



BANCA D'ITALIA
EUROSISTEMA

Report on Operations and Activities Executive Summary

Rome, 31 May 2016

EXECUTIVE SUMMARY

The Bank of Italy's new Statute, which came into force on 11 April 2016, moved the balance sheet approval date forward to bring it into line with the rest of the Eurosystem. It also recognizes the dematerialization of the shareholdings, an initiative designed to facilitate the redistribution of the shares in order to comply with the maximum limit permitted by law. With the increase in shareholders (to 101 at the end of April), the weight represented by each of them has been reduced, in compliance with the objectives established by law.

After detailed discussions with the trade unions, in early 2016 a wide-ranging reform of the staff management system was announced, based on the following criteria: recognizing and rewarding merit; performance management by objectives; time limits for managerial appointments; appraisal of managers by peers and colleagues.

The Bank made some organizational changes at its Head Office and, especially, at its branches.

The main change at Head Office involved the Bank's activities as the National Resolution Authority for banking crises, with the establishment of a Resolution and Crisis Management Unit that reports directly to the Governing Board.

Between October 2015 and January 2016 a total of 19 branches and 3 delocalized supervision divisions were closed; in the 22 cities concerned, there are now the same number of temporary territorial service units, 12 of which will be closed in July 2016 and the remaining 10 in 2018. There are currently 39 branches compared with 97 in 2007. The distribution of branches at the provincial level has now been definitively phased out in favour of branches located in the capitals of the regions and autonomous provinces. The reorganization of some of the Bank's functions will mean greater involvement of the territorial branch network in: supervising financial intermediaries; protecting bank customers; managing the circulation of banknotes and coins; and evaluating the credit risk of loans used as collateral in monetary policy operations. In carrying out its institutional functions, the Bank aims to improve the quality of services for the community; when fully phased in, there will be cost savings of around €50 million a year.

Using resources efficiently and permanently reducing its operating costs are among the strategic aims of the Bank, to be achieved by significant investment in ICT and by rationalizing work processes and organizational structures.

In real terms costs fell by 14 per cent between 2009 and 2014 and recorded a further slight decline of 0.3 per cent last year, despite investments in large IT projects, including the launch of the TARGET2-Securities platform, and the increased activity

in some other sectors. More specifically, the resources allocated for the protection of bank customers rose by 41 per cent overall in the last four years and now account for 17 per cent of total spending on supervisory activities.

In 2015 staff costs came to 57 per cent of the Bank's total expenses; the number of personnel has remained basically stable since 2012. At the end of the year there were 7,032 people on staff (46 fewer than a year earlier): the Bank's internal staff numbered 6,862; of the 170 people seconded to other organizations in Italy and abroad, those on leave of absence while working in international institutions (only 49 staff members prior to the establishment of the Single Supervisory Mechanism) have increased to 126 (of which 105 are currently at the ECB). The Bank invested 3 per cent of total labour costs in training to upgrade and develop the staff's professional skills.

The implementation of monetary policy decisions has required increasing investment as the range and volume of these operations has broadened. The Asset Purchase Programme, launched at the end of 2014, was expanded on several occasions to include public sector securities issued by euro-area countries. Since the programme began, the Bank has bought €62.3 billion worth of Italian public sector securities and €18.4 billion worth of covered bonds. The pace of the purchases is set to increase in 2016 as the programme expands; purchases will also include bonds issued by non-financial firms.

A growing number of Italian intermediaries (189 – ten more than in the previous year) accessed ECB refinancing operations. Loans to Italian banks equalled €158 billion at the end of 2015; 80 per cent of the funds were disbursed via longer-term operations aimed at facilitating access to credit for households and firms.

The European platform for the settlement of securities transactions, TARGET2-Securities (T2S), was launched on 22 June 2015. The Bank developed this platform together with the central banks of France, Spain and Germany and now manages it jointly with the Bundesbank. On 31 August the first phase of the migration of the central depositories and national financial markets was successfully completed with the transition to T2S of Monte Titoli SpA, the third largest European central depository by volume of traffic. The migration of the Italian financial market was a delicate moment, both because of the very large volume of transactions and complex structure of the transactions handled by Monte Titoli SpA, and because of the commitment made by the Bank and the national financial community to guarantee continuity and efficiency, in particular for the settlement of government securities. In the last four months of 2015 about 49,000 securities transactions were settled daily in accounts held with the Bank of Italy. By the end of 2017, T2S will be able to settle securities transactions in 21 countries. The launch of the platform, which required regulatory interventions implemented with Consob, is an important step towards integrating and harmonizing European financial markets and strengthening the role of the Eurosystem in providing payment services.

The TARGET2 system, whose operational management has been entrusted to the Bank of Italy and the Bundesbank, settled 88 million payments in the euro area last year, with an average of more than 350,000 a day; in 99.96 per cent of cases, the transactions were settled in under five minutes. On accounts opened with the Bank of Italy, an average of 40,000 transactions took place each day.

At the national level, to smooth the management of retail payments made by paper instruments such as cheques or by electronic means, a night cycle has now been added to the five daytime cycles of the BI-Comp settlement system managed by the Bank.

