

Governance, rischio e innovazione

Elements of board governance in banking and financial companies

Editors

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Foreword

This book represents a collection of articles and papers by selected participants to the first Banking Board Academy, seminar jointly organized by Università G. Marconi and Oliver Wyman SPP.

Today's environment puts unprecedented demands on board members in financial services firms and beyond. Geopolitical, secular and macro-economic trends pose shift towards a new normal. We have initiated The Banking Board Academy to provide an instructive and informative forum to allow private and public sector stakeholders to connect and discuss how this changing order impacts their role and position within the bank.

The Academy is aimed at assisting board members in strengthening their understanding of this changing environment and provide an opportunity to jointly reflect on key themes such as the role they are asked to play, existing and upcoming regulation, governance challenges and the influence of geo-politics on their role as board member. We hope that you, as delegate, will find the keynote addresses, interactions and discussions both a fruitful learning experience and an inspiring opportunity to connect.

We are very proud of the collaboration between Università G. Marconi and Oliver Wyman SPP to organize this first The Banking Board Academy programme.

Additionally, we are pleased to thank Gruppo Banco BPM S.p.A. in Rome, to have hosted this event in Palazzo Altieri,

their representative offices, allowing participants to enjoy an exceptionally beautiful venue for this Academy.

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Il ruolo del presidente del CdA, alcune riflessioni

L'impianto normativo vigente assegna al presidente del CdA un ruolo autonomo rispetto a quello degli altri consiglieri, caricandolo di poteri e di responsabilità specifiche.

I compiti del presidente hanno rilevanza esterna (rapporti con gli azionisti, con le autorità di vigilanza, rappresentanza della società ecc.) e rilevanza interna (convocazione del CdA e fissazione dell'ordine del giorno; conduzione dei lavori del CdA; cura che il CdA sia adeguatamente informato ecc.). La dottrina giuridica assegna al presidente poteri di impulso, coordinamento e guida del CdA intangibili dagli statuti societari e non comprimibili dallo stesso CdA e che ne costruiscono un fondamentale contrappeso al potere dell'amministratore delegato, anche perché il presidente, a differenza degli altri amministratori, può, al fine di costruire l'ordine del giorno, chiedere informazioni, oltre che all'AD, anche agli altri esponenti dell'esecutivo. Infine, il presidente è l'interlocutore del collegio sindacale (ove esistente) e dei comitati endoconsiliari.

Mentre sono relativamente pacifici poteri, doveri e responsabilità del presidente, meritevole di qualche ulteriore spunto di riflessione è l'insieme delle qualità e dei tratti comportamentali di un presidente, che ne rendono l'azione, nell'ambito dei poteri e doveri che ne delimitano l'operato, efficace nell'interesse della società. In altre parole, l'azione del presidente va giudicata per quello che egli sa fare nell'ambito di quanto gli è permesso di fare.

Tali qualità rappresentano un delicato equilibrio tra caratteristiche opposte, equilibrio che è variabile a seconda delle fasi

della vita della società e con riferimento alle quali il presidente deve avere la sensibilità e la capacità di “aumentarsi” e di “diminuirsi”.

In primo luogo vi è il fondamentale equilibrio riguardante il grado di coinvolgimento nella vita della società: una società che funzioni bene ha bisogno, nelle fasi ordinarie, di un presidente attento, ma senza che un eccessivo coinvolgimento ne influenzi l'indipendenza e faccia assumere al suo operato caratteristiche gestionali e non di mero governo e supervisione. Al contrario, fasi critiche nella vita aziendale richiedono un coinvolgimento più elevato e continuo, anche in considerazione del fatto che grava generalmente sul presidente l'iniziativa di sostituzione dell'AD che si riveli inadeguato a fornire le risposte operative e strategiche che la situazione richiede. Sempre in tema di equilibrio nei confronti dell'esecutivo, importantissimo è il bilanciamento tra *challenge* e supervisione da un lato e sostegno all'operato dell'esecutivo dall'altro.

Una seconda area di equilibrio si ha nel governo dell'informazione: un presidente che sia adeguatamente coinvolto (restando indipendente) nell'attività dell'azienda è il vertice dell'informazione prodotta, anche grazie all'interazione con le funzioni aziendali di controllo, e ha il compito di decidere circa tempi e modi del rilascio di tale informazione, con il difficile ma necessario bilanciamento tra riservatezza, tempestività e completezza.

Una terza area nella quale l'equilibrio è essenziale riguarda la conduzione della discussione e la formazione della volontà in ambito consiliare. Il presidente deve saper guidare la discussione lasciando spazio ai consiglieri, senza urgenza di dire la propria opinione, ma anche senza trattenerla quando necessario; deve saper trarre soddisfazione nel vedere che il CdA arriva ad una decisione che giudica buona anche senza bisogno del suo intervento. La decisione del CdA è tale non solo con riferimento all'oggetto del decidere, ma anche con riferimento al processo, che non lasci strascichi e spaccature. La conduzione della discussione deve essere pertanto attenta a che le punte 'agonistiche' che possono essere presenti nelle argomentazioni dei consiglieri

non influenzino negativamente il clima complessivo; che le decisioni si tengano ‘a maggioranza’ con la frequenza strettamente necessaria. Nel processo di formazione della volontà consiliare, egli deve saper cogliere tempestivamente i segnali di noia, irritazione, serpeggiante malcontento; il protrarsi della discussione, passato lo *sweet spot* della decisione, può infatti peggiorare la qualità della decisione stessa e influenzare negativamente il clima della seduta. Quindi la pazienza nella conduzione della discussione deve essere in equilibrio con la risolutezza di portare a decisione i temi in agenda in modo efficiente, anche dal punto di vista del rispetto dei tempi dei lavori (a loro volta elemento importante nella determinazione della complessiva qualità delle decisioni).

Con riferimento al clima nell’ambito del CdA, è fondamentale che il presidente trasmetta quella che è stata definita “sicurezza psicologica” ovvero che ogni consigliere, nei suoi interventi, possa sentirsi a suo agio nell’esprimere opinioni che poi possano essere superate nella discussione successiva o dalla decisione finale, senza per questo sentirsi in imbarazzo. La natura dell’azione di *challenge* che è richiesta a ogni consigliere comporta infatti, inevitabilmente, che qualche domanda possa avere risposte nette da parte del management. È importante che la domanda che è ‘superata’ dalla risposta non sia vissuta come un errore da parte di chi l’ha posta, come un punto di vulnerabilità esposto in presenza di propri pari. La promozione della sicurezza psicologica si traduce in fiducia tra CdA e presidente e tra consiglieri e questo alimenta la statura e quindi l’indipendenza effettiva (rispetto al management e agli stakeholders) del CdA nel suo complesso, al di là delle qualificazioni dei singoli.

Un presidente che coltivi tali caratteristiche raggiungerà l’imparzialità, che è la qualità più preziosa e che invariabilmente si riflette sul funzionamento complessivo dell’organo e sulla sua ‘produttività’ e quindi, in definitiva, sui risultati della società. L’imparzialità garantisce infatti al presidente la capacità di cogliere rapidamente le diverse sfaccettature di un problema, i vantaggi comparati di una decisione, e, ciò che è davvero

fondamentale, le sue conseguenze 'politiche' - ovvero di lungo termine e nei diversi contesti - sulla vita della società.

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*Regulatory and economic capital for banking firms: risk measurement and assessment with negative interest rates***

1. *Introduction: economic vs. regulatory capital*

With the ending of the Glass Steagall (1933) regulatory framework based on structural separations and reserve requirements on banks' assets, surveillance swung to capital requirements on the liabilities side. Leverage and risk-based ratios became intertwined with capital constraints: this paper shows that the lack of clarity can have important drawbacks. The two ratios have been – and are – monitored by credit institutions for internal risk management and control purposes. Large international banks pioneered techniques to estimate risk (economic) capital. The transformation process which converts assets into a size-risk measure is crucially dependent on the risk methodology adopted. The economic capital approach is also shaped by the (private) cost of capital for the banking firms. With the adoption of capital standards, if the constraints are regarded excessively and unduly tight an inevitable attempt to circumvent the rules is set in motion (the Goodhart Law and/or the Lucas critique, Section 3). This behaviour is inversely related to the quality of corporate governance. Compliance costs to complex

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risk-weighted, one-size-fits-all, constraints create competitive distortions for smaller banks.

The dangers of inadequate recognition of these points were shown notably by the Basel II standard. It appeared as a major advance, it was instead marred by model deficiencies: the risk sensitivity morphed into an incentive for large banks to economize required capital through innovative financial products/ structures, thereby reducing the density ratio. The build-up of both systemic risk and excessive leverage - while apparently maintaining tight risk-based requirements - was not recognized, also as a result of principle-based supervision. The coexistence and overlap of leverage and risk weighted requirements in Basel III represent a complementary approach, but they can create supervisory challenges. Circumvention of the rules may occur in respect of both ratios: their surveillance requires a time process of close monitoring.

As indicated, the concepts of leverage and risk-based capital ratios in banking are interlaced with regulatory frameworks. This is to be expected, but it may prove misleading from an analytical perspective (Miller 1991). The starting point of this paper is different. Independently of a surveillance system let us consider leverage ratios, risk-weighted assets and risk-based capital ratios for banking firms. Assets are funded with equity, debt securities and deposits. A prototype simplified bank (accounting) balance-sheet is the point of reference.

1) $A = C + D$ where

A = Total Assets

C = Capital

D = Debt (which comprises deposits and other interest-bearing liabilities)

The Leverage Ratio (LR) is defined as:

2) $LR = C/A^1$

1. To facilitate the analysis of leverage it is perhaps useful to make reference to other definitions commonly used beyond (2) adopted here where the ratio is measured as capital in proportion to total assets.

Risk-Weighted Assets (RWA) are given by:

- 3) $RWA = wr(A)$ where
 $wr(A)$ is a transformation function of assets into a combined size-risk metric.

On the basis of 3) it is possible to define a Risk-Weighted (Capital) Ratio (RWR):

4) $RWR = C/RWA$

To complete the definitional framework we introduce the Density Ratio (DR):

5) $DR = RWA/A$

The LR can now be expressed as follows:

6) $LR = C/A = C/RWA * RWA/A = RWR * DR$

As 6) shows, the Leverage and the Risk-Weighted Ratios are mechanically linked by the Density Ratio.

The key point introduced so far is the $wr(A)$ transformation process in 3) which converts, at a given point in time, A into RWA , a combined size-risk measure. This process depends on the risk measurement methodology adopted. The issue is further complicated because $wr(A)$ represents a measure of the average risk intensity per unit of assets, at time t . This static framework should be broadened, because risk categories are constantly changing and banks' asset portfolios are continuously adapted to market developments (independently of regulatory constraints).

The Leverage Multiple (LM) is the reverse of LR: $LM = A/C$. A third definition common in the Minsky (1992) Financial instability hypothesis is the Debt Leverage Ratio: $DLR = D/A$.

The static/dynamic nexus manifests itself also on the risk measurement methodology. Static stochastic models (exogenous risk) are commonly adopted instead of dynamic, behavioural approaches which incorporate endogenous and systemic risk. Often the temporal dimension of a stochastic process (time dimension of risk) has not been satisfactorily introduced in the probabilistic theories of risk measures (Artzener, 1999)².

The LR can be interpreted as the maximum percentage loss (in terms of total assets) that can be absorbed by a firm before insolvency. The RWR indicates, in percentage terms, how much of the unexpected losses (UL), over a determined time period, can be covered by the actual capital cushion held by the bank. Therefore a probabilistic framework must be adopted to evaluate UL. Average expected losses (EL) during the relevant time interval are forecast and should be covered in the profit and loss account. By means of more or less sophisticated portfolio models – which are characterized by specific statistical assumptions – a second step is made: the estimation of the amount of loss that exceeds EL, i.e. UL. Several approaches have been developed to define

2. “Traditional” risks are dealt with established (time-invariant) financial metrics. Arguably, current conditions epitomize the challenges of “new” risks which modify the $wr(A)$ function. Fintech operators and Blockchain payments systems pose threats to the business models of most banks (business and payments risks) (BCBS 2017a, EC 2017a). Banks must accept and adapt to the challenges of technological innovation and cyberspace, which can however feed back into a source of independent vulnerability. The risks of IT intrusion and of cyber attacks (Koop et al., 2017) are difficult to assess by means of standard statistical metrics based on past events and therefore on established risk management techniques (cyber risks). Money laundering criminal activities have morphed through technology in ways which make it difficult to allow early detection of suspicious transactions and customers (money laundering risks). A final current example of the time-varying character of risk is represented by climate change – both physical and transition risks. The transition to a low – carbon economy has complex and often contradictory features. The corresponding risks to banking firms are therefore difficult to quantify, also because of the uncertain time frame of the underlying processes and of the effective regulatory constraints on carbon emissions (climate change risks) (Theodore 2019).

and measure UL. UL can be either seen as the volatility (usually the standard deviation) of the loss distribution function, or a quantile-based measure like VaR can be used.

As previously highlighted, the total EL for a portfolio is the sum of the expected losses for the components and can be calculated as the product of probability of default (expected default frequency) (PD) of obligors, the exposure of default (EAD) and the loss in the event of default (LGD).

$$1) EL = PD * EAD * LGD$$

On the other hand, the UL of the asset portfolio can be calculated with the VaR methodology to obtain a quantitative estimate of the maximum default loss that can be incurred with a given probability over a predetermined time horizon. The VaR approach had been developed by large international banks to estimate Economic Capital (EcC)³ before the Basel II Standard, which incorporated and revised the methodology to define Regulatory Capital (ReC): a minimum capital constraint on liabilities. Three points should be recognized:

- i. VaR (and hence UL) are generally calculated on the assumption that the asset portfolio will remain unchanged during the relevant time period (Hull, 2007): the “static” approach, following the expression using in this study.
- ii. VaR (and UL) are expressed as absolute values while LR and RWR are ratios, below unity.
- iii. Traditionally the VaR methodology has been used as the transformation function $wr(A)$ of assets into RWA, but it can be applied also to leverage (Box 1).

3. EcC represents the amount of risk capital that a banking firm estimates internally, on the basis of the statistical models deemed appropriate, necessary to avoid insolvency, given its risk, business model and funding profiles (Matten 2000, Shimpi 2001, Masera 2005, Kenton 2019).

Box 1 – Leverage and VaR

We recall the stylised accounting balance sheet (Eq. 2) and we consider the leverage multiple (LM):

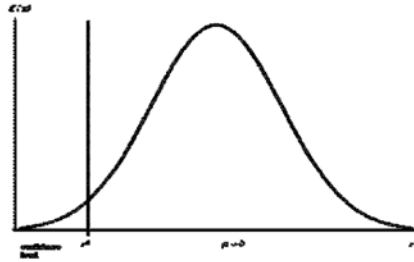
$$[7] \quad LM = \frac{A}{E} = 1 + \frac{D}{E}.$$

Next, we define *VaR* as the maximum loss that a bank with assets *A* can withstand with its equity (*E*) before going bankrupt, given a confidence level (*c*) for a given time period *t*:

$$[8] \quad VaR_c = -r^* A = E_c$$

where *r* is the time-*t* return on assets (Chart 1).

Chart 1 - VaR estimation



where:

$$[9] \quad \Pr(r < r^*) = \int_{-\infty}^{r^*} f(r) dr = 1 - c.$$

$$[10] \quad v_c = \frac{E_c}{A} = \frac{VaR_c}{A}.$$

$$[11] \quad LM_c = \frac{A}{E_c} = \frac{A}{VaR_c} = \frac{1}{v_c}.$$

Over and above the distinction between traditional and new risks and the intrinsic difficulty of transforming assets into a combined stochastic size-risk metric, this paper addresses the compounded difficulties of risk measurement and assessment under negative nominal interest rates (NNIRs). It is showed that, with negative yields, the standard measurement frameworks may become unreliable. A key collateral effect of strongly expansionary monetary policy is the added complexity of risk monitoring and regulation.

2. *Negative nominal interest rates and risk measurement/evaluation*

It is estimated (Bloomberg Barclays Global Negative Yielding Debt Index 2019) that the global stock of debt carrying NNIRs peaked at \$17tn as of August 2019, but declined to \$11tn by year-end (Chart 1). The debt is concentrated in Europe and Japan (Table 1). With the generally low, but positive, inflation currently experienced, nominal interest rates imply that, worldwide, nearly \$36tn of debt securities trade at negative real rates, corrected for current inflation. Also the term premium is now negative for many countries. As of end-2017 the estimated neutral (short term) equilibrium rate of interest on the two sides of the Atlantic, although in trend decline, was still above the zero bound except for the Euroarea (New York Fed, Holston et al. 2017, Charts 2 and 3).

Model risk (the likelihood that the models used to measure risk are incorrect) acquires complex new dimensions with NNIRs. The traditional frameworks utilized to quantify financial risks are subject to stress and may become unreliable. This is on top of the issues of capturing endogenous risk not duly accounted for in the Basel risk methodology (Masera, 2019b). Strong interactions and converging behaviours of economic agents change the “fundamental” statistical distributions characterising markets under normal conditions. More specifically, in the framework of complex systems, there can be a shift from normal-shaped distributions to truncated power laws (heavy tail distributions/extreme value theory) (Chart 4). These changes are especially relevant for the risk evaluation of financial structures based on derivatives.

The three pillars of analysis and measurement of financial risk are represented by the CAPM, the Black-Scholes option pricing models and the efficient frontier approach. All schemes are based on the existence of a risk-free reference rate with a zero-value bound. By the fundamental theorem of asset pricing with risk-neutral probabilities valuation is given by the present value of the expected payoff of each asset. Negative interest rates upset fair value calculation of expected cash flows.

Steady state solutions can be obtained also in the assumption of negative interest rates. But these scenarios appear unrealistic on many grounds, as shall be argued. The modelling problem is centred on the term premium and therefore the term structure of nominal yields. The huge expansion of central bank balance sheets has led to a supply shortage in the market of quality/safe debt. This complicates the liquidity problems. If a turning point is anticipated, the variance and time-profile of prices become very complex to model.

In sum, NNIRs pose serious challenges for risk valuation models – notably those currently used by regulators in risk-weighted capital requirements - and therefore increase uncertainty and risk. This is also the result of non-proportional regulation both in terms of banks' dimension/systemic footprint (in the EA) and of shadow banks, which may be viewed as banks not subject to capital regulation.

For any banking firm the issue of the cost of equity and its relationship with leverage is of key relevance with reference to both EcC and ReC and should be explored in the light of the seminal work of Modigliani and Miller (1958, 1963). The arbitrage M&M models on the irrelevance of the financing structure of any firm (including banks) were based on positive nominal interest rates. With ultra-low negative interest rates for prolonged periods a bias results for debt issues which, at least apparently, raise the enterprise value of the firm. *Ceteris paribus*, levered companies become seemingly more profitable and credit worthy. Indirect evidence of this is offered by the relationship between dividend yields and interest rates (Chart 5, Causeway) and by the very large volume of equity buybacks (also by banks in the US) recorded in the past few years. NNIRs and investor demands for higher yield/higher risk assets concur to account for the very large recent expansion of two financial market: leveraged loans (Goel 2018) and high yield debt of zombie firms (Banerjee and Hofman 2018). In both instances the increased uncertainty in the utilization of risk evaluation models represents an explanatory factory for misallocation of credit and, potentially, systemic Minsky lever risk.

All these factors concur in making the wR transformation function less reliable to assess idiosyncratic and systemic risk notably for banks and other market operators but also for regulatory/supervisory authorities.

3. *Ultra-low interest rates: impact on risk-weighted capital-regulated intermediaries*

In the case of banking firms subject to capital and liquidity requirements the problems are compounded. The (apparently) higher relative cost of equity raises the gap between economic and regulatory capital. This creates a strong incentive to circumvent the rules, according to the Goodhart Law and the Lucas Critique.

Box 2 - The Goodhart Law and the Lucas Critique: implications for capital requirements

The Goodhart law (1975)

Any observed statistical regularity will tend to collapse once pressure is placed upon it for control purposes.

The Lucas critique (1976)

If economic policies influence the statistical relationships upon which economic analysis is based (related to the policies which were in place during the period of analysis), then these relationships cannot be used to predict the outcome of alternative economic policy regimes.

Both models indicate that if regulatory policies – notably on capital requirements - change, banks may behave differently; the statistical relationships (and the information content) which are derived from that behaviour are also changed.

Negative interest rates reinforce the complex nexus between monetary policy and bank capital rules which can be captured only through a macroprudential analytical framework (for an

analysis of these points and the related references see Masera, 2018a). These issues are of special concern in the EA because of the single currency without a state, the zero-risk-weight of government bonds, the lack of both a safe asset and a single deposit insurance scheme, the incomplete reform process of the European Stability Mechanism (ESM). The two-way links have been profoundly shaped by the impact of the prolonged monetary ease and negative yields on the business model of “traditional” credit institutions (Goodhart and Kabiri, 2019).

An overall assessment of these problems requires a preliminary answer to the following questions: are banks “special” because of their capacity to create credit and money (demand deposit), or are they similar to other (loanable funds) intermediaries? According to the latter model, also banking firms are constrained in their credit process by the existing levels of deposits. The credit creation approach holds instead that banks, because of their unique capability of issuing demand deposits can simultaneously increase (and decrease) assets and liabilities. By making new loans they automatically generate corresponding demand deposits.

If the credit approach is valid, the distress to traditional credit institutions (and to the economy’s credit process) is potentially acute. The ability to pass on negative rates to depositors is limited, hence the interest rate margin is severely affected. This is a special detriment to small-medium size banks with a traditional business model (“less significant” banks according to the ECB/SSM definition).

If all banks are subject to one-size-fits-all regulation with high fixed compliance costs (as is fundamentally the case in the EU) credit flows to SMEs are affected. This may feed back into the economy (credit crunch and credit losses) in spite of monetary expansion (for a contrary view see Altavilla et al. 2019, but see also Goodhart and Kabiri, 2019).

Insurance companies are another type of intermediary constrained by capital requirements. The adverse consequences of NNIRs have been amply demonstrated, notably in Germany, and need not be further elaborated here. One point should perhaps

be underlined: the traditional business model reflected the implicit advantage of paying claims with a significant time interval with respect to collection of premiums; under negative interest rates this becomes a cost factor. With due adaptations, the same story applies to pension funds.

4. *The liquidity trap revisited and the risk of illiquidity*

Negative nominal interest rates broke the Keynesian liquidity trap technical constraint in the simplified framework of consols and demand deposits: approaching zero nominal rates no longer provides an explanation for the holding of money.

The important issue is whether with negative interest rates there is a stimulus to real demand by the household and the corporate sectors: i.e. the pushing on a string becomes feasible. While temporarily some support to the real economy has been recorded, the situation appears one whereby more and more doses of the same drug are required, with increasing collateral damages.

As NNIRs spread to medium and small savers the propensity to consume is adversely affected. Uncertainty increases and ex ante savings do not decline. On the other hand, corporations uncertain about future demand postpone their investment projects. A feature of this scenario is the frantic search for “safe” liquid assets with a non-negative yield. Banks and shadow banks interact in the search for and management of global liquidity. Repo funding and collateral are key in this process. But shadow banks are not subject to the capital and liquidity regulation of banking firms. The creation and distribution of excess liquidity across sectors become a further aspect of the complex process. “Today, large excess reserve holdings are, by and large, a reflection of the accommodative monetary policy that central banks have conducted in recent years, and that many, including the ECB, are still conducting today in view of stubbornly low inflation rates. Excess liquidity increased as we rolled out our unconventional policy measures.” (Chart 6, Coeuré, 2019)

The distribution of excess reserves is very different on the two sides of the Atlantic. In the US nearly 90% of excess reserves are held by 1% of the banks. The distribution is more even in the Euroarea. More importantly, the intertwining of banks and non-banks (mainly shadow banking operators) creates risks because money market transactions are dominated by trades with non-banks. In the Euroarea the evidence on the share of unsecured overnight borrowing is offered in a paper by Coeuré (Charts 6 and 7). Pledged collateral represents for G-SIBs a relevant part of funding through shadow banks. This increases effective leverage in the financial system, but it is not appropriately accounted for in banking statistics (Singh and Alam, 2018). Ultra-low rates in the EA incentivize pledged collateral financing.

The fundamental issue is that shadow banks offer liquidity funds (Money Market Funds - MMF) which are not truly liquid. Governor Mark Carney speaking to a Treasury Committee on June 26 2019 indicated to UK law makers that open-ended “liquidity funds” “lead to an expectation on individuals that is not different than having money in a bank... These funds are built on a lie, which is that you can have daily liquidity for assets that fundamentally are not liquidity” (Carney, 2019). Signs of liquidity strains recently appeared also in the US (Kaplan, 2019), and required repo injections from the Fed and a lowering of the prime rate. The M&G decision on December 4 to suspend redemptions of its property funds (M&G, 2019) transcends the issue of hard to trade assets in open-ended funds. It is a sign of impending liquidity crises in the ultra-low interest environment.

