New Rules for Italian Popular Banks

On January 20, 2015, the Italian Government enacted the so-called "Investment Compact" containing measures to stimulate investments in the Italian economy (in particular in Italian small-medium enterprises).[1] The Investment Compact introduces, *inter alia*, important amendments to the "Italian Banking Act,"[2] with regard to certain cooperative banks (*banche popolari*) incorporated in Italy ("Popular Banks").

In a nutshell, the Investment Compact requires the largest Popular Banks in terms of assets to relinquish the distinctive "one-person-one-vote" rule and convert into joint-stock companies (*società per azioni*). The measure currently affects 10 banks, seven of which are listed.

This memorandum provides *(i)* a brief introduction on the key features of the current Popular Banks' regime, *(ii)* an overview of the rules introduced by the Investment Compact, and *(iii)* a preliminary view on the likely impact of the Investment Compact on the Italian banking market.

A. Current Regulation of the Italian Popular Banks

Established in the XIX Century, Popular Banks have been playing an important role in the Italian economy and are a distinctive feature of the Italian banking system.

In consideration of their traditional link with local economies and their original "mutualistic purpose," Popular Banks have always been subject to a special regime.

The key features of such regime may be summarized as follows:

- *"One-Person-One-Vote" Rule*: Each shareholder is entitled to one vote, irrespective of the number of shares held. Also, Popular Banks must have at least 200 shareholders.

[1] Law Decree No. 3 of January 20, 2015. The Law Decree was published in the *Official Gazette* on January 24, 2015 and entered into force on January 25, 2015. Under Italian law, a law decree is immediately effective but lapses retroactively unless Parliament ratifies it (with or without amendments) within 60 days of its publication in the *Official Gazette* (hence, in this case, by March 25, 2015). Amendments to the Investment Compact could be passed by the Parliament during the conversion process.

[2] Legislative Decree No. 385 of September 1, 1993.

- *Cap on shareholdings*: No shareholder may hold more than 1% of a Popular Bank's share capital. However, so-called "banking foundations" may hold up to 3%. No restrictions apply to stakes held by UCITS funds and SICAVs.

- *"Open-Door" Principle*: Instead of a fixed share capital, Popular Banks have a floating share capital which varies depending on the number of shareholders at any given time.[3]

- *Shareholders' Admission*: The admission of new shareholders, which either subscribe for new shares or acquire existing shares, is subject to the consent of the board of directors. In granting or denying its consent, the board should take into account the interest of the company, as well as its cooperative "spirit" and bylaws. Those who are not admitted as shareholders are nonetheless entitled to exercise the economic rights attached to their shares.[4]

- *Limitation on Proxy Voting*: Each shareholder may represent by proxy only up to 10 shareholders (or the lower limit provided for in the company's bylaws). Moreover, the regime intended to facilitate proxy voting and proxy solicitations in Italian listed companies does not apply to listed cooperative companies, including Popular Banks.

In addition, *(i)* at least 10% of the annual net profits of Popular Banks must be set aside as statutory reserve, and *(ii)* the profits remaining after distribution, allocation to reserves (and other uses set forth in the bylaws) must be used for charitable and mutual assistance purposes.

B. The Amendments Introduced by the Investment Compact

The governance and regulation of Popular Banks has been subject to much debate in Italy, and inputs toward their reform have also come from the regulator. In particular, many have observed that the cooperative banking sector is split in two main segments: the first one maintaining traditional roots in the local economies, and the second one looking to expand beyond regional borders to a national scale.

[3] Shareholders are entitled to withdraw from the company and obtain reimbursement of their shares' value under specific circumstances set forth by the law or the bylaws. Furthermore, shares may also be reimbursed in case of either *(i)* shareholder's death or *(ii)* a decision of either the board of directors or the shareholders' meeting to exclude a shareholder under the circumstances set forth by the law or the bylaws.

[4] Such characteristics lead to the distinction between two shareholders' categories, namely a "voting" class of shareholders, entitled to exercise all the rights descending from the participation held, and the "financial" class of shareholders, entitled to exercise only those rights with economic relevance, such as pre-emption rights, and the right to receive dividends and distributions.

In the current scenario, characterized by increased competitive pressure and the need to secure easier access to capital markets, it has been questioned whether the traditional governance model is still suitable for the larger Popular Banks (predominantly listed on the Italian stock exchange). Many believe that, at least in larger institutions, the Popular Banks' regime, originally intended to preserve democratic participation, may instead discourage attendance at shareholders' meetings, limit the representation of active shareholders in the corporate bodies to the benefit of entrenched management and stifle any contest for control.

In an attempt to address these concerns, the Investment Compact amended certain provisions of the Italian Banking Act applicable to Popular Banks, with a view to causing the transformation of the largest Popular Banks into joint-stock companies. These amendments are detailed below.