There have been several legislative changes regarding retail payments: between 2015 and early 2016 the European Regulation on Interchange Fees for Card-based Payment Transactions and the revised Directive on Payment Services came into force, both of which were drawn up with the direct contribution of the Bank during the six-month term of Italy's Presidency of the Council of the European Union. The Bank was designated as the competent authority in Italy to check compliance with the regulations on interchange fees for card-based transactions. Within the framework of the establishment of the Single European Payments Area (SEPA), on 1 February 2016 the adoption of the SEPA standards was completed, enabling the development of innovative payment solutions while maintaining the benefits gained through the integration of payment instruments at European level. As regards financial markets, the European Securities and Markets Authority has recognized that the supervision conducted by the Bank of Italy and Consob on short selling complies with its own guidelines.

The Bank of Italy's banknote production plant produced 1.3 billion notes during the year, equal to about 22 per cent of the Eurosystem's total requirements. Quality control was carried out on the notes in circulation, the value of which is estimated at about €142 billion. Some 890 million worn banknotes were destroyed and about 162,000 suspected counterfeit notes were withdrawn. The launch of the new €20 note was accompanied by a major information campaign for the general public and professional cash handlers.

The Bank continued to supervise the banknote authentication and sorting activities carried out by cash handlers, as it has done since 2012. During the year there were 16 inspections of cash in transit companies (CITs) and banks to verify compliance with the regulations. There were 32 targeted investigations involving 360 bank and post office branches to verify the conformity of the equipment that sorts the banknotes to be distributed to customers via automatic teller machines.

All CITs involved in cash processing have been monitored in the course of the last four years: the inspections identified significant problems in most cases, in particular regarding internal control systems, organizational arrangements and governance, partly due to the fact that these companies tend to be small. Overall, 22 fines were imposed for a total of €475,000; major corrective measures were frequently required. Fragile capital bases and structural weaknesses led to the exit from the market of some smaller firms, which were unable to comply with the regulatory requirements: the number of CITs fell from 68 to 43. Following these interventions, there were fewer problems but there is still a need for greater reliability and operational correctness on their part. Starting this year the Bank is committed to stepping up its analysis activities and on- and off-site monitoring.

At the end of 2015 there were about 21,000 Treasury accounts held at the Bank; the flows handled increased by 6 per cent compared with the previous year. Around 66.7 million collection and payment operations were executed, 96 per cent of which

online. The Bank managed 276 money market operations in relation to the Treasury's payments account and 242 auctions to place public debt securities.

As of 1 January 2016 the online Treasury project is virtually complete. This means that collection and payment operations and financial reporting can be done digitally. The Bank intends to intensify its collaboration with the Ministry of Economy and Finance to make optimal use of the data on collections and payments and to satisfy the demand for greater transparency in the management of the public finances.

In application of EU Regulations, which designate the Bank of Italy as the competent authority to activate macroprudential policies to safeguard the stability of the financial system, in 2015 the Bank put in place the analytical, organizational and operational instruments needed to perform this new function. The market has been informed of the new instruments that can be activated for these purposes, following harmonized criteria but also adding to them where opportune, while observing the limits on flexibility left to the national authorities. In a context in which the growth of bank lending cannot be considered excessive in relation to the economic cycle, the countercyclical capital buffer rate was set at zero per cent. The Financial Stability Board confirmed its inclusion of the UniCredit banking group in the list of global systemically important institutions and the Bank of Italy classified the Unicredit, Intesa Sanpaolo and Monte dei Paschi di Siena groups as domestic systemically important institutions; the additional capital buffer applicable to these banks was fixed with decisions made public by the Bank of Italy. Within the European Systemic Risk Board, the Bank also helped draft the macroeconomic scenario to be used when stress testing the major European banks.

Within the Basel Committee on Banking Supervision, the Bank of Italy contributed to the completion of the international regulatory framework for banks (Basel III), which will be finished this year. The main aims were: to reduce any undesired variability in the risk weights, with specific reference to assets for which some international banks apply particularly low ratios; to avoid, at the same time, an excessive increase of the requirements by referring to the standard methods which are used by minor banks and which should also serve as a point of reference for the internal models of larger banks. Following the decisions of the G20 Group of Governors and Heads of Supervision, the Bank of Italy will work to ensure that the completion of Basel III does not ultimately lead to a large increase in banks' capital requirements.

In the European arena, the Bank contributed to the drafting of the European Banking Authority's guidelines. As regards policies and practices for the remuneration and incentivization of bank staff, the guidelines aim to harmonize the regulatory framework and to regulate several aspects in detail. In relation to how bank products for retail customers (mortgage loans, current accounts, payment services) are structured and distributed, they aim to ensure that the customer base for which the products have been developed matches the customers with whom they are actually placed.

At the national level, the Bank contributed to the reform of Italy's cooperative and mutual banking sector, working alongside the Parliament and Government to draw up legislation and issue implementing provisions.

The Bank was also very closely involved in the decision-making processes of the Single Supervisory Mechanism: in 2015 it participated in 38 meetings of the Supervisory Board and 22 meetings of its Steering Committee, and examined 984 written procedures, of which 147 relating to Italian intermediaries.

