A new renaissance

GLOBALISATION AND EURO ZONE MEMBERSHIP ARE FUNDAMENTALLY RESHAPING ITALY'S BANKING AND PAYMENTS LANDSCAPE. THE RESULTING CHANGES ARE CREATING NEW OPPORTUNITIES FOR IMPROVED DOMESTIC AND CROSS-BORDER CASH MANAGEMENT. **GIANFRANCO TABASSO** AND **PETER DE CRAENE** REPORT.

The Italian banking system is in flux. Until a decade ago, it consisted of many specialised and/or local institutions, the majority of which were directly or indirectly in public hands. A strict legal and regulatory framework hampered overdue consolidation and modernisation. While historically the specialised and localised nature of Italian banking was a force for good – supporting the development of the many family-owned SMEs that are the backbone of Italy's prosperity – it had now becoming a major stumbling block in a single European market. Indeed, compared to their European counterparts, Italian banks were characterised by their low profitability (several of the publicly owned institutions were loss-making), lack of transparency, undercapitalisation and poor customer service.

A GOVERNMENT-LED REVOLUTION In response, successive governments embarked on a full-scale deregulation and privatisation of the sector. Operational specialisation was abandoned and the different legal structures simplified. In essence, there are now only two legal structures: stock companies – some of which are controlled by mutual societies – and co-operative institutions, known locally as *banche popolare*. At the same time, the authorities actively encouraged bank consolidation.

The result was impressive. More than 500 banks were involved in the ensuing consolidation process which culminated in the creation of several large banking groups, (see *Table 1*). The most important of these groups are UniCredit, Banca Intesa, SanPaolo IMI (which includes the regional banking group Cardine) and Capitalia (combining Banca di Roma and Bipop-Carire).

Overall, the number of banks fell from 1,156 in 1990 to 785 in September 2004. Not surprisingly this has led to a marked improvement in the overall profitability and efficiency of the banking sector. From the customer point of view this new-found dynamism is generating a modernised and increased product offering. While much remains to be done, the emergence of universal banks and the increased competition within the rejuvenated banking sector is likely to bolster further innovation.

Executive summary

- Italian governments have embarked on a full-scale deregulation and privatisation of the banking sector which has led to a wave of consolidation and a renaissance.
- The Italian government is under pressure from the European Commission to abandon its policy of vetoing foreign bank takeovers.
- An overhaul of the clearing and payment system has seen this move in line with European best practice.

THE FUTURE IS EUROPEAN Merger and acquisition activity has dropped significantly since the late 1990s. However, this is likely to be only a temporary lull. Indeed, the factors that triggered the first wave of consolidation: increasing European integration and globalisation, have, if anything, become more important. The European authorities continue to press for a truly single European financial services market, while the arrival of the euro has further sharpened competition and the consequent need for cross-border consolidation. In addition, the Italian economy is struggling to adapt to globalisation. Euro zone membership has meant that Italy can no longer use currency devaluation to maintain competitiveness. Furthermore, Italy's traditional labour-intensive industries such as textiles or furniture are particularly exposed to the growing competition from the low-cost central and eastern European economies and India and China. As well as overcoming the impact of globalisation on their corporate business, banks have to adapt their retail service offering to a more stable interest rate environment and growing consumer sophistication. Responding to these challenges and opportunities requires time and capital. In the meantime, nearly all the domestic banks are vulnerable to takeovers by their larger European rivals. To prevent such a scenario from occurring, the Italian banking authorities and government have systematically vetoed foreign acquisition attempts. Instead they have been encouraging the emergence of national champions able to compete effectively within a wider European market in terms of efficiency, product strategy and size.

Thus despite a significant foreign bank presence, both in terms of shareholdings (see *Table 2*) and bank branches (there were 60 foreign bank branches in Italy as at September 2004) no foreign bank controls a sizeable domestic banking operation.

However, time is running out. The new European Commission has made it clear that it wants Italy to abandon its policy of vetoing foreign bank takeovers. Two foreign banks recently tested the resolve of the Italian's bank regulator by launching formal takeover bids for the institutions in which they are minority shareholders. The Spanish bank, Banco Bilbao Vizcaya (BBVA) aimed to acquire Banca Nazionale del Lavoro (BNL), while the Dutch ABN AMRO Bank had set its sights on Banca Antonveneta. As in the past, the Italian authorities encouraged counterbids by local institutions: in the case of BNL, opposition was led by insurer Unipol while Banca Popolare Italiana (formerly Banca Popolare di Lodi) successfully challenged ABN AMRO for the control of Antonveneta.

At the time of writing (July 2005) both BBVA and ABN AMRO seemed to have lost their wager, at least for now. However, this may be the last time Italian banking authorities were able to prevent a foreign bank acquisition. The controversy surrounding the takeover process, which in the case of Antonveneta includes ongoing regulatory and judicial enquiries, suggests that the current policy is unsustainable. In particular, the expiry of several bank shareholder pacts over the next few years may result in further takeover attempts by foreign bank shareholders.

