Can banks be owned?

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ABSTRACT: A now well-established literature in economics assesses the effect of different forms of bank ownership on various measures of banks' performance. Such literature has its theoretical roots in a surprisingly narrow framework, broadly identified with property rights theory *à la* Demsetz and Alchian (or, a bit more recently, Grossman, Hart and Moore).

However, such theory – or bundle of theories – has been increasingly criticized for its inability to account for the emergence, the existence and the functioning of business firms. Indeed, many works and authors counter mainstream property rights theory with the view that firms are entities that cannot be possessed – and that equity ownership should not be equaled with firm ownership.

Nowhere is perhaps this critique more salient than in the field of banking. As the 2007/08 reminded many observers, banks are not just firms or corporations: they are institutions, endowed with a dual social purpose (the creation of money and the setting of rules for access to credit). If it is difficult to conceive the ownership of firms, the ownership of institutions such as banks is obviously harder still to envision.

However, over the past twenty to thirty years, regulatory reform in finance has led to the empowerment of ownership, and especially private ownership, in the field of banking. This is apparent, for instance, with the 2007/44 European Directive, which fully liberalized equity ownership (and control) of banks.

Yet, even within the actual legal and regulatory framework, there are many limitations to property rights as applied to banks. This paper thus has two aims: firstly, to analyze, on the basis of an empirical case study of Italian banking law, the nature and extent of the property rights associated with ownership in banks; and, secondly, to develop a theoretical explanation of the heuristic and empirical limitations of "bank ownership".

KEYWORDS: property rights; bank ownership; bank regulation; institutional theory of the firm; law and economics; Italy

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> "The claims to ownership are subdivided in such a fashion, and are so mobile, that the enterprise assumes an independent life, as if it belonged to no one; it takes on an objective existence, such as in earlier days was embodied only in state and church, in a municipal corporation, in the life of a guild or a religious order." (Walther Rathenau, 1918 [1921])

> "The best way to rob a bank is to own one." (William Crawford, Commissioner of the California Department of Savings and Loans, 1988)[4]

1. Introduction

Banks are owned. Or so it seems. In the common language, but even in economic research, one speaks of "government-owned" banks, of "privately-owned" banks, and so forth. Also, banks are apparently "bought" and "sold" on the market for corporate control: when banks' equity shares change hands, especially when many equity shares change hands, such as this changes the identity of "controlling shareholders" (a term that needs to be specified, as will be done later), it is said that "bank ownership" changes hands, exactly as in other industries.

"Corporate ownership" of banks is the subject of a vast academic literature that purports to show, in particular, how different types of "ownership" (i.e. variation in the "owner's" identity) may affect bank performance. For instance, does "foreign ownership" of banks improve the efficiency of the banking system (as a representative study, see Berger et al., 2005)? Does, by contrast, "government ownership" worsen it (for a paradigmatic article, see La Porta et al., 2002[5])? Thus not only has "bank ownership" acquired a linguistic matter-of-factly quality; it has become a central category for social scientific analysis of banks – their organization and performance[6].

Yet, beyond the its application to the banking industry, the very term of "corporate ownership" is problematic. It is problematic because, at least with the advent of the "modern corporation" in the early XXth century, ownership (which one may define here temporarily as the exclusive right to decide over the use of an asset) has been separated from corporate control, as shown in the seminal study by Berle and Means (1932). As Berle and Means argue, ownership is an evolutionary phenomenon; and it is a legal phenomenon. These authors thus identify the legal bases of a shift in the meaning of ownership that accompanies the emergence of the modern firm.

Berle and Means were not alone in questioning the notion of corporate ownership. Their work locates itself in a rich tradition of North American and Continental European legal, economic and business scholars who have attempted to frame our conception of the modern corporation in terms distant both from the classical and neo-classical traditions alive in the first half of the XXth century, and from the more recent contractual theories of the firm that emerged in the late 1960s and remain very influential in economic scholarship today (see Bondi et al., 2007, for a recent

[4] Cited in Black (2005).
[5] Cited by 2,214 works according to Google Scholar (as of February 25, 2016).
[6] Google Scholar proposes 1,830,000 entries for a search with the keywords "bank ownership"; Scopus has 2,113 results; Web of Science has 2,304 results.

discussion of these authors and the relevance of their legacy for contemporary theories of the firm). In their book, Berle and Means cite some passages of a 1918 book authored by Walther Rathenau, a German polymath[7], who argued that with modern capitalism ownership had been "depersonalized", and thus the enterprise had been "objectified" and existed outside of the owner (Rathenau, 1921).

More recently, economic theoreticians of the firm have echoed similar concerns with the use of a term such as the "firm's owner". In his 1980 seminal article, Fama warned that "ownership of capital should not be confused with ownership of the firm"; and further argued that "Dispelling the tenacious notion that a firm is owned by its security holders is important because it is a first step toward understanding that control over a firm's decisions is not necessarily the province of security holders." (Fama, 1980a: 290)

In this (critical) perspective, is "the problem with firm ownership" (and, by extension, "bank ownership") just a matter of terminology? In other words, couldn't this problematic notion be solved away with substitute notions, with a different vocabulary? For instance, instead of speaking of the "owners of the firm" we may speak of "controlling shareholders" – and attribute to the latter the same characteristics or rights that were previously (nominally) attached to the "owner". This linguistic solution is not satisfactory, however: what Fama, and scores of authors before him (among whom Berle and Means, and Rathenau) question is precisely the *theoretical* relevance of the concept of the ownership of the firm (to paraphrase a section in Fama, 1980a). In other words, the issue is whether the notion has any value for theories of the firm - and whether its disappearance would create difficulties for these theories.

