



BANCA D'ITALIA
EUROSISTEMA

Report on Operations and Activities Executive Summary

Rome, 31 May 2017

EXECUTIVE SUMMARY

Operations

In 2016 the Bank of Italy continued its action to facilitate the redistribution of shareholdings in its capital. Following their dematerialization, the Bank stated its willingness to purchase from market makers active in the new dedicated e-MID segment any shares held in excess of the 3 per cent limit as a result of their purchases. It also established a dividend stabilization fund to strengthen the confidence of current and prospective shareholders.

The Bank of Italy's capital is divided among 115 shareholders (77 banks, 10 social security institutions, 6 insurance companies, 7 pension funds and 15 banking foundations), of which four still hold shares exceeding the 3 per cent limit; voting rights for these shares have been suspended and, since the expiry of the three-year transitional period provided for by law, dividends are no longer paid out. Since 2013 some 27.5 per cent of the Bank's capital has been redistributed, leading to the entry of 74 new shareholders and the exit of 19 old ones, with a net increase of 55.

Last year the strategic planning cycle begun in 2014 came to an end. In the three years 2014-16 several initiatives were undertaken to strengthen the Bank of Italy's role in the Eurosystem, particularly in banking supervision and in the provision of payment infrastructures, to improve the services available to the general public, to raise efficiency in internal management, and to lay the foundations for successfully integrating diversity in human resource management.

The 2017-19 strategic plan involves promoting innovative, efficient and secure payment services, bolstering banking supervision and customer protection, widening the range of information available to the public, and facilitating continued innovation in management and organization.

Last year 12 of the 22 temporary territorial service units set up following the previous year's branch network reorganization were closed; the remaining 10 will be shut down in 2018. The network now consists of 39 branches and plays a key role in supervising financial intermediaries, protecting customers in the banking sector, evaluating the creditworthiness of loans used as collateral in monetary policy operations, overseeing the banknote authentication and sorting activities carried out by banks and cash handlers, testing banknote handling machines, and providing information to the public.

In the early months of 2017 the Directorate General for Markets and Payment Systems was reorganized to strengthen safeguards against risk, enhance efficiency and flexibility in the use of resources and gradually integrate IT processes and procedures. Moreover, the Directorate General for Currency Circulation and the Directorate

General for Accounting and Controls were merged into a single directorate to strengthen management control, keep costs down, raise productivity, and foster competitiveness in the production and distribution of banknotes. At the same time, there was a medium-term review of how the tasks connected to payments and currency circulation on the one hand, and to accounting, management control and tax consulting on the other, could be reconfigured in the future.

After remaining virtually unchanged for three years, in 2016 the total number of people on staff started to decrease again. At the end of the year the Bank's employees numbered 6,885 (147 fewer compared with a year earlier), of which 186 on secondment or on temporary leave to work in other national or international organizations (of these, 117 are at the European Central Bank).

On 1 July 2016 a new staff management system took effect, built around recognizing and rewarding merit, management by objectives, time limits for managerial appointments, and the appraisal of managers' performance by peers and colleagues. Over the course of the year a comprehensive strategy for the prevention of corruption was developed in line with international best practices. To this end, more stringent rules were introduced regarding insider trading and the ban on acceptance of gifts and other benefits, and an Ethics Officer was appointed, whose work will be supported by a separate division with sole responsibility for ethical compliance and the prevention of corruption.

The Bank is continuing its efforts to contain costs, including by assigning them greater weight in the selection of projects and investments. In 2016 its operating costs (€1.5 billion) decreased slightly compared with the previous year (-0.12 per cent; -15 per cent compared with 2009). While expenditure connected to Treasury services and the management of payments systems decreased, that connected to the protection of banking customers increased.

Activities

In 2016 the analyses conducted by the Bank's economists included those on the effectiveness of monetary policy measures in restoring price stability and the risks to financial stability stemming from prolonged recourse to these instruments; they also investigated the redistributive effects of monetary policy and its impact on portfolio allocation and on investors' risk propensity. Other research examined the factors underlying low real interest rates and growth potential in the euro area and the lasting effects of the financial crisis on the saving and investment decisions of households and firms. The studies on banks focused on non-performing loans with respect to recovery procedures, the effects of the latest legislation, and the impact of the economic crisis on bad loans.

A number of initiatives taken last year improved the services offered to users of Bank of Italy statistics. Some were designed to provide more in-depth data to users and better address their information needs; others improved the way the data are released and the functionalities of the Bank's statistical database.

