FINANCIAL TIMES

26-GIU-2013

Dir. Resp.: Lionel Barber

da pag. 4

Audit strips 'window-dressing' from Rome's euro entry drive

Public accounts

Report will fuel debate on Italy's exposure to derivatives and raises awkward questions for ECB's Mario Draghi, writes **Guy Dinmore**

In February, Salvatore Nottola, prosecutor-general of the Italian state auditor, the Corte dei Conti, remarked of Italy's 2012 accounts that "the damage done to the state's income constituted by the negative outcomes of derivatives contracts is particularly critical and delicate".

The extent of that damage has for many years been a closely held secret. Only a handful of officials, past and present, are aware of the full picture, say bankers and government sources.

But with the disclosure today by the Financial Times of a previously confidential 2012 Italian Treasury report the lid is being, at least partly, lifted.

The report, also obtained by the Italian newspaper La Repubblica, will fuel debate on Italy's exposure to derivatives and raises awkward questions for Mario Draghi, head of the European Central Bank and director-general of the Treasury at the time of some of the derivatives deals. It comes as markets have begun to exhibit new nervousness, with the cost of borrowing rising sharply for struggling eurozone countries such as Italy.

At the centre of Italy's relationship with derivatives over the past two decades are its efforts to join the euro. A senior government official and experts consulted said the restructured contracts highlighted in the 2012 report included derivatives taken out as Italy tried to meet tough criteria for the 1999 entry into the euro.

At that point, Mr Draghi was working with Vincenzo La Via, then head of the Treasury's debt department, and Maria Cannata, a senior official involved with debt and deficit accounting. Mr La Via left in 2000 and returned as director-general in May 2012 – with the backing of Mr Draghi, according to Italian officials.

An ECB spokesman declined to comment on the bank's knowledge of Italy's potential exposure to derivatives losses or on Mr Draghi's role in approving derivatives contracts in the 1990s before he joined Goldman Sachs International in 2002.

The report does not specify the potential losses Italy faces on the restructured contracts. But three independent experts consulted by the Financial Times calculated the losses based on market prices on June 20 and concluded the Treasury was facing a potential loss at that moment of about €8bn, a surprisingly high figure based on a notional value of €31.7bn.

Italy does not disclose its total potential exposure to its derivatives trades. The experts contacted by the Financial Times, who declined to be named, noted that the report revealed just a six-month snapshot on a limited number of restructured contracts.

Early last year Italy was prompted, by regulatory filings made by Morgan Stanley, to reveal that it had paid the US investment bank €2.57bn after the bank exercised a break clause on derivatives contracts involving interest rate swaps and swap options agreed with Italy in 1994.

An official report presented to parliament in March 2012 found that Morgan Stanley was the only counterparty to have such a break clause with Italy and disclosed, for the first time, that the Treasury held derivatives contracts to hedge some €160bn of debt, almost 10 per cent of state bonds in circulation. Bloomberg News agency calculated at the time, based on regulatory filings, that Italy had lost more than $31bn on its derivatives at then market values.

The Corte dei Conti declined to comment on the leaked report and the finance police did not respond to inquiries. A finance ministry spokesman confirmed the existence of the report but declined to comment on its contents and possible losses, citing commercial confidentiality. He would not comment on requests made by the police to Ms Cannata.

Gustavo Piga, an Italian economics professor, caused a storm in 2001 when he obtained a derivatives contract taken out in 1996 and accused EU countries of "window-dressing" their accounts. Mr Piga did not identify the country or the bank involved but they have since been named in the media as Italy and JPMorgan.

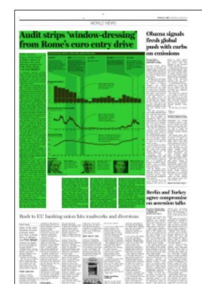
"Derivatives are a useful instrument," Mr Piga wrote. "They become bad if they're used to window-dress accounts," he went on, accusing the unnamed country of ignoring standard derivatives contracts in order to delay its debt interest payments.

Last year Der Spiegel, a German magazine, obtained official documents which it said demonstrated that in 1998 Helmut Kohl, then chancellor, decided for political reasons to ignore warnings that Italy was believed to be "dressing" up its accounts and would not meet the Maastricht treaty criteria for entry, including a budget deficit less than 3 per cent.

Officials, including Giulio Tremonti, the former finance minister, have said the EU was aware and approved of Italy's use of derivatives before euro entry. Greece followed suit two years later but irregularities in its accounts became public only in 2009.

In 2012 the EU General Court rejected a Bloomberg News freedom of information request to obtain ECB files that showed, Bloomberg said, how Greece used derivatives to hide debt.

