Bank of Italy chief sees legal risk in senior bonds bail-in

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Italian banks should be transparent about the bail-in of senior bonds when they sell them to retail customers, Ignazio Visco says

Impairing senior bonds when restructuring a failing bank could pose legal problems in Italy where banks sell the bonds to savers, Ignazio Visco, governor of the Bank of Italy, told *Risk* in an interview.

Italy is in the process of amending its law to comply with the European Union's Bank Recovery and Resolution Directive (BRRD), which gives national authorities the power to impose losses on the shareholders, creditors and depositors of a bank in resolution, to prevent any resort to taxpayers' money.

The incoming Italian legislation is still being finalised but is "broadly consistent with the approach set under the BRRD", Visco said. Under the directive, senior bonds should be bailed in immediately after equity and subordinated debt, and before any corporate, retail and short-term interbank deposits. In contrast, currently Italy affords senior bonds the same protection as deposits and other liabilities necessary to carry out a bank's critical functions such as payment systems.

The treatment of senior debt under the amended law could pose "some legal risk", Visco acknowledged.

"There are always legal issues. You may already be familiar with the problem, but two years ago the Bank of Italy had some doubts about the possibility for these bonds to be bail-inable simply because there wasn't such a clause *ex ante*," he said, meaning a clause that would clearly state whether the bonds can be impaired or not.

The new Italian law, which Visco expects to come into force before the end of September, will provide that clarity. On May 28, the European Commission gave 11 EU member states, including Italy, two months to fully implement the BRRD, saying that if that deadline is not met, it may refer them to the EU Court of Justice.

When financial supervisors implement any new law, they must be "very careful" about the retroactivity of the rule, Visco said without elaborating. "That being said, the treatment of retail instruments versus other debt instruments issued by the banks is a sensitive issue and we have asked banks to properly inform their customers about the bail-in of these instruments."

Compensation claims can also arise under the BRRD due to the 'no creditor worse off' principle, which states that creditors should not sustain greater losses if a resolution authority restructures a failing bank than they would have if the bank had been simply wound up under normal insolvency proceedings. If the losses are greater, affected creditors can be compensated from a national resolution fund, financed by contributions from banks. The directive requires EU member states to set up such funds or equivalent financing arrangements.

Resolution-related legal claims are on the minds of other European countries as well. Germany is discussing a draft law that would subordinate certain senior unsecured debt to other senior liabilities. Earlier this month, the European Central Bank wrote that the proposed subordination should ease the resolution process and "minimise" the risk of compensation claims under the 'no creditor worse off' principle.