of 2010 total balance-sheet assets came to 2.5 times the country's GDP, compared with 3.3 times in Germany and Spain and 4.1 times in France

- The financial system is less highly developed in Italy than in other countries. And the portion of total financial assets consisting of bank assets in Italy is comparable to that in the other countries of Europe

TABLE 1. Size of bank balance sheets in the large euro-area countries (*end-2010 stocks as percentage of GDP for the year*)

	Euro area	Germany	Spain	France	Italy
Total assets	3.50	3.32	3.27	4.02	2.45
Loans to households	0.56	0.57	0.83	0.52	0.38
of wihich: *for house pur chase*	*0.40*	*0.39*	*0.63*	*0.40*	*0.23*
consumer cr edit	*0.07*	*0.07*	*0.08*	*0.08*	*0.04*
other	*0.09*	*0.11*	*0.12*	*0.04*	*0.11*
Loans to fir ms	0.51	0.36	0.86	0.43	0.57
Deposits	2.19	2.07	2.39	2.29	1.47
memo: Total bank assets/financial assets of entir e economy	0.32	0.31	0.29	0.29	

Sources: Harmonized statistics of Eur opean System of Central Banks; Eur ostat. Loans ar e to counterpar ties resident in eur o area.

- **The diversified structure of the system**: large groups and small banks, little (but growing) market concentration. Italian banks are limited companies, cooperative banks (*banche popolari*), or mutual banks (*banche di credito cooperativo*). At the end of 2010 the market shares of these three categories were respectively 80%, 9%, and 7% of customer deposits, with branches of foreign banks holding the remaining 5%

- Reforms have aimed at promoting competition of business models and innovation, while preserving the eco-diversity and coexistence of different approaches

- In this small financial system, the importance of banks in providing finance to firms stands out. Italy's underdeveloped stock market and limited corporate bond market have made industry dependent on bank credit

The lagged impact of the crisis

First impact:

- The traditional business model of Italian banks sheltered them from the 2007-09 crisis

Reasons:

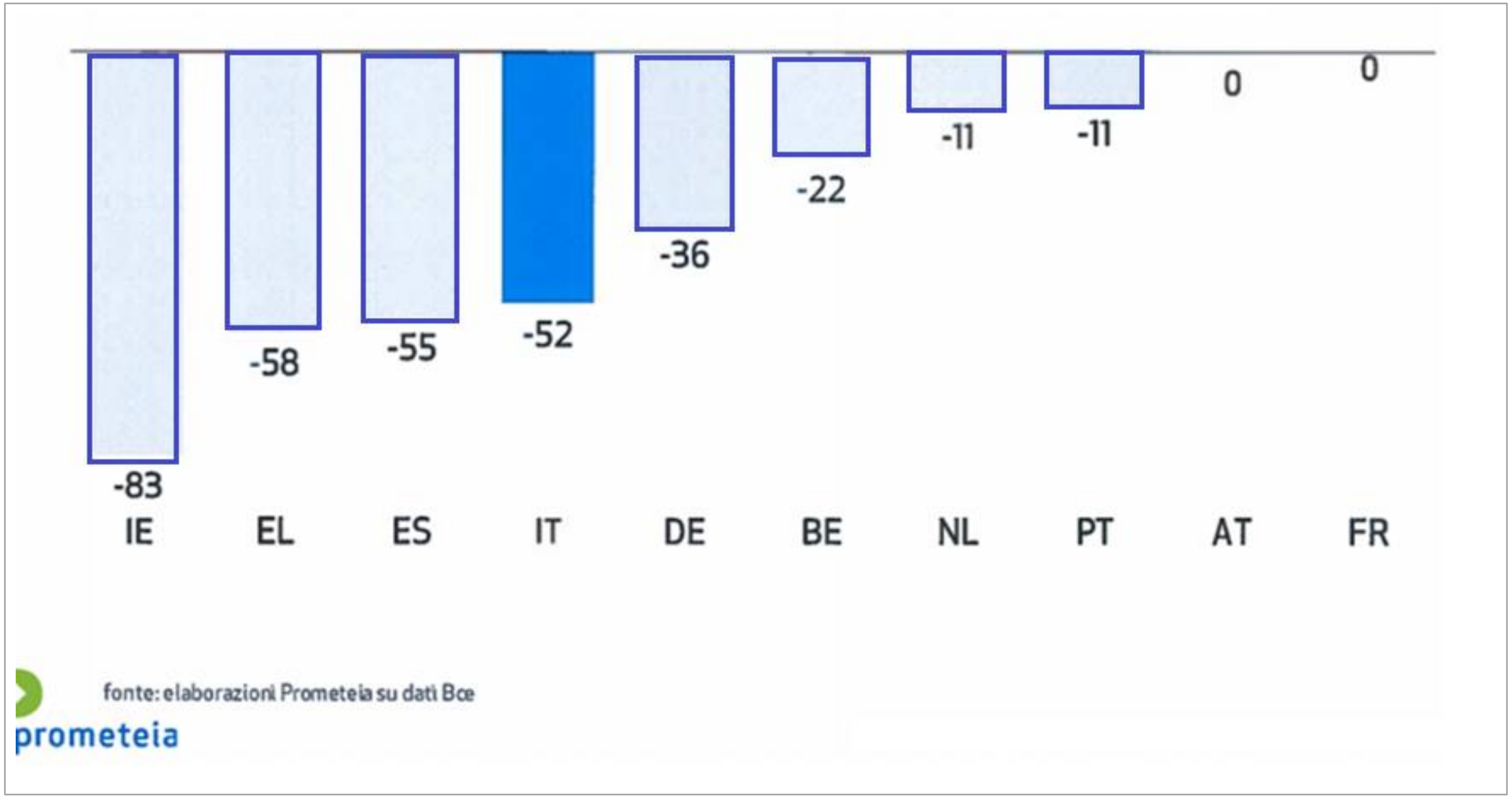
- *funding consisting in deposit and bonds held by households*
- *low leverage*
- *relatively high profitability by international standards*
- *central role of banks in asset management industry*
- *private ownership and competition*
- *competitive lending rates for most products*

Backlash:

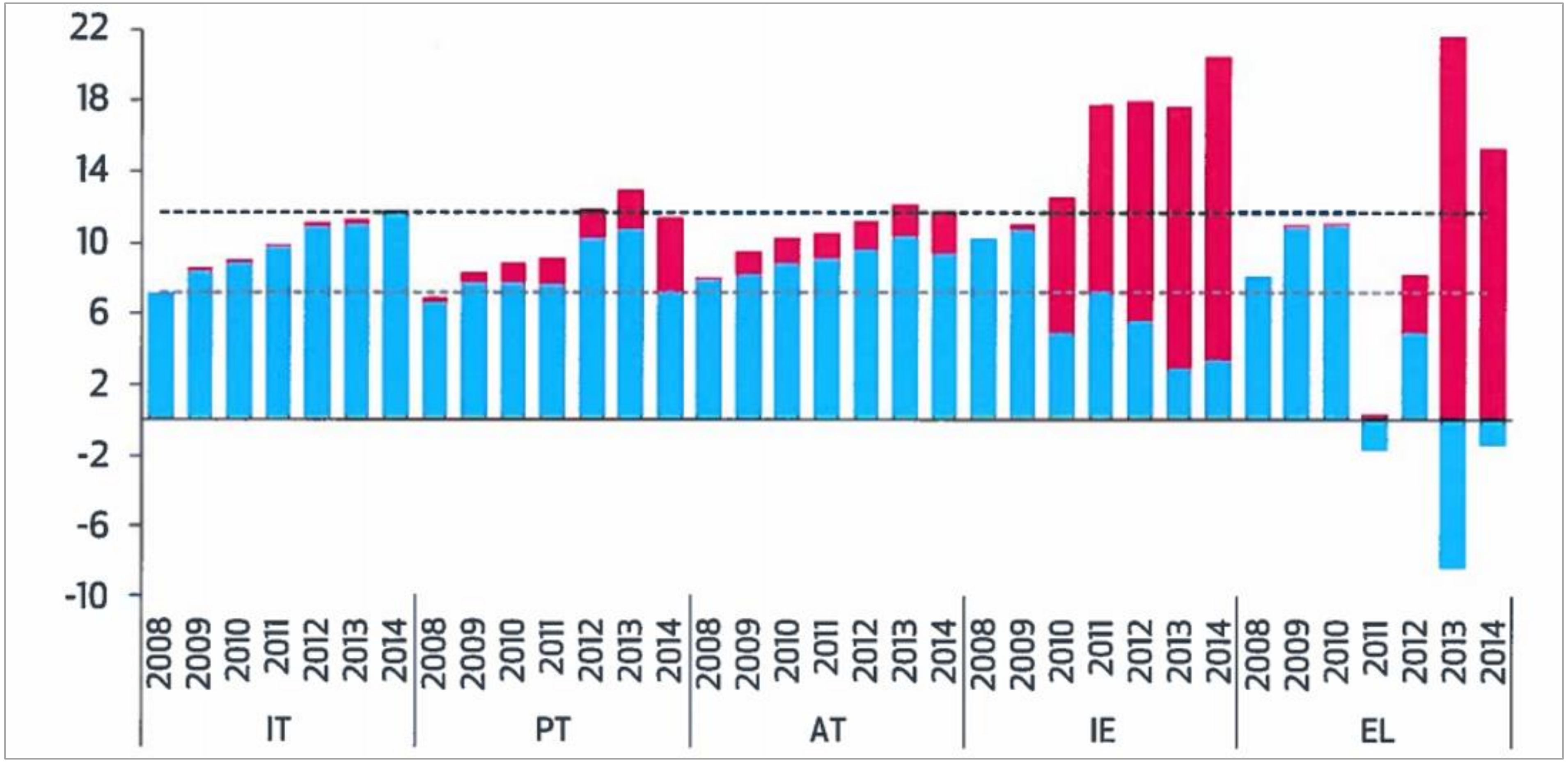
- *no state aid*
- *implication of sovereign debt crisis*
- *NPL and delayed recovery*