"Corporate ownership" is all the more problematic in banks, which are peculiar kinds of firms. Banks fulfill three functions that set them apart from other firms: they (i) provide liquidity to the economy; (ii) produce information and monitoring services; (iii) transform risk. This set of functions explains their peculiar treatment by regulatory authorities. Indeed, the latter is sometimes seen as the true source of bank's uniqueness (for instance, Fama argues that banks are unique because their assets and liabilities are affected by specific regulations, such as deposit insurance or reserve requirements; see Fama, 1980b and 1985). More broadly, individual banks are part of an institutional system (which combines the payment system and the credit system) and can thus be seen as true institutions. If the "ownability" of firms is in question, it is argued here, the "ownability" of institutions such as banks is even more dubious.

The problem of the "ownership of the firm" is, ultimately, a theoretical problem rooted in an empirical question – that of the nature and extension of property rights in relationship to the corporation. The latter is largely a matter of law – the determinant of effective, not theoretical, property rights. As Hodgson reminds us, property is a legally sanctioned right, not to be confused with possession, which indicates the effective control of an asset (Hodgson, 2015). Thus a discussion of "corporate ownership" in banking cannot but ultimately confront theory with the empirical legal foundations of ownership in a particular legal context.

[7] A successful engineer, industrialist, and statesman, Rathenau was murdered in 1922 by right-wing extremists.

Thus, the present paper has two goals: (i) to critically assess the use of "bank ownership" in the economic literature, drawing both on property rights theory and on alternative theories of the firm; (ii) to analyze the empirical nature and extension of ownership rights as applied to banking, in a specific context - Italy.

2. "Bank ownership" and banks' performance: Questionable assumptions

The relationship between "bank ownership" and performance stands at the center of a vast empirical literature, which emerged out of the conjunction of the development of property rights theory applied to theories of the firm after the 1980s, and the wave of bank privatization in the wake of post-communist transition in Eastern Europe (and elsewhere) in the 1990s. The literature has bloomed in the 2000s, benefiting from the appearance of large datasets enabling comparative research and building on the framing of the issue in a seminal article around the question of "government ownership" of banks by La Porta, Lopes de Silanes, Shleifer (La Porta et al., 2002).[8] Although many works at first focused on the analysis of the effects of "bank ownership" on bank performance (broadly defined)[9] (see, in addition to La Porta et al., the widely-cited works of: Altunbas et al., 2001; Berger et al., 2005; Micco et al., 2007; Iannotta et al., 2007; Cornett et al., 2010; see also Haggard & Howe, 2015), the interest of the literature has shifted towards an examination of the effects of "bank ownership" on banks' lending behavior (Sapienza, 2004; Micco & Panizza, 2006; Berger et al., 2008; Beck et al., 2011; Ferri et al., 2014) and on banking risk (Saunders et al., 1990; Shehzad et al., 2010; Bertay et al., 2015).

This literature builds on two assumptions: (1) the assumption that "bank ownership" produces significant effects on bank behavior; and (2) the assumption that these effects vary in function of a variation in "ownership types" generally construed as dichotomous (state versus public, foreign versus domestic, concentrated versus diffuse etc.). Regardless of the empirical findings produced by this literature, which will not be discussed here, many of the works in the "bank ownership"-performance literature present two very problematic characteristics from the point of view of the present study. First, they rely on ill-defined (what sociologists may call "pre-scientific") notions of ownership. Secondly, their empirics are based on a very narrow theoretical foundation.

The "ownership and performance" literature relies on a notion of ownership that confuses the ownership of equity shares with control of the firm. As Dinç puts it, for instance, government ownership consists in "bank assets [being] directly controlled by the government" (Dinç, 2005). Similarly, according to La Porta et al., "ownership allows the government extensive control over

[8] Interestingly, behind the continuing popularity of the issue among financial and banking economists, there has been an evolution in the focus of such works: the crust of the academic works on the topic of "bank ownership" seems to have shifted, in recent years, away from a US or Western European focus towards China, India, or other emerging economies. One may suggest that the decreasing production of US or Europe-centered "bank ownership" studies has to do with the decline relevance of "bank ownership" in a post-2007 crisis context where the distinction between ownership types lacks salience for the understanding of (systemic) banking failures.

[9] The theorization and measurement of performance in many of these studies leaves room for ample criticism. In particular, the widespread use of share price as a measure of performance leads to tautological explanations whereby variations in share ownership are correlated with variations in share price, which arguably might say something about the functioning of equity markets, but very little about the functioning of banks.

the choice of projects being financed" (La Porta et al., 2002: 266). Slightly more sophisticated analyses separate banks' "ownership structure" into various components, such as ownership concentration and the nature of the owner (Iannotta et al., 2007) – however, the authors keep referring to "bank's ownership" and, in a footnote, specify that "We qualify a shareholder as an Ultimate Owner of a bank when it owns more than 24.9% of the bank's equity capital with no other single shareholder owning a larger share" (Iannotta et al., 2007: 2734). A more recent, more sophisticated yet study of the effects of "bank ownership" on banks' lending also repetitiously asserts that banks are owned ("cooperative banks are owned by their members") – but in the course of analysis the terminology shifts away from ownership towards more "neutral" (but perhaps also more vague) categories such as "stakeholder banks" and "shareholder banks" (Ferri et al., 2014).

