## CHAPTER 14

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# COVID-19 AND MEASURES TO SUPPORT ENTERPRISES AND LOCAL AUTHORITIES IN ITALY: THE ROLE OF CASSA DEPOSITI E PRESTITI

This chapter focuses on the strategic role Cassa Depositi e Prestiti (CDP) is playing in response to the Covid-19 crisis. After an overview of the mandate and business of this public development bank, the chapter highlights the adverse impacts of the Covid-19 pandemic on the Italian economy and the extraordinary measures set up by CDP to support the country. These measures, in line with the mission of the bank, are specifically targeted towards enterprises and local authorities and are aimed at supporting liquidity needs to cope with the health emergency, as well as providing financial resources for meeting working capital requirements and sustaining investments and exports.

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## INTRODUCTION

Cassa Depositi e Prestiti (CDP) is a joint-stock company under public control owned by the Italian Ministry of Economics and Finance (83%), with several banking foundations owning the remaining shares.[1] Founded in 1850, CDP is a 'National Promotional Bank'[2] with the explicit mandate of fostering sustainable development, supporting growth in different business areas and boosting employment. According to the 'Articles of Association', the specific corporate objectives of CDP are granting financing to: i) the State, the regions, local authorities, public entities and public law bodies; and ii) public or private entities, with the exclusion of natural persons. The overall aim of the bank is to support initiatives for company growth and invest in research, development, innovation, protection and leveraging of cultural assets, promotion of tourism, environment, energy efficiency, sustainable development and the green economy.

CDP pursues its mandate using several financial instruments, such as loans, guarantees, mezzanine finance and risk-sharing instruments. In recent years, it has also set up equity instruments, such as venture capital and seed funds to finance start-ups and young firms, as well as strategic equity investments in companies of national interest. It offers non-financial services as well, such as technical and administrative assistance, advisory services and

[1] In December 2003, CDP was transformed into a joint-stock company with the State's assets and shareholdings transferred to CDP S.p.A. and assigned to a 'separate account system'. In line with other European national promotional banks, only part of the banking regulations were applied to CDP, that is the provisions of Part V of the Consolidated Banking Act (Legislative Decree No. 385, September 1, 1993) applicable to intermediaries registered in the special list of Article 107 of the cited Decree.

[2] National Promotional Banks – also referred to as 'development financial institutions', 'state investment banks', 'promotional banks' – are "legal entities carrying out financial activities on a professional basis which are given a mandate by a member state or a member state's entity at central, regional or local level, to carry out development or promotional activities" (European Commission 2015).

training programmes. CDP may finance end-customers directly (first-tier lending) or through financial intermediaries that in turn lend on to end-customers (second-tier lending).

On the liability side, CDP typically relies on a mixture of funding sources, such as loans from other financial development institutions, debt instruments issued on capital markets and funding from European programmes. CDP also indirectly relies on deposit funding raised via postal saving products. In line with the rationale for the existence of development banks – i.e. overcoming market failures, stimulating innovation paths and improving institutional frameworks (Yeyati et al. 2007; Gutierrez et al. 2011; Luna-Martinez and Vicente 2012; Mazzuccato and Penna 2016; Eslava and Freixas 2016; Frigerio and Vandone 2020) – CDP typically funds projects with high risk (which is usually the case for start-ups), high-tech or new industries, providing long-term 'patient' capital to promote strategic investments for economic development (e.g. infrastructure projects, export, housing, etc.) or for socially challenging projects (e.g. climate finance, renewable and environmental-friendly energy, food security initiatives). In doing so, CDP plays a counter-cyclical role in times of crisis by sustaining growth and employment when private commercial banks typically disintermediate their credit activity because of deteriorating asset quality, capital shortages, deleveraging and higher risk aversion.

In the aftermath of the economic and financial global crisis of 2008-09, together with many other European development banks, CDP has been called on by European policy-makers to share the management of European Union (EU) financial instruments and to play a primary role in restructuring the economy, channelling leveraged funds into the market, boosting innovation, supporting socio-economic and environmental challenges, and implementing financial instruments and programmes set up to reverse the low level of investment by EU firms, in particular start-ups and small- and medium-sized enterprises (SMEs) (European Commission 2014, 2015). Accordingly, in recent years CDP has significantly increased assets, co-financed a rising number of projects and investment platforms, fostered the growth of venture capital across Italy and enlarged the business volume in resource efficiency, digital infrastructure and innovation. As a result, CDP's total assets have increased from €287 billion in 2011 to €448 billion in 2019 (an increase of 56%), while total loans increased from €220 billion to €311 billion in the same period (a 41% increase).