Cumulated losses over the period 2008-2014 in European Banking Sector

(Euro billion)



Recapitalization with and without «State aid»



T1 ratio without «aid» (%)
T1 ratio with impact of «State aid» (%)

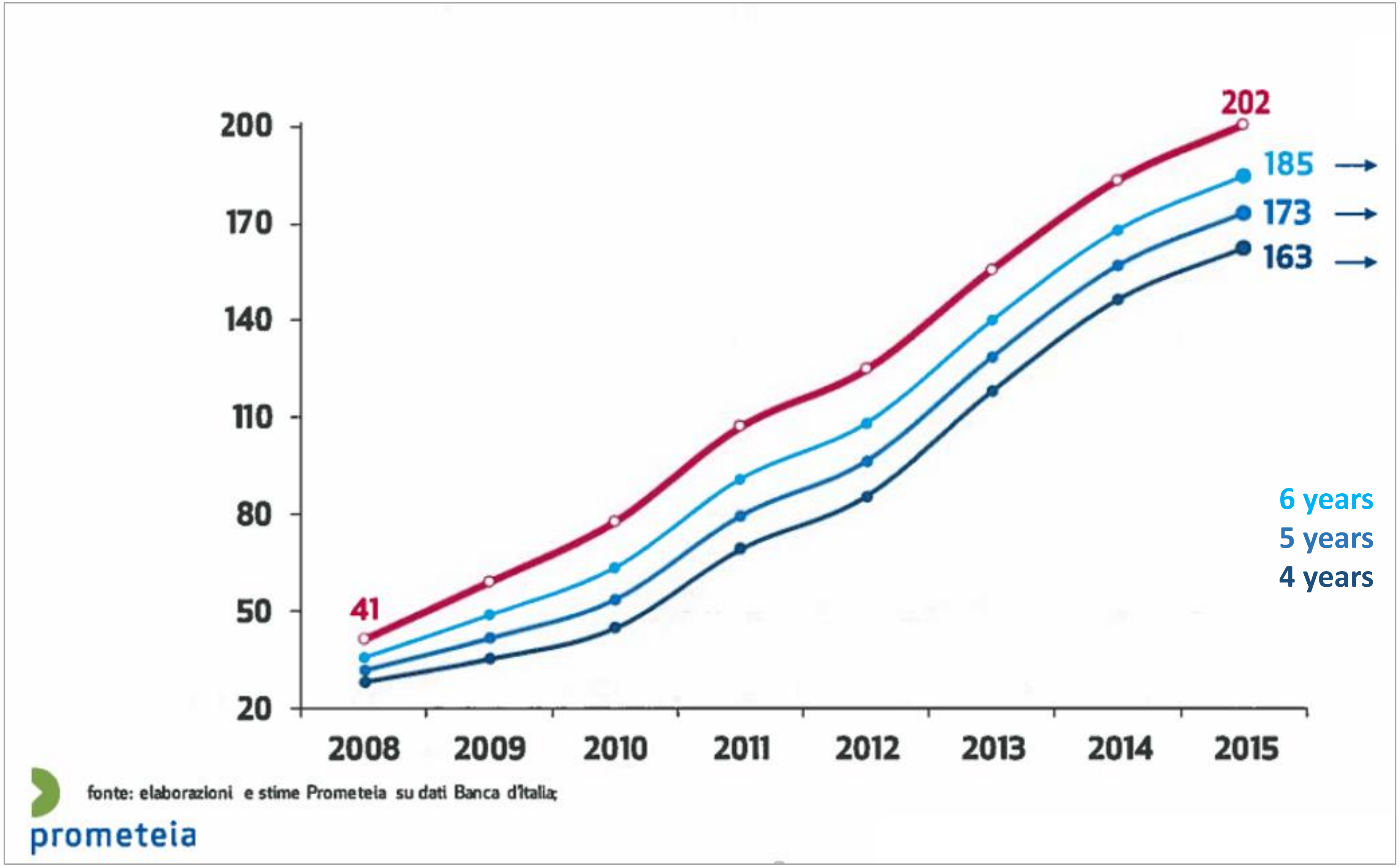
Recent reforms to accelerate the disposal of NPLs

Changes in Insolvency & Foreclosure Regulation	Changes to the Fiscal Framework	State Guarantee on bad loans securitisation (GACS)	Atlante Fund
▪ Persistency of NPLs also due to a clogged judicial system ▪ August 2015: a bankruptcy reform[1] addressing insolvency and foreclosure procedures: ✓ increase speed and efficiency of insolvency procedures and property foreclosures. ✓ Promote higher recovery rates. ▪ May 2016: new measures to reduce debt recovery time.[3]	▪ New fiscal treatment of loan-loss charges adopted in 2015 to encourage write-offs and disposal of NPLs: - Loan-loss charges immediately tax deductible in full (instead of pro-quota in a 5Y) - Remove DTAs related to loan-losses charges in 10 years. ▪ Tax for the acquisition of foreclosed real estate assets: from 9% to a €200 flat[2].	▪ Scheme to enable Italian banks to securitise and offload bad debts with a State guarantee in a way not considered State aid (27 Jan 2016). ▪ Banks' participation will be voluntary. ▪ According to some analysts, it could increase bad loans value by up to 5 percentage points	▪ Atlante Fund is a private-capital-funded safety network designed to support banks' recapitalization and ease the deconsolidation of non-performing loans (NPLs) from banks' balance sheets ▪ It will be managed by Quaestio Capital Management Company SGR SpA ▪ Its subscribers participate in it on a voluntary basis

Notes: 1) DL83/giu-2015/L132/august-2015 -2) To take advantage of the flax tax a buyer must turn around and sell the property within 24 months - 3) DL59/2016

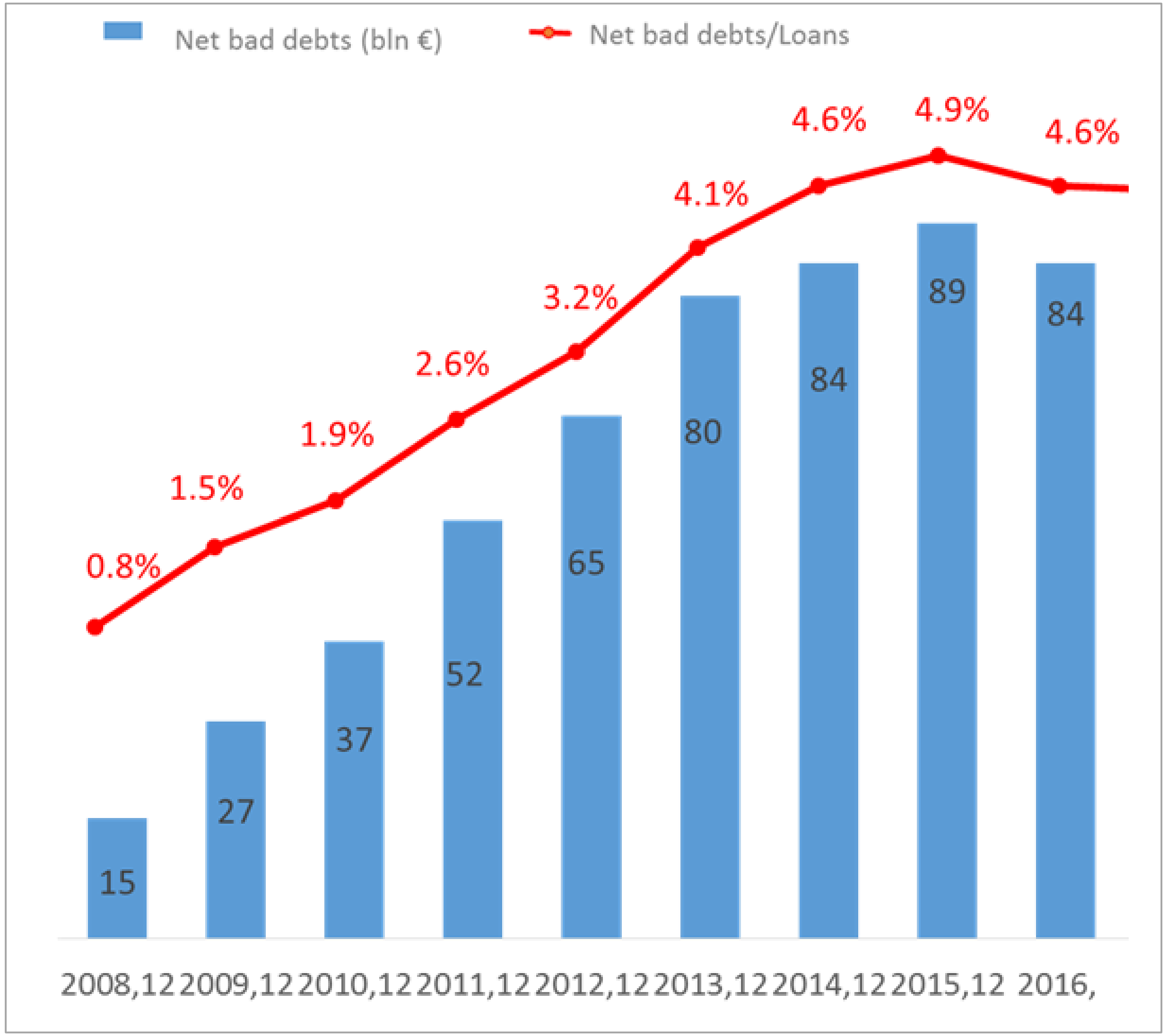
Non-Performing Loans: the timing of the expected recovery