As Hicks originally explained (1974) liquidity should be seen as a stock. The term structure of interest rates, rather than a single rate of interest, is the key connecting factor between liquidity preference, monetary analysis and portfolio selection. Modelling the term structure is under current circumstances very difficult, because market expectation are overshadowed by the volume of market interventions by central banks across the maturity spectrum. More generally, it has now become clear that, beyond the monetary base, liquidity has an intrinsic stochastic nature (ECB 2002, Watanabe 2003). The problems of statistical

modelling of liquidity risk are of paramount importance (Morris and Shin 2004). The traditional assumptions of exogenous risk and stationary Gaussian distributions can prove misleading in the measurement of the (time-varying) stochastic volatility of liquidity assets.

5. *Conclusions*

Well-managed banks – as all firms – are concerned with capital management and risk assessment. Their corporate governance (which must be anchored to the integrity of the Board and the Top-management) should therefore be focused on evaluation of EcC and sustainable value creation (Masera and Mazzoni 2006). Size, business model, exposure to different time-varying risks, risk framework and appetite, corporate governance are primary drivers in the process of quantitative estimation of EcC. The assessment - level and time path of desired capital - depends crucially on the cost of equity, compared to other sources of finance. This reflects also the special character of the banking firm, where risk taking is the *raison d'être* and where deposits are a primary source of finance for traditional credit institutions. These general considerations are in principle independent of banking surveillance, and notably capital requirements, as opposed to structural regulation and to controls on the asset side of the balance sheet - in particular reserve requirements.

The thrust of this paper is on the importance of these internal processes. The view is taken that the M-M propositions on the irrelevance of the components of the liability side do not apply in their extreme form to banking firms. The difference between the private and the social costs/advantages of capital requirements in terms of leverage and/or risk weighted ratios is crucially important. In any event, LR and RWR are linked by DR, which is a control variable for any banking firm.

After the demise of Glass-Steagall, the capital requirements initially introduced in Northern America in 1981 took the form of leverage ratios. The Copernican revolution of requirements in

terms of risk-weighted assets (the Basel standards, ReC) came shortly later (the Basel technical committees already in 1980 were working on an RWA approach).

Basel I was clearly incomplete in terms of scope and of the risk-weighting process (which contained the original sin of zero weight for government securities). The primary emphasis was to introduce a level playing field for large internationally active credit institutions, notably to contain the extraordinary growth of Japanese banks.

Basel II was long debated and enacted in 2006. It was applied in the EU to all credit institution, in the US only to nineteen large banks. The fundamentally static approach to risk modelling and the faith in principle (model) based supervision concurred in creating a misplaced sentiment of complacency: the message of the Goodhart law went unheeded. Four other weaknesses must be taken into account (all of which had been identified by key authors at the time of or even before the enactment of the Second Accord): the lack of concern for systemic risk (Goodhart et al. 1988) and the unsatisfactory treatment of the relationship between micro and macro prudential dimensions (Crockett 2000); the identification, measurement and control of the value of government deposit insurance liabilities (Merton 1997); the absence of credible resolution/liquidation frameworks for banking firms and the moral hazard implications for bank shareholders/managers, with the attendant neglect of the difference between private and social costs/benefits of regulation (Pelizzon and Schaefer 2005); the distortions to competition deriving from one-size-fits-all requirements and the difficulty of ascertaining true economies of scale as opposed to diseconomies from regulations, as shown over a medium term perspective from the comparison between US and EU (Masera 2019a).

The thrust to reform the Second Capital Accord after the GFC came from the US (in the EU the recommendations of the de Larosi re Report (2009) on this issue were only partially and belatedly enacted). It was centred on the joint work of the US Congress and the Regulatory Agencies, in the framework of the Dodd-Frank Act (2010). Advanced models were detuned. Reg-

ulatory tiering was adopted. The interaction of capital reserves and resolution frameworks was enacted. Bail in mechanisms were introduced for very large banks, while liquidation procedures for less significant banks were more clearly defined and entrusted to the FDIC. The role of leverage as a surveillance instrument was reinstated. All this had clear implications for the BCBS work. The Basel III framework in 2013 and the Basel III/IV major reforms introduced in 2017 show the imprint of the rapidly evolving US regulatory approach. The coexistence of Leverage and RWR requirements was set in terms of complementary rules. The issue was often ill-posed, notably in the Euroarea, in terms of an ex-ante “optimal calibration”.

Circumvention of the rules (also in terms of exposure, see for instance Singh and Alam, 2018), can take place in respect of both LR and RWR. If the time dimension and changing features of risk are allowed for it becomes evident that the coexistence of the rules requires surveillance monitoring, also because the constraints offer different information. Risk taking and shifting by banking firms must be assessed in terms of a time process allowing for manifestations of disequilibrium. In this perspective, the search for “steady state” calibration of LR and RWR through DSGE models may prove time inconsistent (it fails to incorporate the Lucas Critique) and, in any event, it is by construction unable to account for endogenous and systemic risks. Capital requirements are usefully complemented by forward looking stress-testing techniques, which are less model dependent. In the quest to avoid excessive compliance costs for community banks, the new US regulatory framework would permit the vast majority of the US banks to satisfy exclusively a leverage requirement ($>9\%$). It might have been preferable to maintain a simplified risk-weighted framework to work in conjunction with the leverage requirements, also to preserve the focus on appropriate corporate governance and internal assessment of risk appetite. Reference to the leverage ratio alone risks destroying the long-term efforts and positive results obtained in fostering the tailored interaction between supervisory review and internal risk/governance procedures.

More generally, a tenet of this paper is that the problems of rightsizing and proportionality of banking rules are of paramount importance. As indicated, there are two sides to the tiering issue. First, the regulatory system within the banking sector should avoid distortions in competition as a result of fixed compliance costs and inadequate consideration of the systemic footprint of banking firms with different size and business model. Second, and equally important, effective proportionality should be enacted as between banks and shadow banks, notably with reference to the tight intertwining of banking firms and liquidity funds through tripartite and reverse repos and pledged collateral. Requirements should be set in terms of a macroprudential framework.

A major drawback of NNIRs is that they affect traditional models of risk measurement and add to uncertainty. Also from this perspective, acritical regulatory reliance on complicated transformation functions converting, at a given point in time, assets into a combined size-risk metric has evident pitfalls. As indicated, the interactive action of in depth supervision (SREP), effective corporate governance (ICAAP) and market discipline plays a key role to cope with idiosyncratic and systemic risks. Exceedingly complex regulatory frameworks “*create the illusion of a well-controlled system, while at the same time creating incentives for regulated entities to game the system*” (ESRB 2019). Effective bail-in (resolution) exit frameworks are the additional pillar of a satisfactory/robust surveillance system.

Tables and charts

Table 1

Negative yields have spread across maturities and countries.

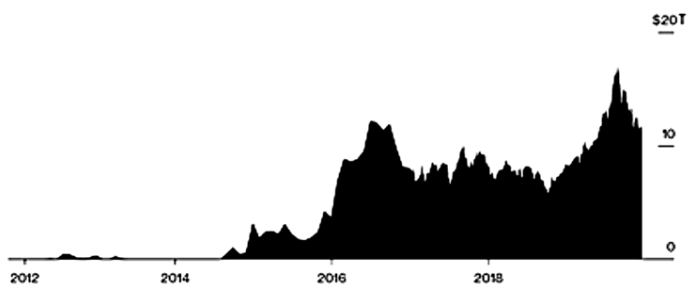
Exhibit 2. Sovereign bond yields of select developed market countries as of 12/31/18 and 8/30/19.

Select Global Bond Yields (%)							
12/31/2018	2 Year	3 Year	5 Year	7 Year	10 Year	15 Year	30 Year
Switzerland	-0.89	-0.86	-0.69	-0.50	-0.31	0.05	0.28
Netherlands	-0.74	-0.63	-0.30	0.01	0.38	0.62	0.90
Germany	-0.63	-0.60	-0.33	-0.12	0.24	0.50	0.87
Sweden	-0.41		-0.04		0.44	0.84	
Japan	-0.15	-0.16	-0.16	-0.15	-0.01	0.22	0.69
France	-0.50	-0.33	0.02	0.26	0.70	1.11	1.62
Spain	-0.26	-0.05	0.33	0.87	1.41	1.94	2.60
Portugal	-0.40	-0.23	0.43	1.12	1.71	2.26	2.90
Italy	0.46	1.05	1.79	2.30	2.74	3.03	3.52
United Kingdom	0.74	0.73	0.90	0.99	1.27	1.50	1.81
Canada	1.86	1.86	1.88	1.91	1.96		2.18
United States	2.49	2.46	2.51	2.59	2.68		3.01

Select Global Bond Yields (%)							
8/30/2019	2 Year	3 Year	5 Year	7 Year	10 Year	15 Year	30 Year
Switzerland	-1.21	-1.22	-1.17	-1.11	-1.09	-0.87	-0.64
Netherlands	-0.91	-0.93	-0.83	-0.73	-0.56	-0.43	-0.19
Germany	-0.94	-0.97	-0.93	-0.89	-0.70	-0.56	-0.18
Sweden	-0.68		-0.74		-0.38	-0.22	
Japan	-0.32	-0.32	-0.36	-0.39	-0.28	-0.10	0.14
France	-0.85	-0.88	-0.78	-0.64	-0.41	-0.11	0.42
Spain	-0.58	-0.57	-0.38	-0.17	0.10	0.52	0.98
Portugal	-0.66	-0.52	-0.36	-0.14	0.11	0.50	1.01
Italy	-0.23	0.01	0.37	0.68	0.99	1.50	2.02
United Kingdom	0.37	0.33	0.32	0.30	0.48	0.71	1.01
Canada	1.35	1.28	1.18	1.16	1.16		1.42
United States	1.50	0.43	1.39	1.45	1.50		1.96

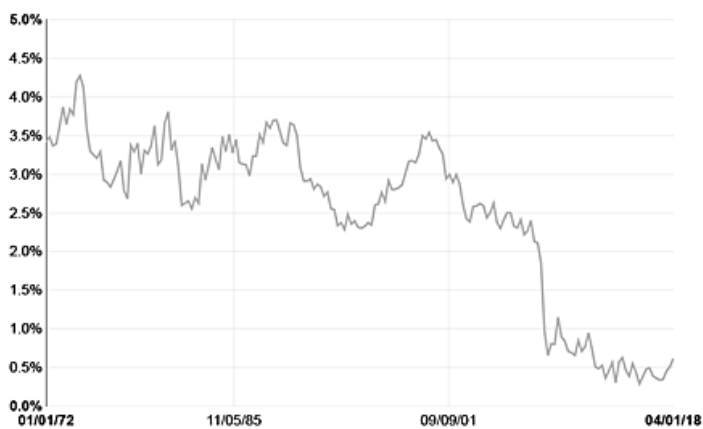
Source: Causeway Capital Management (2019)

Chart 1 – Market Value of Negative-Yielding Bonds in the Bloomberg Barclays Global-Aggregate Index



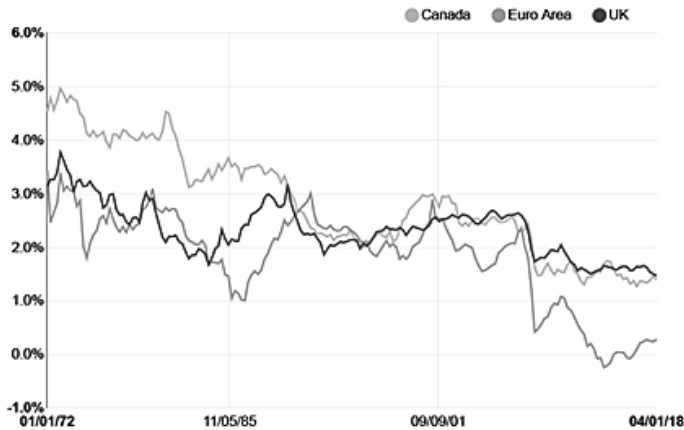
Source: Ainger (2019).

Chart 2 – US estimated neutral rate of interest



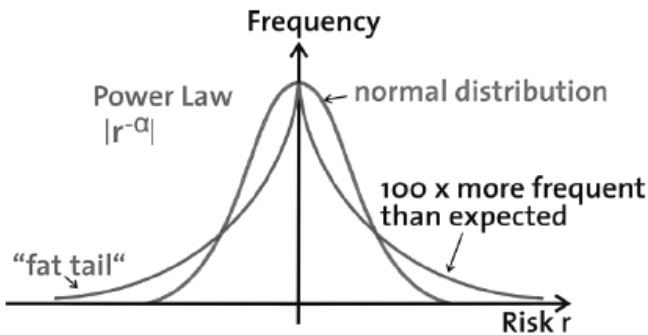
Source: New York Fed: Holston, Laubach, and Williams (2017).

Chart 3 – Estimated neutral rate of interest: Canada, Euroarea, UK



Source: New York Fed: Holston, Laubach, and Williams (2017).

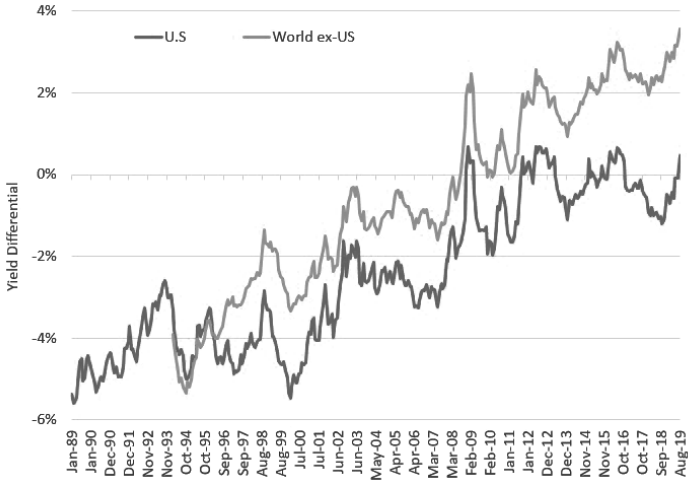
Chart 4 – Power laws and heavy-tail distributions



Source: Helbing (2010)

Chart 5

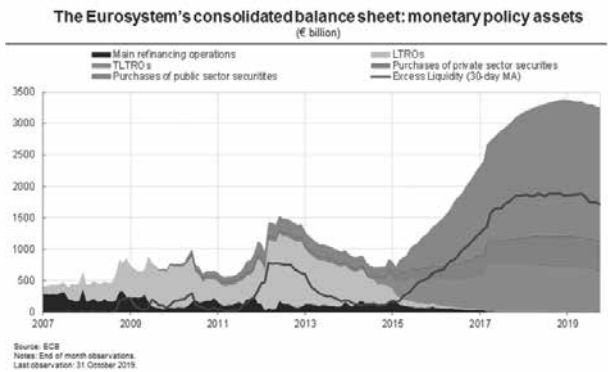
Relative dividend yields offered by developed non-US equities are reaching historic highs.
Exhibit 4. Equity dividend yields minus 10-year sovereign bond yields. World ex-US bond yields are represented by the average of 10-year sovereign bond yields in Japan, UK, France, Canada, Switzerland, and Germany.



Source: Capital Management (2019)

Chart 6

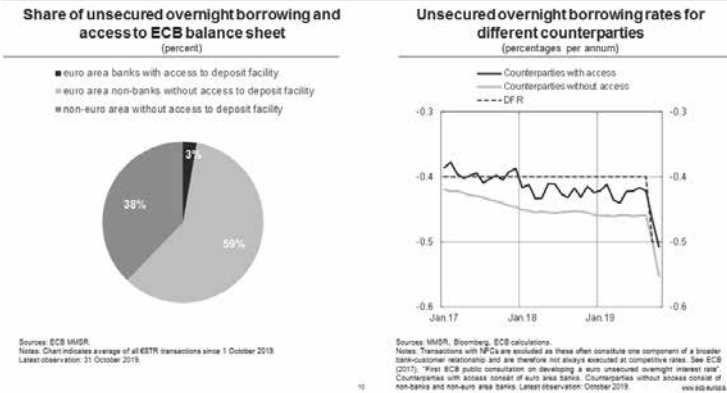
Central banks have injected large amounts of liquidity into the financial system



Source: Coeuré (2019)

Chart 7

Money market transactions dominated by trades with non-banks



Source: Coeuré (2019)

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Lorenzo Bini Smaghi*

Open Finance: a Game Changing Reform

The main theme of this year's conference is the interplay between technology, digitalization and regulation in the financial system.

I would like, in this respect, to make five main points.

The first one seems quite obvious: the digital revolution is one of the key challenges for banks in the coming years, and will affect all aspects of banking activities.

Digitization is clearly a “game changer” for the banking system with large disruptive effects. Such a ‘paradigm shift’ is confirmed by empirical evidence. Let me give just a few examples:

- in 2018, total investment activity in Fintech amounted to \$120 bn. Since 2014, there have been over 11,000 fintech different investments totaling about \$ 380 billion (source: KPMG figures, as of 30 June 2019).
- on aggregate, the total volume of new credit provided by both Fintech and BigTech in 2017 exceeded \$500 billion, which represents a tenfold increase from 2014. However, the total Fintech credit granted as a share of total stock of credit remains comparatively small, with only 0.5% of the global credit volumes in 2017 (source: BCBS).

Beyond figures, while banks are highly challenged, they also have strong core strengths to capitalize on, being a highly and

* (Oliver Wyman-CIGI Conference, Rome 26.11.2019).

widely trusted party. This is a clear competitive advantage that we must protect.

In the meantime, we – as banks - also need to pay close attention not to become “subordinated players” compared to the new entrants. This is the reason why we should look very closely at all the challenges/risks to better integrate them into our business decisions, thereby turning them into opportunities wherever possible.

The opportunities:

1. exploit economies of scale and operational efficiency,
2. provide better yet cheaper services (agile models, innovative tools and platforms),
3. ensure personalized journeys for our clients,
4. promote financial inclusion,
5. deliver improved and more efficient banking processes,
6. exploit innovative use of data for marketing and risk management purposes.

The challenges:

1. the transition to efficient **IT infrastructures and systems**, which are at the essence of digital transformation, requires a significant amount of investments.
2. **cyber-risks** are mounting, as digital tools are becoming increasingly sophisticated and widespread, with providers mainly coming from the US for instance). According to the IMF, the greatest concern for financial institutions are cyber-attacks, which pose greater risks than geopolitical events or even regulations¹.
3. **data privacy/use**: while the GDPR very clearly protects individuals in the use of their data, there is no equivalent

1. “Estimating Cyber Risk for the Financial Sector”, Christine Lagarde, June 2018. According to this note, an IMF staff modeling exercise estimated that average annual losses to financial institutions from cyber-attacks could reach a few hundred billion dollars a year, eroding bank profits and potentially threatening financial stability.

standards in the US or China, even less internationally. We do want both: (i) the highest degree of consumer protection / use of data, and (ii) a level playing field between new players and traditional banks.

4. **societal issue:** we need to address the question of suitability of some emerging technologies such as artificial intelligence, machine learning, blockchain, Libra, beforehand, not after they are being developed.

The disruptive impact of digitalization and new technologies varies according to the type of clientele:

- for **individual customers and professionals** the disruption depends on their degree of digitization (digital proficiency). The relational model is becoming simpler with the increasing adoption of digital in everyday banking, and advisors focused on value-added services;
- for **SMEs and corporates**, while digitalization enhances the offer (accounting, taxation, invoice processing, flow operations, B2B platform) at a lower cost, the banker's advice remains essential for the more specific, complex and diversified needs.

Against this background, ensuring the sustainability of our business model is key to keep matching our customers' fast-changing expectations.

The second point is that banks need to rise to the challenges. There is no alternative.

From a practical standpoint, this requires pushing forward the digital transformation of all banks' businesses and functions to achieve a satisfying digital maturity in terms of technology, people and culture.

This notably implies:

1. digitizing the processes in all businesses, be it for retail banking (through application development / online banking as is the case of Boursorama for SG), international banking services (development of payment tools like Yup in Afri-

ca, or the use of Apple Pay in Russia) or investors-related solution (setting up of a markets platform for wholesale customers, and project development time divided by 2 over the last 4 years thanks to new technologies).

2. forging partnerships with new players to offer new services through the acquisition of FinTech (e.g Treezor) and commercial partnerships.
3. creating innovative business models to better serve our customers over the long term. For instance, our subsidiary Boursorama, the leading online bank in France: 400,000 customers in 2012, more than 2 million in 2019 with a target of more than 3 million in 2021.

However, today's regulatory environment does not allow traditional banking players to really scale up their game by making the corresponding investments: indeed, several loopholes need to be fulfilled right away, at the risk of making banks "subordinated players" to the Tech ones.

This raises two key issues.

The first one, and this is **my third point today**, is that the regulatory framework needs to be adapted to fulfill two key goals:

1. regulation should be **activity-centric, building on the principle "same activities, same regulations"**, to avoid any distortion between traditional banks and new Tech players that increasingly diversify their business model in offering payment services, without being subject to any specific regulations as banks are. We should also conduct in-depth reflections on how to find the right balance between the use of data to provide our customers with better-quality services and products, and the need to ensure their **data privacy**, which is a very clearly recognized through the **GDPR** at the EU level but not internationally. Indeed, as Agustin Carstens, the MD of the BIS, rightly stated: **"If data are the new gold, what is the new gold standard?"**
2. Regulation should also ensure a **level playing field between international banks**:

- this will necessitate a **smart and risk-appropriate EU transposition of the Basel III agreement**: while the multiple revisions of CRD/CRR were undeniably necessary for banks to set aside the right capital requirements to face any possible shocks, the current phase of finalization of Basel III must not result in a significant overall increase of EU banks own funds, that would not be risk-sensitive and risk-proportionate.
- another key aspect in this regard is to have a true level playing field between EU and US banks, in particular with regard to the **prudential treatment of software investments**.

The second issue relates to **banks' profitability in the EU, which has been undermined in recent years by various factors**. Until now, EU banks mostly struggle to keep having a **strong discipline regarding their own funds and costs**, while they also need to have **enough room for continuing to invest to comply with new regulations and to make the necessary IT infrastructures and systems investments** to match their customers' expectations.

The absence of a **fully-fledged Banking Union and of a finalized Capital Markets Union** is particularly damaging. Indeed, while financing the digital transformation requires huge investments and thus requires a strong and profitable banking system, the reality is that today's prospects are quite challenging for EU banks:

- EU banks must keep being profitable in a **'low for long' interest rates environment**, while they pay large amount to the SRF (as a part of the BU), and will have to face the new **Basel III requirements** which disproportionately impact EU banks compared to US ones. As of today, the obstacles faced inside the Banking Union prevent EU banking groups to truly expand across border and to exploit synergies.
- Concerning the **CMU**, Europeans should take bold moves to truly harness the opportunities presented by technology in financial services, as a key driver of market/financial inte-

gration. To compete globally, Europe's innovative companies need access to capital, space to experiment and scale to grow, which is not yet the case.

Meeting all these requirements is only half of the equation: international cooperation between banks supervisors to adapt their supervisory skill set to monitor all the new involved risks is equally important.

This brings me to **the Fourth point** I would like to make.

It is crucial that supervisors anticipate the risks and opportunities arising from financial technologies and innovation. To this end, we welcome the recent announcements made by the BCBS to undertake an assessment of the banking and supervisory implications related to:

1. the risk management challenges associated with the use of artificial intelligence and machine learning in financial services;
2. banks' dependencies on unregulated third parties and the implications for outsourcing supervisory regimes; and
3. supervisory challenges related to data governance and management as well as data security, portability and recovery.

Supervisors should also ensure that **minimum standards such as KYC, AML and CFT are well applied**. In this regard, we welcome the fact that, at the EU level, the supervisory priorities set out by the SSM for 2020 clearly recognize the importance to assess AML & CFT as significant risk drivers of banking sector risks. Most importantly, the SSM includes in its priorities the assessment of bank's business model's sustainability and profitability in the light of increasing digitalization but also IT and cyber risks.

We need to ensure that this is the case in all major jurisdiction.

In addition, supervisors need to consider that the sources of risk are **not limited to regulated financial entities only**. Risks may also come from elsewhere, including non-regulated enti-

ties, With this in mind, **a project such as Libra is inevitably a wake-up call for action**².

- as designed, Libra may improve financial inclusion and lower the costs of domestic and cross border payments. But one should remind that **the absence of state goes hand in hand with the absence of lender of last resort: indeed, who will stand behind such currencies in a liquidity crisis?**
- as rightfully pointed out by Mark Carney in a recent speech³, the terms of engagement for innovations such as Libra must be adopted in advance of any launch of Libra. It should meet the highest standards of prudential regulation and consumer protection.

My fifth and final point is that banks want, and are willing, to compete, but on an equal footing.

The recent announcement made (last Tuesday) by Facebook to develop “Facebook Pay”, reflects once more the wide discrepancies between traditional banking actors and Tech players, both in terms of territoriality and rules:

- on the one hand, GAFA, BigTech/Fintech, operate without any geographical nor regulatory boundaries, thus relying on large pool of resources with less regulatory constraints;
- while on the other hand, European banks operate in a highly fragmented market that restrict their cross-border activities due to heavy regulations.

In this context, we are convinced that banks can turn the “threats” and challenges of digitalization into real opportunities by capitalizing on their core strengths, provided that several essential conditions are met, both at the regulatory and supervisory levels in order to:

- ensure customers’ data privacy,

2. Testo nota?????

3. “Enable, Empower, Ensure: A New Finance for the New Economy”, Speech given by Mark Carney at the Lord Mayor’s Banquet for Bankers and Merchants of the City of London at the Mansion House, London 20 June 2019.