These few examples illustrate a widespread practice among studies of "bank ownership", as mentioned above: that of conflating equity ownership with firm ownership. Yet, as a long tradition in (non mainstream) economic thinking has shown, "firm ownership" is a contradiction in terms (see Biondi et al., 2007, for a synthetic presentation of this literature), as will be further discussed below. In other words, using "bank ownership" as an explanatory or independent variable, without any rigorous discussion of the term, is a severe problem plaguing the works mentioned above. However, one may treat this as a mere terminological problem: if "bank owners" is an incorrect category, one may simply use substitutes such as "controlling shareholders", for instance. This may leave the theoretical argument intact. But this solution would be inadequate because, we argue, the use of a "pre-scientific" notion of ownership[10] actually reflects "pre-theoretical" views on the effects of ownership.

In a nutshell, what most of these (empirical and theoretical) works share is the implicit twin assumption that (i) equity ownership produces effects on a firm's behavior; (ii) these effects are very similar (if not identical) to the effects of ownership of non-firms, such as material assets or consumer goods. One should however immediately distinguish between those works who do consider, sometimes at length, the effect of governance structures and mechanisms that mediate between equity ownership and banks' behavior (for example, by including governance variables in their models) and those works who don't (such as La Porta et al., 2002). The latter lend themselves to the exact same criticism that one may level against theories of property rights applied to theories of the firm (see below). The former, however, warrant further discussion (see below). Before undertaking a further (critical) analysis of the theoretical underpinnings of these mostly empirical studies, it is important to specify that we do not wish here to cast doubt on, or even summarily discuss, the empirical findings of such a large body of works. Rather, by questioning their theoretical foundations in light of the importance of law regulating property rights (which will be discussed in section 4), we wish to suggest that a different view of equity ownership and its effects in banking might provide a new lens through which one may analyze those empirical results.

[10] By "pre-scientific" we mean a notion ("bank ownership", as "firm ownership") that has solid roots neither in theory nor in empirics.

3. Re-dimensioning ownership: from property rights theories to an institutional view of banking

Whether explicitly or not, and regardless of the level of sophistication of the empirical analysis performed, most works in the "bank ownership and performance" literature rely on very tenuous theoretical foundations – noteworthy is, in particular, the paucity of theoretical references and developments used in many empirical works.[11] More importantly, perhaps, the thinness of these foundations owes to the theoretical problems (relative to the existence and effects of "corporate ownership") inherent to the three different theoretical traditions usually invoked: property rights theory, agency theories of the firm (coupled with incomplete contract theories) and "macro" theories of the role of government in the economy.

All three traditions build, more or less explicitly, on the notion that different types of ownership generate different levels of efficiency through different sets of incentives. Private ownership is deemed to be the most efficient form of ownership because it leads agents to internalize costs and therefore, generate the most efficient "cost-reward system" (Alchian, 1965). Shleifer and Vishny, on the other hand, dismiss government ownership as inherently inefficient because of the use of "government-owned firms" for political motivations (Shleifer and Vishny, 1994). A discussion of these arguments has no room in the present study,[12] however, which will focus instead on three connotations of ownership put forward in this literature: (i) the core characteristics of ownership; (ii) the assumption of effectiveness; (iii) the governance implications of property rights theory.

As far as their core characteristics are concerned, ownership rights imply (i) full alienability (i.e. the ability to sell these ownership rights (Alchian, 1965); (ii) full excludability (i.e. the ability to exclude non-owners from the use of a given asset) (Demsetz, 1967). Both notions are effectively criticized in the non-mainstream theories of the firm (see Biondi et al., 2007, building on Berle, 1947). While equity shares are saleable on market, a firm is not – given that even law recognizes that the firm is much more than a nexus of contracts, and that shareholders do not "own" the firm in the sense of being able to exclude others from the use of the firm's assets. Even agency theory, which introduces governance problems to the conceptualization of ownership rights, has to take into account that the modern corporation has "multiple principals" (Weinstein, 2007).

The assumption of effectiveness is also very present in the property tights theories of the firm. Ownership is a "bundle of rights" (Demsetz, 1967) that is never decomposed. If ownership means alienability and excludability, then it implies control over the firm. Ownership is control. Yet even early works in the property rights literature left much room for opposite interpretation. According

[11] For instance, the only two theoretical references cited in La Porta et al.' s seminal study of government banks are Kornai and Shleifer and Vishny (1994) (La Porta et al., 2002).

[12] The most questionable statements are found in the literature on government "ownership" of banks, whose functionalist views of "bank ownership" ("state banks are created for a purpose", Shleifer and Vishny, 1994) contradict one major tenet of property rights theory, i.e. that ownership is endogenous (Demsetz & Lehn, 1985; Demsetz & Villalonga, 2001). Moreover, the question of political influence in banking deserves more sophisticated treatments, such as the one provided in a recent book by Calomiris and Haber (2014).

to Alchian, a 'system of property rights' is "a method of assigning to particular individuals the 'authority' to select, for specific goods, any use from a non-prohibited class of uses." (Alchian, 1965: 818) Furthermore, property rights are "supported by the force of etiquette, social custom, ostracism, and formal legally enacted laws supported by the states' power of violence or punishment." (Alchian, 1965: 817) Law and the legal system thus play an important role in circumscribing the effectiveness of ownership-as-control, an aspect which later drops out of property right theories of the firm. In a similar vein, Demsetz writes that "an owner of PR possesses the consent of fellowmen to allow him to act in particular ways." (Demsetz, 1967: 347) Consent thus determines the contours of the bundle of rights which is elsewhere presented, implicitly, as an absolute.[13][14]

