

BRIEFING

The precautionary recapitalisation of Monte dei Paschi di Siena

Banca Monte dei Paschi di Siena S.p.A. (MPS) is the fifth largest bank in Italy, holding total assets of around EUR 153 billion as of 31 December 2016 (against EUR 214 billion at the end of 2008). This briefing is based on publicly available information and provides an overview of the latest developments.

The measure approved on 4 June 2017

On [4 July 2017](#) the European Commission announced the approval of the precautionary recapitalisation of MPS for a total amount of EUR 8.1 billion. This amount includes the conversion of junior bondholders for EUR 4.3 billion, and a capital injection of EUR 3.9 billion by Italy. In addition, Italy will inject EUR 1.5 billion to compensate the retail investors who were victims of misselling. It is not clear at this stage whether the cost of this compensation will be fully borne by the State, or whether the compensation will be borne by the bank, with Italy getting shares in exchange of this 1.5 billion contribution. The press release of [MPS](#) seems to indicate that the State will only get shares in return for its EUR 3.9 billion capital injection, while the press release of the Commission indicates that “the State will inject EUR 5.4 billion, in return for shares in MPS”.

The State aid amounts to EUR 5.4 billion, and was approved as precautionary recapitalisation by the Commission, meaning the bank was not deemed failing or likely to fail under Article 32 BRRD. For more details on precautionary recapitalisations, see EGOV briefing [PE 602.084](#).

The difference between the capital shortfall as calculated by the ECB (EUR 8.8 billion, see below) and the capital injection (EUR 8.1 billion) is due to additional capital measures, namely asset sales. MPS thereby disposed of several businesses and stakes in February and July 2017.

In addition, MPS will divest a EUR 26.1 billion portfolio of non-performing loans (NPLs) to a private securitization vehicle. 95% of the junior and mezzanine tranches of this securitisation vehicle will be purchased by the fund Atlante II. The deal was signed on 26 June 2017, one day after the Commission approved the measures taken in relation to Veneto Banca and Banca Popolare di Vicenza. The net book value at end 2016 was EUR 9.4 billion, and the portfolio was transferred against a consideration of EUR 5.5 billion (21% of the gross book value). The most senior tranche will benefit from a guarantee of the Italian scheme GACS, an aid-free scheme approved by the Commission in February 2016 (see EGOV briefing [PE 574.395](#)). This disposal is part of a wider updated restructuring plan approved by the Commission, which aims at reorienting the business model towards retail customers and SMEs, and at enhancing risk management.

The calculation of the capital shortfall

MPS was part of 51 banking groups that were scrutinized during the EBA’s 2016 EU-wide stress test. In the 2016 stress test exercise, there was no formal threshold setting out how much capital banks would need to be left with in the crisis scenario (“adverse scenario”), hence none of the participating banks officially passed or failed this stress test exercise (also see EGOV briefing “[Bank stress testing: stock taking and challenges](#)”).

However, MPS stood out as the worst performer among all banks, according to the [results published on 29 July 2016](#): under the adverse scenario, MPS’ fully loaded CET1 ratio was reduced from 12.07 % at end 2015 to -2.44 % at end 2018, that is to say a reduction by EUR 10.1 billion (1451 basis points). No other participating bank reported negative equity as a result of the stress test scenario. In the second half of 2016 the bank booked again large losses on its portfolio of NPLs, following further guidance by the ECB published in September 2016.

Therefore, the bank had to discuss a [capital plan](#) with the ECB and announced that it would seek to raise EUR 5 billion from investors, alongside a disposal of bad loans (*sofferenze*) through a securitization portfolio (with the junior tranche sold to shareholders and the mezzanine notes subscribed by the Atlante Fund). In a [letter sent to the bank earlier in 2016](#), the ECB had indeed required, as the prudential supervisor, a drastic reduction in the portfolio of non-performing loans (from EUR 24.2 billion of net exposure in 2015 to EUR 14.6 billion at the end of 2018).

MPS failed to convince anchor investors after the negative outcome of the referendum of 4 December 2016, albeit it managed to raise EUR 1 billion through a [liability management exercise](#) (buying back subordinated securities with new shares). After the capital raising exercise failed and after the ECB refused to grant more time to MPS, the bank announced before Christmas 2016 that it would ask for a [precautionary recapitalisation](#) from the Italian government. Indeed, on 23 December the Italian government passed a decree allowing MPS to benefit from the [EUR 20 billion bail-out package](#) approved on Wednesday 21 December 2016.

The ECB subsequently raised the capital requirements of MPS by EUR 3.8 billion (from EUR 5 billion to [EUR 8.8 billion](#)). The Italian finance minister [criticised](#) the ECB for the lack of explanations on the decision to increase the amount of capital to be raised by the bank. The bank [indicated](#) that the ECB letter had stated that (i) the bank was solvent and complied with its pillar 2 requirements, (ii) that the application of an 8% CET1 threshold translated into a EUR 8.8 billion capital shortfall, and (iii) that the liquidity position of the bank had rapidly deteriorated in December. The Italian Central Bank [further explained](#) on 29 December 2016 that different hypotheses and objectives would explain the difference between the amount required for the ‘market solution’ (EUR 5 billion) and the amount required for the ‘precautionary recapitalization’ (EUR 8.8 billion). In particular, the amount needed for the precautionary recapitalisation takes into account that “EUR 6.3 billion are needed to realign the CET1 ratio to the 8% threshold” and “an additional EUR 2.5 billion are needed to reach the total capital ratio (TCR) threshold of 11.5%”. Out of those EUR 8.8 billion, “about EUR 4.2 billion would be covered by the burden sharing on subordinated bonds”, while EUR 4.6 billion would be funded by the State.