- adapt the supervisory skills set to monitor new emerging risks,
- ensure close international cooperation between supervisors,
- provide banks with a fair proportionate regulatory framework built on the “same activity - same rule” principle and on the necessity to ensure a level playing field between international banks.

Thank you very much for your attention.

Patrick Kenadjian

*Non-executive directors of European Union
financial institutions: a precious resource that
should be put to better use*

Executive Summary

Boards of directors fulfil many functions, but over time two of them have stood out, although neither is set out in the corporate laws that govern them. These are acting as a strategic advisor to management and monitoring management conduct. Historically, advising came first, but in the last decades of the twentieth century, monitoring gained the upper hand. Since the Financial Crisis monitoring has been emphasized by regulators and supervisors worldwide as a, if not the, key role for boards of directors of financial institutions. This role is even specified in Community Law in the Fourth Capital Requirements Directive.

In view of the dramatic changes which the financial services sector is undergoing due to technological and societal changes, including the potential entry of Big Tech into some of their core businesses, I believe this focus, to the extent it precludes an adequate focus on strategy, needs to change. Directors, in particular, non-executive directors, already see the need for this. It would be a waste of the perspective and expertise these non-execs can bring to determining the need for and shape of what may be fundamental changes in the way their financial institutions are structured and operate if their limited time were to be monopolized by monitoring management, rather than helping them craft the shape of the future of their institutions.

Introduction

Non-executive directors of financial institutions are very much in demand and the demands on them are becoming ever greater. We are currently experiencing worldwide an increased emphasis on the duties and responsibilities of boards of directors and particularly of their independent members with respect to the conduct and especially the misconduct of the enterprises they serve. Whenever something goes wrong, the question “where was the board?” seems sure to follow. This attention and the attendant pressure on non-executive directors (NEDs) is particularly noticeable in the case of financial institutions in general and for those in the European Union in particular. The challenges they face of course have to do with the complexity of modern financial institutions and of their products, leading to the oft asked question of whether some of them might not be “too big to manage”, coupled with the speed of technological change affecting their core products, traditional services and the very form of their organization. Beyond that, however, to understand the full extent of these challenges, I think it is useful to put these NEDs and their institutions in their broader legal, institutional and social context. I would liken the tasks facing the non-executive directors of European Union financial institutions, who serve on a part-time basis, to the complexities of playing three dimensional chess, each dimension following a different set of rules, only one of which is fairly set, the other two evolving more rapidly and in ways not necessarily designed to ease the task of the non-executive director.

The three dimensions

The first dimension is the corporate law of the state under whose laws the financial institution is incorporated, which determines in the first instance how the directors are selected and elected and the roles they can and must play within the corporate entity, the nature of their legal duties to the corporation,

its shareholders and, eventually, other stakeholders, and their eventual liability, civil and criminal, should they fail to live up to those duties. These rules and the related duties are relatively stable and evolve comparatively slowly, based on legislation and litigation.

The second dimension is what I will refer to in shorthand as the banking law and regulation enforced by the authorities which license and supervise the financial institution and which define the institution's license to operate as such. This licensing includes the determination of who is a fit and proper person to act as a director of a financial institution and, eventually to refuse to approve a person or to remove a person as a director for failure to meet the authorities' standards. This power brings with it the ability to define duties and obligations for directors which can diverge from and go beyond those foreseen in corporate law. These rules and the related duties evolve more quickly than the corporate law, based on administrative decisions and can result in removal of directors and restrictions on or even revocation of licenses to do a banking business. As noted above, I use "banking" as a shorthand for regulated financial institutions. In theory, under the principles of the European Banking Union these rules should be a uniform expression of the Single Rule Book developed by the European Banking Authority (EBA) and enforced by the Single Supervisory Mechanism (SSM) but in fact, to the extent the rules are issued under a European Union Directive, which must be implemented (translated) into national legislation, on a national level, rather than pursuant to a Regulation, which applies directly as written, the SSM finds itself acting under a patchwork of some 600 "national options and discretions". Some of these affect issues as basic as whether the "fit and proper" determination of directors may be made before or after the director is publicly nominated and elected. At the time I write these lines the UK is still a member of the EU and I will not treat its rules separately.

The third dimension is that of public and societal expectations concerning the role of directors and of the financial institutions they serve. These expectations can be harder to articulate

clearly and can evolve quite rapidly, resulting in the withdrawal of trust from an institution or a whole category of institutions if they are viewed as having violated the social or societal compact under which the public feels the privileges accorded the institutions are justified. And when this trust is withdrawn, the role of the institution's directors is very often held up to scrutiny.

The banker's dilemma

The first and the third dimension apply more or less equally to all corporate businesses, and directors of Volkswagen can expect to come under just as much scrutiny as those of Wells Fargo when their companies are involved in what appear to be flagrant violations of law and abuse of trust of their customers, although even there financial institutions, whose basic stock in trade is trust and whose products and services tend to seem more interchangeable to the lay person, can expect the consequences to be more severe for them than for an automobile company whose products are usually more clearly delineated in the public mind. But the second dimension is unique to financial institutions and complicated by the nature of their business and their relationship with their regulators and supervisors, a relationship exacerbated by the financial crisis of 2007-2009 (the Financial Crisis) which has been blamed on both "greedy bankers" and on regulatory (and supervisory) failure, as well as excused away as the product of a "perfect storm" for which no one was responsible. Since then financial institutions' boards and their supervisors have been locked into something resembling what Germans call a "Schicksalsgemeinschaft", a community of destiny to see that such events do not recur, with supervisors seemingly determined to deputize the boards as quasi auxiliaries of supervision.

Thus while the Financial Crisis resulted in numerous prudential regulations intended to make financial institutions more robust, in particular those packaged under the title of Basel III, which have attracted perhaps the greatest attention, regulators

and supervisors have also focused on conduct. And there they realized two things. First that regulating substance, largely ex post, might not be sufficient to control the kind of excessive corporate risk-taking which brought us the systemic externalities which caused the Financial Crisis. Second that they should have a natural ally within the financial institutions in combatting future excesses, in the person the institutions' boards of directors. The boards have the advantage of inside access to information about the institution, coupled with the traditional duty to control the direction of the institution. An example outside the Euro area is the UK's Senior Managers Regime. The regime was initially designed to allocate personal responsibility to executive officers of financial institutions who filled designated senior management functions (SMFs), so that not only underlings caught with their hands in the proverbial cookie jar could be held responsible for misconduct, but also those SMFs designated as responsible for the functions involved, if they had failed to ensure proper supervision of the conduct involved. It has since been expanded to NEDs in stages. First to NEDs who perform an enumerated SMF, including chair of the board, risk, audit, remuneration and nomination committees. Finally, the Conduct Rules apply now to all NEDs. Since I said above that I would not deal separately with UK rules, I will stop here. By the time you read these lines the UK will have exited the EU.

Members of the Board of Directors, including NEDs, it became increasingly obvious to regulators and supervisors could be made into a new line of defense against executive excesses with a few appropriate tweaks to the regulatory structure, by imposing duties on boards of directors to do more than what they had traditionally done, i.e. merely monitor the CEO and management and assess overall strategy, to include an express duty to oversee the risk function in ways which now sometimes seem to go beyond merely evaluating risks to the institution itself to include the risks it poses for financial stability overall, as well as to other, often harder to measure, risks, such as cybersecurity and culture. And it is likely that more such assignments are yet to come, including those emanating from the initiative

by the Network for Greening the Financial System (NGFS), whose members include a majority of the national competent authorities within the Banking Union, to expand the definition of financial risk to include climate risk.

This phenomenon is worldwide, with the regulators and supervisors following the Basel Committee on Banking Supervision's July 2015 Guidelines on corporate governance principles for banks. And so it is within the Banking Union, but here there are two important differences. First, whereas outside the European Union, supervisors and regulators are usually acting based on general delegated authority when they increase the pressure on directors, in the European Union, Article 91(8) of the Fourth Capital Requirements Directive (CRD IV) contains a duty for directors "to effectively assess and challenge the decisions of senior management... and to effectively oversee and monitor management decision making." While I am not as alarmed about this as the authors of "Quack Corporate Governance, Round IV" who see this as opening the door to liability for mere negligence under certain member state laws, I do think it does make a difference in how specific regulators and supervisors can be in what they require of directors. Second, it is also important to know, as noted above, whether the resulting rules have been formulated pursuant to a directive or a regulation. For example, the so-called "fit and proper" assessments of members of the "management body" of financial institutions, which, somewhat confusingly, include both management and supervisory boards, have been carried out through the use of Article 91 of the Fourth Capital Markets Directive and CRD IV, as its name indicates, is a directive, not a regulation. It has to be implemented by each member state and they have done so differently (never was the word "translation" to designate this process of implementation more appropriate than here), despite the existence of Joint Guidelines developed by the responsible European Union authorities, the EBA and the European Securities and Markets Authority (ESMA) that were meant to provide a uniform interpretation of the Directive. Some member states quite clearly answered, through their national competent authorities, that they had no

intention of implementing certain provisions of Article 91 as interpreted by the EBA/ESMA Joint Guidelines of September 2017, thus leaving the SSM constricted in its ability to impose its own Guide to fit and proper assessments of May 2018 even for the 119 groups (including 1000 companies) it supervises directly if the national competent authority views it as in contravention of local law. And of course the competent authorities are not going to impose rules with which they disagree on the institutions they supervise directly. The European Central Bank (ECB) is thus campaigning for a regulation to replace that part of the directive to smooth application and provide the always popular level playing field, but until it succeeds we are living in a world where the Banking Union means different things in Belgium and in Bulgaria, amongst other things with respect to fit and proper.

Actual supervision by the ECB is another matter, to the extent that it takes place under a regulation conferring specific authority on the ECB, including the power to impose requirements on credit institutions to have in place robust governance arrangements, including fit and proper requirements for the persons responsible for the management of credit institutions, “to carry out supervisory reviews” and “to remove at any time members from the management body of credit institutions who do not fulfill the requirements” of Union or national legislation. The same distinction applies to the actions of the EBA. Its Guidelines on internal governance are issued pursuant to a Regulation and competent authorities “must make every effort to comply with them”. In contrast, in setting forth guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) the ECB is acting pursuant to a directive and not a regulation, and in any event it is personnel constrained and thus largely dependent on national competent authority staffing in its joint supervisory teams.

Nonetheless, for the significant institutions, what the EBA and the ECB have wrought cannot be ignored and, even if it may not be implemented word for word, it has created the atmosphere in which boards in general and NEDs in particular

must go about their business. The expectations of regulators and supervisors are summarized in the ECB's SSM supervisory statement on governance and risk appetite of June 2016 in which the words "challenge" and "risk" recur:

"The SSM has high and specific expectations regarding banks' boards. Boards should challenge, approve and oversee the management's implementation of the bank's strategic objectives, governance and corporate culture. In this respect, the SSM expects the board to demonstrate its capacity for independent challenging and oversight of senior management. This implies that an institution's board should have an adequate composition and effective organization to ensure that it has the capacity to challenge senior management. The board should include a risk perspective on strategic discussions and demonstrate effective oversight of risk and control functions. In particular, the board should be strongly involved in the validation process and monitoring of the risk appetite framework."

I think we can all agree that the expectations are high, but whether they are specific is another question, and whether it is realistic to expect that a group of part-time NEDs will have the time and expertise to contribute meaningfully in the setting of the institution's risk appetite is yet another. A final question, to which we will return, is how exactly a board is meant to challenge senior management who, except in two tier board systems, normally sit on the board.

The corporate law dimension

To return now to the first of our three dimensions of duties and playing fields, corporate law, there are well established theories and related best practices as to the role of boards of directors of corporations, and especially of their non-executive or independent members, within the corporation. Traditionally, there have been two theories of the board's role, to advise management on the strategic direction of the enterprise and/or to

monitor the actions of management in the corporate interest. These are theories which have attracted a consensus although they are nowhere to be found in the relevant laws. Historically, the advisory function came first and brought with it a set of criteria for selecting board members based on expertise, familiarity with the enterprise and ability to get along with management and other directors. In recent decades the monitoring function has come to the fore and brought with it not only new criteria for selection of directors, especially NEDs, but also the question of in whose interests the monitoring was meant to take place. Since the 1970s that question has been answered in the United States with a primary, if not exclusive, duty towards the shareholders. In Europe the answer has been, variously, a duty to the enterprise as a whole or a duty to a broader group of “stakeholders”, including not only shareholders, but also employees and, conceivably, the communities in which the corporation operates. This broader view has been taken up most recently by an influential group of chief executives in the United States in the August 19, 2019 Statement on the Purpose of a Corporation of the Business Roundtable, signed by 181 CEOs. But none of these corporate law theories has been stretched to cover a duty to preserve financial stability by not taking risks which could cause systemic externalities to spread to other financial institutions. The closest analogy might be to avoid the sorts of risks which could cause serious environmental damage, but this duty differs from the duties supervisors are now asking NEDs to take on in a number of important ways to which I will return below.

On the question of criteria for selection of NEDs three criteria stand out, which are often hard to reconcile: independence, diversity and expertise. Independence is measured in reference to a number of criteria, material, intellectual and social. An independent director should not be a current employee of the corporation, nor derive a significant portion of their income from the corporation. Whether the NED may be a former employee and how far back that employment must lie is a more difficult issue. Intellectual independence in contrast is an attitude of mind, including a willingness to question a consensus

and to go behind the facts or theories presented as a basis for action. Diversity on a board is a more recent concern and the nature of diversity is often rather narrowly defined to cover primarily gender and race, omitting background, which can be a key component. Recent studies of successful entrepreneurs in Silicon Valley underscore the immigrant backgrounds of many of them, which gave them a different view of how things could be done better.

Expertise, especially in the financial services area, has often been presented as a major problem for NEDs, based on the theory that the area is so complex that even if you knew what the right questions to ask were or had the luck to stumble upon them, an outsider would simply not be in a position to understand the answers, while on the other hand current industry expertise was held only by competitors who would be unsuited to the role of NED or by retirees whose expertise, especially in the current era of rapid technological, legal and social change, would most likely soon prove to be too out of date to be useful. There is something to this line of argument, but it overlooks two important things. The first is that not all important issues to come before a board of directors are technical in nature. There was nothing technical about the fraud allegedly being perpetrated on Wells Fargo's customers by opening accounts in their names without their knowledge. If you are continually beating your competition by a wide margin on such simple metrics as new accounts and products per customer, it does not require a lot of expertise to look into management style and employee compensation to realize that something might have been wrong, especially if you had a reporting system that captured and escalated employee whistleblowing reports.

The second is that boards hire and rely on experts in a number of areas, ranging from auditing to employee (and especially top management) compensation, to aid in their decision making. This model can surely be expanded to other areas where technical expertise is needed. The recent report of independent counsel on the responsibility of TSB's board for the catastrophic problems TSB experienced in transitioning from one computer

platform to another specifically faulted the board for relying exclusively on internal reports and evaluations to judge whether the proposed plan of action was realistic or not, rather than seeking out the advice of an outside expert. So long as the experts are selected by the board which sets the scope of their mandate and they report directly to the board, that should be a reasonable way to augment board expertise. Of course, corporate law tells us that the board may not delegate its duties to outside experts and must question and probe the answers it receives, but if it does so in a careful and thorough way, then that should work.

A further question goes to where the board should devote the bulk of its time. Anecdotal evidence shows that a significant percentage of board meetings and of the materials produced for the board are devoted to numbers and compliance issues. This in turn raises two questions. The first is whether a kind of dedicated secretariat hired by and reporting to the board would not be useful to help analyze and organize the flood of documents which board members often get very close to the meeting dates. This is a variation on the idea of expert help but may be more problematic to implement since the work would presumably be done by company employees whose future advancement would depend on management rather than the board, so they would not have the same degree of independence and devotion to the interests of the board as outside experts with the appropriate mandate would have. Still, in view of the amount of documentation involved, it would very likely represent an improvement in board efficiency.

The second question is whether the board, especially the NEDs, should be devoting more time to issues which require fewer numbers to be crunched and more judgment, those which relate to overall strategic direction and those which relate to employee conduct and misconduct and to the culture of the enterprise which largely conditions that conduct. As noted above, questions of strategic direction have in recent years taken a back seat to assessing and policing compliance, the latter being frequently carried out on a micro level rather than focusing on what is often the root cause of compliance problems, which is culture.

This strikes me as not the best use of NEDs' time. Other than being clear on cultural and conduct priorities and ensuring that there is an adequate reporting system to transmit those priorities down the line and a secure whistleblowing channel back up, I would argue that much of what the boards are asked to do in the compliance area could be left to management to free up scarce board time for other matters such as strategy, where the input of NEDs, bringing their outsider/insider point of view can be the most precious.

This is of particular importance as innovations introduced by Fintech firms, whose focus is customer centric, are exposing how product centric and self-referential many financial services organizations are. It is often thought that Fintech innovations are product-driven, but in fact many of them focus on reimagining a product or service from the customer's point of view and are process driven. In the words of one EU bank chair, it is realizing the customer does not want a mortgage, they want a home and the mortgage is only a step in the process of getting one. Seeing things that way can require a fundamental reordering of the institutional structure, a strategic decision of profound importance, and that is precisely the sorts of questions NEDs should be asked to bring a fresh outsider's view to. In an era of disruption, where the traditional knowledge of banking markets and products, which bank management clearly has, no longer suffices, NEDs can help bring an understanding of network effects, helping to evaluate customer needs, preferences and new kinds of relationships. Innovation coming from non-traditional market players from outside the industry and at an unprecedented pace may well require the kind of "out of the box" thinking concerning the future of an institution's business model that the tendency towards group think which often arises from a long history of success can hinder. An NED coming from an industry which has already experienced profound disruption may well bring a much needed new perspective, if asked to provide it. It is the one function no one else, either inside or outside the corporation, can provide as well as the board can, and its importance is paramount.

The challenges currently facing financial institutions are nicely pulled together in “Banking Disrupted? Financial Intermediation in an Era of Transformational Technology”, Geneva Reports on the World Economy 22, Kathryn Petralia, Thomas Philippon and Nicolas Véron, International Center for Monetary and Banking Studies, 2019. They see the provision of financial services as profoundly changing worldwide, so much so that many commentators are predicting “the death of banking as we know it”. They view “some of the dynamics at stake as unprecedented, not least in terms of their ‘hyperscalability’” and ask whether “the threat to the traditional banking model is fundamentally different than in the past” with a need for the incumbents to transform themselves profoundly in order to meet the challenges from outside the industry, in particular from Big Tech, to retain customer relationships and trust in an environment in which the ubiquity and exponential growth of data are having implications as yet poorly understood. “More is different” where data is concerned. And the challenges are coming to their core business functions of maturity transformation, payments and information processing. On payments, the example of China is particularly enlightening as to what can happen if the regulatory regime is favorable. Big Tech mobile payments represent 45% of domestic retail payments, an amount equal to 16% of national GDP. The vast majority (92%) comes from just two companies, Alipay and WeChat Pay. Payments represent 17% of annual revenue for the global financial intermediation system according to the study.

The Big Tech firms dwarf the banks in terms of market capitalization and the banks clearly lag them in technology, customer experience and network effects. The banks lead in lobbying and data privacy and protection, but the strategy to meet the challenge is anything but clear: compete head to head, cooperate, provide specific unique banking products and services or become platforms offering rival products? And this is all taking place at a time when the speed of adoption of innovations is accelerating. The study notes that the time to reach 50 million users has declined from 50 years for telephones to 28 for credit

cards, 18 for ATMs, 12 for mobile phones, 4 for Facebook and 1 for WeChat. So I would suggest the financial institutions should do all they can to profit from their NEDs' input on strategy.

This is not to say that monitoring management is not an important function of the board of directors. On the contrary, it is the one function no one else, either inside or outside the corporation, can provide as well as the board can, and its importance is paramount. The experience of Wells Fargo & Company (Wells Fargo) with its aggressive sales practices is ample proof of that. The Investigation Report of its independent directors dated April 10, 2017, makes clear that aggressive sales practices leading to the opening of unneeded savings and checking accounts were promoted by management and the extent of the problem was hidden from the board of directors. The board in fact only learned of the full extent of the problem (5300 employee terminations for sales practice violations versus the 230 terminations reported to the board) from the contents of the settlement agreement with the Los Angeles City Attorney, the Office of the Controller of the Currency and Consumer Financial Protection Board (Wells Fargo Report, at 109).

The fact that the report was of the independent directors underlines several things. First, that the monitoring function attributed to the board can really only be exercised by the NEDs. In normal times this can be done by committees set up to be independent and on which only NEDs sit, such as the audit, nomination and compensation committees. Second, that if we want them to monitor risk, the risk committee and any separate compliance committee should also be made up of NEDS. Third, in an exceptionally serious situation like the sales practices at Wells Fargo, a special independent committee of the board may be needed.

Nonetheless, too exclusive a focus on monitoring management conduct comes at a cost in terms of time and focus. NEDs have limited amounts of time and bandwidth and it is incumbent on companies to ask themselves whether less time should be spent on monitoring and more on advising. A great advantage a NED brings is a diverse point of view and a different perspective and

while those qualities are useful in monitoring the organization, they are arguably even more precious in helping management make sense of a fast changing economic, social and technological landscape where being inside a large organization may inevitably narrow management perspective. And while I think there is growing recognition in corporate governance circles that the pendulum needs to swing back somewhat towards the advisory function, in the financial services area there seems to be a perception of considerable pressure from regulators and supervisors to hold back the pendulum and focus boards on their monitoring function. See e.g. Salzburg Global Seminar, Session Report 567, *The Corporate Balancing Act: How Can Directors Manage Conflicting Pressures?* (Salzburg, 2016) at p.49. I am not sure this is the product of a conscious effort or a lack of appreciation for the limited time and attention NEDs can bring to their job, which require hard choices to be made on where to invest that time.

I will return to this point in the next section, but I would first like to note the progress financial institution boards have made since the Financial Crisis in improving their performance from a corporate governance point of view. An outstanding study posted on the Harvard Law School Forum on Corporate Governance and Financial Regulation on June 11, 2018 by Aktis Nestor Advisors surveys the governance of the 25 largest European banks a decade after the crisis (Nestor, 2018) and I find its report very heartening from a corporate governance viewpoint. Board size has been reduced (to an average of 14 down from over 20 pre-crisis) while the number of committees is increasing. New committees include not only the separation of the audited and risk committees required by CRD IV, but also specialized committees, such as nomination, compensation, strategy and conduct, and values committees. While more committees can increase the overall work load on NEDs, they serve a crucial function in sharing the burden among NEDs. Boards have been refreshed: 80 have received new chairs and an increasing number of these chairs are independent, the number of international directors and of women directors has increased (to 25% and 34% respectively, the latter representing a doubling since 2007).

NED levels of expertise have also risen, with at least one NED per board with recent financial experience and 49% with senior risk management experience. The profile of NEDs has also been raised: they are also now almost always the chairs of the risk committees. Their average workload is now as high as it was at the height of the crisis: on average the boards meet 14 times a year (up from 11.4 times in 2007) and the attendance rate at meetings is a minimum of 91%, with an average of 96%, reflecting a concomitant drop in outside time commitments, in line with CRD IV requirements. Board compensation has risen 60% since 2007, but “pay per day” has remained constant. In fact it has declined in the case of NED board chairs.

These metrics are particularly significant when one returns to the arguments which were originally made to justify focusing the duties of boards on the monitoring to the practical exclusion of other functions. In *Legal Models of Management Structure in the Modern Corporation: Officers, Directors and Accountants*, 63 Cal.L. Rev 375 (1975), one of Melvin Eisenberg’s seminal papers on corporate governance, he cites a number of constraints on boards which he believes preclude them from taking a more active role than monitoring. He cites time constraints, based on statistics that 45% of boards surveyed met no more than six times a year and 96% met no more than twelve times a year, with meetings usually lasting only a few hours, he comes up with a total of either 18 or 36 hours a year for meetings and no more than an hour to prepare for each hour of meeting. He concludes that this precludes an active role in making business policy. He further cites constraints of information, with only 17.2% of companies sharing manufacturing data, 21.3% marketing data, 5.7% an agenda and 11% nothing at all. He further asks whether the board providing strategic advice is an important function and whether the board is uniquely qualified to perform it. He concludes that advice is “hardly essential to the corporation’s operation” and that the CEO has many other places to turn for advice.

A comparison between his factual premises and the Aktis Nestor Associates data discussed above shows how much has

changed in the amount of time devoted to board duties since 1975. As to the importance of advice, at a time when the outlook for European banks is as negative as the analysts paint it, I am tempted to ask whether it would not come close to a violation of the duty of care which directors have under corporate law for them not to concern themselves with the challenges their firms are facing and simply monitor management conduct.

As to whether an NED is uniquely qualified to advise, maybe we can leave it that they are surely no less qualified to opine on how to preserve customer trust, what consumers want, what to do with the branch network or what the right strategy on digitalization is than the bank's executives or its supervisors. With the market and society changing as fast as they are, the traditional information advantage insiders held concerning the market is dwindling fast. And the perspective from the outside the NED can bring is surely of considerable value.

An interesting study by McKinsey, entitled "Tapping the strategic potential of boards", McKinsey Quarterly, February 2013, notes that most directors realize they should spend more time on strategy, not merely reviewing management plans, but actually debating it. Their input can help de-bias management's approach and help broaden their thinking.

