

Italian banks

Fazio under fire

New controversy over Italy's contested bank bids

IT SEEMED that it was all over bar the shouting. On July 22nd Spain's Banco Bilbao Vizcaya Argentaria (BBVA) abandoned its bid for Banca Nazionale del Lavoro (BNL). Three days later ABN Amro of the Netherlands said its attempted takeover of Antonveneta, another Italian bank, had also failed. The battle for control of these two mid-sized banks, which dragged on for four increasingly bitter months, appeared over, leaving Fortress Italy intact.

But more is now at stake. Antonio Fazio, governor of the Bank of Italy, is in trouble up to his eyebrows. Gianpiero Fiorani, the boss of a home-grown rival bidder for Antonveneta, Banca Popolare Italiana (BPI), is a friend of his. Leaked transcripts reported in the press of telephone conversations between the two tapped by government investigators suggest that the governor may have been less than neutral in his handling of the bids. There are now calls, predictably, for him to resign. On July 27th Consob, Italy's market regulator, suspended BPI's bid for Antonveneta as a "precaution". How did things go so wrong?

For a while, the Spanish and the Dutch looked well placed to breach Italy's banking establishment. The boards of BNL and Antonveneta had endorsed their bids. Mr Fazio had given them permission to increase their stake beyond 20%. And the EU Commission had approved both offers.

Yet behind the scenes, protectors of the banks' *italianità* mobilised their defence. Failing to convince one of Italy's big banks to step in as a white knight, they turned to weaker institutions. One was Unipol, a Bologna-based insurer. Unipol increased its stake in BNL to about 15%. It also recruited shareholders led by Stefano Ricucci and Francesco Caltagirone, two rich property developers, who had bought nearly 30% of the bank. On July 18th Unipol offered cash on the barrel for BNL, financed by a capital increase, debt and asset sales.

The other was Mr Fiorani's BPI, formerly known as Banca Popolare di Lodi. In spite of its anaemic finances, BPI launched two separate bids for Antonveneta, including an all-cash offer. This was after criminal investigations had been started into possible securities-laws violations.

It was in connection with these probes that telephone conversations were tapped. Mr Fiorani was delighted when Mr Fazio called him on July 12th to break the news—before making it public—that BPI's bid had got the go-ahead. According to Italian press reports of that particular chat, an emotional Mr Fiorani replied that he would kiss his friend "Tonino" on the forehead to thank him if he could. Mr Fazio himself may feel less warmly now.

Usually, a company has to prove that it has enough capital before its bid is approved, says Alessandro Roccati at Fox-Pitt Kelton, an investment bank. Analysts

estimate that BPI was short about €1 billion (\$1.3 billion) when it announced its offer.

In all this sorry mess, the only winners are the property developers who made some €900m from the sale of their stake in BNL to Unipol. The losers include Italian consumers, the country's reputation among foreign investors and, now, the credibility of Italy's central bank.

Italians pay their banks much higher annual fees and commissions than other Europeans. Opening an account can require filling out more than a dozen forms; closing one costs a hefty fee. Without foreign competition, Italians will continue to be ripped off, says Davide Serra of Morgan Stanley, an investment bank.

Neither BBVA nor ABN Amro intends to remain a minority shareholder in its erstwhile target, so big chunks of capital will leave the country at a time when Italy's recession-hit economy desperately needs liquidity. ABN Amro's stake in Antonveneta is worth about €2.3 billion, and BBVA's shares in BNL would sell for around €1.2 billion.

Most damaging is the perception abroad of a chaotic tug-of-war between rogue investors, regulators and the judiciary. "We have generated a situation of enormous speculation under the motto 'take the money and run'," says Luca Cordero di Montezemolo, head of the Confindustria, the employers' association.

Consob has ruled twice that BPI improperly acted in concert with other shareholders. Moreover, on July 25th, prosecutors confiscated the shares owned by BPI and ten investors (including Mr Ricucci), amounting to some 41% of Antonveneta's stock. If these shares were to come to the market, ABN Amro, which technically has control of the board now, could become the majority investor by buying its opponents' stakes. Yet having met with such hostility, the Dutch may turn their attention elsewhere.

This is not the end of cross-border bank mergers, says Armin Polster of Deutsche Bank, but banks are now likely to give Italy the same cold shoulder that they themselves received—at least until it's clear whether Mr Fazio should be in charge.

Italian finance: Another year, another scandal

Did Italy learn nothing from Parmalat?

The latest scandals over a contested bank bid show that Italy learned little from Parmalat

LESS than two years ago, the spectacular bankruptcy of Parmalat, a family-controlled Italian dairy group, sent shock waves throughout Italy. It was the biggest scandal in European corporate history, revealing a euro14 billion (\$17 billion) accounting hole that had grown over a decade of deception. The saga cast regulators, bankers and auditors in a desperately unfavourable light for not spotting the fraud much more quickly than they did.

