Finance Committee

of the Chamber of Deputies

Fact-finding on issues affecting the banking and financial system

Testimony of the Governor of the Bank of Italy
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All the main advanced economies recorded a sharp contraction of output in the fourth quarter of 2008. Consumption and investment demand is falling owing to the rapid, generalized deterioration in household and business confidence, the increase in unemployment, the drop in share prices and house values, and tighter access to credit.

The recession has passed to the emerging economies, hit by the drop in exports to advanced countries, the decline in raw material prices, and the sudden reversal of capital flows. The countries that depend most heavily on financing from abroad, such as those of Central and Eastern Europe, are especially vulnerable.

The International Monetary Fund and other official and professional forecasters have progressively revised their estimates of world economic growth downwards. In January, the IMF projected that world trade would contract by almost 3 per cent in 2009 and that GDP would fall by 1.6 per cent in the United States, 2 per cent in the euro area and 2.6 per cent in Japan. It has already announced that the estimates are being newly revised in the light of more recent data. World GDP growth will probably be negative on average for the year.

Economic policymakers have acted promptly to contain the spread of the financial crisis and counter its effects on the real economy. Central banks supplied ample liquidity to the financial system, with interventions of unprecedented size and degree of international coordination. Governments have introduced or strengthened guarantees for bank deposits and securities and have prepared or taken measures to recapitalize financial institutions.

These actions have prevented the collapse of the system but they have not yet shed full light on the financial situation of those banks that invested most heavily in “toxic” assets: there is still uncertainty as to the size and distribution of the losses on the balance sheets of what were once the world’s largest banks. Moreover, it is likely that the recession will cause a further deterioration in banks’ assets.

The restoration of confidence in financial institutions and properly functioning credit markets is essential, along with support for demand offered by monetary and fiscal policies, in order to restart growth.

Official interest rates now stand at minimal levels in the leading economies. There is limited scope for the monetary policy lever to work, although there remains the option of unconventional measures, which are being implemented in part. In some cases, notably the United States, the central bank has put itself in a position to intervene directly in certain segments of the credit market in order to guarantee liquidity to the private sector.

The leading governments have introduced fiscal stimulus measures to counteract the contraction in income and employment. The United States has launched a programme of expenditure measures and tax cuts amounting to almost $800 billion, which will have an overall impact on the deficit for the three years 2009-11 of about 5 per cent of annual GDP. The stimulus measures adopted by the European countries and Japan are of a smaller order of magnitude but considerable nonetheless, partly reflecting differences in the initial condition of public finances and in the operation of automatic stabilizers. In China, too, the Government has announced a broad programme of extraordinary expenditure to boost demand.

The importance of international cooperation for a return to stable world economic growth and the strengthening of the international financial system was stressed at the meeting of G20 finance ministers and central bank governors in Brighton last weekend.

In Italy, as in the rest of the euro area, the recession, which worsened in the middle of 2008, is expected to continue through this year. All the indicators (production, orders and inventories) continue to point to extremely slack activity. GDP is expected to contract in the first quarter of this year, for the fourth consecutive time. The whole of 2009 will probably close with a new, large drop in economic activity, above all in the private sector.

The difficulties of the main outlet markets have affected exports, which were the most important source of support for demand in 2006-07. In January, Italian exports to non-EU countries fell to historic low levels. Firms have cut back dramatically on their investment plans owing to the large margins of spare capacity.

Consumer price inflation, which has been falling since last autumn, stood at 1.6 per cent in February; it is expected to continue to fall until the summer, mainly thanks to the trend in energy and food prices. Despite the contraction in activity, leading international organizations and professional forecasters do not expect a deflationary spiral to set in.

The additional expenditure and reduction in revenue that Italy has approved for counter-cyclical purposes amounts to about 0.5 percentage points of GDP; these measures are financed by others of opposite sign. In addition, previously allocated resources have been channelled into uses that stimulate aggregate demand more effectively.

The decision as to the forms of government intervention to support demand is no less important than the question of its magnitude. They must support the consumption of the weakest categories of citizens and strengthen the economy's capacity for growth through public investment projects that offer a high rate of return and are shovel-ready.