The ambiguities (and theoretical difficulties) of ownership-as-control are seemingly overcome by subsequent works that, while locating themselves in the tradition initiated by Alchian and Demsetz, incorporate governance problems in their models. In these works, the ownership of equity effectively leads to control of the firm *as long as* the governance structure is supportive. This is where, however, the governance implications of ownership rights arises. What happens to "corporate ownership" when the residual claimant stands outside of the firm's operating structure and has no direct control over the firm's conduct of business?[15]

Two distinct theoretical perspectives address this question: agency theory and incomplete contracts theory. The first perspective reaches the paradoxical result that ownership loses relevance precisely when it is affirmed as the main locus of efficiency. Indeed, Fama argues that "ownership", which he quickly reduces to "equity ownership" (as seen above, Fama rightly does away with the notion of "ownership of the firm"), arises mostly as a specialization in risk-bearing (Fama, 1980a). The counterpart for that specialization is the claim on residual cash flows: "The residual risk is borne by those who contract for the right to net cash flows" (Fama and Jensen, 1983: 302). This principal-agent relationship acts as a disciplinary device: cash pay-outs to shareholders reduce managers' power and increase the monitoring of the capital markets when firms seek to finance their activities (Jensen, 1986). On the one hand, the owner disappears: what counts are efficient capital markets that exert disciplinary pressures on management; on the other hand, however, when agency problems are solved or reduced through appropriate governance structures, the types of rights enjoyed by equity holders are exactly equal to the rights of the "firm's owner" as conceptualized in property rights theory. There is still (theoretical) room for ownership as control.

[13] "It is this entire bundle of rights: 1) to be a residual claimant; 2) to observe input behavior; 3) to be the central party common to all contracts with inputs; 4) to alter the membership of the team; and 5) to sell these rights, that defines the ownership (or the employer) of the classical (capitalist, free-enterprise) firm." (Alchian & Demsetz, 1972: 783)

[14] More explicitly yet, Alchian and Demsetz, apparently unaware of the theoretical contradictions that they raise so, later write that ownership rights are "are always circumscribed, often by the prohibition of certain actions." (Alchian and Demsetz, 1973: 17)

[15] Thus, Alchian and Demsetz argue in a footnote to their 1972 article, shareholders are more correctly seen as investors rather than owners. (Alchian & Demsetz, 1972)

The same results obtains from the incomplete contracts perspective. There the basis for ownership rights differ from agency theory: when specific contracting is too costly, the efficient solution (for agents involved in the firm's production process) is to rely on "residual contracting" (Grossman & Hart, 1986). "Ownership is the purchase of […] residual rights of control." (Grossman & Hart, 1986: 692). The filiation to Alchian and Demsetz's initial formulation of property rights theory is much clearer than in the case of agency theory as expounded in Fama and Jensen. In fact, residual rights of control are very similar to ownership rights; they consist in **"**the right to decide how these assets are to be used except to the extent that particular usages have been specified in an initial contract." (Hart & Moore, 1990: 1120)

Thus these theoretical developments suffer from the same weaknesses as early property rights theory as applied to theories of the firm: Ownership is conceptualized as a set "bundle of rights" that has no correspondence in empirical analysis; this conception is at odds with the careful mentions of the legal and conventional limitations to ownership, present in early property rights theory works; equity ownership is assumed to have direct effects in terms of control of the firm, reducing the latter to a bunch of assets or contractual arrangements that contradict, again, the legal reality.

Such a theory of "corporate ownership" presents supplementary problems in the case of banking firms. First, as mentioned in the first section, banks have a peculiar business model – which financial economists have called "qualitative asset transformation". This has two implications: first, the assets at the core of banks' activity are usually not their property; secondly, in banking multiple providers of capital may be seen as competing with each other for banks' control (in particular, depositors may compete with shareholders). As a result, there is no clear residual claimant. An immediate rebuttal of this argument may bring up regulation as a source of control rights (Fama, 1980b). But if regulation establishes who has legitimate claims on residual cash flows, then part of property rights theory falls down – precisely, the part which assumes the endogeneity of ownership rights. As a recent review of the literature on banks' corporate governance shows, the effects of ownership in banking are *always mediated by regulation* (De Haan & Vlahu, 2015).

Secondly, in banking, the thesis that ownership rights may be attributed to residual risk bearers does not work. Indeed, if residual risk is defined as the "differences between stochastic inflows and payments" (Fama and Jensen, 1983), risk in banking is not residual at all: it is, rather, at the center of daily banking business.

Thirdly, and finally, deposit-taking banks cannot be just conceptualized as stand-alone firms: dealing with money, aka legal tender, they stand as interdependent entities within an institutional system (Butzbach and Mettenheim, 2015). Banks' institutional nature shields them, to a great extent (an extent shaped by law, as will be seen below), from equity owners' pretense of exerting ownership rights as conceptualized within property rights theory (as fully alienable and exclusive).