Europe's Enron offered a chance for the comprehensive reform of Italy's financial regulation that it so badly needs. Yet the growing scandal over the contested bids for Banca Antonveneta by Banca Popolare Italiana (BPI) and ABN Amro, a Dutch bank, shows that this opportunity was instead comprehensively missed.

In the first weeks after the Parmalat scandal erupted, reforms were introduced at surprising speed. Just before Christmas 2003, new insolvency legislation was pushed through, inspired by America's Chapter 11. The government was also keen to improve financial regulation. Giulio Tremonti, the finance minister of the moment, wanted to replace the existing hotchpotch--Italy has four financial regulators other than its powerful central bank, all toothless and understaffed--with one strong super-regulator, an Italian equivalent of Britain's Financial Services Authority (FSA). Mr Tremonti also tried to replace the central bank governor's current job for life with a term limited to seven years.

This provoked the first of a series of clashes between Mr Tremonti and Antonio Fazio, governor of the Bank of Italy. Mr Tremonti criticised Mr Fazio for failing to spot the massive accounting fraud at Parmalat. Mr Fazio countered that the central bank was not responsible for how companies report their finances. Yet it does have an internal database that tracks the debt of the country's almost 800 international and domestic banks. It could have acted on warnings that bankers were financing a house of cards, critics claim.

Mr Fazio gained the upper hand, and Mr Tremonti was forced to quit. His proposal was reduced to a draft law calling for the replacement of Consob, the securities-market watchdog, with an Authority for the Protection of Savings, with various responsibilities and resources pinched from the central bank and the antitrust authority. A limit on the central-bank governor's term remained in the draft law but the law itself is still pending in parliament.

Latest developments in the soap opera that the takeover battle for Antonveneta has become have revived discussion of Mr Tremonti's proposal. After ABN Amro announced in March that it would bid for Antonveneta, BPI raised its small stake in the bank to 29% in several steps that involved allegedly illegal financial manoeuvres, now the subject of investigation. The central bank approved each step.

Against this background, Italy's magistrates stepped in. Several weeks ago Milan prosecutors launched a probe into allegations that BPI had violated securities laws. On July 25th they confiscated shares owned by BPI and ten investors amounting to 41% of Antonveneta's stock. On July 27th Consob suspended, belatedly, its approval of BPI's bid. The Bank of Italy finally followed suit. On August 2nd a Milan judge ordered Gianpiero Fiorani, BPI's boss, suspended from his job for 60 days, for fear that he might tamper with evidence. Earlier that day, the judge ratified the seizure of BPI's Antonveneta shares. BPI's board named Giorgio Olmio its interim chief executive.

At the same time, lawsuits and arrests related to Parmalat came as a timely reminder of the fallout of that gigantic corporate scandal. Last week prosecutors requested indictments of Citigroup, UBS, Deutsche Bank, Morgan Stanley, Nextra, the asset-management arm of Banca Intesa, and 13 individuals connected to these banks. On August 2nd prosecutors re-arrested Luca Sala, a former Bank of America employee who worked for Parmalat as chief liaison officer with that bank.

Did nothing change, then, in Parmalat's wake to prevent this banking mess? As soon as the worst of that crisis was over, reform efforts slackened. Maybe Enrico Bondi, special administrator of Parmalat, has done too good a job of cleaning house. Rather than breaking up the firm, he decided to keep it alive and save thousands of jobs. In July Parmalat revealed healthy first-half profits. It is planning to re-list on the Milan stock exchange in October.

Meanwhile, the Italian government is at last awakening to the scale of the dodgy manoeuvres to gain control of Antonveneta. On August 3rd the cabinet met to discuss a report by Domenico Siniscalco, the finance minister, on Mr Fazio's role in the matter. Mr Fazio is no stranger to criticism (see box). But this time he may have trouble outrunning it.

As opposition politicians bayed for the governor's blood, the cabinet was probably wrestling with two issues. The first arises from transcripts of telephone conversations tapped in connection with the BPI probes. These show that Mr Fazio called Mr Fiorani the night of July 12th to break the news that the central bank was approving BPI's bid for Antonveneta. Lawyers argue that he was breaching banking laws by tipping off Mr Fiorani with market-sensitive information. The other is Mr Fazio's decision to overrule his own staff's opposition to BPI's two bids, and to sign their approvals personally.

Mr Fazio is not under investigation for wrongdoing. His main motive for promoting BPI's bids seems to have been the desire to keep Antonveneta in Italian hands. Another reason, say some, was that BPI was on its last legs, and merging it with a healthy bank three times its size was a discreet way of rescuing it. So far, there seems little disposition in government circles to remove him from office. In fact, most ministers are probably hoping that pressure to get rid of Mr Fazio will evaporate during Italy's traditional summer break.