The Government has temporarily extended the possibility of benefiting from social shock absorbers to most categories of atypical workers; further improvements were defined last week. Funding for these measures was recently increased thanks to an agreement between central government and the regions. These provisions are opportune, but there is still the need to tackle a comprehensive reform.

The Government has also announced it is examining provisions to facilitate the expansion of residential buildings and to reduce construction charges. The procedures, contents and timetable of any possible measures are not yet known. Simplifying formalities and reducing charges could constitute a stimulus. The complex nature of this subject, concurrent powers between the central and regional governments, and the need to design the intervention so as to preserve the natural environment and balanced town planning make the effects of such action uncertain in the short term, however.

The amount of firms' receivables from general government, connected with deferments and delays in paying for goods and services, is very high: about 2.5 per cent of GDP, more than 30 per cent of annual general government consumption and investment expenditure. Faster payments would support firms without structurally burdening the public finances.

In countries like Italy, with high public debt, broad and incisive short-term interventions must be compensated for by structural measures giving immediate assurance of the restoration of budget balance in the medium term. It is essential to look farther ahead: the long-term sustainability of the public finances is fundamental to ensure the effectiveness of short-term policies.

Lending and the banks

Italian bank lending has decelerated sharply. The annualized three-month growth rate of loans to the private sector, adjusted for the accounting effect of securitizations, fell to 2.3 per cent in January, from 8.6 per cent in September. On the basis of partial data, lending is estimated to have contracted slightly in February with respect to January.

The slowdown has affected all categories of debtors. For firms, in January the three-month growth rate was 5.5 per cent, about three points lower than in September; however lending to firms with fewer than 20 employees and to manufacturing industry declined. The fall in production and uncertainty about the future of the economy reduced the demand for credit for investment and for funding inventories and working capital.

Lending to households increased by 3.3 per cent in January, against 4.7 per cent last September. The growth in lending to households, which was quite robust a few years ago, had already moderated before the beginning of the financial crisis; the fall in house sales and the drop in spending on durable goods caused a further slowdown. As regards loans for house purchases, which constitute 68 per cent of credit to consumer households, in the fourth quarter of 2008 new loans were down by 20 per cent from a year earlier. Consumer credit for the purchase of goods and services – which accounted for 6 per cent of bank lending to households – slowed sharply.

New mortgage loans at fixed rates amounted to €36 billion in 2008 or 64 per cent of the total granted to households, compared with €32 billion (51 per cent) in 2007. The wide gap between Italy and the euro-area average in the cost of new fixed-rate mortgages (one percentage point in June 2007) has now narrowed to nearly nil. In the last few months the share of new fixed-rate loans has fallen slightly, though remaining higher than in the past (55 per cent in January). One factor in this reduction was the fall in interest rates on variable-rate mortgages, making them more attractive to households; on the supply side, difficulties encountered by banks in recent months in obtaining long-term funds may have induced them to limit their supply of fixed-rate mortgages.

The stagnation in lending is also due to banks' adopting a more cautious policy in lending to households and businesses. The Italian banks participating in the Bank Lending Survey reported that in the fourth quarter of 2008 lending conditions tightened somewhat, while firms' demand for credit was basically stagnant. Between September and December, existing credit lines were reduced by 1 per cent in the face of a virtual standstill in actual lending.

The fact that banks are being more cautious in lending reflects difficulties in the funding markets and the deterioration of customers' creditworthiness.

In 2008 fund-raising by Italian banks from non-resident intermediaries fell by almost 10 per cent. As funding from abroad dried up, banks responded by raising funds from households, in particular by selling bonds. This allowed overall fund-raising to continue to expand, but it did not prevent a sharp slowdown; the average growth rate fell from 11 per cent in 2007 to 5 per cent in 2008; in January the latter figure was confirmed.

In the same year, lending to the private sector grew more rapidly (7.3 per cent). Lending by large banks, which are more reliant on fund-raising abroad and more exposed to market strains, slowed sharply. Local banks, by contrast, maintained similar credit flows to those before the crisis, thanks in part to a greater inflow of funds.