As part of the implementation of monetary policy decisions, together with the other Eurosystem national central banks the Bank of Italy completed 69 refinancing

operations in euros (of which five were targeted longer-term refinancing operations) and 50 in U.S. dollars. Especially favourable conditions led the counterparties active in Italy (about 190) to augment their recourse to Eurosystem lending, from €158 billion to €204 billion at the end of 2016, and to rely increasingly on bank loans as collateral for the credit obtained. Efforts were stepped up to manage the financial assets deposited by banks and to assess the quality of bank loans pledged as collateral through the Bank of Italy's In-house Credit Assessment System (ICAS): more than 43,000 assessments were carried out in 2016, as against 18,000 in 2015.

The asset purchase programme launched at the end of 2014 was expanded several times and now includes bonds issued by non-financial firms; from its inception to the end of 2016 the Bank made about 13,900 asset purchases, of which 8,800 involved Italian public sector securities; the equivalent value of the Italian government securities purchased by the Bank of Italy and the European Central Bank amounted to €209 billion.

Private operators continued to migrate to TARGET2-Securities, the pan-European securities settlement platform developed by the Bank of Italy with Deutsche Bundesbank, Banque de France and Banco de España, and run jointly by the Bank of Italy and Deutsche Bundesbank. In 2016 the second and third group of central securities depositories joined T2S together with their financial market places and on 6 February 2017 the entry of the fourth group of depositories was successfully completed; this included the platform's largest participant, Germany's central depository Clearstream Banking. In 2016 an average of 55,000 securities transactions were settled daily on the accounts held with the Bank of Italy.

The TARGET2 system, also run jointly by the Bank of Italy and Deutsche Bundesbank, settled 88 million payments last year (344,000 on average per day), accounting for 90 per cent of large-value transactions in the euro area. All the payments were settled in under five minutes. On average, 31,000 transactions were processed each day on TARGET2 accounts opened with the Bank of Italy.

To promote the security of digital services, and in particular of payment services provided to households, firms and general government, the Bank of Italy signed an agreement with the Italian Banking Association to set up a computer emergency response team for the Italian financial sector (CERTFin).

The Bank of Italy monitored the liquidity conditions and efficiency of the money market and the secondary market for government securities, especially during periods of heightened uncertainty. Analyses of retail payments confirm the growing use of non-cash instruments (especially online credit transfers and cards). Five country-wide initiatives offering instant payment services between private users were also assessed to verify their compliance with European safety standards and the adequacy of the information being provided to users.

The Bank of Italy's banknote production plant printed over one billion notes, meeting about 17 per cent of the total Eurosystem requirement. Quality control was carried out on the notes in circulation, whose value is estimated at about €146 billion; 830 million worn banknotes were destroyed and about 148,000 suspected counterfeit notes withdrawn. The unveiling of the new €50 note was accompanied by a major information campaign for the general public and professional cash handlers.

The Bank continued to supervise banknote authentication and sorting activities carried out by cash handlers. To assess the adequacy of organizational arrangements and internal controls, 15 inspections were carried out at cash-in-transit companies and banks. A further 52 targeted investigations were completed at 318 bank and post office branches to verify the proper functioning of the equipment that authenticates the banknotes to be distributed via automated teller machines. Four years on, the findings of these inspections point to an improvement in procedural and organizational arrangements and to more incisive policy implementation from top management.

At the end of last year there were about 21,000 accounts opened with the Bank of Italy for Treasury services purposes. Settlement flows grew by 5 per cent on 2015. Around 77.1 million collection and payment operations were executed, 98 per cent of which online. The Bank held 266 liquidity auctions relative to the Treasury's payments account and 234 auctions for the placement of public debt securities.

Since completing the digitalization of its Treasury services, the Bank's focus has shifted to strengthening its cooperation 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 public finances. Last year a new general government transactions information system (Sistema informativo delle operazioni degli enti pubblici, SIOPE+) was launched to improve the monitoring of payment times of general government commercial debts and explore new uses for the data on public expenditure.

As the national designated authority for the activation of macroprudential policies to safeguard the stability of the financial system, the Bank of Italy set the countercyclical capital buffer and other capital requirements applicable to global and domestic systemically important institutions.

The Bank participated in the policy coordination bodies set up to safeguard financial stability. At international level it was active in the Financial Stability Board which, mandated by the G20, promotes and coordinates international policies to prevent or reduce risks to financial stability on a global scale. Its activities focused on: banking regulation reform; the role of the shadow banking system in the funding of the economy and the measures taken to increase security in the derivatives market; building an analytical framework to assess the effectiveness of the G20 financial reforms; measures to deal with emerging risks, including those linked to misconduct and climate change. Within the European Systemic Risk Board, the Bank participated in discussions on systemic risks to financial stability associated with low interest rates and structural changes in the EU financial system, risks in real estate markets and the development of a harmonized system for monitoring them, and risks connected to the activity of central counterparties.