(stock in Euro billion)

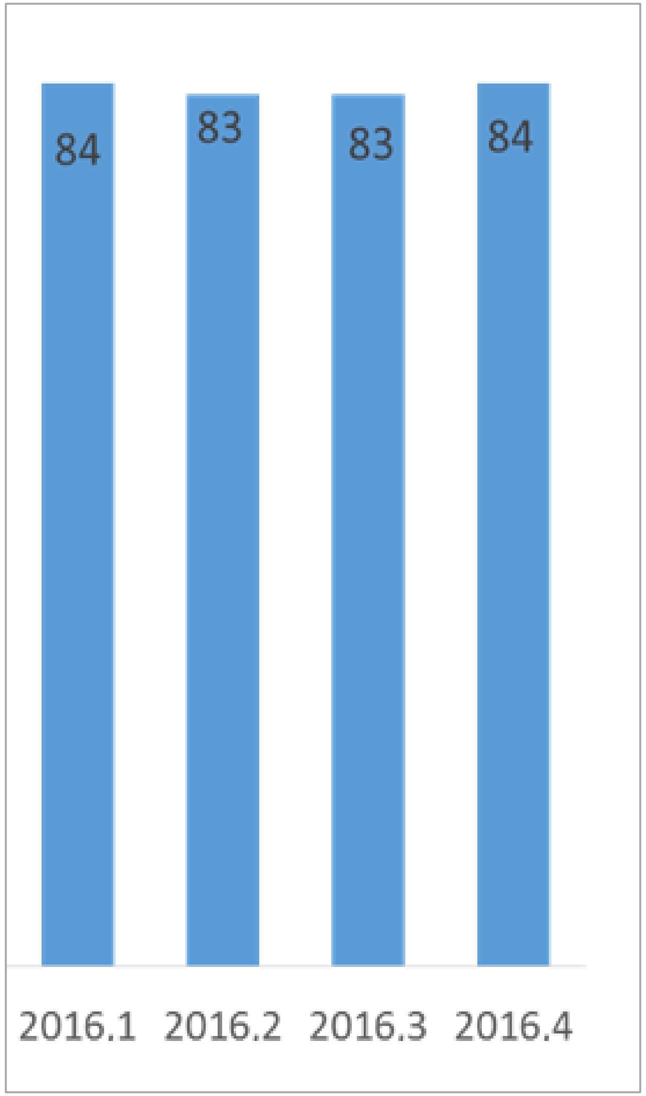


Dynamics of net bad loans and their impact on credit

Source: ABI on Bank of Italy (end-year data 2008-2015)

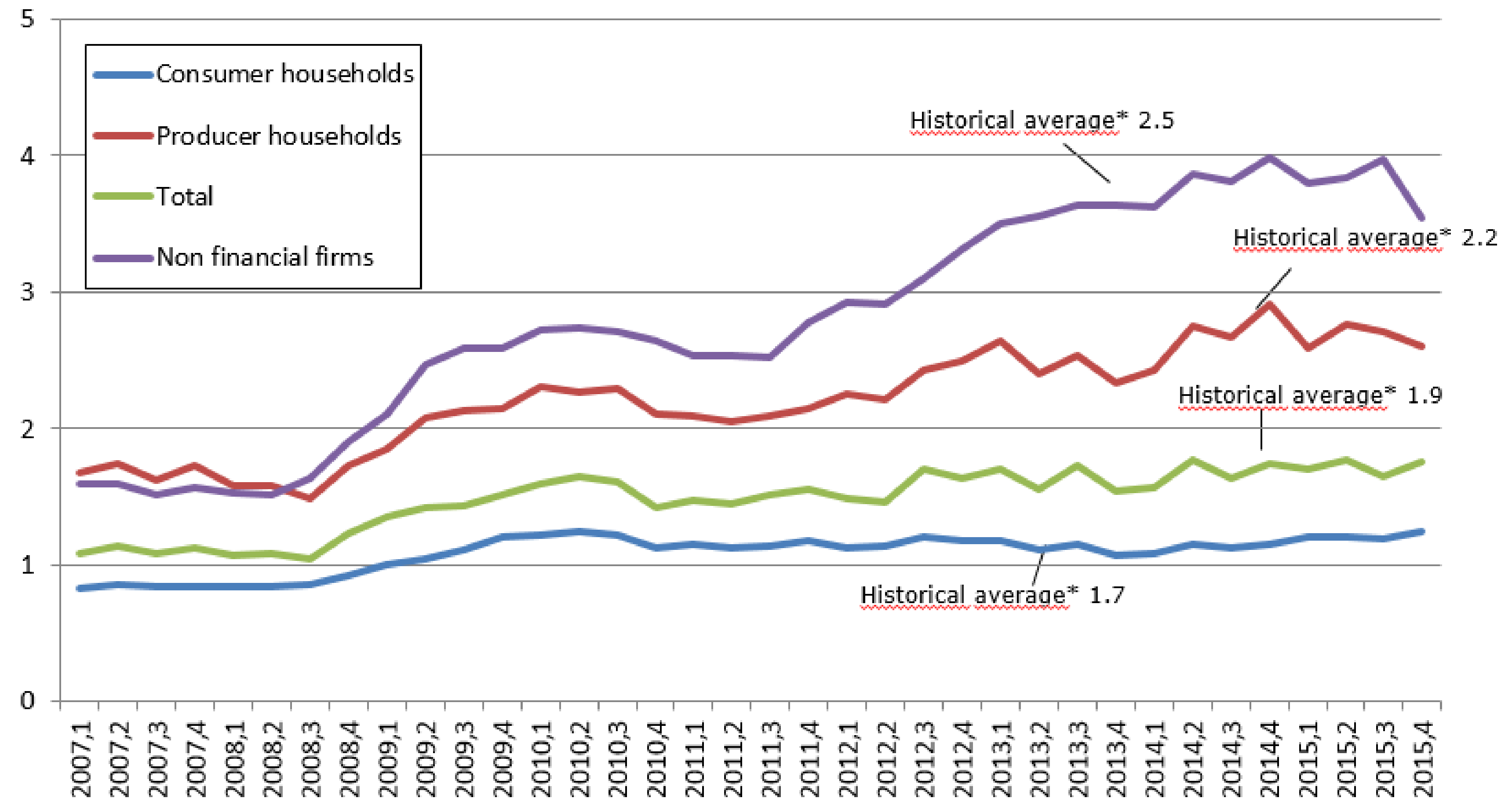


annual trend



monthly trend

New bad debts/Loans
(by number of loans; quarterly YoY; Q1 2007 – Q4 2015)



(*) Historical average: 1990-2015

The challenges ahead

- Public finance
- Investment, growth of the Italian economy
- Profitability
- Development of capital markets
- Private equity & debt, venture capital
- Insurance, pension funds and real estate , long-term savings and investment
- Public guarantees
- The Juncker Plan
- Progress in EMU, Banking Union, Capital Markets Union

Public finance and GDP objectives

Public finance: Outcomes and Medium Term Objectives
(Government targets - DEF 2016, April)

	2014	2015	2016F	2017F	2018F	2019F
			Government targets (April 2016)			
Real GDP growth	-0.4%	+0.8%	+1.2%	+1.4%	+1.5%	+1.4%
Nominal GDP growth	+0.4%	+1.5%	+2.2%	+2.5%	+3.1%	+3.2%
Deficit / GDP	-3.0%	-2.6%	-2.3%	-1.8%	-0.9%	+0.1%
Structural Deficit/GDP	-0.8%	-0.6%	-1.2%	-1.1%	-0.8%	-0.2%
Primary balance /GDP	+1.6%	+1.6%	+1.7%	+2.0%	+2.7%	+3.6%
Public debt /GDP	132.5%	132.7%	132.4%	130.9%	128.0%	123.8%

(1) Net of the Italian share of EFSF loans to Greece and the capitalization of the ESM. For the year 2014 the amount of these loans to Member States of the EMU (bilateral or through EFSF) is equal to €58.2 billion.