- *Limits to Popular Banks' Assets and Mandatory Transformation*: Under the Investment Compact, Popular Banks' assets may not exceed €8 billion;[5] if this cap is exceeded, the board of directors must convene the shareholders meeting to take appropriate actions. If within one year *(a)* the assets have not been reduced or *(b)* the shareholders have not resolved upon the transformation of the Popular Bank into a joint-stock company (or on its winding-up), the Bank of Italy may *(i)* prohibit the carrying out of new business, *(ii)* start a procedure for extraordinary administration of the Popular Bank, or *(iii)* propose the withdrawal of the banking authorization to the European Central Bank and the forced administrative liquidation of the Popular Bank to the Italian Ministry of Economy and Finance.[6]

- *Limits to the Reimbursement of Shares*: The Bank of Italy has been delegated to limit the right of Popular Banks' shareholders to obtain the reimbursement of their shares in case of withdrawal from a Popular Bank, to the extent such limitations are necessary to include such shares in the banks' Tier 1 common equity. Such measure aims at facilitating the transformation mentioned above and limiting its impact on the regulatory capital of affected Popular Banks. In case of withdrawal, the transformation of a Popular Bank into a joint-stock company would normally trigger a statutory withdrawal right for dissenting and abstaining shareholders.

  However, the actual scope of this provision is even farther-reaching, as it limits shareholders' reimbursement rights arising from the exercise of any

5 If a Popular Bank is the holding company of a banking group, the cap applies on a consolidated basis.

6 See Article 1 of the Investment Compact, amending Article 29 of the Italian Banking Act.

withdrawal rights, not only in the case of transformation, but also from the termination of a shareholder's relationship with the company following his/her death or exclusion from the company.

- *Majorities for Transformation and Mergers*: The Investment Compact further incentivizes the transformation (including through a merger) of Popular Banks into joint-stock companies by setting for these transactions statutory majorities generally lower than those applicable pursuant to Popular Banks' bylaws. In particular, the shareholders' meeting of a Popular Bank may approve the transformation into, or a merger which results in the transformation into, a joint-stock company *(i)* on first call, with a two-thirds majority of the total number of the shareholders present at the meeting, provided that at least 10% of the total number of shareholders is present, and *(ii)* on second call, with a two-thirds majority of the total number of the shareholders present at the meeting, regardless of the number of such shareholders.[7]

- *Proxies*: The Investment Compact has slightly relaxed the limitations on proxy voting, by providing that Popular Banks' bylaws must set the maximum number of proxies that may be granted to each single shareholder. Such number cannot be lower than 10 and higher than 20.

- *Coordination with the rules on joint-stock co-operative companies*: Finally, the Investment Compact has modified the provisions of the Italian Banking Act that coordinates the general Italian corporate rules with the special regime of Popular Banks.[8] In this respect, the main amendment enables Popular Banks to issue "quasi-equity" financial instruments (*i.e.*, *strumenti finanziari participativi*) that may be issued by joint-stock and cooperative companies.[9]

[7] Bylaws of Popular Banks generally provide that the transformation should be approved by a minimum fraction of the total number of shareholders. For example, according to the bylaws of Banca popolare di Milano, the transformation of the company shall be deliberated at least by one-seventh of the shareholders with voting rights. Similarly, the bylaws of Banco Popolare require the consent of at least one-fiftieth of all shareholders with voting rights.

[8] Article 150 of the Italian Banking Act.

[9] See Articles 2346, para 6, and 2526, of the Italian Civil Code. Such financial instruments must be regulated by the company's bylaws and may incorporate economic and administrative rights, except for the right to vote at the general shareholders meeting.

C. Timing and Possible Impact of the Investment Compact

The Investment Compact sets forth a staggered timeline for the entry into force of the key part of the reform. Indeed, the measures on mandatory transformation and shares reimbursement discussed above will only become operational after the Bank of Italy issues the implementing regulations. Most importantly, an 18-month grace period following the enactment of such implementing regulations applies to the mandatory transformation of Popular Banks exceeding €8 billion in assets.

The consequences of the enactment of the Investment Compact are not easy to foresee at such an early stage. Furthermore, during the parliamentary ratification process of the Investment Compact, further amendments may be introduced. Nevertheless, a few points can be highlighted.

Out of the 10 Popular Banks which the Investment Compact will force to transform into joint-stock companies, *(i)* seven are listed on the Italian stock exchange[10] and *(ii)* seven fall within the scope of the newly-established Single Supervisory Mechanism and are now under the direct supervision of the ECB.[11] This transformation would make the special regime outlined in paragraph A above no longer applicable to the 10 largest Italian Popular Banks, which would become subject to the general corporate rules for joint-stock companies.

In particular, the replacement of the “one-person-one-vote” rule with the “one-share-one-vote” rule and the abrogation of the ownership cap will likely have a significant impact for these banks which, due to these two features, are currently characterized by very dispersed ownership structures, traditionally led by representatives of the bank's employees' unions.