What now for Antonveneta? Although ABN Amro said last week that its attempted takeover had failed, things look different now. With two-fifths of Antonveneta's shares confiscated, the Dutch are technically in control of the bank. They say they are keen to acquire the remaining shares. BPI's appeal against the seizure of its stake in the bank is likely to be heard in court in September. And Consob can suspend BPI's bid until the end of October.

All this has left Italy's reputation as a sensible place in which to invest more than a little damaged. Yet chances are slim that politicians will soon seek to repair it by enacting financial reform. With elections looming in 2006, every move will be made with an eye on the polls. And that means that very little will change.

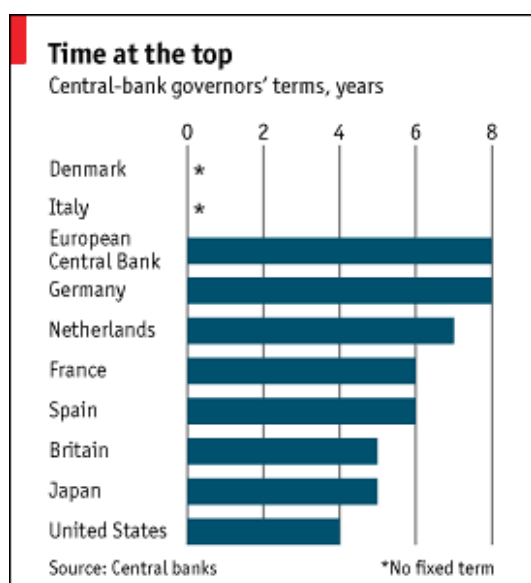
Italy's central-bank governor is under pressure to resign

Fazio's future

ANTONIO FAZIO likes his job as boss of the Bank of Italy. He has worked at the central bank since 1966, becoming its governor in 1993. He is one of the best-paid and most powerful central bankers in the world. Like the pope's, his appointment is for life.

It is little wonder, then, that Mr Fazio is fiercely resisting calls for his resignation as a consequence of his role in the supervision of the takeover battle between Banca Popolare Italiana (BPI) and ABN Amro, a Dutch bank, for Banca Antonveneta. He denies any wrongdoing, and so far he is not under investigation in the ongoing probe of allegations of violations of securities laws at BPI. But his career is nonetheless on the line.

Transcripts of telephone conversations between Mr Fazio and Gianpiero Fiorani, boss of BPI, tapped by prosecutors investigating BPI and reported in the Italian press last week, implied that he actively favoured BPI's bids. This week brought worse. On August 3rd *La Repubblica* and other papers published more revealing details of the cosy chats. "Caro Gianpiero, I will take care of Consob," said Mr Fazio in one conversation in June when he assured Mr Fiorani that he would put pressure on the boss of Consob, the securities-market regulator, to approve BPI's bid for Antonveneta.



Mr Fazio has been under fire before. He has been criticised for his close relationship with Cesare Geronzi, chairman of Capitalia (the former Banca di Roma). In 1999 Mr Fazio, heavily lobbied by Mr Geronzi, vetoed a bid for Banca di Roma by Sanpaolo IMI, a big bank in Turin, without much of an explanation. He then allowed Banca di Roma, though saddled with bad debts at the time, to buy two sickly banks.

Though muttering there has been, some of it from within the Bank of Italy, never has his competence in supervising mergers and acquisitions, and competition in banking more generally, been questioned as openly as it is today. Mr Fazio has definitely lost his credibility as an impartial arbiter of Italian banking, says Federico Bay at Uniprof, a fund manager in Milan. He speaks for many.

If Mr Fazio should decide to go, various candidates are waiting in the wings. One is Tommaso Padoa-Schioppa, a former member of the board of the European Central Bank and once the boss of Consob. Another is Mario Monti, a respected former European Competition Commissioner. There is also talk of appointing an insider, Pierluigi Ciocca, who is deputy director-general of the Bank of Italy.

Much of Mr Fazio's decision depends on whether Silvio Berlusconi, the prime minister, will back him. So far Mr Berlusconi has shied away from suggesting that the governor, who has supported his economic policies, should resign. He may well be undecided: he excused himself because of sickness from the cabinet meeting on August 3rd about Mr Fazio's role in the Antonveneta affair.

Italian banking

Please go, Mr Fazio

Antonio Fazio, the governor of Italy's central bank, should resign or be sacked

CENTRAL bankers have a difficult job. Their effectiveness depends on integrity and discretion, notably on monetary policy but also on issues of banking supervision. Most are sober and careful. The few that have cast doubt on their integrity by stumbling have resigned quickly. What to do, then, when a central banker behaves with such wilful disregard for ethical standards that he ought to resign, but shows no sign of doing so, or even of feeling a smidgen of embarrassment?

