



BANCA D'ITALIA
EUROSISTEMA

Report to Parliament and to the Government

Rome, November 2012



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NOTICE

Unless otherwise indicated, data are processed by the Bank of Italy. No source is cited when the data come from the Bank itself.

PREFACE

The *Report to Parliament and to the Government* outlines the Bank of Italy's activities in 2011 as a participating institution in the European System of Central Banks and the Eurosystem, charged with overseeing the sound and prudent management of financial intermediaries and financial stability, and as a supplier of services to financial intermediaries, government entities and the general public.

The document is part of the body of information that the Bank disseminates with its Annual Report, Economic Bulletin, monthly Supervision Bulletin, Financial Stability Report and with the transcripts of testimonies by representatives of the Bank of Italy before Parliament. As far as possible, any overlaps between this Report and the other publications have been avoided through cross-referencing.

In publishing this document the Bank of Italy fulfils its obligations under Article 19 of Law 262/2005, as amended by Legislative Decree 303/2006 and, as regards the supervision of banks and non-bank financial intermediaries, under Article 4 of Legislative Decree 385/1993 (the Consolidated Law on Banking).

OVERVIEW

In 2011 the Bank of Italy's activity was strongly conditioned by the effects of the financial crisis in Europe and Italy. The Institute operated within its areas of competence and in accordance with its prerogatives on several plans to combat the crisis, both nationally and within the European Union and the Eurosystem, in a context posing new considerable risks.

The external environment

This Report gives a detailed overview of the Bank's role in:

- the conduct of monetary policy, to withstand the tensions over sovereign debt, transmitted to the banking system and the source of a persistent liquidity crisis (Chapters 1 and 2);
- banking and financial supervision, to deal, including at systemic level, with risks stemming from the macroeconomic context and the turbulence in financial markets (Chapters 3 and 4);
- economic research, to support decisions taken by the political and monetary authorities (Chapter 5).

The Bank continued to implement its programme of organizational improvement, setting itself the following strategic objectives for the three years 2011-13: effective internal and external communication, a growing commitment to social responsibility, changes in corporate management practices to increase efficiency by exploiting new technology (Chapter 6).

The monetary policy interventions enacted by the Bank of Italy in the context of the Eurosystem were aimed primarily at combating tensions over liquidity stemming from the sovereign debt crisis, which had grave repercussions on fundraising activities by credit institutions. Using a combination of instruments, over the course of the year substantial doses of liquidity were injected into the market, compensating for the decline in deposits and sustaining the flow of credit to the economy. The measures included the two programmes for the outright purchase of securities on the secondary market and of covered bonds, securities lending, the three-year bank refinancing operations, and the extension of the range of eligible collateral.

Monetary policy

Amplified by the crisis, liquidity risks were closely monitored by the Bank of Italy through greater recourse to quantitative indicators, with a view to ensuring the correct functioning of the monetary policy transmission mechanism and the

activation of emergency contingency measures; the examination of these risks also contributed to the financial stability analyses.

The public debt

The adverse economic conditions affected the public debt issuance policy, defined by the Ministry for the Economy and Finance including on the basis of the information supplied by the Bank, and the debt management activities it conducts on behalf of the same Ministry (placements, government debt swaps and buy backs, debt service). All the auctions held in 2011 recorded a positive outcome. March 2012 marked the first ever issuance of BTP Italia, treasury bonds with innovative characteristics, including indexation to Italian inflation and the payment of a premium on redemption to natural persons holding the bonds to maturity. The Bank was involved in the placement and settlement of the BTP Italia issuance and will provide the related financial service, as it does for the other public debt securities.

Currency reserves and euro denominated assets

The Bank of Italy administers the country's official reserves, which are an integral part of those of the Eurosystem, and holds a financial portfolio denominated in euros, which includes investments of balance-sheet provisions and reserves. Notwithstanding the heightened volatility on the markets, in 2011 the Bank continued to alter the composition of its financial assets in favour of a longer-term orientation. These measures raised the riskiness of the Institute's financial assets: during the year, the new system of integrated risk control came on stream, based on the combined assessment of risks relating to official reserves, the financial portfolio, monetary policy operations and the maintenance of financial stability.

Supervision and financial oversight

Activities in the field of banking and financial supervision aimed to assess the impact of the deteriorating macroeconomic context on the evolution of risks and the adequacy of the capital and organizational safeguards adopted by intermediaries. Special attention was paid to the quality of loan assets and, in the context of financial risk, to exposure to interest rate and liquidity risk.

The negative economic phase influenced the technical assessment of intermediaries, whose average evaluation by the Supervision Area declined with respect to the previous year. In particular, the assessments of lending profiles (confirmed as the risk component carrying most weight), profitability and liquidity risk all deteriorated, while banks' financial situations maintained the best score, above all thanks to the capital strengthening operations undertaken beginning in early 2011.

Regarding the prudential oversight of international banking groups for which the Bank is home supervisor, considerable efforts were made to strengthen cooperation with the European supervisory authorities concerned, through information sharing on methodologies, the streamlining of processes and the coordination of initiatives to support joint decisions on the overall risk and capital adequacy of the groups and their members.

The Supervisory Area kept the evolution of loan quality under close scrutiny, verifying that intermediaries adopted adequate instruments of supervision and control, as well as consistent credit assessment policies. Turning to income, banks were urged to review strategic policies, including with a view to seeking margins

of improvement in operational efficiency and rationalizing organizational costs. Controls on the liquidity conditions of intermediaries displaying signs of tension were also intensified. Particular emphasis was assigned to governance structures and the effectiveness of control systems.

The supervisory rules and controls, aimed at preventing the assumption of excessive risk, made a significant contribution to the notable progress achieved by Italy's banks on capital strengthening.

The Bank placed special emphasis on the substantive correctness of bank-customer relations, including through cooperation with the other authorities in the sector.

The Institute also helped draft more stringent principles for the control of financial market infrastructures and intensified its supervision of market management companies and of security settlement services.

In addition to conducting numerous studies of the sovereign debt crisis and its repercussions on Italy's economy, the Economic Research Area examined several major factors influencing the country's growth potential, such as the economic imbalances between the South and Centre North, deteriorating competitiveness in the North East, obstacles to the planning and completion of infrastructures, and gender gaps. Through the perspective of 150 years of history, an investigation was also conducted into the Italian economy's ability to respond to changes in the international scenario in the long term.

Economic research

In 2011 research into monetary policy and the economic situation in Italy and in the euro area focused on manufacturing activity in Italy and on the transmission of the tensions over sovereign debt to bank rates and the financial markets.

Changes in human resource management (in recruitment processes and career structures), the generalized use of information technology, investment in tools for internal (Intranet) and external (Internet, social networks) communication, have the shared objective of enhancing the day-to-day running of the Institute and ensuring the quality of the services provided.

Human resource management

Account was also taken of the intensive cooperation and exchange of views with national and especially international institutions (first and foremost, with the Bank's European partners).

The decline in staff numbers (6,990 in 2011) is the result of a rationalization of the organizational structure that was begun in past years and has been consolidated in the last two years.

The reorganization of the branch network, among the most striking aspects of this process, has altered the Bank's national profile (today it is present in 64 provincial capitals, including the 6 delocalized supervisory units) and has separated the Bank's operations, competences, and the provision of services (to General Government, the financial system, and the public).

Taken together, these measures have enabled the Bank to enhance its efficiency, flexibility, and readiness in potentially critical situations, and to manage risks thanks to an effective system of internal controls.

Attentiveness to procedural efficiency has helped keep running costs down, which in turn has contributed to the positive economic results, owing primarily to investment activities. The increased risks associated with lending have determined a prudent provisioning policy. Net profits in 2011, equal to €1.1 billion, were assigned by the Board of Directors to the ordinary and extraordinary reserves and to the State in the proportions of 40 per cent and 60 per cent, respectively.

1. THE BANK OF ITALY IN THE EUROSISTEM

1.1 Managing monetary and exchange rate policy

The Bank of Italy conducts monetary policy operations with banks working in Italy and contributes to defining the framework for Eurosystem monetary policy implementation.

In 2011 the Governing Council of the European Central Bank (ECB) changed the official interest rates for monetary policy on four separate occasions.¹

The system of fixed-rate tenders with full allotment of the amounts requested was maintained throughout the year for all refinancing operations.² In the second half of the year the Eurosystem introduced further unconventional monetary policy measures to support banks' liquidity and safeguard the operation of the monetary policy transmission mechanism.³

A six-month refinancing operation was conducted in August and the Securities Markets Programme, or SMP, consisting of definitive purchases of securities on the secondary market, was resumed.⁴

In October a one-year refinancing operation was conducted.⁵ At the same time a second programme of purchases of covered bonds was announced (see box "The programme of covered bank bond purchases and securities lending").

The changing
operational framework
of monetary policy

¹ See Chapter 7 "La politica monetaria comune" in *Relazione sull'anno 2011*, Banca d'Italia, 2012.

² This system was adopted in October 2008 in place of the multiple price auction system when the financial crisis was further aggravated by the collapse of Lehman Brothers. The rate applied to longer-term refinancing is equal to the average rate on main refinancing operations over their life.

³ See the relevant section of Chapter 7 "Le operazioni di politica monetaria" in *Relazione sull'anno 2011*, Banca d'Italia, 2012.

⁴ At the end of 2011 the Eurosystem's purchases under the Securities Markets Programme amounted to €211 billion. Purchases during 2011 amounted to about €145 billion (see the box "Il Securities Markets Programme" in *Relazione al Parlamento e al Governo*, Banca d'Italia, 2011).

⁵ Only the first of the two one-year operations announced in October actually went ahead. The second one was replaced by the first three-year operation. Moreover, the ECB allowed the single counterparties to transfer the financing obtained at the one-year auction to the three-year operation.

THE PROGRAMME OF COVERED BANK BOND PURCHASES AND SECURITIES LENDING

The second Covered Bond Purchase Programme, CBPP2, will entail purchases totalling €40 billion, which will be added to the €60 billion under the first programme. The new programme was launched in November and is expected to continue until October 2012. Its objective is to improve funding conditions for banks and firms.

Bonds will be purchased on both the primary and the secondary market; the Bank of Italy has been assigned around €6.9 billion. In May 2012 the Bank's portfolio of covered bank bonds amounted to about €11 billion, of which €9 billion from the first CBPP.

Acting within the scope allowed by the Eurosystem, the Bank of Italy has launched a securities lending programme designed to put the securities purchased on the market for a limited time in order to provide liquidity support. The service is managed by specialized intermediaries offering two automatic programmes: lending of market securities backed by bonds with at least an A+ rating and full coverage to ensure settlement. Securities lending represents the bulk of this activity.

The average daily amount of loans rose from about €400 million in January 2011 to €1,300 million in December.

In November, as part of a series of coordinated interventions by the leading central banks,⁶ the cost of US dollar refinancing operations was reduced and the three-month operations were extended, along with the weekly operations re-introduced in May 2010.⁷

In December the ECB Governing Council took further steps to support the activity of the banking industry and the smooth functioning of the money market.⁸ It was decided to conduct two three-year longer-term refinancing operations (see box "The three-year refinancing operations"), to broaden eligibility requirements for collateral,⁹ to lower the reserve ratio from 2 to 1 per cent, and to suspend fine-tuning operations to drain liquidity on the last day of the reserve maintenance period.

In 2011 the Eurosystem carried out 134 refinancing operations, against 124 in 2010 (Table 1.1). Eurosystem liquidity-absorbing fine-tuning operations totalled 64, compared with 45 the year before.

⁶ The central banks taking part were: Bank of Canada, Bank of England, Central Bank of Japan, Swiss National Bank and ECB. The measures included the creation of a temporary bilateral swap line between the single central banks.

⁷ Three three-month refinancing operations in US dollars were announced on 15 September 2011.

⁸ For an analysis of the effects of these measures, and particularly the two three-year refinancing operations, see the box "The effects of the three-year refinancing operations", *Economic Bulletin*, Banca d'Italia, April 2012.

⁹ See the box "Measures to expand collateral in Eurosystem operations", *Financial Stability Report*, Banca d'Italia, April 2012.

THE THREE-YEAR REFINANCING OPERATIONS

The ECB Governing Council announced, at its meeting on 8 December 2011, two forthcoming three-year longer-term refinancing operations. The operations were conducted on 21 December 2011 and 29 February 2012 via an auction mechanism with fixed rate tenders¹ and full allotment of the amounts requested. Both operations allow the option of early repayment of all or part of the amount borrowed: about one year after each operation², in conjunction with the settlement of any main refinancing operation, intermediaries may repay even part of the amount requested at the three-year auction.

At the first three-year operation the Eurosystem assigned €489 billion to 523 counterparties. A total of about €1,019 billion was allotted to the European banking system through these two operations. The loans that the Bank of Italy provided to its counterparties amounted €116 billion and €139 billion respectively.

¹ The interest rate is equal to the average rate on main refinancing operations conducted during the life of the respective operations.

² From 30 January 2013 for the first operation and from 27 February 2013 for the second.

Table 1.1

NUMBER AND TYPE OF EUROSYSTEM OPERATIONS

	Main refinancing operations	Longer-term refinancing operations					Fine-tuning operations		Refinancing operations in dollars	Dollar swaps	Swiss franc swaps	Total
		Special Term (1)	3-month	6-month	1-year	3-year	Refinancing	Deposit				
2010	52	12	12	2	–	–	4	45	38	–	4	169
2011	52	12	12	1	1	1	4	64	54	–	–	198
Jan-May 2012 ..	22	5	5	–	–	1	1	22 (2)	28	–	–	62

(1) Operations with a maturity equal to the length of one maintenance period. – (2) Since the last maintenance period of 2011 no operations to drain excess liquidity have been conducted on the last day of the period.

The Bank of Italy's share of total Eurosystem refinancing operations rose steadily from a daily average of 8.5 per cent in the first half of 2011 to 18 per cent in the second half.

Operations to drain liquidity injected through the Securities Markets Programme continued throughout the year.

During 2011 the foreign exchange operations of the Bank of Italy were conducted mainly in connection with general government currency transactions, including for the servicing of Italy's debt. Other operations were carried out for the purpose of altering the size and composition of the Bank's foreign currency reserves.

The Bank provided for the daily publication of the exchange rate quotations of all currencies against the euro and the US dollar.

Foreign exchange transactions

Eurosystem initiatives regarding risk management

In 2011 the Eurosystem examined the situation regarding the risk management of asset-backed securities (ABS). In March the second-best-rating rule came into force, which requires ratings to be provided by at least two agencies. In December ABS with at least a single A rating and backed by residential mortgages or loans to SMEs were accepted for use as collateral in monetary policy operations.

It was also decided to accept as collateral, in addition to claims eligible under the Eurosystem's general rules, other performing credit claims meeting criteria set by the single national central banks (see the section "Collateral"). At the same time the Eurosystem took steps to reinforce its internal credit risk assessment capabilities and increase the number of external credit assessment institutions.

In respect of refinancing operations in dollars and the announcement of operations in Canadian dollars, Swiss francs, yen and sterling, the Eurosystem drew up measures to protect itself against the financial risks, particularly the exchange risks, involved in acquiring collateral in euros. During 2011 rules were also introduced for the implementation of the second programme of covered bank bond purchases, listing the eligible securities and qualified counterparties.

1.2 Liquidity

In the first half of 2011 the amount of liquidity injected in the euro-area economy through monetary policy operations averaged around €590 billion, about €160 billion less than in 2010. The amount grew steadily from July onwards, reaching a peak at the three-year auctions. The excess liquidity continued to mount up, as evidenced by the increase in overnight deposits with the Eurosystem from a daily average of €30 billion in the first half of the year to €173 billion in the second.

The minimum reserve requirement

The Bank of Italy continued to perform the tasks assigned to it regarding the minimum reserve requirement, calculating the amount due by each credit institution resident in Italy and applying the penalties laid down by the Eurosystem for non-compliance.

At the end of 2011, 745 monetary and financial institutions operating in Italy were subject to the minimum reserve requirement; 76 per cent of them used intermediary banks to meet it. During the year the average daily amount of the deposits was €25 billion, equal to 12 per cent of the total reserve requirement of euro-area banks. Eight cases of non-compliance were recorded, compared with 11 in 2010.

In order to facilitate the management of banks' liquidity, in January 2012 the ECB reduced the minimum reserve ratio from 2 to 1 per cent.

Supervision, analysis and management of liquidity risks liquidità

Liquidity risk analysis is an integral part of the steps taken by the central banks to ensure the smooth operation of the monetary policy transmission mechanism and the adoption of emergency measures in the event of a crisis. The financial stability analyses conducted by the NCBs also contribute.

As the liquidity problems caused by the sovereign debt crisis worsened, increasing use was made in 2011 of indicators of the performance of eligible assets, of liquidity traded in the interbank markets, of the net foreign position of the banking system and of leading banks, of changes in the banks' excess reserves and of their counterparty risks. The analyses were included in the material used to draw up the *Financial Stability Report* and at meetings of the committee to safeguard financial stability.

Within the Eurosystem, the Bank of Italy helps to coordinate extraordinary liquidity support operations. It is important to ensure that extraordinary operations, which are carried out by the NCBs, conform with the single monetary policy and do not violate the prohibition against monetary financing.

The Bank examined banks' requests for government guarantees of banks' bond issues, evaluated their liquidity situation and monitored the sector as a whole. At the end of May 2012, government-guaranteed bank bond issues numbered 258, for a total value of €86 billion.

1.3 Collateral

The exposure to the Eurosystem of banks operating in Italy increased from €48 billion in December 2010 to €222 billion a year later. During the same period the total value of the collateral posted rose from €102 billion to €277 billion.¹⁰

Collateral provided by Italian banks

As collateral increased, its composition changed dramatically, with the share of ABS falling from 57 to 22 per cent and that of bank loans from 25 to 15 per cent. At the same time, the proportion of government securities and of uncovered bank bonds both rose from around 7 to 25 per cent.

Following the December measures, in February 2012 the Bank of Italy extended the eligible collateral to include loans carrying a 0.4 (maximum threshold under the general rules) to 1 per cent probability of debtor default 1 year ahead. The loans offered as collateral may be temporarily risk rated using the Bank of Italy's internal credit assessment system. Three new types of loan were made eligible: leasing agreements, factoring without recourse, and loans guaranteed by the export credit insurance agency SACE.

The Bank of Italy's counterparties may offer as collateral securities held by a foreign centralized depository, using either the Correspondent Central Banking Model (CCBM) or a link between the foreign depository and the national one. In 2011 foreign securities of Italian banks deposited with the Bank of Italy averaged about €23 billion, €2 billion of which were offered through the CCBM and €21

Cross-border use of securities

¹⁰ See the relevant section of Chapter 20, "Le attività a garanzia", in *Relazione sull'anno 2011*, Banca d'Italia 2012.

billion transferred via links.¹¹ The average value of the collateral held by the Bank of Italy on behalf of correspondent foreign central banks was around €27 billion.

1.4 Management of the payment systems

The gross payments sector: TARGET2

In 2011 average daily payments settled in the TARGET2 gross settlement system increased in volume (from 343,400 to 348,500) and value (from €2,300 billion to €2,400 billion).¹² The number of participating account-holders banks was higher than the year before, mainly owing to the inclusion of Romania and the increase in the number of internet participants after this facility was introduced in November 2010. At present, some 80 ancillary systems also use TARGET2 to settle their positions.

The Eurosystem, working together with the market and the three central banks running the platform (Bank of Italy, Deutsche Bundesbank and Banque de France, 3CB), has begun to draw up the specifications of the changes needed to link TARGET2 to TARGET2-Securities (T2S).

Participants in the Italian section, TARGET2-Banca d'Italia, include 4 ancillary systems, 99 banks and more than 340 indirect participants. A further 122 banks keep accounts with the Bank of Italy outside TARGET2 in order to comply directly with the minimum reserve requirement and access standing facilities.

The volume of payments settled in TARGET2-Banca d'Italia was unchanged in 2011 at over 33,000 transactions per day. Since August 2011 there has been a reduction in the value of cross-border payments.

The TARGET2-Securities project

The T2S project made a major leap forward between January 2011 and May 2012, regarding both the contractual aspects (see box “TARGET2-Securities: an overview of the relevant agreements”) and the technical and operational aspects, with the publication of the technical specifications last October¹³ and the completion in March of 65 per cent of the software.

In 2011 the Bank of Italy, acting on behalf of the Eurosystem, issued a European call for tenders for two licences to be assigned to providers of value added connectivity services to the system. In January the two selected network providers, SWIFT and the consortium SIA-Colt, signed an agreement with the Bank of Italy for the provision of the services. The Eurosystem decided to use its existing CoreNet communication network to implement the “dedicated link” for participants wishing to connect directly to the system without going through the two providers.

¹¹ In 2011 the Collateral Central Bank Management (CCBM2) project entrusted to the central banks of Belgium and the Netherlands aimed to create a single platform for collateral management was suspended owing to technical difficulties.

¹² See Chapter 20, “Le infrastrutture del sistema dei pagamenti all'ingrosso e dei mercati monetario e finanziario”, *Relazione sull'anno 2011*, Banca d'Italia 2012.

¹³ See CIPA, *Piano delle attività in materia di automazione interbancaria e sistema dei pagamenti*, May 2012.

The T2S National User Group organised meetings with Italian financial market participants to explain the most important features of the project.

TARGET2-SECURITIES: AN OVERVIEW OF THE RELEVANT AGREEMENTS

The contract for the development and operation of T2S was signed on 20 July 2011. It sets out the reciprocal rights and duties of the Eurosystem, which owns T2S, and the central banks supplying settlement services for the platform (Bank of Italy, Deutsche Bundesbank, Banque de France and Banco de España, known together as 4CB).

With the signing of a memorandum of agreement between the Eurosystem and the majority of EU central securities depositories (CSD) in July 2009, negotiations began between the parties concerned; the process came to a close on 8 May 2012 when the Framework Agreement was signed, laying down reciprocal rights and duties. Nine CSDs, including four of the leading euro-area depositories (Monte Titoli, Clearstream Frankfurt and Iberclear), signed the agreement with the Eurosystem. The Governor of the Bank of Italy, as representative of the Eurosystem, signed the agreement with Monte Titoli. The other CSDs located in the euro area, including Euroclear ESES, are expected to sign the Framework Agreement by the end of June 2012. All the signatory CSDs will be eligible for the financial incentives offered by the Eurosystem.

In February 2012 the Eurosystem invited non-eurozone central banks to sign the Currency Participation Agreement (CPA) allowing securities transactions in their national currencies to be settled via T2S. The central banks of the United Kingdom, Switzerland, Sweden, Norway and Iceland decided not to sign up as their financial communities declared they were not interested in using T2S, mainly for reasons of cost. The central bank of Denmark announced it would sign the agreement but not until 2018 and subject to the possibility of settling transactions in Danish kroner. The Danish CDS signed the 8 May Framework Agreement for the settlement by T2S of transactions denominated in euros.

In October 2011 the ECB Governing Council moved to postpone the launch of T2S from September 2014 to June 2015 in order to incorporate several changes to its operation requested by the market.¹⁴

In 2011 the total value of transactions processed by the BI-Comp retail payment clearing and settlement system was €3,100 billion, an increase of 1.6 per cent on the previous year. The total number of transactions (2.1 billion) was 3.2 per cent higher than in 2010.¹⁵

**Role of the BI-Comp
retail settlement
system in SEPA**

¹⁴ See Chapter 20, “Le infrastrutture del sistema dei pagamenti all’ingrosso e dei mercati monetario e finanziario”, *Relazione sull’anno 2011*, Banca d’Italia 2012.

¹⁵ See Chapter 21, “I servizi di pagamento al dettaglio e il servizio di tesoreria statale”, *Relazione sull’anno 2011*, Banca d’Italia 2012.

In accordance with Eurosystem requirements for Single Euro Payments Area (SEPA) infrastructures, BI-Comp has had the capability to handle pan-European payment instruments (SEPA Credit Transfer, SCT, and SEPA Direct Debit, SDD) since their introduction.¹⁶ Participants can exchange such payments with other participants, as well as with intermediaries participating in other retail payment systems with which the Bank of Italy has interoperability arrangements. Currently, the Italian system is interoperable with the private Dutch system Equens for both SEPA instruments (SCTs and SDDs) and with Austria's Clearing Service International (CS.I) but only for SCTs. The Bank of Italy also offers BI-Comp participants an "intermediation" service allowing them to access the STEP2 retail payment system managed by EBA-Clearing in which the leading European banks participate. Currently, 35 Italian banks use the service. These measures ensure that the Italian system is compliant with Eurosystem requirements regarding the interoperability and reachability of SEPA intermediaries.

The Bank of Italy's applications centre

In 2011 further progress was made towards the creation of the Bank of Italy's clearing mechanism (Centro Applicativo della Banca d'Italia – CABI), designed to increase the functions offered by BI-Comp and meet the requirements of SEPA. The CABI will become operational in the summer of 2012 and will allow the Bank to manage independently the exchange of payment information in SEPA format between banks. The CABI will guarantee interoperability with other European systems and intermediation towards STEP2.