The recession is impinging on the quality of credit. The ratio of new bad debts to total lending to firms is rising rapidly: at the end of 2008 it reached 2 per cent, the highest value since 1999, excluding the spike in 2003 when the Parmalat group collapsed. Preliminary data for the first two months of 2009 show a further increase in the number of customers having bad debts for the first time. The exposure of these customers to the banking system more than doubled compared with the same period in 2008.

Although it deteriorated slightly, the quality of credit to households remains high.

Private-sector debt is much lower in Italy than in other countries. Although higher than in the past, households' financial debt is 49 per cent of the sector's disposable income, as against more than 90 per cent for the euro area and about 150 per cent for the United Kingdom and the United States. Firms' financial debt is 75 per cent of GDP, compared with a euro-area average that is about 13 percentage points higher and ratios of 77 and 113 per cent respectively for the United States and the United Kingdom. Compared with the years before the 1993 recession, Italian firms appear to be in a sounder financial position today. At the end of 2007 the leverage ratio, calculated on the balance sheets of more than 50,000 firms, was about 50 per cent, 7 percentage points less than at the beginning of the 1990s. Above all the proportion of financial costs covered by internal sources of financing is higher today.

In the eighteen months of the crisis the major Italian banks have suffered smaller losses than those of other countries thanks to their limited exposure to toxic assets and strong roots in traditional banking activity, the prudence of the regulatory and supervisory framework, and the less pronounced indebtedness of their customers.

For the leading banking groups structured credit instruments are less than two per cent of their balance sheet assets. Investments in the most complex securities are a tiny proportion of the total.

The capital of our banks, which, in contrast with developments in nearly all the other leading countries, has not yet benefited from public recapitalizations, remains above the minimum regulatory requirements. The leverage ratio of the leading Italian banking groups

– a simple indicator that avoids the complicated risk-weighting of assets required by the Basel 2 rules – is considerably lower than that of the main European banks.

The proportion of hybrid capital instruments, the least robust component of tier 1 capital, is small because the Bank of Italy has applied limits that are much more stringent than the relevant international standards. It follows that even when measures of "tangible" capital are adopted, the judgement on the solidity of Italian banks does not change. In line with international practice, the calculation of Italian banks' regulatory capital excludes the book value of goodwill, an item that in present market conditions is subject to considerable uncertainty. Accordingly, any impairment of this item would not affect banks' regulatory capital.

The market's assessments nonetheless consider the possibility that a further strengthening of the banking system may be necessary. Banks must prepare to cope with the risks, already materializing, associated with the rapid deterioration in economic conditions. A fundamentally sound model of intermediation has so far sheltered them from the worst effects of the financial crisis; it cannot make them impermeable to the global recession. Capital strengthening, including by means of the instruments made available by the state, is a condition for maintaining the ability of the banking system to provide the economy with credit.

In 2009 banks' gross income will continue to contract, after an estimated fall of about 5 per cent in 2008, despite the still substantial growth on the order of 8 per cent in net interest income. As in the past it is likely that the decline in economic activity and interest rates will have a negative impact on interest income. According to econometric estimates, a one percentage-point reduction in GDP would lead to a 0.7 percentage-point contraction in net interest income; that produced by a one percentage point fall in money-market interest rates would be much larger, on the order of 3.5 percentage points.

On the international front, the balance sheets of Italy's leading banks are weighed down by their exposures to some Central and Eastern European countries, which are suffering from the particularly serious repercussions of macroeconomic imbalances accumulated in the past. According to BIS data, in September 2008 the Italian banking system's exposure to these countries amounted to just over €150 billion, or 5 per cent of the system's total assets. More than 70 per cent of the exposure is to five countries (Poland, Croatia, Russia, Hungary and Slovakia). The situation is being carefully monitored by the Bank of Italy. At European level, the political will and the instruments exist for intervention to prevent regional crises if necessary.

From the end of September up to yesterday the share prices of the major Italian banks fell on average by more than 50 per cent, in line with the fall recorded by the leading European banks. The share prices of international banks did not benefit from the recapitalization measures adopted abroad.