Source: Italian Ministry of Treasury

An International comparison

Primary balance as a % of GDP

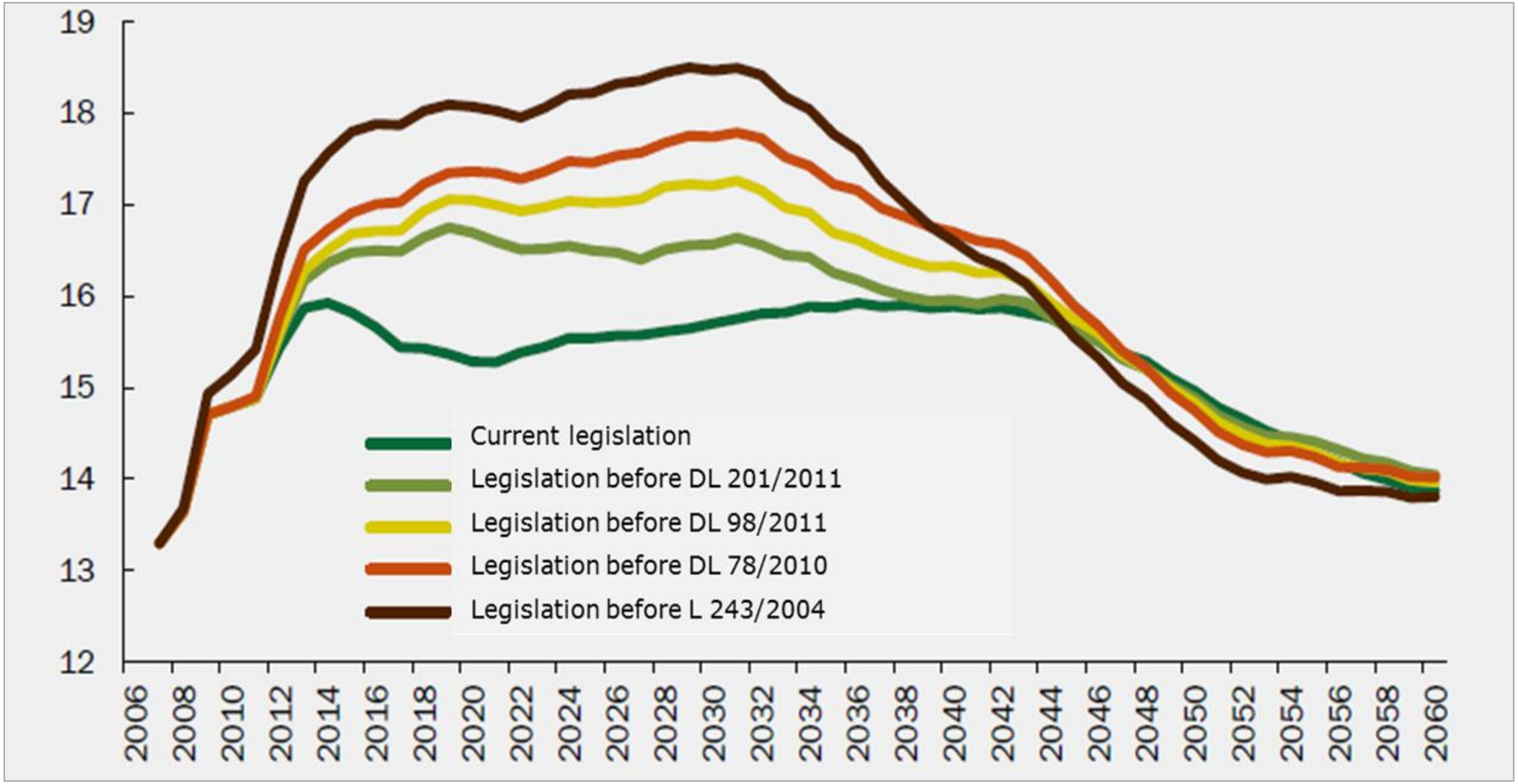
	2013	2014	2015F	2016F	2017F
			EU COMMISSION FORECASTS (3/05/2016)		
Italy	1.9%	1.6%	+1.6%	+1.6%	1.9%
Germany	1.8%	2.1%	+2.3%	+1.6%	1.5%
France	-1.8%	-1.8%	-1.5%	-1.5%	-1.3%
Spain	-3.5%	-2.5%	-2.0%	-1.1%	-0.4%
UK	-2.8%	-2.9%	-2.1%	-1.1%	-0.1%
USA	-1.7%	-1.4%	-0.5%	-0.8%	-0.6%
Japan	-6.4%	-4.1%	-3.2%	-2.6%	-2.3%

Cyclically-adjusted primary balance as a % of GDP

	2013	2014	2015F	2016F	2017F
			EU COMMISSION FORECASTS (3/05/2016)		
Italy	4.2%	3.7%	+3.1%	+2.4%	2.1%
Germany	2.0%	2.2%	+2.5%	+1.9%	1.8%
France	-0.9%	-0.5%	-0.4%	-0.6%	-0.8%
Spain	0.9%	1.1%	0.0%	-0,2%	-0.5%
UK	-1.6%	-2.6%	-2.2%	-1.3%	-0.5%
USA	n.a.	n.a.	n.a.	n.a.	n.a.
Japan	n.a.	n.a.	n.a.	n.a.	n.a.

Source: ABI on European Commission Spring 2016 forecasts (May 2016)

Effect of pension reforms on spending (as % of GDP)

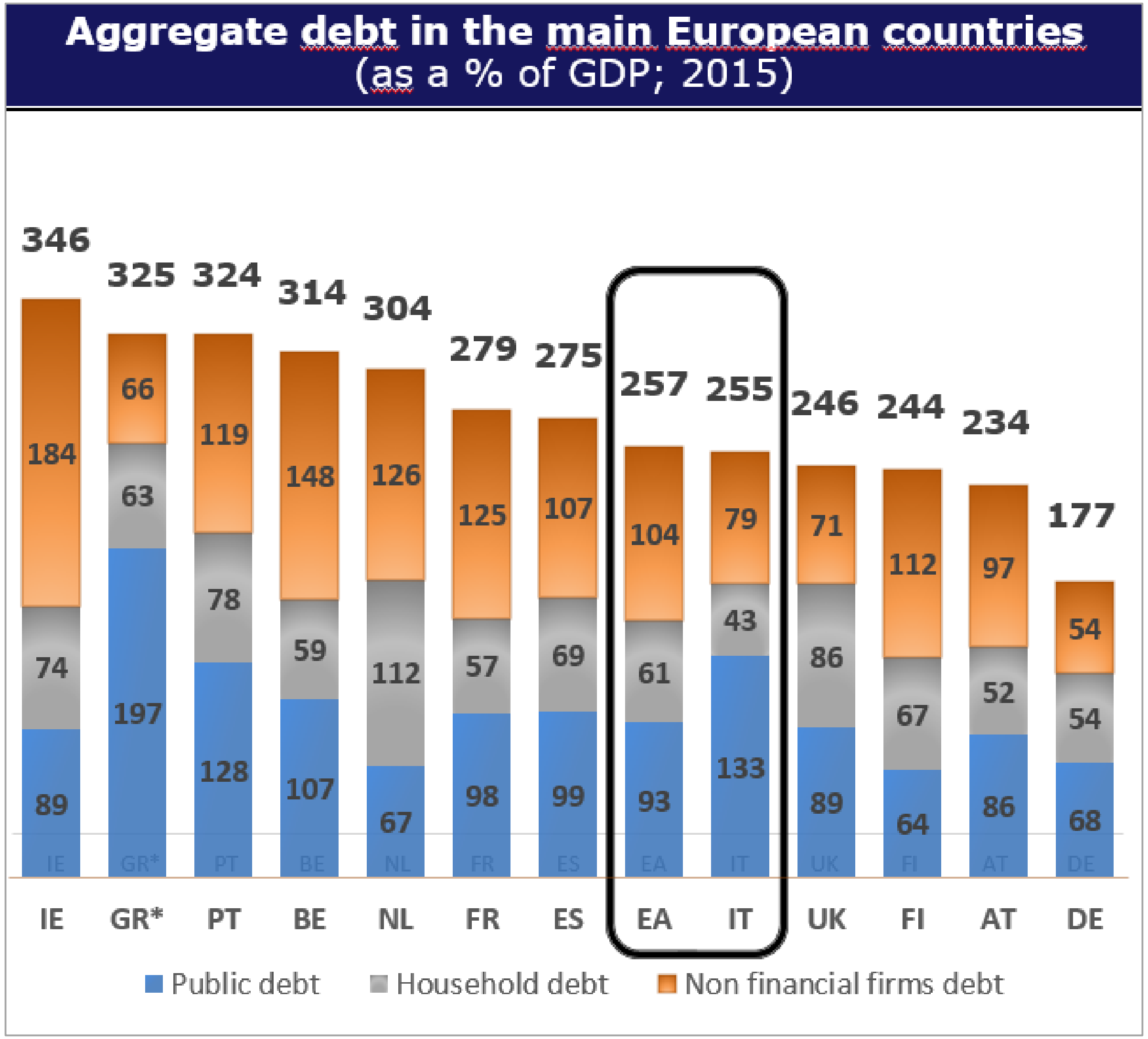


Source: 2016 Economic and Financial Document, April 8, 2016.
Demographic projections from EPC-WGA

