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An Italian Banking Bailout Made in Brussels

REUTERS

EU rules foist more costs on taxpayers by barring honest socialism and creating bigger banks.

By Marcello Minenna

Italy's banks can't seem to avoid controversy. This time it's the government's decision last month to wind down Veneto Banca and Banca Popolare di Vicenza rather than subject them to the eurozone's new bank bail-in rules. This looks like a classic eurozone fudge with Italian characteristics—which it is. But look closer and you'll find it difficult to fault Rome for its actions.

Eyebrows have been raised over the complexity of the process. The banks' loan books are to be divided into two categories. The performing loans and other good-quality assets, worth some €26 billion ($29.61 billion), will go to Italy's largest lender, Intesa Sanpaolo, for €1. The bad loans, with a net value of €10.3 billion, will go to Società per la Gestione di Attività (SGA), established in 1996 as a bad bank to help resolve the Banco di Napoli.

This is very different from the bail-in provisions envisioned by the European Union's directive on bank resolutions. Under those rules, depositors and senior bondholders are supposed to take a haircut in the first instance, with taxpayers entering only as a last resort.

Here, however, losses of roughly €3.7 billion will be concentrated on shareholders and subordinated bondholders. That includes a €2.5 billion loss for Atlante, the bank-recapitalization fund organized by the government and funded by Italy's largest banks and other investors, which recapitalized these banks only a year ago.

Taxpayers will pay a far larger bill, mainly to Intesa. The Milan-based bank will receive a lump sum of €4.8 billion to compensate for costs associated with its role in winding down the two banks and to bolster its capital cushion in light of the new assets it's taking on.

Rome also is offering €12 billion in taxpayer guarantees for any deterioration in the loan portfolio Intesa is buying. The total of €16.8 billion is around 82% of the funds allocated barely six months ago to shore up Italian banks; the remaining funds will hardly be enough to cover the €5.4 billion in state aid to Monte dei Paschi di Siena that was just unlocked Tuesday by the European Commission. And this doesn't factor in Rome's guarantees to SGA for the nonperforming loans it's absorbing.

Critics are right that this solution runs counter to the spirit of the EU's bank-resolution rules. But Rome was given little choice. The EU-level banking regulator determined neither bank was systemically significant enough to demand resolution under the EU directive, leaving Rome to decide alone how to proceed. But when Rome determined that the two institutions were indeed significant enough in their regions that they couldn't be allowed to fail chaotically, other EU rules prohibited a more honest form of socialism that would have benefited taxpayers.

Intesa's involvement was necessitated by EU rules prohibiting outright state aid to banks. Yet Brussels cared only about the form, not the substance, of the ensuing deal. The European Commission liked the fact that the bank assets were being sold in part to a private-sector bidder. It gave no regard to such details as the purely symbolic €1 price being paid, or the taxpayer benefits that Intesa would enjoy.

It would have made much more sense and been less burdensome for Italian taxpayers if Rome had fully taken over the two banks. The SGA "bad bank" could have established an asset-management company to purchase all the assets of the two banks and to fund the operation by issuing asset-backed securities. The inclusion of per-

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forming loans in the collateral portfolio would have reduced the state's direct commitment. That commitment could have been further reduced by the creation of a mezzanine tranche, secured by public guarantees but of limited size and contingent upon the occurrence of enough losses as to fully absorb the junior slice.

Yet it would have been a struggle to get such measures approved, especially in the short time in which Rome had to act. The government would have had to argue that the honest socialism of this alternate procedure would have less impact on public finances, and that despite its ties to the government the SGA is a public company. Brussels might have disagreed.

In effect, Rome was in a bind. The EU imposes resolution and state-aid rules to create some semblance of restraint on taxpayer rescues for failing banks. But the EU has yet to roll out EU-wide deposit guarantees that might reduce the political pressure on governments to expend taxpayer resources.

The result may be the worst of all possible worlds. One irony is for sure: State-aid rules intended to encourage market competition have instead in this case resulted in an enormous taxpayer gift to Intesa, already Italy's largest bank. The current system is fueling the growth of giant institutions in a way that's unlikely to be good for the financial market or consumers.

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