That is the dilemma facing Italy. The Bank of Italy, its central bank, has enjoyed some respect at home and abroad—until recently. Along with the Treasury, it oversaw Italy's entry into the euro. Several banking messes were effectively dealt with, so that Italy can now point to some well-capitalised and well-run banks that are beginning to modernise the country's old-fashioned financial industry. For that, Antonio Fazio, the central bank's governor, deserves credit. Appointed for life on a fat salary in 1993, he showed a streak of independence that largely freed his bank from suspicions that it could be influenced by politicians. That made it something of a rarity among Italian public institutions.

Lately, however, Mr Fazio has undone his good work. First there was his disappointing response to the Parmalat scandal, in which domestic and international banks were directly implicated. After the dairy firm collapsed in late 2003 in Europe's biggest case of corporate fraud, sensible regulatory reforms were suggested by Italy's finance minister. But some of these involved narrowing the Bank of Italy's broad powers. So Mr Fazio used all his influence to brush these useful reforms away or to water them down. This was an ominous sign.

Much worse was to come. When two foreign banks, one Dutch, the other Spanish, launched contested takeover bids this year for a couple of Italy's smaller banks, Mr Fazio pretended that normal scruples would govern the outcome. He publicly denied the accusation that he had a "fortress Italy" mentality. Behind the scenes, however, he intervened blatantly again and again to favour rival Italian bids.

This was especially the case in the battle between the poorly capitalised Banca Popolare Italiana (BPI) and ABN Amro to win control of Banca Antonveneta, Italy's ninth-biggest bank. And it is his conduct in this deal that makes him unfit to remain in his job. Despite serious doubts among his own officials, Mr Fazio seems to have been determined to engineer a reverse takeover of Antonveneta by BPI and to thwart the Dutch bid. But this was possible only by ignoring allegedly illegal and underhand manoeuvres by BPI that led recently to the suspension of its boss, Gianpiero Fiorani, and of the bid. Mr Fiorani is a close friend of Mr Fazio's—so close, in fact, that the central banker personally telephoned Mr Fiorani late at night last month to tell him that he had approved BPI's bid. That phone call, along with many others, was tapped by magistrates who suspected that BPI was systematically breaking the rules and had placed Mr Fiorani under surveillance.

Details of how BPI twisted and inveigled its way to control of Antonveneta make disturbing reading (see [article](#)). So does evidence that a group of businessmen linked to BPI might be trying to wrest control of politically sensitive assets that include *Corriere della Sera*, one of Italy's most respected newspapers. But perhaps most disturbing is that Mr Fazio seems to believe that he has done nothing wrong. The Bank of Italy has issued a statement claiming that its managers have acted properly and legally.

Ciampi's task

It is not yet clear whether or not Mr Fazio has broken the law—in his position the rules allow him a great deal of latitude. But it is already clear that he has not acted prudently or ethically and has, in fact, damaged the Bank of Italy badly. Despite this, Silvio Berlusconi's government has done nothing, and is apparently willing to see the Bank's authority wither. This is a grievous lapse that is not in the country's interest. There is one hope. Carlo Ciampi, Italy's president, was himself once governor of the Bank of Italy and understands the institution's importance. He has the moral and political authority to force Mr Fazio out. He should use it.

Italian banking scandal

Brothers in arms

Many reputations should suffer as a result of a scandal involving Banca Popolare Italiana and the Bank of Italy

"I JUST put my signature on it." These were the now notorious words of Antonio Fazio, governor of the Bank of Italy, on the phone to Gianpiero Fiorani, the chief executive of Banca Popolare Italiana (BPI), Italy's tenth-largest bank, shortly after midnight on July 12th. Mr Fazio had just given approval for BPI to buy a majority stake in Banca Antoniana Popolare Veneta (Antonveneta). "I'd kiss you right now, on the forehead," Mr Fiorani replied, in evident relief. (In an actual embrace, shown above, Mr Fazio is on the left.)

This news meant that BPI's bid for Antonveneta, in which a number of leading international banks have been involved, could proceed. It also seemed to spell certain defeat for ABN Amro, a big Dutch bank, with which BPI had been bitterly contesting control of Antonveneta since March. Antonveneta, based in Italy's wealthy Veneto region, is the country's ninth-largest bank but, by capitalisation, was around three times as large as BPI.

The conversation came to light because Mr Fiorani is under criminal investigation; magistrates had been intercepting his telephone calls for several weeks. His alleged offences include market-rigging connected to dealings in Antonveneta shares, false accounting and misleading the Bank of Italy (BOI), which oversees the banking system.

As supervisor, the BOI is responsible for ensuring the sound and prudent management of Italian banks. Each time a buyer of an equity stake in an Italian bank wishes to exceed certain thresholds—5%, 10%, 15%, 20%, 33% and 50%—it must seek permission from the BOI. Broadly speaking, a potential buyer must show that it has competent and honest management; a solvent balance sheet; and a sound plan for the target bank.