Commentators have anticipated that the enactment of the Investment Compact could pave the way to a new aggregation process in the Italian banking system, following the wave of the early 2000s. This consolidation process could take place among the Popular Banks themselves or could involve, as merger partner, one or more Italian banks facing capitalization problems after the AQR. Foreign banks and financial sponsors could also be interested in seizing the opportunity to access the Popular Banks' markets. Also, once transformed into stock corporations, the seven listed banks may become takeover targets given their dispersed equity ownership. Indeed, as the

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10 *(i)* Banca popolare Emilia Romagna, *(ii)* Banca popolare Etruria e Lazio, *(iii)* Banca popolare Milano, *(iv)* Banca popolare di Sondrio, *(v)* Banco Popolare, *(vi)* Credito Valtellinese and *(vii)* Ubi Banca. See Attachment 1 for details on their major shareholders. The 3 unlisted Popular Banks exceeding the € 8 billion asset threshold are *(i)* Banca popolare di Vicenza, *(ii)* Veneto Banca and *(iii)* Banca popolare di Bari.

11 *(i)* Unione di Banche Italiane (UBI), *(ii)* Banco Popolare, *(iii)* Banca popolare di Milano, *(iv)* Banca popolare dell’Emilia-Romagna, *(v)* Banca popolare di Vicenza, *(vi)* Veneto Banca, and *(vii)* Banca popolare di Sondrio.

Investment Compact was announced the share prices of these banks spiked by 20% to 60%.

The Investment Compact may also result in the potential disaggregation of Popular Banks' groups and/or the disinvestment of assets, so as to ensure that the €8 billion threshold is not exceeded. Indeed, Popular Banks finding themselves close to the threshold may decide to divest certain assets, in order to place themselves below the "red line."

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ATTACHMENT I – Listed Popular Banks' Main Shareholders[12]

Name of the Bank	Main Shareholders	%
Banca popolare dell'Emilia Romagna	none above 2%	N/A
Banca popolare dell'Etruria e del Lazio	Banca popolare dell'Etruria e del Lazio S.c.a.r.l.	2.021
Banca popolare di Milano	Athena Capital S.a.r.l.	5.734
Banca popolare di Sondrio	UBS Group AG	2.811
	Norges Bank	2.287
Banco Popolare	Fondazione Cassa di Risparmio di Lucca	2.033
	Norges Bank	2.891
Credito Valtellinese	UBS Group AG	2.358
Unione Banche Italiane (Ubi Banca)	Silchester International Investors LLP	4.903
	Fondazione Cassa di Risparmio di Cuneo	2.278

Official data on shareholders' identity of unlisted Popular Banks is not publicly available. According to a recent press report,[13] the following appear to be among the main shareholders of unlisted Popular Banks affected by the Investment Compact:

i. Banca popolare di Vicenza: Zonin family; SAVE S.p.A.; Zuccato family; Riello family; Bettanin family.

ii. Veneto Banca: Stefanel family; Amenduni Gresele family; Tomat family.

iii. Banca popolare di Bari: Jacobini family.

12 CONSOB, *Information on Listed Companies.*

13 Corriere della Sera, "*Banche, chi comanderà nelle nuove popolari* ," February 2, 2015.

ATTACHMENT II – Italian Banks Supervised by the ECB[14]

Italian Banks Under ECB Supervision						
	2013			2016 (adverse scenario)		
	CET1	Total Risk Exposure	CET1 Ratio	CET1	Total Risk Exposure	CET1 Ratio
UniCredit S.p.A.	39,164	408,904	**9.6%**	29,419	433,431	**6.8%**
Intesa Sanpaolo S.p.A.	33,333	284,781	**11.7%**	25,772	309,974	**8.3%**
Banca Monte dei Paschi di Siena S.p.A.	5,687	81,393	**7.0%**	-72	75,963	**-0.1%**
Unione di Banche Italiane (UBI)	7,526	63,669	11.8%	5,291	64,500	8.2%
Banco Popolare - Società Cooperativa	4,234	53,329	7.9%	2,632	55,621	4.7%
Mediobanca S.p.A.	4,272	50,841	**8.4%**	3,766	60,379	**6.2%**
Banca Popolare di Milano	2,998	43,528	6.9%	1,766	44,549	4.0%
Banca Popolare dell'Emilia Romagna	3,644	43,507	8.4%	2,350	45,049	5.2%
Banca Popolare di Vicenza	2,178	28,712	7.6%	930	29,305	3.2%
Veneto Banca	1,444	25,338	5.7%	706	25,826	2.7%
Banca Popolare di Sondrio	1,740	23,603	7.4%	1,027	24,452	4.2%
Banca Carige	898	22,989	**3.9%**	-551	23,337	**-2.4%**
Iccrea Holding S.p.A.	1,437	13,480	**10.7%**	1,013	13,764	**7.4%**
Barclays Bank PLC (Italy)*	-	-	-	-	-	-
TOTAL	***108,555***	***1,144,074***	***8.2%***	***74,049***	***1,206,150***	***4.5%***

**** not subject to EBA 2014 stress test***

14 *EBA 2014 stress test results*. Data in millions of Euro.

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