

Excess Capital, Buybacks and Shareholder Remuneration
(with particular reference to banks)
Illusion and Reality

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Abstract

The paper argues that a buyback of own shares followed, or not, by their cancellation cannot be regarded as shareholder remuneration, nor as a source of value creation. Apparent short-term effects on share prices, EPS, ROE or per-share dividends are not economically meaningful, despite a persistent and misleading market narrative that very often attributes such objectives—among other stated ones—to buyback programmes.

The analysis also revisits the notion of excess capital, showing—especially for banks—that conventional estimates based on regulatory metrics and RAF thresholds overlook both risks not yet reflected in capital requirements and estimation inaccuracies. As a result, the ‘true’ excess capital relevant for buyback decisions (and for DDM valuations in the excess capital variant) is substantially lower than what emerges from a simple comparison between a bank’s risk profile and its risk appetite.

Three appendices complement the considerations set out in this paper. In particular, Appendix 1 discusses the simulations, that management is required to perform, to assess the effects of the buyback on the bank’s capital and financial position, with reference to both regulatory and managerial metrics.

From an economic-financial standpoint, buybacks should be assessed in light of the other possible uses of the deployable liquidity: higher dividend distributions, debt reduction, maintaining a robust liquidity buffer, or investing in new growth opportunities. Moreover, rather than referring to the above illusory narrative, it is emphasised that they may be appropriate under specific circumstances, for example as part of management incentive plans, in anticipation of ‘shares-for-shares’ acquisitions, or to reshape the financial structure as deemed appropriate by management. Also taking into account both current and expected regulatory requirements, market and industry benchmarks, and the expectations of the various stakeholders (shareholders, rating agencies, analysts, investors, clients).

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1. Introduction

Through a share buyback, a company buys its own shares in compliance with the relevant regulations. In Italy, the regulation of share buybacks is found primarily in Article 2357 and following of the Civil Code.¹ In particular, Article 2357 (Purchase of Own Shares) establishes the following rules, which also apply when the buyback is conducted through fiduciary companies or intermediaries.

- The purchase can occur only within the limits of distributable profits and available reserves as reflected in the most recent approved financial statement.
- The purchase must be for fully paid-up shares, meaning shares for which the corresponding contribution has been fully made by the shareholders.
- The operation must be authorised by a shareholders' meeting, which determines the details, including the maximum number of shares to be bought, the duration of the authorisation (not exceeding 18 months) and the price range.
- For companies with shares listed on regulated markets or widely distributed to the public, the nominal value of the shares bought back cannot exceed 20% of the share capital (also taking into account for this calculation shares owned by controlled companies).²

These four limitations also apply to purchases of shares of the parent company by subsidiaries (Article 2359-bis of the Civil Code).

In addition to the rules contained in the Civil Code, there are other specific regulations for buybacks involving listed shares or shares traded on an Italian multilateral trading system. In particular, Article

¹ For a comprehensive examination of the possible motivations for share buybacks, along with documented evidence of the operations justified and executed in Italy in recent years, see the analysis by M. Rutigliano and L. Faccincani, 'Il Buyback di azioni proprie. Obiettivi ed evidenze dall'operatività delle principali società quotate italiane' in *Rivista dei Dottori Commercialisti*, No. 4, 2022.

This paper, however, addresses, above all, a different and more specific issue: the buyback undertaken (declared also) for shareholder-remuneration purposes, underscoring that the transaction, in itself, does not produce any substantive benefits, for the company or its shareholders.

² If the limits are not respected, the fourth paragraph of Article 2357 of the Italian Civil Code states: 'Shares acquired in violation of the previous paragraphs must be sold in accordance with methods determined by the shareholders' meeting, within one year of their purchase. In the absence of such a sale, the shares must immediately be cancelled and the corresponding capital reduction must be carried out. If the shareholders' meeting does not take action, the Board members and Statutory auditors must request that the reduction be ordered by the court, following the procedure set out in the second paragraph of Article 2446.' It should also be noted that Article 2357-bis (Special Cases of Acquisition of Own Shares) provides for circumstances in which the limits of Article 2357 of the Civil Code do not apply, but these are not relevant to the present discussion.

It may be noted, as an incidental remark, that when a company's shares do not carry a nominal value, its share capital may—other conditions being equal—end up being higher than that of a company whose shares do have a nominal value, where share capital is calculated as nominal value multiplied by the number of shares in circulation. This follows from the greater flexibility enjoyed by the former in allocating amounts arising from extraordinary transactions either to share capital or to reserves. Consequently, the 20% threshold translates into a different absolute figure in the two scenarios. No further analysis of this issue is needed here.

132 (Acquisition of own or parent company shares) of Legislative Decree 58/1998 establishes that purchases by companies with listed shares, including those made by a subsidiary, must be carried out in a way that ensures equal treatment of shareholders, according to the procedures specified by CONSOB in Article 144-bis of Regulation 11971/1999 (the ‘Regolamento Emittenti’).³

It is also necessary to refer to Regulation (EU) No 596/2014 (‘MAR – Market Abuse Regulation’), which provides, in Article 5 and subject to the conditions set out therein, exemptions from the prohibitions laid down in Articles 14 and 15 of the same Regulation, thereby establishing, including in the EU, a so-called ‘safe-harbor’ regime.⁴

Regarding the specific case of banks repurchasing their own shares, this is permitted only if preapproved by the relevant supervisory authority—the European Central Bank for significant banks and the Bank of Italy for less significant ones. In fact, Article 77 (Conditions for reducing own funds and eligible liabilities), Paragraph 1a of the Capital Requirement Regulation (Regulation [EU] No. 575/2013) establishes that an entity must obtain prior authorisation from the competent authority if it decides to “reduce, redeem or repurchase Common Equity Tier 1 instruments issued by the institution in a manner that is permitted under applicable national law”. The competent authority will grant the authorisation if the entity replaces the repurchased or redeemed instruments with instruments of equal or higher quality under sustainable conditions for the entity’s income capacity or if the entity demonstrates that its own funds and eligible liabilities exceed the capital requirements by a margin deemed necessary by the competent authority (Article 78 [Supervisory permission to reduce own funds], Paragraph 1 of Regulation No. 575/2013).⁵

³ It may be useful to recall that, prior to 1982, issuer share repurchases in the United States operated under a pervasive risk of ex post characterization as market manipulation under Section 9(a)(2) of the Exchange Act and Rule 10b-5, which rendered such transactions effectively unavailable as a corporate tool. The adoption of SEC Rule 10b-18 in 1982 did not confer a substantive authorization to conduct buybacks, but rather established a procedural safe harbor: issuers adhering to specified constraints on timing, price, volume, and manner of purchase benefit from a rebuttable presumption of non-manipulative conduct. Outside this safe harbor, repurchases remain fully subject to the general anti-manipulation regime and to case-specific regulatory scrutiny.

⁴ The topic, although relevant when designing a buyback transaction, falls outside the scope of this paper and is therefore mentioned only as a potential area for further investigation, essentially from a regulatory standpoint, should it be considered of interest.

⁵ According to Article 78, Paragraph 1 of EU Regulation No. 575/2013, the competent authority may also grant the entity a general prior authorization to carry out redemption and buyback operations of Tier 1 capital instruments for a predetermined amount. This authorization is granted for a period not exceeding one year, with the possibility of renewal. The specific regulations for buybacks by banks highlight that such operations can be carried out provided they do not undermine the company’s current and prospective financial and capital adequacy. Naturally, the principle — from the standpoint of economic-financial equilibrium — applies to companies in any sector.

Further important reference provisions are contained in Delegated Regulation 241/2014⁶. In particular, Article 30 (Content of the application to be submitted by the institution for the purposes of Article 77 of Regulation (EU) No 575/2013), paragraph 1, provides as follows, for the evident purpose of ensuring the bank's capital adequacy at both the individual and consolidated level:

1) The application referred to in Article 29 shall be accompanied by the following information:

(a) a well-founded explanation of the rationale for performing one of the actions referred to in paragraph 1 of Article 29;

(b) information on capital requirements and capital buffers, covering at least a three year period, including the level and composition of own funds before and after the performing of the action and the impact of the action on regulatory requirements;

(c) *omissis*

(d) an evaluation of the risks to which the institution is or might be exposed and whether the level of own funds ensures an appropriate coverage of such risks, including stress tests on main risks evidencing potential losses under different scenarios;

(e) any other information considered necessary by the competent authority for evaluating the appropriateness of granting a permission according to Article 78 of Regulation (EU) No 575/2013.

Having summarised the main regulations, this paper further develops some considerations related specifically to buyback operations by listed companies, which are often also presented as a means to provide additional remuneration for shareholders.

Specifically, it will be argued that such operations cannot in any way be considered a form of shareholder remuneration, because the theoretical values of the shareholders' financial portfolios remain unchanged *immediately* after the operation. Regardless of any potential market reactions—which may vary in magnitude and duration and are not necessarily positive following the announcement or execution of a buyback—nor can such possible fluctuations in the share price over the observation period be ascribed in a conclusive manner to the operation itself.⁷

⁶ Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions.

⁷ Extensive literature (see Appendix no. 4) at international level has examined the effects of buybacks on share prices following the announcement and/or the execution of the operation, with mixed and largely implausible results. This is unsurprising, as post-buyback price dynamics, both in the short term and even more so over a multi-year horizon, reflect the multitude of macroeconomic, financial, market and idiosyncratic variables that influence prices under the specific conditions faced by the firm at that point in time — variables that, in practice, cannot be isolate. It should also be noted that the buybacks are undertaken within the maximum threshold authorised by the Shareholders' Meeting, both in percentage terms and in absolute value. Moreover, so as not to exert a material influence on the share price (for this reason, no repurchases are carried out on days or during periods of limited trading activity, such as in the month of August), they are executed through purchases distributed over time by an independent intermediary appointed for this purpose. And in line with the maximum time period authorised by that body (not exceeding the maximum period permitted under the

It can also be reasonably argued that, in an efficient equity market with substantial depth and liquidity, persistent mispricing is unlikely, and in most cases — when such a condition is nonetheless believed to exist — a supposed mispricing cannot be rationally justified by an unbiased and objective valuation. And in any case, it is improbable that such a condition could be corrected — other than temporarily — through a buyback. Moreover, even in the presence of less liquid stocks, a buyback cannot structurally or durably affect the underlying dynamics of supply and demand.

A more detailed articulation of the paper can be outlined as follows, highlighting that the analysis will address, in general terms, share buyback transactions carried out by listed companies, while placing particular emphasis on buyback programmes implemented by banks, given the distinctive managerial specificities that characterise them and the constraints arising from a detailed prudential regulatory framework.

The second paragraph emphasises that a firm creates genuine value for its shareholders through profitable operating performance relative to the risks undertaken. By contrast, capital-management transactions alone may generate only the illusion of value creation, sometimes reinforced by targeted market communications.

The third paragraph focuses specifically on share buybacks, noting that no real value can arise merely from reducing the company's equity, regardless of any immediate effects on market prices or valuation metrics.