Private Sector and Total Debt

- Non financial firms debt on GDP is at about 79% vs 104% on average in the Euro Area
- Households debt is 43% vs 61% Euro Area average
- As a consequence, the Italian aggregate debt is in line with the Euro Area average (255% IT vs 257% EU), better than France (279%). Germany is at the top of the rank with an index just below 180%
- Italy is a country characterized by a high level of net wealth as shown by:
  - ✓ the ratio of "households financial asset on disposable income" is at 371%, better than France (345%) and Germany (286%)
  - ✓ net wealth of Italian households is 8.0 of disposable income, 7.9 in Spain, 7.7 in France and in UK, and 5.6 in Germany

Aggregate Private and Public Debt



Source: ABI on Bank of Italy

- Italian private debt on GDP is among the lowest in Europe: non financial firms debt is 79% vs 104% Euro Area average; households debt is 43% vs 61% average

- As a consequence the Italian aggregate debt is in line with the Euro Area average (255% vs 257%)

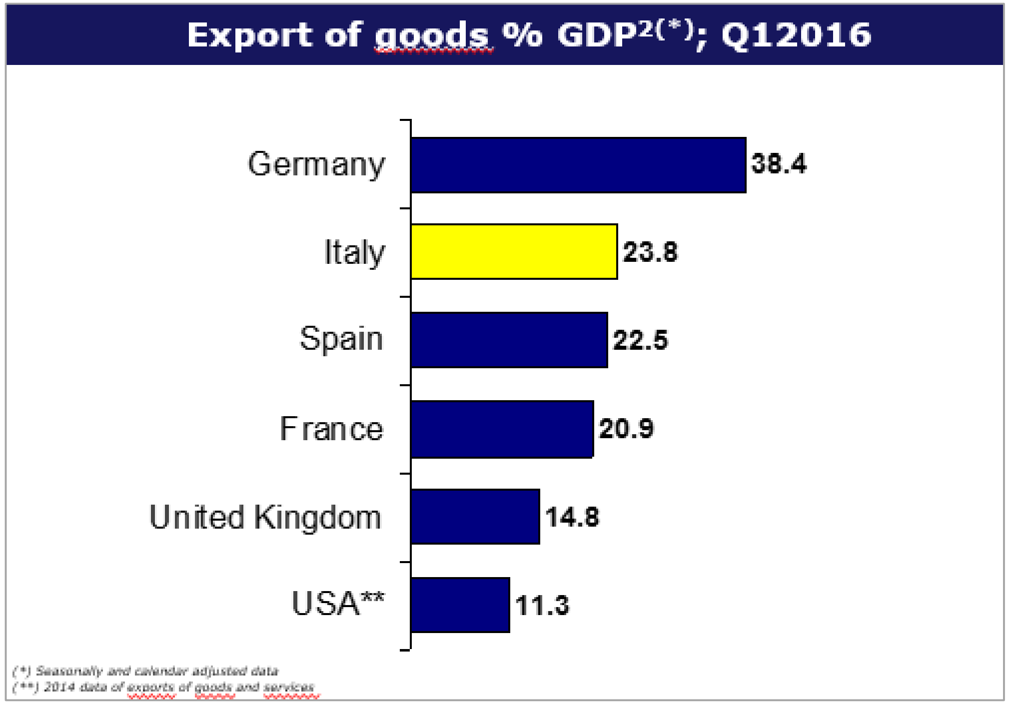
Snapshot of the Italian economy

Main macro-economic indicators for Italy: 2010-2016

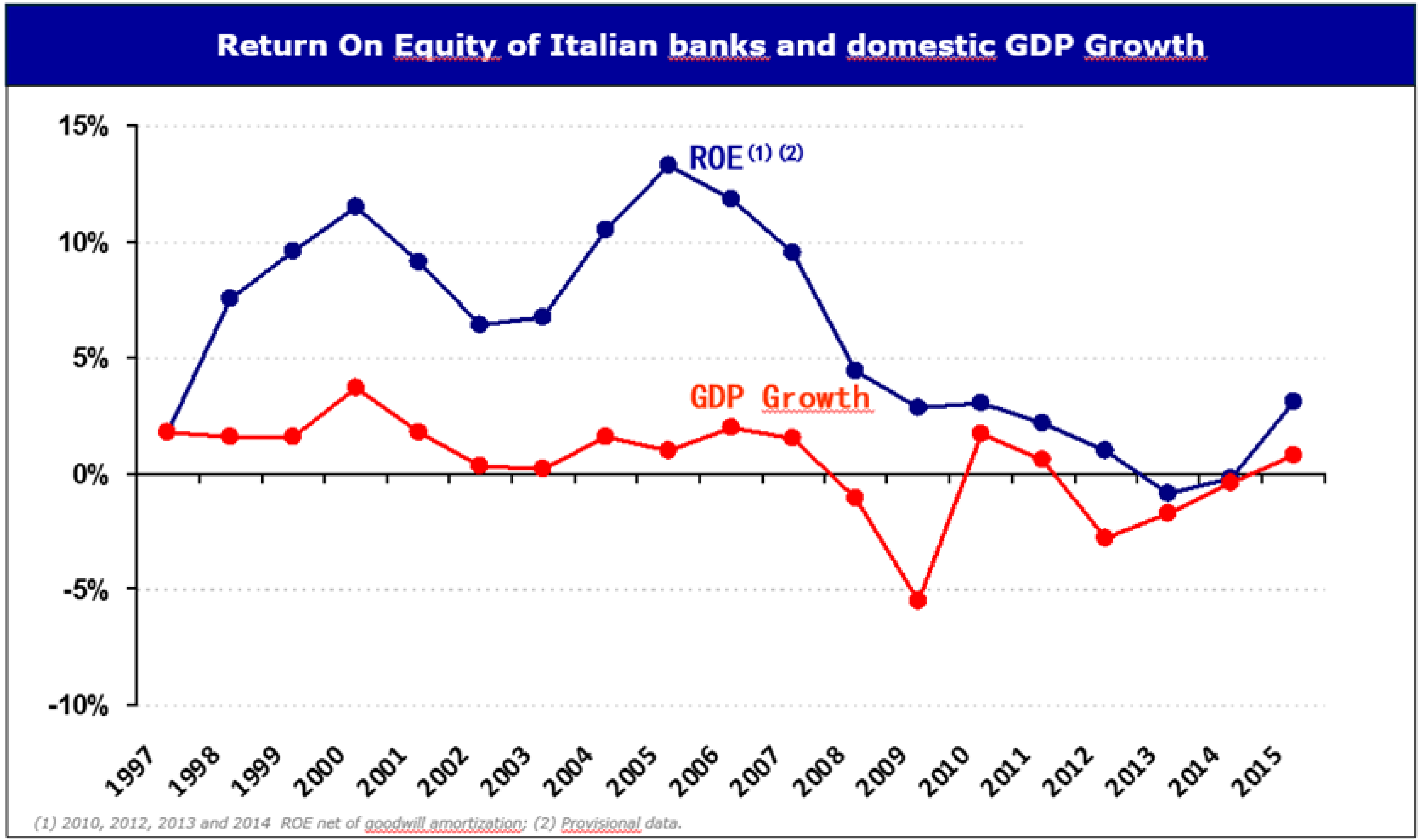
	2010	2011	2012	2013	2014	2015(e)	2016(f)
GDP (EUR billion)	1,604	1,639	1,615	1,609	1,617	1,630	1,661
GDP (YoY changes)	2.0%	2.1%	-1.5%	-0.4%	0.5%	1.2%	1.8%
Unemployment rate (% labour force)	8.4%	8.4%	10.6%	12.2%	12.7%	12.2%	11.9%
Average nominal wages inflation	2.8%	2.4%	2.3%	2.1%	2.5%	2.8%	2.2%
Labour cost per hour (EUR)	25.32	25.97	26.60	27.11	27.78	24.24	23.26
Consumer price index	1.6%	2.9%	3.3%	1.3%	0.2%	0.3%	1.0%
Export of goods (% change)	13.9%	10.4%	4.0%	0.8%	2.1%	4.0%	6.4%
Import of goods (% change)	19.5%	8.1%	-5.1%	-4.1%	-0.9%	3.3%	7.0%