CDP also operates with sufficient profitability: in 2019, the CDP profit before taxes was around €5 million, with a return-on-equity of close to 10%. In recent years, the issue of profitability has become relevant for development banks. Indeed, although it is well recognized that development banks, unlike private banks, have goals that go beyond profitability, given the limited fiscal space available in Member States in the aftermath of the global crisis, development banks are increasingly expected to combine their socio-economic goals with conditions of efficiency and profitability in order to "stand on their own feet" and secure a reasonable level of financial strength and stability without continued capital injections by government.[3]

In fact, the relevance of economic and financial sustainability is now explicitly stated as a key principle in the statute of CDP, as for many other development banks (e.g. Nordic Investment Bank, NRW Bank). Furthermore, strengthening the economics of projects is also crucial to leveraging additional financing for blended programmes and public-private partnership arrangements.

[3] Specifically, in outlining the best practices development banks should follow, the European Commission pointed out that "National Promotional Banks prove to work best where they focus on economically viable projects and operate with sufficient profitability (albeit below private operators' cost of equity) to maintain financial soundness without continued capital injections by the government (profits mostly being retained to bolster future lending capacity)" (European Commission, 2015, p5). Misallocation of resources and destruction of value due to political interference and inefficiencies has historically been one of the major concerns related to the action of state-owned banks ((Hart et al. 1997; Kornai 1979; La Porta et al. 2002; Shleifer and Vishny 1994, 1997).

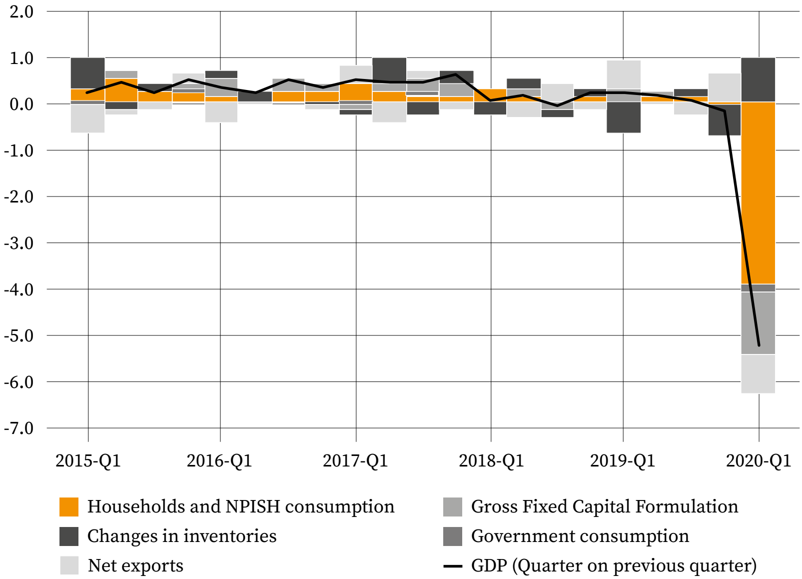
These programmes are attracting growing interest as a way to develop solutions for the delivery of long-term public goals. As explained below, CDP's role in mobilizing liquidity for enterprises, especially SMEs, has been particularly relevant in response to the Covid-19 crisis, given the strong dependency of these small-size firms on bank financing and their inability to directly access the capital market.

## THE IMPACT OF COVID-19 IN ITALY

The first Italian Covid-19 case was announced on February 21, 2020. By June 2020, the country counted more than 230,000 positive cases and more than 33,000 deaths (Istat 2020c). The total number of deaths, compared to that observed in the same period of 2019, increased everywhere in the country. There were strong peaks in some territories and a higher concentration of death among people aged over 65, particularly amongst men.

From an economic perspective, the Covid-19 pandemic and the adverse impact of its containment measures – including the interruption of 2.2 million firms' activities (39% of the total Italian firms, 65% of exporting firms) and 4 million workers (44% of the workforce) – has caused a dramatic fall in economic activity (Istat 2020d). The pandemic has also had a strong impact on foreign demand, international tourism and investment plans, with repercussions on employment, household income, spending decisions and demand for a wide range of goods and services. Overall, GDP fell by 6% in the first quarter of 2020 and is expected to decline by 10% by the end of 2020 (see Figure 14.1).

Figure 14.1: ***The GDP quarterly change and contribution, Italy***




Source: Istat 2020b.

Qualitative indicators, such as business and consumer confidence indexes, also crashed heavily. In particular, the business confidence climate index slumped from 98.8 before the beginning of the pandemic down to 53.7 in May 2020. Although decreases occurred in all the four components of the index, it has been particularly strong in market services (e.g. transportation and storage, accommodation and food service activities, advertising, rental and leasing, scientific research and development, business support activities, sport amusement and recreation activities), with a 60% reduction from January to May 2020 (see Table 14.1). By the end of August, the index slightly recovered, although well below pre Covid-19 levels.