The fourth paragraph draws on the valuation criterion predominantly used for banks when estimating intrinsic value—namely, the Dividend Discount Model in its Excess Capital variant. The point is straightforward: if a buyback reduces excess capital, the bank's intrinsic value necessarily declines. Consequently, the lower number of shares after the buyback is offset by a lower equity value, leaving the theoretical per-share value unchanged.

The fifth paragraph turns again to the banking sector and examines the notion of excess capital, whose quantification is neither obvious nor mechanically derived from the metrics set out in the Risk Appetite Framework. This affects the maximum amount of capital that may theoretically be considered available for a buyback (within the limits set by the applicable regulations), but it also challenges the notion that the entirety of the excess capital, as indicated by the bank's assessments and estimates, can be regarded as a genuinely 'unproductive' resource that could conveniently be

applicable regulation) and at prices falling within a maximum–minimum range (e.g., $\pm 5\%$) relative to the market price of the share, such as the previous day's closing price. It follows, for this reason as well and in addition to what has already been highlighted, that isolating the possible effects of share repurchases is virtually impossible, not even over the relatively short period during which the buyback transactions are announced and executed. Given the multitude of variables that influence market price dynamics, a buyback could be little more than a “whisper in a concert”.

reduced through such transactions. The paragraph concludes by outlining some conditions that should be met for buybacks to be possibly justified as a means of enhancing capital management from a managerial perspective. Also with respect to shareholders and the market more generally, who deserve proper transparency from the company rather than the illusion of magical, immediate benefits.

The sixth paragraph examines Risk-Adjusted Performance Measurement (RAPM) indicators and the impact of buyback transactions on these metrics. It highlights the purely arithmetic effects that emerge in post-buyback measurements, which do not correspond to any genuine creation of value for the firm.

The seventh paragraph addresses a topic of considerable interest: *How Much Capital Should Banks Hold? Buybacks and Capital Management in Banking: a Managerial and Regulatory Perspective*. It will emerge—unsurprisingly—that no simple, univocal or universally valid answer can be given. To this end, the paragraph considers both the internal perspective of bank management and the viewpoint of the supervisory authority, which, contrary to what one might initially assume, does not look favourably upon banks that are over-capitalised without a clear rationale.

A final paragraph provides a concise summary of the main findings of the critical analysis.

The discussion is complemented by four appendices. The first sets out the simulations required to assess the prospective effects of the buyback on the bank's capital adequacy and financial risks, while the second describes in summary the accounting treatment of buybacks. The third Appendix reviews buyback transactions carried out in recent years by some Italian listed companies. The fourth Appendix contains an extensive list of contributions on the topic of buybacks, classifying them according to their most relevant objectives and findings. This is intended — we might say, as a service to readers — solely to benefit those interested in exploring the various aspects of these transactions and their effects, which are not necessarily consistent with the arguments advanced in this paper, specifically devoted primarily to the issue of the alleged remuneration for shareholders and the supposed impact on value creation for the company.

The text is supplemented by footnotes which may perhaps appear somewhat numerous and extensive. We nevertheless trust that the attentive reader will appreciate the substantive considerations and relevant insights developed therein, which serve to clarify, refine and materially enhance the main analysis without weighing it down.

Capital Operations, Dividends and Shareholder Benefits

As is well known, financial markets are dominated by expectations. Stock markets are no exception, and they are perhaps the markets that most clearly reflect the moods and convictions of operators, because their participants include not only institutional investors and professional traders, “usually”

well-prepared and informed, but also a multitude of smaller investors and savers who at times seek quick gains and more easily fall victim to the optical illusions created by announcements and transactions presented as advantageous for shareholders.

Unfortunately, however, real value is not created by announcements or capital operations of any kind, and the effects these announcements and operations can have - typically short term - on stock prices depend only on what market participants expect will happen, either positively or negatively, for the company or its shareholders. A capital operation cannot alter the total value of shareholders' financial portfolios. One need only think of capital increases, whether free, paid or mixed, involving the issuance of new shares at prices lower than the market price, which always results in dilution of the company's value across a greater number of shares in circulation.⁸

It is also well known that dividend distributions, in and of themselves, do not increase shareholders' financial wealth; shareholders will see, under equal conditions, a decrease in the market price of the shares ('dividend drop-off') following the dividend detachment (see Box 1, Example 1, next paragraph).⁹ Therefore, it is only the market's interpretation of the decision to distribute, not

⁸ For example, for a listed company, in the case of capital increases with pre-emptive rights granted to existing shareholders and executed at an issue price below the prevailing market price, the Theoretical ex-right price (TERP) of the share decreases by an amount corresponding to the theoretical value of the subscription right. Accordingly, the shareholder who subscribes to the capital increase by exercising the pre-emptive right does not, in economic terms, benefit from the lower issue price. Conversely, the shareholder who chooses not to exercise the right may sell on the market— to other interested investors — the rights attached to the shares held in the portfolio, thereby offsetting the aforementioned decline in the ex-right market price of the share. Naturally, such a transaction may give rise to an optical-illusion effect regarding the supposed advantage enjoyed by subscribers to the capital increase. In fact, the capital increase typically results in a rise in the number of shares that is more than proportional to the cash inflow generated by subscriptions, which evidently leads to a dilution of the company's overall market value.

For the reasons set out above, historical series of share prices must be adjusted whenever a listed company has carried out capital operations of this kind, in order to ensure the comparability of quotations over time. In Italy, the Italian Association of Financial Analysts (AIAF) regularly publishes the corresponding adjustment coefficients.

⁹ The distribution of dividends is, in reality, a distribution of capital. Although this is obvious—yet not to everyone—it cannot be assimilated to the interest paid on debt securities. As is well known, – but evidently far too often forgotten – shares are quoted according to the so-called cum-dividend price, meaning the gross of the (expected) dividend currently accruing. At the moment of the detachment (or more precisely, at the related resolution of the shareholders' meeting to distribute the profit), the value of the dividend is known. Obviously, the effect of the subsequent coupon detachment ('dividend drop-off') may not always be precisely observable, since, on the first ex-coupon trading day — including at the opening of the session — the price also reflects the supply-and-demand dynamics for that stock, which in turn depend on a wide range of variables and circumstances. Moreover, if the dividend is partially anticipated through an interim distribution before the end of the current financial year, the impact on the share's market price is effectively spread across the two distribution dates.

Awareness of the dividend drop-off, although merely a technical effect arising from the quotation including the accrued dividend, is nevertheless essential for understanding why a buyback—just like a dividend distribution, which produces analogous effects for the shareholder—cannot be regarded as a form of shareholder remuneration. Failure to acknowledge this basic fact leads to unsubstantiated interpretations of the purported benefits of the transaction.

distribute, or how and how much to distribute that can drive the market price up or down, depending on the circumstances. If generous dividends are expected and welcomed by shareholders, the reasons for this are multiple and can vary depending on the type of shareholder.

For example, consider a multi-utility company controlled by public shareholders, typically municipalities or companies affiliated with them, who rely on the dividends from their investments to fund operating expenses or investments, without diluting their holdings through the sale of shares and trusting that future market dynamics can easily absorb the effect of the dividend detachment. Or financial investors and savers with portfolios of varying size might believe that the distribution of dividends reflects the company's good health, and that is capable of generating enough profits to sustain the distribution without significant consequences on liquidity or capitalisation levels. In any case, it should be emphasised that the operation itself does not result in any effect on shareholders' financial wealth; however, it can - through targeted communication campaigns by the company - shape expectations and thus the behaviour of market operators. It cannot be said differently for buyback operations with the possible cancellation of shares when these are announced as a means to remunerate shareholders.¹⁰

Consider, for instance, open-market repurchases, whereby the company buys back its own shares using liquidity deemed to be in excess. With the repurchase of shares, the company's equity value¹¹ (and liquidity)¹² is instantaneously reduced and this value is diluted over a smaller number of shares, net of those repurchased. It does not matter whether or not the market shows clear evidence of this impact: there are multiple determinants of stock price dynamics and it is almost impossible to isolate the effects of any particular variable in hindsight.¹³ The theoretical impact on the overall financial

¹⁰ It is useful to recall at the outset that the purposes of a buyback may not include the cancellation of the repurchased shares (and, therefore, the reduction in the number of outstanding shares). Several motivations may underlie this choice: the creation of a pool of shares to be used for incentive plans or for future 'shares-for-shares' acquisitions. Or, in a not explicitly stated defensive tactical perspective, to strengthen the company's position in the event of potential hostile takeovers by reducing, for as long as deemed appropriate, the free float, increasing the relative weight of stable shareholders, and limiting — at least in the case of target companies operating in industrial sectors — the availability of excess liquidity that could otherwise make the institution a more attractive target. A strategy aimed at future disposals to benefit from potential capital gains is, by contrast, rather unlikely: any positive differences would in any case be recorded in equity (as per the IFRS/IAS principles), thereby strengthening capital adequacy, not in the income statement.

¹¹ Also from an accounting standpoint, book equity is reduced at the moment the company repurchases its own shares, irrespective of any subsequent cancellation. From a CRR-compliant regulatory and prudential perspective, however, the negative impact on CET1 is recognized— for the entire amount authorized—at the moment the permission is granted by the competent supervisory authorities (the ECB, in the case of institutions subject to its direct supervision). See: Delegated Regulation (EU) n. 241/2014, art. 28, par. 2.

¹² From a substantive perspective, this involves shareholders' own liquidity, albeit held through the company, used to reduce the company's equity. Even on these grounds, it is implausible to believe that a buyback could generate value creation for shareholders holding shares.

¹³ The effects of a buyback on market prices are, moreover, diluted over the period during which the repurchases are carried out - up to the maximum amount authorised by the shareholders' meeting - by the

wealth of a shareholder who retains their shares is equivalent to the effect of a dividend distribution for that same shareholder (see Box, Example 1, next paragraph). The only exception - although a different matter - is the non-negligible difference that dividend distributions, in general, are made from profits achieved in the financial year, a condition that is not necessary or always met in a buyback. Equating buybacks with dividends, as a form of 'return' of liquidity to shareholders, as is widely seen, is completely misleading.

Dividends are periodically distributed - subject to the dividend policy and provided the economic and financial conditions allow it - to all shareholders, who consider (although erroneously)¹⁴ these distributions as remuneration for their investment and maintain their status as shareholders.

Share buybacks - often, though not necessarily, at prices pushed upward precisely by the buyback operations - are not ordinary or periodic in nature. They inject liquidity into the market - through a program of purchases spread over time by a financial intermediary appointed for this purpose - in exchange for sales in the market by some shareholders who exit the company, obviously without any direct relationship between these sellers (who cannot be identified in relation to the issuer's buybacks) and the buyer. Shareholders who keep their shares in their portfolio do not receive any payment. In no way can buybacks - either for shareholders who have sold their shares or for those who have kept them in their portfolios - be considered a form of payout. And under no circumstances can any potential positive reaction in the share price - by no means guaranteed, depending on how the market interprets the transaction¹⁵ - be considered a form of remuneration for the shareholder.

That said, since both dividend distributions and share buybacks reduce the company's equity position, it is reasonable to assume that an unplanned buyback of substantial size could lower investors' payout

financial intermediary appointed by the company for this purpose. Consequently, for this reason as well, it is virtually impossible to isolate these components of demand and identify their impact on prices. However, a buyback, once announced and underway, may influence the expectations of shareholders and investors more generally, potentially pushing prices upward, at least in the short term. This reaction does not stem from the buyback as a mechanism of remuneration, but rather from the signalling effect that markets may attribute to the issuer's decision.