Thus, from a corporate law point of view, the boards of large EU financial institutions are well on the way to implementing what is widely considered as best corporate governance practice, in the process overcoming many of the arguments initially raised against their active engagement in strategic matters. However, their priorities still risk being tipped away from strategy back towards monitoring compliance by the perceived preferences of their supervisors.

The regulatory/supervisory dimension

While I sympathize greatly with the task supervisors and regulators have with respect to complex financial institutions, and see the logic of recruiting NEDs to help, I think that a crisper

distinction between what can most profitably be put on to their plates and what supervisors should do themselves could benefit both sides. It could be useful in this respect to contrast between, for example, risk management and culture and between risk models and business models. All four are matters of extreme concern to supervisors and boards, but there is a complementarity as to what each group can bring to the table which I believe speaks in favor of a different emphasis to responsibility in each case.

With respect to risk management, it seems to me that the supervisor brings a much broader range of knowledge stemming from seeing how other similarly situated institutions are dealing with similar instruments and risks, than what directors of an institution have. Looking in from the outside, supervisors are in a better position than insiders or NEDs to spot anomalies in risk or valuation metrics, given the fundamental similarities of the financial instruments and financial institutions involved. Based on this knowledge, are they not in a superior position to question management and challenge their assumptions as to the riskiness of an asset or a concentration of risks, and to suggest or prescribe alternative approaches? The activities of JP Morgan's "London whale" strike me as an interesting example. Who, of NEDs or bank supervisors, is better equipped to evaluate the riskiness of a complex set of derivative trades?

Contrast that with culture, where supervisors can measure what comes out at the end of the process in terms of misconduct, and yet feel ill-equipped to prescribe a particular culture to a particular institution and design the procedures to be followed to implement it. This was brought home to me in the course of a panel I moderated in November 2015 on the topic of "Getting the Culture and the Ethics Right, Towards a New Age of Responsibility in Banking" at the Institute for Law and Finance at Goethe University in Frankfurt where I teach. With me on the panel were a member of the Executive Board of the Deutsche Bundesbank and a Vice President of the Federal Reserve Bank of New York, both of whom championed the importance of culture, an issue the New York Fed had been focusing on for several years already. But both were clearly uncomfortable with

being prescriptive with financial institutions on how to create and sustain a particular culture.

I thus think that an obvious division of labor suggests itself here. Each area is important, but one party is better equipped than the other to handle it. This does not imply that boards can or should rely on supervisors to filter out risky strategies or that supervisors can rely solely on boards to deal with culture, but that each should focus more of their limited store of resources and bandwidth in the areas in which they can be most effective. With respect to risk, the board's role should be primarily to ensure that proper procedures are in place to measure and set risk parameters, but not to examine each risk or even to set the "risk appetite" of the institution. The latter should be set by management and policed by supervisors. Boards cannot and should not dodge their responsibilities with respect to ensuring that there is an appropriate risk management system, but they should resist pressure to "get into the weeds," which would expand their monitoring duties beyond what they traditionally are under corporate law. This is particularly so to the extent that in setting "risk appetite" they are expected to consider the knock-on effects any risks taken by their firm might have on other firms or on financial stability overall. That sort of evaluation of macroeconomic dimensions of risks taken by a single firm clearly belongs in the realm of the supervisor. We should also recognize the limitations on the results their increased involvement could bring. There is little empirical evidence evaluating the effectiveness of the degree of board independence on large bank risks. The one study of which I am aware, by Francesco Valscas, Sabur Mollah and Kevin Keasey of the University of Leeds, entitled "Does the impact of board independence on large bank risks change after the global financial crisis?" appeared in June 2017 in the *Journal of Corporate Finance* and concluded that the only correlation they could find held only for banks which had been bailed out during the crisis and that in most large international banks the degree of board independence did not influence risk. The lead author is quoted by the *Financial Times* and other publications as stating that the key impact of their findings "is that we need

to rely primarily on the role of regulation rather than the role of governance” to control risk taking.

With respect to culture, in recent years operational risk, a broad field which covers both systems and individuals which do not perform as expected, has passed NOLs as a source of reserves taken and losses booked for many banks and behind operational risk often stand cultural issues. In fact, a participant in the Salzburg Session 582, a former president of BP America, stated “I have never worked on a crisis where the fundamental problem wasn’t culture.” A recent item in the ECB’s November 2019 Financial Stability Review estimates that past misconduct by banks has weighed on global profitability and equity positions of banks over the last decade, with the related costs amounting to over USD 350 billion or 15% of total bank equity and that while US banks were particularly hard hit in the immediate aftermath of the crisis, since 2015 European banks have been more exposed.

On culture itself, much has been written about what conduct should be promoted or censured, and of course each institution will have its own particular culture, but it seems to me that three simple goals are a good starting point. First: we do not break either the letter or the spirit of the law; second: we do not take advantage of our information asymmetry vis-à-vis our customers; and third: we recognize our social contract with society. This last point brings us back to the third dimension mentioned at the beginning of this article, but before turning to that theme, a few words concerning a recurring pattern which leads to employee misconduct, which is common to the TSB, Wells Fargo and VW cases. In all three, pressure was put on employees to produce results which were either technically or humanly beyond the norm and little attention was paid to how those results were achieved or even if they were possible to achieve. VW’s CEO allegedly said “geht nicht, gibt’s nicht”, roughly translated as “impossible doesn’t exist”. Employees were made to understand that goals in each case were there to be met, not missed, regardless of whether they were realistic (and in the case of Wells Fargo, management knew that in many cases they

were not), and regardless of the collateral damage incurred. In all three cases that damage was considerable. The IT failure at TSB resulted in what the independent counsel's report characterized as "a complete demolition of trust" and in TSB paying out GBP 370 million in compensation. In the case of VW, "Dieselgate" undercut a key competitive advantage for the company, that of the "made in Germany" brand, as well as resulting in total costs of \$30 billion, and counting. In Wells Fargo's case, it is clear that the problem was a cultural one, of how the "Community Bank" in which the misconduct occurred, saw itself, which was a sales organization and not a service oriented financial institution devoted to furthering its customers' interests. This justified the high pressure tactics on employees to open new accounts (Wells Fargo Report, p.7). Wells Fargo had a metric which recorded when and to what level the new accounts were funded, the Rolling Funding Rate, which declined regularly as sales efforts increased, so that anyone who cared to look could have understood the game. Three years later the first's results are still being weighted down by additional charges for legal costs.

Another area which presents challenges to supervisors similar to culture is the business model, which I would distinguish from risk models. With business models, supervisors can judge what comes out in the way of losses, but are reluctant for a variety of reasons to be prescriptive with respect to imposing a business model on a given institution. For one, a single business model would lead to a monoculture among banks, both reducing the variety of services and products available to customers and tending to increase correlation of risks among banks which can be expected to make them more vulnerable to the same shocks. For another, especially in the current atmosphere of rapid change, no one can be sure what the right business model really is, beyond a certain number of platitudes concerning customer centricity, the need to digitalize and better use available client data without betraying their trust. Changes in prudential regulation designed to make banks more resilient are already accused of causing banks to adopt worryingly similar funding strategies and balance sheet structures, so that supervisors wisely

refrain from going further than evaluating the strengths and weaknesses of different business models without pushing banks in one direction or another. See, e.g. Strategic Review of Retail Banking Business Models, Financial Conduct Authority Final Report, December 2018, which evaluated, but did not choose among, various available business models. Here too the board and especially its non-execs, can contribute an important perspective as the banks are left to work out their own business models, in comparison to the more modest role I would see them playing in evaluating their banks' risk models. There is some encouraging evidence that some supervisors are placing increasing emphasis on the importance of board involvement in defining and evaluating the business model. The difference between the traditional term strategy and the more modern term business model may be more a matter of semantics than of substance. To the extent this is so, the shift of emphasis I am advocating and the emerging supervisory trend may be converging.

The social dimension

Evolving even more quickly than the demands of the regulatory/supervisory dimension are those of the social dimension. As Mark Carney, Governor of the Bank of England put in Remarks to the Banking Standards Board Panel "Worthy of Trust? Law, ethics and culture in banking" (March 21, 2018), "[a]n industry the scale and importance of finance needs social capital as well as economic capital. It requires the consent of society in order to operate, innovate and grow". All corporations benefit from privileges granted to them by society, whether it is limited liability, unlimited life, special tax regimes and, in some cases, a limited legal monopoly on certain activities. But financial institutions benefit from additional privileges, including, in normal times, deposit insurance to encourage the public to deposit funds with them and access to a lender of last resort to provide liquidity to help them stave off runs. In exceptional times, "bail outs" have been added to that menu. In exchange for

these privileges, society feels entitled to require a certain level of conduct. The exact nature of the conduct expected has varied over time. At one point, simply making money was viewed as sufficient. Since the Financial Crisis the requirements have changed, to include environmental, social and corporate governance concerns, factors important in measuring the sustainability and societal impact of corporations, and the basis for public trust in corporations has also changed.

The 2019 edition of the Edelman Trust Barometer confirms that financial services remain the least trusted sector, 21 points below technology, 11 points below entertainment and even 8 points below consumer packaged goods. And while trust in banks is increasing in 15 of 26 markets, the sector is not trusted in many European Union countries, including Germany, Italy, Spain, Ireland and the Netherlands. It barely makes it into the neutral range in the UK. And while the sector has made progress among the informed public, the trust gap widens between the informed and the mass public, and has continued to widen. For an industry whose stock in trade has always been trust, these are alarming numbers. More startling yet are the public's expectations of leadership from financial institutions, not just on matters such as customer experience, in leading on creating and using emerging technologies but also on social issues and making the world a better place for everyone, including addressing income inequality. The public appears to believe that "profits are not an excuse" not to take action to improve economic and social conditions.

These are also attitudes finding increasing resonance in official publications. As an example, the OECD Business and Finance Outlook 2019, entitled "Strengthening Trust in Business" deals with the concept of "wrongdoing before the law or public opinion", without distinguishing between the law and public opinion, as a significant element in restoring or continuing to damage trust in business and finance, which it finds is once again at the front of mind for political and business leaders alike. The report cites the OECD's 2017 definition of trust as requiring that persons "operate consistently with

a set of values that reflect citizens' expectations of integrity and fairness." In the 2019 report the OECD defines the basis of societal trust more clearly as resting "upon expectations that these activities will contribute to sustainable and inclusive economic growth; will not lead to imposition of losses on society through excessive risk-taking; and will be aligned with broader societal values related to environmental, social and labor, among other issues.

In 2018 the consulting firm Accenture took a crack at trying to put a dollar and cents value on what it termed "trust incidents". Accenture strategy, *The Bottom Line on Trust* (2018). They concluded banks were most susceptible to losses of revenue and EBITDA as a result of such incidents, with a negative impact on revenues of 21.8%, as compared to a global average of 5.8%. In an anonymized case of a "B2B Company" named in money laundering allegations it showed a decline in revenue from 2016 to 2017 of a third and a decline in EBITDA of over 60%.

This also strikes me as an area where NEDs can and should play a role and where their input would be more valuable than in detailed monitoring of compliance. With trust being the foundation of banking business, what could be a more important focus of attention for NEDs?

Conclusion

NEDs have a crucial role to play in the governance of their enterprises, but they are part-timers with limited time and attention to devote to this important role. It thus is incumbent on their enterprises to use this precious resource wisely, by focusing their attention on the areas of the business decisions where they can contribute the most. In this time of rapid and disruptive change, I suggest that these areas include in particular strategy and culture. To the extent that the expectations of supervisors run counter to this focus, I would suggest that a rethink of priorities is in order at the supervisory level as well. However, there is encouraging evidence that movement is already taking

place in this direction, in that some supervisors are increasingly emphasizing the importance of board involvement in defining the business model of their institutions, the point at which risk management and strategy come together.

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Daniela Weber-Rey
*Restoring trust - on purpose and societal
responsibility**

The financial markets crisis: improve business, confine risk

Ten years ago we experienced a severe shock. The financial markets crisis jumbled the banking sector upside down, the subsequent crises turned around sovereign debt, and the Eurozone came under challenge – the consequences will impact an entire generation and may well have contributed to the nationalist movements in a number of countries. In any event, these crises have led to a deep loss of trust in the banking sector and in business more generally. All political and public authorities, think-tanks, institutions of all type and academia in many fields have spent time thinking about ways to improve our business environment, to confine risks, and to create more responsibility amongst the leaders and senior management in the financial sector and beyond.

Corporate governance: regulation and controls

The starting point was the view that there may have been many causes for the financial markets crisis, but that it would

* This article has been published in early 2019 in the British Academy Review in a shorter version: Daniela Weber-Rey, 'Lost in detail: setting priorities for corporations in challenging times', *British Academy Review*, 34, 14-18; <https://www.thebritishacademy.ac.uk/publications/british-academy-review/34/lost-in-detail-setting-priorities-for-corporations-in-challenging-times>. It has now been updated.

not have developed in such a rampant manner if the corporate governance of financial institutions globally had been better. Corporate governance deals with relationships (amongst the corporate bodies of a company) and structures (setting objectives and monitoring the company's performance). We have been working all over the Western world – in particular in Europe – to improve and strengthen corporate governance rules for over 10 years now. We have built controls over controls over controls. Clearly there is now regulatory fatigue. It is questionable whether all these efforts to achieve more quality in company decision-making, accountability and controls have really improved our corporate governance. Have we overdone it, created too much complexity, lost the compass for clear principles on the way? Have we really been able to reduce risk for the companies, the financial sector or our economies as a whole? We have definitely reduced the systemic risk in the financial sector by demanding more capital, better liquidity, less leverage (i.e. use of debt), better risk control and compliance management. But we do not seem to have created a better sense of responsibility. We haven't found a way to hold senior executives to account. We have improved our corporate governance frameworks, but we haven't got to the core of it, as we haven't been able to restore the trust of our people in business and finance.

Sustainability: long-term profitability and reporting

In the area of corporate social responsibility (CSR) a different effort has been made to create sustainable business models throughout Europe. An EU Directive of 2014¹, which the 28 EU Member States transposed into their own national legislation

1. EU Directive on the disclosure of non-financial and diversity information, 2014/95/EU; see also Guidelines on non-financial reporting (methodology for reporting non-financial information) from the EU Commission, 2017/C215/01.

by December 2016, provides for much more transparency on four core issues through obligatory reporting by certain large (mainly listed) companies and financial institutions: environmental, social and employee matters, respect for human rights, and anti-corruption and bribery matters.

These are valuable efforts and we shall see what impact they will have. The CSR-reporting – so-called non-financial reporting – will help contain risk and prepare for challenges, and it may contribute to companies better recognising their moral responsibility. But reporting obligations on such CSR aspects have been established irrespective of the business model of a company. They come *post facto*. It does not force the governing bodies of a company to look at their objectives in order to avoid – from the outset, and intrinsically – any particular activity or approach in how it does business, how it deals with its employees, its customers and others, and how it makes the business model in itself sustainable. The concern is that this reporting on CSR aspects will remain a tick-box effort, not really enough to shake up companies and force them to take a new look at the way they do business.

About culture, integrity, values and purpose to (re)build trust

The search is therefore still on for another approach that does not create ever more rules, recommendations and complexity in corporate governance, and that goes beyond mere transparency. It is clear that the regulatory efforts of recent years have not been sufficient to build trust – to change corporate culture effectively such that trust can be rebuilt in society at large. The heavy regulation with an uncertain outcome has led many countries to take a step back and to look at different issues. Particularly in the regulatory environment of the financial sector there has been a lot of reference to culture – cultural change as the way to improve governance, culture as a topic to be taken actively care of by management and boards, culture as an indicator of understanding corporate behaviour.

The UK Institute of Business Ethics, just as one example, published in March 2018 an entire Board Briefing on the topic 'Culture Indicators – understanding corporate behaviour' (author Peter Montagnon), which clearly shows that we are not there yet. Means to improve culture (and to supervise improvement) are still in the making, far from reality in many cases. Its Executive Summary also states clearly:

The starting point is that there can be no effective oversight of corporate culture unless boards have first set and promulgated a statement of values and purpose against which expected behaviour can be defined and measured.

UK: building trust with society as a whole

When the new UK Corporate Governance Code was introduced in July 2018 by the Financial Reporting Council (FRC), its Chairman Sir Win Bischoff said:

... the new Code considers economic and social issues... and with its overarching theme of trust, is paramount in promoting transparency and integrity in business for society as a whole.

Or according to the aforementioned Board Briefing of the Institute of Business Ethics:

Values also matter because they shape the relationships between the company and society as a whole, from which it derives its licence to operate. [Chapter 2]

Even though the 2004 OECD (first issue of the) 'Principles of Corporate Governance' already referred to business ethics and societal interests, for many years the call seems to have been for clear-cut rules of a more technical nature. Now, however, a fuller picture is sought. The business community, academia and regulators alike are looking beyond the detailed rules and

seeking to define the companies' licence to operate as granted by authorities and society. As the Introduction to the new UK Corporate Governance Code words it:

Companies do not exist in isolation. Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity.

As a consequence, Principle 1 B states:

The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.

Integrity, values and culture are presented as underpinning how a company will serve society as a whole.

France: purpose and 'la raison d'être'

While the debate about a company's purpose and its role in society was going on in the UK, Emmanuel Macron, the French President, launched a similar public debate. Business associations provided considerable push-back when ideas were first aired about requesting companies to define in the articles their '*raison d'être*', their right to exist. This approach goes well beyond the purpose of a company. It immediately links purpose with societal aspects and the so-called licence to operate. Whereas the purpose is something aimed for, a goal, the '*raison d'être*' is more far-reaching and suggests that a company would be deprived of its right to exist if not complied with.

It is not surprising that a somewhat softer approach was ultimately chosen in France. First, the French Corporate Governance Code produced and revised by the employers' associations AFEP and MEDEF was changed to incorporate a reference to social and environmental aspects in its June 2018 version, which has now been published. There has long been a general

emphasis in a number of recommendations on acting always in the corporate (best) interest. The corporate interest is well defined in French law. The Code now covers more so-called social and environmental aspects, responsibilities and risk controls, to promote long-term value creation by the company. It should be mentioned that an earlier draft of the new Code version (26 February 2018) covered in Recommendation 1.4 not only social and environmental but also *societal dimensions* which were to be considered for value-creation and corporate purpose. But *this aspect was dropped after the consultation phase* – French business was not quite ready to take this extra step.

However, for some years there has existed a helpful recommendation in the French Code which brings the French ‘corporate purpose’ (*‘objet social’*) very close to the understanding of purpose as described above. Recommendation 5.2, para 2 reads:

The Board of Directors must respect the specific competence of the shareholders’ meeting if the transaction that it is proposing is such as to modify, in fact or in law, the corporate purpose, which is the very basis of the contract founding the corporation.

And yet, the French president and government clearly took the view that more needed to be done, that a *higher purpose needed to be determined to re-establish trust in business*.

Therefore, the French Minister of Economy and Finance, Bruno Le Maire, presented the draft law – ‘PACTE’ –, which was adopted by the National Assembly on 9 October 2018, for sign-off by the Senate. After quite a bit of back and fro between the National Assembly and the Senate, the law PACTE, the ‘Action Plan for Business Growth and Transformation’², is finally voted upon by the National Assembly on 11 April 2019. On 16 May 2019 the Constitutional Court confirms the essentials of the law PACTE, then dated 22 May 2019. It was a difficult birth.

2. In French: ‘Plan d’Action pour la Croissance et la Transformation des Entreprises’; the law PACTE in French: Loi relative à la Croissance et la Transformation des Entreprises

The law PACTE has a clear aim, which is to create ‘liberated companies that are better funded, more innovative and fairer’. Under the heading ‘Fairer Companies’, the French Government states:

Companies do more than simply seek to make a profit. The PACTE will modify the Civil Code in order to assert their social and environmental role and provide them with a true raison d'être. [Government homepage]

The challenge of ‘rethinking the role companies play in society’ was amongst the core topics at the start of the debate in France. Placing companies back in the centre of society by way of ‘far-reaching reform of the philosophy behind business practices’ (President Macron on 15 October 2017) is indeed reaching high. On 11 December 2017 Nicolas Hulot, the (former) French Minister of Ecological and Inclusive Transition, had affirmed that he wanted

to evolve corporate purpose, which can no longer be simply profit-centered,... [but] will ensure that the principles and values of this social and solidarity economy, this pioneering economy, the one that lends a hand, the one that shares, the one that prefers cooperation to competition, now becomes the norm and no longer the exception.

Redefining the corporation and its ultimate purpose is considered by many in France to be *the most ambitious and innovative approach to governance for decades*. The notion of the societal interest of a corporation, protecting the primary interest of the corporation and society as a whole, leads to many tensions with employers’ associations and company representatives. The concern was, in a nutshell, that this approach would create a competitive disadvantage for French companies, make them dependent on environmental activists, lead to multiple disputes, and so on. But a number of CEOs of CAC40 companies (the large listed companies in France) and financial institutions agreed with the approach and called for a change of

mindset in pursuit of the general interest (e.g. Antoine Frérot, Veolia; Emmanuel Faber, Danone; Pascal Demurger, MAIF). One of the leading French newspapers, *Le Monde*, headlined 'Better consideration for the general interest could be a major competitive advantage'.

After intense debate, the draft presented and voted on in a first procedural step still has the ambition to anchor the societal interest of a corporation in the French Civil and the Commercial Code and to incite companies to reflect on their '*raison d'être*'. While the 'social interest' is to be hard law, a softer solution, an option, is introduced for the '*raison d'être*'. The Civil Code is to be changed such that companies have the possibility – not the obligation – to incorporate their *raison d'être* into their statute. The expectation is that such an option will entice companies to be more oriented to the long term. Under the heading 'Raison d'être' in the 962-page document detailing the proposals of the PACTE and covering the impact study, a full page (p. 547/8) deals with the '*raison d'être*', as opposed to the '*objet social*' (corporate purpose) on the one hand and the '*intérêt social*' (corporate interest) on the other hand. The consequences of non-adherence to the '*raison d'être*' (right to exist) are meant to touch in particular on the relationship between the executives and shareholders. Some take the view that the shareholders should be able to hold management to account and ultimately revoke their appointment. In all likelihood, however, there will not be an immediate increase in responsibility. The aim is to raise the visibility of the foundational basis of certain aspects of the company's activities. A violation should correspond to a breach of the statute, which is supposed to give judges the possibility to consider the violation of the *raison d'être* as an element of causality in any claim for damages. This seems to widen considerably the discretion of judges to hold executives to account. To be seen what will really follow.

It will be very interesting to see whether this novel attempt to incorporate the idea of a higher purpose, a '*raison d'être*', into French law will succeed – far-reaching even in its boiled-down

version. It is an approach that is without detailed regulation, is more inward-looking, and is in the hands of the company and its shareholders (and the judges), thereby possibly reaching deeper to the core of how to rebuild trust.

Germany: corporate purpose and societal responsibility

German Corporate Law knows three concepts.

The *company objective* details what a company is allowed to be active in, as decided by its shareholders (*‘Unternehmensgegenstand’*). In case of changes, a formal change of the statutes is necessary.

The *corporate purpose* (*‘Gesellschaftszweck’*) – which is often confused with its objective, and is not defined in such a formal manner – may be wider than the objective: the objective may serve as the means to reach the purpose. It is usually to gain profit (and special rules apply if no profit is intended), otherwise all but illegal goals can be pursued, including idealistic goals, with special rules applying to regulated industries (e.g. the financial sector).

And the *company interest* (*‘Unternehmensinteresse’*) provides the behavioural rules for the legal representatives – management and board – and the basis for their responsibility and liability. Germany follows a stakeholder approach, which means that the company interest needs to take into account not only the interests of the company itself and its shareholders but also the interest of other stakeholders, in particular the employees.

The ‘company interest’ is not defined in law, but the German Corporate Governance Code makes reference to it. The Code is developed and adapted periodically by a Commission instituted by the Ministry of Justice. It highlights the ‘company interest’ by including reference to it as a core responsibility for the management in Germany’s dual board system, the *‘Vorstand’*. Since 2009 the Code also contains a definition of the ‘company interest’, translating the German term with ‘the company’s best interests’ in its preamble (para 4):

The Code highlights the obligation of the Management and Supervisory Boards to ensure the continued existence of the company and its sustainable value creation in line with the principles of the social market economy (the company's best interests).

This amendment occurred in light of the clear findings after the Lehman collapse in 2007 and the ensuing financial markets crisis that the obligations of top management and board members needed to be strengthened. The two aspects particularly referred to in relation to a company's continued existence and value creation are sustainability and the principles of the (German) social market economy. Many of the discussions now being held in France and the UK were already part of the common thinking in Germany, in particular stakeholder value, sustainability and social aspects. It should be acknowledged, though, that the corporate interest as understood in France (*'intérêt social'*) with the goal of economic viability and sustainability, serving as a measure also e.g. for responsibility and liability of management, is not so dissimilar to the German understanding.

To strengthen further the aspect of ethical behaviour on top of legality, the concept of *'Ehrbare Kaufmann'* (reputable business person) was introduced into the German Code in 2017. This concept is not well known in Europe and refers to ideals of the Hanseatic business world.

