



Bank Sales of Own Shares To Customers Under Fire

When Spain's **Banco de Sabadell** SA needed to raise nearly \$2 billion for its takeover of a British bank this year, it instructed branch employees to sell shares directly to retail customers.

By *Joannette Neumann in Madrid, Giovanni Legorano in Milan and Patricia Kowssmann in Lisbon*

One customer said his banker called him several times to entice him to purchase shares. Later, at the branch, the banker placed a 10-by-10-inch box of Nestlé chocolates next to a document and urged him to sign, ceding to Sabadell's management the

right to vote his shares at the annual meeting. The customer, who declined to be named, said he signed and took the chocolates.

In southern Europe, which has a tradition of mutually owned or unlisted savings banks, it is a legal and long-standing practice for branch employees to sell stocks and bonds issued by the bank to people who have deposits and loans with the bank. Sometimes, customers are encouraged to cede their shareholder voting rights to the bank, too.

The practice cost customers dearly during Europe's financial crisis and is coming under fire anew as an inherent conflict of interest that prioritizes banks' balance sheets

over investors' pocketbooks.

In Portugal, clerks of the now collapsed Banco Espírito Santo SA sold €550 million (\$603 million) in debt from the bank's parent to retail customers in late 2013. The parent was already in trouble and has since gone bankrupt. Many clients have lost their entire savings.

Spanish bank customers were saddled with around €3 billion of paper losses after they bought €7 billion of complex bonds from Banco Santander SA in 2007. Five years later, the bonds converted into shares that had plummeted in value. Around 300,000 **Bankia** SA depositors also lost millions after they purchased

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shares in the lender's ill-fated 2011 initial public offering. Bankia was bailed out in 2012.

"The bank should always act in good faith and in the interest of the client," said Fernando Herrero, spokesman for Spanish consumer association Adicae. But when a bank sells its own securities, he said, "the interest that is going to take priority is the bank's interest in obtaining financing."

Banks turn to depositors to sell their securities when institutional investors won't buy or might offer too low a price. Some lenders have another reason to sell to their own customers and build up a large retail investor base: Unlike institutional investors, individual shareholders typically vote in lock step with a bank's management or directly delegate votes to bank executives, as the Sabadell client did.

Some Spanish banks have built up substantial retail shareholder bases, which they perpetuate through repeated sales of their securities to existing shareholders and dividend policies that appeal to individuals, not institutions. Fifty-three percent of all shares in Sabadell, for instance, are held by individual in-

vestors.

"They are shareholders who do not bite," said Javier Santomé, a financial-management professor at Spain's IESE business school.

A Sabadell spokesman said its bankers call retail buyers to inform them about investments, not to persuade them to buy. The bank gives chocolates to shareholders who vote in person at its annual investor

firm separate from a bank.

When some retail banks in Spain, Portugal or Italy offer their own securities, they often mobilize employees whose usual job is to sell home or car loans.

"It's a peculiar characteristic of most continental European markets that people selling these securities have no particular training," said Luis Arenzana of London-based

Caixa Económica Montepio Geral SA.

Facing a capital crunch in 2013, the small private savings bank sold €200 million of participation units—shares issued by a mutual association. Retail clients bought most of the units through branches, a person familiar with the sale said. The units, sold for €1 each, are now worth €0.79 apiece.

When the bank tried in June to sell an additional €200 million of units, regulators dissuaded it from turning to retail clients, according to the person. Without institutional investors in sight, it ended up selling the entire offering to its parent company, a mutual association. The bank has said the parent company would try to sell the offering to institutional investors. A bank spokesman denied that the lender avoided retail clients because of regulators' pressure.

In Italy, unlisted lenders **Banca Popolare di Vicenza** and Veneto Banca lowered the value of billions of euros worth of shares by more than 20% in April, blaming a protracted economic downturn.

Bank clerks had promised the shares wouldn't lose value because the banks are unlisted, according to lawyers and consumer associations

representing retail shareholders.

Roberto Zambrenti, a 43-year-old yoga teacher and entrepreneur in Genoa, said his mother wanted to try to sell her shares from Popolare di Vicenza to pay for an apartment for him and his girlfriend. "We were told it wasn't immediately possible and were offered a loan instead," he said.

Tommaso Caparrotti, an architect in the city of Prato, said he bought €12,500 worth of shares from the same bank in 2012 on a clerk's promise of a better shot at work as a real-estate adviser for the bank.

Even before the shares dropped, he said, he had been asking the bank to sell the unlisted shares, with no luck.

"The bank told me that selling the shares would have taken around a month," Mr. Caparrotti said. "But I had asked to have my money back a year before they decided to lower the price."

Italian regulators are reviewing how the shares were sold, a person familiar with the investigation said.

Banca Popolare di Vicenza declined to comment.

A Veneto Banca spokesman said the bank is "working to find a viable solution" for shareholders seeking to sell their shares.

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meeting and to shareholders who delegate their votes, he said.

Since the financial crisis, European Union lawmakers have approved rules that will allow regulators, starting in 2017, to ban the sale of risky products.

But the lawmakers have stopped short of prohibiting banks from selling their own securities to clients—a rare practice in the U.S. and U.K., where individual buyers typically purchase investments from a broker or financial adviser who works at a

hedge fund Ronit Capital LLP.

In April, Sabadell raised €1.6 billion—€1.1 billion of it from its branch network—to fund the purchase of U.K. bank TSB Banking Group PLC.

The sale was a rights issue, with shares offered to existing shareholders at a discount, a common practice in Europe. Individual investors often clamor for such sales. Buyers of Sabadell's 2013 capital raising have seen their investments increase in value.

That wasn't the case at Portugal's