¹⁴ As already mentioned, the detachment of the dividend causes an immediate decrease in the share price by the same amount, although this is often not directly visible because it is integrated into the price fluctuations determined by the current dynamics of supply and demand for the stock.

¹⁵ Market participants and shareholders may agree with management in believing that the stock is undervalued — implying inefficiencies in the market's price-discovery function — or, alternatively, may view the transaction unfavorably, inferring that management is unable to deploy the firm's capital resources profitably and that the reduction in the company's equity position may increase risk and potentially trigger a downgrade by rating agencies and banks.

As for any conviction on the part of management and the board (as well as the shareholders' meeting, which is called upon to approve the repurchase and cancellation of the shares) that the stock is undervalued, it is highly implausible that the price expressed by a market characterized by good depth and liquidity - and in which a multitude of investors, including institutional participants, both domestic and international, take part - could be considered persistently unrepresentative of the actual market value. Thus justifying a transaction that seeks to interfere with the free interaction of supply and demand in an informed market.

expectations, regardless of what was stated in the industrial plan previously approved and disclosed to the market. The market may therefore factor in compensating effects between the buyback and the expected dividends, avoiding a duplication of the anticipated impact of these two different measures on capital, liquidity, and — at least insofar as such misleading information is frequently communicated to the market — shareholder remuneration.

2. Buybacks and Shareholder Remuneration

Buyback operations are frequent and widespread across companies in different sectors and are justified in various ways by boards of directors when submitting proposals to shareholders' meetings, as evidenced by the disclosures contained in press releases. Among these, there is sometimes an explicit goal of shareholder remuneration.¹⁶ It is, however, reasonable to exclude that management proposes a reduction in capital through a buyback to distribute excess liquidity relative to ongoing and pipeline projects, even when this rationale is not explicit but rather concealed behind other justifications that do not risk undermining shareholders' confidence in management.¹⁷

It is true that, given investment opportunities, capital has a 'cost' that may be higher than the return on capital, a cost that is implicit, of course not observable in the company's accounts, nor directly observable in the market, and whose estimation is, moreover, far from being methodologically uncontroversial. But this does not seem to realistically constitute an argument for managers to justify a reduction of capital in the ordinary course of business.¹⁸

¹⁶ The buyback is often regarded as part of a company's dividend distribution policy approved by Boards of Directors, insofar as it is considered a form of shareholder remuneration. Even though a buyback cannot be assimilated to a dividend distribution, given the heterogeneity of such transactions, it can nevertheless be stated that neither mechanism constitutes shareholder remuneration, and this is precisely what they truly have in common.

¹⁷ See Appendix n.3, *Overview of Stated Motivations for Share Buyback Operations by some Italian listed companies*. There may be undeclared, or insufficiently explicit, motivations, for obvious reasons: for example, reducing liquidity or capital deemed excessive in relation to planned initiatives (the company is financially robust enough to return liquidity to its shareholders); strengthening the position of controlling shareholders (in effect with the company's own resources); supporting the share price and driving it up, possibly alongside a reduction in the float, to help defend against hostile takeovers; increasing earnings per share (EPS) (when designed to increase the remuneration of the management team); meeting analysts' expectations for the potential positive effect on target prices.

¹⁸ One might argue that a buyback should be undertaken when management is unable to deliver a return to shareholders in excess of the cost of equity (Required Return on Equity). However, aside from the fact that the cost of equity is a largely theoretical construct - one that cannot be measured in a robust manner unless one assumes an explicit, and highly unlikely, target return for shareholders - it is reasonable to consider the following: a) it is difficult to envisage a shareholders' meeting approving a buyback with the explicit aim of reducing its own exposure to the company's business, given that shareholders can achieve a better outcome simply by selling shares on the market and investing elsewhere; b) it is equally unlikely that the board would propose a buyback on the grounds of its inability to generate an adequate return on the capital entrusted by shareholders; c) given that the company's periodic profitability may reflect cyclical trends driven even by

However, the remuneration of shareholders, who keep the shares in their portfolio, through a buyback is illusory. The potential price effect specifically caused by the operation, because of a possible positive market reaction upon the announcement,¹⁹ does not have an economic justification related to an increase in the intrinsic value of the equity; therefore, it is not likely to last.²⁰

One might argue that, *ceteris paribus*, earnings per share (EPS) will increase after a buyback because of the reduced denominator,²¹ and so the share price might increase, given a supposed constancy in the price-to-earnings ratio (P/E). But the expectation of P/E constancy after a buyback is unfounded: price dynamics, which may go in either direction, depend primarily on the interpretation of operators regarding the nature and characteristics of the operation within the context of the company's prospective earnings and financial and capital positions.²² Again, market expectations regarding the effects of the operation come into play, as the transaction is neutral with respect to the instantaneous theoretical value of financial portfolios post-buyback .

Moreover, according to a widespread narrative, buybacks are said to be fiscally advantageous compared with dividends, as a supposed alternative form of shareholder remuneration. However, the issue must be addressed correctly. Dividends are certainly taxable income for the shareholders who receive them, subject to the different tax rates applicable to the various categories of shareholders - individuals or corporations -, and taxable either in the year in which they are received, or as a component of the overall taxable income in the fiscal year to which they pertain.

As for buybacks, they produce no direct tax consequences for the company that carried out the repurchase (save for the application of the so-called Tobin Tax, where the relevant conditions are met),²³ or its shareholders, since the latter do not realize taxable income as an immediate result of the

purely exogenous factors, it is implausible to execute buybacks during weaker phases and then resort to capital increases during expansionary periods when economic conditions are more favourable.

¹⁹ Not all announced buybacks are actually carried out to the extent authorized by the shareholders' meeting. In such cases, any potential effects on the share price are, even more so, purely speculative in a broad sense. In any event, disposals of the issuer's shares by members of top management subsequent to the announcement of the buyback should be subject to close monitoring, as such transactions may infringe the applicable market abuse framework.

²⁰ Shareholders who have sold their shares on the market in conjunction with the buyback have received a consideration in line with current prices, which may have been influenced upwards (or downwards) by the announced or executed operation. However, they should not be regarded as the recipients of any presumed attempt to offer additional remuneration to shareholders. Rather, it seems more reasonable to assume that the presumed beneficiaries of the transaction are, in the company's intentions, the shareholders who retain their shares in their portfolio and thereby reaffirm their confidence in management.

²¹ The dynamics of EPS should be evaluated and assessed in relation to the performance of the numerator, which reflects the management's ability to produce economic results by running the company well.

²² It should also be noted that an increase in EPS could still lead to a decrease in the P/E ratio if the share price remains constant or increases proportionally less than the EPS.

²³ As a general matter, the repurchase of treasury shares and their subsequent cancellation does not give rise to taxable income for the company, insofar as the transaction does not result in the realization of any taxable gain and is legally characterized as a capital transaction, which is therefore neutral for income-tax purposes. Under

transaction. Except in the case where a shareholder disposes of the shares shortly thereafter and realizes a taxable gain arising from any increase in the market price, should such increase occur and provided that the tax basis is lower than the sale price. It is therefore evident that it is not the buyback transaction that generates taxable income for the shareholder, but rather any capital gain that might be realized at the moment the shares are sold, which may occur even long afterward. Yet such a potential capital gain reflects the overall demand and supply conditions in the market that materialize up to the date of the share disposal and, as such, is speculative in a broad sense, as it incorporates the prevailing expectations at that moment, without any direct link to the previous buyback transaction.²⁴ Reiterating that both dividends and buybacks do not create value for the shareholder and do not constitute genuine remuneration of the invested resources — whose overall value remains constant, *ceteris paribus* — it is true that the tax effects for the shareholder differ, but only within the terms of a proper comparison, as clarified above.

Given the objectives of this paper, no specific examination of the tax implications under Italian law — let alone in comparison with those of other major jurisdictions — is deemed necessary. The aim here is simply to clarify, from this perspective, the differences between dividend distributions and buybacks from the shareholder's standpoint, a comparison that is all too often presented in misleading terms.

Box n.1. Dividends, Buyback and the Theoretical Instantaneous Value of Stock

1. *A simple numerical example in case of dividend payout (the dividend drop-off)*

The company has issued 1 billion (B) shares. The market price is € 3, so the market capitalisation is € 3 billion. The total dividend is € 50 million, so the unit dividend is € 0.05. Conditions remaining the same, the detachment of the dividend results in a value decrease of € 0.05, meaning that the stock price theoretically drops to € 2.95. The shareholder has received € 0.05 and the ex-dividend price is € 2.95, totalling € 3 (before dividend tax).

The theoretical Value of the company, after the dividend detachment, is € 2.95 billion, calculated as 1 billion shares multiplied by € 2.95 per share.

With 10,000 shares, the shareholder received € 500 in cash. The shareholder therefore holds shares worth € 29,500 and € 500 in cash, for a total value of € 30,000.

Italian law, share buyback transactions fall within the scope of the domestic financial transaction tax (so-called *Tobin Tax*) introduced by Law No. 228 of 24 December 2012 (art. 1, paras. 491–500). The applicable rate is 0.1% for transactions executed on regulated markets (0.2% otherwise). The tax does not apply to the issuance or cancellation of shares, which are expressly excluded from the taxable events.

²⁴ For completeness, it should be noted that in certain jurisdictions (notably the United States, Canada and France) share buyback transactions are subject to a specific tax borne by the company carrying out the repurchase. In France, the applicable rate is 8% where the buyback is carried out for the purpose of cancelling the shares. In the United States and Canada, the rates are 1% and 2%, respectively, irrespective of the purpose of the repurchase. It may be noted that in all three jurisdictions the primary objective of introducing a tax on share buybacks appears to have been the generation of additional fiscal revenue, with an implicit disincentive effect — particularly in France — on the use of such transactions. In Italy, a specific levy on buybacks was discussed relatively recently (in 2025, as a potential revenue-raising measure), but these proposals have, to date, not been pursued further.

2. *A simple numerical example in a buyback of similar size*

The company buys back its own shares for a total cash outflow of € 50 million, so, at a market price of €3, it buys 16,666,667 shares. The number of shares outstanding after the buyback is 983,333,333. The theoretical value of the company after the buyback becomes €2.95 billion, exactly as in the case of a dividend distribution. This reflects the economic equivalence between the two mechanisms.

The theoretical value of the stock post-buyback is: $€ 2,950,000,000 \div 983,333,333 = € 3$.²⁵ The shareholder who kept the shares in their portfolio gains no benefit from the buyback itself.²⁶ It cannot be stated that there was a remuneration decided by the meeting in the form of a share buyback. No capital gain results directly from the operation, so no tax effect occurs where applicable.

If a shareholder holding 10,000 shares wished to partially monetize the investment in order to obtain € 500 in cash—the same amount that would have been received under a hypothetical dividend distribution—they would need to sell 167 shares (rounded figure) at a price of € 3 per share. In that case, the number of shares remaining in the portfolio would be $10,000 - 167 = 9,833$. The shareholder would therefore hold shares worth approximately € 29,500 (rounded) and € 500 in cash, for a total value of € 30,000.