The performance of exports

	1° exporting Country[1]	2° exporting Country
Clothing and fashion industry	**Italy**	China
Leather goods & footwear	**Italy**	China
Textile	**Italy**	Germany China
Non-electronic mechanical	Germany	**Italy**
Basic manufactures	Germany	
Electrical appliances	Germany	**Italy**



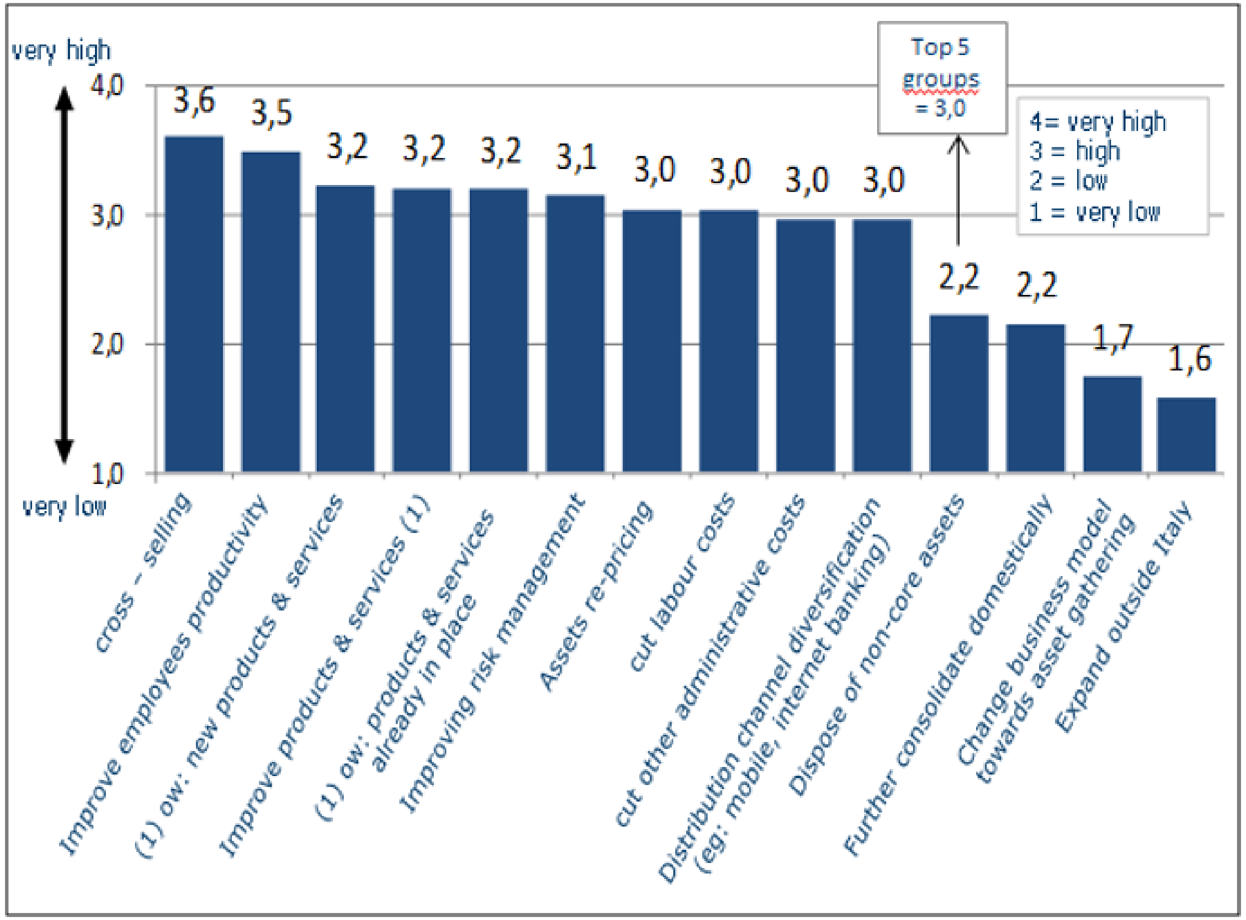
- Italy is Europe's second-largest manufacturing and industrial country, after Germany
- One of the largest export-oriented economies in the euro zone (1st exporting country in a number of goods, such as clothing and fashion industry or leather goods and footwear)
- Italy has a top position in the four Fs (Food, Fashion, Forniture, Ferrari) with strong performance also in new sectors (robotics, mechatronics, biopharma and aerospace)
- The current account surplus has increased further in recent years. The improvement was also due to the contraction of the energy deficit caused by the fall in oil prices
- Imports have begun to increase again at a fast pace. The current account is running a small surplus, even when adjusted for the business cycle (Banca d'Italia estimates)



Source: ABI on Istat and Bank of Italy

How to restore profitability: short & medium terms priorities

ABI survey open to 27 Italian banks CEOs
What should be the priorities for Italian banks in the short-medium terms?



Main priorities:

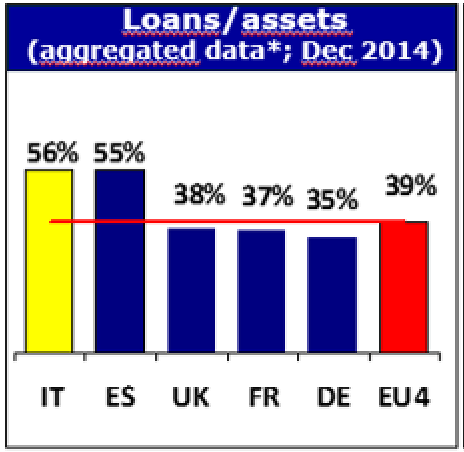
- increase in cross-selling
- increase in employee productivity
- development of existing products & services
- reengineering of products / services even towards distribution of not traditionally retail banking products and services;
- Cost containment: labour and administrative
- diversification of delivery channels (technologies)

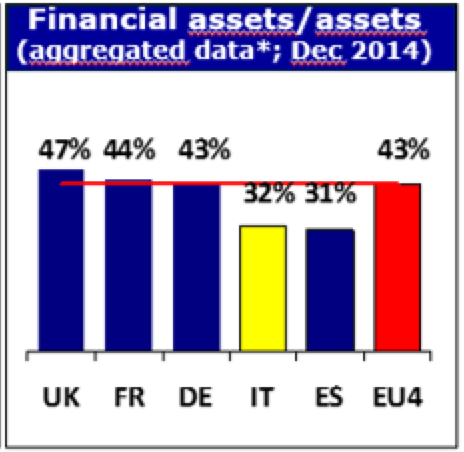
Not only relevant actions on costs but also on the amount and composition of revenues

Source: ABI Survey on Italian banks: Bankers' vs investors' perception (2013)

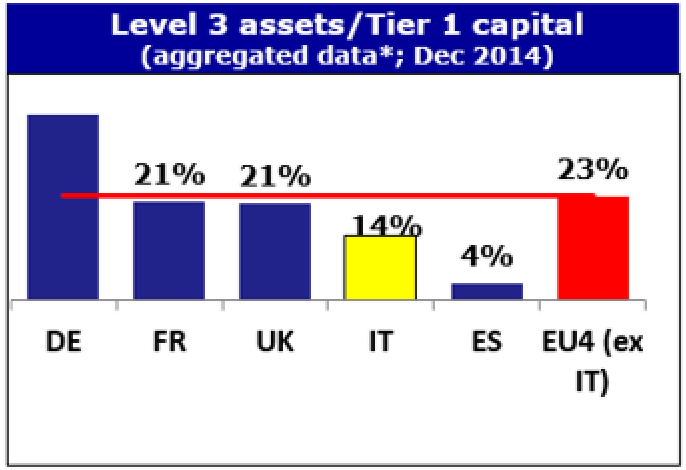
Capital Markets Need to Catch up

1. Business mix: loans to private customers

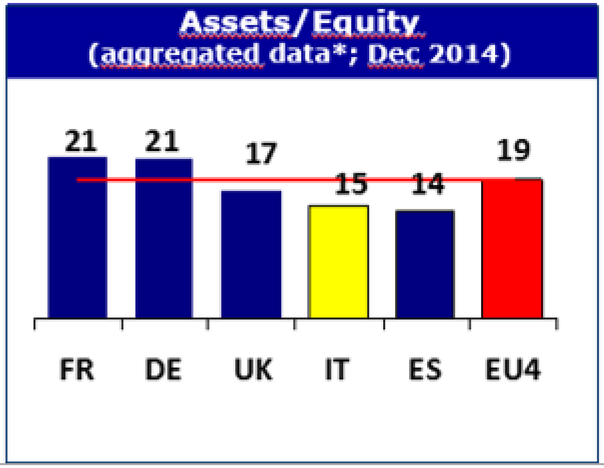




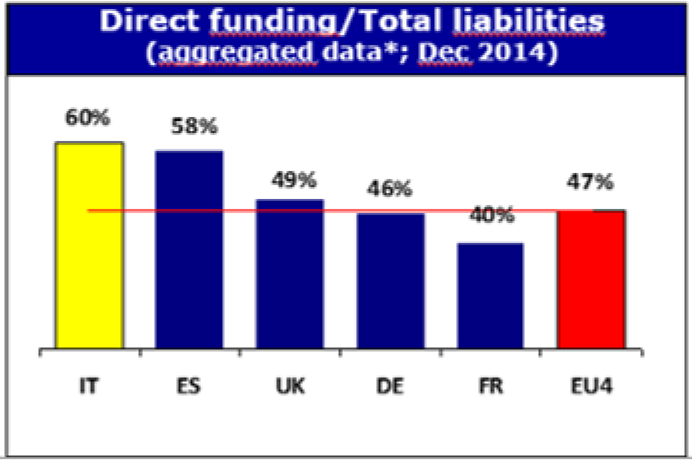
2. Low level of financial/illiquid assets