As a consequence of these theoretical weaknesses, the empirical findings of works in the "ownership and performance" tradition may be reinterpreted to give more weight to other

explanatory variables. In other words, as shown in several recent studies, the differences in behavior between public and private banks has much less to do with equity ownership and much more to do with banks' objectives (Brei & Schclarek, 2015);[16] the existence of a well-functioning capital market (Sarkan et al., 1998); or the general rules applying to banks' operations and management (Milhaupt and Zheng, 2015).[17]

To sum up, while Weinstein (2007) and others criticize the notion of "corporate ownership" and, more generally, PR theories of the firm for the theoretical dead-ends they lead to concerning our understanding of corporate existence and behavior, the main focus of the critical remarks above is the assumption of effectiveness of equity ownership, and in particular its legal effectiveness. Since ownership is a right, it is contingent for both its extension and implementation on laws, legal interpretations and, more generally, the legal system. But this is exactly where the great weaknesses of PR theory lie: its misconceptions or ignorance of law and the legal system (Hodgson, 2015).

What is, in this perspective, the role of laws and regulation concerning governance of firms (and banks)? An accurate answer to this question may necessitate, here again, a change of perspective on governance: instead of being seen and analyzed as mechanisms that tighten the relationship between equity ownership and corporate control, governance mechanisms may be more adequately understood as mechanisms that enable the firm to be governed in the absence, or given the impossibility, of equity ownership *as* control of the firm. As a consequence, while laws and regulation governing corporate governance may be publicly and even theoretically based on the need to give shareholders the effective control of the (banking) firm, they may actually limit equity ownership in its undue pretence of controlling the (banking) firm.

However, such arguments cannot be firmly established without an adequate understanding of what the law and the legal system actually say about the extension and limitations of equity ownership in banking. As a first step towards such understanding, the present study now turns to an analysis of the present legal and regulatory conditions characterizing equity ownership in banking in Italy.

4. What does the law say? The Italian case

The very fact that the contestability of ownership in banking is regulated by rules that do not belong to the common rules applied to ownership supports legal theories that holds that banks are "functionally circumscribed", theories thus in line with institutional views of banks.

In particular, both European and Italian regulation contain a series of measures that strongly constrain equity ownership in banking, through requisites and procedures missing in the regulation of transfers of equity ownership in non-banking firms. This regulatory pattern appears

[16] This argument is symmetrically opposite to the one initially put forward by Alchian in his initial formulation of property rights theory (Alchian, 1967).

[17] As the latter point out in a rhetorical question, "what if a state sets the rules for economic activity […] such that the standard dichotomy between [state-owned enterprises] and [privately-owned enterprises] breaks down?" (Milhaupt and Zheng, 2015: 668).

clearly in the rules governing the operations of banking firms. In particular, the regulation of governance in banks confirms the regulatory shaping of banking activities towards the fulfilment of general or collective interest.

The present section aims to show with some detail the regulations that (i) govern the acquisition, alienation and transfer of equity ownership in banks and (ii) govern banks' corporate governance (that is, the range of rights and obligations deriving from equity ownership).

4.1. The European regulation of equity ownership in financial entities

For a long time Italian law imposed a rigid and reciprocal "separation" between banks and firms – precisely, since the 1929 crisis[18]. Current European regulation (in particular European directive 2007/44/CE[19]) does not leave any discretion to member-States regarding the regulation of banks' equity ownership. However, the previous regulatory regime already conceived rules on equity ownership in banking as instrumental to the fulfillment of "general interest" objectives, of the protection of banking firms' autonomy and of depositors' interests. Regulation was thus permeated with an interpretive technique which tended to harmonize general principles of economic governance with industry-specific rules, in a peculiar mix of private/corporate interests and general interest goals. [20]

In particular, the Italian regulatory regime (embodied in the "*Testo unico bancario*" or Single Banking Law henceforth T.U.B.[21]) gives a key role to managerial autonomy[22] through the so-called "healthy and prudent management" principle, together with the prevention of conflicts of interest and the conduct of a correct assessment of creditworthiness. Together, these principles create hurdles to access to equity ownership in banking, confirming the regulatory specificity of banking firms, motivated by the general interest function they fulfill towards the economy.

European directive 2007/44/CE[23], already mentioned, defines procedures and prudential evaluation criteria that regulatory authorities have to comply with in processes of acquisition and increase of controlling equity in financial entities[24]. The systematic architecture delineated by these rules expresses the existence of a public interest in the assessment of the "quality" of

[18] See Costi (2007), 115, 331; Ciocca (1987), 93; Ferro-Luzzi (1995), 107, 165; Antonucci (2009), 169; Giannini (1940), 707; Guaccero (1997), 5; Irti (1998).

[19] Directive of September 5, 2007, which modifies Council's Directive 92/49/CEE and European Directives 2002/83/CE, 2004/39/CE, 2005/68/CE and 2006/48/CE.

[20] The banking industry was taken into consideration both as a range of economic activities submitted to antitrust law, both as a private sector. See Piovera (1992) 192; Costi (1994), 617; Ghezzi (1992), 1003; Rotondo (2004), *passim*; Spolidoro (1992), 183.

[21] Testo unico delle leggi in materia bancarie e creditizia. The T.U.B. was originally passed as a "legal decree" in 1993 (decreto legislativo 385/1993); the original text has been frequently updated and modified over time. What we call "T.U.B." here is the current version of the regulation – as of March, 2016.

[22] See Capriglione (1988), 718; Santoro (1990), 261; And, more specifically on the finalization of regulation towards the preservation of banks' managerial autonomy, Brescia Morra (2000), 21.

[23] Directive of September 5, 2007, which modifies Council's Directive 92/49/CEE and European Directives 2002/83/CE, 2004/39/CE, 2005/68/CE and 2006/48/CE regarding procedures and criteria for the prudential assessment of acquisitions and increate shareholdings in the financial sector.