The German Code has been undergoing in 2018 and 2019 a complete restructuring and streamlining, while without any intent to change the recommendations massively. The intention is to modernise the structure, make it more business-like and less legalistic. At the same time, the recommendations on 'independence' of (supervisory) board members and remuneration of executives / (management) board members are being completely overhauled in an effort to take account of recent developments (e.g. the revised EU Shareholder Rights' Directive, EU Directive 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement) and the perceived necessity to create more transparency and less possibilities to back out. Since the first draft version which was

presented for public consultation by the end of 2018, the preamble is extended to cover also for the first time social, environmental and (in particular) societal responsibilities of a company:

The company and its responsible bodies have to take account in their actions of the role of the company in society and to reflect on their societal responsibility. Social and environmental factors influence the company's business success. In the interest of the company, the 'Vorstand' and the 'Aufsichtsrat' [management and supervisory boards] ascertain that the potential consequences of these factors on the company strategy and operational decisions are recognised and addressed.³

This first draft also linked in its notes the principle of societal responsibility to management (*Vorstand*) remuneration, which gives it a special kick.

The German Government Commission for the Code has presented a second draft after consultation and the revised Code was finally voted on in December 2019. It is to be published after review by the Ministry of Justice in early 2020.

While this is a different approach compared to the French '*raison d'être*', it wishes to achieve the same goal: to create more responsible companies in which society can again place trust.

A common goal – and further efforts

It is clear that in the UK, France and Germany, as indeed in all of Europe, there is a general view that more needs to be done to restore trust in business and finance. Each country is

3. The German text reads: 'Das Unternehmen und seine Organe haben sich in ihrem Handeln der Rolle des Unternehmens in der Gesellschaft und ihrer gesellschaftlichen Verantwortung bewusst zu sein. Sozial- und Umweltfaktoren beeinflussen den Unternehmenserfolg. Im Interesse des Unternehmens stellen Vorstand und Aufsichtsrat sicher, dass die potentiellen Auswirkungen dieser Faktoren auf die Unternehmensstrategie und operative Entscheidungen erkannt und adressiert werden.'

attempting its own approach. The route chosen may be different in each case, but it is running in parallel and with the same goal. Whether one or the other approach will be more successful in rebuilding trust in finance and business remains to be seen. Cultural change to rebuild trust is in any event a long road with no immediately visible success.

There are further attempts to rebuild trust in particular in Britain and the US, coming from very different ends:

The US Business Roundtable, which has issued since 1978 periodically Principles of Corporate Governance, released on 19 August 2019 a new Statement on the Purpose of a Corporation. It is signed by 181 CEOs, who commit to lead their companies for the benefit of all stakeholders - customers, employees, suppliers, communities and shareholders. The Roundtable redefines the purpose of corporations to promote 'an economy that serves all Americans'. This effort needs to be welcome and clearly takes a similar direction as the European efforts. It is to be seen whether it has any real effect and is not just a marketing approach.

The British Academy pursues since late 2016 an ambitious programme of research on 'The Future of the Corporation', which may well have an impact on the parallel efforts in some of the leading European countries, thereby assisting public policy in Europe to find novel ways forward for the corporation of the 21st century. This programme is the most comprehensive attempt to provide a reconceptualisation of the corporation around purpose. Research by the British Academy proposes a new formula for corporate purpose: "*the purpose of business is to profitably solve problems of people and planet, and not profit from causing problems.*" Commitment to purpose creates reciprocal benefits for the corporation, its stakeholders and society - according to the British Academy programme. The new 'The Future of the Corporation' report by the British Academy, published on 27 November 2019, sets out eight principles to guide lawmakers and business leaders in re-organising business around purpose and contributing to solving social, political and environmental challenges. The first of these principles is:

Corporate law should place purpose at the heart of the corporation and require directors to state their purposes and demonstrate commitment to them.

Find out more about the The Future of the Corporation: <https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business>

In all the approaches referred to in this article, the need for a role of corporations in society, to rebuild trust in business and to improve the impact of business on the environment, inequality and social cohesion, is sought by different means. All approaches appeal rather to values, culture and integrity than mere regulation. Hopefully, one or the other manner chosen will show to society at large that there is a commitment to trustworthiness and companies have a well-defined and aligned purpose such that profit is a product of the corporate purpose, not the corporate purpose itself.

Davide Taliente

How multinational corporations can thrive in the new world order

Introduction

Recent political and societal developments in Western societies have created a backlash against a prevailing world order that for nearly three decades has favoured globalisation and free movement of trade, capital, innovation, and people. That world order, sometimes referred to as the “Washington Consensus,” provided a fertile environment in which multinational corporations (MNCs) prospered and thrived, with rates of shareholder value creation and growth well in excess of more domestic-based business models. The new political and regulatory era that we are entering is likely to challenge the economics, governance, and business models of established MNCs. This Point-of-View examines the new challenges that MNCs are facing and suggests how multinationals will need to evolve to respond to these developments.

The old economic order – a fertile environment for the prosperity of multinational corporations

Historians have observed that the past few decades represent, in a sense, a replay of the first great era globalisation, which flourished briefly towards the end of the nineteenth century. Relative levels of international trade, capital flows, and immigration achieved by the end of the nineteenth century were only

re-attained in the 1960-1970s.¹ The revolutions in the first half of the nineteenth century against a decaying aristocracy laid the foundation for momentous changes at the end of the century: the emergence of new global powers (Germany, US); an enthusiastic embrace of state activism and welfare policies (Bismarck in Prussia, the Fabians in the UK); global expansionism and colonisation into Africa, Asia, and Latin America; global capital mobility under the gold standard; and, last but not least, the coming of age of the joint stock, limited liability corporation that facilitated new financing and risk-taking for long-term investments and infrastructure financing. This first wave of globalisation planted the seeds for some of the MNCs that continue to thrive today².

Similarly, the past three decades (beginning with the fall of the Berlin Wall) have witnessed an acceleration of globalisation, as measured by international capital, trade, and human capital flows³ International collaboration and global trade deals have also greatly benefitted Asian economies, most notably in the case of China, which has seen itself rise to rank of the world's second largest economy.

MNCs benefited greatly during this period: Their business models were suited to spreading innovation globally, accessing diverse pools of human capital, leveraging lower costs of production, and tapping into various sources of finance. According to *The Economist*, MNCs account for 2 percent of global employment, but own or orchestrate the supply chains that account for 50 percent of world trade, account for 40 percent of the value of the West's stock markets, and the majority of the world's intellectual property⁴.

1. Nicholas Crafts, "Globalisation and growth in the twentieth century", International Monetary Fund Working Paper No. 00/44 (Mar. 2000)

2. Examples of such MNCs include Colgate-Palmolive, Continental, DuPont, Exxon, General Electric, JPMorgan, Procter & Gamble, Rio Tinto, Tata, Siemens, BASF

3. United Nations, "Development and Globalization: Facts and Figures 2012", UNCTAD, April 2012

4. Briefing: "Multinationals, The retreat of the global company", *The Economist*, January 28 2017

We looked at the comparative performance of a list of 50 MNC “Titans” that are recognised leaders in their industries, have truly global business models, and generate a significant share of their revenues outside their home markets⁵ Our analysis clearly reveals that the years between 1990 and 2015 have been favourable to shareholders and employees of MNCs, both in absolute terms and relative to any other index of corporate performance:

A. Shareholder value has grown at three times the rate of the average publicly traded company

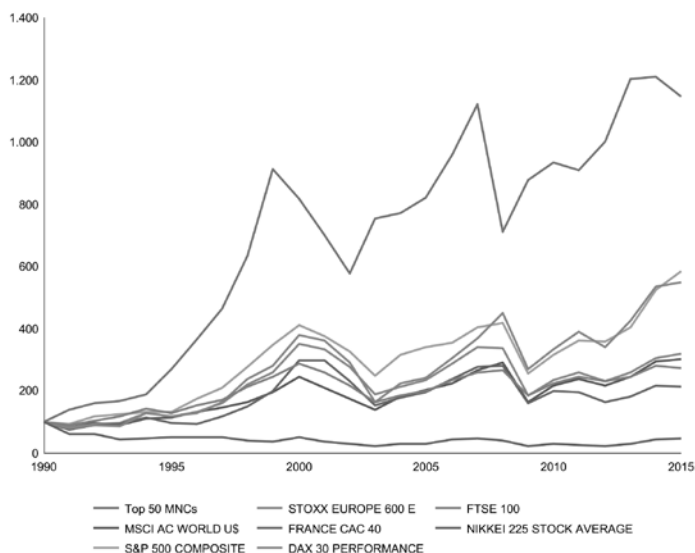
The market capitalisation of the Titans has grown more than three times faster than the MSCI All Country World Index (MSCI ACWI), and at an even faster rate compared to most of the major national indices, as summarised in the chart below.

Over this time period, MNC global “footprints” significantly outpaced economic growth. Whereas world GDP grew at a 4.8 percent rate annually, the Titans on average grew revenues and assets at 5.4 percent and 7.0 percent, respectively.

Key drivers have been the ability to exploit successful business models, investments in brands, and innovations internationally: MNCs mainly originated as companies that were able to excel in their local markets. Low trade barriers, high capital mobility, and a broadly laissez-faire approach to competition policy enabled the replication of successful business models, strong brands, and innovations internationally. This approach has been particularly successful in retail branded products (such as L’Oreal, Nike, and Starbucks), technology (such as Apple and Microsoft), R&D-intensive businesses (such as oil and gas,

5. For the purpose of this paper, we have defined a multinational corporation as a firm that has significant operations in at least three of the four regions (North America, European Union, Asia, and the Rest of World), with at least 15 percent of total revenues coming from two of the three areas external to the domicile area of the MNC. (Please see Appendix for our selection criteria and the list of companies.)

Fig. 1 - *Market cap growth of Top 50 MNCs vs. global and national indices (base 100 in 1990)*



pharmaceuticals, and automobiles), and service industries (such as Sodexo and Marsh McLennan). Investors bought into the economies of scale and scope argument, which sustained the tailwinds for MNC share prices.

B. Operational gearing has been about 30 percent higher for MNCs than for the average more domestic competitor

We compared the profitability of the Titans to a large sample of about 3,500 more domestic-oriented competitors over the same time period. Our analysis shows that Titans' earnings before tax (EBT) was on average 8.5 percent of their revenues vs. 6.6 percent for the group of other companies. In other words – to put this simplistically - if the average competitors were generating a return on capital of 10 to 12 percent, the Titans

were generating 13 to 15 percent, assuming the same capital requirements, a finding that goes towards explaining the shareholder value conclusions in (A) above.

Key driver has been the ability to optimise production costs:

MNCs have benefited from wide disparities in labour costs and skills across countries: Global production models allowed concentration of labour in countries with comparative advantages in terms of skills or labour cost (or both). Indeed, recent analysis of global inequality suggests that this is observable in the comparative stagnation of incomes for lower-paid workers in the developed economies, while incomes in developing economies and higher-paid workers in developed economies have risen.⁶ In addition to advantaged labour costs, MNCs have enjoyed relatively favourable cost of funding in bond and bank finance, largely due to investors' preference for diversification and size. Moreover, MNCs have selectively been able to benefit from favourable financing from countries seeking foreign investments to create employment, or simply favourable tax or planning treatments. This has enabled MNCs to enjoy stronger operational gearing than more domestic competitors, particularly in "dematerialised" businesses (such as technology, telecommunications, media and entertainment, and banking).

C. Tax optimisation led to lower contributions than "headline" corporate taxes

We examined the tax paid (in the aggregate) by the Titans, and compared that to the standard corporate tax rate in their home country. Across the home countries for the Titans, the official corporate tax rate averaged about 34.3 percent between 2010 and 2015. During the same time period, the effective tax paid by the Titans (as a percentage of earnings before taxes)

6. Christoph Lakner and Branko Milanovic, "Global Income Distribution: From the Fall of the Berlin Wall to the Great", World Bank Policy Research Working Paper, Dec. 2013

amounted to an average of about 28.4 percent, while the sample of domestic-based competitors paid a tax rate closer to the official tax rates.

Key driver has been the ability to optimise taxes and capital returns: Tax policies vary between countries, and lateral agreements between governments are not always in place. MNCs have been able to leverage their global footprint to lower their actual tax burden, while remaining in compliance with local tax laws. For example, by centralising higher value activities in the most tax-effective ways, MNCs maximise profits in countries where taxes are low and minimise them in high-tax jurisdictions.

* * *

In summary, the political consensus that drove liberalisation of markets across capital, goods, and labour - known as the Washington Consensus⁷ - was the underpinning of this great era for MNCs. MNCs thrived on global business models that could stretch financial and operational resources to the limit. Beyond rewarding shareholders and employees, MNCs have made contributions to global economic development by raising standards of living across the globe, creating employment in developing markets, and spreading innovations worldwide, as postulated by the economist Joseph Schumpeter more than a half-century ago.⁸ But MNCs have also received the attention and criticism of a new wave of populism: idiosyncratic events linked to tax avoidance, executive compensation, local market

7. The concept and term of the “Washington Consensus” was first presented by the English economist John Williamson in 1989 to summarise commonly shared policy themes by Washington-based institutions at that time. The term then developed and became commonly used to describe the general shift towards free market policies that followed the displacement of Keynesianism in the 1970s.

8. Joseph A. Schumpeter, *Capitalism, Socialism & Democracy*, London: Allen and Unwin (originally published in the USA in 1942; reprinted by Routledge, London in 1994)

infractions (environmental standards and labour laws), accounting scandals, and government bailouts have been cited by the new populists as examples of the MNCs' abuse of the system.

The new world order and implications for MNCs

The Washington Consensus was being firmly challenged as early as the mid-noughties, but in the aftermath of the 2008 financial crisis, the Consensus has now been consigned to the dustbin of history (with the exception of a few marginalised Hayekian and Friedmanite voices). The economic consensus has clearly shifted back towards a stronger role for the state in the oversight of markets and corporate behaviour. This reaction has historical precedents in many major economic and financial crises over the past 200 years. Indeed, this response is conforming to the historical pattern: An economic orthodoxy has formed that believes a) systemic markets⁹ collapse when free, a lesson drawn from the financial crisis, which is commonly attributed to deregulation, unfettered capitalism, and Anglo-Saxon neo-liberalism, and b) consumers' welfare cannot be guaranteed solely by competitive forces. As a result, multiple new government agencies have been created or strengthened (in terms of powers and resources), and regulatory intensity has increased substantially in key economic sectors. By its nature, regulation and agencies operate nationally, a fundamental challenge to the traditional MNC model.

The stage was therefore already set for a sustained push-back against free movement of capital, goods, and labour in the developed world. Our expectation is that this trend will gain more momentum, given the political agendas observed in the recent unexpected political outcomes of 2016 (including

9. "Systemic markets" are markets that are key for the good functioning of the economy and society. If those markets were disturbed, it would have great direct consequences on the overall economy (e.g. financial services, health care, transportation vs. toys manufacturing, coffee shops).

the US elections, Brexit, and the rise of anti-EU movements in Europe). An exception to this trend may be Asia, where developments following the withdrawal of the US from the Trans-Pacific Partnership (TPP) appear to point to greater intra-Asian integration.

Irrespective of Asian developments, we believe these political and regulatory pressures will depress future MNC growth and profitability, compared to the past three decades. This is already apparent: FTSE has found that the profits of the top 700 MNCs have dropped by about 25 percent in the past five years¹⁰, as has the rate of return on foreign direct investment.¹¹

We have identified five factors that will either impair the ability to replicate business models internationally or depress profitability of the MNC business model, or else both.

Table 1: Five factors impacting MNCs in the new world order

		Impact on ability to replicate business models	Impact on profitability
1	Increasing friction and costs in supply chains (employees, goods, and capital)	High negative impact	High negative impact
2	Tougher local competition	High negative impact	High negative impact
3	Growing political risk and uncertainty around foreign investments	High negative impact	Medium negative impact
4	Increasing expectations on local management and governance accountability	Medium negative impact	High negative impact
5	Increasing requirements to conform with broader societal demands	High negative impact	Medium negative impact

Medium negative impact
 High negative impact

Let us dig deeper into the five factors that we believe will have a profound impact on MNCs going forward.

10. The Economist, “The retreat of the global company”, 28 January 2017

11. OECD Statistics, FDI financial flows, data as of 21 February 2017

1. *Increasing friction and costs in supply chains*

Trade policy is veering away from an emphasis on international free trade. According to the World Trade Organisation, there has been a clear rise in the introduction of protectionist measures by the world's leading economies.¹² The G20 countries are increasing the barriers to free trade by introducing new protectionist measures, such as export restrictions on various products and new quotas and tariffs. Since 2008, these economies have introduced 1,583 new trade restricting measures and removed just 387. The restricted movement of goods is coming at a time when the mobility of people has become impaired through tougher immigration controls. The combination of friction in global mobility of goods and in labour will negatively affect the efficiency of internal supply chains (for example by limiting the sustainability of single production hubs), as well as the ability to tap into third-party supply chains as part of core MNC operations (including greater inefficiency in accessing third-party providers in supply chains due to heightened standards of adherence to labour and environmental standards).

2. *Tougher local competition*

Increasingly, countries are establishing industrial strategies, whereby specific sectors are earmarked for overt government support, favourable regulatory treatment, and/or protection from foreign acquirers. Often, this implies the designation of national champions, or national favouritism in tit-for-tat litigation, such as the one carried out by the US and EU against technology companies, banks, and car manufacturers. In addition, technology transferability has been a casualty of protectionism: Several technology players like Uber and Airbnb have found that despite strong market demand for their services, certain business models need significant local adaptation to comply with local

12. WTO OMC, Report on G20 Trade Measures, 21 June 2016

requirements, in part due to pushback from local incumbents. In a world in which even the most traditional businesses are digitalising, this will prove a growing headache by limiting the extent to which innovations can be “cut and pasted” and scaled across jurisdictions.

3. Growing political risk and uncertainty around foreign investments

At a macro level, political risk has increased, which has led to greater uncertainty in the payoff of an investment or entry into specific markets. Put simply, more markets are likely to go wrong for MNCs due to political shocks, and hence portfolio allocation decisions become more complex. As an illustration, FDI (foreign direct investment) originating from the European Union and the US dropped significantly between 2007 and 2015 (as a share of GDP, from 6.9 percent to 3.3 percent for the EU, and from 2.9 percent to 1.8 percent for the US). As a result, the political risk and crisis management insurance market is growing. MNCs are self-insuring political risk exposures: According to an annual benchmarking report, self-protection on political risk nearly doubled from 2013 to 2014.¹³

4. Increasing expectation of local management and governance accountability

In the face of environmental disasters, accounting scandals, banking failures, labour abuses, or general consumer detriment, legal processes have increasingly put the spotlight on MNCs' local management and boards for lack of sufficient oversight, risk management, and compliance. In some sectors, regulators are increasingly prescriptive in terms of expected accountability for

13. Marsh LLC, “Strong Capacity Drives Buyer’s Market for Political Risk Insurance”, Political Risk Market Update, June 2015

local management and boards, as for example in the oil-and-gas and banking industries. Therefore, subsidiaries with lean cost models that leverage global operations and control functions (finance, compliance, legal, and risk management) can expect to come under relentless pressure.

5. *Increasing requirements to conform with broader societal demands*

According to convention, firms have primarily been managed and operated in the best interests of their shareholders, and have traditionally focused on profit maximisation. Against the backdrop of diminished trust in business, increased regulatory scrutiny, and penalties for misconduct, it is unclear whether the conventional corporate model is sustainable going forward. Indeed, emerging politics and regulators are united in their request for MNCs to demonstrate greater social accountability. Requests are increasingly broad ranging, but include contributions to local communities, “ethical” or affordable products, support for specific suppliers or client segments, fair pay policy, and voluntary tax codes. It is no longer considered sufficient for an MNC merely to behave in accordance with all relevant regulation: Corporate responsibilities have taken on a greater dimension, calling for acknowledgement and discharge of obligations to society that go beyond putting customers first and delivering value to shareholders. Increasingly, MNCs are defining their strategies with consideration to a broader set of stakeholders, including customers, employees, society at large, and the environment. As an illustration, Lars Rebién Sørensen, the CEO of Novo Nordisk, crisply summed up the importance of his shift in measuring success: “In the long term, social and environmental issues become financial issues.” There is now wide acceptance that defining corporate social responsibility (CSR) primarily as charitable donations is not good enough, because it lacks relevance to the core operations of the enterprise.

In summary, MNC business models that delivered superior performance by tapping into multiple growth opportunities while keeping costs and financial resources lean are no longer well-suited to the emerging world order. If MNCs fail to adjust to the new world order, it is possible that their profitability models will revert to a series of in-country operations (but with added overhead), with capped growth. The industrial and shareholder value logic of the global MNC would be significantly impaired. Indeed, a death by a thousand cuts may not be outside the realm of possibility, should MNCs fail to respond to the challenge.

Successful MNCs in the new world order

This does not spell the end of MNCs, but it does imply that most MNCs will need to fundamentally rethink their business models and governance to fight these headwinds. In summary, business models that have stretched themselves thinly across the globe may need to be more concentrated in specific countries, achieving greater market share, scale, accountability, and resilience within each country, while benefitting from global capabilities to the extent possible. To succeed, MNCs will need to possess three key hallmarks:

1. From short-term, profit-driven shareholder value, to medium-term, full stakeholder accountability

As traditional short-term, profit maximisation efforts come under fire, the emphasis will shift towards medium-term strategies incorporating the requirements of key stakeholders, including customers, employees, the wider society, and the environment. This will mean complex trade-offs between short-term profitability and medium-term choices, as advocated by Michael Porter and Mark Kramer in 2011 in their

“Creating Shared Value.”¹⁴ Their thesis argues that in the next stage of capitalism, companies must seek a balance between the pursuit of shareholder value and the broader community of stakeholders; hence, responsible and sustainable behaviour needs to be built into the firm’s business model and become part of its core strategy. Porter and Kramer do not view this as philanthropy, but as the next key requirement for creating economic value and sustainability, going well beyond any Corporate Social Responsibility program.

There can be no universal prescription as to how social accountability can be met, as this is specific to each enterprise, the market it operates in, and the local stakeholder priorities. By definition, social accountability needs to be applied differently in each local market. It embraces responsible behaviour in a many different situations, through stronger focus on customer protection and good conduct, environmental-friendly production, transparency on tax and remuneration policies, and retraining of employees whose jobs have been made obsolete by automation.

What might “good” look like in this hallmark?

Boards must ensure that the mission of the corporation balances the conduct of its core business with its social responsibilities. Management should track how social accountability initiatives create competitive advantage through better talent retention, customer trust, and general stakeholder goodwill. Examples might include:

- Evidence of boards expecting management to deliver across a balance of financial and social accountability objectives, with management remuneration models adjusted accordingly.
- Evidence of a tailored approach to individual markets that recognises social accountability requirements of each market.

14. Michael E. Porter and Mark R. Kramer, “Creating Shared Value”, Harvard Business Review, 2011

- Evidence of strategic choices that have short-term costs, yet possess the potential for medium-term value creation. Examples could include:
 - A consumer goods company planning to halve the environmental impact of its product packaging by 2030, despite a significant short-term hit on profitability.
 - A software company hiring 700 people with autism spectrum disorder (ASD) to develop differentiation from the unique problem-solving skill set of such individuals.
- Some firms are shifting away from quarterly earnings guidance, and others are announcing “voluntary” fair tax payment based on sales in a particular country, rather than “deflated” profits due to international transfer pricing.

2. From global to glocal business and governance models

Hallmark (1) above implies more localised and tailored business models, cognisant of local contexts and regulatory requirements. Subsidiaries will need to be strengthened and granted greater autonomy and local decision-making power, which for most MNCs means pushing back against a decades-long move towards globalised organisational structures with “ambassadorial” local management and accountability. MNCs may need to evolve from a model of globally integrated enterprises, to a tightly managed federation of quasi-independent subsidiaries that are united by specific areas in which economies of scale are still possible. From an operational perspective, this may include deepening local supply chains and production processes into subsidiaries. It may be important to reconsider global supply chains and increase local sourcing where possible. Products and services may need to be tailored to local consumer behaviour and regulatory requirements, which for some firms may imply multi-brand strategies to compete more effectively in individual markets. In this model, limited but deeper country commitments may be more profitable to the MNC than a broader portfolio of shallower country commitments. With increased local accountability, knowledge of local customs and regulations becomes more important, especially

for the CEO and management of local subsidiaries. Subsidiary board members will need to dispose of a sound local experience, credibility, and regulatory knowledge.

What might “good” look like in this hallmark?

Group and subsidiary boards should ensure that corporate governance charters create sufficient accountability for local management, while ensuring that corporate headquarters fosters effective collaboration, best-practice sharing, and exchange of experiences. Compared to current MNC models, this could mean leaner headquarters and more robust subsidiaries in terms of their financial resources, skills, and operating platforms. Examples might include:

- Fewer, deeper strategic commitments to specific markets capturing higher market share, rather than shallower participation across a broad range of markets.
- Headquarters will need to be fully cognizant of political and macroeconomic developments in their countries of operation. This may call for well-staffed departments that have early insight into policy developments, and can develop a clear “foreign policy” stance to inform decisions at the global and subsidiary level.
- Full clarity will be required, relating to the accountability of headquarters versus subsidiaries, between local management and group management. Subsidiary boards and management will need to be held accountable for anti-trust, consumer detriment, risk management, compliance, and insolvency matters. This may imply more muscular subsidiary boards than is typically the case.
- Most support functions (such as finance, IT, HR, legal, compliance, and risk management) will transition from a dependency on headquarters, to a state that is tailored to the subsidiary of global standards, methodologies, approaches, and processes set by headquarters.
- Talent management models that ensure an emphasis on local talent management, compared to the traditional model of

“parachuting in” experienced individuals from other parts of the MNC network.

