BANCA D'ITALIA
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Press Release

By the Communications Directorate

Rome, 21 April 2023

The Bank of Italy's intervention power concerning financial instruments: regular assessment of risks to financial stability

Article 7-bis of the Italian Consolidated Law on Finance (TUF), taking into account the provisions of Regulation (EU) No 600/2014 (MiFIR), gives the Bank of Italy the power to prohibit or limit the marketing, distribution or sale of financial instruments (product intervention power) in order to preserve the stability of the national financial system.

In order to exercise its intervention power, the Bank of Italy regularly carries out analyses and assessments of the risks to financial stability that may arise from financial instruments circulating in Italy based on a specific legal, analytical and methodological framework, which is constantly updated and refined.

This press release provides the public with some information on these analyses and assessments.

For more detailed information on the Bank of Italy's intervention power and its activities in this area, see on the Bank's website: *The Bank of Italy's intervention power concerning financial instruments, structured deposits and related financial activities/practices*.

Summary assessments

Based on the most recent analyses and assessments prepared using data up to 31 December 2022, some types of complex securities – specifically, securitizations, additional tier 1 subordinated bonds (AT1, also known as contingent convertibles or CoCos) and certificates – receive the most focus from the Bank of Italy, as they did last year, for the purposes of the exercise of its intervention power,[1] as a result of the growth in their volumes and because of the large price changes to which they may be subject.

Although the risks to financial stability that may arise from these categories of securities seem to be small for now, it should be noted that holders of certificates and AT1 bonds could suffer significant losses in the event of an adverse scenario. In particular, the growth in certificates in 2022 (by €11 billion, to € 52 billion) is fully attributable to retail investors, who, at the end of the year, held €37 billion worth of them. However, this is equal to only 1 per cent of households' financial wealth.

[1] For the list and definitions of all the individual financial instruments analysed as part of the intervention power, see the Bank's website: *Glossary of the types of financial instruments analysed by the Bank of Italy within the scope of its intervention power*.

More detailed information on the analyses underlying the preceding assessments is provided below.

Complex securities – At the end of 2022, debt securities with a face value of around €2,440 billion were in circulation in Italy, 12 per cent (€303 billion) of which were instruments that can be considered complex.[2] Among these instruments, the most common were securitizations[3] (accounting for 38 per cent of the total of complex securities and amounting to €115 billion), subordinated bonds (29 per cent and €87 billion) and certificates (17 per cent and €52 billion; Figure 1 and Table). In 2022, there was a decline in structured bonds and a rise in both certificates and AT1 bonds (Figure 2).

Based on the trend in outstanding volumes, securitizations, AT1 bonds (8 per cent of total complex securities, €25 billion) and certificates, these three instruments could currently be considered a potential threat to financial stability.

The values of securitizations are currently below previous peak levels.

The volume of certificates in Italy rose significantly in 2022 and they are held mostly by households (around 70 per cent). The value of these instruments may be subject to large fluctuations. The Bank of Italy will therefore continue to closely monitor developments in this market.

Volumes of AT1 bonds do not appear to be high in absolute terms, and the absence of these instruments among banks' holdings excludes any contagion risks relating to possible impairment losses. However, these instruments can be converted into bonds or written down (or written off) when the issuer is in crisis. Because of these characteristics, AT1 bond prices may be highly volatile.

Overall, the risks to financial stability stemming from the instruments analysed appear to be contained. This does not rule out that the holders of certificates and AT1 bonds are exposed to the risk of significant losses in the event of an adverse scenario.

Complex securities held by households – At the end of 2022, the amount of complex debt securities held directly by households was around €50 billion, up €11 billion on the previous year. They represented about 18 per cent of total debt securities held by households and 1 per cent of their financial wealth as at September 2022. Certificates – which along with subordinated and structured bonds are the complex securities most widely held by households – are responsible for the increase, having risen by around €11 billion, to €37 billion (Table 1).