In the same period major Italian banks' credit default swap premiums, which started from low levels by international standards, rose by about 70 basis points to about 180 basis points, a figure that is analogous to that obtaining yesterday for the corresponding European index. The premiums payable on credit default swaps are influenced by significant variations in the liquidity of these contracts.

I have noted on several occasions that from the beginning of the turmoil in summer 2007, the Bank of Italy stressed how essential it was for banks to ensure adequate control of liquidity risk. Enhanced monitoring, moral suasion and specific interventions had a rapid and significant impact; they enabled Italian banks to address the worsening of the financial crisis last September with balanced liquidity conditions, which allowed them to emerge from the most acute phases without incident.

Supervisory activity, participation by the Bank of Italy in the collective decisions and actions of the Eurosystem, providing support to the Government and Parliament in the preparation of measures aimed at restoring confidence in the markets – to which I will return shortly – were accompanied by numerous initiatives taken directly by the Bank in the performance of its monetary functions and to alleviate specific difficulties. I have reported on this in detail elsewhere. I wish to recall in particular the swap transactions whereby some of the highest quality securities in the Bank of Italy's portfolio were made available to banks against securities not eligible as collateral for refinancing, in order to strengthen their ability to access these operations with the Eurosystem at times of tension. The swaps were activated from 16 October onwards.

The strong capital base of Italy's central bank has been of great importance in recent months. It enabled us to plan and implement the interventions we believed necessary to support systemic liquidity promptly and for significant amounts, without jeopardizing the Bank's balance-sheet.

While less tense than a few months ago, conditions on the interbank liquidity market are still far from normal. There continues to be a need for initiatives to rebuild confidence and revive trading.

On 2 February trading commenced on the new Collateralized Interbank Market (MIC), a joint initiative by the Bank of Italy, the Italian Banking Association and e-MID SIM S.p.A., the company that operates the e-MID electronic interbank market. Participating banks are given the opportunity to execute transactions with medium-term maturities, in conditions of anonymity and sheltered from credit and liquidity risks. The Bank of Italy evaluates the collateral deposited by the participants and ensures prompt settlement of transactions in the event of default by a counterparty; the banks themselves, which are called on to bear some of the cost of an eventual failure, contribute to the proper functioning of the system on a mutualistic basis. The collateralized market is open not only to Italian banks but also to other European banks that meet the same requirements, subject to an agreement with their home central banks. The volume and prices of trades are satisfactory. Between the first and sixth weeks of activity average daily trades rose from €50 million to €318 million and outstanding deposits reached €2 billion. For maturities of one and two weeks, the most traded by banks, the interest rates on the collateralized market have been consistently lower than those on the uncollateralized market, between 10 and 30 basis points on average per week; on the same contracts the bid-ask spread for the best quotes in the MIC order book have fallen progressively, from 5 basis points to 1 basis point, testifying to increasing market liquidity.

In all the main countries the authorities took steps to support the financial system. In Italy the Government and Parliament, with the technical support of the Bank of Italy, adopted a set of measures to protect depositors, support banks' liquidity and capital, and reinforce their ability to finance economic activity. The provisions, which were adopted under the emergency decree procedure, were ratified by Laws 190/2008 and 2/2009. I believe it is useful to recall their main points.

In a first measure (Decree Law 155/2008, ratified by Law 190/2008), retail banking deposits were granted a state guarantee. The guarantee supplements the insurance provided by the previously existing interbank funds. The measure was important to reassure savers when market anxiety levels were most acute.

A second set of measures, contained in Decree Law 157/2008, empowered the Ministry for the Economy and Finance to grant a state guarantee on new bank liabilities with a residual maturity of between three months and five years, guarantee entities that offer banks securities eligible for use in refinancing operations with the Eurosystem, and supply government securities to banks in exchange for newly issued liabilities (this is in addition to the Bank of Italy asset swap transactions recalled earlier). All these measures serve to guarantee banks access to a sufficient supply of liquidity, in order to ensure that the normal operation of the lending and payments system is never interrupted, even in conditions of serious turbulence. Together with the interventions by the monetary authorities, the announcement of these measures helped ease tensions on the interbank market in the autumn.