Declarations in lieu of protest

The Bank of Italy also issues, through the Rome and Milan clearing houses, declarations in lieu of protest in the case of non-payment of cheques issued without authorization or without funds and processed by the BI-Comp system. In 2011 the number of such declarations was over 105,500, (0.04 per cent of cheques debited), 17 per cent lower than in 2010, due to a generalized reduction in cheque use.

Correspondent arrangements and ERMS

The number of international bodies and central banks of countries outside the euro area to which the Bank of Italy provides European Reserve Management Services (ERMS) was virtually unchanged (23 correspondents at the end of 2011). Investments in securities and deposits totalled €5.5 billion, compared with €12.4 billion at the end of 2010. For the most part this decrease was due to the drop in foreign correspondents' securities held for safekeeping.

Funds belonging to the Libyan central bank, which had been frozen in compliance with the Council Implementing Regulation (EU) No. 233/2011 of 10 March 2011 implementing Council Regulation (EU) No. 204/2011 of 2 March 2011, were released and re-invested after the political and financial situation in the country had returned to normal.

Interbank data base of irregular cheques and payment cards

In 2011 the Bank of Italy, which processes data for the interbank database of irregular cheques and payment cards (CAI), handled some 8,800 requests made to its branches by people wishing to ascertain whether their name was on file.

¹⁶ SCTs were introduced on 28 January 2008; SDDs on 2 November 2009.

Work to verify the information provided by reporting institutions continued; in the past three years these efforts have led to an improvement in the quality of the data on file: the number of entries deleted has been reduced significantly, from 7 to 5 per cent of reports for cheques and from 4 to 2 per cent for cards. The database of people misusing payment instruments has consequently gained in importance. At the end of 2011, 76,160 people were registered as no longer authorized to issue cheques and 257,800 for issuing bank and postal cheques without funds or authorization; the total value of bad cheques was €1,065 million. At the same date, there were around 252,000 people registered for withdrawal of payment cards, 9.3 per cent less than in the previous year.

In 2011 cashier's cheques issued by the Bank of Italy decreased in number with respect to the previous year (from 315,000 to 202,000) and in value (from €3.1 billion to €2.0 billion). This was mainly due to the decrease in cheques for tax refunds issued by the revenue agency.

Cashier's cheques

In 2011 fee income from the services provided by the Bank amounted to €16.8 million, similar to the figure for the previous year. The largest contribution came from membership fees and transaction charges paid by participants in TARGET2-Banca d'Italia and other account-holders (totalling €6.4 million) and fees for declarations in lieu of protest (€4.4 million). Fee income from the CCBM fell from €2.9 million to €2 million as a result of a decrease in its use by the banks (see the section "Collateral"). Revenue from the ERMS for securities was almost halved (from €1 million to around €560,000), while that from time deposits with the Bank more than doubled (from €400,000 to over €1 million).

Revenues from the supplies of payment services

In 2011 changes were made to the structure of BI-Comp fees: the participation fee was increased (producing a revenue of almost €1 million in 2011), as were the unit fees for items presented to the clearing houses and for use of the STEP2 intermediation services.¹⁷

The Bank also received over €58 million from the Eurosystem NCBs as reimbursement of development and management costs incurred as supplier of TARGET2 and T2S.

1.5 Currency in circulation

The Bank of Italy contributes to the production of euro banknotes,¹⁸ which it then issues within the country. It is also currently taking part in preparations for

¹⁷ See Chapter 21, "I servizi di pagamento al dettaglio e il servizio di tesoreria statale", in *Relazione sull'anno 2011*, Banca d'Italia 2012.

¹⁸ The production of euro banknotes is allocated according to a system whereby each central bank is responsible for the share of the Eurosystem's total annual requirements equal to its percentage of the ECB's capital stock. In the interest of efficiency, that share is limited to given denominations, which each NCB must deliver to the Eurosystem according to schedule and respecting specific quality criteria and for which it bears all the costs of production.

the second euro series (ES2). In compliance with regulations on the quality of the currency in circulation and the fight against counterfeiting, the Bank performs a series of tasks designed to safeguard the public's confidence in euro banknotes.

The production of euro banknotes

Banknote production requirements in the Eurosystem continued to fall in 2011 following the decision to postpone the issue of ES2 banknotes and also given the advance production of huge volumes of notes in previous years. Accordingly, the Bank was assigned the production of 890.4 million banknotes, compared with 1,065.8 million in 2010. As well as the share pertaining to the year, in 2011 production of the residual amount scheduled for 2010 was completed and part of the 2012 production was brought forward; requirements for the current year are back to the previous high levels owing to the start of mass production of the first new denomination of ES2.¹⁹ The Eurosystem's annual requirements should remain high during replacement of the denominations of the present series.²⁰

At the Bank of Italy's banknote printing department, work is organized in two daily shifts, a system that has proved effective so far in meeting the production targets assigned and will be able to cope with the heavier workload planned for 2012 and the large volume of production projected for the following years.

The Bank of Italy has provided considerable support to the ECB for the development of ES2, not only at the design and origination stage, but also by carrying out production trials in the printing and cutting section. It has also given strong backing to efforts to adapt the production cycle to the features of the new series of banknotes with a view to large-scale production.

The Bank's printing department, which already meets the high quality and environmental management system requirements of ISO 9001:2008 and ISO 14001:2004, has also obtained for its occupational health and safety management system a certificate of compliance with British Standard OHSAS 18001:2007, a requirement of the ECB for banknote production due to become compulsory from 2013.

Banknote demand and the branches' role in cash circulation

In 2011 the demand for banknotes in Italy grew at a faster pace than in the preceding years. At the end of the year, cumulative net issuance in Italy, i.e. the balance of ingoing and outgoing banknotes from the Bank's branches since the introduction of euro, totalled 153.6 billion, 5.6 per cent more than at the end of 2010 (145.4 billion). More specifically, over 2.6 billion banknotes were put into circulation during the year (+16.9 per cent) for a total value of €94.3 billion, while more than 2.3 billion notes were returned to the Bank (+10.4 per cent), for a value of €86.2 billion.

During 2011 and in early 2012 the Bank's branches carried out a major banknote sorting operation, as a result of which the backlog of notes awaiting verification since the Bank had overhauled its sorting machines two years earlier was reduced to a level consistent with normal operating conditions. Over 2.6 billion banknotes were

¹⁹ Mass production began in June 2012.

²⁰ See Chapter 22, "La circolazione monetaria", in *Relazione sull'anno 2011*, Banca d'Italia 2012.

sorted in 2011, 35.4 per cent more than in 2010; of these around 1.2 billion notes were classified as worn and subsequently destroyed (+38.4 per cent on a yearly basis).

As part of the general reorganization of the Bank's branch network, between December 2011 and May 2012, 23 branches providing mainly customer services terminated all cash operations with banks and Poste Italiane SpA. These services are now provided by 33 dedicated branches.²¹

Article 26 of Decree Law 201/2011 of 6 December 2011 (known as the "Save Italy" decree) ratified by Law 214/2011 of 22 December 2011, brought forward, with immediate effect and in derogation of the provisions of Law 96/1997 of 7 April 1997, the termination date for the redemption of lira banknotes, notes and coins still in circulation, assigning them to the Treasury. On 6 December 2011 lire to the equivalent value of €1,272.4 million were still in circulation. In compliance with the decree, since 7 December the Bank of Italy no longer accepts any requests to exchange lire.

Redemption of lire notes terminated

In 2011 the Bank of Italy classified 145,879 banknotes as forged and withdrew them from circulation (+5.3 per cent on the previous year). The Bank also examined 9,314 damaged banknotes, of which 9,207 were accepted for redemption; 523 notes suspected of being damaged in the course of criminal activity were sent to the provincial headquarters of the Guardia di Finanza for further examination.

Counterfeiting of euro banknotes

The Bank of Italy cooperates in combating flows of funds from illegal activities and complies with the requirements of Legislative Decree 231/2007 of 21 November 2007. As part of this activity, in 2011, 271 suspect operations intercepted by the Bank's branches, for a total value of €7.4 million, were reported to the Financial Intelligence Unit.

In application of the new regulations on the recirculation of currency, in 2012 the Bank conducted the first inspections of professional cash handlers and is currently engaged in the development, and methodological fine-tuning, of systems of off-site data analysis (see box "Provisions concerning the authentication and eligibility of euro banknotes and their recycling").

Currency recirculation controls

PROVISIONS GOVERNING THE CHECKING OF THE AUTHENTICITY AND FITNESS OF EURO BANKNOTES AND THEIR RECIRCULATION

Article 97 of Decree Law 1/2012 of 24 January 2012 (known as the "grow Italy" decree) implemented Regulation (EC) No. 44/2008 of 18 December 2008 (see *Relazione al Parlamento e al Governo sull'anno 2008*) and Decision ECB 2010/14 of 16 September 2010 (see *Relazione al Parlamento e al Governo sull'anno 2010*) endowing the Bank of Italy with the power to regulate and control the activity of professional cash handlers and impose penalties on them. Within the scope of these powers, by Provision of the Governor of 14 February 2012, the Bank of Italy issued enactment rules laying down the procedures and

²¹ See also Chapter 6 of this Report.

organizational requirements for cash handling and activating the Bank's power to conduct on-site and off-site inspections. The provision also implements the regulations on the adjustment measures and administrative sanctions applicable in cases of breach of the rules governing the business of professional cash handling.¹

¹ The Provisions of the Bank of Italy of 29 November 2006, 5 February 2007 and 4 September 2008 are abrogated.

**Operator
communication
systems gli operatori**

During 2011 further progress was made in developing the internet portal, set up in application of the Governor's Instruction of 14 February 2012, to be used for the compulsory statistical reports required from professional cash handlers taking part in the currency recirculation process by authenticating and sorting banknotes²² or by reissuing them through their ATMs. Discussions with operators continued throughout the year to draw up a list of requirements with a view to developing an electronic system for commercial banks' banknote withdrawals and deposits at the Bank of Italy's branches.

²² This must be done by machines that have passed tests run by a Eurosystem NCB and are openly listed on the ECB's website.

2 OTHER FUNCTIONS OF THE CENTRAL BANK

2.1 The State Treasury and banking services for public bodies

In line with the development paths defined for the computerized payment system for general government (SIPA)¹ and e-government provisions, the Bank of Italy, in its function as State Treasurer, aims to increase the efficiency of government payments and to encourage the use of information technology in transactions between general government entities, private citizens and firms.

On 30 November 2011 the Convention between the Ministry for the Economy and Finance and the Bank of Italy entered into force. It dealt with procedures to manage the Treasury's payments account with the Bank, implementing the 2009 Accounting and Public Finances Law. The aim of the reform was to reduce the variability of the balance on the account and improve its predictability to prevent its movements from interfering with the conduct of monetary policy. Under the new system the Treasury's liquidity is divided into three components: (a) available funds in the account, remunerated up to a balance of one billion euros at the main refinancing rate of the European Central Bank; (b) time deposits held at the Bank and remunerated at Eurepo market rates; (c) overnight loans on the money market for the residual amount, remunerated at market rates. The new system led to the stabilization of the daily account balance at around the Ministry's target of €800 million. Furthermore, in December 2011 the average daily total of deposits at the Bank of Italy was about €20 billion and overnight loans around €5 billion.

In 2011, in the context of the State Treasury service and public payments service, the Bank executed some 65 million payments, of which 98 per cent used electronic procedures (Table 2.1). In the framework of SIPA, a procedure was introduced for the electronic management of the expenditure of the local offices of central government departments, thereby dematerializing the arrangements for payment orders. This procedure flanks the other computerized procedures for central and local government expenditure (electronic payment orders, fixed costs and special accounts).

Reform of the Treasury's payments account and liquidity management

Consolidation of the State's electronic Treasury: payments

¹ SIPA was established under a protocol signed by the Bank of Italy, the State Accounting Office, the State Audit Office and the National Centre for Information Technology in the Public Administration (CNIPA), now called DigitPA. It is based on integrating the Government Connectivity System with the National Interbank Network.

Table 2.1

COLLECTIONS AND PAYMENTS MADE BY THE TREASURIES*(millions of euros)*

	2010	2011	Percentage change
Budget revenue	717,854	681,344	-5.1
of which: tax collections	397,544	403,111	1.4
medium-/long-term loans	268,281	221,215	-17.5
Treasury receipts	1,931,690	2,052,772	6.3
of which: special accounts (1)	1,659,344	1,807,030	8.9
<i>Treasury bill issues (face value)</i>	210,642	205,813	-2.3
TOTAL RECEIPTS	2,649,544	2,734,116	3.2
Budget expenditure	693,099	705,389	1.8
primary expenditure (current and capital) (2)	434,505	445,783	2.6
Interest	69,490	73,594	5.9
medium-/long-term loan repayments	189,104	186,012	-1.6
Treasury disbursements	1,943,823	2,064,767	6.2
special accounts (1)	1,723,139	1,860,593	8
Treasury bill redemptions (face value)	220,684	204,174	-7.5
TOTAL PAYMENTS	2,636,922	2,770,156	5.1
Changes in payment account balance			
(receipts – payments) (3)	12,622	-36,040	
<i>Memory items:</i>			
balance a/c	42,332	6,292	

(1) Excluding internal transfers on special accounts, both incoming and outgoing, between the treasuries and the central treasury. – (2) Excluding entries relating to debt management indicated as specific items; includes transfers to the sinking fund for redemption of government securities. – (3) Including payments relating to the establishment of time deposits at the Bank of Italy (17,000 million euros at end 2011).

**Consolidation
of the State's
electronic Treasury:
dematerialization of
collection documents**

Still in the context of SIPA and the guidelines issued by the new Digital Administration Code (CAD), work began in 2011 on the project for the dematerialization of revenue documents. The initiative will contribute further to the efficiency of the public payments system and is also important for the work of the treasuries, aiming to reduce the manual processing of incoming-payment reports. The project called for the joint efforts of the Ministry for the Economy and Finance, the State Audit Office, DigitPA and the Bank of Italy to prepare a decree containing the necessary legislative changes.

**Payments service for
public bodies**

As to payments service operations (which amounted to €38 million in 2011), the growing trend of the last two years has continued, partly due to the increase in temporary benefit payments made by INPS.

**Attachment orders
against general
government bodies**

There has been a marked increase in executive proceedings against the public administration and public bodies. The Bank of Italy is involved in its quality as garnishee, receiving about 21,000 attachment orders in 2011. Various factors

contributed to the increase, notably the effects of Law 89/2001 (the “Pinto Law”), which recognized the right to fair reparation for damages deriving from the unreasonable length of trials.

With the addition in January 2012 of the public parks authorities and the chambers of commerce, the number of bodies contributing their collections and payments data to Siope (the general government transactions information system) now comes to about 13,000. Siope’s website has been improved with new consultation possibilities.

The electronic Treasury: Siope

2.2 Services relating to public debt management

On behalf of the Ministry for Economy and Finance, the Bank of Italy carries out placement, exchanges and buy-back transactions for government securities and debt servicing; it analyses the performance of the secondary market for government securities and collaborates with the Ministry on issuance policy and debt management.

Operations on behalf of the Economy and Finance Ministry and collaboration in issue policy

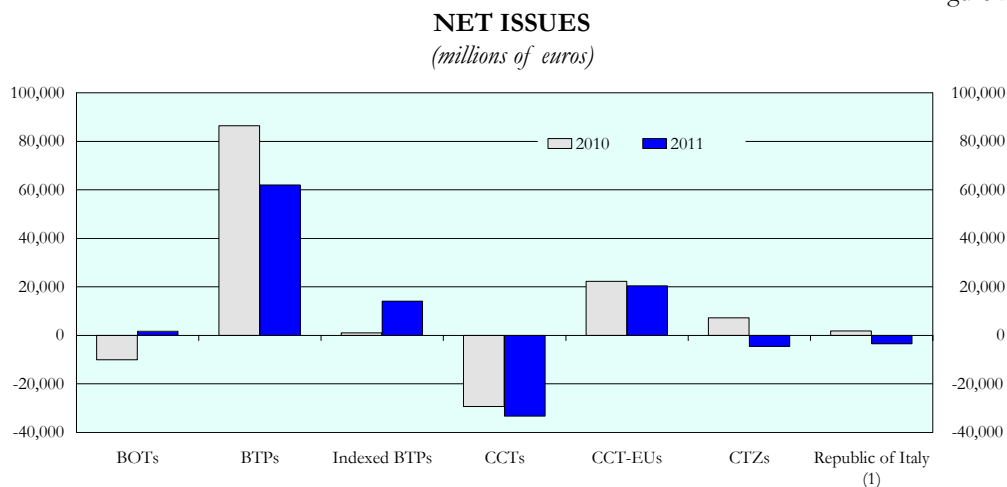
In the context of this function, the Bank provides the Ministry with issue assumptions calculated on the basis of the liquidity requirement forecasts for the central government sector, the performance of securities on the secondary market, the results of the latest auctions and the Ministry’s public debt management targets. These assumptions help the Bank of Italy make its forecasts of the liquidity of the banking system for transmission to the ECB.

In 2011 government securities were placed for a total face value of €441.1 billion (€483.1 billion in 2010), of which €429.7 billion in the domestic market. Net issues of domestic securities amounted to €60.2 million against €77.6 billion in 2010 (Figure 2.1).

Placement and repurchase of public debt securities

In 2011 there were 231 auctions to place securities on the domestic market, of which 119 ordinary auctions and 112 supplementary auctions reserved to specialist primary dealers, in line with 2010.

Figure 2.1



(1) Amounts resulting after foreign exchange hedge transactions.

New securities can also be issued through a syndicate of intermediaries chosen by the Ministry on a case-by-case basis. In 2011 this happened on only one occasion for the launch of the new inflation-indexed 15-year Treasury bonds.

Management of the auction procedure

In 2011, at Treasury bond and credit certificate auctions the Ministry continued to use the so-called “range” procedure by which it decides at its own discretion the quantity to issue within a range announced to the market in advance. As in past years, issue volume was generally near or at the maximum offered. From 2012 this procedure was extended to zero coupon Treasury certificates.

The Bank of Italy’s securities placement procedure has guaranteed that operations are executed rapidly and the results promptly made public. In 2011 the time it took to disclose auction outcomes to the market was the same as the particularly short time recorded in 2010: 3 minutes for ordinary auctions and 12 minutes for those with discretionary choice of volume.

Demand for government securities

Last year a new operator signed the agreement with the Bank of Italy for placement auctions, bringing the number of authorized operators to 38, among which 20 specialists that underwrite almost all issues. There was an average of 24 participants at the auctions. The cover ratio averaged 1.63 per cent, slightly up on 2010.

In March 2012 a new government bond “BTP Italia” was issued with innovative financial characteristics, including indexing to Italian inflation and a bonus at redemption for individual investors who hold the bond from issue to maturity. The Bank was involved in the placement and settlement of the BTP Italia and will perform the related financial services.

Financial service for Treasury loans issued abroad

In order to diversify its sources of funds, the Ministry issues loans denominated in euros and foreign currencies on the international markets through a placement consortium. The Bank of Italy provides the financial service, crediting or debiting the Treasury’s account.

In 2011 the Ministry made recourse to some international issues under the Medium Term Note programme (MTN) for an overall amount of €3.5 billion (€5.7 billion in 2010) against redemptions for a total of €6.9 billion. There were 35 issues of short-term commercial paper, for a value of €7.9 billion, reimbursed before the end of 2011.

The amount of foreign loans outstanding at the end of 2011 was €58.5 billion (€62 billion at the end of 2010). To these were added the loans originally contracted by Infrastrutture S.p.A. under the MTN framework and later transferred to the State’s balance sheet for a total of €9.6 billion.

To limit exposure to exchange and interest rate risk in the case of debtor positions in foreign currency, the Italian Treasury usually makes recourse to cross currency and interest rate swaps, with the financial service provided by the Bank. As a result of these transactions, almost all the debt in foreign currency is fully hedged for exchange risk.

2.3 Management of the reserves and the financial portfolio

The Bank of Italy manages Italy's official reserves, which form an integral part of the reserves of the Eurosystem, and the financial portfolio in euros, which includes investments of provisions and reserves.

The rebalancing of the weights of the different financial assets towards the long-term objective continued in 2011, taking account of market conditions. A new system was introduced for the integrated control of risks based on the joint valuation of those relating to the financial portfolio and to the official reserves, and of risks deriving from the other institutional functions.

In 2011, the institutional framework for management of the official reserves remained unchanged. Besides Italy's reserves, the Bank also managed a part of the official reserves in US dollars held by the ECB, equal to about \$10.5 billion, on the basis of the objectives and criteria defined by the Governing Council.

At the end of the year the value in euros of the net foreign currency assets (Table 2.2), excluding the item "SDRs relating to net assets vis-à-vis the IMF", amounted to €28.1 billion, slightly more than at the end of 2010. Excluding temporary operations, the aggregate fell by €1.1 billion as a result of the sale of dollars, sterling and yen, the proceeds of which were used to buy assets in euros added to financial portfolio.

The gold reserves were valued at €95.9 billion, an increase of more than 15 per cent, thanks to the rise in the price of gold. Changes in net assets vis-à-vis the IMF were mainly the result of loans issued under the New Arrangements to Borrow and drawings by the IMF in favour of third countries.

Management of the official reserves

Table 2.2

GOLD AND NET FOREIGN CURRENCY ASSETS (1) (millions of euros)

	2010	2011
US dollar	18,175	18,970 (2)
Pound sterling	3,682	3,506
Japanese yen	5,571	5,380
Swiss franc	268	275
Other currencies	4	4
Gold	83,197	95,924
SDRs relating to net assets with IMF	1,853	4,421
Total	112,750	128,480

(1) Valued at market exchange rates and prices. Not including financial assets (exchange-traded funds and UCITS shares) in foreign currency held against ordinary and extraordinary reserves and asset provisions, in that they comprise a separate currency item. – (2) Includes temporary operations in dollars worth \$1.546 million under an agreement between the ECB and the Federal Reserve to supply the banking system with short-term liquidity in dollars.

Excluding temporary operations in dollars, the composition by currency of the reserves remained basically unchanged.

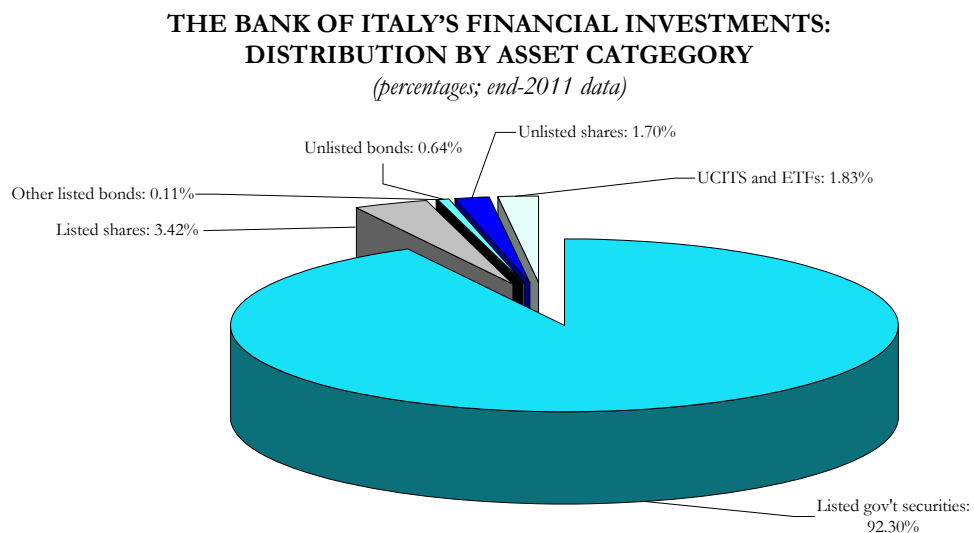
The euro-denominated financial portfolio

The Bank's financial portfolio also includes investments of provisions and reserves and of staff severance pay and pension provisions.

At the end of 2011 the value of the financial portfolio was €123.9 billion, compared with €122.1 billion a year earlier; 93 per cent of the assets consisted in bonds, mainly Italian and other euro-area government bonds, and the rest in shares and units of share-based investment funds (Figure 2.2).

In the share segment, the process of geographical and sectoral diversification continued; in the bond sector, purchases were mainly of Italian and other euro-area government securities.

Figure 2.2



Supplementary pension fund portfolio

The Bank also manages the defined-contribution supplementary pension fund established for staff taken on since 28 April 1993, which is a separate fund from an administrative and accounting point of view. At the end of 2011 the fund had a value of €194 million.

Management of operational risk

In 2011 work continued to quantify exposure to operational risk in investment activity and the reporting of operating incidents went into effect.

3 THE BANKING AND FINANCIAL SUPERVISION FUNCTION

3.1 Supervisory activity: purpose, criteria, exercise

Under the Consolidated Law on Banking the Bank of Italy exercises powers of supervision over banks, banking groups, financial companies, electronic money institutes and payment institutions. Supervisory activity is directed to ensuring the stability, efficiency and competitiveness of the financial system as a whole, the sound and prudent management of intermediaries, and the enforcement of credit and financial law and regulations.