- Simplified and clarified legal entity structures, compared to the byzantine complexity that is typical for most MNCs.

3. Intellectual property as the new organising principle

Hallmarks 1 and 2 – if implemented in isolation – will impair profitability through a relentless build-up of resources in subsidiaries. MNCs will need to work harder to ensure that their global scope can still deliver value to shareholders. This will require greater agility in decision making at the global and local level, while preserving key elements of comparative advantage, such as spreading innovations and benefitting from global scale, particularly in investments in digital technology. We believe the new competitive high ground will be occupied by firms that can truly capture the value of intellectual property (IP). IP is the one corporate asset that cannot easily be stopped or taxed at borders. Outperformance will therefore come from organisations that can capitalise on their IP to support global innovation and agility, demonstrating the ability to renew, adapt, change quickly, and succeed in changing environments. As businesses transition into the digital world, the ability to fully capitalise on valuable IP increases: IP creation and tailoring to local social accountability requirements rely on big data techniques for insights. Clear evidence of these are firms like Airbnb, Netflix, Skype, Uber, and Zappos, which have successfully disrupted traditional businesses by ensuring that the IP embedded in their technology platforms could be scaled globally, tailored quickly to local market needs, and subsequently fine-tuned to adapt to emerging client demands, trouncing traditional competitors in the process. The traditional MNCs organisational matrix of product/region/function clearly militates against the organisational speed observed in these highly dynamic disruptors. By contrast, organisational structures for the disruptors rarely look like a traditional corporate matrix: IP concepts and clusters are more commonly the dominant organisational principle for these

firms, a fact that implies frequent organisational fine-tuning. MNCs will need to emulate IP-spreading practices and organisational principles that are found in fully digital business models to satisfy client, product, and regulatory trends and to fine-tune supply chains and production processes.

What might “good” look like in this hallmark?

- Evidence of accelerated time-to-market, faster product/service tailoring in each market, and greater process efficiency catalysed by specific IP: fast propagation of best practices, innovation, and insight across the global network, despite traditional organisational rigidities.
- Evidence of IP-centred virtual global networks or fluid organisational clustering that can get around travel and immigration restrictions: This may evolve from models with perfect division of labour, to more collaboration and working in networks that consist of multidisciplinary/multifunctional teams with greater autonomy.
- Growth in costs at local subsidiaries is offset by leaner and more flexible central costs in global functions.
- Evidence of a corporate culture that operates on the principles of “analyse, delegate, and empower”, rather than on “command and control.”
- Evidence of innovations supported by processes and structures, such as providing separate spaces where innovations can be discovered, developed, and enhanced through trial-and-error, prior to their integration into the main organisation.

* * *

In the near term, MNCs will increasingly be caught in the crossfire of the new world order. This will challenge the traditional business model that benefitted from free movement of labour, goods, and capital. MNCs can thrive in the future state of the world, but this will require a fundamental rethinking of their global footprint, business models, and governance arrangements. Inefficiencies caused by the implications of greater social

accountability and glocal business models will need to be fought hard. Critical to outperformance will be those organisational structures, processes, and tempo that capitalise on differentiating IP, producing a step change in the quality and speed of decision making in local markets and production processes.

Appendix: Technical Notes

Table: Appendix I: Definitions

<i>Term</i>	<i>Definition</i>
Multinational Company (MNC)	<i>For the purpose of this paper:</i> Company having significant operations in at least three of the four regions North America, Europe, Asia, Rest of the World with at least 15 percent of total revenues coming from two of the three regions external to its domicile area.

Table: Appendix II: List of large multinational companies used in this document ("Titans")

<i>Company name</i>	<i>Exchange: Stock symbol</i>	<i>Primary industry</i>
France		
AXA S.A.	ENXTPA:CS	Multi-line Insurance
Bouygues S.A.	ENXTPA:EN	Construction and Engineering
L'Oreal S.A.	ENXTPA:OR	Personal Products
Renault S.A.	ENXTPA:RNO	Automobile Manufacturers
Sanofi	ENXTPA:SAN	Pharmaceuticals
TOTAL S.A.	ENXTPA:FP	Integrated Oil and Gas

<i>Company name</i>	<i>Exchange: Stock symbol</i>	<i>Primary industry</i>
Germany		
Adidas AG	DB:ADS	Apparel, Accessories and Luxury Goods
Allianz SE	DB:ALV	Multi-line Insurance
BASF SE	DB:BAS	Diversified Chemicals
Bayer AG	DB:BAYN	Pharmaceuticals
Bayerische Motoren Werke AG	DB:BMW	Automobile Manufacturers
Daimler AG	XTRA:DAI	Automobile Manufacturers
SAP SE	DB:SAP	Application Software
Siemens AG	DB:SIE	Industrial Conglomerates
Volkswagen AG	XTRA:VOW3	Automobile Manufacturers
Italy		
Assicurazioni Generali S.p.A.	BIT:G	Multi-line Insurance
Japan		
Fujitsu Ltd.	TSE:6702	IT Consulting and Other Services
Honda Motor Co., Ltd.	TSE:7267	Automobile Manufacturers
Nissan Motor Co. Ltd.	TSE:7201	Automobile Manufacturers
Panasonic Corporation	TSE:6752	Consumer Electronics
Ricoh Co., Ltd.	TSE:7752	Technology Hardware, Storage and Peripherals
Sony Corp.	TSE:6758	Consumer Electronics
Toshiba Corp.	TSE:6502	Industrial Conglomerates
Toyota Motor Corp.	TSE:7203	Automobile Manufacturers

<i>Company name</i>	<i>Exchange: Stock symbol</i>	<i>Primary industry</i>
LUXEMBOURG		
ArcelorMittal	ENXTAM:MT	Steel
Netherlands		
Heineken N.V.	ENXTAM:HEIA	Brewers
SPAIN		
Repsol, S.A.	BME:REP	Integrated Oil and Gas
Switzerland		
Nestlé S.A.	SWX:NESN	Packaged Foods and Meats
Novartis AG	SWX:NOVN	Pharmaceuticals
United Kingdom		
BP PLC	LSE:BP.	Integrated Oil and Gas
Royal Dutch Shell PLC	ENXTAM:RDSA	Integrated Oil and Gas
Unilever PLC	LSE:ULVR	Personal Products
Vodafone Group PLC	LSE:VOD	Wireless Telecommunication Services
United States		
Apple Inc.	NasdaqGS:AAPL	Technology Hardware, Storage and Peripherals
Cisco Systems, Inc.	NasdaqGS:CSCO	Communications Equipment
Dell Technologies Inc.	NYSE:DVMT	Systems Software
Exxon Mobil Corp.	NYSE:XOM	Integrated Oil and Gas
Ford Motor Co.	NYSE:F	Automobile Manufacturers
HP Inc.	NYSE:HPQ	Technology Hardware, Storage and Peripherals
Intel Corp.	NasdaqGS:INTC	Semiconductors
McDonald's Corp.	NYSE:MCD	Restaurants
Microsoft Corp.	NasdaqGS:MSFT	Systems Software

<i>Company name</i>	<i>Exchange: Stock symbol</i>	<i>Primary industry</i>
Nike Inc.	NYSE:NKE	Footwear
Oracle Corp.	NYSE:ORCL	Systems Software
PepsiCo, Inc.	NYSE:PEP	Soft Drinks
Pfizer Inc.	NYSE:PFE	Pharmaceuticals
The Boeing Co.	NYSE:BA	Aerospace and Defense
The Coca-Cola Co.	NYSE:KO	Soft Drinks
The Procter & Gamble Co.	NYSE:PG	Household Products
The Walt Disney Co.	NYSE:DIS	Movies and Entertainment

Pier Luigi Gilibert

Keynote speech on Funding Innovation

I want to thank you for inviting me to be part of your event.

I've been asked to talk about the topic how innovation can be funded successfully. In doing so, I will take a European perspective. Indeed, my thesis will be that, not least given the amounts involved, successfully funding innovation will have to integrate a European dimension.

There is no doubt that today, the financing of innovation is a growing concern around the world both for private enterprises that wish to remain competitive, and for national policy makers that look at innovation as part of their internal industrial policy toolkit and, sometimes, even of their economic sovereignty and geopolitical goals. This is also why governments invest in higher education, knowledge, research and science, and target a growing part of their public spending to R&D projects.

But what title or legitimacy has the EIF to discuss funding innovation?

Let me start by saying, that one can look at innovation as some sort of public good. Public goods are associated with positive externalities. Indeed, innovation will not only benefit those that pay for it with stronger market positioning, but will also create well-paid jobs, wider consumer choices, higher productivity, faster growth and better quality of life for all. Most of such benefits are not factored into private sector calculations.

These aspects imply that private market mechanisms alone may not always provide adequate incentives to innovation, leading to suboptimal investment situations.

This is also why, the EIF – due to its dual nature as a public institution with a market-oriented business model – is called upon to address such market gaps, using financial instruments, such as portfolio guarantees and private equity.

Let me say a few words about the EIF and its role in funding innovation.

About the EIF

Our mission is to facilitate access to finance for European SMEs, promote entrepreneurship and social inclusion, and, more and more in recent years, support innovation across different thematic sectors (digital technology, life sciences, environment, climate, security, agriculture).

And, what we see is that innovation is more and more happening in agile SMEs, either individually or clustered around incubators or accelerators forming digital innovation hubs, or in public or private laboratories and research / scientific centres, rather than in large corporates.

This requires us to adapt to this more diffused innovation model and think carefully about new ways to fund this type of innovation, while continuing to ensure a continual pipeline of financing opportunities for small businesses in general.

We have been doing this since 1994 [i.e. for 25 years now]. We committed EUR 10.1bn in 2018, benefitting around 280,000 small businesses and sustaining 2.8 million jobs in Europe.

Financing evolutionary (incremental) vs. Disruptive innovation

A further challenge is that the financing needs of innovative small businesses are very diverse. Most of them are well established content to invest in evolutionary/incremental innovation by applying recent, but tried and tested, technologies to existing products or processes, while, others stand ready to disrupt an industry.

In the first case, an innovative technology company may lack the collateral for a standard bank loan. Or a fast growing business might prefer to make a single repayment at the loan's maturity rather than small payments throughout the lifetime of a loan, creating more risks for the lender.

In the second case, a start-up may need an early injection of capital to develop a prototype, or convert research into a marketable product. Lacking collateral – since their main asset is the idea itself – they are not safely bankable in commercial terms.

How do we respond to all this?

The EIF's strategy is structured around the two main pillars: the first one is represented by various forms of guarantee instruments – more suitable for “incremental innovation”, which accounts for 60% of what we do.

Although banks hugely supports SME financing in Europe, their risk appetite for SME lending as an asset class is generally low and falling. The rate of return on SME lending may be insufficient to remunerate the regulatory capital deployed. By providing portfolio guarantees for such loans, that is, by sharing the risks with them, we incentivise banks to take more risk in their SME financing.

The EIF's guarantee commitments in 2018 alone amounted to EUR 6.5bn, leveraging close to EUR 24bn, and were primarily driven by a guarantee programme called InnovFin, that is Finance for Innovation, targeting companies that can be defined as innovative. This has been part of the EFSI programme, also known as the Juncker Plan, which was deployed by the EIB Group as from mid-2015 and that will now run to end-2020.

Turning now to the more radical forms of innovation, what is often referred to as “deep tech” - meaning AI, robotics, big data, blockchain, - the best instruments to fund them are in the Venture Capital and private equity space. At the EIF, the equity business line represents around 40% of our work (EUR 3.5 bn last year). It supports innovative, fast-growing businesses through various forms of venture capital, private debt and equity.

We have been investing into VC funds that have supported a few big names that ring a bell to everyone – e.g. Skype, Sky-scanner, Revolut, Transferwise, Zalando – and Spotify (Sweden), the largest European exit of all times in April 2018.

These are all European start-ups that we have helped finance in the early stages of their development.

Given this experience, we are deeply convinced that there is substantial innovation potential in Europe – excellent research, world-class research facilities, and brilliant minds. What is new is the fact that a stronger entrepreneurial spirit and risk-taking culture is gradually making its way among the new generation of Millennials, which look with optimism to a career as start-uppers and innovators, rather than to a regular job (which may no longer exist).

The European Venture Capital market has progressed significantly over the past two decades, in part also due to EIF's investment activity based on the policy objective of creating a sustainable and integrated financial market in Europe (not least under the project of the Capital Market Union addressing the fragmentation of EU's financial markets), that is more attractive to private sector investors, and thus less dependent on public sector funding.

However if, from a return perspective, the EU VC landscape has, I think, reached par level with that of other geographies, we are still far away from a well-functioning VC ecosystem.

In particular, whilst more and more European tech companies show potential for global leadership in their technology segment, a very low number of them retain their independence and their European base across their late stage development until public listing and beyond.

The liquidity and scale of the US capital markets outpaces the attractiveness of any European market and it is most likely the case that US based VC funds will be leading the financing rounds of late stage technology companies in Europe, and then list them on the US rather than Europe.

This may not make any difference from a pure return perspective, but such companies effectively become US-based even

if research and production are kept in Europe. As a result, from a taxation point of view, these companies migrate to non-EU jurisdictions and create economic value flows that do not benefit Europe.

To put this phenomenon into context, Europe's tech companies counted 63 financing rounds of, or above, USD 100m in 2018 and so far this year. Of these, only a quarter have been led by European investors (and by corporates more than VC funds). Half of these rounds have been led by US-based funds and the remaining 25% by Asian investors.

To support Europe's innovation capacity, there is thus a need to promote the emergence of EU-based VC funds which have the scale and international recognition for leading such financing rounds, and do so using the Euro rather than the US dollar.

What can we do – what are we doing

Since mid-2015, the EIF has been deploying the SME window of EFSI – the Juncker Plan. This has given us substantial firepower to support innovation and innovative enterprises on both the equity and the debt financing side.

To date, we have committed almost EUR 7.3bn under EFSI which, by crowding-in other leaders, public and private, will make available EUR 162.5bn in support of 950,000 SMEs across Europe.

But it's not only about volumes. We have focussed our investments in areas that mostly need our attention, and at least 60% of such investments are targeting research and development, as well as other innovative areas.

Just an example, EIF investments in the technology transfer segment – an area of major importance for innovation – amounted to EUR 500m last year, particularly in Germany and France. This is a good start but we find that much more can (and should) be done to facilitate research spinouts and support student teams in their ambitions to create new enterprises.

In Italy, we have set up and deployed in 2017 the so-called ITATech initiative, a VC programme aiming to invest EUR 200m of early-stage venture capital financing for innovative Italian start-ups issued from academic or private research centres. ITATech is now fully committed, has mobilised probably as much of additional investments, and is helping turning academic research into commercially viable applications.

This programme has been supported by both EFSI and Italian funding, this coming from CDP.

Over the years, we have successfully supported other regions and economies with underdeveloped equity markets, including of recently for example the EquiFund in Greece, a EUR 300m FoF with an Innovation-dedicated compartment, which has raised a further EUR 200m from other investors. We have launched similar initiatives in Portugal, Bulgaria, Estonia and Romania, to name just a few.

But working along national lines is unlikely to close the innovation gap between Europe on the one hand and, say, US and China on the other hand. We need to look at innovation from a more European perspective. Indeed, it is unlikely that even large economies, such as Germany, can maximise technological leadership by acting alone.

It is thus important that a truly pan-European approach to funding innovation takes a more prominent role. An occasion will present itself within the future European budget framework to be put in place as from 2021 under the name of InvestEU (*on which I will say a few words later on*).

Eu-wide framework

Luckily, there are other signs that things are moving in the right direction under this respect. For instance, since the recent Siemens-Alstom related decision of the European Commission [*blocking their merger*] earlier this year, a lot has been said about the delicate balance between the EU's

traditional openness to foreign investors and the lack of reciprocity, displayed by other countries and how constraining (internal) rules, like competition and state aid policies, can be in supporting EU competitiveness and innovation potential in an increasingly open and competitive world-wide geopolitical context.

Technology and industrial policy issues are also becoming more central in light of the current trade disputes among the EU, US and China. Europe's chances are limited if single economies are each thinking about innovation in an isolated way.

In this respect, the recent Franco – German Manifesto [*published in February this year*] aims to develop a joint plan for a coherent industrial policy in Europe. Let me quote a few passages from it:

“Europe’s economic strength in the coming decades will be hugely dependent on the ability to remain a global manufacturing and industrial power. The industrial sector is changing before our eyes due to digitalisation.

New industrial sectors are appearing such as those linked to artificial intelligence, and others are changing at great speed such as the car manufacturing or railways sectors.

Massively investing in innovation is a priority: we will only succeed if we are the ones creating, developing and producing new technologies.”

Then let me quote their proposals, which is:

“To create a European strategy for technology funding under the InvestEU, which is capable of leveraging private capital to cover the equity needs of start-up and innovative tech companies.

A strong EU commitment to disruptive innovation within the framework of the European Innovation Council (EIC), to support very high-risk deep tech projects at the European level.

To become world leaders on Artificial Intelligence: France and Germany will intensify their cooperation in artificial intelligence (AI) and shape the EU’s ambitions expressed in its coordinated plan on AI.”

What lessons to draw, and what to do, going forward

As mentioned before, EFSI has been a key driver of the EIF's actions over the past few years. EFSI has also been at the forefront of innovation financing.

For the near future, EFSI will continue its support till the end of 2020, with a total target of mobilised investment of EUR 500m. A large fraction of this amount will be dedicated to funding innovation, with both existing financial products and with new ones that are now being introduced.

The InvestEU programme will then replace EFSI in the 2021-2027 period, combining into one single legal framework the numerous financial instruments now supported by the EU budget. InvestEU will be based on a EUR 38 billion guarantee from the EU, and will aim to mobilise around EUR 650 billion of new investments in strategic areas of the European economy. One of the 4 thematic programmes, in addition to SMEs, Sustainable Infrastructure and Social Inclusion, will indeed be Innovation (EUR 8.5 bn).

Making good use of such European funds, alongside with national resources, will be crucial in funding Europe's innovation. But most likely not enough. As we said at the beginning, the funding of innovation should also be a priority for the private sector, meaning also institutional investors or larger corporates. Something which in the US has been the case for several decades, greatly contributing to the birth those technology platform companies (Apple, Alphabet, Facebook, Amazon, and the like) which, through their market dominance in their respective sectors, not only have the financial means to acquire their potential future competitors, but effectively control the access of new technologies to the market.

In short, I believe the presence of institutional investors in the technology markets via private equity investments, also before any public listing, is a necessary conditions to bring technological leadership back to Europe. The stage of development of Europe's VC and PE markets, while still incomplete as I argued before, makes this alternative asset class, if properly structured,

a more mainstream and attractive investment proposition than in the recent past, both in terms of portfolio diversification and in terms of yield enhancement, particularly in the light of a continuing low interest rate environment. Furthermore, an exposure to the financial rewards of emerging technologies is nowadays best achieved through the private rather than the public equity market.

This is why the EIF is now actively reaching out to institutional investors (pension funds, insurance companies, family offices and sovereign wealth funds) from the EU and beyond, offering them a best-in-class access to such markets. It is a growing segment of our strategy and to date we have received around EUR 450m in commitments from institutional investors from 4 EU countries, to our newly created Asset Management Umbrella Fund.

Closing

To conclude, let me say that in less than a week's time, on 21 July, the world will celebrate the 50th anniversary of the Apollo lunar landing – a milestone in human achievement and a product of technical innovation under several respects.

We tend to forget – or perhaps we don't think about it at all – that such extraordinary achievement required many different sectors to collaborate and innovate together. And it required substantial financing.

The upcoming anniversary is therefore a good reminder that efficiently funding innovation may enable us to tackle some of the greatest challenges of our own times – and make our lives more enjoyable.

Thank you for your attention.

Guido Bastianini

*Governance, strategie e redditività: recenti evoluzioni per le imprese bancarie**

*La crisi economico-finanziaria degli anni 2007-2009
e la revisione normativa*

Nel corso degli ultimi dieci anni vi sono state rilevanti e significative modifiche alle regole che disciplinano l'attività delle banche, quale reazione alla grande crisi finanziaria degli anni 2007-2009, che hanno inevitabilmente influito sulle scelte strategiche e sulla redditività degli intermediari.

Tra le principali linee di sviluppo regolamentare le riforme di Basilea 3¹, oltre che l'avvio della supervisione bancaria da parte della Banca Centrale Europea ("BCE"), le iniziative intraprese dall'Autorità Bancaria Europea ("EBA") e le riforme approvate, più di recente, dal parlamento Europeo. Si è trattato di riforme introdotte gradualmente, nel complesso risultate incisive, che hanno portato in un decennio risultati tangibili. La più significativa innovazione va sotto il nome di Basilea

* Il presente testo incorpora anche alcune tematiche trattate in un più ampio intervento tenuto il 6 giugno 2019 in occasione del convegno "*I bilanci delle banche: quali strategie di redditività?*" organizzato da Sapienza Università di Roma e Bancaria Editrice - ABI Servizi in occasione della pubblicazione del libro "*Il nuovo bilancio delle banche*" di Tutino F.

1. Basel Committee on Banking Supervision (BCBS) (2010), *Basel III: A Global regulatory framework for more resilient banks and banking systems*, Basel, Bank for International Settlements, December e Basel Committee on Banking Supervision (BCBS) (2010), *Basel III: International framework for liquidity risk measurement, standards and monitoring*, Basel, Bank for International Settlements, December.

3², accordo sviluppato nel 2010 con molteplici finalità, tra le quali una maggiore patrimonializzazione, il miglioramento della qualità del capitale, la riduzione della leva finanziaria, il miglioramento delle condizioni di liquidità, una gestione più efficiente delle crisi bancarie. Un solo dato segnala quanto sia stata incisiva la nuova regolamentazione: il coefficiente minimo per le componenti patrimoniali di migliore qualità è passato dal 4 per cento richiesto da Basilea 2 al 7-8,5 per cento previsto da Basilea 3³.

Nel frattempo, dalla fine del 2014 il controllo a livello di eurosystema è stato esteso all'intero sistema bancario e ha riguardato sia la vigilanza vera e propria (attraverso l'SSM, *Single Supervisory Mechanism*), sia la gestione delle crisi (attraverso l'SRM, *Single Resolution Mechanism*).

La complessità e la lunga fase transitoria nell'applicazione delle modifiche hanno portato nel dicembre 2017 a quella che è stata definita la finalizzazione delle riforme di Basilea 3⁴, ulteriore accordo che ha quale obiettivo la riduzione dell'eccessiva variabilità tra le varie banche nel calcolo delle attività ponderate per il rischio. Tale iniziativa si focalizza principalmente sul miglioramento della coerenza e della comparabilità delle attività ponderate per il rischio delle banche, incidendo sui modelli interni che consentono alle banche di calcolare le proprie ponderazioni del rischio⁵.

Più di recente, il 16 aprile 2019 il Parlamento europeo ha approvato il c.d. *banking package* che ha fra i principali obiettivi

2. In relazione a Basilea 3, in Europa sono stati approvati il Regolamento CRR (*Capital Requirements Regulation*), direttamente applicabile, e la Direttiva CRD IV (*Capital Requirements Directive*), recepita in Italia nel giugno 2015.

3. Bank for International Settlements (2018), Relazione economica annuale 2018, giugno.

4. Basel Committee on Banking Supervision (BCBS), (2017) *Basel III: Finalising post-crisis reforms*, Basel, Bank for International Settlements, December. Le nuove regole saranno introdotte gradualmente ed entreranno pienamente in vigore nel 2027.

5. Signorini L. F. (2019), *La regolamentazione della finanza: le sfide affrontate nel settore bancario e le sfide future per l'intermediazione non bancaria*, 18 maggio.

l'ulteriore riduzione dei rischi nei bilanci bancari e la limitazione dell'esborso di denaro pubblico in caso di crisi creditizia.

Infine, occorre richiamare il particolare rilievo, per le banche di alcuni paesi, delle iniziative in tema di gestione del credito deteriorato della BCE (*Linee guida per le banche sui crediti deteriorati (NPL)*); il c.d. *Addendum*), della EBA (*Linee guida sulla gestione delle esposizioni deteriorate e soggette a forbearance*), del Parlamento europeo (Accordo del 18 dicembre 2018 che prevede una copertura minima delle perdite) e l'introduzione del nuovo principio contabile IFRS 9 a partire dai bilanci relativi al 2018⁶.

Le nuove regole e gli equilibri economico-patrimoniali delle banche

Emergono quale significativo *driver* di cambiamento le innovazioni regolamentari, dal momento che le nuove regole su capitale, leva, liquidità, NPL, ecc., finalizzate a una maggiore stabilità del sistema, impongono agli intermediari una più efficiente allocazione del capitale, con incentivi impliciti al *derisking* e al *deleveraging*⁷.