Thirdly, to deal with potentially difficult situations, Decree Law 155/2008 authorizes the Treasury to subscribe capital increases of banks facing a situation of capital inadequacy ascertained by the Bank of Italy. The Government shareholding takes the form of non-voting preference shares; such public intervention is subject to the presentation of a restructuring plan assessed by the Bank of Italy.

Lastly, Decree Law 185/2008 (ratified by Law 2/2009) authorizes a financial intervention by the state to increase the capital of fundamentally sound banks. In this case it is not a question of rescue operations, but of a measure to strengthen the system and, in a macroeconomic environment that has deteriorated sharply, to avert a perverse spiral between loan defaults and credit restriction. The state intervenes by taking up financial instruments issued by banks. These can be counted for prudential purposes in core tier 1 capital, because both their remuneration and their value depend on the issuer's profitability and capital adequacy, and they may therefore be used to absorb possible losses in all circumstances. Applicant banks must adopt a code of ethics, including with regard to executive compensation, and undertake to sustain the financing of customers, particularly households and small and medium-sized enterprises. This commitment has been appropriately defined, taking into account the level of the demand for loans and the need to maintain standards of prudent credit allocation.

The measure has been made operational by a decree of the Minister for the Economy and Finance. The Bank of Italy has given banks the necessary technical guidance. The economic terms of the issues must comply with the guidelines established by the European Union; several alternative schemes have been defined, partly at the request of the Bank of Italy, to make adherence to the plan more advantageous for banks that intend to redeem their instruments within a relatively short time. The terms of the Italian instruments are in line with those offered by other European countries. I expect banks to make use of them in suitable amounts.

The recapitalization law also provides for monitoring the transactions and their effects on the economy and institutes special observatories at prefectures, with the participation of the interested parties. The Bank of Italy will supply the Ministry for the Economy and Finance with data and analyses on the evolution of credit and borrowing costs on a regional basis, as an additional supplement to the ample geographically disaggregated data already released in its publications. The statistical information will allow any specific situations of tension to be identified.

It is essential that analysis of credit conditions at local level not stray into a role of pressuring banks, prompting them to relax the standards of sound and prudent management in the selection of borrowers. In my opinion, political and administrative interference in assessments of individual cases of creditworthiness must be avoided. Lending is and must remain an entrepreneurial activity, based on a prudent, professional evaluation of the validity of companies' plans. Sooner or later, imprudent banks end up in distress and also cease lending. But the test posed by the crisis is severe and requires the ability to be good bankers even when the economy is doing badly. The inevitable deterioration in loan quality due to the recession calls for far-sighted choices: just keeping the accounts straight is not enough. Firm support for creditworthy customers prevents an excessive credit squeeze, which would aggravate the recession, thereby worsening the position of banks' customers. As I have already said, every opportunity must be taken to strengthen the capital of banks, choosing the most appropriate form in each case: recourse to the market, retained earnings, or the instruments offered by the state.

The restoration of confidence in the banking system is a global, not a national question. In my view, four conditions are essential. First, the uncertainty still surrounding the value of the most troubled assets on banks' balance sheets must be dispelled; this must become an integral part of public interventions in support of the financial system. It is indispensable, especially in Europe, that similar measures be based on common principles, in order to avert competitive disparities between intermediaries of different countries and between banks exposed in differing degrees to the problem of impaired assets.

Second, in determining recapitalization objectives, it is vital that the definitions of bank capital be the same at international level.

Third, the authorities have made it clear that they intend to protect all systemically important institutions, endow them with the capital needed to face stress conditions, protect depositors and have the shareholders alone bear any losses. To all intents and purposes banks' other creditors are protected against losses. This must be explained with absolute clarity; it is the only way to drastically reduce the risk premiums that the markets are still demanding on bank liabilities.

Fourth, it is time to go beyond dealing with the problems inherited from the past and consider how to ensure the availability of credit from now on. Recapitalizing banks is necessary to this end, but it is not sufficient; there is a need to think about new, even unconventional instruments.