The Consolidated Law on Finance specifies the purposes of supervision over intermediaries engaged in investment services and asset management as safeguarding confidence in the financial system, protecting investors, ensuring the stability, orderly functioning and competitiveness of the system, and enforcing financial legislation. In this sphere the Bank of Italy is responsible for controls on intermediaries' risk containment, capital soundness and sound and prudent management.

The Bank's supervisory duties were affected radically by the reform of the rules on financial intermediation enacted with Legislative Decree 141/2010. In March 2012 the public consultation on the implementing regulations was concluded. The regulations set out a system of rules governing the matter and subject the financial intermediaries entered in the register referred to in Article 106 of the Consolidated Law on Banking to a supervisory regime equivalent to that applied to banks and investment firms.

Under Article 127 of the Banking Law, the Bank of Italy is responsible for promoting transparency in banking and financial services and correct relations between intermediaries and customers. It must also provide the necessary technical support for the Banking and Financial Ombudsman (Arbitro Bancario Finanziario, ABF).

The Bank is assigned a major role in combating money laundering and the financing of terrorism. It is responsible for issuing secondary legislation in this field, overseeing compliance and adopting corrective measures and sanctions for the institutions supervised. The Financial Intelligence Unit (FIU), which operates independently within the Bank of Italy, receives reports of suspicious transactions, analyzes them and forwards them to the competent law enforcement authorities.

Starting in 2011 the Bank has begun publishing its yearly plan for the banking and financial supervisory regulations to be issued, which are opened to public consultation.

Supervision involves analysis of the various types of risk, applied on a consolidated basis and in accordance with the principle of proportionality. Coordination between off-site controls and on-site inspections makes it possible to guard against overexposure to risk. Integration with macroprudential analysis fosters the early detection of factors of risk and their potential impact on capital and earnings, thus strengthening the ability of the system and of individual intermediaries to deal with emerging crisis situations.

Examination of individual intermediaries supplements the broader assessment of financial stability produced in the Bank's twice-yearly *Financial Stability Report*. The *Report* sets out the Bank's analyses of the state of the financial system, within the global economic and financial framework, and of the main risk factors and their possible impact.

3.2 Supervised intermediaries

The structure of the banking and financial system

At the end of 2011 there were 2,041 supervised intermediaries in Italy, 517 fewer than at the end of 2010 (Table 3.1). The number in the register under Article 106 of the Consolidated Law on Banking fell by 506 as a result of the cancellation of securitization vehicles and payment service companies as well as an increase in deletions requested by intermediaries themselves (129) and those decided by the Bank due to irregularities (20).

Banking groups numbered 77; their companies with registered office in Italy comprised 188 banks, 9 investment firms, 30 asset management companies, and 19 holding companies (including 6 parent companies), 130 other financial companies and 93 instrumental companies. Of the groups, 20 had establishments abroad with 60 branches and 88 subsidiaries. There were 77 foreign bank branches and 24 subsidiaries of foreign banks.

Ten banks began operations and 30 ceased operations in 2011, the result of 23 mergers or closures, 6 liquidations and one conversion into a financial company.

The number of financial companies in the special register fell to 188 as the result of 22 deletions, owing in part to tighter constraints on the types of business the companies may perform.

The register of payment institutions counted 34 institutions, 33 of them entered in the course of the year.

The sectoral lists and registers comprised 75,869 financial agents, 131,855 loan brokers and 357 gold dealers, respectively.

Table 3.1

THE STRUCTURE OF THE ITALIAN FINANCIAL SYSTEM

	31 December 2010				31 December 2011			
	Number of intermediaries				Number of intermediaries			
	Banking group members (1)	Investment firm group members	Not members of groups	Total	Banking group members (1)	Investment firm group members	Not members of groups	Total
Banking groups	-	-	-	76	-	-	-	77
Investment firm groups	-	-	-	19	-	-	-	20
Banks	205	-	555	760	188	-	552	740
<i>of which: limited company banks</i>	178	-	55	233	162	-	52	214
<i>cooperative banks (banche popolari)</i>	17	-	20	37	18	-	19	37
<i>mutual banks (banche di credito cooperativo)</i>	9	-	406	415	8	-	403	411
<i>branches of foreign banks</i> ..	1	-	74	75	1	-	77	78
Investment firms	11	22	78	111	8	23	71	102
Asset management companies and SICAVs	35	6	157	198	31	6	153	190
Financial companies entered in the special register under Article 107 of the Consolidated Law on Banking	69	-	126	195	65	-	123	188
Financial companies entered in the general register under Article 106 of the Consolidated Law on Banking	73	2	1,213	1,288	36	1	745	782
Electronic money institutions	-	-	3	3	-	-	3	3
Payment institutions	-	-	1	1	9	-	25	34
Other supervised intermediaries (2).....	-	-	2	2	-	-	2	2

Sources: Supervisory registers and lists.
(1) Italian-owned groups or Italian sub-groups owned by foreign companies; includes parent undertakings (banks or investment firms). –
(2) Bancoposta and Cassa Depositi e Prestiti.

Supplementary supervision of 6 financial conglomerates continued in 2011; the conglomerates were identified jointly by Bank of Italy, Consob (the Companies and Stock Exchange Commission) and Isvap (the insurance supervisor). For the three conglomerates whose prevalent business is banking and finance, the Bank of Italy is responsible for coordinating supervision and ensuring that the conglomerate adopts policies and procedures to guarantee capital adequacy and control of risk concentration and intragroup transactions.

At the end of 2011 there were 33,609 bank branches in Italy, practically the same as a year earlier. There were 26,856 financial salesmen and 1,604 financial service stores. The number of ATMs increased by 1.5 per cent during the year to 45,547 and that of POS terminals by 7.4 per cent to 1.57 million. Bancoposta had 13,340 branches in 7,670 municipalities.

Considerable use is made of electronic channels for the execution of banking and payment transactions. The number of customers ordering transactions online

The distribution network

remained unchanged during the year at 15.4 million, while customers using online information services expanded from 3.9 to 4.3 million; 7.8 per cent of customers are firms. The number of phone banking customers fell from 9.4 to 8.0 million).

3.3 Controls on banks and banking groups

Analysis and evaluation

Last year the Bank of Italy's programme of analysis and monitoring was directed to determining the impact of the unfavourable economic cycle and the euro-area sovereign debt crisis on risks and on the adequacy of the capital, organizational, and managerial safeguards against them. Special attention was paid to the quality of loan assets, assessing their effects on banks' profitability and capital adequacy, and to liquidity risk.

The technical situation of intermediaries was judged worse than in 2010, in particular the scores for credit quality, income and liquidity risk. Capital adequacy again received the top score, thanks to capital increases.

The Bank continued to base its analyses on the operating data of the intermediaries, especially for the risk profiles that require flexible and timely measures, such as liquidity risk.

Analysis of international groups: supervisory colleges

The supervisory rules on international banking groups were modified to provide for joint risk assessment and decision by home and host authorities. The Bank of Italy sustained a substantial effort to strengthen cooperation with the other European supervisory authorities towards joint decision concerning the overall risk and capital adequacy of banking groups and their components.

The Bank of Italy is home supervisor for ten banking groups: UniCredit, Intesa Sanpaolo, Monte dei Paschi di Siena, Banco Popolare, Banca Popolare dell'Emilia Romagna, Unione di Banche Italiane, Credito Emiliano, Mediobanca, Banca Leonardo and Banca Mediolanum. Except for the two largest groups, UniCredit and Intesa Sanpaolo, whose presence abroad is most extensive, the supervisory colleges operate under simplified procedures.

In running the colleges for the two major groups, the Bank completed a series of initiatives, including ICT measures, for swifter information exchange between authorities. The two colleges¹ met a total of five times. There was specific examination of issues involving money laundering and terrorist financing.

The Bank of Italy participated as host authority in the meetings of 13 supervisory colleges for foreign banks. The main issues dealt with were the effects of the crisis

¹ Participants are the supervisory authorities of Austria, Bulgaria, Croatia, Czech Republic, Germany, Hungary, Ireland, Latvia, Luxembourg, Poland, Romania, Serbia-Montenegro, Slovakia, Slovenia and the United Kingdom. Representatives of the European Banking Authority also attend. For purposes of macroprudential supervision, the colleges dealing with problems of liquidity in Europe are also attended by delegates of the ECB and the European Investment Bank.

on overall risk and the strategies of the groups and of single local banks for dealing with the tensions.

With the approval by the G20 of the guidelines developed by the Financial Stability Board for solid, effective resolution of crises at global systemically important banks,² all the FSB member countries, including Italy, endorsed a plan for implementing the guidelines in respect of those banks. One step in implementation is the formation of Crisis Management Groups, one of whose tasks is to draft recovery and resolution plans. The Bank of Italy is a member of three of the groups, one as home supervisor (for UniCredit) and two as host supervisor (BNP Paribas and Crédit Agricole). Consistent with the international commitments undertaken, the final draft of these plans is scheduled for the end of this year.

A total of 1,260 supervisory interventions – warning letters and meetings with corporate officers – were effected in 2011 (Table 3.2), an increase of 35 per cent compared with the previous year. These actions, based on the findings of off-site analysis, bore mainly on credit and liquidity risks.

Supervisory interventions

Table 3.2

SUPERVISORY INTERVENTIONS ON BANKS

	2010			2011		
	Meetings	Warning letters	Total	Meetings	Warning letters	Total
Members of top 6 groups	63	41	104	63	23	86
Other limited or cooperative banks	122	142	264	177	251	428
Mutual banks	287	281	568	410	336	746
Total ...	472	464	936	650	610	1,260

On liquidity risk, the two longer-term refinancing operations announced by the BCE towards the end of the year eased the strains on banks' funding. However, close attention continues to be paid to liquidity, in view of the considerable uncertainty that still characterizes the financial markets during the current phase and the temporary nature of the ECB measures. The Bank of Italy has asked banks to reinforce the more stable funding components, consistently with market conditions, and thereby gradually reduce their dependence on ECB financing. Italian banks' exposure to interest-rate risk is generally not significant. In the cases in which it is greater, they were asked to take measures to bring the risk indicators back within the limits. In addition, a sample of eleven banking groups that use internal risk assessment models were surveyed in order to gain additional information on their techniques for measuring the exposure to possible changes in the yield curve.

There was an intensification of encounters with banks' functional departments (risk management, compliance, internal audit and anti-money-laundering) and with corporate bodies (control committees, oversight councils, boards of auditors).

² FSB, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2011.

Last year the Bank of Italy continued its action, begun at the commencement of the financial crisis, to spur banks to use all the available tools to further strengthen their capital bases, including by means of prudent dividend policies focused on self-financing. At the start of 2012 banks were asked to plan measures to ensure compliance with the new Basel III rules that go into effect starting in 2013. The banks' attention was called to the need for capital management measures to reach or maintain (through appropriate target ratios or trigger ratios) tier 1 ratios well above the regulatory minimum.

The UniCredit, Monte dei Paschi di Siena, Banco Popolare and Unione di Banche Italiane groups – to which the EBA capital exercise recommendation was addressed, and which had capital shortfalls on 30 September 2011 – were asked to submit plans for capitalization to comply with the target of a core tier 1 ratio of 9 per cent by 30 June 2012. The Intesa SanPaolo group was already compliant.

With regard to the Internal Capital Adequacy Assessment Process of capital planning (ICAAP), the aspects needing improvement are the ability to forecast capital requirements and the operating procedures to satisfy them, risk measurement methodologies, and the development of plans to cope with the capital charges estimated in stress testing. The banks have been asked for closer involvement in the capital planning process of the directive and control bodies and of the operational functions as well as for closer integration of ICAAP with strategic and operational planning.

In 2011 and the first part of 2012 the Bank of Italy proceeded with its activity of analysis to check the robustness of the internal models for measuring capital requirements against credit, market and operational risk already validated and of those still to be validated. The analysis was based on rigorous standards and prudent, robust validation methodologies. To date authorization to use internal rating models to calculate capital requirements has been given to seven banking groups (UniCredit, Intesa SanPaolo, Monte dei Paschi di Siena, Unione di Banche Italiane, Banco Popolare, Banco Popolare di Milano, and Credit Emiliano)³ and two subsidiaries of foreign banks (BNL of the BNP Paribas group and Dexia). Pre-validation analysis is under way for two other groups: Mediobanca (as regards its large corporate portfolio) and Cassa di Risparmio di Parma of the Crédit Agricole group (for its retail portfolio).

Where weaknesses were detected either in the models or in the internal control systems, the Bank of Italy imposed additional capital requirements in order to prompt the swift implementation of the necessary corrective measures.

The Bank of Italy is participating in two international initiatives – at the Basel Committee and the EBA (only as regards credit risk) – for the adoption of strict supervisory and control practices in the calculation of banks' risk assets. Early in 2012 an exploratory analysis was begun on the internal rating systems of the main

³ The first three of these groups use the advanced approach for credit risk measurement, whose parameters include "loss given default" and in some cases "exposure at default".

Italian banking groups to discover any divergences in the calculation of capital requirements against essentially similar risk assets.

The Bank of Italy continued its work to improve the banks' corporate governance, organization and control systems. Amendments to some institutions' statutes were requested for better alignment with the best organizational arrangements found within the banking system, which were identified through an analysis carried out by the Banking and Financial Supervision area and published on the Bank of Italy website. The number of administrative proceedings increased sharply compared with previous years (Table 3.3).

Governance, organization and control, remuneration

Table 3.3

MAIN SUPERVISORY ADMINISTRATIVE ACTS CONCERNING BANKS

	2010	2011
Statute amendments.....	127	172
<i>of which: capital increases</i>	26	38
Special capital adequacy ratio	14	5
Mergers, divestitures.....	30	40
Acquisition of stakes in banks	36	39
<i>of which: revocation of authorization to hold</i>	0	0
Acquisition of stakes in other financial or insurance intermediaries.....	39	26
Establishment and provision of services in non-EU countries	1	1
Depositary bank.....	1	1
Investment services.....	7	8

The Bank of Italy took particularly vigorous action to bring banks' remuneration practices into line with the supervisory rules issued in implementation of the European directive of 24 November 2010 (the third capital requirements directive, CRD3) and the EBA's guidelines. In view of the current cyclical phase the banks were requested to curb overall variable remuneration components and to ensure that these are strictly linked to performance indicators that are properly adjusted for risk.

The Bank of Italy, in authorizing various plans for corporate reorganization, called on banks to step up their efforts to streamline their group structure and branch networks for greater operating efficiency, including by a stronger focus on their core business.

The structure and branch networks of banking groups

During the year a total of 66 plans for expanding branch networks were submitted, most by relatively smaller, local institutions. Two were rejected for technical and organizational shortcomings. The larger banks acted mainly to rationalize their branch networks.

With regard to banks specialized solely in the provision of credit, supervisory action concentrated on the quality of the loan portfolio and the ability to cope with liquidity risk. For those specialized in investment services, there was close attention to new forms of risk exposure deriving from the revamping of strategy to regain sufficient profitability.

Controls on specialized banks

Supervision of local banks

The aggravation of the recession has had repercussions on the profitability and risk exposure of local banks in Italy.⁴ In the second half of the year they also had to deal with funding and liquidity strains in connection with the sovereign debt crisis. Although weaker earnings undermined the ability to accumulate capital, their main strength remains their good capital endowment.

Supervisors kept the evolving quality of loan assets under closely observation, verifying that the intermediaries were employing adequate monitoring and control instruments as well as consistent credit assessment policies. As to earnings, the local banks were asked to refine their strategic planning with a view among other things to improving operational efficiency and rationalizing cost structures. In addition, liquidity controls were stepped up on the banks showing signs of strain, which were subsequently allayed in some cases by the issue of government-guaranteed liabilities under Article 8 of Decree Law 211/2011 (the “Save Italy” decree) enacted on 6 December. Special importance was attached to governance arrangements and effective control systems.

3.4 Controls on asset management companies and investment firms

Controls on asset management companies and products

The supervision of asset management companies and SICAVs focused last year on the intermediaries most severely affected by the financial crisis and on analysis of extraordinary operations aimed at rationalizing and strengthening corporate organization.

Administrative procedures governing the various phases in the institutions’ life and the creation of the funds they manage numbered 232 in 2011, compared with 317 in 2010 (Table 3.4).

Table 3.4

CONTROLS ON ENTRY AND PRODUCTS

	2009	2010	2011
	Asset management companies		
Authorization to exercise activity.....	13	9	3
Change in ownership.....	36	34	39
Change in business operations.....	14	36	28
Mergers and divestments.....	11	11	12
Total asset management procedures.....	74	90	82
	Investment funds		
Approval of rules.....	241	217	143
<i>of which: new funds.....</i>	<i>95</i>	<i>75</i>	<i>44</i>
<i>of which: amendments.....</i>	<i>146</i>	<i>142</i>	<i>99</i>
Merger of funds.....	9	10	7
Total investment fund procedures.....	250	227	150
Total administrative procedures.....	324	317	232

⁴ Twenty-six Bank of Italy branches are responsible for supervision of local intermediaries (i.e. smaller and less complex banking and financial institutions active mainly at regional or at most interregional level). In December 2011 Italy had 543 such institutions (489 banks, 33 other financial intermediaries and 21 investment firms).

The Bank examined 39 applications for changes in ownership, considering integrity, correctness in business relations and the financial soundness of the potential purchasers. In most cases the changes were the result of rationalization of the group to which the intermediary belonged.

There were 28 requests to extend or modify the intermediary's range of business, consisting most frequently in the creation of types of investment fund not provided for in the original authorization or the extension of activity to consultancy and portfolio management.

Since May 2011, owing to the amendment of Article 37 of the Consolidated Law on Finance, the Bank of Italy's approval is no longer required for mergers and rules, or rules changes, involving funds reserved to qualified investors or hedge funds. In view of the consolidation of market-led models for the rules of alternative funds and their investors' lesser need for protection, Parliament elected to abrogate prior supervisory authorization for these products, without prejudice to powers of control.

The Bank examined 143 applications for approval of investment fund management rules; 44 were for the institution of new funds, 99 for rule amendments. In another 48 cases intermediaries exercised the option to establish funds (mostly harmonized, open-end funds) by the procedure providing for general approval. Seven fund merger procedures were carried out.

A total of 139 new investment funds were established in 2011: 64 open-end securities funds, either harmonized or not, 15 private equity funds and 60 real-estate funds (including 9 hedge funds), almost all of them reserved to qualified investors.

Supply-side restructuring continued. Mergers eliminated 80 open-end funds last year, or 11 per cent of those in business at the start of the year. Another 30 funds were liquidated.

The Bank's judgments on the asset management companies' technical situation and organization were basically in line with those of the previous year. As for many years now, the examination of the technical components was supplemented by valuation of strategic, operational and reputational risks.

Supervisory analysis and intervention on asset management companies

Of the 189 asset management companies and SICAVs examined, 121 were found to be in favourable situations, for 60 the analysis found problematic aspects in the technical situation, and 8 had a particularly unfavourable situation ascribed to strategic problems often associated with defective governance and organizational weakness.

Interventions were directed to monitoring these problematic situations, with special attention to companies that were having difficulty in managing closed-end real-estate and private equity funds. A total of 390 interventions were carried out, compared with 255 in 2010: 139 meetings with corporate officers and 251 letters.

The most problematic intermediaries were called on to take corrective measures. The Bank asked them to eliminate the shortcomings detected, to devise plans for recovery and relaunching, and to strengthen their organization and internal control systems.

Three management companies in the real-estate sector were prohibited from establishing or activating new investment funds.

Analysis of investment firms

In 2011 the Bank of Italy conducted 94 analyses of investment firms not belonging to banking groups, 75 by the head office and 19 by branches. Problem situations were found at 40 firms, most of them active in placement and trading.

The unfavourable judgments depended mainly on problems of income and strategy. The state of the economy hindered the adequate growth of volume both for start-ups and for established firms. In some cases the examination found anomalies in governance and organizational shortcomings relating to risk assessment and management.

Interventions on investment firms

Supervisory interventions on investment firms numbered 119 last year, compared with 128 in 2010: 61 letters and 58 meetings with corporate officers. A total of 70 firms were involved.

Corrective or preventive actions (73) were taken in respect of intermediaries with problems of governance or organization, as well as persistently low income and capital, in some cases failing to meet the minimum requirements. The intermediaries subjected to inspection were called on to make improvements in their governance, internal control systems, and compliance with the rules on money laundering and usury.

In the area of internal controls the Bank continued its verification of the organizational solutions adopted by the intermediaries, calling for corrective measures where necessary. The firms were urged to improve the quality of their supervisory reports.

Owing in part to the earnings and capital weakness of some operators, during the year the Bank examined a number of applications for changes in ownership and for entry, modification or deletion of investment firm groups from the register. In the framework of the proceedings under the Consob's jurisdiction, the Bank issued its required opinions on the extension or revocation of authorization to provide investment services.

3.5 Controls on Article 107 financial companies, payment institutions and electronic money institutions

In 2011 the Bank of Italy sent formal letters or held meetings with corporate officers of 56 intermediaries entered in the register envisaged by Article 107 of the Consolidated Law on Banking; 25 of these actions were taken by Bank branches. The institutions involved account for 30 per cent of the total assets of Article 107 intermediaries. The interventions (39 letters and 47 meetings) focused not only on the technical situation but also on governance and control arrangements.

The Bank paid renewed attention to consumer credit, in particular institutions granting loans secured by the pledge of a fifth of salary or pension and the like. In a

communication to the industry the Bank called on intermediaries to eliminate some non-compliant conduct and still unsatisfactory practices concerning relations with distribution networks, transparency on rate determination, indemnity to customers, and accounting practices.

The set of mutual loan-guarantee consortiums subject to prudential supervision stabilized. In view of the innovative nature of the new rules, which requires constant dialogue with intermediaries, the Bank elected to keep supervisory powers in this sphere at the head office. Specific studies were performed on the accounting treatment of income, capital and risk. Special attention was paid to the standards for classifying impaired loans and on the composition of regulatory capital, which in many cases depends on government contributions.

Last year the Bank initiated its supervision over payment institutions. Given the need for dialogue with those that had been included in the set of supervised intermediaries only recently, here too the choice was in favour of centralized oversight. There were 19 interventions (14 letters and 5 meetings), most of them in the second half of the year. The problems discussed were risk management, corporate governance and product distribution methods.

The monitoring of electronic money institutions continued, with special reference to two institutions previously subjected to extraordinary measures. In one case the special administration procedure was terminated.

3.6 Controls on Article 106 financial companies and other intermediaries

The number of applications for entry into the general register provided for in Article 106 of the Consolidated Law on Banking diminished again in 2011, one factor in the decline being more rigorous entry controls involving not only verification of the formal requirements but also an examination of the company's business reports.

Entry controls

At the end of 2011 the general register comprised 782 intermediaries, of which 33 were new entries during the year (37 in 2010). Mutual loan-guarantee consortiums numbered 610; new entries during the year numbered 12, continuing the downward trend for these intermediaries as well. There were 123 credit unions (*casse peota*), down from 126.

Since 30 June 2011 loan brokers and financial agents are no longer entered in the Bank of Italy's registers. Of the 131,855 loan brokers listed, 122,516 were natural persons and 9,339 were companies (when the new regulatory framework goes into effect only companies will be able to be registered). Of the 75,869 financial agents, 70,547 were natural persons and 5,322 companies; it is estimated that about 29,000 are engaged exclusively in money transfer.

As the gold market turned up, there was rise in the number of registered gold dealers, in whose regard the Bank has limited powers of verification of satisfaction of the legal requirements (Figure 3.1). Of the 357 dealers listed, 76 were registered in 2011.

Figure 3.1



Supervisory interventions

The rationalization and reordering of the Article 106 general register continued last year. The number of intermediaries fell considerably. The more restricted scope of the activities reserved to these intermediaries under Legislative Decrees 11/2010 and 141/2010 resulted in the removal of loan securitization vehicles and payment institutions (mainly money transfer agents). The Bank of Italy checked intermediaries' compliance with the requirements of Legislative Decree 11/2010 and asked them, where necessary, to amend their statutes appropriately.

With a view to the entry into force of Legislative Decree 141, the Bank initiated widespread verification not only of satisfaction of the law's requirements but also of the intermediaries' actual business operations. Prudential controls to gauge individual intermediaries' capital adequacy found an overall improvement in compliance.

The procedure for electronic transmission of reports on corporate bodies was extended last year to the intermediaries entered in the general register. The first checks found progressive adaptation to the supervisory instructions.

Special attention was given to problematic segments. Loan-guarantee business recorded an increase in demand in 2011 in response to the economic cycle and laws requiring the presentation of guarantees backing obligations undertaken; and the analysis confirmed the large-scale issue of guarantees on the part of institutions that were unauthorized or lacked the requirements (specifically, mutual loan-guarantee consortiums under Article 155 of the Consolidated Law on Banking). In addition to deleting violators from the register, the Bank also continued its cooperation with the Finance Police, supplying information and analyses highlighting any operational anomalies. Through its website, the Bank also conducted a special campaign to alert and inform the public concerning the characteristics and permissible activities of loan-guarantee institutions⁵.