In concreto, i regolatori nel ridurre il rischio di instabilità della banca hanno limitato la produttività potenziale e/o effettiva di alcuni dei suoi fattori produttivi, rappresentati dalle riserve di patrimonio e di liquidità. Il rischio da alcuni prefigurato, pur senza mettere in dubbio che l'esigenza di stabilità prevale su quella dell'efficienza e della redditività, è che tale regolamenta-

6. In relazione all'avvio dell'IFRS 9 le banche italiane hanno riflesso nella valutazione dei crediti, effettuata il 1° gennaio 2018, varie strategie di recupero, che includono anche la probabilità di cessione di crediti deteriorati. Per alcuni intermediari l'*impairment* è risultato rilevante in termini di impatto sul patrimonio e sui coefficienti patrimoniali. Il totale delle maggiori rettifiche di valore effettuate in data 1° gennaio 2018 è risultato per le banche sottoposte a vigilanza diretta di BCE di oltre 13 miliardi di euro, dato superiore all'utile netto cumulato del 2018 delle stesse banche.

7. Vacca C., Sibilio N. I., Cusmano L., Soprani P. (2016), *I modelli di business bancari analisi e prospettive evolutive*. Bancaria, aprile.

zione in fase ciclica recessiva possa determinare una redditività insufficiente, incapace di corrispondere alle attese degli investitori e inadeguata per attrarre nuovo capitale azionario⁸.

In tale contesto regolamentare le banche hanno rivisto strategie e modelli di *business*, con incisivi interventi sulla struttura del bilancio, dei costi, delle attività e della presenza geografica. Sono evidenti i progressi verso una maggiore solidità del sistema bancario, così come la profittabilità inadeguata per effetto della contrazione dei ricavi, per la difficoltà di comprimere i costi e per la presenza di numerosi problemi c.d. di *legacy*.

In generale, si osserva uno spostamento dell'attività bancaria verso modelli di *business* maggiormente orientati alla clientela al dettaglio caratterizzati da fonti di raccolta e reddito stabili, con maggiore dotazione e qualità di capitale, minore dipendenza dalla raccolta all'ingrosso, maggiori riserve di attività liquide di elevata qualità e la riduzione della negoziazione in conto proprio⁹.

Tuttavia, gli sforzi delle banche per cogliere i benefici delle riforme e generare una redditività adeguata e sostenibile non hanno ancora portato a risultati del tutto soddisfacenti, come testimoniano, tra l'altro, le valutazioni azionarie che permangono su valori contenuti, spesso con livelli dell'indicatore *price to book* inferiore all'unità, in alcuni casi in misura significativa anche per banche di grandi dimensioni.

La dinamica risulta ancora meno positiva ove messa a raffronto con il sistema finanziario degli USA che ha fatto registrare negli anni 2008-2009 una caduta della redditività più elevata di quella della Ue, soprattutto in relazione ad un'opera di profonda "pulizia" dei bilanci bancari sostenuta da iniezione di capitale, anche con il sostegno pubblico, a fronte di una rapida ripresa che ha portato le banche USA a far registrare risultati superiori a quelli del periodo precedente alla crisi in modo stabile fin dal 2013.

8. Mottura P. (2018), *La banca commerciale: sostenibilità del modello di intermediazione*. Bancaria, aprile.

9. Bank for International Settlements (2018), *Relazione economica annuale 2018*, giugno.

A fronte di ciò le maggiori banche europee stentano a recuperare in valore assoluto i livelli di profitto del periodo precedente alla crisi e fanno registrare, nella media, ritorni sul capitale nell'intorno del 6 per cento, meno della metà di quanto fatto registrare negli anni 2006-2007; la dinamica riflette l'incremento della patrimonializzazione e la riduzione della leva finanziaria.

Contestualmente, si osserva che alcuni settori dell'intermediazione non bancaria stanno erodendo importanti e profittevoli segmenti di *business* finora gestiti dalle banche. Tra di essi operatori digitali; provider tecnologici; attori finanziari non bancari, come poste e assicurazioni; operatori finanziari di emanazione di soggetti operanti in altri settori (servizi, industria, gdo, ecc.).

Soprattutto ciò che è connesso a innovazioni regolamentari, finanziarie e tecnologiche sta continuamente provocando rilevanti impatti, con le banche che si trovano ad operare in un terreno di gioco via via meno definito. In particolare, la competizione da parte di soggetti non bancari, specificamente del *FinTech*, rimane un aspetto verso cui le banche potranno cogliere opportunità (ad esempio con *partnership*) o subire minacce per l'accresciuta competizione.

Al riguardo, si rilevano anche opinioni non benevole nei confronti dello stato e delle prospettive del sistema bancario europeo. In un articolo di *The Economist* dell'aprile 2019 viene esaminata la situazione del sistema bancario europeo e sono formulati giudizi assai severi sullo stato delle banche in Europa, che può essere sintetizzato con il titolo dell'articolo: "*La terra dei morti viventi*"¹⁰.

Le analisi della BRI e della BCE sull'evoluzione del sistema bancario

Sulle tematiche richiamate sono stati sviluppati numerosi studi e approfondimenti. Tra di essi: *Structural changes in*

10. The Economist (2019), *The land of the living dead*, 6th April.

banking after the crisis, BRI, gennaio 2018¹¹ e *SSM thematic review on profitability and business models. Report on the outcome of the assessment*, BCE, settembre 2018¹².

L'analisi del documento della BRI mette in luce numerosi aspetti relativi all'evoluzione del sistema bancario e ne segnala le principali implicazioni per la stabilità e l'efficienza.

Innanzitutto rileva come la crisi ha messo fine a un periodo di forte crescita delle attività del settore bancario, con una contrazione del settore bancario rispetto all'attività economica. L'aggiustamento si è verificato principalmente attraverso una riduzione dei volumi di *business*, piuttosto che con l'uscita di imprese dal mercato; i processi di concentrazione sono risultati marginali. Le banche hanno riorientato la loro attività riducendo il *trading* e le attività più complesse, verso attività con minore necessità di capitale, innanzitutto l'attività bancaria tradizionale verso clientela. Questo schema è evidente nei cambiamenti nei portafogli di attività delle banche, nel mix dei ricavi, nella maggiore dipendenza dai depositi da clientela.

In conseguenza, la redditività bancaria è generalmente diminuita rispetto a quanto facevano registrare i modelli di *business* prevalenti nella precedente situazione di tassi più elevati. Su di ciò ha inciso la minore leva finanziaria indotta dalla nuova regolamentazione; inoltre, la maggior parte delle banche europee, sta registrando ricavi in riduzione e una base di costi resistente ai tagli, inclusi, in alcuni casi, i costi c.d. *legacy* associati a precedenti decisioni di investimento e cattiva gestione.

Le implicazioni per la redditività delle banche segnalano l'opportunità di ricercare e conseguire ulteriori tagli di costo e aggiustamenti strutturali, anche tramite aggregazioni.

Tuttavia viene segnalato che banche ed operatori devono adattarsi a un "*new normal*", nel quale la redditività riflette in

11. Bank for International Settlements (2018), *Structural changes in banking after the crisis. Report prepared by a Working Group established by the Committee on the Global Financial System*, CGFS Papers n. 60, January.

12. European Central Bank (2018), *SSM thematic review on profitability and business models. Report on the outcome of the assessment*, September.

parte fattori ciclici che la comprimono, ma anche una maggiore patrimonializzazione e bilanci più resilienti. Le preoccupazioni del mercato sulla bassa redditività possono privare le banche di nuovi capitali o incoraggiare l'assunzione di rischi e maggiore leva finanziaria.

In alcuni casi, tuttavia, la bassa redditività potrebbe anche segnalare l'esistenza di eccesso di capacità produttiva e scarsa attenzione verso fenomeni di consolidamento.

* * *

Il documento BCE dà conto di un'analisi, svolta tra il 2016 e il 2018, finalizzata a valutare in profondità i driver di profittabilità e i modelli di *business* delle istituzioni direttamente vigilate da BCE.

L'iniziativa nasce dalla volontà della BCE di approfondire le sfide che interessano le banche europee nella revisione dei modelli di business. Sfide che includono bassa profittabilità e pressione sui ricavi dovuta all'ambiente economico; basso livello dei tassi di interesse e l'elevata competitività sui mercati; livelli elevati di crediti deteriorati e la necessità di "ripulire" i bilanci; digitalizzazione e nuovi competitori (*FinTech* e grandi società tecnologiche); regolamentazione più rigorosa e la necessità di adattarvisi.

L'analisi relativa alla profittabilità è stata sviluppata a livello di azienda al fine di esaminare i differenti aspetti del modello di *business*, partendo dall'esame della capacità di generare ricavi dall'attività *core* fino alla capacità di comprendere e orientare le loro attività e implementare le strategie individuate.

Emerge come il contesto macroeconomico caratterizzato da bassi tassi di interesse, mercati del lavoro eterogenei e un'espansione economica disomogenea abbia inciso sui modelli di *business* delle banche. Ruolo significativo ha avuto la politica monetaria accomodante che, da un lato, ha allentato la pressione sul costo del rischio e sostenuto la crescita dei prestiti e, d'altro canto, ha contribuito alla compressione del margine di interesse.

I principali risultati dell'analisi consentono di esaminare alcuni aspetti di rilievo per le strategie di redditività delle banche.

Riguardo ai temi di contesto emerge come i modelli di *business* e la redditività siano sotto pressione per vari motivi quali: la riduzione dei ricavi legata ai bassi tassi di interesse, la dinamica economica, la crescente competitività. In alcuni casi permangono elevate rettifiche relative al credito deteriorato e problemi di *legacy*, per retaggio di spese legali e costi di struttura ereditati dai precedenti cicli espansivi.

Dal lato dei ricavi gli elementi di maggiore criticità riguardano il permanere di tassi d'interesse estremamente contenuti, per di più con una curva per scadenza dei tassi d'interesse particolarmente piatta.

Dal lato dei costi emerge quale parametro significativo quello delle strutture ereditate dai precedenti cicli espansivi. BCE segnala la presenza di *“ancora 40 o più filiali per 100.000 abitanti in molte nazioni e di più di 400 dipendenti per 100.000 abitanti nella maggior parte”*¹³. Un riferimento omogeneo all'Italia consente di rilevare quanto la struttura territoriale e lavorativa risulti ancora distante dai riferimenti europei: il dato medio italiano risulta di 45 (circa 42 a fine 2018) sportelli e di 470 (oltre 460 a fine 2018) dipendenti ogni 100.000 abitanti¹⁴.

13. I confronti fra i quattro maggiori paesi della UE (ex UK), che rappresentano circa il 70 per cento del totale sportelli, fanno rilevare significative differenze: ad esempio, su dati riferiti al 2018, la Germania ha circa 35 sportelli ogni 100.000 abitanti, mentre la Francia oltre 55 e la Spagna quasi 57.

14. Tutto ciò nonostante la riduzione degli sportelli in Italia negli ultimi 10 anni sia stata del 25 per cento (il dato medio era di 57 sportelli ogni 100.000 abitanti nel 2009) e quella dei dipendenti di quasi il 16 per cento (550 dipendenti ogni 100.000 abitanti nel 2009).

In Italia si rilevano significative differenziazioni geografiche riguardo alla densità degli sportelli sul territorio (nord ovest 53, nord est 62, centro 48, sud 28) e anche dei dipendenti, sempre ogni 100.000 abitanti (nord 649, centro 487, sud 155).

I modelli di business e le opzioni strategiche

Le analisi sviluppate da BCE non individuano un modello di *business* ottimale nella UE e neppure viene rilevato un qualche collegamento con particolari collocazioni geografiche; emerge che ciascuna banca deve trovare il proprio assetto ottimale tra costi e ricavi e che i driver principali sono: a) l'efficienza dei costi; b) la capacità di generare ricavi più alti di quelli delle aziende comparabili.

Al riguardo, la riduzione dei costi di per sé non risulta un fattore decisivo e il semplice taglio dei costi del personale e delle strutture sul territorio spesso va a incidere sulla capacità di mantenere o migliorare i livelli di reddito.

Da ciò l'opportunità di adattare e rivedere i modelli di *business* piuttosto che di portare avanti esclusivamente iniziative di riduzione dei costi, che in alcuni casi potrebbero risultare affrettate e controproducenti.

In sintesi, ogni banca deve essere capace di individuare il proprio *trade-off* ottimale; l'evidenza dei dati segnala che è possibile essere redditizi anche in condizioni macroeconomiche sfidanti, indipendentemente dal modello di *business*.

In tale contesto l'analisi della BCE dedica particolare attenzione a quello che appare un tema centrale: la guida strategica di ciascuna azienda, cioè la capacità del *management* di impostare un percorso finalizzato a obiettivi di lungo termine.

Non vi è dubbio che le banche che hanno fatto registrare i migliori risultati mostrano spiccata capacità di guida strategica, cioè la capacità del *management* di operare su obiettivi a lungo termine, quali *governance*, *risk management*, strategia e processi relativi a reddito, costi e *pricing* dei finanziamenti.

La mancanza degli elementi appena richiamati può pregiudicare la capacità della banca di valutare criticamente il bilanciamento rischio/rendimento delle strategie, di comprendere i *driver* di profitto, di analizzare i rischi al ribasso e di definire misure di mitigazione nel caso in cui i rischi si

materializzino. Emerge come molte banche devono rafforzare il processo di analisi critica della ipotesi alla base della loro strategia e degli obiettivi a medio termine a livello di consiglio di amministrazione.

Governance e gestione del rischio

La *corporate governance* bancaria rappresenta un aspetto da analizzare con grande attenzione nell'esame della gestione di una banca, in particolare, per i riflessi che determina sulla *performance* e sulla propensione al rischio.

Carenze nella *corporate governance* e nella gestione dei rischi rappresentano un fattore critico che può portare a eccessiva, imprudente o, addirittura, inconsapevole assunzione di rischi, con conseguenti danni economici e reputazionali.

Si tratta di un aspetto costantemente all'attenzione delle Autorità di vigilanza, come testimonia il fatto che è uno dei quattro aspetti valutati nel processo di revisione e valutazione prudenziale (SREP, *supervisory review and evaluation process*)¹⁵, dalle cui analisi risulta quello che evidenzia le maggiori criticità, con giudizi non particolarmente positivi per oltre il 70 per cento degli intermediari vigilati da BCE (dato riferito al 2018).

Numerose e fondamentali in argomento sono le iniziative di BRI¹⁶ ed EBA¹⁷, oltre che gli interventi regolamentari e di prassi della UE, della BCE e della Banca d'Italia.

Tra i numerosi approcci alla tematica, riveste particolare interesse quello della BRI: "*L'obiettivo principale del governo societario dovrebbe essere quello di salvaguardare l'interesse degli*

15. I quattro aspetti valutati sono: 1) modello imprenditoriale; 2) *governance* e gestione del rischio; 3) rischio di capitale; 4) rischio di liquidità e di provvista.

16. Basel Committee on Banking Supervision (BCBS) (2015), *Guidelines Corporate governance principles for banks*, Basel, Bank for International Settlements, July.

17. European Banking Authority (2017), *Guidelines on internal governance under Directive 2013/36/EU*, 26 September. (il testo è stato pubblicato anche in italiano il 21 marzo 2018 con il titolo: *Orientamenti sulla governance interna*).

stakeholder in conformità all'interesse pubblico su base sostenibile. Tra gli stakeholder, in particolare riguardo alle banche retail, l'interesse degli azionisti dovrebbe essere secondario rispetto agli interessi dei depositanti".

Più di recente, dal 30 giugno 2018 trovano applicazione i nuovi *Orientamenti sulla governance interna*, predisposti dall'E-BA e indirizzati alle banche e alle imprese d'investimento, che affrontano le principali tematiche attinenti la *governance* quali: i) il ruolo, la composizione e la responsabilità dell'organo di amministrazione e dei comitati endoconsiliari; ii) il quadro di *governance*; e iii) il quadro e i meccanismi di controllo interno.

Gli orientamenti richiamati definiscono il ruolo e le responsabilità degli organi di amministrazione e controllo e individuano tre diverse linee di responsabilità interne: le linee di *business*, la funzione di *risk management* e di *compliance* e la funzione di *internal audit*. Sono enfatizzati i doveri e le responsabilità del consiglio di amministrazione riguardo la funzione di vigilanza nella supervisione del rischio, incluso il ruolo dei comitati endoconsiliari.

Inoltre, le disposizioni dell'Unione Europea spaziano dalla composizione degli organi di amministrazione e controllo, alle caratteristiche di professionalità e onorabilità degli esponenti, alla struttura e alle attività che vengono riservate al CdA e di cui le norme delineano gli elementi fondamentali (*Risk appetite framework*, Icaap, Ilaap, Piano di risanamento).

Negli anni più recenti l'attenzione degli operatori si è spostata dai requisiti patrimoniali alle regole, sempre più stringenti, in materia di organizzazione interna delle banche, al fine di evitare l'inadeguata gestione dei rischi o la scarsa consapevolezza e considerazione degli stessi nell'assunzione delle decisioni. La nuova regolamentazione si preoccupa, in altri termini, di assicurare che l'assetto di governo societario e l'organizzazione aziendale siano idonei a realizzare un efficace *risk governance framework*¹⁸.

18. Frigeni C. (a cura di) (2016), *La governance delle società bancarie*. 7-9 aprile.

In quest'ottica emergono due aspetti: da un lato, l'esigenza che l'attività venga orientata in ragione del grado di rischio individuato ex ante (*risk appetite*); dall'altro, quella di fare in modo che gli obiettivi di rischio individuati siano monitorati nel continuo, adottando interventi di aggiustamento in caso di scostamento (*risk accountability*).

Nella *governance* bancaria hanno così assunto un ruolo centrale concetti di taglio finanziario, connessi alla individuazione della massima esposizione al rischio consentita (*risk capacity*), alla fissazione degli obiettivi di rischio (*risk appetite*) e alla devianza tollerata rispetto agli stessi (*risk tolerance*), nonché alla misurazione dell'esposizione al rischio in un determinato momento (*risk profile*),

Le tematiche della *governance* e della gestione dei rischi risultano, quindi, cruciali per ogni azienda, ancora più per quelle più deboli, che nel programmare la propria strategia devono prendere decisioni consapevoli sull'assunzione di rischi e assicurarsi che la loro capacità di guida strategica sia commisurata al rischio delle loro attività.

Ad esempio, le banche che pianificano di tagliare i costi devono preoccuparsi di non incidere sulla gestione e sul controllo dei rischi essenziali, di salvaguardare il franchising e gli investimenti necessari (ad esempio in IT) per raggiungere obiettivi aziendali a lungo termine.

Oppure, nella valutazione di strategie basate sull'assunzioni di nuovi significativi rischi occorre che sia valutata la coerenza rispetto al capitale regolamentare.

Fondamentale in materia di gestione dei rischi risulta, infine, il ruolo del consiglio di amministrazione, ove devono risiedere adeguate competenze, e il ruolo del *Chief Risk Officer*, che oggi ha diretto e regolare accesso al consiglio di amministrazione. Obiettivo è quello di permeare ogni azienda di un'adeguata cultura del rischio capace di indirizzare l'organizzazione e i suoi comportamenti¹⁹.

19. "Risk culture should be distinguished from the broader concept of non-financial risk. Risk culture can be considered as "the norms and traditions of

Il ruolo del Presidente del CdA

Pertanto, gli amministratori sono chiamati a gestire, nella loro attività collegiale, le alternative strategiche, i rischi assunti, a predisporre i presidi di *risk management* e dei controlli interni, a verificarne nel continuo la funzionalità.

In tale ambito, un ruolo fondamentale è riservato al Presidente del CdA, figura *super partes* che deve possedere requisiti di professionalità rafforzati rispetto a quelli degli altri amministratori non esecutivi e garantire il corretto funzionamento dell'organo di amministrazione e i molteplici interessi degli *stakeholders* della banca.

La regolamentazione della Banca d'Italia attribuisce al Presidente *“una funzione cruciale per garantire il buon funzionamento del consiglio, favorire la dialettica interna e assicurare il bilanciamento dei poteri, in coerenza con i compiti in tema di organizzazione dei lavori del consiglio e di circolazione delle informazioni che gli vengono attribuiti dal codice civile”*²⁰. Quindi, il Presidente deve promuovere *“l’effettivo funzionamento del sistema di governo societario, garantendo l’equilibrio di poteri”*, ponendosi *“come interlocutore dell’organo con funzione di controllo e dei comitati interni.”*

A questo riguardo, nel concreto dispiegarsi dei compiti del Presidente emergono alcuni aspetti di rilievo per il funzionamento dell'organo di amministrazione, cui deve dedicarsi, quali la predisposizione:

behavior of individuals and of groups within an organization that determine the way in which they identify, understand, discuss, and act on the risks the organization confronts and the risks it takes” (International Institute of Finance (2009)). Tratto da Bank for International Settlements (2018), *Structural changes in banking after the crisis. Report prepared by a Working Group established by the Committee on the Global Financial System, CGFS Papers n. 60, January, pag. 34*. 20. Banca d'Italia (2013), *Disposizioni di vigilanza per le banche. Circolare n. 285 del 17 dicembre e successivi aggiornamenti*. Cfr. Parte I - Titolo IV - Governo societario, controlli interni, gestione dei rischi Capitolo 1 - Governo societario Sezione V - Funzionamento degli organi, flussi informativi e ruolo del presidente.

- a) dell'ordine del giorno e la conduzione del dibattito consiliare;
- b) della documentazione a supporto dell'attività del CdA;
- c) dei verbali del CdA e delle relative decisioni.

a) l'ordine del giorno

Nella predisposizione dell'ordine del giorno e nella conduzione del dibattito consiliare è opportuno che il Presidente focalizzi i lavori innanzitutto sulle materie di rilievo strategico, garantendo che ad esse sia dedicato il tempo necessario, anche per l'esame cui sono tenuti i comitati endoconsiliari (tra i quali, comitato rischi, comitato nomine, comitato remunerazioni).

Tuttavia, l'esperienza sul campo fa rilevare come spesso i lavori del CdA siano occupati e dedicati ad aspetti regolamentari e di *compliance*, con un'ottica prevalentemente retrospettiva piuttosto che prospettica.

Con ciò limitando il tempo e le opportunità di analisi, discussione e decisione relativa alle tematiche strategiche, che includono la comprensione dei rischi aziendali, delle opportunità di *business*, delle scelte aziendali.

Pertanto, tra i più rilevanti compiti del Presidente vi è quello di gestire l'ordine del giorno quale strumento di scrutinio delle alternative strategiche, di indirizzo delle conseguenti decisioni aziendali, di monitoraggio dell'esecuzione delle strategie.

Ad esempio, riguardo alle tematiche regolamentari e di *compliance*, prevalentemente finalizzate alla verifica dell'adempimento di norme, regolamenti, ecc, l'agenda del CdA potrebbe essere gestita dal Presidente con modalità finalizzate a garantire i necessari flussi informativi, limitando le analisi collegiali ai soli aspetti che manifestano necessità di approfondimento e decisione.

Si rileva, inoltre, che numerosi punti all'ordine del giorno dei CdA relativi a tematiche regolamentari e di *compliance* hanno quale esito l'affermazione: "il CdA prende atto", senza alcuna effettiva necessità di elaborare una decisione.

Quindi, avendo presente che l'ordine del giorno del CdA deve tener conto di crescenti (talvolta eccessivi) requisiti di supervisione e *compliance*, appare utile agire sulle modalità operative, con innovazioni finalizzate a rendere più snello ed efficace il lavoro svolto dal CdA.

b) i flussi informativi

Il Presidente del CdA deve inoltre garantire che venga predisposto un efficiente flusso di informazioni a beneficio del consiglio di amministrazione, dei comitati consiliari e tra consiglio e comitati, al fine di contribuire in modo costruttivo alle discussioni e alle decisioni. In tale ambito, emerge l'importanza del ruolo che può essere svolto dai comitati consiliari nell'esame preliminare delle questioni più complesse e nello snellimento dei processi informativi e decisionali su aspetti prevalentemente retrospettivi e regolamentari.

Solo quale esempio, l'utilizzo di flussi informativi strutturati e analitici può consentire adeguati approfondimenti, con una migliore comprensione della realtà aziendale. In conseguenza, l'esame delle questioni più complesse e le relative decisioni non potranno che essere un fattore rilevante di differenziazione nella qualità del lavoro svolto dai consigli di amministrazione, con significativo impatto sul processo decisionale e sulla consapevolezza nell'affrontare le sfide che ciascuna organizzazione deve affrontare.

c) i verbali

Un ulteriore aspetto di rilievo, talvolta ritenuto un semplice adempimento amministrativo, concerne la predisposizione del verbale del CdA e la formalizzazione delle decisioni. Anche in tale ambito emerge il ruolo decisivo del Presidente del CdA che, nel coordinare l'attività del segretario del CdA, deve garantire l'equilibrio della sintesi dei lavori consiliari, che non può certamente essere rappresentata dalla semplice trascrizione o riassunto della registrazione dei lavori delle singole sedute.

Il verbale delle riunioni del CdA deve infatti riportare gli argomenti trattati, esponendo chiaramente le considerazioni espresse, le alternative esaminate e le decisioni assunte e le azioni concordate.