[24] On the directive, see Aldisio (2008), 3; Troiano (2010), 53.

controlling shareholders (Costi, 1995: 118) and confirms the overall aim of guaranteeing banks' managerial autonomy with respect to shareholders, in line with the "healthy and prudent management" principle (Brescia Morra, 2012: 247). The protection of banks against potential damages resulting from the behavior of shareholders represents a cornerstone of the current regulatory model (Rotondo, 2009: 218).

4.2. Authorizing the acquisition of equity.

Within Italian law, one should emphasize that the acquisition of any share of equity leading to "significant influence" (*influenza notevole*) over management, or to control over a bank or the parent company in a bank holding firm, has to be previously authorized whenever it crosses a determined threshold (art. 19 T.u.b.)[25]. The notion of "significant influence" is aimed at including within the range of application of the rule cases where a subject acquires equity shares below the 10% threshold but is able in fact to condition a bank's managerial and financial decisions.

This form of "preventive control" on bank's equity ownership is so important that it affects equity ownership in "non-financial" firms that own equity in banks (Costi, 2007: 327). The ultimate goal of such regulation is to avoid that "external" subjects (external in terms of interests, and of personal characteristics) acquire a position of power that leads to an excessive influence over the management of a bank, especially when there are conflicts of interest.

The specificity of banking is also confirmed by the possibility, for regulatory authorities, to cancel the authorization to equity ownership, with a legal duty to sell the equity shares in question, and automatic "freezing" of rights attached to equity ownership. This rule clearly represents an external, authoritative intervention on whomever holds equity in banks, which contributes to greatly diminish the contestability of the transfer of equity ownership in banking.

Similarly, another aspect of regulation that makes it difficult to access to banking equity is the possibility of an assessment of equity shares acquisitions according to "proportionality". This means that the regulatory authority, through "secondary regulation" (i.e. sublegal rules), should take into consideration the type of regulated entities and the specific characteristics of the activity conducted, differentiating if necessary between banks and other financial intermediaries or controlled societies (Vella, 2007: 202). Confirming the hypothesis formulated in the present study, one should underline the fact that the detailed assessment required by the European directive applies to bank ownership only, while it is possible not to apply these stringent rules to other financial entities.

[25] See Enriques (2005), 166; Antonucci (2009), 172.

4.3. Information and communication duties.

The Italian regulatory regime also includes a series of rules aimed at enforcing the "transparency" of banks' shareholdings, [26] and of controlling subjects (art. 20 ss. t.u.b.)[27]. The duty to communicate "relevant shareholdings" allows banks to know (more effectively than what would be possible under common regulation) – their own shareholdings, and enables regulatory authorities to identify the holders of significant equity shareholdings. This helps the authorities to establish an adequate "map" of bank shareholdings and, more importantly, of effective distribution of power within equity shareholders. [28] The identification of "relevant" shareholders is conceived both to avoid the excessive influence of subjects that are external to banking over banking operations and to guarantee an adequate flow of information to the regulatory authority, so that it may exert its functions in a satisfying manner.

Communication is mandatory in the following cases: following operations subject to authorization, or in case of waiver of authorized operations; when a determined threshold (for equity ownership) is crossed; in cases when shareholdings are reduced below the pre-set threshold.

Within the same regulatory category, there are communication obligations concerning the "shareholdings agreements" (*patti parasociali*) over voting rights, that is, all the agreements between shareholders that generate (effectively or potentially) effects coinciding with those deriving from one shareholding. The duty to communicate any agreement leading to concerted voting in a bank or a bank-controlling firm lasts the whole duration of the banking firm (Marchetti, 2000: 159).

The regulation of communication duties should shed light on any conditioning of managerial powers, and allow management to take the decisions most adequate to the bank's management, so avoiding conflicts of interest. Thus, when a shareholders' agreement may cause prejudice to the bank's "healthy and prudent management", the Bank of Italy (banks' main regulatory authority) has the right to suspend the voting rights of participants to the agreement in question.

Still within the realm of information duties, the regulatory authority may request information from "interested" subjects, so as to reach a full transparency of shareholdings of banks and bank-controlling entities (art. 20 t.u.b.) In particolar, the regulatory authority may request from banks or controlling entities the names of shareholders, along with the characteristics of settlors who hold the equity shares. This rule aims to include in the range of its application those subjects who intervene in the conclusion or the implementation of shareholders' agreements. It thus represents a very peculiar extension of the authority's powers in terms of information beyond the range of controlled subjects[29].

[26] See Campobasso (1994), 285.
[27] See Marchetti (2000), 158.
[28] See Costi (2007), 535; Benocci (2012), 208.
[29] See Siclari (2012), 262.

Within the same regulatory domain, the Italian regulatory authority may request from subjects holding shares in banks' equity the names of shareholders and controlling subjects (art. 21 t.u.b.), since it is possible to acquire, while not being part of a shareolders' agreement, a position of influence on the bank's management, which does not result from the agreemen or from shareholdings. Such a request goes far beyond the range of controller subjects, since it concerns entities of any nature that hold equity shares in banks. It is a form of control over all the stakeholders in a position of exerting influence over banks' management – control that should consent to reach any situation of *de facto* (or indirect) exercise of shareholder's power, situation that does not come under the main communication duties mentioned above.