Special inquiries were initiated on the risks entailed in acquiring small, impaired, uncollateralized credit claims, an activity that in recent years has involved a growing

⁵ http://www.bancaditalia.it/vigilanza/avvisi/avvisi-106-altri/Garanzie_testo-consolidato.pdf.

number of intermediaries listed in the general register. Problems were found in operators' soundness and transparency and in the effective transfer of risks away from the original creditors.

Distance and on-site controls revealed widespread failure on the part of intermediaries to heed the rules on usury, money laundering and transparency. In the most serious cases restrictive measures were taken. Some cooperative financial companies engaging in granting loans were found to have conducted fundraising operations from members that were in violation of the regulations, in that they constituted unauthorized banking business. The restrictive measures consequent to the detection of the irregularities helped to diminish the number of intermediaries in the Article 106 register.

Controls on financial agents and loan brokers were stepped up to verify continued satisfaction of the requirements for registration. The reform of this sector instituted more selective standards and also made the two professions mutually exclusive, thus leading to a good many requests for delisting. At the end of the year the self-regulatory body provided for by Legislative Decree 141/2010 was established; when the new regulations go into effect it will be responsible for keeping the registers, performing controls on the persons entered, and implementing the rules. The Bank of Italy remains directly in charge of enforcing the rules for transparency.

The agents' and brokers' self-regulatory organization (Organismo degli agenti e dei mediatori, OAM) comprises 11 trade associations of financial agents, loan brokers, banks and other financial intermediaries. Once the reform is implemented, its website (www.organismo-am.it) will serve as the portal for applications for entry in the register and for the posting of the registers as well as for useful information for users.

Gold dealers, who are subject to an attenuated regime of controls to ascertain continued satisfaction of the registration requirements, were also subjected to more penetrating checks on capital adequacy and integrity both upon registration and subsequently.

One specific action bore on possible abuses in the gold dealers' advertisements in the exercise of such unregulated business activity as the purchase of jewellery from private customers and its subsequent resale ("cash for gold" business). The Bank issued a communication to the market governing proper use of registration numbers; the irregularities detected were subjected to repressive measures.

3.7 Inspections

The Bank carried out 221 on-site inspections in 2011 (compared with 211 in 2010 and 205 in 2009), including 169 inspections of banks or banking groups. The inspections were diversified in scope, frequency and modularity according to the different types of information sought, including macro-prudential. Most (171) were broad-spectrum, accompanied by 31 targeted, 7 follow-up and 5 thematic inspections

Controls on agents, brokers and gold dealers

Inspection activity

plus 9 for the validation of Basel II internal risk models (including 2 conducted together with other targeted inspections). Those carried out by the Bank's branches numbered 129, of which 117 were broad-spectrum. Visits to minor and specialized intermediaries increased.

Integrated inspection planning

Inspection planning was adapted to integrate off-site prudential checks with on-site inspection focusing on the various areas of compliance at the supervised intermediaries' headquarters and individual branches.

Scope of inspections

The broad-spectrum inspections examined strategy guidelines, governance, capital soundness, earnings capacity and organization. Special attention was paid to lending procedures. Inspectors considered the quality of borrower selection, disbursement, and the management and recovery of credit in the small business segment, all in relation to strategy, governance, organizational structure and the effectiveness of internal controls.

The Bank carried out thematic inspections at the leading Italian banking groups, in part to gather the requisite macroprudential information on the "grey area" portfolios of loans that are still performing but at risk of impairment (mostly business loans and home mortgages). At the same time the inspectors assessed not only the banks' organization but also the way in which lending policies were adapted to the economic cycle.

Inspections targeted on liquidity were conducted simultaneously at a set of banking groups, concentrating on detailed analysis of financial equilibrium and liquidity balance. The other areas of inquiry included the adequacy of governance and control processes within the business model, the operation of information systems, how well internal capital adequacy assessment is integrated into strategic planning at consolidated level, the branch network, and capital adequacy.

Follow-up inspections evaluated the measures, including reorganization, taken to correct the shortcomings brought to light in the original inspections as regards governance and control of credit, financial and operational risks. Special inquiries were directed at foreign banks and subsidiaries, focusing on compliance with the regulations on money laundering, in particular the existence of satisfactory processes for checking and detecting suspicious transactions.

The Bank continued to verify the banks' internal models for determining capital requirements. As regards credit and operational risks, the checks focused first of all on the adequacy of the systems installed and the effectiveness of the initiatives undertaken to extend the method to other group members or portfolio segments and on the corrective measures needed to overcome weaknesses, as well as minimum consolidated capital requirements. They also bore on the internal models' ability to properly represent risk aggregates and provide corporate decision-makers with a solid basis for developing strategy guidelines. As for market risks, the checks concerned the incremental risk charge and methodologies for calculating stressed VaR.

Subsidiaries in Italy and abroad were inspected, consistently with the verification programmes agreed in supervisory colleges to assess the present and future effectiveness of the parent company's direction, coordination and control action.

Within the framework of the colleges, Bank of Italy representatives continued to take part in inspections conducted by the host country supervisors at local branches of Italian banking groups; there were also bilateral meetings to improve cooperation and the exchange of information. Cooperation with foreign supervisors also permitted inspection by mixed groups of inspectors at two Italian intermediaries.

Inspections at asset management companies, mostly private equity fund managers and some managers specializing in real-estate funds, bore chiefly on corporate governance, strategic planning, the selection and monitoring of investment assets, and control systems. Ownership, the composition of corporate bodies and the effectiveness of control functions received specific attention.

Inspections at investment firms were mostly broad-spectrum, judging the adequacy of governance and organization to the complexity of the firms' business and exposure to risk factors.

Inspections at intermediaries in the register under Article 107 of the Consolidated Law on Banking mainly involved those in consumer credit and servicing, leasing and factoring, credit card issuance and management, and the issue of guarantees. One mutual loan-guarantee consortium was inspected to gauge capital soundness and the consistency of its organization and operations both with prudential regulations and with its own strategic choices.

Inspections at intermediaries in the register under Article 106 were often aimed at compliance with the rules on transparency and money laundering, the appropriateness of organizational arrangements, and relations with the distribution network.

In collaboration with Consob, joint inspections were conducted at one asset management company and one central securities depository. Another inspection – a one-off verification – checked the procedures by which counterparties manage and transmit the data on bank loans in guarantee pools for Eurosystem refinancing operations.

Broad-spectrum inspections (which numbered 124 in 2011, up from 116) resulted in an increase in the number of favourable assessments (scores of 1, 2 or 3) from 51 to 76 and a decrease from 15 to 11 in the number with serious problems (scores of 4 or 5; Table 3.5).

Inspection results

Table 3.5

ASSESSMENTS OF BROAD-SPECTRUM INSPECTIONS OF BANKS, 2011

Assessment	Region			Total
	North	Centre	South	
Favourable	0	0	0	0
Mostly favourable	12	4	4	20
Partly favourable.....	29	9	18	56
Partly unfavourable.....	17	9	11	37
Mostly unfavourable	6	1	1	8
Unfavourable.....	1	0	2	3
Total.....	65	23	36	124

Inspection remarks

In many cases the critical areas found by inspectors at banks and banking groups involved shortcomings in credit management and the relevant information systems. As to liquidity, recurrent problems concerned vulnerability in the strategy/organization and operations areas.

The most common problems brought to light by inspections at 15 asset management companies and 10 investment firms were: (a) poor organization of the investment process; (b) vulnerability of strategic design and profit generation, the latter not always backed by adequate internal controls or carefully planned marketing; and (c) failure to adapt to regulations.

The problems disclosed by inspections at intermediaries in the Article 106 and Article 107 registers (9 and 16 respectively) were the following: (a) improper application of or non-compliance with the rules on transparency and money laundering; (b) inadequacy of organization and of relations with the distribution network; and (c) violation of the minimum capital requirement. Irregularities in the conduct of corporate officers were also found, often cases of conflict of interest.

3.8 Sanctions and deletions from the register

The sanction procedure

A reasonable system of sanctions is an indispensable complement to supervisory action; it is essential in order to suppress conduct in contrast with sound and prudent management and transparent, correct relations with customers. In this way it helps to ensure market stability and the protection of saving.

The Bank of Italy's powers of sanction are governed by Title VI of the Consolidated Law on Banking (for banks and financial companies), by Part V, Title II of the Consolidated Law on Finance (for investment firms and asset management companies), and by Title V of Legislative Decree 231/2007 (as regards money laundering). The persons to whom the sanctions apply are generally the natural persons directly responsible for the violations; the companies involved are generally jointly liable with the individual managers for the payment of fines, but with the obligation of recourse against those individuals. Sanctions are levied following an administrative proceeding that is initiated when a sanctionable irregularity is detected by off-site supervision or on-site inspection or reported by another authority. When the sanction proceeding is notified, the persons accused can submit a defensive brief in writing or at a personal hearing.

The Bank of Italy's inquiry is designed to acquire and assess the relevant acts and information. It ends with a proposal to the Bank's Governing Board, which is empowered to issue the sanction.

Sanctions are publicized in extract form in the Bank of Italy's *Supervisory Bulletin*; those involving violations of transparency rules must be publicized in at least two nationally distributed newspapers, one of them a business publication, on the responsibility and at the expense of the sanctioned intermediary, which must fulfil this obligation within 30 days.

The Bank imposed 116 sanctions in 2011, down from 145 in 2010. The natural and legal persons fined numbered more than 1,100. Although the number of fines levied decreased, their total amount remained substantial (€15.7 million), owing to the gravity of the violations, in particular those detected at intermediaries that were later subjected to extraordinary restrictive measures; in 24 cases the sanction proceedings were dismissed with no action taken.

In the first five months of 2012 the fines levied totalled €5 million; 41 sanction measures were imposed on more than 300 natural and legal persons, while 10 proceedings were dismissed with no action taken.

Most of the sanctions were for irregularities in the intermediaries' administrative organization and internal control systems, which often failed to provide adequate safeguards against risk. A number of sanctions were also imposed for shortcomings in the controls effected by the intermediaries' board of auditors, irregularities in the various phases of the lending process, and violations of the rules on transparency and correct customer relations.

The financial reforms now under way are aimed primarily at strengthening regulatory enforcement. Within the European Union, a proposal for a directive released on 20 July 2011 seeks to harmonize member states' sanction regimes in order to enhance their efficacy, proportionality and power of deterrence. The directive will have a significant impact on Italian law; it provides for widening the spectrum of sanction instruments, which should not be restricted to fines alone and should be applicable both to individuals and to legal persons, and also significantly increases the maximum amount of fines.

In any case, the Bank of Italy has begun its own sanction reform project. A measure issued on 27 June 2011 by the Governor revised the sanction procedure, providing that the inquiry, to be conducted by a single structure, be submitted for the examination of the Committee of Inquiry into Irregularities only in cases of particular complexity, those lacking precedents, and those of systemic importance.

The supervisory instructions laying down the principles and rules for the exercise of the Bank's powers of sanction were posted for consultation in May 2012. The guidelines consequent to the reform call for the integration of the sanction instrument with the exercise of the supervisory functions, incentives to encourage the active cooperation of the institutions supervised and their adoption of corrective measures, guarantees for the right to defense for the parties subjected to the proceedings, and the simplification of the inquiry process.

The reform modifies every phase of the sanction proceeding. The ascertainment of violations, which must be authorized by the Managing Director for Banking and Financial Supervision, will be integrated with the process of review and prudential assessment of intermediaries.

The formal charge of irregularities can now be notified to the intermediary by simplified means, such as certified e-mail. In their defensive briefs, to demonstrate

a spirit of cooperation between the parties, the accused must submit only essential, relevant documents.

Under the principle of separation between the inquiry and decision phases, the conclusive measure must be issued not by the body that carried out the inquiry but by the Bank's Governing Board. In deciding the amount of fines, the standards of proportionality and seriousness of the offense will be taken into account. In any event, at every phase in the proceeding the Bank of Italy has the power to undertake supervisory interventions, such as warning letters or specific measures vis-à-vis the intermediary.

In 2011 and the first five months of 2012, at the Bank's proposal the Ministry for the Economy and Finance ordered the deletion of 23 persons operating in the financial sector from the register referred to in Article 106 of the Consolidated Law on Banking. The irregularities that provided the grounds for their expulsion from the market varied: unauthorized collection of savings, repeated violation of the requirements of communication to the Bank as supervisory authority, and lack of the minimum capital and liquidity required to provide credit in the form of guarantees.

3.9 Crisis and other special procedures

Thirteen crisis management procedures were initiated in 2011, involving 8 banks, 3 asset management companies and the branch of a French investment firm. In the first five months of 2012, 5 new crisis management procedures involved 2 mutual banks, 2 asset management companies and a banking group parent (Table 3.6).

The interventions were motivated by serious administrative irregularities or violations of the law, owing to shortcomings in governance and control structures, dysfunctions in the various phases of credit concession, and non-compliance with the anti-money-laundering and transparency requirements.

In designating the special administrators, the Bank applied the standard of alternation, verifying the qualities of professional expertise and independence called for by the law and making sure there was no reason, even simply of appropriateness, for opposing the designation. In 2011 and the early months of 2012 the Bank posted on its website the code of ethics for members of special administrative bodies and the guidelines for appointment of outside consultants. In the case of special administration, upon designation the special administrators were given operational indications for carrying out the procedure and for drafting periodic reports.

Special administration and provisional management

Seven intermediaries were placed in special administration or provisional management in 2011 and three in the first five months of 2012. The measures were taken to prevent irreversible deterioration of the technical situation. In four cases only, the procedure was undertaken also because of serious losses of capital. The procedures bore on intermediaries in various parts of the country with no discernable

geographical pattern. In some cases the intermediary's situation had been damaged by opaque relations with intermediaries located in San Marino.

Table 3.6

**CRISIS MANAGEMENT PROCEDURES
AT SUPERVISED INTERMEDIARIES(1)**

Intermediary	Procedure (2)	Administrative act (3)	Legal basis (4)
	2011		
Européenne de Gestion Privée (Italian branch)	CL	DM of 10/01/2011	Art. 58 (1), TUF
BCC della Sibaritide	CL	DM of 11/03/2011	Art. 80(1) and Art. 80(2), TUB
Banca UBAE	PM	BI measure of 12/03/2011	Art. 76 TUB
Cape Natixis SGR	SA	DM of 04/04/2011	Art. 56(1.a), TUF
Banca UBAE	SA	DM of 08/04/2011	Art. 70 (1.a), TUB
Banca MB	CL	DM of 06/05/2011	Art. 80(1) and Art. 80(2), TUB
Total Return SGR	SA	DM of 12/05/2011	Art. 56(1.a-1.b), TUF
Banca S. Vincenzo La Costa Credito Cooperativo	CL	DM of 27/05/2011	Art. 80(1) and Art. 80(2), TUB
Investimenti e Sviluppo SGR	CL	DM of 07/07/2011	Art. 57(1), TUF
BCC Luigi Sturzo	SA	DM of 09/09/2011	Art. 70(1.a-1.b), TUB
BCC Altavilla Silentina e C.	SA	DM of 20/10/2011	Art. 70(1.a-1.b), TUB
Banca Network Investimenti	SA	DM of 14/11/2011	Art. 70(1.a-1.b), TUB
Istituto per il Credito Sportivo	SA	DM of 28/12/2011	Art. 70(1.a), TUB
2012			
Cape Regione Siciliana SGR	SA	DM of 16/01/2012	Art. 56(1.a), TUF
Cape Natixis SGR	CL	DM of 20/02/2012	Art. 57(1), TUF
Credito Cooperativo Fiorentino - Campi Bisenzio	CL	DM of 26/03/2012	Art. 80(1) and Art. 80(2), TUB
Tercas – Cassa di Risparmio della provincia di Teramo	SA	DM of 30/04/2012	Art. 70(1.a), TUB
Banca di Monastier e del Sile CC	SA	DM of 04/05/2012	Art. 70(1.a), TUB

(1) Procedures initiated between 1 January 2011 and 31 May 2012. – (2) CL = compulsory administrative liquidation; SA = special administration; PM = provisional management. – (3) DM = Ministerial Decree; BI measure = Bank of Italy measure. – (4) TUB = Consolidated Law on Banking; TUF = Consolidated Law on Finance.

In March 2011, on grounds of absolute urgency, UBAE bank had to be placed under provisional administration; the bank was the subsidiary of a Libyan bank subject to an asset freeze consequent to the political upheaval in that country. The measure served to ensure the continued operations of the bank while still complying with the rules against international terrorist financing. UBAE was then placed under special administration, which was ended in March 2012 with the return to ordinary management.

In September and October 2011 the Luigi Sturzo mutual bank of Caltagirone and the mutual bank of Altavilla Silentina and Calabritto were placed under special administration, in both cases owing to heavy capital losses as well as serious irregularities and infractions.

In November Banca Network Investimenti was placed under special administration for serious irregularities and infractions and serious capital losses owing to persistent operating losses. Action to restore the health of the bank was

hindered by serious problems of governance. On 31 May 2012, as a result of mounting deposit outflows and the consequent deterioration in the institution's liquidity, a one-month suspension of all types of liability was ordered under Article 74 of the Consolidated Law on Banking (the restitution of financial instruments to customers was not suspended).

At the end of 2011 Istituto per il Credito Sportivo was placed under special administration, following a period under a government-appointed manager ordered on 17 June 2011. On 28 December the Ministry for the Economy and Finance ordered that as of 1 January 2012 the bank would be placed under special administration, on the basis of the Bank of Italy proposal of 28 June, the bank's situation being, in practice, unmanageable. The special administrators began fact-finding and initiated a consultation with the relevant ministries and shareholders to design a balanced framework of governance. In February 2012 the Bank of Italy pronounced a favourable opinion on the granting of a government guarantee on the institute's new liability issues (under Decree Law 201/2011) and lifted the ban on lending to new customers that had been put in place by the government-appointed manager.

In April 2012 the special administration procedure was initiated for the group parent bank Cassa di Risparmio di Teramo on grounds of severe shortcomings in governance and internal controls which, in conditions of general operational opacity, resulted in a badly deteriorated situation.

Delta S.p.A. and its subsidiary SediciBanca S.p.A. are still under the special administration initiated in 2009. In November 2011 the Court of Bologna approved a debt restructuring agreement that provides among other things for the transfer to Intesa San Paolo of the bank accounts of SediciBanca and of its Bentos Assicurazioni affiliate.

Between January 2011 and May 2012, fourteen special administration procedures were closed. Eight returned to ordinary management (Banco Emiliano Romagnolo, BCC di Cagliari, Mantovabanca, Banca di Credito dei Farmacisti, Credito di Romagna, MobilMat Imel, BCC di Scandale and UBAE). One (BCC di Offanengo) was merged with another, neighbouring mutual bank. In five cases (BCC della Sibaritide, BCC di San Vincenzo La Costa, Banca MB, Credito Cooperativo Fiorentino and Cape Natixis asset management company) compulsory administrative liquidation had to be ordered.

Compulsory administrative liquidation procedures

Five compulsory administrative liquidation procedures were ordered during 2011 and two more in the first five months of 2012. In two cases (Européenne de Gestion Privée and Investimenti e Sviluppo SGR) the liquidation order was immediate⁶; in the other five it followed a period of special administration.

In May 2011 the compulsory liquidation of Banca MB got under way. Depositors were safeguarded thanks to a complex operation involving the Interbank Depositor

⁶ For EGP, liquidation was ordered at the proposal of the Consob and with the Bank of Italy's favourable opinion, following the liquidation of the parent company at the order of the French authorities.

Guarantee Fund and UniCredit as receiver of assets. The plan also provided for a restructuring of the liquidated bank's debt.

In February 2012 the asset management company Cape Natixis SGR was put into compulsory administrative liquidation, in view of the special administrators' conclusion that all possibility of autonomous survival in the market had been definitively and irreversibly compromised.

In March 2012 compulsory administrative liquidation of Credito Copoperativo Fiorentino was begun. The complicated transfer of its assets and liabilities to Chianti Banca was accomplished with the financial intervention of the Interbank Depositor Guarantee Fund, which, in an unprecedented move, also acquired the liquidated bank's impaired assets.

Sicilcassa continued its credit recovery actions, albeit with increasing difficulty owing to the contractionary phase of the cycle and the poor quality of the residual loan assets. The bank sought ways to speed asset realization and settlement of the main lawsuits. Among other things, the liquidators proposed an agreement with the national agency for the administration and disposal of goods seized or confiscated from organized crime, in order to resolve the dispute over Sicilcassa loan assets affected by the confiscation of the collateral assets that had backed them.

On 31 May 2012, 41 compulsory administrative liquidation procedures were under way (for 18 banks, 5 asset management companies, 17 investment firms and one branch of a French investment firm). Between January 2011 and May 2012, three procedures were closed (Danubio SIM, Cassa rurale ed artigiana di Corigliano Calabro and Banca di Cosenza Credito Cooperativo).

Società per la Gestione di Attività S.p.A. continued with the liquidation of the problem assets acquired from Banco di Napoli and Isveimer. It made operating profits of €113 million in 2011, while the residual assets still to be recovered amounted to €367 million.

The liquidation of Isveimer also continued in 2011. At the end of the year the institute had residual assets of €103 million, essentially claims on banks, government securities, and credits with the Treasury. The final deficit on the liquidation procedure was estimated at the end of 2011 at €753.9 million, €5 million less than the year-earlier estimate.

3.10 Relations with general government bodies, the judicial authorities and other national authorities

In 2011 the Bank received 252 requests for information submitted by the Government following parliamentary acts of inquiry and oversight, including 48 questions for immediate response. The information provided to the Government mainly concerned questions relating to the effects of the market turbulence, access to credit for firms and households, the revision of the Basel Accord, the

Information to Parliament

special procedures undertaken towards supervised intermediaries, transparency in intermediaries' dealings with customers, the costs of banking and financial services, and derivative instruments. In the first four months of 2012 the Bank received 124 requests (of which 17 for immediate response).

Members of the Governing Board and representatives of the Supervision Area provided the Bank of Italy's contribution to parliamentary fact-findings, also in connection with the examination of draft legislation on economic and financial matters.

Cooperation with Consob

The Strategic Committee set up under the memorandum of understanding between the Bank of Italy and Consob conducted frequent examinations of various subjects of common interest during the year.

The Bank of Italy and Consob issued a joint communication on the division of tasks between the compliance and internal audit functions in the provision of investment services. The two authorities also defined procedures for coordinating anti-money-laundering controls on intermediaries.

In 2011 the two authorities conducted a joint inspection of an asset management company, applying the procedures established during the previous year. The Bank of Italy sent Consob 29 reports concerning matters of possible interest that the Bank had found in the course of supervisory activity; the Bank received 20 requests for information and documentation from Consob.

Cooperation with the Antitrust Authority

In order to ensure the efficiency and consistency of oversight, contain the costs borne by intermediaries and provide effective protection for consumers, in February 2011 the Bank of Italy and the Antitrust Authority signed a memorandum of understanding that governs the coordination of their respective powers with regard to transparency and fairness in intermediaries' dealings with customers and unfair business practices.

Relations with the judicial authorities

In 2011 the Bank of Italy continued to cooperate with the judicial authorities in the fight against economic crime: the number of reports sent by the Bank of Italy concerning matters of possible criminal significance increased by 24 per cent, from 165 in 2010 to 204. There was intensive, timely interaction with the office of the public prosecutor of Milan (38 reports) and with those of Rome, Naples and Florence.

With reference to the types of crime, the increase in reports regarding money laundering (from 63 in 2010 to 91 in 2011) is partly ascribable to the more highly ramified nature of controls. The other cases reported included episodes of embezzlement, violation of the anti-usury provisions and unauthorized banking

The Bank of Italy responded to a growing number of requests for information and documentation from the judicial authorities in the context of penal proceedings (354, compared with 260 in 2011). Employees of the Bank also assisted the investigative authorities as appointed technical advisors (24 appointments in 2011) and witnesses (in 29 penal proceedings).

Cooperation facilitated supervisory activity: the information transmitted by the public prosecutor's offices, from the very first stage of investigations, made it possible to focus supervision and improve the timeliness of interventions.

Under the 2007 memorandum of understanding, last year the Bank of Italy sent the Finance Police 38 reports concerning potentially anomalous cases and responded to 123 requests for information. Upon prior agreement with the Bank, the Finance Police carried out 54 anti-money-laundering inspections of intermediaries referred to in Article 106 of the Consolidated Law on Banking, finding anomalies in 21 cases; the Finance Police also sent the Bank of Italy 490 notifications of irregularities detected during their checks on financial agents or loan brokers.

Collaboration with the Finance Police

The Bank of Italy conducts a quarterly survey of the average percentage rates of charge applied by banks and by financial intermediaries referred to in Articles 106 and 107 of the Consolidated Law on Banking, and replies to questions of interpretation from reporting parties.