So the criminal investigations and the fact that two of the BOI's senior staff, worried about the strength of the bank's balance sheet, had refused to approve BPI's bid made Mr Fazio's decision hard to understand. That it was a grave error of judgment became obvious on July 25th when magistrates impounded BPI's shares (and those belonging to close allies) in Antonveneta. (The BOI declines to comment other than to say it has acted properly.) Two days later, Consob, Italy's stockmarket regulator, had no choice but to freeze BPI's offer for up to 90 days, as it also suspected that BPI's offer documents "seriously lacked important information". Then, on August 2nd, a judge ordered that Mr Fiorani and BPI's finance director be suspended for the next two months.

But the story of BPI's attempt to buy Antonveneta not only raises serious questions about the BOI, Mr Fiorani and his allies. It also raises doubts about the judgment of banks that have lent their reputations and balance sheets to BPI, and about the ethics of some of them.

Based on *The Economist's* examination of publicly available information, set out below, the first obvious question is: why did any leading bank want BPI as a customer? And the second: why was the BOI, with privileged access to information, so keen for BPI, rather than a bigger and healthier rival, to buy Antonveneta?

Through a buying spree, Mr Fiorani has transformed BPI, until recently called the Banca Popolare di Lodi, from a regional bank into one with a presence nationwide. For instance, it has 137 branches in Sicily after buying eight small banks there in just five years. Between 2000 and 2004, BPI spent roughly €6 billion (\$7.4 billion at current rates) on acquisitions, often paying what one analyst describes as "very generous prices".

These purchases have created a complex group: it comprises BPI, the quoted parent bank, which has about 60% of the group's retail branches, and two quoted subsidiaries, one of which is Bipielle Investimenti. Few analysts cover BPI (and even fewer its two quoted subsidiaries), and few big institutional investors own shares. Because of the group's constantly changing shape, comparative analysis of its results is tricky; it is difficult to measure how well acquisitions have performed.

Since 2000, the group has raised €3.6 billion from shareholders in six capital increases. BPI has used its branches to promote its shares (and other financial instruments) to customers, many of whom have become shareholders. Around 40,000 bought shares for the first time in its most recent issue for €1.5 billion in July, taking the total number to over 200,000.

Follow the money

But to the extent that these capital increases and other financial instruments have been paid for with money sitting in customers' accounts, BPI has not actually brought any new cash on to its balance sheet. Although it has improved BPI's capital ratios, such a switch of money from deposits to capital erodes future income by reducing lending possibilities.

An examination of the BPI group's accounts reveals aggressive accounting practices. BPI is treating some costs, such as those of capital increases and extraordinary personnel expenses, as intangible assets to be written off over several years rather than in one.

And how healthy is its balance sheet? The BOI assesses the solvency of a bank by the adequacy of its core capital—the minimum amount of capital a bank is required to hold to support its lending. Under EU rules, this must be kept above the minimum levels at all times. The starting point for the calculation is the net assets shown in a bank's accounts.

However, in BPI's case, there are doubts about the prudence of its accounts. Provisions against loans, which are lower than average, are one issue; if BPI's were adjusted to the level of, for example, Capitalia, a large Italian bank in which ABN Amro has a 9% stake, its net assets would fall by €337m. And BPI's 20% stake in Cassa di Risparmio di Bolzano, a savings bank, is overvalued by €209m when measured by the price that a purchaser, acquiring a majority interest, paid for a

10% stake last year. If the group's core capital at the end of 2004 were adjusted for just these two items, it would fall short of the mandatory level.

Moreover BPI has off-balance-sheet commitments which, if valued at market prices, would reduce its net assets further. It has promised to pay Deutsche Bank €330m in 2008 for 30m shares of Bipielle Investimenti that the German bank bought for only €198m in 2003. At the end of 2004, these were worth a mere €174m.

BPI will have to apply international accounting standards when it prepares its accounts for 2005. In the absence of reinforcement of its capital, application of these standards might expose the fragility of its balance sheet. For instance, off-balance-sheet commitments, such as that with Deutsche Bank, will have to be marked to market. And goodwill will be subject to an annual impairment test; if it is true that BPI has overpaid for its acquisitions, then substantial write-downs might be necessary.

In addition to its commitment to Deutsche Bank, BPI has others, mainly to the holders of minority stakes in subsidiaries. At the end of 2004, these amounted to €881m, over €500m payable in cash by mid-2005. To the extent that goodwill arises from the purchase in cash of these stakes, BPI's core capital would reduce further. This is because intangible assets do not count towards a bank's core capital.

But the BOI has postponed introducing a directive that would require banks to take account of these prospective commitments in the calculation of their core ratios. If these had been applied to BPI's core capital at the end of 2004 together with the other adjustments, then the bank would have fallen well short of mandatory levels.