4.4 Sanctions. Suspension of voting rights (and other rights)

The non-observation of rules governing shareholding in banks is punishable through civil (art. 24 T.U.B.), administrative and criminal sanctions. The T.U.B creates a system that "freezes" the voting rights attached to non-authorized shareholdings (when such authorization is suspended or cancelled) or to shareholdings not in compliance with communication duties (art. 24 T.U.B.) [30]; while there is an obligation to alienate shares when these shares correspond to non authorized or forbidden shareholdings (art.24 T.U.B., comma 3).

"Relevant" shareholdings are subject to transparency duties, and to an extensive control. This aspects reveals the need, embedded in the regulatory regime, to guarantee not only general interest, close to administrative law (trust in banking entities, systemic stability), but also private interests, common to all shareholders, among which the stability and capital adequacy of the particular banking firm. [31]

Whenever the prohibition of voting is not respected, the decisions made with the contribution of those voting rights that should have been suspended may be legally challenged[32]. The specificity of such rule consists in the fact that the legal challenge may be raised by, (in addition to the subjects usually legitimized by law, the regulatory authority itself[33], when it holds that the violation of the law damages the public interest, which is indirectly protected through the identification of shareholders[34].

Law attributes to the Bank of Italy a power that does not concern the protection of legality, or of a social interest in a strict sense, but that corresponds to the specific regulatory objectives pursued by the regulatory authority itself – power that is exercised with discretion in its regular operations. Finally, the T.U.B. includes the obligation to alienate "all" the shareholdings for which no authorization has been received, or authorization has been cancelled.

[30] Regulation determines interference into shareholding activities whenever shareholdings are acquired without the required authorization, or in case of omission of communication. See Manzone (1996), 377; Brescia Morra (2000), 40.
[31] See Santoni (2012), 299; Vella (2011), *passim*.
[32] See Costi (2007), 539; Santoni (2012), 199; Benocci (2007), 243.
[33] On the criteria that should guide the regulatory authority when contestino shareholdings, see Antonucci (2009), 192; Santoni (2012), 196.
[34] Cfr. SANTONI (2012), 200.

4.5. Regulating banks' corporate governance

The regulation of banks' corporate governance has been revised in the wake of the 2007/2008 global financial crisis, so as to guarantee the "healthy and prudent management" of Italian banks. However, the pre- and post-crisis regulation of banks' corporate governance shows a strong continuity, predicated upon the conception of banking as a specific activity that, according to art. 10 of the T.U.B., is characterizing by monetary intermediation and the functional linking of collecting savings and lending activities. Beyond economic activities of general interest, banks are also held to carry larger social functions, requiring stringent governance rules, which can be verified in the context of prudential regulation (Cera, 2015).

In this area of bank regulation, current Italian regulation directly reflects the efforts made at the international and European level to address specific problems regarding banks' governance, such as the problem of the inadequacy of previous rules and internal controls in front of excessive risk-taking. Thus international bodies (in particular the Basel Committee for Banking Supervision) have adopted a series of principles that should guide national regulations on banks' corporate governance and internal control systems[35].

These principles have been transposed at the European level through Directive 2013/36/UE ("CRD IV"). They concern the organization of internal controls and the process of risk management, given the guidelines produced by the European Banking Authority (EBA) and the Basel Committee. Subsequently (in July 2013), in Italy, the Bank of Italy published chapter 7 of Title V of the Circular 263/2006 (concerning internal controls) and (in May 2014), chapter 1 of Title IV of Part One of the Circular 285/2013 (concerning corporate governance). Given that the CRD IV Directive only contains broad guidelines, the Bank of Italy could implement those guidelines through much more detailed rules adapted to the national banking system.

The last (fourteenth) regulatory update as of early 2016, brought to the regulatory regime concerning banks' governance in Italy, is a regulation dating November 24th, 2015, which aims to implement EC Delegated Regulations 61 and 62 of 2015. They concern liquidity and leverage and modify and complement the regulations contained in CRD IV and in EU Regulation n. 575/2013 ("CRR"). These (National) regulations innovate in that they clarify specific aspects regarding the newly-introduced (at international level) Liquidity Coverage Ratio and Leverage Ratio. Such modifications indicate the modalities through which discretionary rules can be applied, according to the aforementioned Regulations issued by the European Commission.[36]

[35] FRIGENI (2015).

[36] Which have modified regulation concerning liquidity risk contained in CRR, upgrading it to "first pillar" risk, and updated the rules concerning the Leverage Ratio along the lines of the most recent guidelines produced by the Basel Committee.

Altogether, these regulatory measures[37] are articulated in general principles and specific rules. The regulation of the role and functioning of governance bodies, and of their relationship with the corporate entity of banks, are wide-ranging. On the one hand, the rules emphasize the duties of governance bodies to guarantee adequate control of the risks undergone by the bank in its day-to-day activities, attributing to the Board of directors the duty (that cannot be delegated) to define, approve and evaluate the correct implementation of schemes of risk control. On the other hand, the regulations produce a re-organization of responsibilities and competences of the supervisionary body, with respect to the managerial bodies. Such regulations have direct effects on the nature and exercise of ownership rights in banking.

The classical corporate governance problem of coordinating and harmonizing diverging interests among stakeholders assumes a specific aspect in banking, tank in large part to a specific regulatory regime. As seen above, the regulation of equity ownership in banking creates a series of communication and information duties on the part of those subjects with shareholdings such that they may enable them to exert an influence on the bank's management (Galanti, 2008: 469). In addition, these regulations impose strict limitations on the acquisition and alienation of equity shares.