Anti-usury action

Decree Law 70/2011 modified the formula for determining the threshold rates for anti-usury purposes, which are now calculated by increasing the average rate by one fourth (rather than one half) and then adding four percentage points: the difference between the threshold rate and the average rate may not exceed eight percentage points in any circumstances. The new methodology is designed to limit the difference between average rates and threshold rates, thereby helping to mitigate credit rationing.

As part of the activity to prevent extortion and usury, the Bank of Italy collaborates with the prefects' offices.

3.11 Action to prevent and combat money laundering and terrorist financing

In 2011 the Bank of Italy offered its contribution in the main international fora devoted to the safeguard of the integrity of the financial system.

International cooperation

The Financial Action Task Force (FATF), under its Italian presidency, which began in July 2011, finished revising its Recommendations for combating money laundering and the financing of terrorism. The new standards, approved in February 2012, call for measures to combat the financing of the proliferation of weapons of mass destruction, the inclusion of tax crimes among the "predicate offences" for money laundering, the strengthening of the risk-based approach and more effective mechanisms of international cooperation.

The Bank of Italy takes part in the work of the Anti Money Laundering Expert Group (AMLEG), instituted within the Basel Committee, and the Anti Money Laundering Committee (AMLC), set up in 2011 by the Joint Committee of the European Supervisory Authorities. During the year the Expert Group contributed to the revision of the FATF Recommendations and of the Basel Committee's Core Principles with regard to the safeguarding of the integrity of banking sector. The

AMLC carried out surveys on the rules in force in the member states regarding customer due diligence, with a view to fostering the convergence of national anti-money-laundering practices.

As part of the technical assistance projects financed at EU level, the Bank of Italy hosted a delegation from the Central Bank of Montenegro and met with representatives of the Central Bank of Albania.

National primary legislation

The reference threshold for limitations on the use of cash was reduced to €1,000 by Article 12(1) of Law Decree 201/2011, converted into Law 214/2011; this measure enhances the transparency and traceability of transactions.

Secondary regulation

The Bank of Italy's regulation of March 2011 concerning organization, procedures and internal controls to prevent intermediaries and other persons engaged in financial activity from being used for purposes of money laundering and terrorist financing entered into force on 1 September 2011. In July 2011 clarifications were issued on certain provisions regarding the anti-money-laundering officer, outsourcing, the person charged with reporting suspicious transactions, and trust companies.

March 2012 saw the conclusion of the public consultation on the supervisory instructions concerning customer due diligence, which contain provisions implementing primary legislation and providing a systematic operating guide to those falling within their scope, and on the proposed changes to the rules for the keeping of the single electronic archive.

Within the technical group set up at the Ministry for the Economy, in which the Bank of Italy participates together with representatives of the Finance Police, the Bank contributed to the discussion of questions concerning the application of anti-money-laundering rules and helped to frame replies to the queries from intermediaries.

Anti-money-laundering controls

Monitoring intermediaries' compliance with the anti-money-laundering provisions is part of the broader activity of prudential supervision; it is performed according to the so-called risk-based approach.

Examinations conducted in the course of ordinary supervisory inspections and targeted on-site controls were supplemented again last year by checks at individual branches of banks. These involved 74 branches of 26 different banks located in Liguria, Puglia and southern Lazio. Compared with the outcome of the previous checks, the results show, in general, a steady improvement in compliance, fostered by the Bank of Italy's work of raising awareness, control and intervention; however, there are still deficiencies in customer due diligence, particularly in identifying the beneficial owner, in the completeness of data and in the carefulness of the related assessments.

The Bank took specific measures in the light of the findings of the inspections. It levied administrative fines on 56 intermediaries for violation of the anti-laundering rules, for a total of €10.7 million (€4.1 million in 2010). In addition, it sent reports

to the judicial authorities and the Financial Intelligence Unit (FIU) for the matters within their respective spheres of competence.

In May 2011 the Bank provided the system with an overview of the results of the inspections carried out the previous year, not least with a view to enhancing intermediaries' awareness and orienting their future action.

A total of 109 reports from intermediaries were examined, the bulk of them concerning irregularities in the records in the single electronic archive, due, in several cases, to deficiencies in the procedures used by the managers of outsourced services. The Bank of Italy drew attention to the need for strict compliance with the rules on outsourcing, and provided operational instructions in this regard.

In the evaluation phase of supervisory proceedings the reliability of the organizational arrangements against money laundering was systematically assessed; where irregularities were found, intermediaries were requested to take action regarding controls or to adopt suitable corrective measures.

Within the Financial Security Committee the Bank of Italy contributed to the analysis of terrorist financing and to evaluating applications for payment relating to persons subject to international freezes. In accordance with the positions expressed by the Committee, in April 2011 the Bank of Italy called intermediaries' attention to the need for strict compliance with the restrictive measures taken by the EU in regard to some countries affected by episodes of political instability.

Cooperation among authorities: the Financial Security Committee

The Supervision Area of the Bank of Italy and the Financial Intelligence Unit continued their cooperation, exchanging information on the anomalies detected during the controls within their respective spheres of competence (39 reports by the Bank, 29 by the FIU).

Cooperation with the FIU

3.12 Transparency, intermediaries' relations with customers, and financial education

In 2011 the Bank of Italy stepped up its efforts for the improvement of intermediary-customer relations, making use of the stock of information derived from complaints, and supplied the necessary technical support to the Arbitro Bancario Finanziario (ABF), the banking and financial ombudsman.

Controls, which are planned drawing on the information derived from the integrated system for monitoring intermediary-customer relations,⁷ were conducted with methods calibrated to the characteristics of the intermediaries concerned. Controls focused increasingly on the organizational arrangements adopted to ensure that in every phase of activity due attention is paid to the rules on transparency and to the legal and reputational risks inherent in dealings with customers.

Transparency controls

⁷ The system includes, among other items, the data obtained from checks on transparency, the outcomes of complaints to the ABF, and the facts and circumstances described in reports received by the Supervision Area of the Bank of Italy.

In 2011 checks on compliance with the transparency rules – conducted as part of the ordinary on-site controls – numbered 277 and involved branches of 145 intermediaries.⁸ The results indicated a general improvement in customer relations. However, problems persist with regard to the organizational arrangements adopted and completeness of pre-contractual disclosure. In addition, inconsistencies were found between the conditions advertised and those actually applied by intermediaries, and some cases of delay in complying with the new rules on consumer credit came to light.

When irregularities were found, the Bank of Italy called the intermediaries' attention to the need for more scrupulous compliance with the transparency rules, asking them to inform the Bank of the measures taken, including those of an organizational nature, to ensure more transparent and correct customer relations. It initiated administrative sanction procedures against 13 intermediaries. Moreover, in the first few months of 2012 it initiated administrative proceedings against 2 intermediaries pursuant to Article 128-ter of the Consolidated Law on Banking, for restitution of sums unjustifiably received.

Analysis of the intermediaries' websites and the documentation available on them supplements the set of instruments of control. In this context, the Bank of Italy, together with the Antitrust Authority, took part in the EU “sweep” of the websites of intermediaries active in the consumer credit sector and the “sweep plus” exercise that monitored the pre-contractual information made available, in order to verify their conformity with EU legislation. Where problems were found, steps were taken with specific intermediaries; measures were also taken to sensitize consumer credit operators to the need for complete and substantive compliance with the relevant provisions in force.

Complaints

The Bank of Italy received 6,560 complaints last year (5,700 in 2010). The economic crisis led to an increase in the number of complaints about failure to disburse funds or requests for early repayment of loans; 46 per cent of all complaints concerned the management of credit. The Bank also received nearly 1,100 complaints about erroneous reports on file with the Central Credit Register.

The Bank of Italy examines the complaints received from a supervisory perspective and asks the intermediaries involved to provide clarifications. It replies to complainants, providing regulatory or technical information where appropriate, and informs them of the possibility of lodging a complaint with the ABF.

Analysis of the complaints can bring to light weaknesses in the individual intermediaries' handling of customer relations, regarding which the Bank of Italy takes appropriate action. If widespread and frequent problems are found, measures are taken to sensitize the whole banking and financial system. In particular, last year such measures concerned the introduction of fees on cash withdrawals at bank

⁸ In particular, transparency checks were carried out at 265 branches of 133 banks, 7 intermediaries entered in the register referred to in Article 107 of the Consolidated Banking Law and 5 entered in the register referred to in Article 106 of the same law.

branches, the activity of granting loans secured by a pledge of one fifth of the borrower's salary or pension, requests for repayment relating to past relationships, and the provision of guarantees by intermediaries lacking the requisite authorizations.

In 2011 the ABF was asked to decide on 3,578 complaints, 80 per cent of them from consumers and the remaining 20 per cent from firms or professionals. During the year it reached a decision on 2,760 complaints, with a favourable outcome for the customer in 62 per cent (1,109 decisions upholding the complaint and 611 cases in which the matter of dispute was declared no longer to exist because the customer had been satisfied in the meantime).

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Notice of an intermediary's non-compliance with a decision of the ABF or failure to cooperate with the ABF is published on the ABF's website and, at the intermediary's expense, in two daily newspapers with a national circulation. Where appropriate, the notice also mentions that the dispute has been submitted to the judicial authorities. Up to now there have been only three cases of non-compliance, all three involving intermediaries no longer operating on the market.

The Bank of Italy informs the public of the activity carried out by the ABF, taking responsibility for publishing the ABF's annual report and updating its website, where the decisions taken by the ABF's colleges are available in anonymous form. In April 2011 the Bank of Italy's website published a summary of the main principles and recommendations contained in the ABF's decisions, in order to make them more widely known.

The Bank of Italy continued in its commitment to the financial education of the public, strengthening the activity begun in the past years.

Financial education

The project carried out in schools, in agreement with the Ministry for Education, Universities and Research, was extended in the 2011-12 school year to involve more than 1,000 classes and 20,000 students throughout Italy. The effectiveness of training was measured by administering tests to the students before and after the classroom sessions.

The results of the tests conducted in the 2010-11 school year showed an increase in students' knowledge at all levels of schooling. In particular, for primary school students the percentage of correct answers rose from 52 to 71 per cent, for students in lower secondary school from 55 to 65 per cent and for those in upper secondary school from 52 to 64 per cent.

To consolidate the results achieved, the Bank has developed educational material specifically aimed at youngsters. Three pamphlets on the subject "Money and non-cash payment instruments" have been prepared, in paper-based and electronic format, for students in primary, lower secondary and upper secondary school.

The Bank continued to contribute to the international fora, such as the OECD, and to assist the Bank of Albania in developing financial education initiatives, including measurement of the population's financial literacy.

To improve the instruments available to the public for financial decisions, practical guides concerning mortgage loans, current accounts and the ABF will be issued shortly.

3.13 International cooperation

During 2011 the Bank of Italy continued to work within the numerous international committees that are implementing the programme of financial reforms agreed by the G20. In particular, recommendations were adopted for limiting the risks associated with systemically important financial institutions (SIFIs), a methodology was developed for the monitoring and analysis of risks generated by the shadow banking system, and a review of international accounting regulations was undertaken.

The measures to address the risks associated with SIFIs

The G20 recommendations aim to reduce the likelihood and the impact of SIFI failures. To achieve the first objective, capital surcharges will be introduced and supervision enhanced. For the second objective, effective crisis management and resolution systems will be developed.⁹

In November 2011 the FSB published the first list of global systemically important banks (G-SIBs); the list of insurance companies and market infrastructures is now being drawn up. The G-SIBs list will be updated yearly and for the time being contains only one Italian bank, the UniCredit group.

Work is under way to decide on the appropriate treatment of domestic systemically important banks (D-SIBs). The Bank of Italy has repeatedly underlined the importance of setting up a prudential regime for domestic systemic branches of G-SIBs that is consistent with the one governing the G-SIBs themselves. The objective is to ensure a suitable level of coordination between home and host authorities and avoid duplication of capital requirements and excessively tight constraints on the allocation of capital.

Regarding the recommendations aimed at reducing the impact of possible SIFIs failures, the “Key Attributes of Effective Resolution Regimes for Financial Institutions” (KAs) drawn up by the FSB require the competent national authorities to be equipped with a broad range of tools for the purpose. The Bank of Italy participates in the work of the FSB to develop a method of transposing the recommendations into national jurisdictions, assessing their consistency with what has been decided by the FSB and identifying possible corrective measures. A peer review of existing national legislation will be conducted in the latter part of 2012. The Bank of Italy has begun in-depth studies to pinpoint the legislative amendments needed to transpose the KAs. These amendments will have to take account of the European Commission’s recent proposal for a directive to strengthen and harmonize crisis management regulations.

⁹ See Chapter 19, “L’azione di vigilanza”, in *Relazione sull’anno 2011*, Banca d’Italia, 2012.

The EBA has carried out preliminary studies of the methods followed by banking groups to draft recovery plans and by the competent authorities to draft resolution plans. The Bank of Italy took part in drawing up two documents, one describing the experiences of member countries, which has been published for consultation, and the other examining the appropriate outline and content of recovery plans. The results of consultation on the second document will be useful to the EBA in order to identify best practices and establish regulatory technical standards (RTS) and implementing technical standards (ITS) for the development of recovery and resolution plans, a task with which the EBA is entrusted under Article 25 of the regulation instituting it (Regulation (EU) No 1093/2010 of the European Parliament and Council Regulation 1093/2010 of 24 November 2010).

In April 2011 the FSB conducted a preliminary study and monitoring of the shadow banking system (defined as the set of entities or activities generating systemic risks, including through forms of regulatory arbitrage). The first recommendations concerning possible legislative measures, drawn up in collaboration with various standard setters (Basel Committee, IOSCO) and with national regulators, are expected at the end of the year. In Italy, several factors limit the risks of the shadow banking system: (a) tight indirect regulation (conducted through bank intermediaries), particularly regarding the inclusion of vehicles within the perimeter of the consolidated banking group; (b) the broad scope of regulation, which extends also to non-bank intermediaries; and (c) specific regulations, such as those on securitizations. In March this year the European Commission published a green paper on shadow banking for consultation. The Bank of Italy took part in the consultation, together with the Ministry for the Economy and Finance, Consob and Isvap, stressing the need for other countries to follow Italy's regulatory approach. That approach is based on the principle of equivalent prudential rules for all subjects entering into the same types of risk, regardless of the sector in which they operate, but calibrated proportionately.

Studies on the shadow banking system

The international review of accounting regulations that began in October 2008 is now nearing completion.

Review of international accounting rules

In May 2011 the International Accounting Standards Board (IASB) published new international accounting standards containing rules on consolidation and disclosure. Under the new approach, the consolidation of accounts is related to the power to direct an entity's operations and to obtain a return proportionate to its economic performance. In order to fully extend the scope of consolidation, the Bank of Italy has proposed that the new approach be evaluated only after it has been in operation (say, for two to three years) and on the basis of the experience gained.

Review of IAS 39 relating to financial instruments continues. The new rules now being drawn up regarding the impairment of financial instruments measured at amortized cost are based on the concept of expected loss rather than incurred loss, and they require loan exposures to be classified into one of three buckets and written down to a level consistent with the deterioration in the quality of the borrowers' loans. The Bank of Italy, with a view to keeping the pro-cyclical effects to a minimum, has stressed that the new impairment model must ensure ex ante that there are sufficient provisions to absorb losses when they actually occur.

The new Core Principles for Effective Banking Supervision

In December 2011 the Basel Committee published a consultation document on the new Core Principles for Effective Banking Supervision. The Bank of Italy agreed as to the need to issue stricter supervisory standards incorporating the lessons learned from the crisis, especially as regards systemically important banks. It also called for the quality of controls on cross-border groups to be improved through closer collaboration among the authorities and more effective consolidated supervision by the home country authority. The document issued by the Committee assigns enhanced powers to the host country authorities. Specially, if a group runs into difficulty, the host authorities are allowed, independently and regardless of any action taken by the home authorities, to adopt safeguards and take measures to ring fence the assets of foreign bank branches. This possibility could hinder the exercise of consolidated supervision in the case of groups that have chosen an integrated business model, could heighten the tensions between different components of the group and the respective competent authorities in the event of a crisis, and could even hamper the necessary corrective measures. Final approval of the new principles is due to be given in September 2012, in conjunction with the biennial conference of international supervisory authorities.

During 2011 the Bank of Italy took part, together with the Ministry for the Economy and Finance, in the Europe-wide negotiations regarding the legislative measures required to carry forward the internationally agreed reform programme.

The transposition of Basel III in Europa

Negotiations for the adoption of Basel III within the EU are coming to a conclusion. Two pieces of legislation will be passed by the end of the summer: a directive (Capital Requirements Directive, CRD4) updating, among other things, the provisions relating to authorization to engage in banking business, freedom to provide services, cooperation between home and host supervisory authorities, prudential controls, and capital buffers; and a regulation (Capital Requirements Regulation, CRR) governing prudential requirements and responding to calls for a single European rulebook¹⁰. Negotiations focus on the following aspects: defining criteria for the recognition of capital instruments in common equity tier 1; prudential treatment of deferred tax assets (DTAs); the new rules on liquidity risk and leverage ratio; and the introduction of exceptions to the principle of maximum harmonization in order to allow member country authorities to take account of any systemic risks in their national economies.

The regulation assesses capital instruments according to the principle of their economic substance alone, not that of their legal form, which would limit accounting to ordinary shares. The Bank of Italy is in favour of a decisive role for the EBA in monitoring and assessing the capital instruments so as to minimize any disparity of treatment within the EU.

The Italian delegation agreed on the transposition at EU level of the Basel Committee's decision on DTAs that do not depend on the banks' future earnings

¹⁰ See Chapter 19, "L'azione di vigilanza", *Relazione sull'anno 2011*, Banca d'Italia, 2012.

(e.g. those envisaged by Italian legislation, as amended by Law 214/2011); therefore, instead of being deducted from capital, they must be 100 per cent weighted.

The Bank of Italy advocates coordinating the Basel agreements and the Community proposal to place a regulatory limit on financial leverage.

The national authorities can use prudential supervisory tools to take account of any structural differences between national financial systems and of the phases of the economic cycle characterizing member countries' real economy. The Bank of Italy is in agreement with this approach and has proposed some mechanisms for preventive coordination, also suggesting that the European Systemic Risk Board (ESRB) play a major role to ensure the implementation of the single European rulebook and avoid a segmentation of the single market.

Finally, the Bank of Italy is closely following the debate on the prudential treatment of exposures to small and medium-sized enterprises.

The Bank of Italy is taking part, together with the Ministry for the Economy and Finance and Consob, in negotiations on the proposal for a directive (MiFID2) and regulation (MiFIR) governing markets in financial instruments presented by the European Commission in October 2011. Accordingly, the Italian delegation supports the general tone of the review, particularly as regards the questions of greater transparency of trades at all levels, including for non-equity instruments, and the prohibition on independent financial advisors receiving fees or incentives from principal intermediaries. Regarding the tightening of rules on the governance of investment firms – also applicable to a limited degree to banks offering the same services – the Italian delegation, along with others, called for full alignment with the rules envisaged by CRD4 applying to the same institutions.

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for financial instruments**

The European institutions are currently discussing two legislative proposals to reorganize Community regulations on statutory audits of accounts: one a proposal for an amendment to Directive 43/2006/EC of 17 May 2006 on statutory audits, and the other a proposal for a regulation on statutory audits of entities of public interest, including banks. The Bank of Italy welcomes the Commission's initiative as a stronger harmonization of regulations at European level could help to improve the quality of statutory audits, a need that has been highlighted by the recent crisis. During the negotiations, the Bank of Italy pointed out that the member countries should retain their existing discretionary powers to define what constitutes an entity of public interest, thus ensuring that the regulation applies to all supervised entities.

**Review of the directive on
external auditing**

The financial crisis has highlighted the need for policies to safeguard the stability of the financial system as a whole, not just that of individual banks. Hence the need also to devise adequate systems of macro-prudential supervision. In January 2012 the ESRB issued its recommendation on the mandate of macro-prudential authorities calling on member countries to recognize a macro-prudential function in their national legislation, to set out its objectives, and to identify a competent independent authority endowed with suitable tools and powers, while also attributing a major role to the central bank. The Bank of Italy welcomed the recommendation,

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and in particular was in favour of the suggestion to allow national legislators to assign responsibility for the function to a committee of authorities as a means of taking into account specific national situations.

Bilateral and multilateral supervisory cooperation

During 2011 the Bank of Italy carried out extensive studies of the financial systems and regulatory and supervisory systems of some 20 non-EU countries where Italian banks have already set up branches or where they plan to expand, or where banks intending to open in Italy are located. Because of the changed macroeconomic context, such analyses are increasingly important in ensuring the effectiveness of the Bank of Italy's supervisory action and the prudent management of risks by Italian banking groups.

Special attention has focused on the regulatory framework of other countries regarding the confidentiality of information and compliance with FATF's recommendations concerning the prevention of money-laundering and terrorist financing.

Various agreements were signed during the year, including two general bilateral memorandums on supervisory cooperation with the central banks of Albania and Brazil; specific agreements for cooperation with the Russian central bank on supervision and information exchange on the branches of the UniCredit and Intesa Sanpaolo groups; and multilateral agreements for the colleges of supervisors of eight Italian banking groups (Banco Popolare, Unione di Banche Italiane, Banca Monte dei Paschi di Siena, Credito Emiliano, Banca Popolare dell'Emilia Romagna, Banca Mediolanum, and Banca Leonardo, Mediobanca) and three international groups for which the Bank of Italy is host authority (Deutsche Bank, State Street Bank, and RBC Dexia).

3.14 Regulatory activity

In line with the strategic objectives set out in the Supervision Area's regulatory activity plan for 2011,¹¹ the Bank of Italy directed its action to adapting the domestic framework to the legislative and regulatory measures taken and the approaches that emerged at EU level and to updating, strengthening and rationalizing the corpus of regulations within its competence. The Bank also issued communications, clarifications and implementing guidelines on banking and financial regulations and cooperated with the Ministry for the Economy in the process of producing legislation.

Adaptation to the European regulatory framework

With a view to bringing domestic regulation into line with the EU framework, in December 2011 the Bank of Italy implemented Directive 2010/76/EU (the Third Capital Requirements Directive: CRD3), which amended prudential regulation to rectify weaknesses that came to light in the prudential rules during the recent financial crisis. The changes, which concern banks and investment firms, are

¹¹ See Chapter 19, "L'azione di vigilanza" in *Relazione sull'anno 2010*, Banca d'Italia 2011.

designed to strengthen the calculation of capital requirements both quantitatively and methodologically and to fit the prudential rules more closely to the actual risks. In particular, changes were made to the provisions on regulatory capital, credit risk, securitizations, market risks, public disclosure and covered bonds issued by banks.¹² Again, to implement the CRD3 rules, in March 2012 the Bank of Italy and Consob initiated a public consultation on proposed amendments to their joint Regulation of 29 October 2007. The amendments extend the rules on compensation systems for banks and banking groups to apply to providers of investment services and activities.

After the publication of Legislative Decree 47/2012, which made the necessary amendments to the Consolidated Law on Finance, the transposition of Directive 2009/65/EC (UCITS4) was completed with the issue of the Bank of Italy's Regulation of 8 May 2012 concerning collective asset management and with the amendments to the Bank of Italy-Consob joint Regulation of 29 October 2007 concerning the organization and procedures of intermediaries that provide investment or collective asset management services. The directive is aimed at enhancing the integration and efficiency of the European UCITS market through a series of measures that foster cross-border operations by asset management companies (see the box "The changes to the regulations on collective asset management").

THE CHANGES TO THE REGULATIONS ON COLLECTIVE ASSET MANAGEMENT

In the context of the rules governing the cross-border operations of asset management companies, the content of the manager's so-called European passport was expanded: a management company may now establish and manage harmonized funds in countries other than its home country (EU management companies may establish funds in Italy, while Italian asset management companies may establish UCITS in other EU countries).

Mergers and demergers between UCITS were regulated ex novo. In particular, mergers between harmonized funds established in different EU countries are now possible; these operations require approval by the authority responsible for supervising the merged fund.

Other important changes concerned the introduction of master-feeder structures, characterized by the presence of a fund ("feeder") that invests at least 85 per cent of its assets in another fund ("master"). Alongside harmonized master-feeder structures (whose regulation derives from EU legislation), rules were adopted for non-harmonized master-feeder structures, which are subject exclusively to national regulation.

Specific prudential rules were established for money market funds, in accordance with the guidelines of the European Securities and Markets Authority.

Important changes were made to the rules governing UCITS' risk management system. In particular: (a) principles on which the risk management system must

¹² See Chapter 19, "L'azione di vigilanza" in *Relazione sull'anno 2011*, Banca d'Italia 2012.

be based were introduced; (b) new rules were laid down concerning the method of calculating UCITS' total exposure in derivatives (maximum financial leverage); (c) the limits within which UCITS may resort to efficient portfolio management techniques (repos, securities lending, etc.) were clarified compared with the previous rules.