Capital ratios are important to supervisors and depositors; investors are more interested in profits. But there is little consolation here. The 2004 accounts show that, at best, the parent company, BPI, the heart of the group with 577 branches, did little more than break even, if dividends from its subsidiaries are excluded. Even then, two factors favourably influenced its results. First, the marking-to-market of its portfolio of securities at the end of the year produced a net profit of €55m compared with a net loss of €9m the previous year.

Second, there was an increase of €30m in "expenses" recovered from customers' accounts, some (or all) of which may be explained by unusual entries in the final quarter. Astonished customers found charges, ranging from €30 to €125, for items such as "urgent commissions", "post and telephone expenses" and "extraordinary commissions" on their bank statements dated December 31st, the bank's year end. Many asked for reimbursement, and some raised the matter with the judicial authorities. These charges imply a desperate attempt to boost profits.

There are also doubts about the quality of Bipielle Investimenti's profits. Its consumer-credit company booked a profit of €70m—representing an acceleration of future interest—from a securitisation of receivables. This flatters current profits and is only sustainable if consumer debt continues to increase, thereby allowing more securitisations. Another division enjoyed windfall profits of €26m because banker's drafts drawn on it had not been presented within the requisite time. Together, these items accounted for nearly half of Bipielle Investimenti's pre-tax profits.

Another serious concern is transparency. Nowhere is it apparent in the group's 2004 accounts that BPI has an equity investment of €154m in an obscure investment vehicle called Victoria & Eagle Strategic Fund (VESF), based in the Cayman Islands; this holds, or at least did in June, 4.1% of BPI. If BPI had bought the shares directly, disclosure in its accounts would have been mandatory. And, unlike an investment by BPI in its own shares, the investment in VESF is not deductible from BPI's core capital.

The pact of the matter

In spring 2004, Antonveneta was up for grabs; it was clear that a shareholders' pact, which owned 31% of the bank, would not be renewed in April 2005. The pact's members included ABN Amro, the Benetton family and several businessmen, one of whom was Emilio Gnutti, a controversial financier. These parties had formed the pact in March 2002 to provide stability of ownership and ensure autonomy for the bank's management. One possibility was a merger between Antonveneta and Capitalia. This deal fell apart when the BOI would not allow ABN Amro—the biggest shareholder in both the banks—more than 15% of the merged bank, whereas ABN Amro wanted 20%.

Mr Fiorani had a different idea; he began to promote BPI as a significant shareholder in Antonveneta. Mr Fazio, whose opposition to foreign ownership of Italian banks is well known, met Antonveneta shareholders. In early December, according to the Benetton group, he encouraged Gilberto Benetton, who was keen to sell his family's 5% stake, to be a good Italian when making his decision. Two weeks later, BPI extended the Benettos a loan of €325m to be repaid in cash or with its shares in Antonveneta.

Mr Gnutti controls Hopa, an investment company, of which Mr Fiorani is a director. And Hopa and BPI have reciprocal shareholdings. Mr Gnutti was keen to increase his stake in Antonveneta, and was a natural ally for Mr Fiorani. Their plan was to gain control of Antonveneta's board at its annual general meeting at the end of April, an objective possible with around 30% of the votes.

Mr Gnutti has recently found himself in various scrapes. He has been found guilty of insider trading, though in Italy no conviction is definitive until confirmed by the final appeals court, which is yet to happen in Mr Gnutti's case. He is also currently on trial with a fellow director of Hopa, the chief executive of Unipol, an Italian insurer which has just launched a €5 billion bid for BNL, an Italian bank, for alleged insider trading in Unipol bonds.

Three reports by Consob show how Mr Fiorani and Mr Gnutti went about their business. BPI could not immediately buy a sizeable stake in Antonveneta. This was because it would need the BOI's permission; it had neither enough core capital nor a credible plan for the bank.

So between December 2004 and the end of February, BPI lent €552m at advantageous interest rates to 18 associates of Mr Gnutti, to buy 9.5% of Antonveneta. The Consob report states that there is a strong presumption that BPI promised these businessmen that it (or its allies) would eventually buy these shares

and that they would make a gain. Another 20 people, including Stefano Ricucci, a property developer, bought a further 11.7% of Antonveneta, with BPI providing loans of €666m to 19 of them. BPI should have disclosed details of these loans to the BOI, but did not.

And press releases, which claimed to correct rumours about dealings in Antonveneta's shares, gave misleading information. For instance, on April 6th, BPI correctly stated its own stake but (falsely, on the basis of the Consob reports) denied there were any other agreements—written or oral—with third parties in respect of other shares. BPI's plan of deception was well under way.