3. *A simple numerical example in the case where, after the buyback, a dividend distribution is also decided, with an increase in the unit dividend for the shareholder*

Taking Example 2, the theoretical value of the stock post-buyback is $€ 2,950,000,000 \div 983,333,333 = € 3$. If another €50 million in dividends are distributed, the unit dividend is $€ 50,000,000 \div 983,333,333 \approx € 0.0508$. Conditions remaining the same, the detachment of the dividend results in a value decrease of € 0.0508, meaning that the stock theoretically drops to € 2.9492. The shareholder receives € 0.0508 and the ex-dividend price is € 2.9492, totalling €3 (before dividend tax).

²⁵ A necessary clarification is in order. The dividend detachment constitutes an immediate distribution of capital that instantaneously affects the market price of the share (dividend drop-off). By contrast, the repurchase of treasury shares, as is well known, is typically spread over a given period of time rather than carried out in a single transaction, as in the simplified example. Therefore, given that repurchases are not subject to an immediate disclosure when they are carried out, their effects cannot be isolated from the normal dynamics of the share price. It follows that, when repurchases are disclosed by the company — as required under the applicable regulatory framework and, where relevant, pursuant to an internal transparency policy — what becomes apparent is a possible, though by no means assured, positive impact on EPS. This may contribute both to the illusion of benefits for shareholders and to potential upward pressure on the share price, rather than reflecting the reduction in the company's equity.

²⁶ It should be noted that the number of shares subject to the buyback, relative to the total number of shares issued, is proportionally identical to the theoretical reduction in the economic value of equity compared with the pre-buyback level, i.e. approximately 1.67%. The shareholder who retains the shares in his portfolio, as illustrated in our simple example, receives no benefit from the transaction, and the repurchase price is not relevant from this perspective.

From an accounting standpoint, however, the purchase price becomes relevant for the company executing the repurchases, when compared with the book value of the share, since it determines a greater or lesser impact on the company's accounting equity depending on whether the repurchase price is higher or lower. A repurchase carried out at a price above book value results in a greater reduction of equity, whereas a repurchase below book value mitigates that effect. (Appendix n. 2, *A short note on the accounting treatment of treasury share buybacks under IAS 32/IFRS*).

And one might still argue that, with the same total dividend amount, the shareholder will receive an increased dividend because of the reduced number of shares in circulation, forgetting, however, as previously mentioned, that the detachment of the increased dividend per share reduces the price of the share by the same amount, the already-noted and incontrovertible dividend drop-off (see Box n.1, Example 3). Therefore, the instantaneous value of the overall portfolio (cash and the value of the shares) remains constant. The only way to create real value for shareholders is through profitable management decisions, not through such operations.

It is often argued that, through share buybacks, a shareholder who retains their shares increases their proportional ownership in the company, which is invariably presented as a benefit. However, this overlooks the fact that the shareholder ends up with a larger percentage stake, but in an overall smaller real equity base, conceived in terms of intrinsic fundamental worth and abstracted from the market's contingent and possibly transitory reactions. Naturally, the perspective of majority shareholders may differ, as an increase in their percentage of control can constitute a specific objective, for instance in defending against unsolicited takeover attempts.

The repurchase and cancellation of its own shares impact the company's net worth. This impact depends on the relationship between the repurchase (market) price (P) and the Book Value per Share (BV_{PS}). If $P/BV_{PS} > 1$ (for example, 1,5), net worth will decrease in proportion to that multiple; the opposite effect obviously occurs when $P/BV_{PS} < 1$ (see Appendix n.2, *A short note on the accounting treatment of treasury share buybacks under IAS 32/IFRS*).

Many believe that the price paid for the share repurchase should be regarded as a critical value driver in assessing the overall attractiveness of the transaction from the shareholders' perspective. Such assessment should therefore be based on a comparison between the repurchase price ('P') and the intrinsic value per share ("W_{PS}") estimated through the chosen valuation methodology. When the condition $P < W_{PS}$ is met, the transaction is typically considered value-accretive for shareholders from an economic standpoint (that is, once growth projects are funded and balance-sheet strength is preserved).

Obviously, as previously clarified, this reasoning, on the part of those who subscribe to it, only holds if the market prices the shares at levels below their intrinsic value, we might say assuming that such value can be known and commonly agreed upon. Unfortunately, this condition is far from guaranteed, particularly considering that share repurchases — typically not executed as a one-off transaction but implemented over an extended horizon by intermediaries mandated by the bank — are carried out at prevailing (fair-value) market prices, without any specific, and indeed unlikely, verification being

performed on each occasion to ensure that the above condition is actually satisfied.²⁷ In our view, this constitutes a very weak argument in support of buybacks.

But there is more. For a shareholder who keeps the shares in the portfolio, the price at which the company repurchases its own shares—whether above or below any estimate of intrinsic value—is irrelevant when assessing whether a buyback is more or less advantageous than a dividend distribution (Box n.2).

Box n.2. Dividend–Buyback Equivalence for the Individual Shareholder. The Irrelevance of the Market Price

Assumptions

- N : total number of shares outstanding
- P : market price per share
- $V = N \cdot P$: market value of the company
- D : dividend per share
- n : number of shares held by the shareholder
- $c = nD$: cash amount the shareholder wishes to obtain
-

Case 1 — Dividend Distribution

After the dividend is paid, the share price adjusts to $P - D$. The shareholder holds n shares worth $n(P - D)$ and receives cash nD .

$$\text{Total value} = n(P - D) + nD = nP$$

the same total amount prior to the dividend distribution.

Case 2 — Share Buyback at Market Price

To obtain the same cash amount $c = nD$, the shareholder sells:

$$x = \frac{nD}{P}$$

Remaining shares:

$$n - x = n \left(1 - \frac{D}{P} \right)$$

Value of remaining shares:

$$n \left(1 - \frac{D}{P} \right) P = n(P - D)$$

Cash received: nD .

$$\text{Total value} = n(P - D) + nD = nP$$

the same total amount prior to the buyback, equal to the total amount before and after the alternative represented by the dividend distribution.

Conclusion

The shareholder’s total value is **identical** under a dividend distribution and under a buyback, regardless of the market price of the share. The belief that a buyback is “advantageous”, compared with a dividend distribution, when the market price happens to be below intrinsic value is therefore

²⁷ From an accounting point of view, it should be noted that, whatever the repurchase price of a company’s own shares, the IFRS approach treats buybacks as equity transactions: they alter the structure and amount of shareholders’ equity but never affect the income statement. See again, Appendix n.2. *A short note on the accounting treatment of treasury share buybacks under IAS 32/IFRS.*

incorrect from the individual shareholder's perspective, who can always replicate the dividend through a proportional sale of shares.

The neutrality of the buyback–dividend choice for the individual shareholder does not imply that the repurchase price is irrelevant for the company. While the shareholder can always replicate the dividend by selling a proportional number of shares at the prevailing market price, the company records the buyback as a direct reduction of equity under international accounting standards. The amount of equity withdrawn—and therefore the impact on regulatory capital—depends on the repurchase price. A buyback executed at a higher price drains more equity (and liquidity) and reduces supervisory capital more deeply; a buyback at a lower price has the opposite effect. The repurchase price is therefore immaterial for the shareholder's immediate position, yet fully relevant for the company's balance sheet and, indirectly, for the long-term position of shareholders who remain invested.

We also read that a share buyback mechanically increases the Return on Equity (ROE), although this uplift is purely arithmetic and driven by a reduction in the denominator. Is this necessarily positive for shareholders? We believe it is not.²⁸ It should first be noted that any supposed increase in ROE implicitly assumes that earnings remain at least stable post-buyback; all else being equal, net income should instead decrease, as a result of either reduced investment or higher financial charges. Moreover, ROE is an accounting metric - with well known limitations - that does not represent a proxy for the shareholder's Total Return for the period, which is instead determined by the combination of dividend distributions and changes in the share price, whether realized or unrealized. Accordingly, the purely arithmetic impact on ROE — even though it may fall within management's objectives and be highlighted in targeted disclosures to the market — cannot be regarded as a value-enhancing outcome for shareholders in the context of a buyback.

But we should not be misunderstood. Given a certain level of equity, an increase in ROE driven by a rise in the numerator (current or expected net earnings) is certainly good news for both management and shareholders, as it reflects genuine organic growth in equity—regardless of the timing and form of any distributions to shareholders. However, the multi-year evolution of ROE must be assessed with due care, through a critical examination of the dynamics of both the numerator and the denominator (and their respective composition), rather than by observing the accounting indicator in an uncritical manner — and, moreover, through a point-in-time lens rather than a through-the-cycle perspective. This is a basic principle of ratio-based financial statement analysis.

²⁸ Similarly, following a paid-in capital increase, ROE declines; however, here as well, this occurs for a purely arithmetic reason, which does not allow for a superficial and immediate negative assessment of the company's profitability.

4. Buyback and Bank evaluation with DDM in the Excess Capital variant

The primary methodology for valuing a bank's equity²⁹ - particularly in the context of M&A transactions - is the Dividend Discount Model, applied in its Excess Capital (EC) formulation. Under a two-stage structure, the model is typically expressed as follows, consistent with standard practice and specialized financial literature:

$$W = \underbrace{+Excess}_{\substack{\text{theoretically it could be returned} \\ \text{to shareholders}}} \underbrace{(-Deficit)}_{\substack{\text{Requires urgent recapitalization} \\ \text{or derisking}}} Capital_0 + \sum_{t=1}^n \frac{\overset{\text{analytical forecasting}}{DIV(dist)_t}}{(1 + K_{e,hg})^t} + \frac{\overset{\text{annual Excess capital}}{\overset{\text{perpetual income (growth «g»)}}{DIV(dist)_{n+1}}}}{(K_{e,st} - g_n)(1 + k_{e,hg})^n}$$

Any 'excess capital'³⁰ is therefore explicitly estimated within the model and treated as a separate component from the present value of distributable dividends. It follows that a share repurchase mechanically reduces the bank's equity value (and any excess capital); moreover, it either lowers the financial income that would otherwise be generated by the liquidity employed in the buyback, or increases financial charges if the repurchase is funded through additional leverage. From this perspective too, a buyback cannot be regarded as a source of value creation for the bank and its investors that could be seriously announced as the immediate objective, or one of the objectives, of the transaction. Nor do we consider that the conclusion would differ for non-financial firms, where the EC version of the DDM is, in any case, generally not used as a valuation tool. Indeed, even in this case, equity value remains the objective of the firm's valuation (including within an enterprise-value assessment), and a more highly capitalized company, ceteris paribus, will reasonably reflect such a condition in its intrinsic value.

Obviously, in the case of banks, it is necessary to consider the impact of a buyback on capital-adequacy conditions (regulatory capital ratios, and from the standpoint of the Pillar 2 economic perspective) and on the institution's overall financial balance. In this regard, one should take into account, for example, the effects on the CET1 and leverage ratios, as well as on the MREL requirements (Minimum Requirement for Own Funds and Eligible Liabilities). This point will be revisited in the next paragraph, in order to better define the notion of 'excess capital' from an economic-financial perspective, as an alternative to the prudentially driven view, and, where relevant,

²⁹ Banks and other Financial Intermediaries subject to prudential regulation that imposes minimum equity-ratio requirements. We recall that the bank's valuation is always carried out on the basis of the equity value (equity value versus enterprise value).