As part of the transposition of the directive, new rules were issued concerning the exercise of the functions of depositary bank for UCITS and pension funds; an ex ante authorization was introduced on a general basis for appointment as depositary bank or person authorized to calculate the value of fund units.

In June 2012 the Bank of Italy issued the provisions on payment institutions and electronic money institutions, implementing the amendments made to the Consolidated Law on Banking by Legislative Decrees 45/2012 and 230/2011. The provisions transpose Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions and lay down a set of rules also applying to payment institutions, given the fundamental sameness of the regulatory regime established by Community legislation and the advantages in terms of regulatory simplification.

**Revision, strengthening
and rationalization of
regulations**

In updating, strengthening and rationalizing regulations, some recent measures were incorporated into the provisions of prudential supervision for banks with regard to (i) permissible equity interests, risk asset exposures and conflict of interests with related parties, (ii) covered bonds issued by banks, and (iii) the carrying out of depositary bank functions.¹³

In December 2011 the Bank of Italy conducted a comprehensive revision of the rules on the Arbitro Bancario Finanziario (ABF) in order to take into account the entry into force of Legislative Decree 28/2010 on mediation in matters of civil and commercial law and to address the needs that emerged during its initial application. In addition to governing relations both between procedures before the ABF and civil trials and with other conciliation and mediation procedures, the recent rules mainly concern the composition and functioning of the colleges, appeals and the phase that comes after a decision by the ABF.

March 2012 saw the conclusion of the public consultation on the supervisory regulation on financial intermediaries pursuant to Title V of the Consolidated Law on Banking as amended by Legislative Decree 141/2010. Finalization of the draft of the new regulation marked the start of the overall revision of the rules governing persons operating in the financial sector.

With the transposition of the UCITS4 Directive, the Regulation of 8 May 2012 on asset management completely superseded the previous rules, making the regulatory framework more organic by also adapting it to the intervening changes in legislation, markets and supervisory approaches.

¹³ See Chapter 19, "L'azione di vigilanza" in *Relazione sull'anno 2011*, Banca d'Italia 2012.

In May 2012 the rules on credit risk were amended to eliminate the remaining cases in which the time limit was set at 180 days (instead of 90) for classifying exposures past due or in breach of overdraft limits as impaired (see the box “The classification of exposures past due or in breach of overdraft limits”).

THE CLASSIFICATION OF EXPOSURES PAST DUE OR IN BREACH OF OVERDRAFT LIMITS

For the purpose of identifying impaired overdue exposures, prudential regulations, in line with the options given to member states by Directive 2006/48/EC (Capital Requirements Directive), provided as follows:

- banks and intermediaries using the standard method were permitted to apply the limit of 180 days to certain exposures through 31 December 2011;
- banks and intermediaries using advanced (IRB) methods were permitted to apply the limit of 180 days: (a) through 31 December 2011 to exposures to firms resident or with their head office in Italy; (b) indefinitely to exposures to persons resident or with their head office in Italy classed as retail loans or as exposures to public sector entities.

The rules change, effective 31 May 2012, sets the limit at 90 days – for prudential, reporting and balance-sheet purposes – for all supervised intermediaries and regulated portfolios, thus eliminating the residual derogations that provided for a limit of 180 days.

The elimination of the permanent derogations implements the FSB’s recommendations on this point (see *Peer Review of Italy. Review Report*, 27 January 2011) and brings Italy into line with best practices at international level.

The public consultation regarding the new supervisory provisions concerning sanctions and the exercise of sanction power by the Bank of Italy began in May 2012. The provisions respond to the need for rationalization by gathering in a single corpus the rules previously addressed to the different categories of supervised intermediaries, and contain the updates required by the numerous regulatory changes of the last ten years.

Within the framework of the Bank of Italy-Consob joint Regulation of 29 October 2007 on intermediaries’ organization and procedures, in April 2012 the Bank and Consob issued a joint communication on the implementation of the standards and guidelines developed by the European Securities and Markets Authority (ESMA) regarding systems and controls for trading platforms and for investment firms that use highly automated trading systems.

In May 2012, with a public communication, intermediaries potentially eligible for entry in the future single register provided for by the reform of Title V of the Consolidated Law on Banking were invited to analyze and comment on the implementing technical standards for prudential reporting developed by the European Banking Authority (EBA) for banks and investment firms even though the standards were not directly addressed to them. In fact, in accordance with the approach already

**Communications,
clarifications
and implementing
guidelines**

adopted for prudential regulation, the Bank of Italy intends to bring the prudential reporting formats for financial intermediaries into line with those for banks, except for some specific features. The aim is to ensure the homogeneity of prudential reports, with a reduction in the reporting burden for intermediaries belonging to banking or investment firm groups and advantages for the supervisory authority in data acquisition, management and analysis.

In the field of corporate governance, a series of measures regarded the composition and functioning of companies' governing bodies. In January 2012 the Bank of Italy addressed a communication to the market to promote the correct and efficient functioning of banks' governing bodies. The communication drew intermediaries' attention to the importance of the governing bodies' composition and of the adequate professional experience of their members on the one hand. It also underlined the importance of the identification and formalization of operating practices, the circulation of information among and within corporate bodies, and the clear definition of the tasks assigned to each internal committee. After providing indications on the process of self-evaluation by the board of directors, the communication urges banks to bear in mind the central role that the EBA guidelines assign to risk monitoring and management.

To ensure homogeneous application of the ban on accepting or holding corporate offices in competitor firms and groups in the credit, insurance and financial market pursuant to Decree Law 201/2011, converted into Law 214/2011, the Bank of Italy, Consob and Isvap, in cooperation with the Antitrust Authority, developed common standards on which to base the assessments falling within their respective spheres of competence.

Institutional cooperation in the production of legislation

The Bank of Italy cooperated in various capacities with the institutions engaged in producing legislation in the banking and financial sectors.

In line with the growing awareness at EU and international level of the importance of the quality of corporate governance for the sound and prudent management of intermediaries, the Bank of Italy continued its action on this front. With regard to the rules governing banks' and investment firms' compensation and incentive systems, the Bank cooperated with the Ministry for the Economy and Consob in defining the amendments to be made to the Consolidated Law on Banking and the Consolidated Law on Finance in order to complete the transposition of the Third Capital Requirements Directive. The amendments were adopted with Law 217/2011 (the Community Legislation Implementation Law for 2010) and, among other things, gave the Bank of Italy specific powers of intervention to limit the total amount of the variable portion of compensation disbursed by individual intermediaries, where such limitation was necessary to maintain a solid capital base.

The Bank also provided assistance to the Ministry for the Economy and Finance regarding numerous regulatory measures, including initiatives to promote competition, transparency and consumer protection.

The Bank contributed to drafting the regulations implementing Legislative Decree 141/2010. The public consultation promoted by the Ministry for the

Economy of Finance was recently concluded for two of these regulations: the draft regulations establishing the minimum organizational requirements for entry in the register of loan brokers, and the requirements for entry in the register of financial agents for intermediaries that exclusively provide payment services.

In addition, the Bank contributed to formulating the convention establishing the characteristics of a basic account which it is compulsory for banks, Poste Italiane S.p.A., payment institutions and electronic money institutions to offer pursuant to Decree Law 201/2011.

In the context of the reform of the architecture of European supervision, the Bank of Italy together with the other national authorities (Consob, Isvap and Covip) cooperated with the Ministry for the Economy and Finance in drafting the legislative decree transposing Directive 2010/78/EU (the so-called Omnibus Directive). The directive governs relations between national supervisory authorities and the powers assigned to the European supervisory authorities in the banking, securities and insurance sector (the EBA, ESMA and European Insurance and Occupational Pension Authority), the Joint Committee of European Supervisory Authorities and the European Systemic Risk Board. Its transposition involved numerous texts composing the regulation of the financial sector and required the formulation of consistent solutions governing the manner of participation of the Bank of Italy, Consob, Isvap and Covip in the European system of supervision, with particular regard to: (a) the possibility to apply to the European authorities in case of conflicts with competent authorities of other member states; (b) the obligations to exchange information and to cooperate with other authorities, including through the delegation of tasks and responsibilities; (c) mechanisms to ensure compliance with the acts of the European authorities that are binding for supervised entities; (d) the obligation for national authorities to take into account the objective of convergence of supervisory practices within the Union and the effects of their own acts on the stability of other member states' financial systems.

3.15 Regulatory impact assessment

The year saw a further progress in the activity of regulatory impact assessment (RIA) as an integral part of supervisory rulemaking by the Bank of Italy. In application of Law 262/2005 (on the protection of saving and rules governing the financial markets) and the Bank's 2010 implementing regulation, the RIA function provided continual support, with tools of economic analysis and cost-benefit assessments, to the policy-making activities performed as part of the banking and financial supervision functions (issue of secondary legislation, advice to Parliament on primary legislation, contribution to the international regulatory process).

As regards secondary legislation, impact assessment supported several regulatory proposals, including those on: connected lending; operations of financial intermediaries (implementing the reform of Title V of the Consolidated Law on Banking); and modification of the 180-day limit for classifying exposures

Domestic dossiers

as past-due for prudential purposes. The extension of the RIA framework on a trial basis to supervisory reporting rules continued during 2011 and will continue throughout 2012.

International activity

The support provided by regulatory impact assessment to the international regulatory process also increased progressively: robust and timely analyses on the possible effects on the Italian banking and financial system of the main policy options under discussion in international fora aim at strengthening the Bank's negotiating position. Many assessments were conducted in connection with the work at EU level on the prudential rules to implement the Basel III package (Fourth Capital Requirements Directive – Capital Requirements Regulation). This made it possible to provide analytical support on issues of particular importance for Italy (such as the prudential treatment of deferred tax assets and loans to small and medium-sized enterprises). These analyses also benefited from the data acquired through periodic monitoring of the new prudential standards, coordinated at international level by the Basel Committee on Banking Supervision and the European Banking Authority.

4 THE FUNCTIONS OF MARKET SUPERVISION AND PAYMENT SYSTEM OVERSIGHT

The Consolidated Law on Finance gives the Bank of Italy authority, shared with Consob, for the supervision of wholesale government securities markets and multilateral systems for the trading of money deposits in euros, as well as of the infrastructures for the clearing, guarantee and settlement of transactions and for central securities depositories (the financial market infrastructures, FMIs, engaged in post-trading). Under Article 146 of the Consolidated Law on Banking, the Bank of Italy is also assigned the task of payment system oversight, to be performed so as to ensure the smooth functioning, reliability and efficiency of the system and protect the users of payment services.

The Bank of Italy performs these activities within the European System of Central Banks and in collaboration with the other competent authorities at national and international level (see the box “Cooperation among the authorities on the supervision of markets and post-trading”).

At global and European level 2011 and the first six months of 2012 saw many initiatives aimed at strengthening the solidity of the financial system in the face of the risks implicit in the poor performance of the markets. In particular, these initiatives concerned: the definition – by the Committee on Payment and Settlement Systems, the BIS and IOSCO of new and more rigorous principles to apply to financial market infrastructures on a global scale; the commitment of the Financial Stability Board to increasing the transparency and reducing the risks of OTC derivative transactions; the European initiatives serving to regulate important aspects of the activity on financial markets and some categories of financial market infrastructures (central counterparties and central depositories).¹

Europe, besides, saw further activity aimed at increasing the integration of the retail payment services market and promoting the use of electronic instruments, in order to reduce transaction costs and put the economy on a higher potential growth path.

COOPERATION AMONG THE AUTHORITIES ON THE SUPERVISION OF MARKETS AND POST-TRADING

The importance of markets from the macroprudential standpoint is highlighted by the present crisis: the reasons for some of the Eurosystem’s unconventional measures lie in the potential risks that the inefficiencies of

¹ See Chapter 20, “Le infrastrutture del sistema dei pagamenti all’ingrosso e dei mercati monetario e finanziario” in *Relazione sull’anno 2011*, Banca d’Italia 2012.

financial markets, especially those for European government securities, could undermine the effectiveness of monetary policy and threaten price stability in the euro area.

As part of the new European system of financial supervision, within the European Systemic Risk Board, central banks have been entrusted with new tasks of macroprudential supervision to foster the stability of the financial system; this has also confirmed the role that the supervision of financial market infrastructures plays both in curbing systemic risks and in ensuring the effective transmission of monetary policy. The structure and functioning of markets influence the ability of intermediaries to manage liquidity, counterparty and market risks; dysfunctions can have a major impact on access to credit.

At national level as well, the division of responsibilities by objectives sees central banks directly involved as guarantors of financial stability. This tendency, also confirmed by the recent legislative choices made by the United Kingdom and Belgium, is not weakened by the guidelines adopted for the reform of European supervision, sectorally divided into three authorities: the European Banking Authority (EBA) for banks, the European Insurance and Occupational Pensions Authority (EIOPA) for insurance companies and pension funds and the European Securities and Markets Authority (ESMA) for markets. In this context, identifying the boundaries of the responsibilities of the different authorities is crucial for the specification of effective instruments of cooperation, at national and international level, that the new CPSS-IOSCO principles for market infrastructures require central banks and other supervisory authorities to have. The new regulation in Europe (European Market Infrastructure Regulation, EMIR) provides for a cooperation obligation among authorities and, in particular, between the ESMA and the ESCB.

4.1 The performance of the functions at international level

Work carried out within the CPSS and IOSCO

Under the joint CPSS-IOSCO initiative, the Bank of Italy took part in the Steering Committee and ten working groups. On 16 April 2012 the “Principles for financial market infrastructures” were published after a public consultation begun in March 2011. The authorities have been asked to adopt the new principles in their supervisory activity by the end of 2012; financial market infrastructures must comply with the new requirements as soon as possible. Work is also under way, with the contribution of the Bank of Italy, to define the methodology for assessing FMIs that supervisory authorities must adopt and the disclosure framework with the information that such structures will be required to provide to the market; both the documents were published for consultation in April 2012. The supervisory assessment scheme will be supplemented by guidelines concerning the management of the different phases of the crisis, whose formulation has been entrusted to a working group headed by the Bank of Italy together with the UK Financial Services Authority.

The Bank contributed to the initiatives aimed at increasing the availability of information on financial transactions, to allow operators to manage risks better and the authorities to supervise more effectively. It also participated in the initiatives of the CPSS and IOSCO aimed at defining the data that trade repositories must gather, record and disseminate and took part in the analyses of the FSB for the establishment of the legal entity identifier of persons involved in financial transactions.

As for the OTC Derivatives Regulators' Forum, cooperation continued among the competent authorities on the analysis of the infrastructures for the settlement of OTC derivatives; the Bank of Italy is contributing to the subgroups charged with identifying the trade repositories operating at international level and defining the characteristics they must have in order to provide the service of registration for the various classes of derivatives.

OTC Derivatives Regulators' Forum

In 2011 the Committee on the Global Financial System (CGFS) of the BIS set up a working group, in which the Bank of Italy participates, to analyze the effects on intermediaries of the requirements for accessing central counterparty services, which are obligatory for clearing standardized OTC derivatives.

Work within the Committee on the Global Financial System

As part of the oversight activity performed on a cooperative basis by the authorities of the main countries, the Bank of Italy is part of the body charged with the oversight of SWIFT, the technological supplier of a worldwide network; in 2011 and the early months of this year the action taken was concentrated on the management of the operational risks and the technological adjustment for network messages. The Bank also provided Italian diplomacy and the Financial Security Committee with assistance in assessing the technical consequences on the Italian system of the suspension of financial messaging services to Iranian institutions (Council Regulation (EU) No. 267/2012 of 23 March 2012).

The oversight of SWIFT and CLS

The Bank of Italy also contributed to the work of the committee supervising the Continuous Linked Settlement (CLS) system, of which it is part together with the other central banks of the G-10 and those of the other 17 countries whose currencies are handled by the system.

In 2011 cooperation was strengthened between the functions of supervision and those of oversight in addressing the problems regarding the stability of the infrastructures and intermediaries operating on derivative and foreign exchange markets. The Bank of Italy participated in the work that the Basel Committee on Banking Supervision (BCBS) is carrying out with the CPSS and IOSCO to assess the effects on banks of the revision of the capital requirements for exposures to central counterparties; it has also been a member of the group set up in September 2011 by the CPSS, IOSCO, the BCBS and the CGFS to establish the collateralization requirements for derivative transactions not guaranteed by a central counterparty (margining requirements); and it has contributed to the activity of the joint BCBS-CPSS group charged with analyzing the management of the risks associated with foreign exchange transactions and drawing up guidelines for their supervision.

Work carried out within the Basel Committee on Banking Supervision

In addition, in connection with the Basel Committee's work on liquidity, the Bank of Italy participates in the activity of the joint BCBS-CPSS group charged with establishing the indicators for monitoring banks' intraday liquidity risks.

The initiatives of the BIS concerning innovative payments

The Bank of Italy also participated in the preparation of the report published in May 2012 which examined the development of the retail payment market and analyzed the prospects and stimuli for and the obstacles to the spread of innovative payments, together with the aspects of interest to central banks.

Cooperation within the FATF and the initiatives for financial inclusion

As part of the work of the Financial Action Task Force (FATF; see chapter 3: The banking and financial supervision function), the Bank of Italy, as responsible for payment system oversight, continued with the revision of its recommendations (completed in February 2012). The purpose of the revision was to increase the transparency of payment flows and to ensure a supply of services complying with the provisions on combating money laundering and the financing of terrorism. The Bank of Italy also coordinated a working group charged with drawing up guidelines for the issue of prepaid cards and for internet and mobile payments.

Relations with the European Commission

In the performance of its functions of market supervision and payment system oversight, the Bank of Italy participates in the regulatory initiatives of the European Commission. In the case of financial markets, the initiatives concerned: i) a harmonized regulation of short sales of shares, government securities and credit default swaps on sovereign issuers; the new rules will enter into force on 1 November 2012, Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012; ii) Regulation (EU) No. 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR); iii) the revision of the legislation on financial markets (Directive 2004/39/EC, MiFID), which strengthens the powers of the authorities to protect investors, on which negotiations had begun in 2011 in the European Parliament and the Council.

To strengthen the rules governing the infrastructures of the securities markets, in March 2012 the European Commission published a proposal for a regulation of the Parliament and the Council on central securities depositories and securities settlement systems. The Bank of Italy is following the negotiations as a participant in the delegation of experts led by the Ministry for the Economy and Finance.

In the field of retail payments, last March saw the approval of the regulation that lays down the deadline for migrating to the European standards for credit transfers and direct debits, which are decisive for the creation of a Single Euro Payments Area (SEPA).

The Bank of Italy is also present in the Payments Committee, which, among other things, has been entrusted with revising Directive 2007/64/EC (the Payment Services Directive, PSD) so as to remove some doubts that arose during the transposition of the legislation into national legal systems and consider the evolution of technology in the field of micropayments.

The Bank of Italy participates in the activity of the European Securities and Markets Authority (ESMA) on the drafting of the secondary legislation provided for by the *European Market Infrastructure Regulation*; together with the ECB and the Dutch central bank, it represents the ESCB in the *European Banking Authority working group* charged with establishing the capital requirements for central counterparties.

Work carried out
within ESMA and EBA

As of December 2011, as the national authority competent for securities settlement systems and central counterparties, the Bank of Italy alternates with Consob in the meetings of ESMA's Post-Trading Standing Committee (PTSC), which follows matters concerning securities settlement, central counterparties and trade repositories.

In 2011 the Bank of Italy again participated in the shared oversight of the euro-area large-value payment systems. It collaborated on the assessment aimed at verifying the conformity of the 5.0 version of TARGET2 with the "Core Principles for Systemically Important Payment Systems" published by the BIS; the complete conformity of the system was confirmed. As for Euro1, the other European large-value settlement system, with the ECB providing coordination, the Bank of Italy took part in the overall assessment of its observance of the Core Principles referred to above. The results of the exercise were made public in November 2011: it was found that the system fully observed Core Principles from I to IX and broadly observed Core Principle X (Governance), owing to the absence in the organizational structure of an independent risk management function. EBA Clearing, the owner of the system, has undertaken to implement this function.²

Oversight shared with
the Eurosystem

The Eurosystem is revising the oversight framework for retail payment systems; the Bank of Italy coordinates the group charged with reclassifying the systems, establishing the oversight standards and identifying the characteristics of the infrastructures to be subjected to shared oversight. A document has been put out for public consultation on the oversight requirements for links between systems within the euro area.

Particular attention has been paid to strengthening the safeguards for the security of payment cards and other innovative payment instruments: in this field the ECB has promoted the establishment of the European Forum on the Security of Retail Payments, in which central banks and banking supervisory authorities participate. The Forum has prepared a set of recommendations to strengthen security and counter fraud in order to increase consumers' confidence in payments made over the Internet. The document containing the recommendations is currently undergoing public consultation; once it has been approved, the recommendations will be embodied in participant countries' national law.

The Bank of Italy collaborated in the drafting of the Eurosystem's responses to the consultation paper entitled "Green paper towards an integrated European

² See www.ecb.int/pub/pdf/other/oversightassessment201111en.pdf.

market for card, internet and mobile payments”, prepared by the Commission to analyze the obstacles to the complete integration of payments in Europe.

4.2 The regulatory framework governing market infrastructures in Italy

In October 2011 the Bank of Italy, in concert with Consob, approved amendments to the regulation of the Italian central counterparty (Cassa di Compensazione e Garanzia) to include Cassa Depositi e Prestiti among eligible participants; in March 2012 it approved the regulation on the tri-party collateral management services of Monte Titoli.³

The regulation governing the MTS wholesale government securities market, operated by MTS S.p.A., were amended in 2011. Primary dealers no longer have to post quotes observing predetermined quantitative parameters – which had proven inadequate in a period of market volatility – but only to show better overall performance than the market average. The Bank of Italy monitored the process of rules revision and issued its opinion to the Ministry for the Economy and Finance pursuant to Article 66 of the Consolidated Law on Finance.

The Bank also communicated to Consob, pursuant to Article 63 of the Consolidated Law on Finance, its opinion on the new regulation of the wholesale MTS Corporate market for trading in corporate bonds and the bonds of international organizations whose shares are owned by national governments.

4.3 Trading and post-trading oversight

The money and financial markets

The oversight of markets focused on monitoring the repercussions of the financial crisis, which affected both the euro deposit market and the Italian government securities market. There was constant attention to evaluating the initiatives of the market operating companies in terms of stability and efficiency. In June 2011 the e-MID interbank deposit market launched its new e-MID Repo segment, collateralized by government securities and bonds.⁴ The MTS government securities market introduced a new mid-price function designed to attract the large trades often made outside regulated markets. In the fourth quarter the MTS group also launched Agency Cash Management, a new electronic platform for the tri-party repo market.

³ See Chapter 20, “Le infrastrutture del sistema dei pagamenti all’ingrosso e dei mercati monetario e finanziario” in *Relazione sull’anno 2011*, Banca d’Italia 2012.

⁴ Ibid.

Last year the Bank called on Monte Titoli to review its schedule of penalties for failure to settle transactions when they fall due, in order to limit their number and value.⁵

Centralized securities management, settlement and guarantee systems

Controls on market management companies concentrated on their ability to properly manage risks. The growing access of non-Italian operators was kept under observation. Market developments were discussed in numerous meetings with the management companies, sometimes in collaboration with other Italian and foreign authorities.

The management companies

The regular supervisory meetings with the companies engaged in central depository activity, clearing, guarantee and settlement of financial instruments focused on analysis of strategy, risk management and the measures taken to ensure business continuity. The Bank called on the Italian central counterparty (Cassa di Compensazione e Garanzia) to consider the need for a capital resources policy in harmony with the new European regulation.

In March 2012 an agreement was concluded between the London Stock Exchange Group – which controls Borsa Italiana, MTS, CCG, and Monte Titoli – and LCH.Clearnet. In meetings with LSEG representatives the Bank of Italy stressed the need to make the most of the Italian component within the new group structure.

Three supervised companies were inspected in 2011 or the early months of 2012.

The Bank of Italy cooperates with the French authorities in overseeing the connection between CCG and the French central counterparty for clearing of Italian government securities. In 2011 the authorities paid special attention to the central counterparties' management of sovereign risk, inviting them to devise a common policy to limit the procyclical effects of changes in margin requirements.⁶ The features of this policy were agreed on in the course of meetings between the Bank of Italy and the authorities of France, Belgium, the Netherlands, Portugal and the United Kingdom (the joint regulatory authorities) responsible for oversight of the LCH.Clearnet group of which the French central counterparty is a member.

Cooperation with other authorities

4.4 Action for business continuity in the financial marketplace

The Bank of Italy is responsible for coordinating the Committee for Business Continuity in the Italian financial system, which embraces Consob, the Civil Protection Department and the most important Italian financial institutions. In 2011 the Committee conducted a crisis simulation to assess the effectiveness of banks' organization and the adequacy of communications procedures. A procedure

⁵ See Chapter 4, "Markets, Eurosystem refinancing and payment infrastructures" in *Financial Stability Report*, Banca d'Italia April 2012.

⁶ See Chapter 21, "I servizi di pagamento al dettaglio e il servizio di tesoreria statale" in *Relazione sull'anno 2011*, Banca d'Italia 2012.

for sharing test plans among participants, designed to mitigate the risks of interdependence, went operational at the start of 2012.