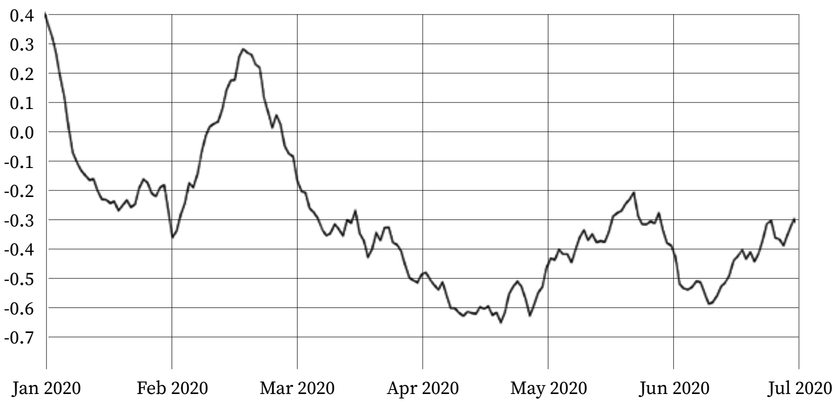
Table 14.1: ***Business confidence climates***

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug |
|---|---|---|---|---|---|---|---|---|
| Manufacturing | 98.8 | 99.1 | 86.4 | n.a. | 72.3 | 80.9 | 85.3 | 86.1 |
| Construction | 142.7 | 142.3 | 139.0 | n.a. | 108.4 | 124 | 129.7 | 132.6 |
| Market services | 98.9 | 98.6 | 75.2 | n.a. | 39.1 | 52.2 | 66 | 74.7 |
| Retail trade | 105.9 | 106.7 | 94.8 | n.a. | 68.3 | 80 | 86.7 | 94 |
| Total confidence index | 98.5 | 98.9 | 79.2 | n.a. | 53.7 | 66.8 | 77.0 | 80.8 |

Source: Istat 2020a.

As for consumer confidence, the Social Mood Index of people's perception of the crisis began decreasing in mid-February and continued on a downward trend to the end of May (see Figure 14.2), mainly due to expectations of unemployment and deterioration in income. Financial markets also collapsed, with a reduction of 10,000 basis point in the FTSE MIB Index (Milano Italia Borsa) – the benchmark stock market index for the Italian stock exchange – in a few days, and a huge increase in volatility (see Figure 14.3).

Figure 14.2: ***Social Mood Index***




Source: Istat, 2020d.

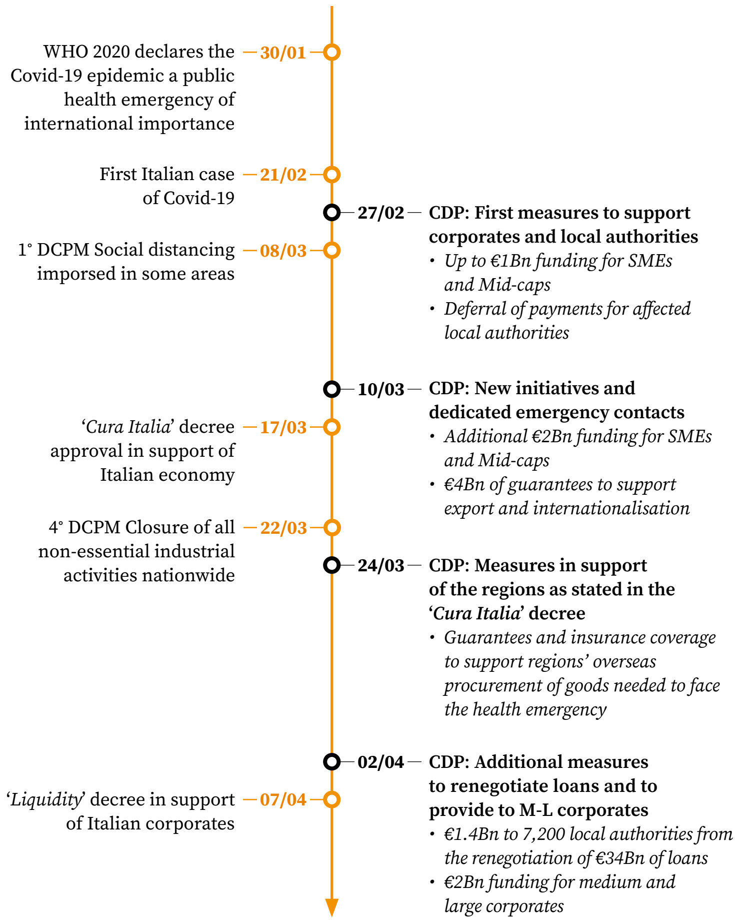
Figure 14.3: ***FTSE Milano Italia Borsa (MIB) Index***


Source: Borsa Italiana, website.