3. Low level of financial leverage



4. High percentage of retail funding



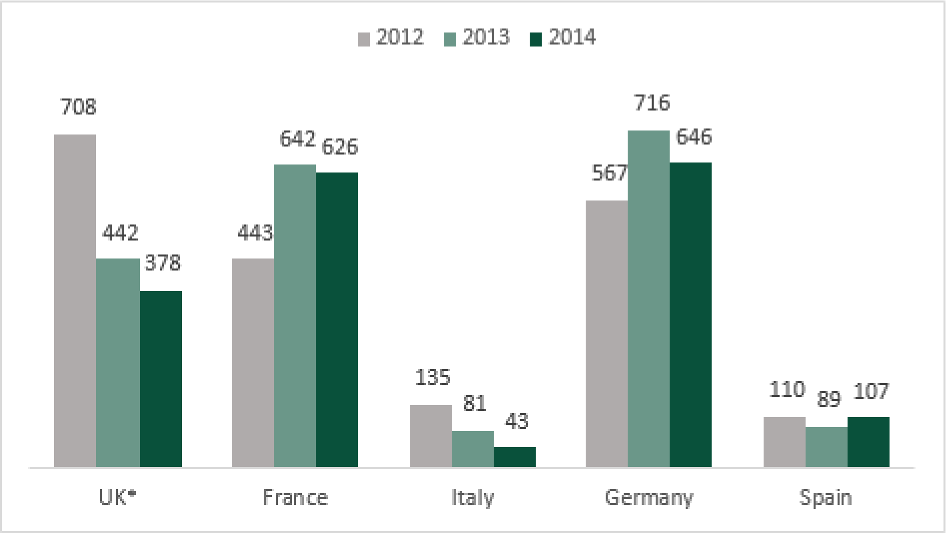
Venture Capital still lagging behind

- Italian venture capital market is quite small (both in terms of amount invested and companies financed) in comparison with the main European ones: UK, France and Germany.

- In 2014, the amount invested in Italy was equal to 43 million Euro involving 84 companies. In the same year, the average amount invested in UK, France and Germany was double the Italian one.

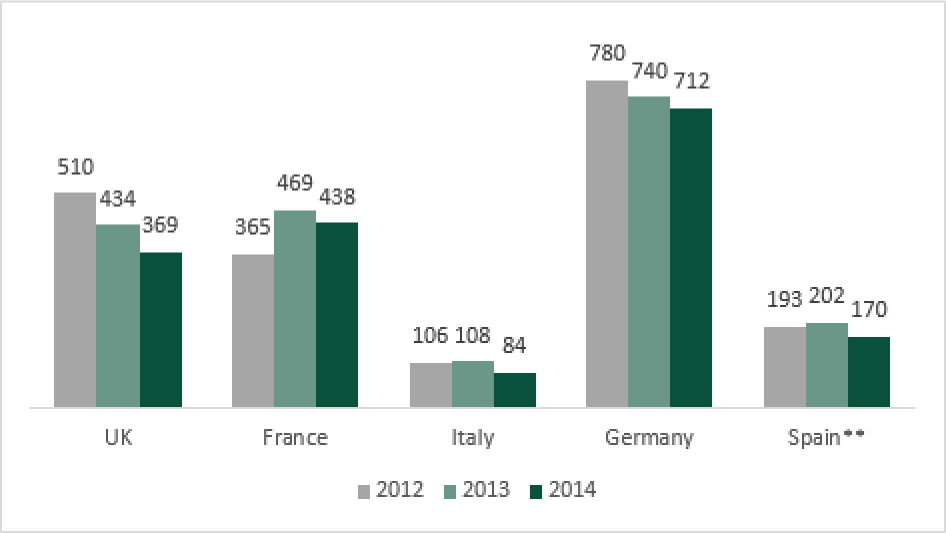
- Concerning the number of players, in 2014, 25 venture capitalists were active in Italy, with respect to 151 in UK, 110 in France, 160 in Germany and 154 in Spain

Amount invested in venture capital (Euro Mln)



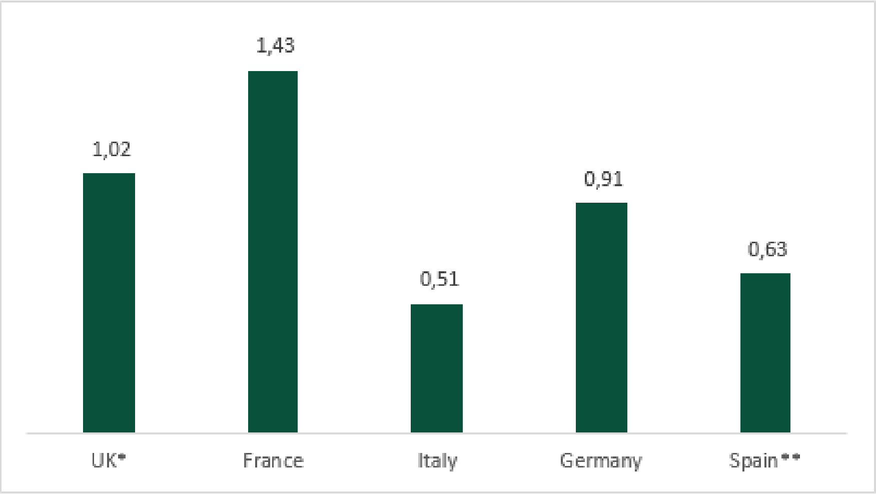
*£ Mln
Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)

Number of venture backed companies



**Number of investments
Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)

Average amount invested (Euro Mln, 2014)



*£ Mln
**related to investments and not to companies financed
Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)

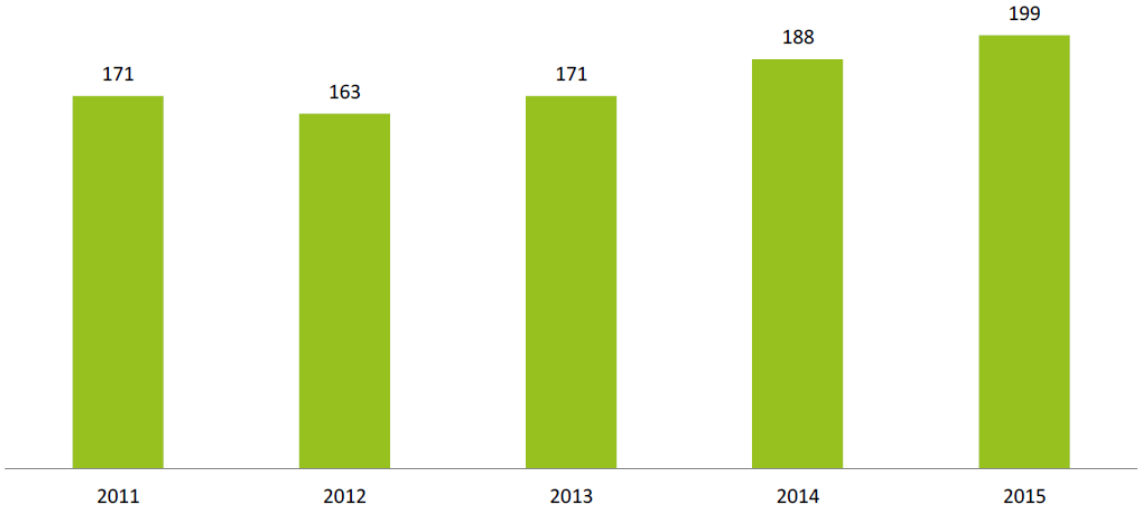
Venture Capital…but recovering fast

- In 2015 the Italian private equity and venture capital market has showed a strong growth, reaching the second highest amount invested ever. International players showed a growing interest in the Italian market