Complex derivatives – Around 5 per cent of derivatives with Italian counterparties can be considered complex. Credit default swaps dominate, while other types of complex derivatives are not very common (Figure 3). At the end of 2022, the total notional value of complex derivatives (i.e. the sum

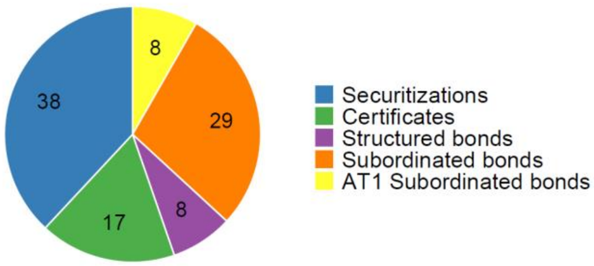
[2] The securities (either complex or non-complex) considered for the possible exercise of the intervention power comprise the bonds and securitized financial instruments with characteristics typical of derivative contracts, such as certificates and covered warrants, while shares and investment funds are excluded.

[3] Self-securitizations are not considered.

of long and short positions) was around €424 billion, a level similar to that observed a year earlier.[4] The historically low amount of derivatives currently in circulation in Italy suggests that there are no significant risks to financial stability associated with these instruments for the time being.

Figure 1

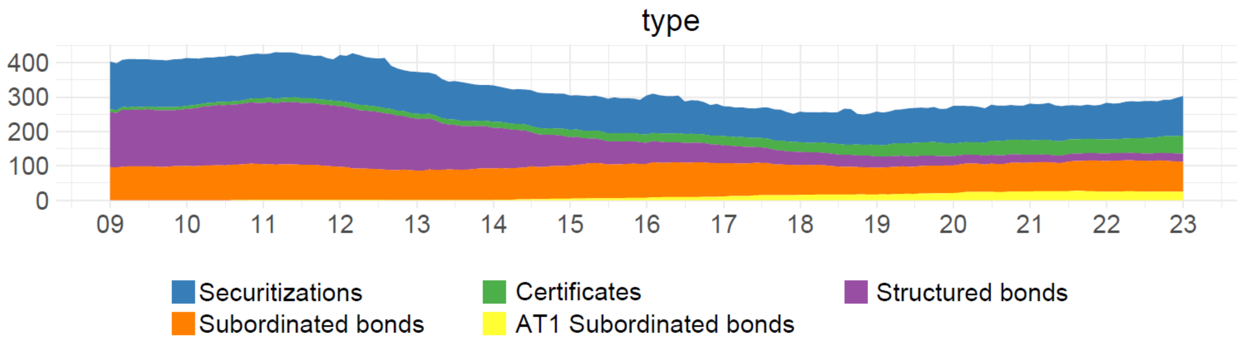
Breakdown of complex securities by type (1)
(data as at 31 December 2022; per cent)



(1) Shares are calculated on the basis of the value of the instruments.

Figure 2

Amounts of complex securities by type
(billions of euros)



[4] The figure published in the 26 April 2022 press release and referring to 31 December 2021 equaled €296 billion. Starting with this press release, derivatives are analysed by exploiting the EMIR database (see the Methodological Appendix). Based on these data, the volume of outstanding derivatives amounted to €399 billion at the end of 2021.

Table 1. Amounts of complex securities by type of instrument and holder sector (1)

(data as at 31 December 2022; billions of euros)

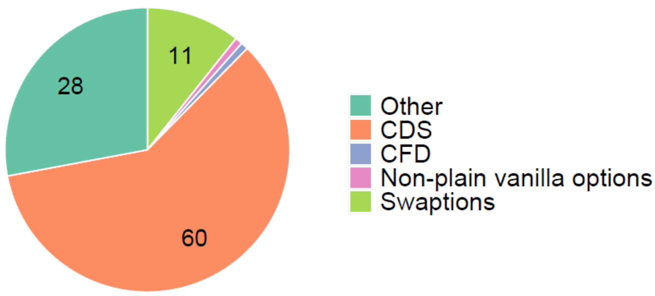
	Securitizations	Certificates	Structured bonds	Subordinated bonds	AT1 subordinated bonds	Total
Foreign	40.7	2.2	7.0	13.0	11.7	74.6
Banks	37.9	7.7	3.6	3.4	0.8	53.5
Households	0.9	37.0	3.9	7.2	1.4	50.5
Insurance companies	4.2	1.7	3.1	28.1	3.0	40.1
Investment funds	6.2	0.1	1.5	15.2	2.7	25.7
Other financial intermediaries	13.3	1.1	1.0	3.7	1.0	20.1
Firms	4.7	1.9	0.7	2.6	1.0	10.8
Public sectors	0.4	0.1	1.3	1.1	0.2	3.0
SPVs	0.8	0.0	0.4	0.0	0.0	1.2
Other (2)	6.4	0.4	1.3	12.4	3.3	23.7
Total	115.5	52.2	23.8	86.7	25.1	303.2