As part of ongoing discussions about strengthening the standards of microprudential supervision and ensure the sound and prudent management of financial intermediaries, the Bank contributed to the work of the Basel Committee on the regulatory framework on credit risk and leverage. It also contributed to the European Banking Authority's guidelines on several matters, including the prudential supervision of investment firms and customer protection measures, especially in connection with sound remuneration

policies for all staff involved in the sale of bank products and services, in order to shield consumers from the consequences of distorted incentives.

At national level the Bank is continuing its efforts to reform Italy's mutual banking sector to ensure and preserve the sound and prudent management of the new groups that will be set up, their competitiveness and efficiency, compliance with prudential rules, and consistency with their mutualistic nature. In November new rules were enacted on fund raising by non-bank intermediaries.

The Bank played an active part in the Single Supervisory Mechanism. In 2015-16, supervision of Italy's significant banks covered 14 banking groups, 9 branches of 6 banks established in other participating EU states and 1 branch of an EU country that is not part of the SSM.

Supervision of the less significant banks involved 53 banking groups, 383 stand-alone banks, 4 Italian subsidiaries of banks established in countries that are not part of the SSM, 19 EU branches of non-SSM countries, and 8 non-EU branches.

In 2016 over 7,400 fact-finding or corrective actions were undertaken, comprising periodic and targeted assessments, meetings with company representatives, requests for information or warnings; there were 140 inspections, of which 45 at significant banks. More than 520 administrative decisions regarding Italian banks were adopted.

The supervision of non-bank financial intermediaries entailed about 2,100 fact-finding or remedial actions, 60 inspections, and over 530 administrative decisions. For the purpose of setting up the new single register, the Bank is assessing regulatory compliance by the intermediaries applying for inclusion in order to safeguard the reliability and integrity of the market, while taking account of the differences between intermediaries. Some 278 intermediaries were deleted following their failure to apply for inclusion in the new register, 190 applications were approved, 49 were withdrawn or rejected, and 95 are still being processed.

Approximately 10,000 complaints from customers about alleged anomalous behaviour by banks and financial intermediaries were examined; in line with international best practices, the handling of complaints serves to build an integrated system of customer protection, thereby helping to identify phenomena that can direct regulatory and supervisory action more appropriately, promoting dialogue with the general public, and encouraging financial education initiatives.

To verify compliance with the rules on transparency, 153 inspections were carried out at the branches of banks and other intermediaries leading to notifications of breach of compliance and corrective measures against 94 intermediaries. As a result, intermediaries returned about €35 million to customers for improper charging of fees.

For more serious violations the Bank of Italy initiated sanction proceedings; in 2016 it adopted 45 decisions resulting in penalties of €10 million, which are paid directly into the State budget.

The Banking and Financial Ombudsman received over 21,600 complaints (60 per cent more than in 2015) and issued 13,770 decisions (up by 32 per cent on the

previous year); in 75 per cent of cases the outcome was in favour of customers. To meet the rising demand for consumer protection, the system was bolstered with the establishment of four new panels with technical secretariats in Bari, Bologna, Palermo and Turin. These are in addition to those already operating in Milan, Naples and Rome. The Ombudsman's new web portal is nearing completion and will enable users to file their complaints online.

Financial education initiatives in schools reached over 114,000 students, 25 per cent more than in 2015, and the number of events open to adults was increased. The Bank's efforts in this area will be redoubled with its participation in the Committee for the Planning and Coordination of Financial Education.

Last year the Bank of Italy worked with Italy's financial intelligence unit (Unità di Informazione Finanziaria) on a model for analysing banks' exposure to the risks posed by money laundering and the financing of terrorism. As part of its supervisory activity, checks were carried out at 153 bank branches and 119 warnings were issued to supervised entities.

At the beginning of 2016 the Bank of Italy had 11 special administration procedures open relative to banks, asset management companies and other intermediaries; during the year one procedure was initiated in relation to a small bank. Two of the procedures were closed with the intermediary's return to ordinary administration, five with their liquidation, and two with mergers into their respective parent companies. At the end of the first quarter of 2017, three special administration procedures are still ongoing, of which two in relation to banks.

The Bank of Italy's Resolution and Crisis Management Unit was closely involved in the implementation of the resolution plans adopted for Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara and Cassa di Risparmio della Provincia di Chieti. The sale of bad loans to the asset management vehicle was completed and, after complex negotiations, the contracts for the sale of the four bridge banks were signed with provisions for guarantees and other conditions precedent, including intervention by the National Resolution Fund to increase the capital of the bridge banks and the carving out of a portion of their non-performing loans. On 10 May the sale of the first three bridge banks was completed while preparations are still under way for the sale of the fourth bank's shares, which is expected to be finalized by mid-2017.