

ANALYSIS

Venerable but vulnerable

'The foundation is the way of fossilising elites. It is a circulation of money among friends'

As the woes of the world's oldest bank throw its Tuscan home town into turmoil, how the fate of its biggest shareholder is resolved will test the extent of Italian willingness to adjust to change.

By Rachel Sanderson

In the vaults of Monte dei Paschi di Siena resides a document of which employees of the 540-year-old Italian bank are morbidly proud. It is a death penalty handed out in the earliest years of what is regarded as the world's oldest bank to a man who tried to steal some of its gold. Torn and yellowing, it is a symbol of the bank's power at a time when its clients were living through the upheaval of the Renaissance.

Half a millennium later, with the eurozone's sovereign debt crisis tipping Italy into another period of change, the bank and the Tuscan hill-top town where it is based again provide a microcosm of the tensions at play in Italian society.

Monte dei Paschi is now the country's third-largest bank. But like the government in Rome, it is struggling with a plunge in the market value of sovereign bonds as investors fret at Italy's high debt and long pattern of near-zero economic growth. As European regulators demand the bank raise €3.2bn in extra capital, Monte dei Paschi is no longer able to fund the charitable foundation that owns nearly half of its shares and that has functioned locally like a modern-day Medici. Citizens who prided them-

selves on a quality of life built on the spoils accrued over centuries are no longer sure of their future.

The drama unfolding in Siena is also symbolic not only of the struggle Mario Monti, Italy's new technocratic prime minister, faces in driving growth in one of the world's top 10 economies but also in how the once wealthy, cosseted provincial elite of Europe face a world in which their fortunes are in decline. "In Siena they didn't understand that being around for 500 years counted for nothing," says one senior Italian banker. "It is a common thread in Italy. You could call it the temptation of trying to survive without the market."

Siena's problems began in 2007. At a time when Europe's banks were rapidly internationalising, Giuseppe Mussari, the chairman of Monte dei Paschi, struck a deal that has reverberated ever since. In the carve-up of ABN Amro, the leading Dutch banking group that Royal Bank of Scotland and others had just bought, Mr Mussari paid €9bn for Antonveneta, a bank from the region near Venice, in order to vault Monte dei Paschi into Italy's big league.

At nearly 20 times annual earnings, more than twice the average multiple of Italian peers, it looked challenging even at the time and strained Monte dei Paschi's finances to the limit.

Mario Draghi, then the Italian central bank governor and now a central figure in the struggle to save the euro as president of the European Central Bank, waved the deal through. It was seen as vital in protecting Italian banks – and the high private wealth of Italians – from being swallowed up by bigger foreign groups. However, it dealt a blow to Siena's financial security.

To those who questioned the wisdom of his actions, the response of Mr Mussari and his managers was consistent: doubters just did not understand how Siena worked. "There are two things in Italy that have been proved to last: the Vatican and Monte dei Paschi," one said at the time.

For a while they were proved right. Monte dei Paschi's illustrious past secured its future. While RBS and Fortis of Belgium were undone by their involvement with the Dutch bank, Monte dei Paschi had a homemade buffer, an all-Italian solution in the form of its foundation. In the 1990s Italy had sought to privatise its banks but wanted to preserve the charitable roles they had held in the community for centuries. Thus, newly created foundations were given stakes in the banks they had once been part of so that they could continue to fund

local charities from the dividends they received.

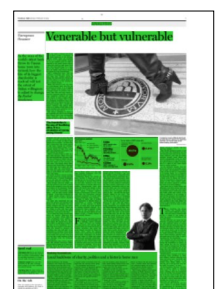
Strengthening their powers, foundations also became structures reflecting the political make-up of their communities. Each big bank has at least one, although none to the extent of that in Siena, where it is the only large banking foundation that still controls its legacy bank.

Fondazione Monte dei Paschi di Siena provides a large part of the funding for the city of Siena, through the dividends it receives from its 49 per cent stake. Tuscany is one of the richest regions in Europe. Most of its wealthy entrepreneurs bank with Monte dei Paschi and thanks to their patronage it is known in the city as *Babbo Monte* ("Daddy Monte") because of its largesse. In the 15 years until 2010, the foundation received estimated dividends of nearly €2bn, equal to €40,000 for every resident.