The potential recourse to a precautionary recapitalisation is possible, subject to State aid approval, if the capital shortfall stems from a (hypothetical) adverse scenario of a stress test. However, what was rather different in the MPS case was the large gap between the capital position of the bank under the baseline and the adverse scenarios: 14.27 percentage points (“pp”) according to the 2016 stress test. This gap was on average 4.5 pp in the [2016 stress test](#). This is in line with the previous exercises (4.67 pp in the [2015 SSM stress test](#) on 9 banks, and 3.2 pp in the [2014 SSM stress test](#)). It is to be noted that the impact of the stress scenario was also important in the stress test carried out on Greek banks in 2015 (7.5 pp). For more details on precautionary recapitalisations, see EGOV briefing [PE 602.084](#).

Therefore, this large gap does not seem to stem from the methodology used, but rather from the idiosyncratic (lack of) robustness of MPS balance sheet under the stress test scenario. As the Italian Central Bank [explained](#) on 29 July 2016 “[a]bout half of the overall reduction in Monte dei Paschi’s capital can be put down to a decrease in the interest margin; the other half is due to an increase in capital allowances and loan loss provisions and to write-downs on the AFS government securities portfolio. Two thirds of the P&L account loss comes from a decrease in net interest income. The idiosyncratic shock (equal to 220 basis points), which is proportionate to the bank’s initial rating (B-), is much greater than the shock assumed for higher rated banks (25 basis points for banks rated AAA), particularly since its effects continue for three consecutive years”.

As to the 8% threshold used by the ECB to determine the capital requirements, it is similar to the threshold used in Greece in 2015 in aftermath of the capital controls, but differs from the threshold used in 2014 and 2015 for other euro area banks (5.5% under the adverse scenario).

Previous recapitalisations, State aid measures and restructuring plans

In 2009 MPS participated in the Italian bank recapitalisation scheme and Italy subscribed hybrid bonds (“Tremonti bonds”) for an amount of EUR 1.9 billion. The scheme aimed at supporting the financing of the real economy and the bank was deemed [financially sound](#). The bank also benefitted from liquidity support in the form of state guarantees.

Table 1: Financial highlights of Banca Monte Paschi di Siena (2008-2016)

Banca Monte dei Paschi di Siena		2016	2015	2014	2013	2012	2011	2010	2009	2008
Total Assets	(mEUR)	153.178	169.012	183.444	199.106	218.886	240.794	244.279	224.815	213.796
Net Income	(mEUR)	-3.231	390	-5.347	-1.439	-3.190	-4.698	987	225	931
Tier 1 Ratio	%	8,17	12,85	8,67	10,62	9,52	10,30	8,37	7,52	5,13
NPL Ratio	%	33,614	33,84	29,81	21,50	16,36	12,90	10,63	9,53	7,68
Capital Impairment Ratio (unreserved impaired loans / equity)	%	285,87	214,13	304,54	247,83	187,91	97,35	49,08	43,02	33,40
Number of Employees		24.560	25.731	26.548	28.013	30.382	31.550	31.880	32.475	33.973
Number of Branches		2.032	2.133	2.344	2.793	2.671	2.793	3.069	n.a.	n.a.

Source: EGOV based on Orbis Bank Focus

MPS started making very significant losses in 2011 and 2012. Most of the losses were then related to the previous acquisition of Banca Antonveneta in 2008 for EUR 9 billion. About EUR 5.5 billion of impairments were booked in 2011 and 2012 on this participation. In addition, unclear accounting practices on two structured transactions (with Nomura and Deutsche Bank) forced the bank to book further losses in 2011 and 2012, for a total amount of EUR 1.2 billion.

This resulted in a second State recapitalisation in 2013 with the Italian government replacing the *Tremonti bonds* with new hybrid bonds (“Monti bonds”) for a total amount of EUR 4.1 billion (net increase of EUR 2.2 billion). This new aid was approved by the European Commission as restructuring aid, subject to the implementation of a restructuring plan.

MPS then came under direct supervision of the ECB in November 2014. As all banks that came under direct supervision, MPS was subject to a Comprehensive Assessment that comprised an Asset Quality Review and a Stress Test. In view of this comprehensive assessment, and because MPS had booked losses again in 2013, MPS decided to raise EUR 5 billion of capital in 2014, including EUR 3 billion aimed at repaying most of the Monti bonds subscribed by the Italian Treasury.

Despite this recapitalisation, MPS reported the highest capital shortfall of all participating banks, amounting to EUR 2.1 billion. As disclosed in the [Aggregate Report on the Comprehensive Assessment](#), the total shortfall of *all* participating banks (post net capital raised) amounted to EUR 9.47 billion, more than 20% of which were related to MPS. MPS was in particular penalized by its portfolio of non-performing loans, and had to write-down EUR 4.2 billion following the asset quality review. This explains the very significant loss booked again in 2014.

In 2015 MPS raised EUR 3 billion of capital, in line with the capital plan agreed with the ECB following the comprehensive assessment. It also repaid the remaining *Monti bonds* (EUR 1 billion) and submitted a new restructuring plan which was approved by the European Commission.

In total, from 2011 to 2015 (prior to the 2017 precautionary recapitalisation), MPS booked net losses of EUR 14.3 billion, raised private capital for EUR 8 billion, and repaid EUR 2 billion of State aid. The State support received in 2009 (EUR 1.9 billion) was indeed repaid in 2013, while the Monti bonds subscribed in 2013 (EUR 4.1 billion) were repaid in 2014 and 2015. As to its operations, since 2010 MPS has reduced its balance sheet by 37%, its branches by 34%, and its staff by 23%.

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