In sintesi, emerge come il Presidente nello svolgimento dei compiti attribuiti dalle normative applicabili debba svolgere un ruolo da “regista”, guidando i lavori del CdA, definendone l’agenda, assicurando che i membri del CdA ricevano tempestivamente documentazione accurata, predisponendo la bozza del verbale dei lavori, con ciò assicurando a tutti i consiglieri partecipazione effettiva e informata.

D’altro canto, è pacifico che il Presidente non possa avere alcun ruolo esecutivo e non possa essere coinvolto, neppure *de facto*, nella gestione della banca.

Conclusioni

Riguardo alle sfide della profittabilità emerge come le posizioni dei vari operatori siano piuttosto variegate e come la redditività differisca in misura significativa tra le varie banche.

Non si rinviene una dimensione che si adatta a tutti gli approcci alla redditività, così come le strategie tra le banche con le migliori *performance* risultano piuttosto differenziate tra loro riguardo ai costi ed ai ricavi.

Recenti analisi evidenziano che le banche con migliori *performance* presentano un significativo incremento della componente dei ricavi, favorita da una rilevante capacità di diversificazione; una dinamica più contenuta dei costi, determinando rilevanti guadagni di efficienza; forte crescita degli investimenti in IT, con ciò evidenziando una particolare propensione verso il futuro dell’azienda²¹.

21. Andersson M., Kok C., Mirza H., Mór  C. e Mosthaf J. (2018), *How can euro area banks reach sustainable profitability in the future?*, Special Feature, Financial Stability Review, November, European Central Bank. November.

Con un'ottica prospettica, emerge come le strategie riflettano ancora in misura significativa tematiche di *legacy* e, quindi, lo stato presente del *business* e della redditività: le banche più deboli stanno cercando di ridurre i costi e gli Npl; le banche più solide e con migliori *performance* tendono a focalizzarsi sulla crescita.

Pur non essendoci aspettative di ritorno a livelli di redditività quali quelli precedenti alla crisi, in conseguenza delle modifiche del contesto, dei profili di rischio e della patrimonializzazione, tuttavia le banche devono necessariamente operare per conseguire, con una visione di lungo periodo, un appropriato ritorno sul capitale e sugli attivi in gestione al fine garantire lo sviluppo del *business* in modo sostenibile.

In tale contesto, emerge il ruolo centrale della guida strategica, cioè della capacità del *management* di impostare un percorso finalizzato a obiettivi di lungo termine, quali *governance*, *risk management*, gestione di reddito, costi e *pricing* dell'intermediazione con la clientela.

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Angelo Federico Arcelli*

*Cenni sulla storia e sul funzionamento
della Banca europea per gli Investimenti
("BEI")***

1. *Cenni alla storia della BEI*

La Banca europea per gli Investimenti ("BEI") è stata istituita dal Trattato di Roma nel 1957, divenendo operativa il 1 gennaio 1958. Essa è un ente di diritto sovranazionale, al cui capitale possono partecipare solo gli stati membri dell'Unione europea, che, in forza del suo trattato istitutivo è equiparata in molte prerogative alle altre istituzioni europee¹.

La BEI è una banca di sviluppo, che opera sul mercato e finanzia la sua attività creditizia emettendo prestiti obbligazionari a medio lungo termine. Grazie al sostegno implicito dei Paesi membri, non rappresentato da una garanzia, ma dalla potenzialità di richiamare la quota di capitale non versato (al momento pari al 91.39% del nominale sottoscritto), la BEI ha ottenuto da tutte le principali agenzie di *rating* la migliore valutazione possibile (la "trippla A"), il che le consente di raccogliere, tramite

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1. Cfr. "Statuti della Banca europea per gli Investimenti", 2004, art. 30.5: *"The Protocol on the Privileges and Immunities of the European Communities shall also apply to the Fund, to the members of its organs and to its staff on the terms and conditions laid down in the Treaty establishing the European Community"*.

emissioni obbligazionarie, a condizioni estremamente competitive, prossime a quelle dei Paesi membri, un ammontare di capitali rilevante sul mercato volumi finanziari.

Questo consente alla BEI di finanziare progetti di interesse europeo, secondo gli indirizzi di volta in volta suggeriti dai governi dei Paesi membri nelle sedi istituzionali (consigli europei e, soprattutto, il Consiglio dei Governatori della banca stessa), a condizioni vantaggiose, per durate molto lunghe e facendo scattare un “effetto catalizzatore” degli investimenti privati.

Il vantaggio dell'intervento della BEI consiste, quindi, essenzialmente nell'applicazione di tassi di interesse ridotti su prestiti a lungo termine. Questo è, cosa possibile perché essa è un ente non orientato al profitto, e quindi il differenziale tra quanto è il costo della raccolta e quanto viene richiesto alle controparti si riduce a una percentuale (inferiore ai normali tassi di mercato) necessaria per coprire i costi amministrativi, i rischi operativi e garantire la rivalutazione del capitale rispetto all'inflazione.

La BEI è nata, con lo scopo di sostenere lo sviluppo economico delle aree meno forti dell'Unione e accrescere la coesione tra le economie dei paesi membri. All'epoca della sua creazione, la BEI, era quindi molto orientata all'intervento in Italia. Non fu esclusa, per un certo periodo, l'ipotesi di considerare una città italiana come sua sede, ma, nel corso delle trattative al momento della sua creazione, prevalse l'idea di una soluzione “provvisoria” in Lussemburgo, geograficamente prossimo ai principali paesi fondatori, e l'Italia ottenne la nomina del presidente per i primi due mandati (vedi tabella 1).

Tabella 1²

<i>I presidenti della Banca europea per gli Investimenti</i>	
<i>presidente</i>	<i>mandato</i>
Pietro Campilli (Italia)	febbraio 1958 a maggio 1959
Paride Formentini (Italia)	giugno 1959 - settembre 1970

2. Fonte: BEI

<i>I presidenti della Banca europea per gli Investimenti</i>	
<i>presidente</i>	<i>mandato</i>
Yves Le Portz (Francia)	settembre 1970 - luglio 1984
Ernst-Günther Bröder (Germania)	agosto 1984 - marzo 1993
Sir Brian Unwin (Regno Unito)	aprile 1993 - dicembre 1999
Philippe Maystadt (Belgio)	gennaio 2000 – dicembre 2011
Werner Hoyer (Germania)	in carica dal gennaio 2012

La BEI ha una struttura di governance abbastanza complessa, che riflette lo spirito del trattato istitutivo e il legame con i Paesi membri. L'assetto decisionale della banca prevede il sussistere di tre livelli di decisione: il Consiglio dei Governatori, il Consiglio di Amministrazione e il Comitato Direttivo.

Il Consiglio dei Governatori è formato dai rappresentanti dei governi dei Paesi membri, generalmente i ministri delle Finanze o del Tesoro in carica, uno dei quali, con rotazione semestrale, diversa per successione dalla rotazione della presidenza dell'Unione europea, assume il titolo di "presidente del Consiglio dei Governatori" ed è la massima autorità dell'istituzione.

Questo consiglio, tuttavia, ha un ruolo più formale che sostanziale, dato che si riunisce una volta all'anno (di solito in giugno, in occasione dell'Assemblea annuale) e ha, tra le sue competenze, la nomina del presidente e dei vicepresidenti della BEI, la definizione della strategia di alto livello, l'approvazione del bilancio e della relazione annuale collegata, nonché le decisioni straordinarie attuabili senza revisione del testo statutario (ad esempio, ma non solo, gli aumenti di capitale). I Governatori sono, di regola, uno per ciascun Paese membro dell'Unione europea.

L'attività ordinaria della Banca è indirizzata dal Consiglio di Amministrazione, che si riunisce con cadenza quasi mensile (di norma almeno dieci volte all'anno) e approva le operazioni di concessione dei prestiti, le linee di politica gestionale (i bilanci preventivi e il budget annuale) e strategica (politica dei tassi di interesse, obiettivi di raccolta e attività nei vari Paesi membri) della BEI.

Il Comitato di Direzione è l'organo esecutivo a pieno tempo della Banca, e ne gestisce gli affari correnti. Esso si riunisce a cadenza settimanale (con delle pause in estate e a fine anno), e approva, discutendole in dettaglio, tutte le operazioni di prestito e di raccolta della BEI, decidendo la loro proposta al Consiglio di Amministrazione. Il presidente, di solito congiuntamente con i membri del Comitato di Direzione, ha, inoltre una serie di poteri e deleghe specifiche relative alla gestione corrente (ad esempio, ma non solo, le decisioni relative all'assunzione del personale, alla politica di remunerazioni, alle promozioni, all'organizzazione interna – dipartimenti e direzioni – e a tutto quanto concerne il management operativo necessario all'attività ordinaria).

Ai tre organismi decisionali, si affianca il Comitato di Verifica, che è composto da sei membri (tre effettivi e tre supplenti), con l'incarico di garantire la coerenza complessiva dell'attività della banca, il rispetto delle procedure, il corretto funzionamento degli organi di controllo interno e la fedele rappresentazione della realtà nei bilanci annuali.

2. Il Fondo Europeo per gli Investimenti ("FEI") e il suo legame con la BEI

Il Fondo Europeo per gli Investimenti ("FEI") è stato istituito nel 1994³ sulla base proposte discusse tra i principali governi europei e menzionate nell'ambito del Consiglio europeo di Edimburgo del dicembre 1992.

Esso è nato come strumento di cooperazione tra le istituzioni europee (BEI e Commissione Europea) e il settore bancario commerciale. Va aggiunto, però, che, in origine, la BEI, che aveva sottoscritto il 40% del capitale, a fronte del 45% sottoscritto dalla Commissione Europea (30%) e dagli azionisti privati (15%) – in origine il 15% del capitale rimaneva non allocato – non integrava

3. Lo statuto del FEI è stato approvato nella prima assemblea generale (il 14 giugno 1994), e, successivamente, modificato dall'assemblea generale del 19 giugno 2000.

il FEI in un gruppo⁴. Questo accadde solo dopo la decisione, nel giugno 2000, di portare al 60% circa la quota di capitale sottoscritta dalla BEI, consentendole in tal modo di contare sulla maggioranza.

Il FEI è dotato di personalità giuridica autonoma⁵, ed ha sede in Lussemburgo⁶. Esso ha come missione il contribuire al raggiungimento degli obiettivi dell'Unione Europea⁷, particolarmente nel sostenere lo sviluppo delle Piccole e Medie Imprese ("PMI") e dei settori innovativi. Per raggiungere questi fini esso è autorizzato a rilasciare garanzie o a partecipare, direttamente o attraverso altri strumenti di investimento (ad esempio fondi di "venture capital"), al capitale delle iniziative imprenditoriali sostenute⁸.

4. Per le quote di capitale e i singoli azionisti, cfr. "Statuto del Fondo Europeo per gli Investimenti", giugno 1994 e successive modificazioni, Annesso I e II. Cfr. anche, id., art. 4 comma 1, *"The founder members of the Fund shall be: 1. the European Community, hereinafter called the "Community", represented by the European Commission, hereinafter called the "Commission", 2. the European Investment Bank, hereinafter called the "Bank", 3. the financial institutions, the list of which is annexed to these Statutes (Annex I), hereinafter called the "Financial Institutions"*.

5. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 1.

6. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 3.

7. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 2.1: *"The task of the Fund shall be to contribute to the pursuit of Community objectives."*

8. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 2.1: *The Fund shall pursue this task through activities consisting of: a) the provision of guarantees as well as of other comparable instruments for loans and other financial obligations in whatever form is legally permissible, b) the acquisition, holding, managing and disposal of participations in any enterprise subject to the conditions laid down in paragraph 2 (i) of Article 12 of these Statutes.*

2.2: *In addition, the Fund may engage in other activities connected with or resulting from the tasks set out in this Article. The activities of the Fund may include borrowing operations.*

2.3: *The activities of the Fund shall be based on sound banking principles or other sound commercial principles and practices as applicable. Without prejudice to the provisions of Article 28, the said activities shall be pursued in close co-operation between the Fund and its founder members or between the Fund and its actual members at the relevant time, as the case may be."*

La *governance* del FEI prevede tre livelli di autorità: l'Assemblea Generale, il Consiglio di Amministrazione e il "Chief executive"⁹.

L'Assemblea Generale è il momento in cui tutti gli azionisti si riuniscono, una volta all'anno o quando i portatori di almeno il 13% del capitale lo richiedano (nel qual caso si avrà un'Assemblea Straordinaria), ed è il massimo organo di governo del FEI¹⁰. In occasione dell'Assemblea annuale si decide l'approvazione del bilancio, le linee strategiche e i piani di budget per gli anni seguenti, le nomine – quando a scadenza di mandato – del presidente e del Consiglio di Amministrazione, nonché le decisioni straordinarie attuabili senza revisione degli statuti. In caso gli statuti vadano rivisti, è richiesto un "quorum" dell'85% del capitale in favore di una determinata delibera per poter deliberare validamente in merito L'assem-

9. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 9: *"The Fund shall be managed and administered by the following three authorities: a) the General Meeting; b) the Board of Directors; and c) the Chief Executive"*.

10. I poteri dell'Assemblea Generale sono molto ampi. In particolare, Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 12.2: *"The General Meeting shall: (i) Take any decision authorising the Fund to conduct the operations provided for in the second indent of paragraph 1 of Article 2 of these Statutes. (ii) Approve the Rules of Procedure of the Fund. (iii) Decide on the admission of new members. (iv) Approve the annual report submitted by the Board of Directors. (v) Approve the annual balance sheet and profit and loss account. (vi) Determine the appropriation and distribution of the net income of the Fund. (vii) Appoint the members of the Audit Board of the Fund. (viii) Exercise the powers laid down in Article 34 of these Statutes for adopting any amendments to these Statutes. (ix) Decide on the increase of the authorised capital of the Fund, and any calls for non-paid-in subscribed capital. (x) Subject to the conditions laid down in Article 26 of these Statutes, decide on the increase of the ceiling on the commitments of the Fund. (xi) Take decisions to suspend or expel members. (xii) Take decisions concerning the permanent termination of the operations of the Fund and distribution of its assets. (xiii) Appoint the members of the Board of Directors and any alternates to these members from the individuals designated pursuant to Article 15, paragraphs 1 and 3 of these Statutes. (xiv) Compulsorily retire a member of the Board of Directors if that member is no longer able to fulfil his duties or is guilty of serious misconduct. (xv) Exercise all powers conferred upon it by any other provision of these Statutes"*.

blea è presieduta dal rappresentante del membro che detiene il maggior numero di azioni¹¹.

Il Consiglio di Amministrazione è formato da 7 membri, che possono essere coadiuvati da altrettanti supplenti¹², in carica per un mandato di due anni, rinnovabile. Esso si riunisce a cadenza frequente, di solito almeno mensile, ha poteri molto ampi¹³, e, soprattutto, approva le proposte presentate dall'organo operativo di gestione del FEI, il "*Chief executive*" o "*CEO*" o "Direttore Generale".

Il terzo pilastro della governance del FEI è un organo composto da un solo uomo, il "*Chief executive*" o "*CEO*", che è il massimo dirigente del Fondo, in carica per cinque anni, rinnovabili, e con ampi poteri circa la gestione ordinaria e corrente¹⁴

11. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 13: "*General Meetings shall be chaired by the representative of the member with the highest number of shares in the Fund*".

12. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 15.

13. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 16: "*In addition to the powers conferred upon it by the other provisions of these Statutes, the Board of Directors shall: (i) Decide on all operations of the Fund. It may delegate the power to decide in whole or in part, as it deems appropriate. (ii) Adopt guidelines and directives for the operations and the management of the Fund. (iii) Draw up proposals for submission to the General Meeting. (iv) Fix the general conditions for participations. (v) Set return criteria for the Fund's operations. (vi) Determine the objectives and the limits of the borrowing operations referred to in Article 2, paragraph 2 of these Statutes. (vii) On the basis of proposals made by the members of the Fund in accordance with the procedure laid down in the Rules of Procedure, appoint the Chief Executive and his/her deputy, if any. It shall also have the power to dismiss the Chief Executive and his/her deputy, if any. (viii) Supervise the Chief Executive and his/her deputy and ensure that the Fund is managed in accordance with the provisions of these Statutes and with the guidelines and directives laid down by the Board of Directors. (ix) Submit the annual accounts and the annual report on the activities of the Fund to the General Meeting. (x) Convene General Meetings of the Fund. (xi) Without prejudice to the powers of the General Meeting, take decisions on any other matters falling outside the competence of the Chief Executive*".

14. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 21.1: "*The Chief Executive shall be responsible for the day-to-day management of the Fund in accordance with the provisions of these Statutes and the guidelines and directives adopted by the Board of Directors*".

e con il mandato a predisporre l'agenda del Consiglio di Amministrazione e di portare all'attenzione di tale organo le proposte circa le nuove operazioni¹⁵. Questa funzione assomiglia molto all'equivalente presente nelle strutture di governo delle aziende private, e, in effetti, ne mutua molta parte dei suoi poteri.

15. Cfr. "Statuto del Fondo Europeo per gli Investimenti", cit., art. 20.1: *"The Fund shall be managed by a Chief Executive. He/She shall act independently and serve the best interests of the Fund and shall be accountable only to the Board of Directors in carrying out his/her duties"*.

Agenda

Dates

July 15–16, 2019

Day venue

Palazzo Altieri, Representative offices in Rome of Gruppo Banco BPM SpA, Piazza del Gesù, 49 – 00186 Roma

Dinner Venue

Nuovo Circolo degli Scacchi, Via del Corso 518 – 00186 Rome

MONDAY 15 JULY (10:30–18:00, followed by dinner)

TIME	SEMINAR / ACTIVITY
10:30–11:00	Registration and welcome coffee
11:00–11:05	Opening of the day
	Opening of the sessions of the day and welcome to speakers and delegates <ul style="list-style-type: none">• Andrea Federico (Partner, Oliver Wyman)
11:00–11:30	Welcome and introduction
	Welcome address and introduction to the seminar <ul style="list-style-type: none">• Mauro Paoloni (Deputy Chair, Banco BPM) – Welcome address• Prof. Rainer Stefano Masera (Dean of Economics, Università G. Marconi) – Introduction to the seminars
11:30–12:45	Seminar #1
	Upcoming regulatory and board priorities – presentation and group discussion <ul style="list-style-type: none">• Introductory remarks: Prof. Ignazio Angeloni (Senior Fellow, Harvard Kennedy School); Dr. Christian Ossig (CEO, Bundesverbandes Deutscher Banken)• Chair: Rodrigo Pinto Ribeiro (Partner, Oliver Wyman)
12:45–14:30	Lunch
	Networking lunch <ul style="list-style-type: none">• Keynote address: Fabrizio Saccomanni (Chair, Unicredit), introduced by Claudio Torcellan (Partner, Oliver Wyman)
14:30–16:00	Seminar #2
	Governance elements across Europe, their evolution and the most relevant characteristics today – presentation and group discussion <ul style="list-style-type: none">• Introductory remarks: Belen Romana (Non-executive Independent Director, Santander); Daniela Weber-Rey (Board member, HSBC Germany)• Keynote: Luc Frieden (Chair, BIL)• Chair: Prof. Patrick Kenadjian (ILF, Goethe University, Frankfurt)
16:00–16:30	Coffee break
16:30–18:00	Seminar #3
	A review of the policy rationale and business opportunities and challenges in cross boarder M&A in Europe – presentation and group discussion <ul style="list-style-type: none">• Introductory remarks: Davide Taliente (Head of EMEA, Oliver Wyman); Carlo Corradini (Board Member, Fondazione Cariplo)

	<ul style="list-style-type: none"> Chair: René Brühlhart (Chair, AIF – Vatican City)
19:00–22:00	Networking dinner (seated) Nuovo Circolo degli Scacchi, via del Corso 518 (00186 Rome) <ul style="list-style-type: none"> Keynote speech: Lorenzo Bini Smaghi (Chair, Société Générale), introduced by Bruno de Saint-Florent (Partner, Oliver Wyman)
TUESDAY 16 JULY (09:00–18:15, followed by optional dinner)	
TIME	SEMINAR / ACTIVITY
09:00–09:05	Opening of the day Opening of the sessions of the day <ul style="list-style-type: none"> Bruno de Saint-Florent (Partner, Oliver Wyman)
09:00–10:30	Seminar #4 Geo-politics and Geo-economics – presentation and group discussion <ul style="list-style-type: none"> Introductory remarks: Prof. Franco Frattini (formerly European Commissioner and Foreign Affairs Minister of the Italian Republic); Giorgio La Malfa (formerly Minister of European Affairs of the Italian Republic) Chair: Frédéric Visnovsky (Deputy General Secretary Head of Resolution, ACPR – Banque de France)
10:30–11:00	Coffee break
11:00–12:30	Seminar #5 Challenges in the role of a Chair – Testimonies and group discussion <ul style="list-style-type: none"> Introductory remarks: Costas Michaelides (Chair, NBG); Nuno Amado (Chair, Millennium bcp) Chair: Andrea Federico (Partner, Oliver Wyman)
12:30–14:30	Lunch Networking lunch <ul style="list-style-type: none"> Keynote address on Funding Innovation: Pier Luigi Gilibert (CEO, EIF), introduced by Arturo La Valle (Professor, Università G. Marconi)
14:30–17:45	Seminar #6 (break: 16:00–16:30) Increasing the effectiveness and impact of the Board in a volatile market <ul style="list-style-type: none"> Facilitators: Keith McCambridge (Partner, Oliver Wyman); Kevan Jones (Partner, Oliver Wyman)
17:45–18:00	Wrap-up of the two days Wrap-up of the Banking Board Academy and reflection on the seminars across the two days <ul style="list-style-type: none"> Yiannis Zographakis (Board Member, NBG); Isabelle de Wismes (Board Member, Unicredit)
18:00–18:15	Closing remarks Closing of the seminar sessions of The Banking Board Academy <ul style="list-style-type: none"> Federico Arcelli (Partner, Oliver Wyman); Prof. Rainer Stefano Masera (Dean of Economics, Università G. Marconi)
19:00–22:00	(Optional) Dinner Nuovo Circolo degli Scacchi, via del Corso 518 (00186 Rome)

Delegates

#	SURNAME	NAME	ROLE	INSTITUTION
1	Amado	Nuno	Chair	Millenium bcp
2	Angeloni	Ignazio	Senior Fellow	Harvard Kennedy School
3	Anolli	Mario	Board Member	Banco BPM
4	Arcelli	Federico	Partner	Oliver Wyman
5	Bastianini	Guido	CEO (Former)	Banca Carige
6	Bini Smaghi	Lorenzo	Chair	Société Générale
7	Brühlhart	René	Chair	AIF – Vatican City
8	Carruet	Frank	Ambassador of Belgium in Italy	Government of Belgium
9	Corradini	Carlo	Board Member	Fondazione Cariplo
10	de Saint-Florent	Bruno	Partner	Oliver Wyman
11	De Sanctis	Luigi	Partner	Oliver Wyman
12	de Wismes	Isabelle	Board Member	Unicredit
13	Fassati	Ariberto	President	Cariparma
14	Federico	Andrea	Partner	Oliver Wyman
15	Frattini	Franco	Former European Commissioner and Foreign Affair Minister of Italy	European Commission, the Italian Republic
16	Frieden	Luc	Chair	Banque Internationale a Luxembourg
17	Gennaro	Alessandro	Professor	Università G. Marconi
18	Gilibert	Pier Luigi	CEO	European Investment Fund
19	Giovannini	Renato	Dean of the School of Law Full Professor of Banking and Finance	Università G. Marconi
20	Jones	Kevan	Partner	Oliver Wyman
21	Kenadjian	Patrick	Adjunct Professor	ILF, Goethe University
22	Lavalle	Arturo	Director of the R&D Department	Università G. Marconi
23	Locatelli	Rossella	Board Member	Intesa Sanpaolo
24	Masera	Rainer	Dean of Economics	Università G. Marconi
25	Marcarino Paris	Angela	Head of Asia and Pacific Public Sector Operations	European Investment Bank

#	SURNAME	NAME	ROLE	INSTITUTION
26	McCambridge	Keith	Partner	Oliver Wyman
27	Michaelides	Costas	Chair	NBG
28	Monticelli	Carlo	Deputy Governor	Council of Europe Development Bank
29	Ossig	Christian	CEO	Bundesverbandes Deutscher Banken
30	Paoloni	Mauro	Deputy Chair	Banco BPM
31	Pinto Ribeiro	Rodrigo	Partner	Oliver Wyman
32	Romana Garcia	Belén	Non-Executive Independent Director	Santander
33	Saccomanni	Fabrizio	Chair	Unicredit
34	Sella	Maurizio	Chair	Banca Sella
35	Taliente	Davide	Managing Partner & Head of EMEA	Oliver Wyman
36	Torcellan	Claudio	Partner	Oliver Wyman
37	Tremonti	Giulio	Chair	Aspen Institute Italia
38	Trequattrini	Gianluca	Secretariat of the Directory and Communication	Banca d'Italia
39	Visnovsky	Frédéric	Deputy General Secretary Head of Resolution	ACPR – Banque de France
40	von Habsburg-Lothringen	Istvan	CEO	Azmut SA
41	Weber-Rey	Daniela	Supervisory Board Member	HSBC Germany
42	Zographakis	Yiannis	Board Member	National Bank of Greece

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