(1) The holder sector field is reported only in the *Matrice dei conti*, and not in the reports under Article 129 of the TUB or in the Securities Register. To more accurately map the sectors, this table also draws on data extracted from the Securities Holdings Statistics by Sector (SHSS). (2) This item also includes: i) the case in which the holder's sector is not known; ii) other residual sectors beyond those reported.

Figure 3

Breakdown of complex derivatives in banks' portfolios by type (1)

(data as at 31 December 2022; per cent)



(1) The shares are calculated on the basis of the notional value of the instruments, which is the sum of the long and short positions.

For definitions of individual financial instruments, see the Bank of Italy's website: *Glossary of the types of financial instruments analysed by the Bank of Italy within the scope of its intervention power*.

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Methodological Appendix[5]

The Bank of Italy has developed a methodological framework to identify and assess risk areas that may concern financial instruments marketed, distributed or sold in Italy or from Italy. The analysis on debt securities uses the statistical and supervisory reporting that banks and other supervised intermediaries send to the Bank of Italy. Information from the securities register and from reports under Article 129 of the TUB are also used. The methodological framework is constantly updated and refined.

Derivatives are analysed using data from the EMIR database. In the supervisory reporting templates, the information is usually reported in an aggregate form, with reference not to the individual contract but to the broader type of instrument, the characteristics of the underlying instrument and the direction of the position taken. The data contained in the supervisory reports relate to instruments held by banks and are reported quarterly. The EMIR database, instead, contains daily information on individual trades carried out by financial and non-financial counterparties (Italian entities or those with an Italian parent company). Use of the database also means that it is possible to more precisely classify complex derivatives and eliminate any overlap in those cases in which the same contract is reported by more than one party. The scope of the analysis is now broader in terms of the type of derivative, the nature and residence of the counterparties than it was when supervisory reports were used.

The methodology involves splitting financial instruments into ‘complex’ and ‘non-complex’ categories.[6] Each financial instrument is assigned a complexity indicator according to the type of instrument and the nature of any underlying assets. Thereafter, a two-stage analysis of risks is performed on complex securities.

In the first step, a complex financial instrument is considered potentially risky if the outstanding amounts exceed the 90th percentile of the historical distribution of its amount observed over the last five years. However, since the EMIR data are available starting from January 2021, the length of the historical series used to calculate the threshold for derivatives instruments is currently two years.

The financial instruments identified in the first step as being potentially risky are further analysed at a second stage, in which a risk assessment is carried out through the analysis of a variety of indicators (including the complexity, riskiness characteristics of the instrument, and characteristics of the reference market) using methodologies selected ad hoc by experts involved in the analysis based on the characteristics of the instruments. At this stage, quantitative analyses are supplemented by

[5] For more information on the methodologies used by the Bank of Italy for analyses relating to its intervention power, see the Bank’s website: *The Bank of Italy’s intervention power concerning financial instruments, structured deposits and related financial activities/practices*.

[6] For securities, the following are considered complex: securitizations (excluding self-securitizations), certificates (including credit linked notes and covered warrants), structured bonds, subordinated bonds, AT1 subordinated bonds. The following are considered non-complex, in addition to the residual types: shares, commercial papers, covered bonds, rights, ETFs, investment funds, bonds (others), Italian and foreign government bonds, and self-securitizations. Starting from this press release, these latter instruments are considered non-complex securities because they involve transactions carried out by banks solely in connection with Eurosystem refinancing operations and they cannot be placed on the market. For derivatives, the following are considered complex: contracts for differences (CFDs), credit default swaps (CDSs), other options (non-plain vanilla), spread bets, swaptions, non-plain vanilla options and other derivatives contracts. The following are considered non-complex: forwards, forward rate agreements (FRAs), futures, plain vanilla options, and swaps other than CDSs.

discretionary assessments, for example of the adequacy of the effects expected from the imposition of prohibitions or limitations with respect to the risks identified.