BANCA D'ITALIA
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Press Release

By the Communications Directorate

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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 periodically updated and refined.

This press release provides some information on the most recent analyses and assessments. More detailed information on the Bank of Italy's intervention power and its activities in this area can be found 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, prepared using data up to 31 December 2023, securitized products and certificates continue to be the Bank of Italy's main focus in relation to any exercise of its intervention power due to their complexity, the growth in their volumes and the large price changes to which some of these securities may be subject.[1]

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 could be exposed to significant losses in the event of adverse scenarios, the likelihood of which is difficult to assess. The robust growth in certificates in circulation in 2023 (up by €20 billion, to €75 billion) is mostly attributable to the least risky categories – those with full or partial capital protection (up by €15 billion, to €45 billion) – and yield enhancement certificates (€3 billion higher, to €24 billion), which may offer higher yields than the market but without capital protection. Households held most of the certificates (€53 billion at the

[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'.

end of 2023, from €37 million at end-2022), equal to 5 per cent of the total value of the securities they held.

More detailed information on the analyses underlying the preceding summary assessments is provided in the following section.

Complex securities – At the end of 2023, debt securities with a face value of €2,754 billion were in circulation in Italy, 12 per cent (€339 billion) of which were instruments that can be considered complex.[2] Among these instruments, those potentially posing the greatest risk to financial stability were securitization products[3] (accounting for 38 per cent of complex securities and amounting to €127 billion) and certificates (22 per cent and €75 billion; Figure 1 and Table 1). A sharp increase in certificates (36 per cent) was observed in 2023, while securitized products only rose slightly (Figure 2).

At the end of 2023, the amount of complex debt securities held directly by households was €70 billion, up €20 billion on the previous year, and equal to 16 per cent of total debt securities held by households. Among complex debt securities, certificates are most widely held by households and are largely responsible for the increase (having risen by around €16 billion, to €53 billion, Table 1).

Securitizations – At the end of 2023, the amount of securitized products amounted to €128 billion, below the peaks reached in 2012. The increase under way since 2017 is mainly linked to the sale of bad loans by banks. In addition, almost all of the securities associated with securitizations and issued by resident special purpose vehicles (SPVs) are traditional in nature and are sold to professional investors;[4] more than 75 per cent of the value of the securitized tranches issued by resident SPVs are ranked as senior.[5]

Certificates – The notional value of outstanding certificates in Italy increased significantly in 2023 (by €20 billion, to €75 billion). The value of these instruments may be subject to large fluctuations, even greater than those of the underlying assets, particularly under adverse market conditions. However, the increase (of €15 billion, to €45 billion) is mainly attributable to the least risky category, i.e. that offering capital protection (partial or total) if the instrument is held to maturity. The latter category also comprises most of the outstanding securities (60 per cent), followed by yield enhancement certificates (32 per cent) – which offer returns above market rates but do not offer capital protection – and leverage certificates (3 per cent), which are the riskiest. Italian households

[2] The securities (whether complex or non-complex) over which intervention power may be exercised are 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] Excludes the transactions in which the originator bank acquires all the securities issued by the SPV in order to be used as collateral for Eurosystem refinancing operations.
[4] In traditional securitizations, the pool of assets provided as collateral for investors is transferred to an SPV, thus allowing the bank to transfer the risk off its balance sheet. By contrast, 'synthetic securitizations' do not involve the disposal of the pool's assets and the credit risk is transferred through the conclusion of credit derivatives with the SPV.
[5] Data on securitizations are only granular in the case of resident SPVs.

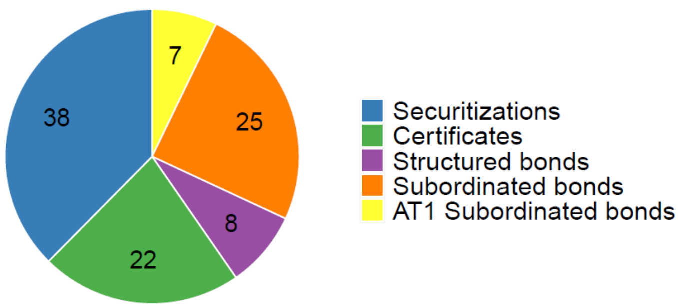
own most of the outstanding certificates in Italy (70 per cent at the end of 2023), but they only make up a small share (5 per cent) of their total securities holdings.