Supervision consists in the scheduling of annual controls of Italy's banks (both on- and off-site, and in order to validate their internal risk measurement systems) and in the supervisory review and evaluation process. The latter entails assessing the adequacy of banks' capital profiles, liquidity, and organizational aspects in relation to the risks undertaken, and deciding on the actions to be adopted. In 2015 over 5,900 fact-finding or corrective actions were undertaken, 153 inspections concluded, and 360 administrative decisions adopted.

The supervision of non-bank financial intermediaries entailed over 2,200 fact-finding or remedial actions, 51 inspections and over 500 administrative decisions. Work is under way on the creation of the new register of financial intermediaries: 324 entities applied to enrol, of which 78 had been authorized for inclusion by the end of March 2016. Additional information is being obtained to complete many other applications.

A total of 10,300 complaints from customers about alleged anomalous behaviour by banks and financial intermediaries were examined last year. These serve not only to obtain data on episodes of non-compliance with regulations or organizational malfunctions and to detect cases of abusive exercise of banking and financial activity, but also to plan financial education initiatives. To verify compliance with the rules on transparency, 266 inspections were carried out at the branches of banks and other intermediaries. Pressed by the Bank of Italy, €65 million have been reimbursed to customers for improper charging of fees.

The Bank of Italy supports the work of the Banking and Financial Ombudsman by shouldering all its operating expenses and selecting some of the members of the panels. In 2015 the Ombudsman, which currently operates through the three panels located in Milan, Rome and Naples, received over 13,500 appeals, almost four times the volume handled in 2010, the first year in which it became fully operational. It took 10,450 decisions, up by 22 per cent from 2014; in 68 per cent of the cases, customers' complaints were upheld. Due to the rapid increase in the number of appeals lodged, processing times have progressively lengthened. This year the Bank accordingly decided to establish four new panels with technical secretariats in Turin, Bologna, Bari and Palermo. A new online portal will also enable consumers to lodge appeals electronically in the future.

Financial education initiatives in schools have reached over 90,000 students, 50 per cent more than in the previous campaign. The Bank of Italy also took part in the first national survey of financial education initiatives, which will be used to draw up a strategy to improve Italian citizens' financial literacy. As part of the Bank's ongoing dialogue with consumer groups, a series of workshops and seminars were organized to launch specific initiatives for adults, in a bid to enhance their financial awareness.

In 2015 the Bank of Italy opened 3 special administration procedures in addition to the 20 already under way in relation to banks, asset management companies and

intermediaries listed in the special register; 6 were completed with the intermediary's return to ordinary management, 6 intermediaries were liquidated, and 7 procedures are still ongoing. For 4 ailing banks it was necessary to resort to the resolution procedure introduced with the transposition, in November last year, of the EU Directive on the Recovery and Resolution of Banks and Investment Firms. The measures taken – which under the new rules mean that the resolution costs are borne by shareholders and subordinated debt holders – ensured the banks' operational continuity by initiating their restructuring in the interest of the local economies where they are established. The measures also prevented potential threats to financial stability and avoided the State having to contribute directly to the cost of the rescue.

Also in relation to the obligations arising from the Bank's membership of the Eurosystem and the Single Supervisory Mechanism, in recent years activities in the field of statistics have acquired increasing importance; this was reflected in the reorganization of the Bank's statistical function, in 2015, to reinforce its core mission. The Bank of Italy's long experience and tradition of drawing on Central Credit Register data for statistical and supervisory purposes led it to support the ESCB's project dubbed AnaCredit (analytical credit datasets), set up to create a Europe-wide database on credit. Overcoming the resistance of other countries with different approaches in this field, the draft ECB regulation was submitted to public consultation, which was concluded in January 2016. The construction of the infrastructure that will handle the AnaCredit database will be overseen by the Bank of Italy, the ECB and the central banks of Spain and Portugal.

Economic research focused, as usual, on the topics most closely related to the Bank's participation in the decision-making processes of the ECB Governing Council and other European bodies. Last year the analyses conducted by the Bank's researchers concerned in particular the risks stemming from low inflation, to which several essays and policy reviews were devoted; these studies made a significant contribution to forming the analytical basis for decisions on the extraordinary monetary policy measures taken by the ECB's Governing Council.

Research has also addressed the most important issues for structural and short-term analysis of the Italian economy, the public finances, financial markets and intermediaries, the world economy and international finance. The results have been published and debated at numerous seminars and conferences, including the one reserved annually to the public finances, organized with the participation of analysts and researchers from academia and the major international institutions. A total of 93 working papers were published; the Bank's researchers authored 56 articles featured in peer-reviewed journals.

In 2015 the set of statistics published on the Bank's website was significantly expanded. In January 2016 Italy became the first country to be certified as fully meeting the requirements of the new Special Data Dissemination Standard Plus (SDDS Plus) drawn up by the International Monetary Fund for the publication of comparable economic and financial statistics, also thanks to the Bank's commitment to publish all the categories of data required for this purpose.