This last point is especially pertinent for Italy, where neutralizing the complex financial instruments whose value has plunged is of limited relevance and finding instruments that directly affect the availability of loans for firms and households is more important.

One possibility would be the issuing of public guarantees for the senior tranches of pools of new loans, with a view to reviving an important channel of financing, loan securitization, that has completely dried up today. If banks are able to sell part of their loans on an active and liquid secondary market, they can use the liquidity obtained to reactivate the supply of credit.

A scheme of this kind would have to be carefully designed in order to ensure its effectiveness in terms of new lending, give banks a correct structure of incentives and minimize the costs to taxpayers. The originator bank should retain some of the risk, thereby still having the incentive to select creditworthy borrowers; it should pay a suitable fee for the issue of the guarantee, commensurate with the quality of the underlying loans. Limiting the public guarantee to the least risky portion of the pool of securitized loans keeps the state from being assigned an inappropriate role in the assessment of creditworthiness. Objective criteria could be established for selecting loans of good quality (for example, mortgages with a loan-to-value ratio not above a given limit and loans to small and medium-sized firms backed by the Guarantee Fund for Small and Medium-Sized Enterprises), so as to encourage subscription of the entire pool of securitized loans by the market and limit the possible cost to taxpayers.

Some features of the tax treatment of banks and other intermediaries in Italy that lack a clear economic logic and produce a competitive disadvantage with respect to other countries should be reconsidered.

Value adjustments to loans are deductible from taxable income each year only up to 0.3 per cent of a bank’s total outstanding loans; writedowns exceeding that amount are deducted over a period of eighteen years. The limit and the rules on the writedown period have been tightened repeatedly in recent years. It is difficult to see the economic justification or to find comparable provisions in the other major European countries. In France, Germany and the United Kingdom, value adjustments are tax-deductible on a loan-by-loan basis, in line with those stated in the accounts; in France and Germany, flat-rate allocations to provisions are also allowed. The penalization of Italian banks is pro-cyclical, because the burden is greater during cyclical downturns, when loan losses increase; at present, the mechanism is exerting a disproportionate impact on the credit system.

In banks accounts, the limit on the deductibility of value adjustments results in an advance payment of taxes, in essence a tax credit. At the end of 2007 this credit amounted to some €4 billion; for 2008 it comes to €1.4 billion. Writedowns are also non-deductible for the regional tax on productive activities (IRAP) and thus diminish profit. The total impact of these deduction limits on banking profit amounts to some €400 million yearly.

A loss always becomes fully deductible when it is realized – if the debtor is in bankruptcy proceedings; otherwise, the revenue agency can object that the loss is not “certain and precise,” with the risk of an ensuing tax dispute. This risk affects the cost and availability of credit. In the present phase, during which loan losses will presumably increase, it would be advisable to diminish, as much as possible, the causes of regulatory uncertainty and hence the tax risks for the system.

Starting with 2008, a portion of banks’ interest expenditure (currently 4 per cent) is no longer deductible from corporate income tax or the regional tax on productive activities. The ceiling also applies to transactions on the interbank market, thus constituting a drag on its operations. For a bank, interest expenditure is what the cost of raw materials is for any other business. Neither the United States nor the main European countries have any equivalent rule. Also starting last year, administrative expenses and depreciation are only 90 per cent deductible for purposes of IRAP, while dividends are exempt for 50 per cent of the amount received. These limits are specific to the financial industry and do not apply to other enterprises. Official estimates put the total cost of the non-deductibility of interest expenditure this year at €1.1 billion, a quarter of this due to interbank transactions.

This year, the VAT exemption on auxiliary services provided within a banking group is abolished. The exemption reduced the cost to banks of the non-deductibility of VAT on purchases of goods and services and made up for Italy's lack of the "group VAT" regime, which in many other European countries avoids the application of VAT to intra-group transactions. It is desirable that Italy institute the "group VAT" regime envisaged by the Community directive, thus coming into line with the other main EU member states.

Considering that government estimates put the additional cost of the non-deductibility of VAT at €400 million a year, the overall reduction in banks' net profits due to these specific direct and indirect tax measures will be nearly €2 billion this year.