## CDP AND COVID-19: KEY ACTIONS

Since the beginning of the Covid-19 pandemic in Italy, the CDP, together with the Italian Ministry of Economics and Finance, has been at the forefront, putting several extraordinary measures in place to support public entities, local bodies, infrastructure and enterprises. Less than a week after the first case of Covid-19 was announced, the CDP set up the measures to support enterprises and local authorities (see Figure 14.5).

Figure 14.4: ***CDP's key actions to support enterprises and local authorities***




Source: Cassa Depositi e Prestiti, 2020c.

There are a variety of measures and instruments adopted by the CDP to support the economy in response to Covid-19. These measures, in line with the mission of the bank, are specifically targeted towards enterprises and local authorities (Cassa Depositi e

Prestiti 2020a, b). As far as enterprises are concerned, measures are aimed at supporting temporary liquidity needs, meeting the working capital requirements of Italian businesses, supporting investments, relaunching exports and diversifying reference markets. As for local authorities, measures are aimed at enabling regions to receive immediate financial resources, payment moratoria, guarantees and insurance coverage with the ultimate goal of receiving necessary supplies in the shortest time possible to cope with the health emergency. The following sections summarize these actions.

**Moratoria and deferral of instalments, renegotiation of loans**

Moratoria, deferral of instalments and renegotiation of loans are intended to free up resources that can be promptly used to face balance-sheet tightness due to the pandemic and to finance expenses that cannot be postponed to overcome the health emergency phase. These measures are especially relevant for the budgets of local entities (municipalities, metropolitan cities, provinces, unions of municipalities and 'mountain' communities), regions and autonomous provinces that are facing liquidity tension due to the combined effect of the increase in expenses related to the epidemiological emergency coupled with the likely reduction in tax revenues. They are expected to allow approximately 7,200 entities to free up resources in 2020, with up to €1.4 billion in support, reflecting about 135,000 loans for a total debt residual of €34 billion (Cassa Depositi e Prestiti 2020b, e). Renegotiation of loans, accompanied by a similar measure taken by the private Italian banking system, also target enterprises. To access these measures firms are required to have a healthy balance sheet before 31 December 2019 (Cassa Depositi e Prestiti 2020f).

**Insurance and guarantees**

Insurance and guarantees are designed to guarantee loans from banks and to provide insurance coverage to support exports. For enterprises, the main goal is to facilitate the supply of loans by banks to finance working capital needs (e.g. raw materials, warehouse stocks, half-processed products) and to cope with the shock that hit the national and international production chain and the temporary delays in collecting the proceeds of existing orders. Insurance coverage is aimed at guaranteeing big foreign players, especially in the oil and gas sector, infrastructure, energy and agrifood, to boost their purchase of Italian goods and services.[4]

For local authorities the main goal is to guarantee loans from banks and other financial institutions and to provide insurance coverage to support procurement oversees (direct and indirect) sought by Italian regions to buy the goods needed to face the health emergency, such as medical equipment, accessories for individual protection, diagnostic devices and other non-medical goods.

**Provision of liquidity**

Provision of liquidity, mainly targeting enterprises (Cassa Depositi e Prestiti, 2020b), have the goal of supplying new funding to SMEs, medium and large enterprises. Funding is provided both in the form of first-tier lending (directly to the end-customer) and second-tier lending (to banks and financial intermediaries that in turn lend on to end-customers). For medium and large companies, the CDP supplies short-term and medium- to long-term loans to support staff costs, investments or working capital in production facilities and business activities located in Italy. Loans are also aimed at supporting temporary liquidity needs, mainly in investment research, development, innovation, protection and enhancement of cultural heritage, promotion of tourism, environment, energy efficiency, promotion of sustainable development and green economy.

[4] According to CDP's documents, the process is carried out entirely online with pre-stabilized financial documentation, rapid resolution times and a pre-stabilized pricing on the basis of a risk/return metrics/profiles agreed upon with the bank and paid for either upfront with the finalization of the loan agreement or in a 'running mode' with each interest payment according to the contract.

