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## FROM ETHICAL FINANCE TO SOCIAL FINANCE IN ITALY

### (Summary)

The financial market is almost naturally called to be the matter of the regulation by the legal system. Traditionally, however, the profiles governed by the legislator are aimed at bridging information asymmetries or at containing risks related to financial activities falling on savers or on the overall stability of the system. There is no shortage of cases in which financial operators autonomously decide to pursue non-speculative goals and use financial activities for ethical or social purposes, or operate according to parameters based on ethical evaluations or social repercussions of the financial activity they perform. Recently there has also been a legal recognition of these profiles of financial activity, which can be seen in the micro-credit discipline, in the one enacted in the Consolidated Banking Act on ethical and sustainable finance or, finally, in the provision of financial instruments to support the so called third sector, enacted in the legislative decree 3 July 2017, no. 117 (Third Sector Code). These openings to ethics, social and sustainability obviously must be positively welcomed, but the actual impact is yet to be verified.

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**Classification JEL:** G21, G23, G29

### 1. The Ethical finance movement

The Ethical finance movement (the forerunner of social finance) has been developing since the end of the 1970s in Italy. The idea was that in finance, money should be the means and not the purpose, and that in the use of money to produce money, the human being should be the reference.

This movement took on a concrete form in the constitution of ethically oriented subjects who have carried out financing activities according to the

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scheme of the mutual benefit societies (financial cooperative societies, or *Mutue di Auto Gestione* – MAG). The first MAG to be established was MAG Verona in 1978, which, according to a law dating back to 1886, began to operate by collecting money from its members in the form of share capital to finance self-managed economic initiatives, offering opportunities for ethical and solidarity-based financing, granting loans with favorable interest rates.

The movement reached remarkable dimensions in 1993, involving over 5 thousand members, financing 500 projects and creating 5 thousand jobs<sup>1</sup>. These experiences – which have reached the point of creating a real bank (called the Ethical Bank) – have, however, remained very limited<sup>2</sup>. The tightening of the discipline of the non-bank financial intermediaries (progressively implemented under law No. 197/1997 – on the fight against money laundering –, up to the reform of Title V of the Consolidated Banking Act (CBA), Legislative Decree N° 385 of 1993, a reform which took place through Legislative Decree No. 141 of 2010, which renewed Article 111 of the CBA and introduced an ad hoc discipline for the micro-credit, has created many difficulties of adjustment for the operators of ethical finance, who had difficulties in achieving the standards set for all the intermediaries.

On the other hand, the crisis of 2007–2008 and its heavy social consequences in all European countries, has taken away credibility from traditional finance and has pushed us to reflect on the opportunities that an alternative model of finance could offer. In fact, rather than looking for an “alternative” model of finance, many see a need to return financial activities to their roots, to the social function to which finance owes its birth and from which they were completely torn apart over time, following increasingly speculative and short-term strategies.

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<sup>1</sup> M. Calvi, *Sorella Banca*, Monti, Saronno 2003, p. 32.

<sup>2</sup> In Italy, however, credit co-operatives were widespread. The co-operative movement originally was inspired by economic solidarity goals. Furthermore a few local entities (originally from the Veneto region) survived the various reforms of the banking system. They were born as no profit associations, drawing inspiration from the mutuality ideals and organised according to the tradition, aimed at collecting the spontaneous small savings of its members, extending small consumer lending. These associations called *cassepeota* could continue to be active thanks to a special law (d.lg. 4.8.1999 n. 342) which set forth special exemptions to let the *cassepeota* continue in their activity which, otherwise, they should relinquish due to the stringent discipline the Consolidated Banking Act imposes to any subject operating in the financial sector, particularly waiving from the minimum requisites on capital adequacy.

These reflections have given rise to new projects aiming to invest in previously neglected sectors, identifying new financing models, or new instruments, new operators, which have determined a consistent development of the emerging social finance industry<sup>3</sup>.

## **2. The many facets of Ethical Finance: what is meant by social finance today?**

From the 1970s onwards we have witnessed the birth of a movement that revolves around the concept of “ethical finance” in Italy. Today we speak rather of “social finance”. However, this is grafted onto a very fertile ground of ancient European and Italian traditions, in which cooperation has played a leading role, giving rise to collaboration, solidarity and social emancipation.

Taking note of the change in terminology, it has to be specified that the meaning of social finance, which is today used more than in ethical finance<sup>4</sup>, is not unambiguous<sup>5</sup>.

