The 'precautionary recapitalization' of Banca Monte dei Paschi di Siena

The difference between the amount of the capital injection for Banca Monte dei Paschi di Siena calculated on the basis of the 'market solution' (€5 billion) and the amount required in the case of a 'precautionary recapitalization' by the Italian state (€8.8 billion) depends on the different hypotheses and objectives of the two measures, which also imply different methods of calculation and lead to different results.

The 'market solution' was directed at private investors and aimed to drastically reduce the bank's credit risk, thereby guaranteeing its stability in the face of the negative result of the stress test published in July 2016 by the European Banking Authority (EBA). This solution envisaged the sale of all bad loans and an increase in the level of coverage of loans that were 'unlikely to pay'. The cost of these operations was calculated at €5 billion, of which about €3 billion to cover the losses deriving from the sale of the bad loans and €2 billion to increase the coverage ratio of the unlikely-to-pay loans.

The 'precautionary recapitalization' is a measure provided under European legislation (the Bank Recovery and Resolution Directive - BRRD) in exceptional circumstances, to remedy a serious disturbance to the economy of a Member State and preserve financial stability. In these cases, in order to strengthen the capital of a bank, extraordinary State aid of a precautionary and temporary nature is permitted as long as the bank is solvent and the intervention is compliant with the rules on State aid. These rules mean that a State can only intervene after the subordinated bonds have been converted into equity (the burden sharing principle). If the subordinated bonds were sold to retail customers without complying with the relevant transparency rules, the impact of the burden sharing principle may be mitigated.

The amount of 'precautionary' capital that a bank can request from the State is the amount necessary to cover the capital shortfall deriving from the adverse scenario of a stress test. In the case of Banca Monte dei Paschi di Siena the requirement has been assessed by the ECB at €8.8 billion in reference to the stress test published by the EBA.

This amount was determined given the outcome of the stress test under the adverse scenario (for Banca Monte dei Paschi di Siena, its fully loaded common equity tier one (CET1) ratio was -2.44 per cent) and by calculating the amount necessary to bring the CET1 ratio to 8 per cent and the total capital ratio (TCR) to 11.5 per cent, as decided in a special meeting of the ECB's Supervisory Board.

In particular, the requested amount of €8.8 billion was determined by taking into account the following two requirements (see the Figure 'Use of resources'):

− €6.3 billion are needed to realign the CET1 ratio to the 8 per cent threshold (taking into account the initial lowering and the subsequent partial reconstitution of the exemption threshold for the deduction of negative capital components); of these €6.3 billion, about €4.2 billion would be covered by the burden sharing on subordinated bonds and about €2.1 billion would be provided by the Italian state;

− an additional €2.5 billion are needed to reach the total capital ratio (TCR) threshold of 11.5 per cent to compensate for the elimination, as a result of the burden sharing, of the subordinated bonds (lower-quality capital instruments) previously included in total capital.

Pending subsequent and more precise verification, the immediate cost to the State would therefore amount to about €4.6 billion (€2.1 billion to cover the first requirement and €2.5 billion to satisfy the second); to this must be added the subsequent compensation of retail subscribers (about €2 billion, to be verified on the basis of the status of the subscribers and their actual willingness to adhere to the State compensation scheme), for a total of about €6.6 billion. The cost to entities other than the Italian state will be about €2.2 billion. Accordingly, the total cost amounts to €8.8 billion (see the Figure 'Funding sources').

Use of resources
(billions of euros)

2.5

6.3

■ Target CET1 ratio 8%   ■ Target TCR 11.5%

Funding sources
(billions of euros)

2.2

6.6

■ State   ■ Other