³⁰ In a subsequent paragraph, the notion of 'excess capital' — a concept that cannot be unambiguously quantified from an economic-financial standpoint — is examined both in relation to the bank's valuation and to its potential role in supporting the rationale for a buyback.

also in relation to the perspective embedded in the Board-approved Risk Appetite Framework (RAF). Even in the case of non-financial companies, however, the impact on the firm’s financial and capital structure must still be assessed.

5. Conventional and economic, or true, ‘excess capital’ in the banking sector³¹

Further general considerations can be made again with specific reference to the banking sector. It is sometimes argued that maintaining a capital level significantly and persistently above regulatory minima – and, in particular, above the risk-appetite threshold set out in the board-approved Risk Appetite Framework– is, as a general rule, inefficient. This view rests on the mistaken assumption that capital not absorbed by risks as measured under the prudential/regulatory or internal framework is, by definition, unproductive or unnecessary.

The analytical flaw lies precisely here. Banks measure risks in terms of capital absorption both from a regulatory perspective (Pillar 1 risks) and from an economic perspective (Pillar 1 and Pillar 2 risks), the latter also allowing, where applicable, a reassessment of Pillar 1 risks through internal models that are not eligible for regulatory purposes. In both cases, the estimation of risk-weighted assets – and therefore of required capital³²– is based on different conventional rules, whether regulatory or internal. These rules may be revised to explicitly address, or reinforce the coverage of, risks already identified (for example, consider cybersecurity and climate risks, the latter in their multiple forms and associated impacts), or to incorporate newly emerging risks deemed relevant for individual institutions or for the banking sector as a whole, as evidenced, for example, by the growing prominence of geopolitical risks, which are not yet taken into account in prudential regulation, nor explicitly embedded in the internal-capital estimation carried out from an economic perspective.³³ Nor can entirely unforeseeable risks be disregarded, and one need only consider the severe effects caused by the coronavirus (COVID-19) pandemic, particularly on banks’ credit risk. This does not, of course, imply that capital buffers should be calibrated so as to cover any type of catastrophe —

³¹ General considerations on this matter can also be extended to non-financial corporations, which are, of course, not subject to regulatory capital-adequacy constraints.

³² From an internal economic perspective, the capital resources available to cover Pillar 1 and Pillar 2 risks constitute what is commonly referred to as Economic Capital, or Available Financial Resources, or Available Internal Capital, which are compared with the capital absorbed by those risks, commonly referred to as Internal Capital, or Absorbed Internal Capital. From a regulatory perspective, the bank’s own funds, measured in accordance with prudential requirements, are intended to cover Pillar 1 risks, which are estimated on the basis of standardised algorithms or internal models where authorised by the supervisory authority for that purpose.

³³ In reality, geopolitical risk cannot be regarded as a “new risk”; rather, it is necessary to reassess the risks already included in the bank’s material risk map in light of the current and prospective geopolitical situation, taking into account the foreseeable or potential amplifying effects on the risks already identified.

theoretically possible but highly improbable — yet it does serve as a reminder of the need to assess the bank’s capital requirements with appropriate prudence from an internal capital-management perspective.

Against this backdrop, the so-called ‘excess capital’ — if present and identified as such — cannot be regarded as genuinely unnecessary or unproductive. Rather, at times it is, in whole or in part, substantially absorbed — although this is not visible under the estimation procedures currently applied — within the bank’s operations to cover existing risks that remain unquantified or are measured only within the limits imposed by prevailing methodological conventions, whether regulatory or based on internal models.³⁴

A reduction of share capital through buyback transactions cannot therefore be justified by the purported – and often insufficiently substantiated – existence of ‘excess capital’ relative to the target ratios approved by the board of directors within the RAF (Risk Appetite Framework). It is, in fact, a notion that is difficult to define in absolute and truly unambiguous economic-financial terms. Nor a buyback can it be justified by the idea that such capital is inherently surplus. Rather, buybacks may be justified, if at all, solely by management’s legitimate objective of steering the bank’s financial structure in light of shareholders’ expectations and prevailing market conditions, on the basis of management’s inherently discretionary and subjective assessment as recognised by the shareholders’ meeting.

But what appears to be ‘excess capital’ is, in part and quite reasonably, merely capital exceeding perceived needs under a contingent regulatory and managerial framework, based on incomplete models and partially captured risks. Capital deemed excessive today may prove necessary tomorrow, should non-modelled existing risks materialise or supervisory requirements evolve.³⁵ Obviously, although part of the excess capital identified may in fact be regarded as covering what could be described as latent risks, it nonetheless holds that capital above certain thresholds may indeed be perceived as excessive — what we have referred to as ‘true excess capital’ — from the perspective

³⁴ Naturally, it may also reasonably be expected that the evolution of internal risk-measurement methodologies could lead to capital savings by providing a more accurate assessment of the institution’s overall risk profile.

³⁵ For illustrative purposes, one may consider the Credit Spread Risk in the Banking Book (CSRBB), as defined by the EBA Guidelines that entered into force only on 31 December 2023. These Guidelines require institutions to explicitly identify, measure, and monitor this risk, distinguishing it from Interest Rate Risk in the Banking Book (IRRBB). Furthermore, as is well established, banks update their Risk Map at least annually, identifying within the broader risk inventory those risks deemed material—both in the current environment and on a forward-looking basis—and taking into account the applicable materiality thresholds as assessed by management. Only these risks, which are relevant for managerial oversight and measurement purposes, are then subject to quantification. It follows that the remaining risks of the broader long list, although duly recorded, are not measured unless and until they become material at a later stage. The notion of ‘excess capital’ is inherently bank-specific, as it depends on the perimeter of material risks covered by the internal capital assessment, and is subject to change over time, including as a result of acquisitions.

of management, shareholders, the market and even the supervisory authority. On this point, reference is made to paragraph 7 (How much capital should banks hold? Buybacks and Capital Optimization in Banking).

BOX n.3. Further Insights into the Assessment and Interpretation of ‘Excess Capital’ in Banks

It may be useful to better clarify how ‘excess capital’ is identified on the basis of regulatory metrics and the Risk Appetite Framework. Prudential regulation sets minimum percentage capital-ratio levels that are uniform, in that they apply to all banks without distinction, which translate into minimum capital requirements when applied to risk-weighted assets (RWA) estimated using the permitted methodologies (standardised or internal models) and referring exclusively to Pillar 1 risks. The coverage of Pillar 2 risks is ensured, from a regulatory standpoint, through an additional bank-specific percentage requirement (P2R), again applied with reference to Pillar 1 RWA. This creates an apparent inconsistency, as the regulatory coverage is aimed at risks (Pillar 2 risks) that are not fully aligned with the reference base (Pillar 1 RWA).

In reality, the use of Pillar 1 RWA as the calculation base for the coverage of Pillar 2 risks is necessary to ensure system-wide standardisation in the application of the requirement. Through the SREP assessment, supervisors are (should be) fully aware of the relevance of Pillar 2 risks and calibrate the P2R percentage accordingly, even if it is applied to a base that is not perfectly aligned with the underlying risk set.

A similar logic applies to the prudential buffers that complement minimum regulatory requirements: the Capital Conservation Buffer, the Countercyclical Capital Buffer, the buffers for Global and Other Systemically Important Institutions, and the Systemic Risk Buffer. The same holds for the Pillar 2 Guidance, a non-binding but strongly supervisory-driven expectation, expressed as an additional percentage add-on. Superimposed on the grid of regulatory minimum requirements are the capital-adequacy thresholds defined by management and approved by the board within the RAF: Risk Capacity, Risk Tolerance, Early Warning, and Risk Appetite (target ratio)³⁶. These thresholds are calibrated each year, or whenever needed, in light of past and expected risk dynamics and the bank’s overall, and inherently variable, risk appetite.

³⁶ It should be recalled that the Risk Capacity, Risk Tolerance and Early Warning thresholds are designed to safeguard regulatory minima, whereas the Risk Appetite thresholds reflect planning assumptions and market expectations. It should be emphasised, however, that supervisory authorities do not expect institutions merely to meet the regulatory minima, including on a forward-looking basis and under stressed conditions. On top of the amounts required by regulators and supervisors, banks are expected to determine for themselves the level of capital needed to sustainably pursue their business models.

From this perspective, it becomes important for banks also to monitor the level and evolution of so-called economic capital (or available internal capital), which is not subject to regulatory minima, so as to maintain a current and forward-looking safety buffer over the required internal capital. The indicator used for this purpose may be defined, as in a significant case, as the Available Financial Resources Ratio, calculated simply as the ratio between available internal capital and required internal capital. This ratio should, of course, remain above one, at a level consistent with the thresholds set for Risk Tolerance, Early Warning and Risk Appetite, and aligned with the Business Plan (while no Risk Capacity threshold is defined, since—as noted above—no regulatory minima apply). From this standpoint, regulatory capital and economic capital — together with the related risk absorptions — must be jointly and consistently subject to active management in a capital-efficiency and optimisation perspective, appropriately addressing situations in which the two approaches may provide potentially conflicting signals. Further insights on this topic are provided in Section 7.

This framework confirms that ‘excess capital’—typically measured as the difference between the actual CET1 ratio (the so-called risk profile) and the Risk Appetite (target ratio) set in the RAF—reflects the combined effect of regulatory and managerial conventions. These conventions determine, first, the regulatory minima and, subsequently, the managerial thresholds proposed by management and approved by the board. ‘Excess capital’ is therefore a largely estimated quantity and is likely to be understated, in line with the considerations set out above. This should be taken into account whenever such a measure is deemed relevant for decisions outside ordinary business operations that require consideration of the capital deemed to exceed the company’s needs.

A final remark. The considerations developed here are not intended to highlight any inadequacy in the regulatory framework, nor in the internal policies and processes used to estimate the risks that determine the so-called (absorbed) internal capital at the various reference dates. Rather, they suggest caution toward measurements that may be interpreted as precise results, rather than as necessary approximations arising from the conventional perimeter of the risks that are formally captured and estimated.

This point should be taken into account when referring to the existence of ‘excess capital’ in the context of M&A transactions and valuations or share buybacks.

How, then, can true ‘excess capital’—understood in economic rather than merely conventional terms—be quantified for the specific purpose of potentially justifying a buyback intended to eliminate or reduce such surplus, based on management’s assessment, an exercise that is necessarily grounded in discretionary, forward-looking judgement?

In the case of a company exhibiting substantial organic capital generation as a result of strong and sustained profitability, it becomes evident that the equity-to-debt ratio cannot expand indefinitely without a deliberate managerial assessment of whether such a trajectory remains compatible with an efficient capital structure. A level of own funds that could justify a buyback may be inferred from the following indicative elements³⁷:

- capital and liquidity standing above the short-to medium-term targets, themselves set at an adequate distance from current (and expected) thresholds — whether regulatory in nature or not — including bank-specific SREP requirements, where applicable;³⁸
- an ‘excess capital’ identified through a broader, medium-term perspective of sound and prudent management, rather than merely against regulatory thresholds or those defined in the RAF;

³⁷ In Appendix n. 1, the required simulations of the prospective effects of the buyback are referenced, with regard both to the capital adequacy indicators and to those relating to financial risks.