The Bank collaborated in planning a simulation to check on the ability of the ESCB central banks to cope with extreme emergencies.

4.5 Oversight of payment systems, technical infrastructures and payment services

Legislation and controls

The Bank of Italy took part in the work for the transposition into Italian law of Directive 2009/44/EC on settlement finality in payment and securities settlement systems and on financial collateral arrangements. The result was Legislative Decree 48, dated 24 March 2011.

In the area of services to final customers (consumers, firms, general government entities), in July the Bank issued a measure for “Implementation of Title II of Legislative Decree 11/2010 on payment services (Rights and obligations of the parties)”. To foster the use of efficient, reliable means of payment, the measure lays down binding rules both for the users and for the providers of payment services and specific provisions for the security of payment instruments.

The Bank collaborated in the drafting of measures to discourage the use of cash, facilitate access to banking services and encourage the use of payment cards. Specifically, these measures were embodied in the “Save Italy” decree (Decree Law 201 of 6 December 2011 converted into Law 214 of 22 December 2011) and the “Grow Italy” decree (Decree Law 1 of 24 January 2012 converted into Law 27 of 24 March 2012).

Law 106 of 12 July 2011 amended Royal Decree 1736/1933 (the law on cheques) to establish the legal validity of cheques presented in electronic form. This responded to a request made by the Bank of Italy and supported by the banking and postal system as part of an interbank project for cheque dematerialization. The framework must be completed by an implementing regulation issued by the Ministry for the Economy and Finance after consulting the Bank of Italy, which will then have twelve months to adopt the necessary technical rules.

In implementation of Article 146 of the Consolidated Law on Banking, new rules on retail payment oversight were drafted. The measures are addressed to payment service providers and managers of retail payment systems with registered offices in Italy. They also apply in large part to the Bank of Italy as manager of the BI-Comp clearing and settlement system. The measures have been submitted for public consultation and for the opinion of the ECB.

SEPA

The migration of credit transfers and direct debits to Single Euro Payments Area standards proceeded slowly in most of Europe, including Italy. Starting late in 2011 the Bank of Italy organized eight meetings with representatives of the financial system, business and consumer organizations to determine the reasons for the delay

and design corrective measures. In view of the slowness of the process, a special European regulation made the migration compulsory.⁷ The task of controlling the adjustment process is now assigned to governmental institutions and public authorities. The Bank of Italy will have to designate the national payment schemes for which the migration will be compulsory and those – “niche” schemes and those outside the scope of the regulation – for which it is not. The Bank will also undertake a campaign to publicize the benefits of migration to the new standards.

The oversight of retail payment services bore both on entry into this market and on the subsequent offer of services to customers. In 2011 the Market and Payment Systems Oversight Department took part in administrative proceedings leading to the authorization of 37 new payment institutions, with checks on their satisfaction of the functional and technical security requirements. More generally, in assessing the efficiency of the payment system the Bank examined initiatives for innovative payment methods – sometimes cooperative schemes – undertaken both by banks and by other businesses (e.g., telecommunications corporations).

The assessment of the 26 largest payment card schemes in the euro area (national and international) continued. The assessment of domestic schemes was completed and a qualitative review of the conclusions begun. Cooperative oversight of the Visa and MasterCard international schemes is still under way.

Payment schemes

The two-year period of assessment of Italy’s retail payment systems (SIA/BI-Comp, ICBPI/BI-Comp and ICCREA/BI-Comp) was concluded in 2011. Seven meetings were held with the overseen entities to judge the effectiveness of the measures adopted in response to the observations made by the overseers. Beginning in the first quarter of 2012, the monitoring of correspondent banking as a settlement channel was strengthened by integrating supervisory reports with intermediaries’ correspondent account transactions.

Retail payment systems

Verification of the operational risks of market and payment system technological infrastructures continued. Development plans were monitored, control systems analyzed, compliance with business continuity guidelines assessed. The automation of the data flow on the operations and malfunctions of SIA as outsourcer of the European STEP2 system was completed during the year. In the course of this activity the Bank of Italy held three meetings and one fact-finding mission.

Payment infrastructures

The performance of the TARGET2-Banca d’Italia system was analyzed periodically to assess risk profiles, operating efficiency and practicality. There was specific analysis of intraday liquidity risk.⁸ In the twice-yearly meetings with the members of the TARGET2 National User Group the Bank gathered users’ opinions concerning the system’s services and checked their involvement in ongoing development projects.

Large value payment systems

⁷ See Chapter 4, “Markets, Eurosystem refinancing and payment infrastructures” in *Financial Stability Report*, Banca d’Italia April 2012.

⁸ See Chapter 4, “Markets, Eurosystem refinancing and payment infrastructures” in *Financial Stability Report*, Banca d’Italia April 2012.

5 RESEARCH AND ECONOMIC ANALYSIS, STATISTICS AND INTERNATIONAL RELATIONS

5.1 Analysis in direct support of monetary policy

The Economic Research and International Relations Area contributes to the monetary policy decisions taken by the Governing Council of the European Central Bank (ECB) by producing analyses, in-depth studies and assessments which serve as supporting materials for the Governor at Council meetings and for the Bank's representatives in the committees of the European System of Central Banks (ESCB) and the related working groups. For this purpose the Area monitors and analyzes short-term economic developments: it makes projections for the main macroeconomic variables in the Italian economy and in the euro area; it prepares in-depth analyses of the economic trends in the main countries and geographical areas; it studies specific economic policy issues.

In 2011 some 950 economic reports were produced on short-term developments in Italy, the euro area and the international markets (400 in the first five months of 2012). Following consultations with both national authorities and EU institutions the Bank completed the procedures for the adoption of 107 ECB Opinions in 2011 and 34 in the first five months of 2012. The meetings of the committees and working groups of the Eurosystem and the ESCB at which staff in the Area participated numbered 144 in 2011 and 67 up to May 2012. The proceedings were described in a series of reports (170 in 2011 and 70 in the first five months of 2012).

Numerous specific studies dealt with the sovereign debt crisis and its repercussions on Italy's economy: the transmission of tensions in the financial markets to credit supply conditions for the private sector; the effects of the crisis on the finances of banks, households and firms; the credit risks developments for financial intermediaries; the strengthening of European and national accounting rules. Econometric simulations assessed the macroeconomic effects of the measures to adjust the public finances and of alternative paths to fiscal consolidation, to estimate the impact on potential output of the structural reforms launched by the Government. Other analyses included: the monetary policy implications of the new regulatory standards established by the Basel Committee on Banking Supervision (BCBS) and their effects on the macroeconomic picture; the risk factors for international financial stability; international current account imbalances and the risks of a disorderly adjustment; the global financial assistance network and international monetary reform.

The results of these studies are in the Bank's official publications, first and foremost the Annual Report, quarterly Economic Bulletins and Financial Stability Reports, as well in the two series devoted to the dissemination of research papers and analysis (Working Papers and Occasional Papers).

5.2 The main topics of research

In 2011 research into monetary policy and the economic situation in Italy and in the euro area focused on manufacturing activity in Italy and on the transmission of the tensions over sovereign debt to bank rates and the financial markets.

**Economic outlook
and monetary policy
in the euro area**

As part of the analysis of the Italian economy, research was conducted into developments in industrial production in the period following the recession of 2008-09, and into the factors behind industry's failure to recover pre-crisis production levels. The updating of the estimates on total factor productivity was completed as were several analyses of the determinants of property prices. Finally, studies were launched to examine the factors influencing trends in saving in the last twenty years.

The sovereign debt crisis had major repercussions on banks in Italy and in the euro area; two studies assessed the transmission of the tensions on the government securities markets to bank rates in Italy and the main euro-area countries.

As part of the research into financial markets, analyses were made of the demand for Italian government securities by investor category and on the effectiveness of the Government guarantee schemes for bank bond issues. Two other studies were conducted as part of an initiative by the Committee on the Global Financial System (CGFS) in the Bank for International Settlements: the first examined the relationship between sovereign risk and banks' funding conditions, the second looked at the investment strategies adopted by insurance companies and pension funds.

In the context of research into the role of macroprudential policies in preventing financial imbalances, on 14 and 15 December the fifth edition of the conference on money, banking and finance was held in the Bank of Italy. Organized in conjunction with the Centre for Economic Policy Research (CEPR) and titled *Macroprudential Policies, Regulatory Reform and Macroeconomic Modelling*, the conference provided an opportunity to reflect on the effectiveness of macroprudential instruments and of regulation in containing the build-up of risks to financial stability.

In 2011 the Bank stepped up its examination of explanations for the structural weaknesses in Italy's economy and the competitiveness gaps which have emerged in the past fifteen years. Research was conducted into the effects on firms' behaviour of institutional factors – such as the availability of share capital, the regulation of markets, and the functioning of the civil justice system. The impact of the internationalization process on the propensity to innovate and on the demand for skilled labour was also analyzed. Special attention was paid to the influence of the market structure on price dynamics, consumer well-being, and firms' location choices.

**Structural
economic analysis**

Two conferences presented a series of papers on gender gaps in Italy; the studies undertaken regarded hiring mechanisms and career paths for women, wage gaps, a comparative analysis of the performance of firms run by men and women and an assessment of the effects of public incentives for female entrepreneurs. Various research projects were completed on infrastructure in Italy; special attention was paid to the financial planning and selection of the works; the related papers were presented at a conference held in April 2011.

The analysis of geographical divergences in Italy continued. Two research projects were completed, respectively titled *Economic Integration Between the Mezzogiorno and the Centre North*, illustrating the economic ties between the two areas from a macroeconomic and microeconomic perspective, and *The Economy of the North East of Italy*, highlighting the slowdown in economic growth in this area, starting from the second half of the 1980s and analyzing the specific difficulties of local manufacturing.

The effects of the crisis on banks' budgets and on the financial conditions of Italy's households and firms continued to be monitored. Research focused on the working of the interbank market, the quality of banks' assets and the characteristics of intermediaries' balance sheets, which influenced the supply of credit; for firms and households an assessment was made of the effectiveness of government provisions and of agreements underwritten by the Italian Banking Association (ABI) and consumer associations to mitigate liquidity tensions. Numerous studies were conducted of the public finances, especially as regards the effects of budgetary policies on economic activity, the links between macroeconomic imbalances and sovereign risk, and the impact of national accounting rules and of the reform of the European institutional framework on the sustainability of the public finances. In the light of the current process of decentralization, several studies of expenditure decisions, taxation and borrowing by Italy's local government entities were presented in a workshop.

To mark the 150th anniversary of Italian Unification the Bank organized two conferences. The first, titled *Italy and the World Economy 1861-2011*, analyzed the Italian economy's ability to respond to changes in the international scenario and was contributed to by foreign experts. The second, organized in conjunction with Istat and the University of Rome Tor Vergata, published the reconstruction of the main aggregates in the national accounts for the period from 1861-2011.

The international economy

Research in international economics examined the analytical instruments employed by the International Monetary Fund (IMF), especially as regards exchange rates and balance-of-payments disequilibria, also to support the G-20 Mutual Assessment Process (MAP). The evolution of rules to prevent and resolve debt crises in order to improve control of systemic risks was also studied.

Research in international trade centred on: the greater capacity of non-linear models to explain the impact on trade of changes in output; the benefits linked to the reduction of information asymmetries; the effects of the international fragmentation

of production. Regarding financial flows, one study looked at the role of increasing integration between emerging and advanced economies.

In the context of research on emerging countries, an analysis was made of trends in house prices and their effect on private consumption. Specific work was conducted on the economic policies adopted in China and India. Other research involved the countries of Eastern Europe and the Mediterranean region, with special emphasis on the local impact of the international crisis, and developing countries, with an examination of the role of aid and financial inclusion.

Part of the research to celebrate 150 years of Italian Unification involved the preparation of historical reconstructions of monetary and financial statistics for the period 1861-2010.

**Statistical
research**

The Bank's researchers continued to make comparative international analyses, including those on: the financial systems of the main industrialized countries, analyzed on the basis of their financial accounts; the characteristics of the banking systems of the main European countries; developments in the insurance and pension fund sectors in the OECD countries. Other studies examined the effects of bank-firm relations on the availability of bank credit.

Research on firms and households conducted by the Statistics Area was chiefly concerned with improving the quality of the data and methodologies. In particular, a survey was carried out in conjunction with Istat of the useful life of capital goods and research was launched with the intention of improving the quality of the capital stock estimates. Using the data collated in the Survey of Industrial and Service Firms, statistical models were studied for forecasting the growth in investment of Italian firms and research was conducted into the issue of employment policies for family-run businesses. The initial results of the short-term Italian Housing Market Survey, conducted jointly with Tecnoborsa and the Territory Agency, were analyzed with the aim of identifying the predictive capacity of market developments.

In the households' sector, research was conducted into the effects over time of inequality in the distribution of income and wealth and on job satisfaction levels. Analyses were also made of the effects of the use of ATM cards on the average quantity of cash held.

In the Area responsible for compiling foreign trade statistics, several papers focused on trends in exports of Italian goods and of those produced by the main trading partners in the euro area since the start of the decade, examining in particular the consequences of the inclusion of China and other countries with low labour costs in the global trade system.

The economic research activity conducted at Bank headquarters is complemented by that carried out by the delocalized units situated in provincial capital branches, which is more oriented towards the analysis of the local economies. The delocalized units prepare a six-monthly publication on the economy of the individual regions and a six-monthly survey on credit demand and supply conditions throughout Italy.

**The contribution
of the delocalized
economic analysis
and research units**

5.3 The Library and the Historical Archives: publications and activities

Series and academic publications

The findings of the Bank of Italy's economic research are disseminated in the first place through its own publications, following careful scientific review. In the "Working Papers" series, some 56 papers were published in 2011, and 29 in the first four months of 2012. In the "Occasional Papers" series, there were 27 issues during 2011 and 14 in the first four months of 2012. The "Workshops and Conferences" series features the papers of conferences dealing with the public finances, infrastructure, the economy of the North-East, and North-South economic integration. In addition, there have been 18 issues of the series "Economic History Working Papers" and a volume on Italy's foreign trade, "*Il commercio estero italiano: 1862-1950*" published as part of the "Historical Series of the Bank of Italy". External publications are also an important indicator of the quality of the research carried out and a further channel of distribution. Bank of Italy researchers published 51 articles in external academic journals in 2011 and 11 books or chapters in Italian and 9 in English. In addition, at the end of May 2012, there were 39 journal articles and 11 books or book chapters forthcoming. In order to foster awareness of the research activity carried out within its walls, the Bank also publishes an e-newsletter in English for the national and international academic community, and disseminates its main series on the Bank of Italy website, on both the SSRN and the RePEc networks, from which about 40,700 Bank publications were downloaded in 2011.

The Library and the Historical Archives

Besides the usual institutional activities of managing the Bank's Library and the Historical Archives, revising and editing the official publications, the two structures have been fully engaged in initiatives linked to the celebrations of the 150th anniversary of Italian Unification. Following the exhibition sponsored by the Bank, *The Currency of United Italy: from lira to euro*, described in last year's report, this year saw participation in setting up the exhibition, *La Macchina dello Stato* (The Machinery of State), organized by the Prime Minister's Office together with the Central Archives of the Italian State, for which the section on Italian monetary unification was prepared. As part of the activities to acquire new documentation, it is worth noting that the Historical Archives now hold banking supervision papers covering the period 1961-1977 (about 9,000 archival items), which significantly add to the documentation on this subject. In addition, as regards the exploitation of the fonds comprising books of historical interest, the electronic cataloguing of the fonds that belonged to Lionel Robbins was revised and upgraded and work has begun on the fonds that belonged to Ernesto Rossi. In the sphere of bibliographical activities, a preliminary bibliography of the works of Tommaso Padoa-Schioppa was prepared for the conference in his memory. In the context of collaboration between central bank libraries, it is worth noting the Library's participation and contribution to the organization of the "2nd Central Bank and International Financial Institution Librarians' Workshop" held in October 2011 in Washington at IMF Headquarters.

5.4 Production of statistics

In the course of 2011 the indicators required by the new procedure for European surveillance to prevent and correct macroeconomic imbalances were defined and then published in early 2012 by the European Commission in its first *Alert Mechanism Report*.

**Alert mechanism
innovations
segnalistiche**

In the framework of the ESCB, work to prepare the ECB statistics regulations for holders of securities and the financial statements of insurance companies (in coordination with the European Insurance and Occupational Pensions Authority, EIOPA). The new European system of national and regional accounts in the Community (ESA 2010) will presumably be approved before the start of 2013. Work continued on adjusting the international statistics framework in response to the information gaps highlighted by the financial crisis.

At the request of the European Banking Authority (EBA) a data flow of alerts of a financial and prudential nature was established for a sample of banking groups. The prudential alert rules for banks and investment firms incorporated the innovations introduced by the EU Directive of 24 November 2010 No. 76 (CRD3).

When the memorandum of understanding between Istat and the Bank of Italy was signed at the beginning of the year, a further annual flow of data was defined to supplement the national accounting estimates.

In 2011 action was taken regarding some of the data managed by the Central Credit Register to implement the provisions of Art. 8-bis of Decree Law 70/2011, as amended by Law 148/2011 on the settlement of late payments.

**Central credit
register data collection**

In Europe, work was started by the joint task force of the Monetary and Financial Statistics and the Credit Registers working groups to define a harmonized set of detailed credit data for statistical, economic research and macroprudential supervision purposes. Since May 2012, Romania and the Czech Republic have been part of the exchange of data covered by the Memorandum of Understanding on the exchange of information among National Credit Registers.

Participation continued in the main international conferences on standardizing registration data for legal entities and financial instruments.

The registers

Particular importance was given to collaborating in initiatives relating to the new ESCB Register of Institutions and Assets Database (RIAD), the EuroGroups Register database coordinated by Eurostat, and the future system of the international coding of firms (the “legal entity identifier”). As regards identification data for financial instruments, there are some projects under way on standards in the sector (ISO), the maintenance of the Centralized Securities Database and on the production of European statistics on financial instruments.

In 2011, work was finished on the reconstruction of the historical series on Italy’s balance of payments and net international investment position in order to bring

Balance of payments data

it into line with the new direct reporting system introduced in 2010. Data was made available for periods prior to the end of 2007. The publication of the reconstructed series concluded a process of revision that had taken more than two years.¹

Work continued on adjusting the data collection system to meet the new international standards. The updated definitions were set out in the sixth edition of the IMF's *Balance of Payments and International Investment Position Manual* and adopted in Europe under specific EU and ECB rules.

Data flows

During 2011, the quarterly *Statistical Bulletin* was accompanied by a monthly release, outlining the main financial phenomena regarding credit, giving wide territorial and sectoral detail and, from the first 2012 edition, an early report of some of the data included in the quarterly bulletin. Publication of the quarterly flows in relation to the loan default rates has recommenced.

New tables were added to the *Supplements to the Statistical Bulletin* regarding the sectorization of deposits and interest rates, securitization of bank loans, and general government debt. Up-to-date estimates of household wealth and the findings of the survey on Italian household income and wealth in relation to 2010 were published.

As regards the ECB, the division continued to participate in the Household Finance and Consumption Network working group to produce a survey on euro-area households. The publication of the findings and related microdata is planned for the first half of 2013.

Interest in statistical publications has remained very high, as witnessed by the access data for the Bank of Italy's online statistical database (BIP). In particular, the number of hits for the items offered by the application was around 610,000 (of which 165,000 in the English version).

Lastly, work continued as usual providing data flows for the various categories of end-users (see the box "Bank of Italy data flows").

BANK OF ITALY DATA FLOWS

To the European Central Bank

Data are sent monthly on the accounting position of the Bank of Italy, of other monetary financial institutions (MFIs i.e. banks, money market funds, electronic money institutions, and the Cassa depositi e Prestiti) and of non-money market funds and on the real economy.

On a quarterly basis detailed data flows regarding the other MFIs and financial intermediaries are transmitted. Other quarterly releases are the historical series for the compilation of the euro-area financial accounts, data on stocks and flows of financial assets and liabilities in the public sector, and data on insurance companies and pension funds.

¹ See the box "The new data collection system for Italy's balance of payments" in *Economic Bulletin*, January 2011.

Data are transmitted six-monthly on electronic money circulation, on credit by economic branch of other MFIs and, annually on the structural indicators of the Italian banking system. Information on the public finances is sent annually and quarterly to contribute to the ECB's government finance statistics.

The Bank of Italy also transmits statistics on Italy's contribution to the balance of payments (monthly and quarterly) and to the euro-area's financial position (quarterly and annually). Statistics on the official reserves and liquidity in foreign currency are transmitted on a monthly basis.

To intermediaries

The Bank of Italy supplies flows of data returns, mainly via internet. These products include aggregate data for the whole system or by group of intermediaries. It also provides detailed information on customer debt through the Central Credit Register.

To the general public

The Bank of Italy publishes its *Statistical Bulletin* quarterly, providing analytic information on operations carried out by banking and financial intermediaries. The *Supplements to the Statistical Bulletin* are usually published monthly and provide an analysis of the current economic situation. Other statistics are published on the Bank of Italy's website.

To other bodies

The Bank of Italy, collaborating with other supervisory authorities, systematically sends data flows to Consob (Italian Companies and Stock Exchange Commission), the deposit guarantee system,¹ Istat (Italian National Institute of Statistics), the Prime Minister's Office, the Ministry for the Economy and Finance, the Ministry for Agricultural Policies, ABI (the Italian Banking Association) and other associations in the category. Internationally, the Bank of Italy satisfies requests for information from numerous organizations including, besides the ECB, the European Commission, Eurostat, the IMF, the World Bank, the BIS and the OECD.

¹ Comprising the FITD (the Interbank Deposit Protection Fund) and the FGD (the Mutual Deposit Guarantee Fund).

5.5 International cooperation

The Bank of Italy acts in the various fora for international economic and financial cooperation: the International Monetary Fund, the World Bank and the Regional Development Banks, the Organisation for Economic Co-operation and Development, the Financial Stability Board, the Bank for International Settlements, regulatory and supervisory organizations, the European institutions, the Eurosystem, and the informal intergovernmental groups (G7, G10 and G20). The main objectives of cooperation are to identify and monitor risks to the world

The international fora

economy, the stability of the global financial system, the resolution of financial crises, and the fight against poverty. The Economic Research and International Relations Area liaises with the government authorities in order to formulate and represent Italy's position on the matters dealt with in these fora. The Area prepares the reports for the meetings attended by the Bank's representatives.

The activity of the Bank's foreign offices

The activity of the Bank's foreign representative offices reflects the Institute's attention to geographical areas of growing relevance both in the global arena and for Italy's economy. The number of economies analysed rose to 26 after the Financial Attaché in Moscow was entrusted with the task of monitoring developments in Kazakhstan and Ukraine.

The foreign network comprises representative offices in London, New York and Tokyo, and the Financial Attachés based at Italian embassies and consulates in Berlin, Cairo, Istanbul, Moscow, New Delhi, Paris, Beijing, San Paolo, Washington and the Permanent Representation of Italy to the European Union.

In 2011 the foreign network produced 220 analyses of short-term economic developments and research into economic-financial and legal issues; special attention was paid to the sovereign debt crisis in Italy and in the euro area, and to how it is perceived outside of Europe. Other studies examined the economic and political consequences of the Arab Spring in the Middle East and Mediterranean regions, the reform of the controls on the financial system in the United States and the implementation of the Dodd-Frank Act, the political transition in China and the need to reform its development model.

International technical cooperation

The Bank of Italy is strongly committed to technical cooperation with other central banks and supervisory and financial authorities. In the course of the year the Bank promoted 141 initiatives, of which 89 abroad. Some 234 central bank officials from 46 countries benefited from training courses in Italy. These initiatives were made possible thanks to the combined efforts of 34 departments at the Bank's Head Office, the Financial Intelligence Unit, three of the Bank's branches, the financial attachés in Cairo, Moscow, Beijing, San Paolo and New Delhi and several external actors.

Turning to the multilateral initiatives funded by the European Union, last year the Twinning Programme with the Bank of Albania continued, with the Bank of Italy acting as project leader. As regards the technical cooperation programmes run by the Eurosystem, to which the Institute contributes, the one in favour of the Central Bank of Egypt continued while those with the Central Banks of Russia and of Bosnia and Herzegovina came to an end; the two-year programme for the strengthening of supervisory activity in the EU candidate and potential candidate countries was also concluded.

In 2011 four international technical cooperation seminars were held on monetary policy, cash handling, financial education and credit analysis.

6. THE ORGANIZATIONAL STRUCTURE, RESOURCES, THE ACCOUNTING SYSTEM AND TAX DEPARTMENT, THE LEGAL DEPARTMENT, INTERNAL AUDIT

6.1 The Bank's organizational structure and work processes

To enhance the coordination of the Bank's activity within the Eurosystem and cross-function consistency of approaches and policies with regard to financial stability, the Bank set up two bodies – the Coordinating Committee for participation in the ECB Governing Council and Eurosystem Committees, and the Coordinating Committee for financial stability – and a Technical Secretariat for the Eurosystem and Financial Stability.