Within the same perimeter (social finance in the broadest sense), we can thus find common cases with remarkable differences, but with the common aim to answer the needs often neglected or partially met by credit and financial markets.

Such unmet needs normally deal with individual and collective vulnerabilities (such as poverty, illness, poor education, gender discrimination or disability), but also, in a more specific way, untapped entrepreneurial potentialities (which are, in all their forms, the desire of individuals and groups to innovate), or long-term investments without immediate economic returns.

This allocation of financial resources is mainly inspired by evaluation criteria of an ethical and moral nature that persist over time: whilst remaining profit-making, it puts this in second place to the pursuit of meritorious public goods. In particular (and for this reason we speak of sustainable finance), putting the

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<sup>3</sup> As an example of the attention dedicated to the to the phenomenon at the European level we mention that on 22 march 2018 the EU Commission unveiled an Action Plan on plan on financing sustainable growth. This document, based on the recommendations rendered by the High-Level Expert Group on Sustainable Finance (HLEG), indicates the measures the Commission intends to adopt to steer the capital market towards an inclusive and sustainable economy.

<sup>4</sup> Also for the issues raised by the reference to ethics.

<sup>5</sup> Sometimes there are strict distinctions, other times are used as synonyms terms such as: social finance, ethic finance, moral finance, sustainable finance, alternative finance, mutualistic finance, self-managed finance.

persistence in time of the effects of financing in the foreground, tracing the lines of not only economic development, but also a social development lasting over time<sup>6</sup>.

The answer to the request for financing from projects or subjects – for various reasons – denied by the “speculative” finance or not socially oriented, was given in Italy in the past by Mag, who first started forms of micro-credit, then also by financial intermediaries working in traditional circuits, but prompted to modify their own standards in the social sphere, up to the use of new channels, such as the platforms of social lending and crowdfunding.

### 3. Microcredit and the Ethical Bank

As we have already mentioned, before the crisis of 2007, in Italy, there were subjects carrying out activities that could be traced back to ethical finance, but without specific legal recognition. The MAG were the pioneers in Italy of ethical finance<sup>7</sup>, supplying funds according to the criteria of solidarity, reciprocity, ethics and transparency. The savings collected among the members were dedicated to loans, first to the members, to finance self-managed economic initiatives, then also to subjects in difficulty or to subjects proposing social projects with positive effects on the environment and on the area. For this reason, they had already begun to do “social” finance aimed at supporting projects with a social value: for example, innovative and eco-compatible production and exchange systems, or aimed at promoting social integration or overcoming family difficulties.

In this context, some Mag have begun to activate micro-credit counters, to offer lending to people and micro-enterprises that could not find answers to their need for credit in the traditional banking circuit (for example, because they were not able to provide guarantees)<sup>8</sup>.

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<sup>6</sup> In particular the sustainable finance was dealt by the European institutions, namely with the strategic recommendations of the High-Level Expert Group on Sustainable Finance (HLEG), and the measures the Commission intends to adopt to steer the capital market towards an inclusive and sustainable economy (31 January 2018).

<sup>7</sup> Actually “forerunners” of the movement for the ethical finance were the credit co-operatives. As times passed by, a significant number of credit co-operative credit banks lost the mutualistic profile, which was the main feature of their beginning or, in the case of the other co-operatives banks, the *banche popolari*, the model of a co-operative company was driven only by organizational preferences and not by the pursuit of a mutualistic vision.

<sup>8</sup> In the year 2013 in Italia 105 micro-credit initiatives have been recorded and they lent slightly less than 10 thousand micro-loans, for a total amount of more than 100 million euros. By number, the largest portion of the micro-credits (59,9%) have been extended with a social and

Following the tradition of the Mutue di Autogestione (Self-management loans), the first Italian ethical bank was conceived in 1999: Banca popolare Etica (The People's Ethics Bank). According to the founders this should have taken the form of a cooperative credit bank, but, in order to overcome the territorial limits imposed on the activity of the cooperative credit banks in the Italian legal system, the form of the popular bank was adopted (which has the structure of the cooperative society, but – today, we would say – not predominantly mutualistic). The articles of association proclaim credit as a human right (to be allocated in compliance with banking regulations, which require that the criteria of sound and prudent management and economy of management be respected), and it is stated that the profit deriving from the possession and exchange of money must be the consequence only of activities oriented towards the common good and to be shared equally among all the subjects that contribute to its realization. The maximum transparency of the operations is pursued, the participation in the choices of the enterprise by partners and the savers, the use of the money for the good of the community, with support to activities of social, cultural and environmental utility, and the exclusion of the activities which hinder the human development and contribute to violate the fundamental rights of the person and the education of the client<sup>9</sup>.