Regarding corporate governance, the Italian regulatory regime has, for a long time, allowed the co-existence of multiple, variegated types of ownership and governance (Bruzzone, 1997: 194). As seen above, equity ownership in the banking industry is regulated by Europea Directive 2007/44/CE (transposed in national regulations), which defines procedural rules and assessment criteria that National regulatory authorities have to comply with in procedures of acquisition and increase in "qualified" shareholdings in financial entities. In Italy, these rules are contained in a single section of the Single Banking Law, namely Chapter III of Titolo II (art. 19-24) and in art. 25 of the same text ("honorability" requisites).

The explicit aim of these regulations is to establish clear, precise and uniform rules for the assessment of shareholding acquisition on the part of national regulatory authorities, so as to limit discretion and avoid discrimination (Banca d'Italia, 2010, 2). In the Italian version, these rules are guided by the overarching principle of "healthy and prudent management", already mentioned, which represents a true regulatory innovation.

As shown above, current regulations, both at the European and national levels, establish a series of terminological distinctions that produce regulatory effects and, in particular, effectively circumscribe the governance impact of equity ownership in banking. First, the concept of "participating interest", originally defined as the existence of a "durable link" between the shareholder and the entity in question[38], now extends to "the ownership, direct or indirect, of

[37] "*Disposizioni di vigilanza in materia di organizzazione e governo societario delle banche*".

[38] According to a 1978 European Directive, ""participating interest" shall mean rights in the capital of other undertakings, whether or not represented by certificates, which, by creating a durable link with those undertakings, are intended to contribute to the company's activities." (Article 17 of the Fourth Council Directive 78/660/EEC of 25 July 1978).

20 % or more of the voting rights or capital of an undertaking"[39]. The Italian Single Banking Law identifies as "participation"[40] the following: equity shares and other financial instruments that attribute administrative rights, or rights listed in art. 2351, last comma, of the Civil Code. Secondly, European regulations identify the existence of "qualifying holding" in relation to "significant influence" exerted by shareholders above a certain threshold of equity ownership[41].

Similarly, the notions of "indirect participation" and "control", in art. 22 and 23 of the Single Banking Law assume an important role, since they integrate the normative content of the complex regulation of participatipons (Maimone, 2006, 106). In particular, Art. 22 fills an important regulatory gap with the introduction of the notion of "indirect participation", which includes any form of intermediation in the acquisition of equity ownership in banking (Costa, 2013, 194), that is, the acquisition operated by controlled firms, trusts, or intermediate persons.

Another important regulatory contribution to the specific treatment of equity ownership in banks is given by the rule governing honorability requisites in subjects participating to banks' equity (art. 25 t.u.b.). This rule actually codifies a principle long existing and consolidated in Italian law, that is, the presupposition that any relevant power of influence over a bank must be exercised only by those subjects (physical or legal persons) in possession of personal honorability characteristics (Alessandra, 2010, 174).

Finally, various rules concerning information duties for banks, and subjects included in consolidated banking supervision (artt. 51 ss. of T.U.B.) weigh on the relationship between ownership and governance, given that they govern intra-group relationships between banks and those subject, financial or not, that are part of them. Article 51 of the Single Banking Law, for instance, rules that banks must send to the regulatory authority frequent information, balance sheets and any other document required. Article 66 determines the rules of consolidated information supervision in banking.

Conclusions

The current regulatory regime governing equity ownership in banks in Italy strongly supports the view presented in the first sections, that is, the view that whatever the weaknesses of property rights theory as applied to theories of the firm, it is clearly inadequate to represent the actual (effective) extent of ownership rights in banking. More importantly, the multiple limitations to the acquisition of equity ownership and to the exercise of ownership rights that exist in the Italian case demonstrate the peculiar treatment of banking firms within corporate law. In this sense, banks are (still) treated more as institutions, with important public goods functions, than as private corporations.

[39] Article 4, comma 11 of EU Directive 2006/48.
[40] Art. 1, comma 2, lett. *h-quarter* of T.U.B.
[41] "'qualifying holding' means a direct or indirect holding in an undertaking which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking" (Article 4, comma 11, of European Directive 2006/48).

This state of things is all the more remarkable as one considers the recent history of banking and the banking industry in Italy – a history characterized by a massive move away from public and ad hoc forms of non-private ownership, in the 1980s, to private ownership and the joint-stock company form in the subsequent decades.

Certainly, Italy is a specific case. Thus the conclusions reached here might be non generalizable. However, this objection might be weakened if one considers that national banking regulation in European Union member countries has been strongly influenced by European-wide regulatory efforts and has gradually converged towards, if not a unique, at least comparable models. Comparative analyses of the legal and regulatory treatment of equity ownership in banks may help buffer the findings of the present study. Another rebuttal to the aforementioned objection arises from the (voluntary) circumscription of the analysis of the legal/regulatory limitations to equity ownership and ownership rights as conceptualized in the property rights theory (and the ownership and performance literature in banking). Indeed, the analysis proposed above was limited to the explicit treatment of ownership and governance in (Italian and European) regulation. However, there are many other potential sources of limitations of ownership rights, located not in the explicit regulation of equity ownership, but in the regulation of banks' operations and activities. The fact that banks are strongly limited to undertake some activities evidently places a limit on the far-ranging "right to use" attributed to owners by the property rights theory. In other words, even if one held that a bank's owner was equated with the controlling shareholder, the latter is limited in the nature and the range of strategic decision she might want to take – strategic decisions that embody the "right to use" that belongs to ownership rights. This, we hypothesize here, might prove to be the ultimate nail to the coffin of PR theory applied to banks and banking.

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