BANCA D'ITALIA
EUROSISTEMA

Clarifications regarding the Banca Popolare di Vicenza

- Events at Banca Popolare di Vicenza (BVP) came to the public's attention in recent weeks when it was reported that the public prosecutor's office in Vicenza had launched an investigation. In the debate that ensued, the Bank of Italy's actions were repeatedly called into question, based on mistaken premises or fundamental misunderstandings. The Bank of Italy refrained from comment out of respect for the investigating magistrates, with whom it has been actively cooperating for months. Without going into the substantive issues forming the basis of the enquiry, we believe it is appropriate – and have informed the public prosecutor's office to this effect – that certain points be clarified in order to avoid misinterpretations and eliminate misunderstandings.
- The **first clarification** regards the price of shares of an unlisted cooperative (*popolare)* bank such as BPV. The Italian Civil Code[1] assigns responsibility for setting the price of shares to the general shareholders' meeting, which votes on a proposal by the Board of Directors. The Bank of Italy has no direct power to determine share prices.
- Nonetheless it has, on numerous occasions, called on BPV to establish adequate procedures and objective criteria for setting the price of its shares. In any event the Bank of Italy could only advance methodological criticisms, not make value judgments, and this without prejudice to the responsibility of the management boards, and in particular that of the shareholders' meeting, to determine the share price.

[1] Article 2528.

- There have been numerous similar requests in the past, starting in 2001 when, amongst other things, an inspection revealed a lack of objective criteria in setting the share price. As a result, the Bank of Italy imposed administrative sanctions on BPV's directors and already on that occasion forwarded its inspection report to the public prosecutor's office.
- This issue was revisited in an inspection conducted in 2007-08 which revealed that, while consistent with the bylaws, the price-setting procedures were based on unwritten rules and insufficiently rigorous assessments lacking in independent expert opinions. Again, the Bank of Italy again imposed new administrative sanctions on BPV, consistent with the regulations in effect at the time.[2]
- A subsequent inspection in 2009 revealed that, despite repeated requests by the Bank of Italy, BPV had failed to adjust its share price to reflect its earning capacity that had deteriorated in the meantime. When pressed on the issue, BPV pledged to seek the advice of an external consultant.
- Only in 2011 did BPV issue guidelines for determining the share price in the general shareholders' meeting and seek the opinion of an external expert; the share price – which had been increasing until then – remained unchanged at €62.50 for four years in a row, before dropping back to €48 in 2015.
- As mentioned above, the Bank of Italy does not have any direct influence in setting the share price. However, the entry into force of CRD IV in 2014 introduced a substantive element of direct concern to the supervisory authorities: share buybacks. Until 2013, the Bank of Italy was required by law to authorize such buybacks only if they exceeded 5 per cent of capital. As of January 2014, authorization is required for all share repurchases. The standard for deciding

[2] As of 12 May 2016, the decree transposing Regulation (EU) No. 575/2013 has granted the Bank of Italy more extensive powers of intervention, which it can exercise once the implementing legislation has entered into effect.

whether or not to grant authorization is purely prudential: when a bank repurchases its own shares it reduces its capital and this must be carefully assessed by the supervisory authorities.

- In 2014 it emerged that BPV was buying back its own shares without having first sought authorization. At that time the Bank of Italy was engaged in the comprehensive assessment and preparing for the transition to the Single Supervisory Mechanism (SSM), which was launched in November 2014. In agreement with the new European supervisory set-up, we included among the objectives of an inspection scheduled for early 2015 a check on how the trading of own shares was conducted.
- The on-site inspection, carried out by Bank of Italy staff under the aegis of the SSM but fully aligned with the supervisory action taken by the Bank of Italy up to then, discovered that BPV had repurchased its own shares without the necessary authorization, and brought another problem to light.
- The inspection revealed that BPV had failed to deduct from own funds substantial amounts raised against loans it had disbursed to subscribers of its shares without notifying the Bank of Italy.
- It is worth bearing in mind that if a bank does not make the reports prescribed by law, in off-site supervisory activities links between purchases of shares and loans are not detectable; this can only be revealed by an on-site, targeted inspection.
- Moreover, the Bank of Italy's inspections of BPV's credit risk had not found any evidence of irregular financing for share purchases. This may be attributed to the fact that, in line with supervisory practices, inspections of banks' credit risk focus on a sample of customers in worst-case conditions, while loans such as those granted by the BPV for the purchase of own shares and not reported to the Bank of Italy usually involve clients with positive credit ratings.

A **second clarification** is required here**.** Loans that may be granted by a bank to clients against purchases of the same bank's shares are lawful if authorized by an extraordinary shareholders' meeting.[3]

- This, however, is to miss the point: shares purchased by means of a loan disbursed by the same issuing bank cannot be included in own funds. Specific prudential rules say as much. The reason for this is clear: the rules consider this capital as an initial buffer for absorbing any losses; it must therefore comprise genuine resources, not those at high risk of being wiped out by unpaid loans.
- The findings of this year's inspection of BPV and the resulting decisions of the Supervisory Board of the SSM have obliged the bank to strengthen its regulatory capital buffers. BPV's senior management has been replaced, the bank has recently agreed to its transformation into a joint stock company and has approved a capital increase and share listing; this will ensure transparency in price formation and liquidity for investment in shares.

[3] In compliance with the conditions laid down in Article 2358 of the Italian Civil Code.

In conclusion:

- Over the years, BPV has been subject to intensive supervision by the Bank of Italy, with numerous inspections (seven in the last decade alone) of various operational aspects, including finance, credit, transparency and anti-money-laundering initiatives.
- Several problems have been resolved, though in accordance with the existing legislation on professional secrecy, the Bank of Italy cannot disclose them publicly. For a certain period of time the Bank of Italy also imposed restrictions on BPV's capital resources and group structure. In more recent years, BPV has submitted various proposals for the acquisition of other banks, though none have gone through.

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