At the same time, the larger domestic banks may prefer to diversify outside the Italian home market through alliances or cross-border mergers rather than to pursue the government-backed strategy of creating national champions; the recently agreed tie-up between Unicredit and HypoVereinsbank being a case in point.

Italian authorities fear that the foreign banks will focus on the profitable retail banking to the detriment of the local businesses that underpin most of the country's prosperity. Local bank support is particularly crucial at this juncture when many a small family business is relying on its local house bank to help it weather the storm of increased globalisation. However, even taking into account these genuine concerns, the truth of the matter is that Italian companies can only

Table 1. Major commercial banks

Bank	Total assets (€m*) 31 Dec 2004
Banca Intesa	310,058
UniCredit	300,186
SanPaolo IMI	180,193
Banca Monte dei Paschi di Siena	102,934
BNL-Banca Nazionale del Lavoro	87,215
Capitalia	82,468
Banca Antonveneta	42,125
Banca Lombarda e Piemontese	37,824

Source: www.bankersalmanac.com.

* Exchange rate as at 20.07.05

benefit from increased bank competition. Several of the large foreign banks trying to gain a foothold in the Italian market have an excellent track record in the provision of corporate services. Overall, increased foreign investment should improve quality of service and product offering as well as substantially reduce bank costs.

PAYMENT AND CLEARING SYSTEM In the run-up to EMU membership, the Italian Central Bank, Banca d'Italia, and the banking community undertook a complete overhaul of the clearing and payment system to bring it in line with its most advanced neighbours. Combined with a growing usage of electronic payments and payment channels, this has greatly facilitated corporate cash management, which is now increasingly in line with European best practice.

Payment instruments As in most other Western European countries, electronic payments have become the major non-cash payment method. However, paper-based payment instruments remain relatively important. In terms of specific payment instruments, the credit transfer is most widely used. While an increasing percentage of credit transfers is processed electronically, there remains a substantial proportion of paper-based credit transfers. The latter are mainly used for retail purposes. Italy has two paper-based giro systems:

The *Mediante Avviso* (MAV) is a system whereby bills with pre-printed due amount are sent to debtors by the creditor's bank for payment at any bank or post branch; and

The *Bollettino Bancario* (Freccia) is a system similar to MAV, except that it allows creditors to send pre-printed bills directly to their debtors.

The secondly most used instrument is the direct debit, which can either be pre-authorised (RID) or require authorisation before every collection (RIBA). While *Rapporti Interbancari Diretti* (RIDs) are aimed at consumers, *Ricevuta Bancaria Elettronica* (RIBAs) are widely used by companies as an electronic substitute to bills of exchange. Though declining in usage, cheques remain a relatively important instrument.

In 2003, RIBA and MAV accounted for 13.2% of all payment transactions, RID for 19.2% and electronic and paper credit transfers for 9.6% and 8.1% respectively, while 26.3% transactions were made with debit cards at point of sale. The remainder involved cheques and other paper instruments, (see *Table 3*).

As is the case in many other areas, northern Italy acts as a trendsetter for the rest of the country in the north terms of payment habits; according to central bank figures only 17% of companies were still using cheques in 2003 as opposed to 48% in the south.

In the retail sector, card payments usage is increasing on the back of a growing automated teller (ATM) and point of sale (POS) network. According to Banca d'Italia, there were 39,035 ATMs and 926,929 POSs at the end of 2003. At the same time, there were 124.5 million credit cards and 24.8 million debit cards in circulation. Several banks are also offering corporate purchasing cards. The historic economic divide in Italy is also reflected in the ATM and POS networks, with availability and usage more prevalent in the north and centre of the country.

CLEARING SYSTEMS The Italian clearing system is composed of a SwiftNet-based RTGS system, Banca d'Italia Regolamento Lordo (BI-REL), which is linked to the European Central Bank's clearing system TARGET, and a low-value net settlement system, Banca d'Italia Compensazione (BI-COMP).

Managed by the Banca d'Italia, BI-REL handles all urgent domestic electronic credit transfers exceeding €500,000 as well as all cross-border payments.[1] Clearing and settlement occurs on a same-day basis and with immediate finality. Participation is either direct or indirect. All participants can access BI-REL via SWIFT, which links system participants directly to the Banca d'Italia. Transactions are transmitted between the BI-REL participants and Banca d'Italia via the SWIFT Y-Copy service.

BI-REL participants can access information on their settlement accounts held at the Banca d'Italia using the SWIFT Net Interactive and

Table 2. Foreign bank and insurance companies' shareholdings of major Italian banks

Bank	Foreign share holders	Country of origin	Percentage	Date
Banca Intesa	Crédit Agricole	France	17.84%	7 July 2005
	Commerzbank	Germany	3.35%	
UniCredit	Allianz*	Germany	4.88%	July 2005
	Aviva	Britain	2.56%	
San Paolo IMI	Banco Santander Central Hispano	Spain	8.45%	July 2005
Banca Nazionale del Lavoro	Banco Bilbao Vizcaya*	Spain	14.75%	30 March 2005
Banca Antonveneta	ABN AMRO Bank*	The Netherlands	29.98%	15 July 2005

*Has launched takeover bid.