High taxes mean less self-financing, less capital, less lending capacity.

A bank's good name, the basis of a solid relationship with customers, is always a precious asset, and all the more so in times of crisis. Safeguarding and enhancing the banking system's reputation requires irreproachable conduct in practice, no less than strict rules.

Transparent and correct relations with customers protect consumers. They spur competition, ensuring full comparability of products. They are an important part of sound and prudent bank management, because they reduce reputational and legal risks. They safeguard the stability of the system.

It is the responsibility of Consob to oversee the transparency and correctness of those who offer financial products and investment services to the public. For typical banking transactions, the law assigns such supervision to the Bank of Italy. This activity has been stepped up in recent years. We have set up a special unit to monitor banks' relations with customers. We have drafted a radical revision of the regulations under our jurisdiction. Tomorrow, public consultation will begin, using the Internet, on two major proposals: one for the practical institution of the new procedure for out-of-court settlement of disputes between banks and customers; the other for new provisions, designed in part through discussions with associations of banks, other intermediaries and consumers, to make the protections for correctness in dealings with customers more effective. With these new rules we intend to make the documents for customers clearer, more concise and comparable. The instruments governing the most common products, mortgage loans and current accounts, will be especially incisive.

For some time now we have intensified our controls. As far as it is within our power, we have directed them to substantial and not merely formal compliance with the rules. In the last three years we have performed checks at 452 intermediaries and more than 2,300 branches. Where we have found specific violations of the rules on notifying the public of the conditions offered, we have initiated sanction procedures (a total of 49, 11 of which have concluded with the levying of sanctions). In 206 cases, though the grounds for formal sanction were lacking, we called upon the intermediary to comply more closely in substance with the rules; we asked for the introduction of organizational arrangements and internal controls to guarantee better customer relations. Where necessary, intermediaries were required to refund sums of money unduly collected from customers and report on this to the Bank of Italy. Recently we have extended our controls to banks' websites, in order to make sure that on-line customers have protection equivalent to that enjoyed by those using the traditional branch network.

Bank customers often write to the Bank of Italy to report what they consider to be incorrect conduct. We receive nearly 6,000 letters a year. In every single case we respond to the writer and ask the bank involved to explain its position, providing a clear answer and reporting it to us. Where necessary, we take the appropriate supervisory measures.

On mortgage loans, we have reminded intermediaries of the need to join in the interbank procedures for loan portability. Recent rules changes now allow sanctions for non-compliance. On current accounts, we conduct an annual sample survey of banks' terms and conditions, whose results will be presented in our Annual Report.

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The crisis has highlighted the need to correct some significant features of the international financial architecture. More robust capital requirements for banks together with measures to counter their pro-cyclical effects; limits on excessive leverage for financial institutions; the extension of prudential rules to segments of financial business that in some countries have largely escaped coverage; strengthening the role of central banks in guaranteeing the macroeconomic aspects of stability – these are the most important elements of a radical and expeditious programme of revision that has been set in motion with a speed and a degree of international cohesion that would have been unthinkable a short time ago.

The need for strong global coordination is evident and universally recognized. The major emerging countries have taken a larger role in the governance of the financial system. This is not just a matter of fairness; it is a requisite for effective intervention.

I do not intend to dwell on these themes here. But I would like to stress that improved supervisory coordination is essential above all at European level, if we want to preserve the benefits of the single capital market. There is growing support in Europe for bold solutions involving the sharing of some regulatory and supervisory functions. The new European supervisory architecture will not dispense with the wealth of knowledge, expertise, and familiarity with the market built up by national supervisors: it will need to capitalize on these assets within an integrated framework. The experience of the European System of Central Banks shows that this route can be taken successfully.

The recent report of the high-level De Larosière Group of experts points in this direction. In particular, I should like to underscore its attention to macroprudential supervision, to be assigned to a central body; the stress on the harmonization of rules and supervisory standards; and the call for Community coordination of the “colleges” that exercise supervision over the large European banking groups. The decision-making processes of the system, the powers and responsibilities of European and national supervisors, have to be designed with care. The European Commission’s intention to proceed with all necessary speed is commendable.