Citizens of Siena talk of getting their bathrooms or kitchens fixed, or undertaking a vanity publishing project, at the expense of *Babbo Monte*, to which they made petitions for funding personal projects. As a consequence, Siena regularly topped rankings as the wealthiest city in Italy and the one that offered the best quality of life, a matter known to every grateful Sienese.

For its part, the bank had both a stable, loyal shareholder and a willingly captive clientele. Many of these are families who had grown rich during Italy's postwar boom and would not dream of banking anywhere else given the social support provided by Monte dei Paschi. Thus, when Mr Mussari needed extra capital after his ill-timed Antonveneta acquisition, the foundation was happy to oblige and ensure the status quo remained untroubled.

Across Italy, the phenomenon of the *fondazioni* is part of the reason why up until the end of last year you could be forgiven for thinking – if you were in wealthy pockets of Tuscany, Piedmont or Emilia Romagna – that national data pointing to a decade of annual growth of barely 1 per cent and rapidly eroding competitiveness



must be referring to somewhere else.

But there were disadvantages. Duncan McDonnell of the European University Institute in Florence says that because of their political connections and their historic importance in the community, foundations tend to support the status quo over meritocracy or innovation. He sees it as a pattern repeated up to the highest levels of power in Italy – and one that has been violently shaken by the crisis. “The foundation is the way of fossilising elites. It is a circulation of money among friends,” Mr McDonnell says.

In the case of Siena, the past confidence of the city’s elite also meant it lacked a plan B if things went wrong. SienaNews, the English-titled but Italian-language local paper, describes what has happened since the cost of repaying Italian debt reached record highs last year “as the worst crisis in 600 years” for the city. That is because nearly 90 per cent of the Monte dei Paschi foundation’s assets are concentrated in the bank, a higher proportion than elsewhere in the country. So when the bank cut dividend pay-outs during the crisis, the foundation’s inflow of funds dried up.

In his office high above the city’s central Piazza del Campo, Franco Ceccuzzi, Siena’s newly elected mayor, wants the entire management of the bank and the foundation to retire because he believes they left the city unprepared for the ferocity of the sovereign crisis. On one count, he has already been answered. The bank recently appointed an outsider, Fabrizio Viola, as new chief executive. It is the first time someone from outside Siena has taken the job. “In a time of great change, change is needed,” Mr Ceccuzzi says simply.

How did the position become so bad for the bank, the foundation and the city? Having been burnt by the Antonveneta takeover, and with its capital structure already weak, Monte dei Paschi’s management erred on what they considered to be the side of caution and invested in Italian sovereign debt to a value of four times larger than its capital cushion.

In the panicked months that followed the spread of sovereign contagion to Italy, the foundation revealed it was €1.1bn in debt to a consortium of 13 foreign banks. In a desperate attempt to keep control of the bank, it had borrowed heavily to subscribe to a rights issue at Monte dei Paschi. That was demanded by European regulators as the crisis further undermined the bank’s capital by reducing the value of its bond holdings.

The banks led by Credit Suisse and JPMorgan want their money back and the foundation cannot pay. This raises the prospect that a consortium of foreign banks could take control of the bank as collateral. In an attempt to head off that prospect, the foundation has said it will reduce its stake. In a

double whammy of bad timing, European regulators also want Monte dei Paschi to raise another €3.2bn of capital. If it fails to do so by June, it risks nationalisation.

Those watching the drama unfold, who include Italy’s most senior officials, say that how the crisis is resolved will provide a signal of the extent to which the country is changing in the era of Mr Monti.

On one side there are signs that old networks of Siennese power are making only sufficient moves to ensure the broad picture stays the same. Mr Mussari will retire as Monte dei Paschi chairman when his term comes up for renewal in April – but he will stay in the national spotlight as head of the Italian Banking Association. The former chief executive, Antonio Vigni, who made way for Mr Viola, is now a consultant for the foundation.

But optimists see the sovereign crisis as a game changer for the city by forcing the foundation to reduce its stake, paving the way for investors better suited to helping steer the bank out of the crisis. Bankers say in the longer term the bank will be run better and may end up as part of a larger European group.