When BPI told the BOI on February 11th of its intention to buy up to 14.9% of Antonveneta, the BOI could not have been more helpful. It approved the application over a weekend. The authorisation said that BPI should build up its stake only to the extent it took measures to strengthen its core capital. This was to ensure full and continuous respect for the minimum level. Normally, however, the BOI achieves this goal by insisting that a bank strengthen its core capital before giving permission. The BOI did not inform Antonveneta about the authorisation until April 23rd, an unusual delay; nor did BPI tell ABN Amro (which it met in March for talks) or the market.

But then ABN Amro made a move, announcing a cash offer for Antonveneta at €25 per share. If this offer succeeded, Mr Fiorani's plan would be in tatters. So to block ABN Amro, BPI would need a majority of Antonveneta's shares.

ABN Amro's offer could not proceed until the BOI gave its permission. However, when the Antonveneta pact expired on April 15th, the Dutch bank, the biggest shareholder with 12.7%, could increase its stake up to 33% if the BOI let it.

At the end of March, ABN Amro asked permission to acquire control, a process likely to take more than a month. To ensure it was free to buy shares as soon as possible after April 15th, it also asked—in the hope it would be granted without delay—to cross the 15% and 20% thresholds.

But, on April 19th, the BOI said ABN Amro could not increase its stake beyond 20%. The principal reason given was that the bank's request was tantamount to one for majority control and therefore needed the same scrutiny as the one to exceed the 50% threshold. This meant the Dutch bank could buy only another 7% of Antonveneta when the pact expired.

Meanwhile, again without informing Antonveneta, the BOI, applying a different standard, had authorised BPI to acquire up to 29.9%, taking only three days to approve BPI's request of April 4th.

The BOI was aware that BPI did not then have enough core capital to acquire more than 20%. However, it was receptive to the idea that BPI acquire voting rights for the remaining 10% by stock-borrowing. This involves renting shares for a limited period in return for a fee. The BOI thought BPI would buy these shares outright once it had strengthened its capital base.

But BPI was working to a different plan. After April 15th, when the Antonveneta shareholders' pact expired, large volumes of that bank's shares would be on the

market. By April 18th at the latest, according to Consob's reports, BPI had formed a secret concert party, which included Mr Gnutti, Mr Ricucci and six others. Under stock-exchange rules, people acting in concert to acquire shares in a listed company are regarded as one. This is to prevent the circumvention of takeover law, such as that requiring a mandatory cash offer once a bidder exceeds a 30% threshold.

Altogether now

Between April 15th and 22nd, the concert party group, in some cases with further loans from BPI, conducted a huge buying operation from pre-arranged sellers and at pre-arranged prices. Except for those who became members of the concert party, all the people that BPI had financed earlier in the year sold their shares, making profits of €236m, including €110m by 15 associates of Mr Gnutti which an Italian court froze on August 2nd. The judge described these operations as "financial piracy".

On April 27th, the BOI relented and gave ABN Amro permission to increase its stake to 29.9%. But by then, BPI's secret concert party had 46.7% of Antonveneta (including BPI's direct stake of 29.3%) and its allies at least a further 8.5%. By the time the BOI finally gave ABN Amro's bid the green light on May 6th, control of Antonveneta was already sewn up; any suggestion that the market would decide was farcical. Three days later, BPI announced a rival all-paper offer which, it claimed, was more valuable than the Dutch bank's cash offer.

But on May 10th, Consob ruled that BPI was part of an illegally undeclared concert party and said that the concert party must make an all-cash bid for Antonveneta. Suspicious that information was being withheld from the market, Consob had decided in mid-March to investigate all BPI's direct and indirect dealings in Antonveneta shares since November 2004.

Consob sent the detailed report behind its ruling to both BPI and the BOI, and even published it on its website. And soon after, as has been reported in the Italian press, members of the concert party (and most of those who had bought Antonveneta shares with BPI loans) were under criminal investigation for either alleged insider trading or market abuse.

Anything for a fee

Yet none of this put off a syndicate of ten banks, including BNP Paribas, Deutsche Bank, Dresdner Bank and the Royal Bank of Scotland, from making available on May 31st a facility of up to €4.9 billion to fund BPI's mandatory cash offer. Without this financing, BPI's bid would have been dead in the water. As security, these banks took a pledge on BPI's holding in Antonveneta, the very shares that magistrates subsequently impounded on July 25th. And despite all the unanswered questions, both Lazard and Dresdner Kleinwort Wasserstein (DKW), have been acting as financial advisers to BPI. Both Lazard and DKW decline to comment, as do banks involved in the syndicate.

Consob's report should have set alarm bells ringing, particularly at the BOI, not least because BPI and its concert party had acquired more than 30% of Antonveneta in

flagrant violation of banking legislation. But the BOI did not begin an inspection at BPI until June 20th. Strangely, it started one at Antonveneta first.