Loans may also be co-financed by the private banking system, with a CDP share of greater than €5 million and a maximum duration of six years (with a grace period of up to 24 months),[5] and counter-guaranteed by the State until 31 December 2020.[6] To be eligible to apply for this type of financing, companies must have an annual turnover of more than €50 million, and be able to demonstrate losses due to the Covid-19 emergency, equal to at least a 10% reduction in turnover compared to the same period of the previous year

As for SMEs, lending to support investments and working capital needs is granted to banks that, in turn, supply loans to enterprises at lower interest rates compared to the market. Funding from CDP to banks has a maturity from three to 15 years, and banks are required to grant new finance to enterprises with a maturity from one to 10 years (Cassa Depositi e Prestiti 2020f). To ensure the highest possible transparency, CDP asks the banks to indicate, in the loan agreement with the company, the cost at which the funding is obtained from CDP and the maturity, thus giving evidence of the margin applied by the bank to enterprises.

## THE COVID-19 SOCIAL RESPONSE BOND

In April 2020, the CDP also launched the Covid-19 Social Response Bond to support Italian enterprises and local authorities that had been adversely affected by the pandemic. The bond totals €1 billion and was subscribed to by institutional investors (53% domestic

[5] The amount of the CDP share is expected to be no greater than the highest value of the following: 25% of 2019 revenue, as indicated in the approved budget or tax declaration, or twice the company's 2019 staff costs, as indicated in the budget or the certified data, if the company has not yet approved the budget.

[6] Counter guarantee has the following coverage percentages: 90% of the loan amount for companies with less than 5,000 employees in Italy and turnover of up to €1.5 billion; 80% of the loan amount for companies with a turnover of between €1.5 billion and €5 billion or with more than 5,000 employees in Italy; 70% for companies with a turnover of more than €5 billion.

investors, 47% foreign investors) and divided in two tranches with the following features: €500 million, three years, 1.5% fixed annual coupon; €500 million, 7 years, 2.0% fixed annual coupon.

Funds raised through the Covid-19 Social Response Bond are intended to provide both immediate relief in the context of the current emergency and to support, in the medium to long term, overall economic recovery. In line with the UN's Sustainable Development Goals 3 and 8 (i.e. to "Ensure healthy lives and promote well-being for all at all ages" and "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all") the bond's targeted initiatives include easing access to credit for Italian SMEs that have been severely affected by the pandemic and supporting public administrations and local authorities in strengthening and intensifying local healthcare capacity. Initiatives to be financed may include helping corporates, mainly SMEs, to access banking and financial services, also through direct lending, providing local authorities with financial support in their efforts related to healthcare, social and economic measures, financing the construction, development, maintenance or renovation of healthcare facilities, medical equipment and technologies for the improvement and protection of public health (Cassa Depositi e Prestiti 2020c).

## CONCLUSION

Although it is too early to evaluate the effectiveness of the measures that have been put in place by CDP in the face of the Covid-19 crisis, it seems that the bank's engagement has been strong, prompt and relevant. The CDP is playing a key role in providing liquidity to enterprises and local authorities, as well as implementing financial instruments and programmes to contribute to reversing the current drop in the level of investment and consumption. With the preferred creditor status and other risk-sharing mechanisms, the CDP is also creating the conditions to work as a catalyzer of private finance towards supporting investments and stimulating a response to the health emergency.

The extraordinary measures put in place by CDP to face the Covid-19 pandemic are a clear example of the unique role public banks can play in facing negative extreme events and mitigating market failures. With the injection of liquidity, guarantees, debt and equity instruments, CDP is assisting with the health emergency and sustaining growth and employment, whereas private banks are mostly disintermediating their credit activity because of higher risk aversion, capital shortages and deleveraging.

This countercyclical role of public banks has already come to light in response to the global financial crisis, when CDP started playing a primary role in restructuring the economy, channelling leveraged funds into the market, boosting innovation and supporting socio-economic and environmental challenges. Indeed, in the last few years CDP has provided long-term 'patient' capital to promote strategic investments for economic development, such as infrastructure projects, export and social housing, or for socially challenging projects such as climate finance, renewable and environmentally-friendly energy and food security initiatives.

Public bank financial support overcomes funding gaps stemming from a private sector that is reluctant to provide funding to socially valuable projects, which may prove unprofitable, at least in the short term, due to the impossibility of monetizing positive externalities. CDP has also funded several projects with high risk, which private banks do not finance if there are difficulties in evaluating the business, and in the innovation process, where expected returns take time or if there is a lack of guarantees and collateral.

Given the growing relevance and role of development banks in Europe, the 2015 Communication to the European Parliament and the Council of the European Commission pointed out that "Member States that do not yet have a national promotional bank may consider setting one up" (European Commission 2015, 2).

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