

## **Italian Banking and the Revolving Door**

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**Abstract:** This paper explains the concept of the revolving door and how it affects society. It discusses a few examples in Italy where the movement of public employees into private banks may have contributed to recent bankruptcies and scandals. In the third section, the paper describes Italian regulation and its inadequacies on the issue. The final section prescribes some policies that can begin a virtuous process towards the safe institutionalization of the phenomenon.

### **Introduction**

In 2016 the former president of the European Commission Juan Manuel Barroso became the new non-executive chairman of Goldman Sachs. This event raised concerns and started a heated debate in the European Parliament on the phenomenon of revolving doors. It finally led to the publication of a report by an independent panel that acquitted Barroso and Goldman Sachs from any wrongdoing. This case focused the attention of the public, but the movement of employees from positions in public offices to the private sector is common, especially among top management. It has also attracted the attention of researchers. Over the past 14 years the number of top executives from regulatory agencies who end up in private firms has increased by more than 24% (Shive and Forster 2016). The movement tends to have significant positive effects on the firm's risk management (stock return volatility declines, capital ratios improve, loan loss provisions decline). The channel through which the phenomenon of revolving doors affects a firm's performance is still debated and, assessing it with different perspectives leads to different ethical conclusions. Two main hypotheses (with corresponding ethical perspectives) prevail on how revolving doors affect the firm's performances.

### **How does the revolving door affect an economy?**

There are two main hypotheses: the so-called “*schooling hypothesis*” and the “*quid-pro-quo hypothesis*”. The former assumes revolved regulators are often more skilled and clearly more familiar with regulation, therefore they add further productivity to the firm. Kempf (2017) also finds that former regulators’ performances improve with news about employment opportunities. She claims the regulators have more incentives than employees from private firms to work hard and improve their skills to signal their abilities to potential employers. Shive and Forster (2017) find evidence of positive effects on a firm’s efficiency by hiring revolving regulators. They claim the same effect is absent for unregulated firms. This point further supports the “*schooling hypothesis*”.

The “*quid-pro-quo hypothesis*” is more ethically questionable. Under this hypothesis the increase in productivity comes from practices at the border between legality and illegality. The improvement would not be in efficiency and productivity, but rather the firm gains in political connections and preferential treatment in public procurement, access to finance and firms can even benefit from further tax exemptions (Schofield and Caballero 2017). To further support this hypothesis, Faccio et al. (2006) show how the differential in profits between firms hiring former regulators and firms with limited political connections are positively correlated with the environment of corruption. This would mean that, in more countries where corruption is more prevalent, hiring former public officials have a greater value. This can only imply a link between corrupt practices and revolving doors, supporting therefore the *quid-pro-quo hypothesis*. The regulators, considering the opportunities for future employment, can find themselves in situations where there are conflicts of interest, possibly harming social public good. They can, for example, strengthen and complicate regulation aimed at increasing their value to private firms once in the job market (Lucca et al. 2014), or even directly favour the firms willing to hire them. Faccio et al. (2006) also show how companies hiring revolving regulators are more likely to be bailed out by the governments when struggling. Political connections are proven to be a market distortion resulting in a loss in efficiency (Brezis and Cariolle 2016). In particular high concentrations of political influence in private firms often lead to low trust in the legal system and property rights preservation, lower tax compliance and higher barriers to entry in the market for firms with lower levels of political connection (Slinko et al. 2005).

In summary, there is evidence supporting both hypotheses. It is likely the two arguments are valid, therefore a complete ban of employees moving from regulatory agencies to private firms can negatively affect the firms’ productivity, but measures preserving the independence of public agencies avoiding dangerous conflicts of interest seem necessary. A fair regulation would encourage the hiring of former regulators that could increase a firm’s efficiency but discourage morally questionable behaviours that lead to a loss

in efficiency of the entire market. Italy experienced significant problems with regulators engaging in the practice of revolving doors that led to disastrous consequences.