Sources: Relevant bank data.

Table 3. Statistical overview of payment instrument usage in Italy

	Millions of Transactions		% change	Traffic (€bn)		% change
	2002	2003	2003/2002	2002	2003	2003/2002
Cheques	538.1	506.2	-5.9	1,195.8	1,180.1	-1.3
Debit cards	553.4	610.7	10.4	48.6	59.1	21.6
Credit cards	358.3	374.0	4.4	33.8	35.0	3.6
Credit transfers	996.6	1,023.8	2.7	36,444.1	36,067.0	-1.0
Direct debits	690.7	722.3	4.6	802.8	935.5	16.5
Total	3,137.1	3,237.0	3.2	38,525.1	38,276.7	-0.6

Source: Bank for International Settlements, CPSS Red Book statistical update, March 2005

Browse services. Bi-COMP is itself divided into two subsystems:

- *Rete Dettaglio* – an electronic low-value clearing system that clears all low-value electronic payments (low-value credit transfers, direct debits, ATM and POS transactions as well as truncated cheques and bankers' drafts). Rete Dettaglio is managed by Società Interbancaria per l'Automazione (SIA), the Italian interbanking payments system technology and services provider. The standard clearing cycle for credit transfers is two days;

- *Recapiti Locali* – a paper-based clearing system managed by the Banca d'Italia for the clearing of all paper-based items that cannot be truncated, i.e. on average, any cheque above €12,500 or bankers's draft exceeding €3,000. The normal clearing cycle is two days. However, an intra-day deposit cut-off time – 09:00 CET for presentation the following day – can affect the length of this cycle.

In 2003, BIREL processed 86.2% of all payments, the balance being cleared by BI-COMP (7.9%) and the new Securities clearing, EXPRES II, (5.9%).

TARGET 2 Banca d'Italia has joined forces with Deutsche Bundesbank and Banque de France to develop TARGET 2. The new European platform should be operational at the beginning of 2007.

THE ITALIAN CASH MANAGEMENT LANDSCAPE

Liquidity management Most Italian banks are now able to offer liquidity management services to their corporate customer base, with daily cash concentration (zero and target balancing) being the most widely used technique. Notional pooling is technically feasible, but high withholding taxes and the fact that legal offset is not allowed, mean banks are reluctant to offer notional pooling solutions. Cash concentration is allowed between entities of the same group and can include both resident and non-resident entities. In addition to explicit itemised charges, banks may take float and, increasingly rarely, lifting fees. Larger customers are generally able to negotiate discounts. Withholding tax applies to resident accounts. As a result, many international groups prefer sweeping cash to a non-resident account for inclusion in a centralised pool located outside Italy. It should also be noted that Italy imposes reporting duties for resident/non-resident that exceed €12,500. As a rule, Italian banks tend to have limited cross-border service offerings. Another hurdle to efficient cash management is the lack of multi-bank cash management offerings, despite Italian companies having an above average number of relationship banks.

Other cash management techniques such as netting, leading, lagging and re-invoicing are also allowed and widely used.

Connectivity Usage of electronic and internet banking is widespread. According to the Italian Banking Association there were over 8 million home and corporate banking users at the end of 2003. The Italian banking community has created a national electronic banking standard, Corporate Banking Interbancari (CBI), which is used by the majority of domestic and foreign banks in Italy. As a result companies have access to cheap multi-bank reporting and transaction initiation services. At the end of 2004, CBI was used by over 459,000 companies.

Short-term investing and funding Italian banks generally pay interest on credit balances. Overdrafts and credit lines (anticipazioni) are available for short-term funding. Italy also has a supplier credit culture. On the investment side, Italy has a well-developed money market. Treasury bills (BOT) and certificates of deposit are the most important short-term investment products on offer.

The ongoing consolidation and internationalisation of the Italian banking landscape combined with the in-depth modernisation of the payment system, payment instruments and channels are generating numerous opportunities for companies to improve and streamline their cash and treasury management in line with international best practice.

Gianfranco Tabasso is Managing Director, FMS Group, which specialises in the integration of business processes and bank-customer straight-through processing (STP).
Gianfranco.tabasso@fmsgroup.it
www.fmsgroup.net

Peter De Craene is Editor at WWCP Ltd, an independent financial publisher providing country information, research and marketing support.
peterdecraene@wwcp.net
www.wwcp.net

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1. Most large Italian banks also participate in EBA's EURO1, STEP1, STEP2 cross-border systems. However, the low average value of TARGET customer payments initiated by Italian banks indicates that Italian companies prefer TARGET for commercial payments.