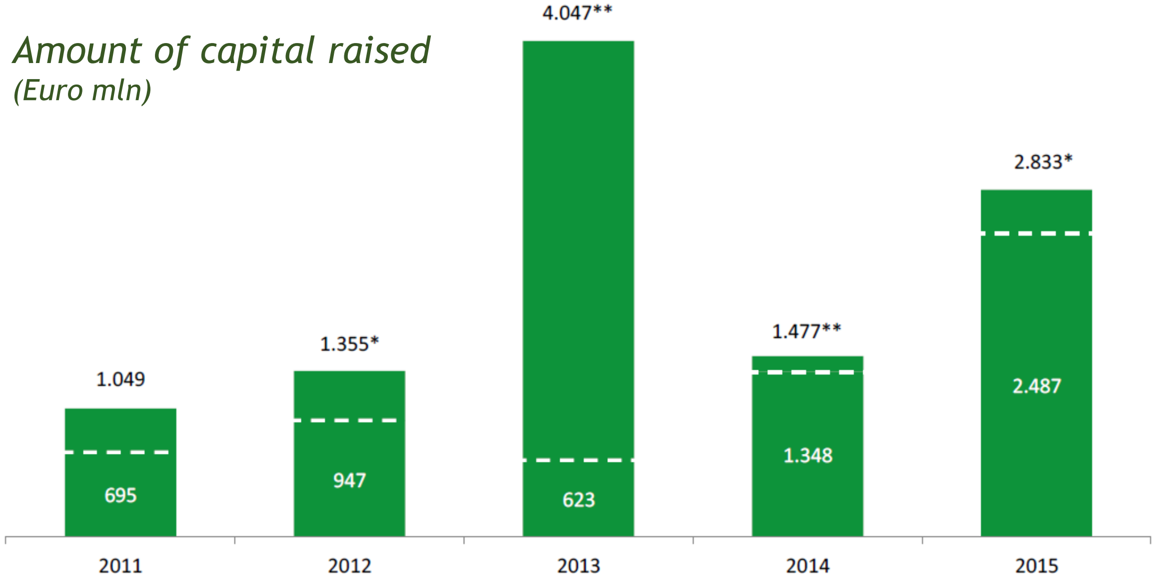
- Positive signals came also from fundraising almost doubled in comparison with the previous year, thanks to important players reaching a close during 2015

- Finally, divestments experienced a positive trend too, increasing both in terms of number and of amount divested

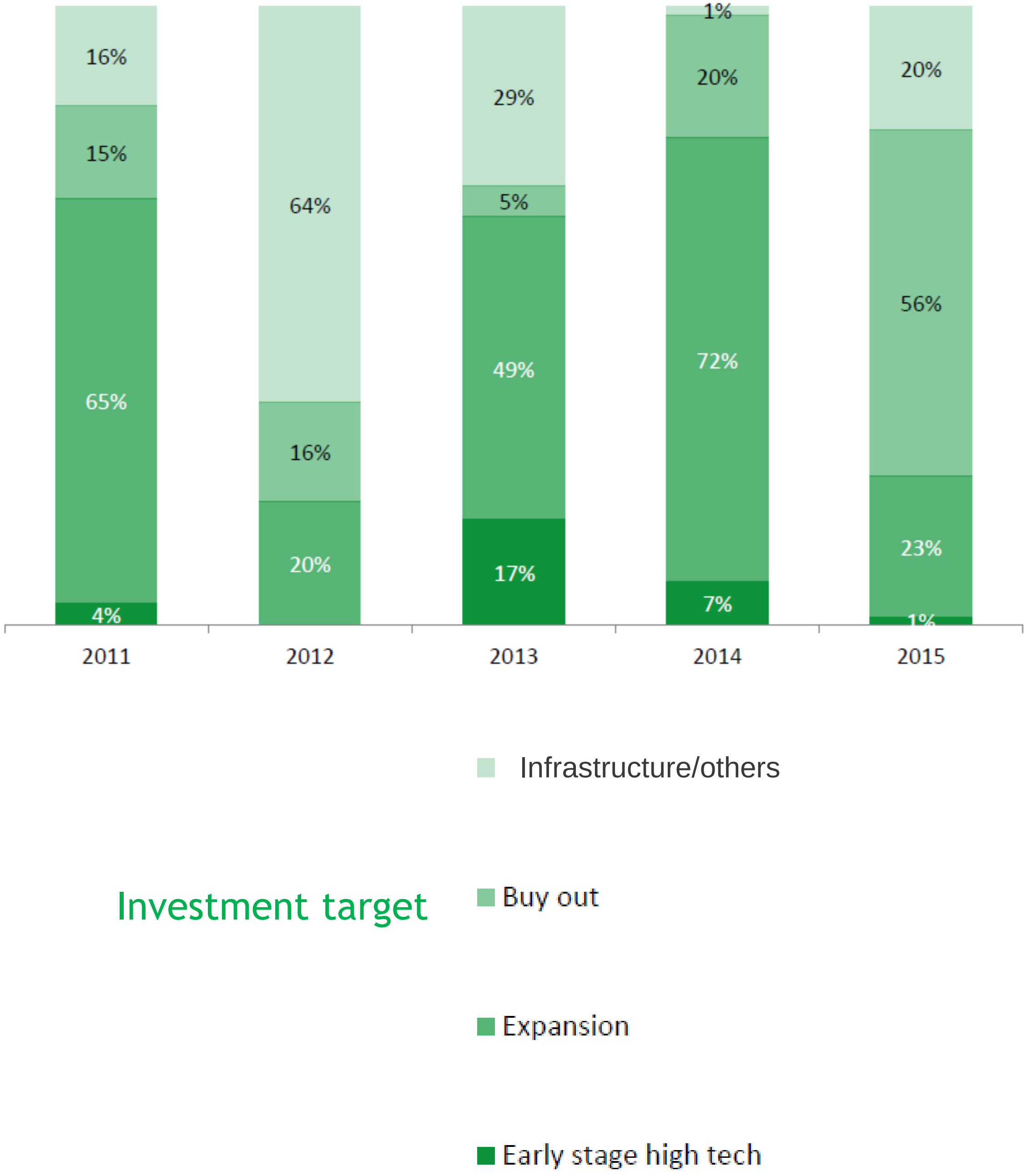
Number of players



Amount of capital raised
(Euro mln)



Investment target



- In 2015 ten of Italy’s largest *banche popolari* are morphed into joint-stock companies

- Banca Popolare di Milano and Banco Popolare have agreed to merge — creating Italy's third largest banking group by assets after UniCredit and Intesa S.Paolo

The Borsa Italiana Elite programme: an Italian best practice

- ELITE is a programme designed to help SMEs prepare for accessing to long term financing opportunities.

- ELITE offers an innovative approach, including training, a working area supported by tutorship, and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, providing access to Private Equity and Venture Capital funds, debt products, etc.

- The long term objective of ELITE is to improve SMEs access to more sophisticated skill-sets, networks and a diversified capital pool in order to accelerate growth opportunities

EFSI in Italy

- EFSI projects approved by the EIB in Italy are expected to mobilise around € 10.5 billion, with EIB Group financing under EFSI amounting to € 1.6 billion

    - ✓ 8 approved projects in the innovation and infrastructure window, across various sectors of key interest to the Italian economy: transport (3 projects), energy (2 projects), research and innovation (2 projects), and ICT (1 project)

    - ✓ In the SME window, the EIF already signed 13 agreements with Italian intermediary banks. These agreements are expected to benefit over 36,000 start-ups, SMEs and Mid-Caps in Italy

- Around 10% of all requests received so far by the European Investment Advisory Hub came from Italian stakeholders

IPE – EFSI SMEW - Geographical spread in EU

EUR m as of 15 June 2016	Number of transactions (a)	EFSI contribution (b)	Mobilised Investments 2 (c)	Mobilised Investments 2 (per mandate) RCR	COSME LGF	InnovFin SMEG	Exp. # SMEs to be supported
Austria	1	20	280	-	-	280	500
Belgium	7	78	965	113	252	600	3,256
Bulgaria	4	10	220	-	143	77	2,183
Croatia	3	4	105	-	64	41	988
Cyprus	-	-	-	-	-	-	-
Czech Republic	5	37	724	-	374	350	4,990
Denmark	4	24	400	-	101	298	1,657
Estonia	4	17	606	179	427	-	3,710
Finland	1	15	210	-	-	210	375
France	18	378 *	5,607	2,359	1,386	1,862	20,260
Germany	18	291	5,371	1,764	2,333	1,274	30,376
Greece	2	16	224	-	140	84	2,150
Hungary	3	7	432	-	411	21	4,529
Ireland	3	45	421	141	140	140	1,658
Italy	**30 ***	**364**	**8,114 ***	**1,702**	**3,850**	**2,562**	**34,042***
Latvia	2	1	70	-	70	-	1,000
Lithuania	2	1	70	-	70	-	1,000
Luxembourg	2	11	154	-	-	154	275
Malta	-	-	-	-	-	-	-
Netherlands	4	42	303	277	26	-	516
Poland	5	22	707	-	631	76	8,182
Portugal	3	42	588	-	-	588	1,050
Romania	2	5	70	-	-	70	125
Slovakia	1	6	140	-	140	-	2,000
Slovenia	1	8	388	-	388	-	3,600
Spain	7	181	3,524	715	2,450	359	14,607
Sweden	4	46	585	221	-	364	663
United Kingdom	11	326	4,172	3,639	79	453	2,121
* Multi-Country	41	1,524	14,212	14,114	-	98	1,681
Total	188	3,520	48,661	25,222	13,477	9,962	147,500

* Highest