

THE MIGHTY MEDICI'S

by [Steve Brown](#)

In the annals of banking history, the Medici's stand as icon. Started in 1397 as a family run community bank headquartered in Florence, Italy, management grew the bank into one of the most influential in Europe. Dominating banking in the 15th century, the Italians were one of the first to understand that to be successful in banking; management must be intertwined with industry. As European trade flourished during the Renaissance, the Medici's chose to specialize in wool manufacturers and exporters. Soon, the Italians became known as the world's bankers and the Medici's stood at the top of the pyramid. This was no easy feat, as the powerful Catholic Church considered money-lending to be usury – a mortal sin at the time. Then, like now, bankers were as about as resourceful as it comes and the Medici's developed various subterfuges to earn a profit without technically charging interest. One elaborate exchange rate system included "gifts of interest," with fees tacked onto the sale of goods. This was one of the ways the Medici's earned a steady 20% profit without being condemned to a life of eternal hell. In addition, to pricing innovations, the Medici's made a specialty at banking the movers and shakers of Florentine politics (which gave the Bank unparalleled influence). However, the Medici's single largest success factor was being the exclusive banker to the Catholic Church. As the Church's influence spread, so did the Medici banks and with it, cheap deposits. Instead of controlling the empire itself, the Medici's were the first to utilize on a grand scale a corporation in societa. Members of the Medici family would partner with local families of influence in key regions around central Italy. Then, in what amounted to a limited liability structure, they would start a bank while retaining a controlling interest. They would operate each bank through a centralized holding company. Like most good business stories, the inability to change was at the heart of the Medici's downfall. The Catholic Church that provided such a huge, interest free deposit base made greater and greater demands, driving up costs and increasing the lending risk of the Bank. Corruption followed wealth and it seemed the Medici clan was at the heart of nearly every scandal. Adultery, slavery and murder all played a role and soon many of the Bank's reputable private clients were driven away. To make matters worse, the Church, princes and governors that the Medici's so meticulously banked, all ran into problems and failed to repay their loans. At one point in time, the Bank's largest creditor was the Pope himself with millions in unpaid loans. Without diversification, the Bank ended up taking huge losses. Back then, most local management did not even attempt to collect on defaulted loans, amid fear of political or moral reprisal. The societa structure that worked so well in good times caused internal fighting and dissention when credit became an issue. By the mid-1500's the Medici banking empire was a shadow of its former self and was largely disbanded. To this day, Italian bankers still talk about the "Medici touch" of lavishing extreme personal service on customers (and charging high fees). Like the Rothchild's, Morgan's and other U.S. banking empires, the Medici story serves as a colorful reminder about the roots of the banking industry.

BANK NEWS

M&A x2

Bank of Montreal subsidiary, Harris N.A. (\$40.2B, IL), will buy Ozaukee Bank (\$694mm, WI) for \$190mm in stock, or approximately 3.69x book. The acquisition adds 8 branches to Harris' existing 229 in the Midwest. In addition, Harris said it would also buy Merchants and Manufacturers

Bancorporation (\$1.5B, WI) for \$137.2mm or about 1.12x book. Merchants has 6 bank subsidiaries and 45 branches.

OCC / OTS

The ABA issued a position report against the merger of the two regulators on the grounds that it will limit "charter choice" among institutions.

AML Expense

A KPMG study found that spending on anti-money laundering systems and processes has increased 71% for U.S. banks over the last 3Y. Items that drove up expenses the most included transaction monitoring and staff training.

Charter News

Omni Financial Services Inc. (\$641mm, GA) has purchased a Texas charter and will open a full-service branch in Dallas.

Home Sales

Freddie Mac predicted that U.S. home sales in 2007 will drop to their lowest level since 2001 due to rising interest rates, stricter lending standards, and an up tick in foreclosures.

Credit Crunch

Huntington Bancshares (\$34B, OH) warned that its Q2 profit will drop 26% as credit costs have risen faster than expected. The announcement left investors wondering whether the warning is a prelude to an industry-wide credit crunch or merely a symptom of the recession in MI and OH.

U.S. Expansion

Shinhan Financial Group, Korea's second-largest banking company, wants to expand its lending business in the U.S. through acquisitions and is considering IL, TX, D.C., and the Pacific Northwest as possible target markets.

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