³⁸ Equity (CET1, Tier 1 and Total Capital), Liquidity (LCR and NSFR), Leverage, MREL (Minimum Requirement for Own Funds and Eligible Liabilities) regulatory ratios, and MDA (Maximum Distributable Amount).

- the absence of supervisory findings (ECB/Bank of Italy) regarding capital and liquidity adequacy, both in quantitative terms and with respect to the composition of the relevant aggregate ;
- solid results in the latest regulatory as well as internal stress tests³⁹;
- capital and liquidity levels above relevant peer benchmarks;
- a return on capital significantly below benchmark levels, where such underperformance is negatively perceived by analysts and the market more broadly, as well as by shareholders — particularly majority shareholders;
- favourable assessments by analysts and rating agencies;
- no strategic discontinuity relative to the established business model;
- the absence of opportunities for extraordinary acquisition transactions within a reasonable planning horizon.

Accordingly, the assessment should not be driven by the pursuit of a theoretical most appropriate financial structure, nor merely by compliance with regulatory minima, but rather by a combination of favourable factors based on a necessarily very subjective, current and forward-looking evaluation of the bank’s capital structure efficiency from the point of view of the management of the bank, while ensuring an appropriate balance between the prudential perspective and the need for an efficient use of capital.

6. Buyback and Risk Adjusted Performance Measures, with additional remarks on capital configuration for planning and control purposes in banks

The most commonly used risk-adjusted performance indicators are considered here, namely RORAC (Return on Risk-Adjusted Capital), EVA (Economic Value Added), and RARORAC (Risk-Adjusted Return on Risk-Adjusted Capital):

- $RORAC = NOPAT / \text{capital}$, where $NOPAT = \text{Net Operating Profit After Taxes}$, i.e., an operating profit measure net of taxes.
- $EVA = NOPAT - \text{cost of capital \%}^{40} \times \text{capital}$, or, equivalently: $EVA = (NOPAT / \text{capital} - \text{cost of capital \%}) \times \text{capital}$, that is: $(RORAC - \text{cost of capital \%}) \times \text{capital}$.
- $RARORAC = EVA / \text{capital} = RORAC - \text{cost of capital}$.

³⁹ This indicates resilience in adverse scenarios and the bank’s capacity to preserve adequate safety margins even under macroeconomic or credit shocks.

⁴⁰ We prefer to define it as the ‘Minimum required return on capital’, although even under this designation it does not constitute a parameter that can be determined with genuine reliability. Depending on the measurement objectives, the reference will be to allocated or absorbed capital.

This is not the place to examine the signalling properties of these indicators in depth; however, it is immediately evident that a buyback leads to an increase in their values, creating a discontinuity that may impair the proper interpretation of the variations observed before and after the buyback.

We do not believe that the indicators calculated after the buyback should be regarded as ‘distorted’ by the effects of the transaction. Rather, as with all synthetic indicators — whether accounting-based or risk-adjusted —, we consider it essential that users of the information be made aware of the effects of the buyback, by presenting - at least initially - the impact of the resulting discontinuity.

Following the previous short remarks concerning the effects of a buyback on risk-adjusted performance indicators, further general considerations can be made with specific reference to the estimation of the indicators in question by banks, particularly regarding which capital configuration should preferably be used for their estimation.

It is generally preferable to refer to the so-called ‘(absorbed) internal capital’, as it covers the full map of risks considered relevant and material for a given bank or banking group (Pillar 1 and Pillar 2 risks). Moreover, these are managerial-oriented measurements, and therefore the perimeter limitations imposed by the Pillar 1 regulatory perspective may be inappropriate. Naturally, this holds only insofar as such risks are unquestionably and directly attributable to the operational scope under analysis through the aforementioned risk-adjusted metrics.

In planning and control processes, the RORAC therefore aims to monitor accounting profitability in relation to a risk-adjusted quantity, but it does not measure net value creation. It expresses only - in percentage terms - the (accounting) earning capacity per unit of capital absorbed (or allocated, in the ex-ante perspective of economic-financial planning). This is because the calculation does not incorporate the minimum expected return on that capital; net of such expectation, the operational activity being measured may reveal either value creation or value destruction, based on the accounting and managerial parameters adopted in deriving the estimate of the indicator.

In other words, in the absence of a benchmark parameter, even a significantly positive RORAC does not necessarily allow, ex post, a positive assessment - according to a net value-creation perspective - of the results achieved by the unit under monitoring, or by the bank or group as a whole. Nonetheless, it remains a widely used indicator, also useful for comparisons over time and, where possible, with competitors, provided that the indicators are calculated according to a sufficiently homogeneous methodology — which is by no means guaranteed — and that users are fully aware of the actual nature of the information it conveys.

Finally, it should be noted that the economic-capital planning process must include not only an ex post verification of absorbed capital, but also ex ante criteria for allocating capital to the various units

or business segments. In this way, implicit or explicit risk-return targets are assigned to the respective managers, who are expected to conduct their operations so as to achieve the budgeted results, with direct implications for the RWAs within their perimeter and, consequently, for the capital actually absorbed as a share of the allocated capital. It follows that any ex post evidence of unabsorbed capital may be explained by internal or external market circumstances that are neither controllable nor foreseeable, but may also reflect managerial underperformance relative to agreed or expected targets. In such cases, ex-post managerial control may usefully highlight an adjusted RORAC, for example by placing allocated capital—rather than absorbed capital—at the denominator, thereby showing the profitability (NOPAT) achieved relative to the capital “resources” made available to management. Analogous general considerations apply to the EVA and RARORAC indicators as well.

In interpreting the indicators under consideration, estimated for the bank as a whole, account must therefore be taken both of the discontinuity arising from the possible execution of a buyback transaction and of the discontinuities that may stem from changes in the capital configuration used to estimate those indicators, as well as from any modification of the accounting criteria applied to the actual calculation of NOPAT.

7. How Much Capital Should Banks Hold? Buybacks and Capital Management in Banking: a Managerial and Regulatory Perspective

If buyback operations are carried out as a non-recurring and extraordinary capital-management tool, rather than as a non-occasional (pseudo)form of additional shareholder remuneration, it becomes particularly relevant to ask what should be understood by capital ‘optimisation’ in banking.

It should be emphasised at the outset that this is not a strategic or tactical management objective that can be pursued through any form of ‘magical’ optimisation⁴¹ formula. Banks exhibit multiple dimensions of heterogeneity across several relevant aspects: their business model; their geographical and sectoral reference markets; the structure of their liabilities in relation to the composition of funding sources and of their assets, both on-balance-sheet and off-balance-sheet; and one could continue with a wide range of additional specificities, including organisational features and elements relating to the internal control system, which characterise each individual bank and its respective banking group.

Naturally, capital management is subject to the fundamental constraint of the regulatory framework governing capital requirements, imposed on banks in various forms and through various instruments.

⁴¹ The term ‘optimisation’ does not appear to be appropriate in an economic-managerial analysis, when the variables guiding the choices deemed preferable in the relevant context are numerous and often characterised by trade-offs that require a judgement-based approach.

The related capital needs can be managed, to some extent, by refining internal methods for estimating risks and therefore risk-weighted assets, and, over a different time horizon, through strategic choices that favour business areas characterised by lower capital absorption (for example, the widespread focus of banks on asset management).

Assuming that the bank has already acted along the lines mentioned above, and that the level of risk appetite with regard to capital adequacy – once regulatory requirements and bank-specific prudential buffers have been met – is consistent, as it must be, with the business plan approved by the board of directors, the question is straightforward (though the answer is not): to what extent any capital surplus above the appetite level (to be considered as a minimum level, being, as noted, a reflection of the business plan) may be appropriately reduced or eliminated (net of any considerations relating to “true excess capital”, if adopted), through dividend distributions or share buybacks, and above all for what reason such action should be undertaken.

Given that the bank’s creditors, in various capacities, consider themselves – as they should – sufficiently protected by the safeguards represented by the highly intrusive supervisory controls, as well as by internal control systems that are themselves subject to supervisory scrutiny, and by the protections in place for the various categories of creditors and the individual operational exposures, the analytical perspective becomes that of the shareholders, the holders of so-called risk capital. In particular, for our purposes, shareholders with an investment horizon that is not strictly related to trading or, in any case, not of a very short-term nature.

Assuming that the risk of default can be considered remote over a time horizon within which it is realistically possible to project forecasts and hypotheses regarding internal and external scenarios, the expectations of all shareholders⁴² relate, also in comparative terms⁴³, to a satisfactory total return on the investment, measured jointly through dividends and the appreciation of the share price. It follows that the various prospective measures of equity profitability, whether accounting-based or risk-adjusted, become relevant in confirming these expectations.

In this context, a buyback – provided that favourable conditions exist with regard to the bank’s capital, leverage and liquidity position – may represent an extraordinary measure⁴⁴ aimed at strengthening the prospective return on equity, thereby consolidating expectations in terms of total return, with reference both to dividend distribution and to share-price appreciation. “Prospective” means that the

⁴² This analysis does not take into account the specific objectives of controlling shareholders.

⁴³ The cost of capital is a convenient theoretical reference point, nothing more.

⁴⁴ It should be reiterated that, when a buyback is instead used as a quasi-ordinary tool to interfere – in practice but not explicitly – with market dynamics, to create impressions among investors (and often analysts), or as a means of signalling management’s views regarding a more appropriate and unspecified level of the share price – implicitly assuming, with a degree of overconfidence, that the market is inefficient in its price-discovery function – it effectively loses its strategic relevance as an instrument of capital management.

immediate and punctual effect on such indicators (as well as on EPS) is not relevant, as it would merely reflect, in arithmetic terms, the reduction in the number of shares resulting from the buyback; this would constitute in too many cases a purely cosmetic and illusory effect. Rather, what matters is the expected impact on those indicators in light of the development and growth strategies – hopefully successful in achieving the projected economic outcomes – implemented by the bank’s management in view of the scenarios that can be discerned over the planning horizon.

In this way, we have only partially answered the above question; however, in addition to the considerations already set out, we do not believe that there is a generally valid response that can be summarised in a theoretical principle applicable under all conditions. In practice, when positioning and assessing the capital levels of an individual bank, attention is also paid to sector benchmarks, variously referring to banks – including European ones – with characteristics deemed similar. While these may provide a useful reference point, we consider that the differences among institutions, particularly when the comparison extends to other countries, are in fact such, across multiple dimensions, that benchmarks cannot constitute a meaningful indication for capital management.

The following considerations refer to the possible perspective of the supervisory authority regarding the adequacy of a bank’s capital, clearly not with reference to the regulatory minima supplemented by the appropriate prudential buffers. The question, rather, is whether, from the regulator’s standpoint, excessively high capital levels may be regarded as inefficient—an assessment that appears counterintuitive given the authority’s mission to safeguard the stability of the bank and of the financial system as a whole.