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

Complex derivatives – Around 4 per cent of derivatives with Italian counterparties can be considered complex. Swaptions and credit default swaps dominate, while other types of complex derivatives are not very common (Figure 3). At the end of 2023, the total notional value of complex derivatives (i.e. the sum of long and short positions) was around €550 billion, a level lower than observed a year earlier.[6] 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

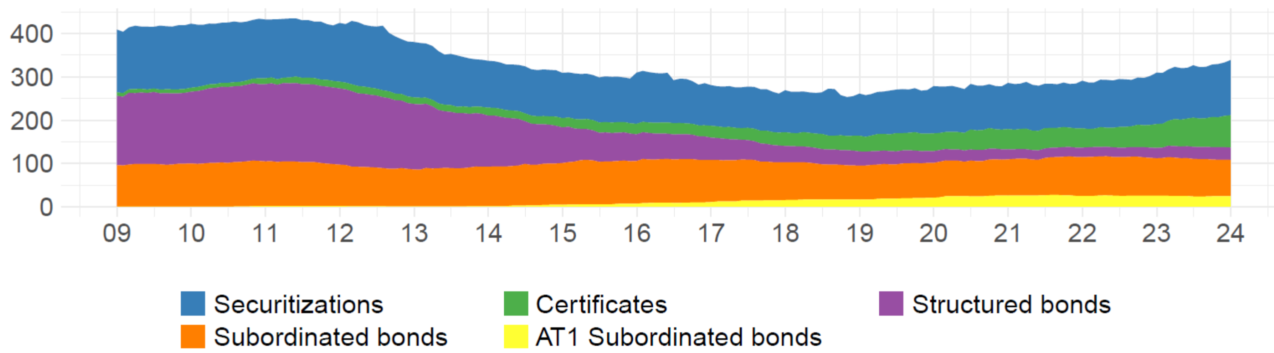
Breakdown of complex securities by type of instrument (1)
(data as at 31 December 2023; per cent)



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

Figure 2

Amounts of complex securities by type of instrument
(billions of euros)



[6] The figure published in the 21 April 2023 press release and referring to 31 December 2022 equalled €424 billion. The series have been modified, for previous observations as well, as a result of the change in the range of counterparties included in the analysis.

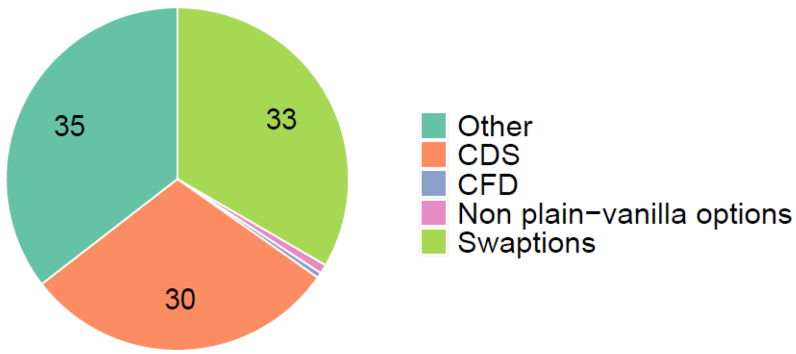
Table 1. Amounts of complex securities by type of instrument and holder sector (1)
(data as at 31 December 2023; billions of euros)

	Securitizations	Certificates	Structured bonds	Subordinated bonds	AT1 subordinated bonds	Total
Foreign	49.0	2.6	9.1	12.4	10.9	84.1
Banks	36.2	10.0	2.4	3.3	0.4	53.5
Households	0.8	53.0	6.6	7.6	1.9	70.0
Insurance companies	3.8	3.8	2.8	25.9	2.5	36.6
Investment funds	9.7	0.1	1.7	13.5	2.1	27.1
Other financial intermediaries	10.5	1.5	1.1	4.4	1.4	18.9
Firms	5.7	2.6	0.8	3.1	1.2	13.4
Public sectors	0.3	0.2	1.4	1.1	0.2	3.1
SPVs	0.8	0.0	0.5	0.0	0.0	1.3
Other (2)	10.5	3.1	2.0	12.6	3.5	31.6
Total	127.3	74.7	28.5	83.8	24.1	338.5

(1) The holder sector field is only reported in the Matrice dei conti, and not in the reports under Article 129 of the TUB or in the Securities Register. To map the sectors more accurately, 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; and ii) other residual sectors beyond those reported.

Figure 3

Breakdown of complex derivatives by type of instrument (1)
(data as at 31 December 2023; per cent)



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

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*'.

Methodological Appendix[7]

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 and the ECB's SHSS database are also used. The methodological framework is periodically 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.[8] 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 three 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

[7] 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*.

[8] 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. 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.

Media Relations Division – Banca d'Italia
e-mail: stampabi@bancaditalia.it