**Changes
in the organization
of the Head Office**

To strengthen its activity for financial education, the Bank established the Financial Education Unit, which promotes and develops initiatives to improve the population's knowledge of economics and finance, pursue relations with authorities, institutions and organizations, and communicate the role of the Bank in this field externally.

A Management Coordination Committee, chaired by the Director General, has been established to strengthen the integration of the different organizational variables, including for the purposes of strategic planning (see the box "The new strategic planning system"). The Committee coordinates innovative management initiatives that involve a multiplicity of functions and checks their results.

THE NEW STRATEGIC PLANNING SYSTEM

The key features of the Bank's new three-year strategic planning system are: (a) the guidance and stimulus provided by the Governing Board in formulating the Bank's vision, selecting objectives and monitoring progress; (b) identification of a limited number of strategic objectives; (c) quantitative indicators for effective monitoring of progress in reaching the objectives; (d) strict integration between objectives, activities and resources under the action plans; (e) streamlined and flexible planning procedures.

The objectives identified for the three years 2011-13 are: (a) to improve the thoroughness and effectiveness of the external and internal communication of the results of the Bank's actions and the management of its resources; (b) to

pursue innovation in the Bank's operations in order to increase their efficiency; (c) to strengthen the Bank's commitment to social responsibility.

These objectives flank and support the Bank's overall commitment in carrying out its institutional activities and are directed to improving the quality of services provided and the efficiency of work processes through technological and organizational innovation. For each objective, ad hoc working groups have been appointed to carry out the activities within fixed time limits.

The reform of the branch network

The Bank carried out various initiatives in 2011 to refine and consolidate the new organizational model of its branch network (see the box "The new organizational model of the Bank's branch network").

THE NEW ORGANIZATIONAL MODEL OF THE BANK'S BRANCH NETWORK

The project for a reorganization of the Bank's branch network was launched by the Governing Board in 2007, in keeping with the experiences then under way at the major central banks of the Eurosystem. It was developed through a collegial process, open to participation by all the components of the Bank, and finally approved by the Bank's General Council.

The new structure was put in place between 2008 and 2010, on schedule, with interventions regarding all the variables: distribution of functions and tasks, organizational structures, human resources, technology, work processes, internal regulations, logistics.

The new model is based on functional specialization and the regional compass of institutional activity at local level. It turns on regional branches, which perform the full range of services, and branches specialized in cash handling, supervision and user services.

The configuration is modular and flexible, open to the evolution of the context in which the branch network operates. The unitary, comprehensive approach taken to implementing it envisages a balanced functional link between the number, tasks and territorial distribution of the different types of branches.

Technological innovation has improved the promptness of external and internal communications, the quality of services provided to users and efficiency of operating processes.

In the field of currency circulation, the use of new advanced-technology systems for banknote handling has permitted a complete integration of all the phases of the work process and the virtually complete elimination of manual handling. The handling of banknotes with the new system is totally reliable and enables the Bank to serve users more swiftly.

The State treasury service is also now carried out chiefly with the use of information and communication technologies.

Overall, the reform has made it possible to strengthen the Bank's institutional activity at local level and achieve appreciable improvements in organizational efficiency, in part by reducing costs.

Between the end of 2007 and the end of 2011 the number of staff assigned to the branches decreased by 840, from 3,509 to 2,669 (Table 6.1). The creation of specialized units makes it easier for the Bank to capitalize on the staff's professional expertise.

Self-management has been reduced very substantially – by 37 per cent – as a consequence of the structural and organizational changes and process simplification and innovation.

The rationalization of procedures, internal rules and work processes mainly concerned the tasks of support to institutional activities and internal administration; it was achieved in part by greater recourse to digital signature services, use of which was extended in order to favour the development in full of electronic interchange and the dematerialization of document flows. A significant increase was achieved in external exchanges of electronic documents having legal value, a development assisted by the spread of similar instruments, particularly certified electronic mailboxes, among individuals, enterprises, general government bodies and intermediaries. In the two years from March 2010 to March 2012, the share of certified email increased from 8 to 26 per cent for incoming documents and from 40 to 80 per cent for outgoing ones.

The simplification of work processes

With the accreditation of the Bank's digital signature infrastructure by the European System of Central Banks (ESCB) on 29 August 2011, the Bank is enabled to provide certification services also for IT projects carried out within the ESCB.

The Bank's internal rules on expenditure are updated continually to take account of the changes in external regulations and legislation on public procurement. Specific instructions have been issued to apply the regime introduced by the regulation implementing the Public Procurement Code (Presidential Decree 207/2010).

The Bank improved the measures to ensure business continuity even in the face of emergencies and strengthened testing of the related procedures.

Business continuity

The organizational and governance framework of the operational risk management function was completed: in accordance with the approach adopted at Eurosystem level, an Interfunction Committee on Operational Risks was established to assist the Governing Board in developing guidelines and verifying their state of implementation. A new organizational unit within the Organization Department acts as the Committee's technical secretariat, conducts analysis and methodological development, assists the Bank's units in applying operational risk management policies and coordinates the Bank's operational risk management system.

Operational risk management

Analysis of the Bank's main operational risks, with the indication of response plans where necessary, is expected to be completed by the end of the year.

6.2 Human resource planning, management and training

On 31 December 2011 the Bank of Italy had 6,990 employees, against estimated staffing requirements of 7,315 positions. Branch employees (who numbered 2,669) accounted for 38.2 per cent and head office employees (4,321, including 171 at foreign delegations, embassies and consulates, and other authorities, entities and institutions in Italy or abroad) for 61.8 per cent. Managers accounted for 8.7 per cent of total staff and other officers for 20.3 per cent. The average age of the Bank's personnel was 48.3; 46 per cent were university graduates; 35.3 per cent were women. Of the women, 5.4 per cent were managers and 20.6 per cent officers (Table 6.1).

Table 6.1

COMPOSITION OF STAFF BY GRADE AND GENDER										
GRADE	Number at 31.12.2011					Number at 31.12.2010				
	Men	Women	Total	Branches	Head office (1)	Men	Women	Total	Branches	Head office (1)
Managers	475	132	607	130	477	495	124	619	135	484
Officers	912	507	1,419	386	1,033	935	498	1,433	381	1,052
Coadjutors	745	511	1,256	495	761	767	510	1,277	540	737
Other personnel	2,393	1,315	3,708	1,658	2,050	2,504	1,329	3,833	1,742	2,091
Total	4,525	2,465	6,990	2,669	4,321	4,701	2,461	7,162	2,798	4,364

(1) Includes the Financial Intelligence Unit, delegations abroad and staff seconded to other entities.

The staff decreased by 172 by comparison with the end of 2010 as the result of 468 terminations and 296 new hires (190 men and 106 women) during the year. Recruitment focused mainly on renewing operational units with versatile staff members (137 new employees) and on meeting the Bank's need for technicians and specialists in economics, statistics and law (88 new employees).

In the hiring procedures, special care was taken with communication. The Bank's website section on competitions was enriched. Electronic means were also used to notify participants promptly of the results of the single tests, making the whole procedure faster and more efficient. What is more, the recruitment announcements gave more detailed job descriptions than in the past and a more detailed account of the qualifications needed (for instance, there were special competitions for university graduates to be assigned to positions in banking supervision, procurement, and local economic research). Where possible, the eventual location to which the hire would be posted was also made known.

During 2011, 95.3 per cent of the staff (6,660 employees) engaged in some form of training activity, for a total of 206,000 hours of training (an average of 31 hours per participant). A "value and leadership" training project was initiated to support head office managers in handling change and fostering the balanced development of specialist and managerial skills.

In November the Bank made the transition to SAP's HCM human capital management software to register employee's working hours, absences and leaves, dematerializing a good many paper documents and streamlining self-administration processes.

6.3 The application and infrastructure planning and development and the provision of ICT services

Information technology is a crucial tool in the execution of the Bank's institutional mandate, especially regulatory and supervisory activity, and in its participation in determining and implementing the common monetary policy. The IT function has the task of ensuring the reliable operation of the Eurosystem's gross settlement system and constantly promoting operational innovation for process efficiency both domestically and internationally.

The application and infrastructure planning and development

The Bank's IT function carried on its development activity in 2011 both for institutional tasks – with a major effort involving planning for the ESCB – and internally, completing the realization of the most important internal procedures in support of process modernization and renovating infrastructure technology to enhance the range of user services. With a view to shortening time to market and increasing innovation, a new, agile methodological process was introduced for project development, to contain realization times and better serve user needs.

The European TARGET2 gross settlement system made further functional innovations. Work continued on the new TARGET2 Securities settlement platform.

As regards communication between national central banks, the Bank of Italy is an active participant in the planning and realization of a new telecommunications network within the ESCB. Work continued to strengthen the security safeguards for the new inter-NCB e-mail system based on international best practices and standards.

As part of the State treasury service performed by the Bank, a new version of the General Government Transactions Information System (SIOPE) was installed, with additional functions and more complete reporting. The Bank's applications centre is concluding its development work for the execution of retail payments by means of SEPA instruments.

Internally, rationalization and process simplification proceeded (see the box "The modernization of internal processes"). The new human resources management system went operational. Also, significant advances were made in the management of real estate assets, document processing in compliance with the dictates of the Digital Administration Code, and the new expenditure procedure.

As to services to final users, given the importance of communication and today's new media, the IT function worked to reinforce the tools for collaboration and integrated communication, including an experimental programme to introduce instruments of enterprise social networking.

THE MODERNIZATION OF INTERNAL PROCESSES

The introduction of an enterprise resource planning (ERP) application platform represented the concrete realization of the plan for a fully integrated modern system, which in practice comprises the management of the entire Bank (accounting, expenditure, banknote production, buildings, personnel). In an ERP system, data are coded consistently, uniquely, without ambiguity. Processes are carried out according to the most common practices at the leading national and international institutions; they embody standard control mechanisms for constant checking of data and work flows. Functions are constantly updated and can adapt rapidly to changing internal and external regulations. These features make for more comprehensive and more sophisticated controls, thanks to the integration of the ERP systems with the Bank's state-of-the-art business intelligence products, which permit more thorough inspection of work processes to locate trouble spots and opportunities for optimization.

In a dynamic, complex context, the Bank continues to pay the greatest attention to technical and organizational safeguards for data security and risk management; cooperation with other financial institutions was further enhanced to design shared methods of combating the new computer crimes.

Provision of ICT services

In the field of corporate social responsibility, last year saw the start of the implementation phase of the restructuring of the Bank's data processing centres in accordance with "green IT" logic (see the box "The green data processing centre"). Further, the Bank began activities under its multi-year development plan for engineering ICT management processes. The first phase of the project envisages the creation of a central database for service assets and configuration management, with data on the numerous technological components in ICT services provisioning.

THE GREEN DATA PROCESSING CENTRE

Internationally, the theme of "green IT" is one of the drivers of technological development and innovation in the field of information and communications technology. Its underlying principles combine social responsibility with economy and have won the backing of governments, public institutions and companies.

The Bank of Italy's green IT project provides for the installation, at the two separate data processing centres, of modular energy-efficient "islands" with integrated internal cooling systems. Working on small volumes and in close correlation with the heat dispersion produced by the computers, these systems greatly increase energy efficiency.

The shift from "room" air conditioning to "island" cooling will cut energy consumption by half. The new structures also save space and installation time in ICT development. The first two islands are scheduled to go operational in September 2012, and by April 2013 three more units will be installed in each data centre.

Automatic data matching systems will make ICT service management more efficient, to the benefit of final service quality and human resource deployment.

Special emphasis was placed on information system change management, with a view to mitigating the related operational risks.

6.4 Property and purchasing

Efforts in the property sector focused on ensuring the complete functionality and business continuity of the Bank's institutional buildings and the related technological plant, improving anti-crime security systems, complying with the changes in workplace safety legislation, and increasing the commitment to social responsibility (see the box "Social responsibility and environmental protection").

In particular, the adaptation of the buildings in the Rome area that are considered strategic proceeded. This work also aimed at increasing the productivity and security of the individual buildings, in ways consistent with the dictates of economic viability.

In the wider context of a rationalization of the Bank's property, the contract for the advisory services for the sale of the buildings made available following the reorganization of the branch network is now being executed. The person awarded the contract has performed due diligence and estimated the value of the properties; the valuations have been examined by a Bank committee. The notices of sale of the first properties put on the market will be published starting in June 2012.

SOCIAL RESPONSIBILITY AND ENVIRONMENTAL PROTECTION

Strengthening the Bank's commitment to social responsibility is one of the objectives of the Strategic Plan for 2011-13. The environmental protection measures to be taken in the fields of energy, renewable sources, waste and sustainable mobility come under this objective.

With a view to enhancing the systematic quality of its actions for social responsibility, in 2011 the Bank began the groundwork for a Sustainability Report, to be prepared by the end of 2012, which will make use of specific indicators to illustrate the Bank's initiatives in such fields as equal opportunity, the promotion of culture and the environment. In addition, the project to eliminate architectural barriers so as to make the Bank buildings that are open to the public completely accessible for the physically disabled has reached an advanced stage.

The Bank's ecological footprint was reduced in 2011 (see *2011 Environmental Report*). This was achieved in part through:

- (a) the reduction of energy consumption by means of operational measures and the adaptation of buildings and plant, and with the adoption of advanced energy design standards;

- (b) the reduction of paper consumption and greater use of recycled paper;
- (c) the inclusion of “green clauses” in procurement contracts.

In addition, the initiatives for green public procurement proceeded.

For anti-crime security, the Bank is continuing to develop the initiatives for the renewal of the digital video surveillance system (competitive award procedure under way) and integrated security systems (in the planning phase); implementing the measures to strengthen the security safeguards will take about four years overall. In the international sphere, the Bank continued to cooperate with Eurosystem and non-Eurosystem national central banks for the exchange of significant information in the security field.

Dissemination of the new branch network maintenance model proceeded. The model is based on the award of a single contract for maintenance work and services on the buildings of the branches located in the same region or in a group of adjacent regions, with the objective of reducing costs but not the quality of maintenance. In conformity with the legislation on procurement contracts, in the selection procedures criteria were adopted that put a premium on service quality and minimization of the Bank’s ecological footprint.

Further checks on the anti-seismic adequacy of the Bank’s buildings were conducted under a research contract signed with the Structural and Geotechnical Engineering Department of La Sapienza University of Rome.

The objective of containing expenditure while maintaining high standards of quality and paying increasing attention to environmental issues guided the procurement of goods and services. In selecting contractors, the Bank employs the instruments and procedures envisaged by the legislation on public contracts (Legislative Decree 163/2006). At the beginning of the year the related responsibilities were concentrated in the Purchasing Department, which as part of the organizational revision of procurement is now charged with carrying out the procedures for all the units of the Bank except, for the present, those assigned to purchase resources for specialized functions.

The accounting function

The Department has prepared an overall multi-year plan on the basis of the requested submitted. In contract management, the Bank took steps to enhance the safeguards of quality and social responsibility. At international level, it continued to take part in the work of the Eurosystem Procurement Coordination Office.

To make the works of art in its possession more accessible, the Bank has made it possible for the general public to view the most important of them on its website. The “virtual museum” gathers together images of paintings, sculptures and places and also provides art-historical information and themed tours of the works comprising the collection. In addition, restoration of a large sculpted frieze that allegorically portrays the Bank has been completed. The frieze is now on view at the atrium of the building on Via Quattro Fontane in Rome.

The Bank's workplace safety system evolved further with the Bank delegating responsibility to managers, who file half-yearly compliance reports. For banknote production, a workplace safety management system compliant with the international standard BS OHSAS 18001:2007 has been developed.

6.5 The annual accounts and accounting information

The Bank of Italy's accounting system is based on units at the Head Office and in the branch network, each of which keeps records of the transactions for which it is competent. The Bank's Statute makes its Board of Auditors responsible for performing accounting checks while for the year 2011 the accounts were audited by PriceWaterhouseCoopers, the firm selected by competitive tender and in compliance with the rules established by the Statute of the ESCB.

The Bank of Italy's accounts for 2011 closed with a net profit of €1,129 million.¹

During 2011 the Accounting and Control Area underwent a reorganization aimed, in particular, at strengthening the accounting function by focusing the basic units on the phases into which it is divided (accounting, checking and reporting). The reorganization provided an opportunity to revise the methods used for the second-level accounting controls from a standpoint of proportionality and consistency with the potential risks – financial, operational and reputational – underlying the various parts of the accounts, thereby strengthening the control on and the reliability of the financial information produced. The restructuring represented the organizational response to the need to orient the second-level controls so as to achieve greater efficiency and effectiveness, in line with best international practices. The strengthening of the second-level accounting safeguards has brought about a change in the logic underlying the controls themselves, aimed now primarily at ensuring the correctness of the process (rather than of the individual acts), through the use of methods based on anomaly indicators and sample analyses.

At European level the Bank participates in the activity of the Accounting and Monetary Income Committee, a consultative body of the Governing Council of the European Central Bank for accounting matters and the sharing of monetary income. In 2011, among other things, the Committee analyzed accounting and annual accounts problems connected with securities acquired for monetary policy purposes, with special reference to Greek debt securities held by Eurosystem central banks under the Securities Markets Programme.

6.6 The control of operations and expenditure

With the reorganization of the Accounting and Control Area, the cost control system was restructured, both to broaden the objectives and to use more functional operational instruments.

¹ See Chapter 22, "Relazione sulla gestione e bilancio dell'esercizio" in *Relazione sull'anno 2011*, Banca d'Italia 2012.

The control of operations

An important part of the reform was the strengthening of the control of operations in support of the decision-making processes and integrated with the Bank's strategic planning. The strengthening of the monitoring instruments, through more advanced forms of measurement of company performance, is aimed at achieving not only efficiency and cost effectiveness objectives for operations and administrative correctness for expenditure documents but also accountability. The transparency objectives pursued by the Bank of Italy are based on principles in line with those of the legislation governing the transparency of the public administration.

In 2011 the objective of holding down costs to the levels established with the approval of the annual budget was achieved in full. The factors that contributed to this result included both the effects of the process of organizational reform involving the Bank and the action to achieve a more rational management of resources through careful use of the instruments of expenditure planning.

The control of competitive tendering procedures

The controls entrusted to the Expenditure Committee on the legitimacy of tendering procedures and the premises underlying contracts that are negotiated or declared secret also contributed to achieving the objective of holding down costs. To this end, the use of competitive procedures was encouraged to ensure the maximum participation, so as to select the "best offer" in terms of price/quality every time.

6.7 The fiscal function of the Bank of Italy

The Bank of Italy is subject to both direct and indirect taxation, at both central and local government level. Among the 27 countries of the European Union, the central banks of five other countries (Austria, Belgium, France, Portugal and the United Kingdom) are subject to corporate taxation. All the central banks of the Economic and Monetary Union are subject to VAT.

The tax regime of the Bank of Italy

For the purpose of determining the Bank of Italy's tax base for income tax and the regional tax on productive activities, reference is made to the annual accounts drawn up in accordance with the provisions and recommendations of the ECB. The Bank of Italy's taxes for the 2011 fiscal year amounted to €1,101 million (€925 million for 2010)².

The Bank manages its tax affairs by means of a dedicated structure that handles its payments of corporate income tax, the regional tax on productive activities, VAT and other taxes, acts as withholding and declaration agent, and manages disputes with the tax tribunals.

As part of its tax activity, the Bank, together with the other NCBs, has sought to avoid unequal treatment as regards VAT on shared Eurosystem operations and investments. An analysis has also been made of the impact of the US legislation provided for by the Foreign Account Tax Compliance Act (FATCA).

² See Chapter 22, "Relazione sulla gestione e bilancio dell'esercizio" in *Relazione sull'anno 2011*, Banca d'Italia 2012.

Last year a first periodic report was prepared monitoring the tax risks deriving from the activity of the Bank's central and peripheral units.

In 2011 analyses were carried out on the tax regime applying to real-estate funds, the reform of the taxation of financial assets, and the new forms of taxation of the financial sector envisaged at international level (financial activity tax, bank levies and financial transaction tax).

6.8 The Legal Services Department

The Bank of Italy draws on the services of internal lawyers, entered in the special list attached to the lawyers roll, for legal questions and research. Among the tasks entrusted to them is the conduct of civil and administrative disputes. At the penal level the activity mainly involves intervening as a civil party in proceedings concerning crimes harming goods whose protection is entrusted to the Bank. The Legal Services Department supports the various units of the Bank by giving opinions, participating in working groups, providing assistance in the sanctioning procedures for which the Bank is responsible and in the reporting of crimes to the law enforcement authorities. Lawyers from the Legal Services Department participate in working groups with other units of the public administration and at the ECB and other Community institutions.

Duties

In 2011 the Bank of Italy was a party in 293 new trials, a reduction of 14.8 per cent on the previous year, when there were 344 new trials. Trials for the administrative sanctioning of banking and financial intermediaries (responsibility for which was transferred from the Rome Court of Appeal to the Lazio Regional Administrative Court on 15 September 2010) decreased by 9.8 per cent from 91 in 2010 to 82 in 2011 (compared with 39 in 2009 and 66 in 2008). Trials before the Court of Cassation and the Council of State also decreased, from 31 to 21.

The activity performed in 2011

A total of 322 decisions were obtained during the year,³ of which 244 were favourable, 17 unfavourable and 7 partially unfavourable. The percentage of favourable decisions, 91.04 per cent, was basically in line with the previous years. With special reference to actions brought against measures adopted by the Bank in the performance of its supervisory functions, the positive trend of decisions recorded in recent years was confirmed: of the 46 decisions adopted by administrative judges (Regional Administrative Courts and the Council of State) 30 were favourable and 2 unfavourable (the remaining cases ended without a decision); lower and appeal court judges adopted 33 decisions, of which 30 were favourable to the Bank, 2 partially favourable and 1 unfavourable.

At the penal level the Bank intervened as a civil plaintiff in 12 new cases and participated in a trial as the person liable under civil law with respect to crimes of association to engage in criminal activity and unauthorized financial activity.

³ The figure includes decisions involving interim injunctions and administrative proceedings concluded in other ways (peremption, cessation of the matter under dispute, withdrawal, supervening lack of material interest).

In its advisory capacity the Legal Services Department handed down much the same volume of opinions in 2011 as in the previous year; for the most part they concerned banking and financial supervision, competitive tenders and contracts.

Particular attention was paid to legal analysis and research. During the year three Legal Research papers were published on issues of particular institutional interest and five seminars were organized, some of which were international.

The Bank continued to provide legal support in various fora (the European Commission and Council, the World Bank, Unidroit and Unicitral). Within the ESCB, in addition to the usual participation in the Legal Committee and the provision of support to the Governor of the Bank of Italy as a member of the Governing Council, the Bank's lawyers were involved in the preparation of the tender documents for the connectivity service of the platform for the T2S service. One of the Bank's lawyers has been seconded to the newly established European Systemic Risk Board (ESRB) and another to the ECB.

6.9 The internal audit function

In the Bank's internal control system the audit function is performed by the Internal Audit Department, which is charged with making independent assessments of the adequacy of the Bank's control and risk-management systems and with promoting their continuous improvement. If requested, it gives advice on specific issues. Within this framework, each year the Department carries out on-site interventions and distance analyses.

The audits performed in 2011

The choice of audits to be carried out in 2011 was made using the usual methodology based on the analysis of risk: the checks involved work processes, central and peripheral organizational units, and IT applications and infrastructures, so as to cover the Bank's various activities (both institutional and not) and, for the riskiest activities, they had a short time horizon. Interventions were also planned, on the basis of a programme agreed at European level, for domestic components of ESCB processes.

A total of 33 audits were carried out in 2011, as against 27 in 2010. In general the results showed there was awareness of risk management in the areas subjected to audit.⁴

Distance analysis

The Bank's Internal Audit Department used a structured follow-up process to monitor the action plans prepared by units to overcome shortcomings found during audits. The results were positive: in most of the cases the shortcomings were overcome on time, in the remainder the plans are being carried out.

Last year saw the first Control Risk Self-Assessment exercise performed by branch managers. The Department analyzed the results and generally found a

⁴The Department also ran four branches that were temporarily without a manager.

situation marked by attention to and protection against risks. Where problems were found, initiatives have been launched to overcome them.

The other distance-analysis activities performed in 2011 gave rise in some cases to checks on paper documents and, more generally, provided information used to prepare the audit plan and guide on-site checks, thus making it possible to broaden the protection against risks and, at the same time, to use resources efficiently. Other factors contributing to enhance the Department's effectiveness and efficiency included the updating of the support methodologies and the ideas produced by comparisons made with the Department's international counterparts.

The Audit Committee, made up of three members of the General Council and with the participation of a member of the Board of Auditors as an observer, oversaw the activity of the Department. The Committee drew up its first annual report, finding an adequate degree of attention to risks by the Bank and compliance of internal audit activity with audit policy and international standards.

The Advisory Committee

The Department held periodic meetings with the Board of Auditors and cooperated as usual with the Bank's external auditors.