It is plausible that, in a SREP Letter addressed to a bank, the supervisory authority may note that “*the capital headroom is still relatively low in comparison with peers, both in the current and forward-looking scenarios.*” However, the authority may also raise observations in the opposite situation, when the bank appears over-capitalised. In such cases, the remark does not concern *capital adequacy* per se, but rather the coherence and credibility of the business model, within the section devoted to the Business Model Analysis (BMA).

An over-capitalised bank, in the absence of specific justifications—such as a planned acquisition, technology investments not yet fully quantified, or latent risks for which the bank wishes to remain prepared—may be perceived as an institution with limited strategic vision, insufficient project development, and a low propensity to support the real economy through lending or through the expansion of activities consistent with its operating model.

A persistent excess of capital also tends to translate into low structural profitability on equity, that is, net of extraordinary items, non-recurring effects, and occasional capital gains. This condition

inevitably affects the market valuation of the bank's shares, penalising shareholders, both in terms of an inadequate dividend payout relative to the level of capital and in terms of stock performance (total return). At the same time, an over-capitalised bank may struggle to ensure a return on equity that is consistently above the cost of capital. Although ROE and K_e differ conceptually and methodologically to an extent that renders the comparison highly imperfect, it still represents a reference point closely monitored by analysts and investors.

An excessively high leverage ratio relative to regulatory minima may also indicate an inefficient use of financial leverage, with the consequence that the bank may be unable, over the medium term, to ensure a return on assets exceeding the cost of debt. This further depresses the return on equity.

In conclusion, although the topic would merit more extensive analysis, an excess of capital may be interpreted by the supervisory authority as a sign of weak economic vitality, strategic fragility, lack of vision and project development, inadequacy of the management and supervisory bodies in fulfilling their institutional responsibilities, insufficient support to the real economy, and limited attention to shareholder expectations.

A potentially unfavourable supervisory assessment of an over-capitalised bank should therefore not appear counterintuitive: the authority evaluates two distinct yet equally relevant dimensions. On the one hand, capital adequacy; on the other, the sustainability of the business model.

In this context, the issue of share buybacks also acquires strategic significance: the repurchase of own shares may reflect an awareness of the need to address the weaknesses outlined above, realigning economic-financial parameters with strategic and managerial perspectives. Alternatively, supervisory observations may act as a strong incentive towards more efficient capital management, at times accompanied by a discontinuity in senior leadership positions.

8. Conclusions

One must wonder who the 'victims' are of the optical illusion that leads people to believe that a buyback represents an additional form of remuneration for shareholders or a real driver of value creation. They are most likely small shareholders and savers, but it is possible that the perceived benefits of a buyback could influence the market as a whole, sometimes including professional and informed investors, and also analysts.

A buyback is an operation that, in the life of a company, should be truly extraordinary⁴⁵, in the same way as paid-in capital increases, motivated with the necessary transparency, and in any case it should not be meant - either explicitly or implicitly - to provide a form of remuneration to shareholders.⁴⁶

It is necessary to point out in conclusion that:

- A buyback could at times push prices higher, at least in the short term, but on the basis of artificial demand that is not strictly market-driven⁴⁷.
- If the buyback involves a significant number of shares, even within the quantitative limits set by the applicable regulations, the free float decreases, potentially creating—at least in the short term, under specific market conditions and when the free float is already modest—a scarcity of shares that could artificially influence the stock price.
- A buyback could weaken the financial position and worsen the debt-to-equity ratio, particularly when the outflow is financed with additional debt. Consequently, it could adversely impact the company’s ability to access financing markets, its credit rating, and its interest coverage ratio.
- It diverts financial resources that could be used productively in ordinary operations or new investment projects, fostering development and profitability.
- It can ‘magically’ boost EPS, sometimes even instrumentally, to provide a more favourable representation of performance, with potential consequences for managerial compensation schemes, including bonuses or stock-option plans if linked to EPS.

⁴⁵ In reality, the execution of an initial buyback may foster expectations—among shareholders and the market more broadly—of a continued use of this capital-management instrument whenever the relevant conditions are met. Consequently, the failure to undertake such expected transactions could adversely affect the dynamics of the company’s share price. Once again, expectations may at times matter more than the firm’s underlying fundamentals.

⁴⁶ Although share repurchases cannot be qualified as a genuine instrument of shareholder remuneration and do not generate any increase in the intrinsic or fundamental value of the stock, individual and collective asset management schemes may nonetheless derive indirect advantages when they hold non-negligible exposures to the securities concerned. In such circumstances, the potential upward adjustment of portfolio valuations - *ceteris paribus* - results in an improvement in the performance indicators of the management vehicles, thereby producing an essentially illusory perception of long-term value creation for investors and, conversely, an immediate and concrete benefit for portfolio managers whose compensation structures are contractually tied to such performance metrics.

⁴⁷ It is worth noting that in no way a support for the share price should be explicitly configured as a buyback objective, and in fact such an objective, assuming it exists, should not be declared, potentially resulting in market manipulation in violation of the relevant legislation. Instead, it is often stated by the board, in a much more nuanced way, that the aim is to convey a signal of confidence to shareholders and the market, a different formulation intended to communicate the same message to the market. However, if the shareholders’ meeting convened to authorize the buyback genuinely believes that the company’s shares are materially and durably undervalued, it is unclear why the shareholders themselves would not increase their own holdings, thereby benefiting from the appreciation that the market should ultimately and duly recognize. Conversely, if they refrain from doing so, one might reasonably infer that they are not truly convinced of the alleged undervaluation.

- Recalling that a firm’s long-term development and growth (g) depend on profitability and on the rate at which earnings are reinvested (RR) - according to the well-known, simplified yet illustrative relationship⁴⁸ $g = ROE \times RR$ -, if the reinvestment rate decreases as a result of substantial buyback operations, growth will likewise decline.
- The repurchase of a company’s own shares entails a reduction in the company’s equity and can therefore be carried out only in the presence of ‘excess capital’. In this regard, and with particular reference to banks, it has been clarified that ‘excess capital’ should be estimated by taking into account the need to cover the risks currently not addressed by prudential regulation, and those not captured for the purposes of capital adequacy in the bank’s internal economic perspective—risks that are deemed to exist in the management of the specific entity, although considered at present non-material.
- Although this distinction is, to say the least, extremely difficult to quantify⁴⁹, it has nonetheless been proposed to distinguish between what we define as ‘conventional excess capital’ and ‘true excess capital’, from an economic and all-risk-coverage standpoint, which is realistically lower than the former, also in light of model risk and the necessary approximations involved in the estimates. This distinction is relevant for any assessment in which it matters, for example in M&A transactions requiring the valuation of other financial intermediaries or in the context of buybacks.
- Although a buyback does not entail any contemporaneous creation of value for shareholders—and, in fact, results in a simultaneous reduction in the firm’s equity base—, it could nevertheless, when viewed from a medium-to long-term perspective, contribute to a ‘more efficient’ management of the firm’s capital structure — albeit an objective that is not quantifiable or definable in absolute and generally valid terms —, through the prudent deployment of financial leverage, thereby enabling an improvement in return on equity that is substantive rather than short term, artificial and merely arithmetic in nature. This obviously presupposes that the company will be able, on a forward-looking basis, to generate a return on assets structurally exceeding the cost of debt capital (the “leverage effect”, understood not as the outcome of a mathematical formula, but in a broader economic-financial perspective aimed at profitable management).

⁴⁸ This, of course, assumes that management and the board are able to identify profitable investment opportunities, which is precisely the object of their respective roles within the company—namely, managerial execution and strategic oversight.

⁴⁹ It is not realistically possible to propose a methodology that would be valid in all circumstances for quantifying ‘true’, as opposed to ‘conventional’, excess capital. It should be the responsibility of an attentive and informed management team to formulate — in the specific situation at hand and with adequate justification — a reasonable order of magnitude.

- Finally, the critical issue of determining the level of capital adequacy that allows for a meaningful assessment of capital efficiency cannot, in practice, be resolved through an algorithm, nor through generalised considerations applicable across different institutions. In the context of buybacks, the topic has been examined both from the management’s perspective and from that of the supervisory authority, which—as might initially seem counterintuitive—does not look favourably upon banks that are over-capitalised without a clear rationale.

Buybacks are proposed by managers and chief executive officers (CEOs) to the boards of directors and then taken to shareholders’ meetings. There is sometimes a specific technical-financial knowledge gap between management and the directors, who might approve some operations without fully understanding their real motivations and assessing the consequences. The contribution of an internal committee, such as a ‘control and risks’ committee, assisted if necessary by external independent consultants to fill any knowledge gaps, could be helpful in supporting these decisions. The board has the duty and responsibility to foster an informed, constructive and lively dialogue in the interest of all shareholders without distinction, while ensuring the clarity and transparency of the information provided to shareholders and the market.⁵⁰

Among the many objectives of economic policy, there has long been a push to increase the number of companies that open their capital to third-party shareholders, gaining listing on a regulated market and thus fostering a greater inflow of Italians’ savings into equity investments. Despite the higher costs businesses incur to comply with the regulatory framework for companies addressing public savings, and considering the implications and constraints related to the presence of minority shareholders in the company’s capital structure, the benefits for the company are indisputable. These include, among others, strengthening the financial structure, acquiring additional resources to realise investment projects, strengthening relationships with banks and the financial market, and increasing attractiveness for more professional and experienced managers.

The relationship with the shareholders of a company listed on a regulated market should be governed by a heightened standard of transparency with respect to transactions that directly affect their position, such as capital operations or dividend distributions. The points discussed in this paper, we are

⁵⁰ This statement requires no specific demonstration. For years, supervisory authorities — particularly banking supervisors such as the European Central Bank and the Bank of Italy — have worked to raise the qualitative standards of corporate bodies, both generally and with regard to emerging issues and risks. The Fit and Proper regulatory framework has marked a significant step forward in aligning board members’ profiles with their responsibilities, complemented by a form of moral suasion that is less visible but no less stringent. Obviously, not all members of the board of directors can possess expertise in every area of relevance for the purpose of carrying out the strategic oversight required by the applicable regulations. What is required, rather, is that the board includes diverse and complementary professional backgrounds, so that the body, as a whole, is *fit and proper*. In three words: competence, genuine independence and strength of character are indispensable requirements; in their absence, a board of directors risks becoming little more than a merely formal body.

convinced, highlight a truth that should be entirely obvious to industry insiders, but certainly not always to shareholder-savers who might fall victim to optical illusions regarding the returns promised by equity investments following these operations.

In conclusion, buybacks should be understood as a tool and, from an economic-financial standpoint, should be assessed in light of the other possible uses of the deployable liquidity: higher dividend distributions, debt reduction, maintaining a robust liquidity buffer, or investing in new growth opportunities. Moreover, they may be appropriate under specific circumstances, for example as part of management incentive plans involving future share issues and their allocation to beneficiaries, or to offset the dilution arising from previous issuances of shares for stock-based compensation, in anticipation of ‘shares-for-shares’ acquisitions, or to reshape the financial structure as deemed appropriate by management. Also taking into account both current and expected regulatory requirements, market and industry benchmarks, and the expectations of the various stakeholders (shareholders, rating agencies, analysts, investors, clients).