### **Italian Banks and Revolving Doors**

In recent years the Italian banking system has been bedevilled by numerous scandals and bankruptcies. One of the most infamous cases is the nationalization of the Banca Popolare di Vicenza (BPV). In 1996 Gianni Zonin became president of the bank and started a policy whereby overpriced shares of the bank were purchased as a prerequisite for obtaining loans. After almost 20 years the castle collapsed, and shares of the bank went from 62.5 euro to less than 10 cents in a few months, creating a loss of about 6.2 billion euro for shareholders.

The fair question at this point is: where were the regulators and inspectors? From 2001 to 2014 the bank went through multiple inspections and investigations that did not lead to any concrete corrective action. In 2001, the Italian central bank concluded that the price of BPV's share was not in line with the indicators. The official that signed the report was Luigi Amore. He became the Audit manager of the Banca Popolare di Vicenza shortly after. Similarly, Andrea Monorchio, after 13 years as general accountant of the state, was named on the board of directors and then became the vice president in 2014. In 2001, after the inspection, the public prosecutor's office opened an investigation, but it was soon after archived. Some years later the Chief Prosecutor of Vicenza, Antonio Fojadelli was named on the board of directors of a company controlled by the bank. In 2008 Zonin hired the former general secretary of the Italian central bank as the general secretary of the BPV. In 2012 Gianandrea Falchi (another member of the secretariat of the central bank) conducted a second investigation. Again, a negative outlook ensued, but no sanctions were placed. In 2013 Gianandrea Falchi was hired as the chief of institutional relations (Vanni 2016).

Another example of negative effects of the revolving door syndrome is the case of Monte dei Paschi di Siena (MPS). After numerous attempts to save the bank it was finally nationalized in 2017. The poor management of the assets of the bank was the result of decades of close links between the board of the bank and politicians. Last year, JP Morgan designed the rescue plan which was then implemented. The president of JP Morgan in the euro region happened to be Italy's former minister of economics Vittorio Grilli. He was minister until 2014, the year of the first of three recapitalizations of MPS.

These two examples do not necessarily imply any illegal action, but it seems clearly to indicate the problem of "revolving doors" needs to be regulated. Having a conflict of interest does not necessarily imply the person will favour her own interest. These examples of people going from public agencies to private firms are not necessarily instances of their committing any illegal

action, but the question arises whether stricter regulation could have avoided some of these financial breakdowns.

### **Italian Regulation**

In 2015 Transparency International ranked Italy 17<sup>th</sup> out of 19 countries considered in its report. The report took into account three main features: transparency, integrity and equality of access. The first refers to whether lobbyist interaction between firms and public officials are made public. Integrity measures the strength and enforceability of regulations and the presence and effectiveness of codes of conduct for both public officials and lobbyists. Finally, the report measures whether public decision-making is equally accessible to representatives of different interests. In measuring integrity, the report also looks at a country's actions for fairly regulating the phenomenon of revolving doors. Its measures are, in general, below average for Italy, but the worst performances concern post and pre-employment restrictions and the non-existent code of conduct for lobbyists. What is encouraging is the existence of a moderately effective ethical code for the public sector and voluntary ethical code for lobbyists (Mulcahy 2015). There is no requirement for a cooling-off period after the end of a job in a regulatory public agency, except for holders of government positions (just one year) (Martini 2015). This measure is instead present in all European institutions and most European countries. The only restrictions concern working in public institutions if the individual has worked in the previous 2 years in private firms regulated or financed by the public institutions. Another restriction only prevents public managers from being hired in companies that benefitted from their public activities. Yet, that restriction was not enough to prevent Zonin from hiring members of the secretariat of the central bank or members of the public prosecutor's office. Furthermore, there is no ethical committee required to approve movements from the public to the private sector. There is a complete lack of regulation in this area.

As mentioned, there is a code of conduct and multiple ethical codes for public employees, but there are no clear chapters on conflicts of interest and the phenomenon of the revolving door is barely mentioned. Transparency International suggests there is a lack of regulation for the whole lobbying sector. This deficiency is the result of years of defamatory campaigns against lobbyist activities, which led the public to link lobbying automatically with corruption instead of as part of a healthy democratic process. The lack of consideration of the category, led to a series of failures to recognize the role of the lobbyist at a normative level, although in the past decades over 50 bills were presented and discussed in the Italian parliament. To compensate for the lack of recognition, the Italian organization of lobbyists, named "Il Chiostro", recognizes the profession and sets a series of ethical codes to be followed as a requirement of joining the association. Nevertheless, Italy developed a socio-political context that created a lobbying system based on personal connections, rather than institutionalized channels (Del Monte et. Al 2014). This is the

same kind of issue the revolving doors phenomenon faces and helps us better understand the problem. In Italy, the practice of revolving doors is also based on personal connections and is not properly regulated and institutionalized. In this context, both public agencies and private firms struggle to differentiate between legitimate and unethical hiring.