Additional reporting by Giulia Segreti in Rome



FINANCIAL TIMES
26-GIU-2013
Dir. Resp.: Lionel Barber
da pag. 4

Diversionary tactics: how Italy joined the euro

Mid-1990s
Italy used derivatives contracts, with up-front payments made by banks, to reduce its publicly reported debt and deficit ratios in order to meet criteria to join the euro

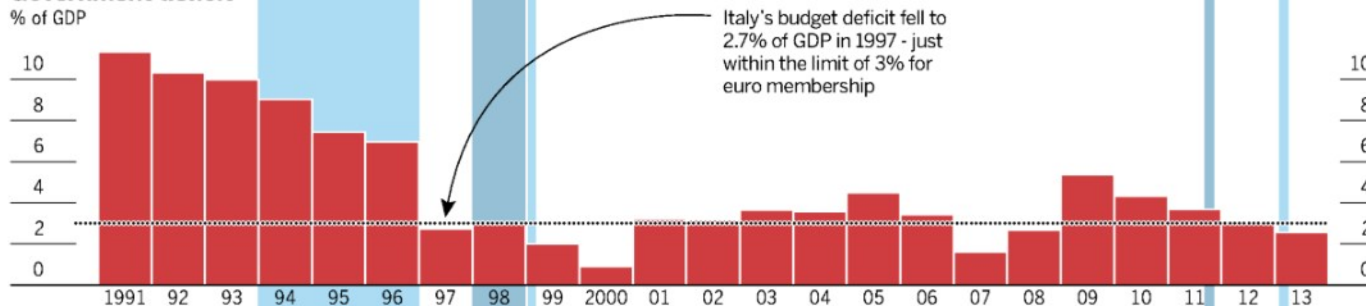
1998
Helmut Kohl, German chancellor, warned that Italy is 'dressing up' its accounts and would not meet Maastricht treaty criteria to join euro, according to a 2012 report in Der Spiegel

Jan 1 1999
Italy joins the euro

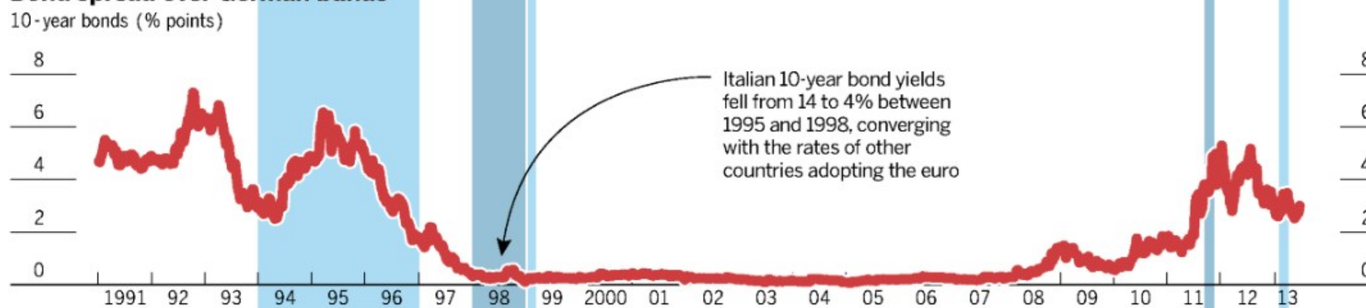
Nov 2011
Mario Draghi leaves post as head of Italy's central bank to become head of the ECB

Early 2013
Report by Italian Treasury detailing debt transactions and exposure in the first half of 2012 alarms auditors enough to call in Guardia di Finanza

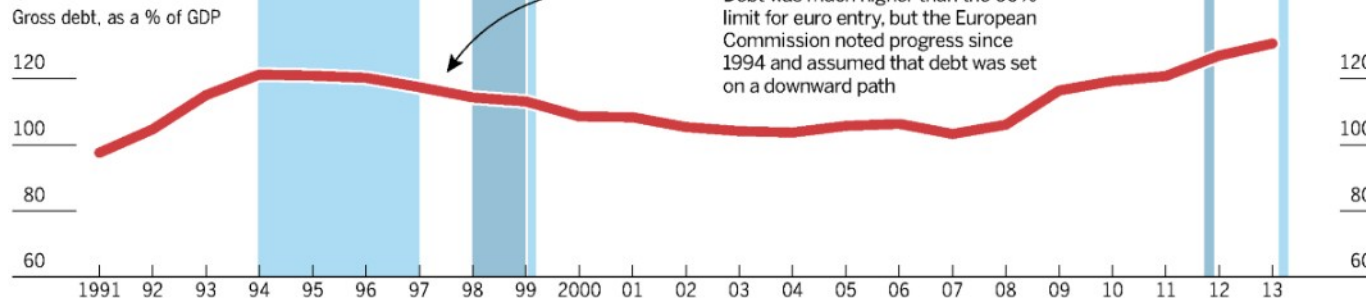
Government deficit
% of GDP



Bond spread over German bunds
10-year bonds (% points)



Government debt
Gross debt, as a % of GDP



Key players

Mario Draghi, now head of the European Central Bank, was director-general of the Italian Treasury at the time

Vincenzo La Via, then head of the debt department. Left the Treasury in 2000 but returned as director-general in May 2012

Maria Cannata, head of the Treasury's debt management agency, then a senior official involved with debt and deficit accounting

Sources: IMF; Thomson Reuters Datastream

FT graphic