They do not relate to the operating activities that generate shareholder value through the performance of the core business. It is incumbent upon both the board of directors and the shareholders’ meeting to exercise rigorous oversight over such initiatives, ensuring that: (i) they do not give rise to unwarranted increases in top management’s compensation — particularly where remuneration is, in any respect, tied to EPS-based metrics or to the firm’s stock price; (ii) the share-repurchase programme is not designed to exert any artificial — and therefore prohibited — influence on the share price; and, finally, (iii) they do not generate illusory expectations for shareholders and investors through a merely cosmetic effect that may at times conceal underlying problems.

We wish to emphasize, in conclusion and with even greater clarity to avoid any unintended misunderstanding, that the contribution we offer does not, as a matter of principle, intend to express a negative judgment on share buyback operations as such, however they may be implemented. Rather, it is directed at the narrative and rhetoric that often accompany these operations when they are presented — among other objectives, hopefully more credible and convincing— as a form of shareholder remuneration additional to the distribution of dividends, and (purportedly) capable of ensuring an authentic creation of value for the company and for its shareholders.

Appendix n. 1.

The Need to Simulate Buyback Effects on Banks' Capital Adequacy and Financial Risks

In view of the impact of the transaction on the bank's current and prospective capital adequacy position, it is necessary to carry out a simulation—typically over a three-year horizon—of the effects on the capital adequacy indicators, assessed both from a regulatory perspective and from the bank's internal economic perspective, and compared with their projected development under the assumption that the buyback is not executed. The simulation must be carried out under both a baseline scenario and an adverse and stressed scenario, and must confirm that the indicators will remain above the thresholds approved by the Board of Directors within the Risk Appetite Framework (RAF), and therefore, a fortiori, above the minimum regulatory requirements established for the bank by the competent authorities (the European Central Bank or the Bank of Italy).

The simulation therefore covers, for the regulatory (or Pillar I) perspective:

- the CET1 ratio, Tier 1 ratio and Total Capital ratio;
- MREL TREA and MREL TREA Subordination;
- MREL LRE, MREL LRE Subordination and the Leverage Ratio;
- MDA (Maximum Distributable Amount)⁵¹;

and, for the internal economic (or Pillar II) perspective, at least the so-called Available Financial Resources Ratio.⁵²

Tier 1 ratio (CET1 + Additional Tier 1) and Total Capital ratio (Tier 1 + Tier 2)

$MREL\ TREA = (Eligible\ Liabilities + Total\ Capital) / RWA$

$MREL\ TREA\ Subordination = (Subordinated\ Liabilities + Total\ Capital) / RWA$

$MREL\ LRE = (Eligible\ Liabilities + Total\ Capital) / LRE$

$MREL\ LRE\ Subordination = (Subordinated\ Liabilities + Total\ Capital) / LRE$

$Leverage\ ratio = Tier\ 1 / LRE$

⁵¹ In summary, MDA represents the maximum amount available for variable payments of a bank i.e., dividend payments, AT1 coupon distributions or variable remunerations. and comes into force whenever the applicable requirements are not met.

⁵² It is the ratio—less widely known but relevant for ICAAP purposes—between the capital resources measured from the bank's internal economic perspective (the so-called “economic capital”, or “available internal capital”) and the “(absorbed) internal capital”, namely the capital absorption associated with the risks deemed material for the bank, including those not captured under the regulatory perspective and, where applicable, measured using internal models different from those employed for regulatory purposes. Evidently, the indicator must remain well above one in order to help ensure a prudent level of capital adequacy, including from a forward-looking perspective and under stressed conditions.

MREL: Minimum Requirement for Own Funds and Eligible Liabilities

Eligible liabilities: CDP loans, certificates, senior preferred and senior non-preferred instruments

Subordinated liabilities: senior non-preferred instruments

TREA: Total Risk Exposure Amount or RWA

RWA: Risk-weighted assets

LRE: Leverage Ratio Exposure measure; leverage exposure (broadly comparable to total assets)

Similarly, a simulation of the expected impact of the buyback transaction on financial risks is also required.

With regard to liquidity risk, the simulation covers, from a regulatory perspective:

- the Liquidity Coverage Ratio (LCR), a short-term liquidity indicator;⁵³
- the Net Stable Funding Ratio (NSFR), a structural liquidity indicator.⁵⁴

Even though the impact of the buyback on interest rate risk in the banking book is less pronounced than its effects on capital adequacy and liquidity, the adjustment to the bank's financial structure may require a simulation of the prospective impacts at least on the following risk indicators:

- Sensitivity of Net Interest Income (NII) ⁵⁵;
- Sensitivity of Net Interest Income (NII) (Supervisory Outlier Test - SOT NII)⁵⁶;
- Sensitivity of Economic Value of Equity (EVE) ⁵⁷;
- Sensitivity of Economic Value of Equity (EVE) (Supervisory Outlier Test - SOT EVE)⁵⁸.

⁵³ This core indicator is defined as the ratio between the stock of high-quality liquid assets and net cash outflows, under stress assumptions, over the 30 calendar days following the reporting date, where net cash outflows are calculated on the basis of regulatory parameters rather than management-specific projections, so as to ensure a consistent approach to the estimation of the indicator across the banking system. Prospectively, the indicator naturally reflects the decrease in liquidity resulting from the resources employed in the share buyback.

⁵⁴ This core indicator is defined as the ratio between the amount of Available Stable Funding (ASF) and the amount of Required Stable Funding (RSF). The buyback leads to a reduction in available stable funding (ASF) due to a decrease in CET1 equal to the amount of the buyback. For this indicator as well, the amount of RSF is estimated on the basis of regulatory parameters rather than management-specific projections. The simulation of the impacts on other liquidity risk indicators of an economic, rather than regulatory, nature (Asset Encumbrance, Gap Ratio and Time to Survival) may be deemed unnecessary for the specific purposes at hand.

⁵⁵ Risk-specific indicator defined as the potential change in net interest income, expressed in percentage terms, under a parallel interest-rate shock of ± 100 bps, measured against expected net interest income.

⁵⁶ Regulatory indicator calculated as the change in net interest income, expressed in percentage terms, under the interest-rate shock scenarios required by the regulatory framework, measured against Tier 1.

⁵⁷ Risk-specific indicator defined as the potential change in the economic value of equity (EVE), expressed in percentage terms, under a parallel interest-rate shock of ± 200 bps, measured against own funds.

⁵⁸ Regulatory indicator calculated as the change in the economic value of equity, expressed in percentage terms, under the interest-rate shock scenarios required by the regulatory framework, measured against Tier 1.

Appendix n.2

A short note on the accounting treatment of treasury share buybacks under IAS 32/IFRS

When a listed company repurchases its own shares, IAS 32 requires that those shares be classified as *treasury shares* and accounted for as a direct deduction from equity. They cannot be recognised as a financial asset, because an entity cannot hold a claim on itself. As a result, the repurchase reduces equity by the amount of the consideration paid, including any directly attributable transaction costs. A negative reserve is recorded in connection with the purchase of treasury shares.

Treasury shares are not subject to periodic remeasurement; they are carried at cost until their possible cancellation or resale on the market (in which case, naturally, at market prices). In any case, they do not give rise to gains or losses in the income statement. Neither the repurchase nor any subsequent resale affects profit or loss: all related effects are recorded directly in equity. Accordingly, if the company later reissues the shares at a price different from the original cost, the difference is recognised within equity — typically in retained earnings or another appropriate reserve — but never through the income statement.

Treasury shares also carry no economic rights. They are counted for the purposes of determining the quorum for the valid constitution of the shareholders' meeting, but the shares so acquired are not taken into account for the purposes of determining the voting quorum.

They are excluded from the calculation of earnings per share (EPS), because they are not considered outstanding for IFRS purposes. Dividends theoretically attributable to treasury shares do not participate in the distribution and remain within the entity; such amounts may be allocated to a non-distributable reserve or, depending on how the shareholders' meeting determines the amount of profits to be distributed, may result in an increase in the per-share dividend payable to shareholders. Should the bank decide to cancel the shares, the cancellation reduces the number of shares outstanding. The negative reserve recorded for the purchase of treasury shares is offset against equity. In essence, the IFRS approach treats buybacks as equity transactions: they modify the structure and amount of shareholders' equity but never affect the income statement.

Appendix n.3

Overview of Stated Motivations for Share Buyback Operations by some Italian listed companies

The review covered 56 listed companies—namely the 40 constituents of the FTSE MIB and 16 additional issuers that executed share repurchases in 2025. For each company, the documentation submitted to shareholders’ meetings held between 2023 and 2025 was examined, focusing on the agenda items concerning authorisations to purchase treasury shares. The analysis is concentrated on the sections explicitly outlining the motivations for the proposed buyback programs.

Across the sample, several recurring rationales emerged. Many companies framed buybacks as a tool for shareholder remuneration, often presented as an additional or alternative distribution to dividends. Others emphasised the creation of shareholder value, either directly or through the improvement of financial structure. A number of issuers explicitly linked buybacks to the increase in Earnings Per Share (EPS) resulting from the cancellation of repurchased shares. Several companies also justified buybacks as being in the best interest of the company and its stakeholders, particularly in specific market conditions.

We do not believe we need to add any comments to the survey conducted, beyond what has already been highlighted in the paper.

Shareholder remuneration

- Enel: buybacks used ‘to grant Shareholders an additional remuneration compared with the distribution of dividends’ (2025).
- Enel: buybacks ‘is aimed at providing Shareholders a remuneration in addition to the distribution of dividends, as a result of the cancellation of treasury shares purchased for this purpose’ (2026).
- Eni: authorisation aimed ‘to grant Shareholders an additional remuneration compared with dividends’ (2023–2025).
- Nexi: buyback considered ‘a more effective solution for shareholder remuneration than a dividend’ in current market conditions (2024–2025).
- UniCredit: buybacks repeatedly framed as part of the shareholder remuneration policy under the *UniCredit Unlocked* strategic plan (2023–2025).
- Basicnet / CIR: buybacks intended ‘to remunerate shareholders in particular market conditions’ (2023–2025).

Creation of shareholder value / best interest of the company

- Hera: buybacks among the tools ‘to increase value creation for shareholders’ (2023–2025).

- Snam: objective to ‘increase shareholder value also through the improvement of the Company’s financial structure’ (2023–2025).
- STMicroelectronics: repurchases authorised ‘when in the best interest of shareholders and other stakeholders for creating long-term value’ (2023–2025).
- Stellantis: buybacks permitted when ‘in the best interest of the Company and its stakeholders’ (2023–2025).

Increase in Earnings Per Share (EPS)

- Ferrari: buybacks allowed when they ‘would increase earnings per share’ (2023–2025).
- Mediobanca: buybacks intended ‘to support the growth of earnings per share through the cancellation of the shares purchased’ (2023–2024).
- Brembo: motivations include ‘increasing earnings per share’ (2025).
- OVS: cancellation of treasury shares aimed at ‘increasing the value of shares outstanding’ (2025).

Appendix n.4

References on Stock Buybacks: main motivations, effects on market prices, implications for managers, impacts on value creation and capital structure, regulatory aspects

Underlying motivations

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