Even before Consob's report, the BOI should have noticed a gaping hole in BPI's core capital. For technical accounting reasons, this hole opened up as soon as BPI's ownership of Antonveneta exceeded the 20% threshold. If BOI officials had monitored BPI's declarations to Consob, they would have noticed that BPI notified the market on April 19th that it had exceeded this threshold. According to calculations submitted by ABN Amro to an administrative court, BPI's core capital reached dangerously low levels after April 18th.

The hole was eventually plugged at the end of June by the last disposal in a series. Between May 18th and June 29th, BPI sold various minority interests of up to 20% in unquoted banking subsidiaries for €1.08 billion. The buyers were Deutsche Bank, Dresdner Bank and a company called Earchimede. (This company, in which BPI has a 12% stake, is controlled by companies associated with Mr Gnutti.) Deutsche Bank paid €721m; Dresdner Bank €220m and Earchimede €139m. In turn, Deutsche Bank sold to BNP Paribas half of each of the stakes it had just bought. BNP Paribas says that Deutsche Bank was its client.

Under banking rules, such disposals improve capital ratios only if they are genuine disposals. Temporary warehousing of stakes with third parties does not count.

Several aspects of the contracts, copies of which *The Economist* has seen, suggest these were not genuine disposals. For a start, BPI trumpeted these deals as industrial partnerships with the banks, but side agreements with Deutsche Bank give BPI the right to buy back within one year the shares that Deutsche Bank and Dresdner Bank had just bought, and for exactly the same amount these banks had paid. (For this right, Deutsche Bank charged fees of €75.6m.)

Then there is the price at which the deals were done. For instance, Deutsche Bank paid €183m for 10% of Cassa di Risparmio di Bolzano, when a stake of the same size sold for €79m just last year.

And BPI has given only a one-year guarantee on the level of dividends that these unquoted banks will pay; this hardly enhances the attractiveness of these illiquid stakes. Furthermore, the contracts contain none of the usual representations and warranties that purchasers usually require from sellers. The list of anomalies goes on.

An indication that these are temporary disposals would be if the purchasers had some right, even if indirect, to their money back from BPI. But BPI has stated in filings with Consob that no such arrangements exist. If this really is true, then Deutsche Bank appears to have acted with cavalier disregard towards its own shareholders' interests; it seems to have no exit route for its large investment. In fact, common sense suggests that Deutsche Bank has some undisclosed mechanisms—probably involving complex derivatives—to protect itself.

Deductive reasoning suggests that the disposals are in effect temporary; if so, the two German banks have helped BPI to window-dress its capital ratios. Deutsche Bank says: "We are comfortable with every aspect of this transaction, and will continue to co-operate with the authorities."

In a call intercepted by investigating magistrates, Mr Fiorani, talking about an Earchimede board meeting on June 29th at which the contract with BPI was to be discussed, described the disposal to Earchimede as "temporary with a capital T".

Whatever the case, BPI has not disclosed in stock-exchange filings important contracts with either Dresdner Bank or Deutsche Bank. No mention has been made of a significant stock-borrowing contract with Deutsche Bank relating to Antonveneta shares, or of derivatives contracts with Dresdner Bank for nearly 2% of Antonveneta shares.

The role of J.P. Morgan also raises questions. It acted as joint bookrunner for a share issue that ABN Amro undertook on March 30th to help finance its purchase of Antonveneta. At the same time, its Italian arm agreed to act as co-ordinating bank for ABN Amro in connection with its offer. However, BPI was then J.P. Morgan's counter-party in two derivatives contracts, dating from January 2005. One was a put-and-call agreement for 5m Antonveneta shares; the other a forward purchase of 5m Antonveneta shares. According to ABN Amro's advisers, J.P. Morgan did not disclose any conflict of interest to the Dutch bank before agreeing to act. J.P. Morgan says derivatives contracts are confidential as are its internal processes for managing conflicts. It claims ABN Amro was aware of the derivatives when it agreed (which it says was on April 12th) to act as co-ordinating bank.

Curtains

This six-month saga, which is gripping Italy, is now near its end. Criminal charges are almost certain. The interesting questions are: who will be charged and what will be the nature of the charges?

Mr Fiorani's tenure as chief executive of BPI is probably over, and his bank's takeover of Antonveneta is unlikely. New management at BPI would take a hard look at the bank's books. It would surprise few in Milan's financial circles if a new team at BPI were to find that the bank was, in reality, bust at the end of last year. (Ironically, as a result of its July share issue and other capital-raising deals, the bank is now flush with cash.)

If so, the question is whether Mr Fazio or others at the BOI knew or suspected this. If Mr Fazio did, this may explain why he wanted BPI to take over Antonveneta; merging a failing bank with a larger rival is one way of hiding the first's problems, if only temporarily. Or perhaps Mr Fazio's judgment was impaired by the closeness of his relationship with Mr Fiorani.