Representing a younger view that is becoming more prevalent in Italy, local blogger Federico Marconi says Siena has long been “mentally and economically lazy” because of the funding from *Babbo Monte*. “Let’s grow up, get a real job and stop asking daddy for money,” he says.

In the meantime, however, the situation in Siena, which is mirrored across Italy, is that it is growing poorer. Funding from the foundation to the city and the surrounding region fell by 80 per cent in the past two years. Signs for bingo halls and pizza by the slice, which commentator Aldo Cazzullo has termed the new face of crisis Italy, are popping up.

For his part, Mr Ceccuzzi, the new mayor, wants to put Siena forward for consideration as European City of Culture for 2019. It is a way to exploit Siena’s greatest unblemished asset – its past.

Speed read

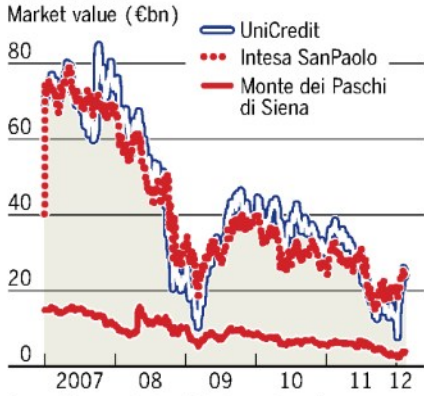
● **Damaging deal** Monte dei Paschi di Siena is trying to recover from the ill-timed acquisition of Antonveneta, while its controlling foundation is in worse financial shape after big borrowings

● **Takeover target** Both could find themselves at the whim of foreign banks, putting at risk local charitable and political funding

● **Funding need** The bank’s board is being renewed but regulators want it to raise €3.2bn of capital by June

Renaissance awaited

Italian banks



Source: Thomson Reuters Datastream; Consob

€4bn
BMPS market value
Feb 16 2012

€15.8bn
BMPS market
value May 18 2007

€9bn
Price BMPS paid
for Antonveneta

€25bn
BMPS holdings of
Italian sovereign debt

Top four holders of BMPS voting rights

Fondazione Monte
dei Paschi
di Siena



Unicoop Firenze



Axa Investment
Managers Paris



JPMorgan



Banking foundations

Local backbone of charity, politics and a historic horse race

Monte dei Paschi is the leading employer in the Tuscan city of Siena and provides more than half of the loans made to local businesses and residents. But for more than a decade, at least as important to the area was the foundation that owns 49 per cent of the bank. Up until 2008 it handed out about €250m a year to Siennese charities – more than the city budget.

The Italian government created banking foundations in the early 1990s to facilitate bank privatisations. As banks in the country had themselves traditionally played substantial charitable roles in the community, the foundations were given stakes in the lenders to sustain those activities.

A regular stream of dividends from the banks kept the voluntary sector going.

The foundations also became important funders of grassroots political organisations, usually reflecting the politics of the community where they were based. In Siena this means the left, which is dominant in the town. In areas of the Veneto region, foundations lean towards the populist Northern League.

Most foundations have diversified their holdings so as not to be so reliant on the banks. Many banks, such as Intesa Sanpaolo and UniCredit, Italy's largest by assets, had meanwhile grown by taking over smaller rivals, further diluting the foundations' stakes. Siena

was the exception, partly because of fierce local loyalties. Nearly 90 per cent of the Monte dei Paschi foundation's assets come from the lender.

Managers at both the bank and the foundation are thus desperate to maintain the status quo. They fear Monte dei Paschi would otherwise be a target for other European groups keen to gain a customer base that includes a rich hinterland of entrepreneurs in Tuscany and Veneto.

A foreign owner would be unlikely to fund the city as the foundation has done. Among its most high-profile donations are those to Il Palio, a 300-year-old bareback horse race held in Siena's central square. Bankers say

Monte dei Paschi also has room to cut costs – another reason why residents, who otherwise largely rely on the tourist industry for jobs, want the foundation to remain in control.

Paul Furlong, professor of European economy at Cardiff University, says unwinding the foundations "will have an important impact on the way Italy's voluntary sector operates". Likening the foundations to the "very closed networks" of power that operate elsewhere in Italian society, such as corporate shareholder pacts, he says there is no easy way to replace these arrangements. "They have been part of the fabric of society and a network for governance for generations."