However, it was only in 2017 that the Italian legislator decided to give autonomous recognition to these operational characteristics. In fact, the 2018 Budget Law introduced an article dedicated to ethical finance into the CBA (Article 111-*bis* of the CBA), entitled: “Ethical and sustainable finance”.

The elements identified by the Italian legislator to identify operators of ethical and sustainable finance, show a very restrictive approach. In fact, in order to enjoy the fiscal benefits deriving from the category of the ethical finance operator, he/she needs to carry out an ethical investigation for requests for financing and to publish the details of such financing to prove it, to grant

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welfare finalities, while by amount the lion's share was the loans granted with self-employment finalities, which drained close to three quarters of the amounts.

<sup>9</sup> See art. 5 of *Banca Etica*, by-laws (ed. 2015), available at: [https://www.bancaetica.it/sites/bancaetica.it/files/web/la-banca/Chi-siamo/statuto/Banca%20Popolare%20Etica\\_Statuto.pdf](https://www.bancaetica.it/sites/bancaetica.it/files/web/la-banca/Chi-siamo/statuto/Banca%20Popolare%20Etica_Statuto.pdf) Another bank adopted in the by-laws previsionisimili: Banca Prossima, organised under the joint stock company (*società per azioni*) model, which pursues «both yeary profits from the business and the creation and storage of value for the company and its shareholders» with the goal of creating “social value” and e di expand the access to credit, mainly to support the no profit sector. Whether this bank can be included in the “ethical bank” category according to art. 111-*bis* of the Consolidated Banking Actis debatable. On the issue see E. Macchiavello, *Commento all'articolo 111 bis* in *Commentario* a cura di Capriglione, Cedam, Padova 2016.

part of the loans to non-profit organizations and social enterprises, not to distribute profits but to reinvest them in the activity, to have a democratic and participatory governance and to adopt fair remuneration policies. The need to use an internationally recognized ethical rating, however, is currently causing problems, given that, at present, the ethical rating is not standardized on an international level (on the contrary, it is widely discussed).

On the micro-credit front, the most significant regulatory innovation in recent years has been the discipline introduced into the CBA by Legislative Decree No. 141 of August 13, 2010 (later amended in 2010 and finally by Legislative Decree No. 169/2012), rewriting Article 111, laying down specific rules for entities that can provide micro-credit as an exception to the provisions of Article 106 et seq. of the CBA on financial intermediaries that provide financing. In reality, this intervention was necessary in order not to preclude the possibility of granting unsecured loans to disadvantaged individuals or businesses at an early stage, by intermediaries who – in the absence of ad hoc exceptions – could no longer operate after the entry into force of the more stringent rules dictated by the new version of Article 106 of the CBA on financial intermediaries who provide financing.

#### 4. Innovative financing instruments for the social economy

In Italy, the legislation on social finance has developed both on the side of forms of collection through digital platforms to finance projects deemed worthy (see the rules on crowdfunding), both in the sense of funding for “the social economy” (see the code of the third sector).

We can therefore say that, also in terms of instruments, social finance has undergone a considerable evolution in the period following the crisis. On the one hand, the operators of the traditional finance – so to speak – have begun to show interest in satisfying the needs of the social economy and, to this end, have begun to propose ad hoc financing instruments; on the other, new financing channels have opened up for operators who were previously neglected by traditional finance thanks to the crowdfunding and social lending platforms<sup>10</sup>.

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<sup>10</sup> On the discipline of social lending platforms see **E. Bani**, *Le piattaforme di peer to peer lending: la nuova frontiera dell'intermediazione creditizia*, in: **M.-T. Paracampo** (ed.), *FinTech. Introduzione ai profili giuridici di un mercato unico tecnologico dei servizi finanziari*, Giappichelli Torino 2017, 163 pp.; on the evolution of crowdfunding regulation **E. Macchiavello**, *La travagliata evoluzione normativa dell'equity crowdfunding in Italia*,

The Italian legislator has taken into account both profiles on the occasion of the recent reform of the Third Sector Bodies (Legislative Decree... Code of the Third Sector), in which Title IX (Articles 77 and 78) is precisely dedicated to the instruments of social finance, with the aim of channeling and bringing resources deriving from instruments proper to the financial market into the third sector. In fact, the so-called titles of solidarity<sup>11</sup> (Article 77) have been disciplined and a favorable tax regime has been provided for, to be applied to social lending (Article 78), both for the managers of the portals and for the subjects who, outside the exercise of business activities, lend funds through social lending portals<sup>12</sup>.

