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SSM and the Quiet Revolution: Italy to Reform Banking and Finance Legislation Under EU Provisions

BY BRUNO COVA & PATRIZIO BRACCIONI

Law No. 154 of the 7th of October, named "Legge di delegazione europea 2013-bis" ("Law 154"), which has entered into force on the 12th of November, was enacted in order to implement EU directives into Italian legislation on a wide series of topics.

Article 3 provides for a very wide empowerment of the Italian Government to adapt current legislation to the EU Capital Requirement Directive and Capital Requirement Regulation, among the Europe wide legal pillars of the Single Supervisory Mechanism. This will entail substantial changes to Italian banking and finance legislation, mainly the Banking Act of 1993 and the Finance Act of 1998. The Italian Government will have to enact detailed regulations by next February.

The quality of boards of directors and subsequent responsibilities; a new and much more severe penalty system for employees, directors, auditors, and consultants; and internal organisations with more defined tasks and responsibilities will be only some of the effects the new rules will produce.

Foreword

EU Directive 36/2013 of the 26th of June 2013 about prudential supervision over banks and investment companies, known as Capital Requirement Directive IV ("CRD IV"), should have been implemented by Member States no later than the 31st of December 2013. Last January, the EU Commission had warned the Italian Government that such deadline had not been met. However, the Government introduced a wide draft law to be approved by Parliament, "Legge di Delegazione Europea 2013-bis," which would delegate the Government to adapt Italian legislation to EU Directives published in the second half of 2013, which includes CRD IV.

Due to the very wide scope of topics concerned, from immigration issues to banking law, Parliamentary debate has been long. Draft law was finally approved by the Senate on the 17th of September 2014, became Law No. 154 on the 7th of October, and was published in the Official Gazette of the 28th of October. Entry into force occurred on the 12th of November, 15 days after publication according to the ordinary constitutional term.

Based on recent legislative provisions dating back to 2012, the Government is bound to execute delegated legislation from an EU source no later than three months after entry into force of law of such delegation. This implies that the Government will have to enact all of the required new legislative provisions by next February.

Article 3: Reform of Both Banking and Finance Legislation

Article 3 of Law 154 sets forth the guidelines which the Government will have to apply in adapting current Italian legislation to CRD IV and the Capital Requirement Regulation, which is EU Regulation 575/2013 of the 26th of June 2013. The latter is a Regulation which is already self-executing; however, certain details need to be clarified.

Article 3 is made of two sections. Section 1 is divided into letters, each of which relates to a certain number of topics. Section 2 simply explains that the envisaged reform will not have to bring more costs and only available resources will have to be used.

Letters a), b), and c) contain very wide guidelines to the Government. They simply state that it should modify and integrate Legislative Decree No. 385 of the 1st of September 1993 (the Italian Banking law) together with Legislative Decree No. 58 of the 24th of February 1998 (the Italian Finance law).

Where possible, such changes can be brought through the regulatory powers of the Bank of Italy, the Italian Banking Authority (the National Competent Authority, or NCA, according to SSM language), and CONSOB, the Italian Market Authority.

Starting from letter d) onwards, issues become more detailed. The latter relates to changes needed both in the requisites of bank board members and the requisites of participants to a bank capital. With reference to the requisites of board members, changes might be relevant, though not radical.

As of today, board members must have requisites of honorability and professionalism in a very wide sense. CRD IV provides for no contradiction of these principles but adds somewhat more stringent conditions. In fact, it states that board members must have a level of professionalism such that it should allow them to effectively control the management.

This does not imply that any board member should be expert on everything about the banking industry (accounting, risk, capital requirements, compensation, etc.), but the board as a whole—with proper representation of different professional knowledge, as well as by age, gender, experience, and educational background—should make it possible to reach the target. There may appear to be little change from a formal point of view, but this is a substantial modification when compared to many years of common Italian practice.

Letter e) is another significant change in the Italian scenario. The Bank of Italy will be provided with the power to remove board members if their presence is deemed to endanger safe and prudent management of the bank itself. Historically, the Bank of Italy had publicly requested this power many times, but it was never granted except in the case that the bank became subject to enforcement procedures. In the very near future, this pre-condition will be no longer required.

It is clear that removal of board member can also be decided by the ECB in its new role of European Banking Supervisory Authority. In the latter case, the Bank of Italy will be bound to execute the ECB's decision in Italy, according to SSM rules.

A further point of high interest is Letter h). It provides for new rules for the protection of whistleblowers. According to international regulatory standards, the Bank of Italy had already issued regulations about the protection of whistleblowers, but it is likely that these regulations will have to be updated and modernized.

In the European view, whistleblowers are no longer seen as something to be treated carefully, but as a potential extremely valuable support on behalf of supervisory activities, which need both to be encouraged and enlarged on behalf of different supervisors/regulators. This will also imply that local inspections managed by the ECB Joint Supervisory Teams could be based on information collected through whistleblowing.

Letters i), l), m), o), and p) relate to the new penalty system to be introduced, which, compared to the existing one, will be much more onerous and severe. What we had anticipated in our Client Alert of the 8^{th} of May on the CRD IV penalty system on banks is fully confirmed.

For a brief recap of the main points, any individual employee, board member, auditor, or advisor (potentially including lawyers) connected to the banks who puts in place a breach of applicable laws and/or regulation, can be subject to a fine from a minimum of 5.000 to a maximum of 5 million Euros. EU proportionality principle, as developed by the jurisprudence of the EU Court of Justice, will always apply, in the sense that the gravity of the penalty must be compared to the gravity of the breach.

On the other hand, banks can be fined up to 10% of their consolidated turnover (not profit). This also means that any violation put in place by any subsidiary, even the smallest one, will be subject to the same rule.

Furthermore, if the individual author of the breach has obtained determinable benefits, or the bank has obtained determinable benefits resulting from the breach, the fine applied will be the double of the benefit obtained, even if the amount exceeds the caps described above.

In other words, both for individuals and for banks, when a breach procures economic benefits that can be determined/measured, pecuniary fines do not have any limit or cap. In addition, penalties related to the prevention of money laundering will have to be updated according to the new criteria.

These are all very relevant changes in the Italian financial environment, where such punitive powers had never been attributed to any regulatory authority in the past.

Conclusions

The soon-to-be-implemented changes in the legal framework for banks and listed companies will be relevant and substantial, and they will require that banks, listed companies, and their directors and shareholders introduce appropriate measures. For instance:

- shareholders of banks and other financial entities will have to pay more attention to the composition of their boards, where directors will have to ensure the adequate level of specific competence on banking and/or banking-related matters;
- directors will need to ensure that they maintain the appropriate level of competence and be mindful of the increased likelihood of exposure of wrongdoing and the increase in the range and severity of sanctions;
- banks and financial institutions will have to introduce mechanisms to facilitate the reporting of wrongdoing by so-called whistleblowers; and
- listed companies, banks, and financial institutions will generally need to review their regulatory and legal risk management and compliance systems to ensure that they are effective in light of the legislative changes.

Further relevant changes to Italian banking law are expected as soon as the SRM, Single Resolution Mechanism, comes into play.

Finally, the reform will give rise to new questions and issues both at EU and domestic levels, implying that an era has come to an end while a new one is on the horizon.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Milan lawyers:

Bruno Cova	Patrizio Braccioni	Flavio A. Acerbi
39.02.30414.212	39.02.30414.210	39.02.30414.218
brunocova@paulhastings.com	patriziobraccioni@paulhastings.com	flavioacerbi@paulhastings.com