Bank of Italy – Palazzo Koch

Additional comments by Governor Visco at the delivery of his Concluding Remarks

Rome, 31 May 2017

Let me now make some brief, less formal, observations.

In recent years the Bank of Italy has come under fire. The tone of the criticism has at times been very harsh, the reasoning often seriously flawed. It has stood accused of failing to comprehend what was happening at several banks. Or of having acted too late. It is not for me to judge. We have written and spoken about what we did and how we did it, and there will be further opportunities to explain and clarify. I can only assure you that the Bank of Italy's staff and Governing Board have always demonstrated the utmost commitment. On this occasion I would, however, like to recall some of the lessons that we have learnt from this crisis.

Let me start by saying that banking crises are not, unfortunately, a novelty. And, as history demonstrates, they cannot always be prevented. In the 1970s we had Italcasse, Sindona, the Banco Ambrosiano. Two decades later, in the 1990s and immediately before the privatization wave, came Banco di Napoli, Banco di Sicilia and Sicilcassa.

Unfortunately, cases of poor – if not downright dishonest – management, are fairly frequent, irrespective of who is in government or at the helm of the Bank of Italy. Tools are required to minimize the repercussions. And these repercussions can prove particularly detrimental, especially after a double-dip recession, when the economy's performance only compounds strategic errors and careless or unscrupulous management. As happened in the cases we have seen in recent years.

Today more than ever we must prioritize how we assess the people in charge of banks. Whenever absolute dominions are established, the risk increases that management will exploit its apparent impunity to abuse its power or show partiality. This can translate

more or less rapidly into the bank's failure. For under two years now, the Bank's supervisors have been empowered to remove managers, unlike in the past when they could dismiss the entire Board of Directors only when under administration, a situation where several special conditions had to be met. Now, after being cautioned, if shareholders put off adopting the necessary measures, the intervention must be timely and decisive. It has been so. It will be again in the future if necessary.

It has been confirmed that banking crises must be resolved at the earliest possible opportunity. Allowing them to drag on for months or years is deleterious because as time moves on, so do the rules, the people, the economy, even the banking market. Compared with the past, the Bank of Italy's supervisory powers to address these crises are now less effective: the use of public funds is restricted to a few exceptional cases and even the use of the Deposit Insurance Fund is considered tantamount to improper State aid. Between the goals of stability and efficiency, including the just objective of minimal public intervention to safeguard competition, the current legislation strongly favours efficiency.

Not only this. It has become more difficult to find buyers for ailing banks because even if it has not dried up entirely, that market is shrinking. If – as we must – we wish to avoid sparking the distrust of customers, we have to act within a matter of weeks and not wait months or even years. But the complexity of the procedures and the sheer number of authorities involved under the new banking union laws are not helping us, at a time when, on the liability side, banks may still lack adequate tools that can be freely and skilfully employed for rapid recapitalizations. Banks must, of course, equip themselves with these instruments as soon as possible, but for those for which this will prove too

costly, interventions must be prepared to make their market exit as simple as possible, via mergers, disposals or other solutions, and at no cost to retail customers.

We have seen how the severity of the recession and lengthy recovery procedures have led to an increase in the stocks of non-performing exposures and bad loans, which have reached very high levels though not those of the currency crisis of 1992-93. In Italy NPLs are backed by considerable collateral and personal guarantees. We have pushed for these to be assessed prudently, advocating for write-downs on NPLs to be increased. Banks record NPLs net of write-downs in their balance sheets but the data are almost always spoken of in gross volumes and the collateral and guarantees are assigned much lower values than would seem reasonable to expect. Lengthy recovery procedures and legitimate balance sheet concerns go some way towards explaining the size of the stock of NPLs and the slowness of its reduction. Given at times insufficient information and inertia in pursuing recoveries and restructurings, these reasons fail to reassure markets, analysts and regulators. It is of little use to point out differences across countries, in laws and practices. We must acknowledge this and rapidly remove from balance sheets loans that risk turning sour, as happens elsewhere. We need to work to do this in an orderly fashion, including by adapting national laws and practices to those prevailing internationally.

Finally, we have learnt that we must pay attention to the information we provide to the public. With the transition to European-wide supervision and the transposition of EU laws on bank resolutions, the world has changed. We sought, to no avail, both a more gradual approach and the non-retroactivity of several new legal provisions. We learnt, on

the other hand, that there was a lack of awareness at political level, among members of the press, and on the part of banking customers, of the transformation under way. But also and above all, we learnt that when products were sold (well before the spectre of resolution was invoked) the public's understanding of the risks associated with junior debt (whose sale was wholly legitimate and permitted under the international rules on banks' capital) was already very limited. Not to mention its awareness of the risks associated with the shares so widely distributed among clients of cooperative (*popolari*) banks. Financial education is a long-term undertaking: a sea change such as the one associated with the introduction of burden-sharing first, then bail-ins, has clearly demonstrated how important an investment it is. And how vital it is to monitor the correctness of behaviour and to safeguard those who are most vulnerable. Safeguards that cannot only be *ex post*. We are committed to ensuring just this and, for our part, will redouble our efforts in the future.