Social lending<sup>13</sup> is one of the ways in which crowdfunding can be configured; it is a loan between equals. The virtual platform becomes the means to bring together individuals interested in lending money (“lenders”) with others who need financial resources (“applicants”). At present, in Italy, social lending is regulated by the Bank of Italy’s regulations aimed at safeguarding the reserve of savings collection activities among the existing public in favor of banks. On the other hand, crowdfunding, the so-called equity based crowdfunding, has been regulated. The Italian one was one of the first disciplines to be introduced in Europe. Italy was the first European country to have specific and organic regulations regarding so-called equity crowdfunding. In 2012, the so-called “Decretocrescita bis” regulated the “innovative start-up”; the „management of portals for raising capital for innovative start-ups” (Article 50 of the Consolidated Law on Finance) and the “offers through portals for raising capital” (Article 100 of the TUF).

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*il nuovo regolamento Consob e la prospettiva di regolazione del crowdfunding a livello europeo: una disciplina destinata a breve vita?*, Riv. dir. banc. 2018/16; and, more generally on the problems regulators are called to solve due to the evolution of the so called FinTech **M.-T. Paracampo**, *FinTech e RegTech: approcci di regolamentazione e di supervisione*, in *FinTech. Introduzione ai profili giuridici di un mercato unico cit.*

<sup>11</sup> The law 106/2016, art. 9, lett. h), indicates as a principle the introduction of mechanisms for the dissemination of solidarity securities and other forms of social finance aimed at social solidarity objectives.

<sup>12</sup> The implementation modalities of the provisions relating to the social lending tax regime are not yet defined as they are delegated to the decree of the Minister of Economy and Finance.

<sup>13</sup> The trend is expanding, but the interpretation is not always non è però sempre reassuring: see **R. Di Raimo, C. Mignone**, *Strumenti di finanziamento al terzosettore*: “phenomena as the so called peer to peer lending clearly the discomfort generated by a financial system perceived as not very reassuring and the robust thrust to exit from its borders to re-create a network of simple and transparent relationships, in the logics of a disintermediated mutuality. The same phenomena also suggest that there is a potential significant offer of financial resources corresponding to a demand for stability and, more generally, safety”.

However, the matter is evolving and the European Commission has put forward a proposal for a regulation which tends to subject all the crowdfunding platforms to a single discipline, whether they be equity or lended based<sup>14</sup>.

Solidarity bonds, on the other hand, have a more tormented history behind them. In fact, they were introduced by Article 29 of Legislative Decree 4.12.1997 No. 460 (“Reorganization of the tax discipline of non-commercial entities and non-profit organizations of social utility”) to allow a new kind of fundraising to be allocated to the financing of non-profit organizations<sup>15</sup>, but in fact have not had a concrete application. The market has turned to other instruments, such as social bonds<sup>16</sup>, which the Italian banking sector has experienced since 2012 and which the legislator has been inspired in dictating the discipline of Article 77.

<sup>14</sup> **E. Macchiavello**, *Commento all'articolo 111 bis* in *Commentario a cura di Capriglione*, Cedam, Padova 2016.

<sup>15</sup> **F. Belli**, *Finanziamenti con l'emissione di titoli di solidarietà*, in *Guida Normativa*, 5 febbraio 1998, 47.