### **Policies and Recommendations**

Conflict of interest is the first matter to regulate in order to limit the practice of revolving doors. The most common measure to prevent this is the provision of cooling-off periods after the end of public employment. As previously explained, in Italy a cooling-off period is only required for jobs after government employment and only for a one-year waiting period. This measure aims at decreasing the ability of public officials to influence policymakers and regulators. Transparency International recommends that a cooling-off period should last at least 2 years, but should be evaluated in each case depending on the potential gravity of the conflict of interest and considering the specificities of each position. Following a body of regulation, Italy needs an advisory board responsible for approving questionable post-public employments, which can provide help and advice in particular cases. In some countries like Portugal and Spain, public officials are required to make public any future employment plans.

To be effective, such a regulatory body and advisory board would need to be backed by enforcement authority. The first challenge of enforcement is that public bodies often lose track of the future careers of former public officials and often, private firms and banks are not even aware of sanctions pending on an individual. Provisions on transparency of the careers of former public officials should be applied. They can include: requiring regular reporting of professional activities, making public any restrictions applied to public officials, directly informing employers of specific restrictions. The second challenge is designing a system of effective and enforceable sanctions that act as a deterrent but always taking into consideration the principle of proportionality. The deterrents can include: cancellation of contracts, fines to the employer and the employee, and a ban from public offices (Martini 2015).

The EU considers the examples of Canada and France to be virtuous. Canada approved the Conflict of Interests Act in 2007 and the Lobbying Act in 2008 that provided clear rules on how to handle the revolving door problem. Canada's cooling-off period can be 5 years in length for members of the government and there is a large body of regulation for specific jobs with special attention to former ministers and public servants. The sanctions can lead to a lifetime ban on switching sides from the public to the private sector and vice versa (Freund and Bendel 2017). The two Acts also put in place two independent officers in Parliament with broad competences and adequate resources. The Commissioner of Lobbying employs a staff of 28 people and a budget of 3 million euro. It oversees issues related to lobbyists and updates a

registry that monitors professional lobbyists. In the EU, a similar kind of office (the EU Transparency Register) employs less people and has three times more registrants. The second position is the Conflict of Interests and Ethics Commissioner. This office monitors conflicts of interests of members of the government or public servants at all levels. It also advises on issues related to post-employment obligations. In a period of two years 55 penalties were issued and more than 200 investigations were opened (Freund and Bendel 2017).

France, after being hit by numerous scandals (for example, the resignation of the Budget Minister Cahuzac in 2013), established the High Authority for Transparency in Public Life (HATVP) in 2014. The Authority assesses two declarations of interest per public officer: one at the beginning and one at the end of the mandate. It also assesses post-employment issues. The regulation requires a three-year cooling-off period and all new private activities must be authorized. The HATVP has significant powers even over sanctions. It can prevent or apply restrictions in case the employment opportunities do not comply with its ethical standards. To keep up with this amount of work the Authority has a budget of over 6 million euro and a staff of 40 full time employees. It was able to oversee more than 5,000 declarations and sentenced 23 cases. A senator has been sentenced to 6 years imprisonment for omitting a Swiss bank account. Fines for a simple omission can be more than 60,000 euro (Freund and Bendel 2017).

### **Conclusion**

Clearly, a similar system to Canada or France needs to be established in Italy. The starting point must be a new culture with a new understanding of the intentions of the activity of lobbying. Italy must acknowledge the benefits from the movement of people from the public to the private sector and the important role played by lobbyists in modern democracies. After recognizing and institutionalizing the phenomenon, the country needs a comprehensive and coordinated body of legislation that can prevent cases like Banca Popolare di Vicenza and Monte dei Paschi di Siena.

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