Italy

Monte dei Paschi: What's next?

- **The private recapitalisation of Monte dei Paschi di Siena (MPS) had not met the expected success.**
- **A new solution will have to be found to make the bank's situation more viable.**
- **The Italian government temporary support could be provided in the months ahead to shore up both solvency and liquidity.**

Monte dei Paschi di Siena failed to finalise its plan to raise EUR 5 bn in new equity. The absence of anchor investor(s) and the bank's announcement of deteriorating liquidity explain among other things the market's lack of interest in the recovery package. The EUR 2 bn that was already raised via two voluntary plans to convert bonds into shares was not enough to bolster investor confidence (the conversion only took effect if the capital increase was successful). In any case, another recovery plan will have to be drawn up for MPS.

After the private capital increase was abandoned even before the 31 December 2016 deadline, Italy's Council of Ministers approved law-decree n°237/2016. The latter authorises the Treasury to raise an additional EUR 20 bn to shore up Italy's domestic banking sector. The funds will be allocated to the Minister of Finance, and are designed to reinforce bank liquidity and solvency. It also provides for a guarantee on newly issued bonds, as well as for purchases of bank shares if necessary. On 29 December 2016, the European Commission (EC) authorised Italy to extend its guarantee scheme to support banks' liquidity for an additional six months. The funds injected as part of the decree's solvency component are not to be considered as State aid, and thus are subject to EC approval on a case-by-case basis.

According to the actual considered plan, MPS will be subject to a "precautionary recapitalisation" to "preserve Italy's financial stability". This objective justifies the exceptional, temporary measure, which does not imply the resolution of the bank and authorises state intervention[1]. For MPS to benefit from this support, the European Central Bank (ECB) must have first confirmed that the bank was solvent. This assessment is based on the results of the baseline scenario of the stress tests conducted by the European Banking Authority (EBA) in 2016.

As an exception to the "bail-in" rule, however, the amount of the capital injection must be estimated based on the adverse scenario of the EBA stress tests. The amount of the capital shortfall is now estimated at EUR 8.8 bn[2]. This would allow MPS to conserve a fully loaded CET1 ratio of 8% and a total capital ratio of 11.5% during a crisis such as the hypothetical one used to calibrate the stress tests.

While awaiting a more precise evaluation, the Bank of Italy estimates the amount of government assistance for MPS at EUR 6.6 bn: EUR 4.6 bn for the recapitalisation of MPS and EUR 2 bn to compensate 40,000 individual investors of the bank. The Italian government justifies this compensation mechanism on the lack of information on the real risks being undertaken by retail investors during the sale of subordinated bank bonds. Compensation could take the form of the conversion of subordinated bonds into shares, followed by their conversion into senior bonds with the same value. The actual question focuses on whether the compensation should be made regarding junior bonds' nominal value or, as argued by the chairperson of market regulator Consob, according to the price paid by investors if they bought the bonds below par on the secondary market. The transitory nature of this support might limit the cost for taxpayers. "Other" entities would be called on to contribute the remaining EUR 2.2 bn necessary to reach the EUR 8.8 bn target. Their bonds should be converted at 18%, 75% and 100% of nominal value.

The Italian State would temporarily become MPS' majority shareholder, with a stake of more than 70%, which might jeopardise the participation of the private fund Atlante in the disposal of MPS's non-performing loans (NPL). The fund stated that if the government's participation in the recapitalisation plan exceeded EUR 1 bn, then it would not take part in the purchase of NPLs. If this is effectively the case, the market is bound to take a more cautious view of the bank.

All in all, MPS could soon issue EUR 15 bn in bonds with state support to ensure its liquidity in the months ahead. The precautionary recapitalisation could be orchestrated within the next few months. This leaves open the question of the amount and timetable for the disposal of MPS's non-performing loan portfolio. To date, Consob continues to suspend trading in MPS shares, which plunged 28% between 19 and 22 December 2016.

[1] "What is a precautionary recapitalisation and how does it work?" European Central Bank, 27 December 2016.
[2] "The 'precautionary recapitalization' of Banca Monte dei Paschi di Siena", Bank of Italy, 29 December 2016.