<sup>16</sup> *Social Impact Bond* are defined in **OECD**, *Social Impact Bonds. State of Play & Lessons Learnt*, Paris 2016 as an innovative financing mechanism in which governments or commissioners enter into agreements with social service providers, such as social enterprises or non-profit organisations, and investors to pay for the delivery of pre-defined social outcomes. More precisely, a bond-issuing organisation raises funds from private-sector investors, charities or foundations. These funds are distributed to service providers to cover their operating costs. If the measurable outcomes agreed upfront are achieved, the government or the commissioner proceeds with payments to the bond-issuing organisation or the investors. In reality, the term “bond” is more of a misnomer. In financial terms, SIBs are not real bonds but rather future contracts on social outcomes. They are also known as Payment-for-Success bonds (USA) or Pay-for-Benefits bonds (Australia). The Italian scholars stress the fact that the word “bond” do not qualify nature of the security, and merely show the link between the yield of the financial transaction and the social impact generated by the financed activity, **A. De Giudice**, *I social impact bond*, Franco Angeli, Milano 2015; recently **R. Mignone**, *Investimento a impatto sociale: etica, tecnica e rischio finanziario*, *Rass. dir. civ.* 2016, 925 ss.; **R. Di Raimo**, **C. Mignone**, *Strumenti di finanziamento al terzo settore e politiche di intervento locale nella «società inclusiva» europea*, *Giust. civ.* 2017. See also **G. Pasi**, *Challenges for European Welfare Systems. A Research Agenda on Social Impact Bonds*, *Review of Applied Socio-Economic Research* 2014/8, pp. 141–151; *Id.*, *I social impact bond: nuovi schemi negoziali tra misurazione dell'impatto e finanza strutturata*, in: **F. Maino-M. Ferrara**, *Secondo rapporto sul secondo welfare in Italia*, Centro di Ricerca e Documentazione Luigi Einaudi, Torino 2015, 23. For an overview of the positions in the doctrine as to the relationship between Project financing and SIB, see **R. Di Raimo**, **C. Mignone**, *op. cit.*, no. 75; *ibidem* there is a comparison between two generations of social finance: solidarity securities and social impact bond. Social impact bond have been defined as “the frontier outpost of social finance, the last effort to part from the supporting concept of acts and activities functional to the capitalistic exploitation of wealth: activities organised and financed to «do good»”.



Compared to the previous discipline dictated by Article 29 of Legislative Decree 460/1997 and the Ministerial Decree 328/1999, that of Article 77 should ensure greater dissemination of the instrument, in fact, the provision of tax breaks for banks that issue solidarity bonds and individuals who subscribe to them, is likely to be unnecessary in view of the limitations that have been introduced and that end up making the issuance of this type of securities unattractive to banks and the provision of a series of financial breaks.

The provision of a series of financial advantages to issuers does not at present appear to be such as to overcome the criticality that imposed the limitations give rise to.

## 5. Conclusions, so Far

There are opposing opinions on these “openings” to ethics, to “social” to “sustainability” on the part of the financial market.

Ethical finance, which has been present in Italy for almost 40 years now, should demonstrate that it is possible to keep together participation; social and environmental orientation of investments; non-speculative attitude and management of banking and financial complexity, thus giving its implicit contribution to the balance and stability of the economic-financial system as a whole. If it does not develop as hoped, however, we could find ourselves dealing with social finance, to which, following the crisis, unimaginable spaces were opened, but perhaps only “by virtue of a sort of blank mandate of trust, due more to the demerits of traditional finance than to the fact that the effectiveness of social finance initiatives has been ascertained”.

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## OD ETYCZNEGO FINANSOWANIA DO FINANSÓW SPOŁECZNYCH WE WŁOSZECH

### (Streszczenie)

Rynek finansowy winien być ze swej natury podatny reglamentacji prawnej. Tradycyjnie prawne modele reglamentacji rynku finansowego mają na celu łączenie asymetrii informacji lub ograniczanie ryzyka związanego z działalnością finansową, ciężącego na oszczędzających lub ogólną stabilność systemu finansowego. Nie brakuje przypadków, w których podmioty działające na rynku finansowym samodzielnie podejmują decyzje spekulacyjne i wykorzystują działalność finansową do celów etycznych, społecznych lub działają zgodnie z parametrami opartymi na ocenach etycznych lub społecznych skutkach działalności finansowej, którą wykonują. Prawne uznanie wymienionych wyżej profili działalności finansowej można zaobserwować w sferze mikrokredytu, w tym wprowadzonym w ustawie o bankowości skonsolidowanej w sprawie etycznych i zrównoważonych finansów lub wreszcie w zakresie dostarczania instrumentów finansowych, za pomocą którego wspierany jest tzw. trzeci sektor, o którym mowa w dekreście ustawodawczym 3 lipca 2017 r., n. 117 (trzeci kod sektorowy). To otwarcie na etykę, społeczność i zrównoważony rozwój musi być pozytywnie ocenione, ale jego rzeczywisty wpływ na rynek finansowy nie został jeszcze zweryfikowany.

**Słowa kluczowe:** etyczne inwestowanie; mikrokredyt; finanse społecznościowe