

*"Fixing and Completing the European Banking Union:
what needs to be done"*

Italian Banks: criticisms and actions needed

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BANCA D'ITALIA
EUROSISTEMA

Véron general statements

1) **Creating true single market:**

Need for a more comprehensive approach

✓

2) **“Half banking union”:**

European Banking Supervision: a step forward, not yet enough ...

✓

3) **Resolution framework:**

- Still untested, Yet to establish credibility

✓

4) **European banking supervision:**

- transition still unfinished

✓ X

- governance and transparency to be improved

✓ X

- LSI's oversight barely started

X



Véron and the Italian Banking Sector

Problems highlighted:

- **Many small banks** ✓
- **Politicized governance** ✓X
- **High non performing loans** ✓
- **Weak profitability** ✓

Actions needed:

- **Thorough process of triage, incl. many LSIs**
- **Recapitalization, restructuring, consolidation**
- **Resolution of any insolvent bank**

Criticisms:

- **Public authorities reluctance to act** X
- **Atlas Fund as a "sticking plaster"** X
- **"Convoy approach" threatens largest banks** X
- **Limited clean-up so far** X

Italian Banking Sector: problems highlighted

Concerns about the state of affairs of Italian banks are **legitimate but somewhat overstated**

- 2016 EU-wide stress test outcome for Italy:
 - notwithstanding the long-lasting recession, **most banks have robust fundamentals**;
 - **bold actions taken by Monte dei Paschi**
- Not a widespread problem, but **well-identified cases of serious but manageable weakness**, compounded by ownership structure and governance problems, which are being addressed
- **The same is true for LSIs** (472 banks/banking groups in all, of which 365 BCC)

Italian Banking Sector: problems highlighted

- **NPL** problem is serious, but emphasis often based on misleading figures; banks need time to address the problem; in specific cases the **solution has to be accelerated**; the **deterioration in credit quality** has been gradually abating
- **Profitability** still weak; banks have to reduce costs and diversify revenues, but profitability of Italian banks almost in line with that of European banks (of similar size and business model);
- **Capital strengthening** continues; expected benefits from recent **reforms**

Asset quality (stock)

- The end-2015 figure of €360 billion NPLs is misleading (€163 billion written down)
- The value of bad loans, net of write-downs, €87 billion, is more informative. Of these, €50 billion backed by collateral worth an estimated €85 billion, with the remainder backed by personal guarantees (estimated at €37 billion) or unsecured
- The value of the real-estate collateral carefully assessed (2014 AQR and after)
- Other NPL (UTP, Past due) very different from bad loans; need to be carefully examined

NPL and guarantees

(billions of euros and per cent; December 2015)

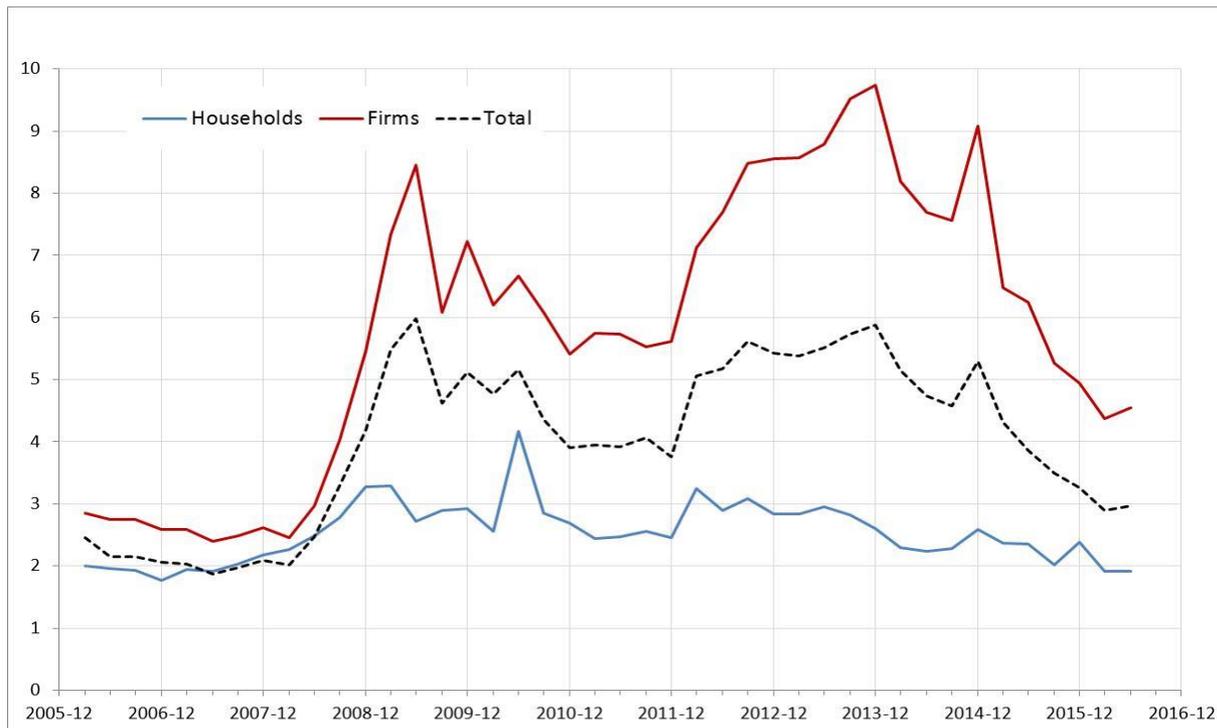
	Gross exposure	Net exposure	Gross percentage composition	Coverage ratio	Share of collateralized and guaranteed loans (1)	Real estate collateral (1)	Personal guarantees (1)
Total NPLs	360	197	18,1%	45,4%	67,0%	160	52
Bad loans	210	87	10,6%	58,7%	66,4%	85	37
Others	150	110	7,6%	26,7%	67,7%	75	15

(1) Data from Supervisory reportings on a solo basis.

Asset quality (flows)

- The deterioration in credit quality has been gradually abating
- The improvement is expected to continue, driven by the economic recovery

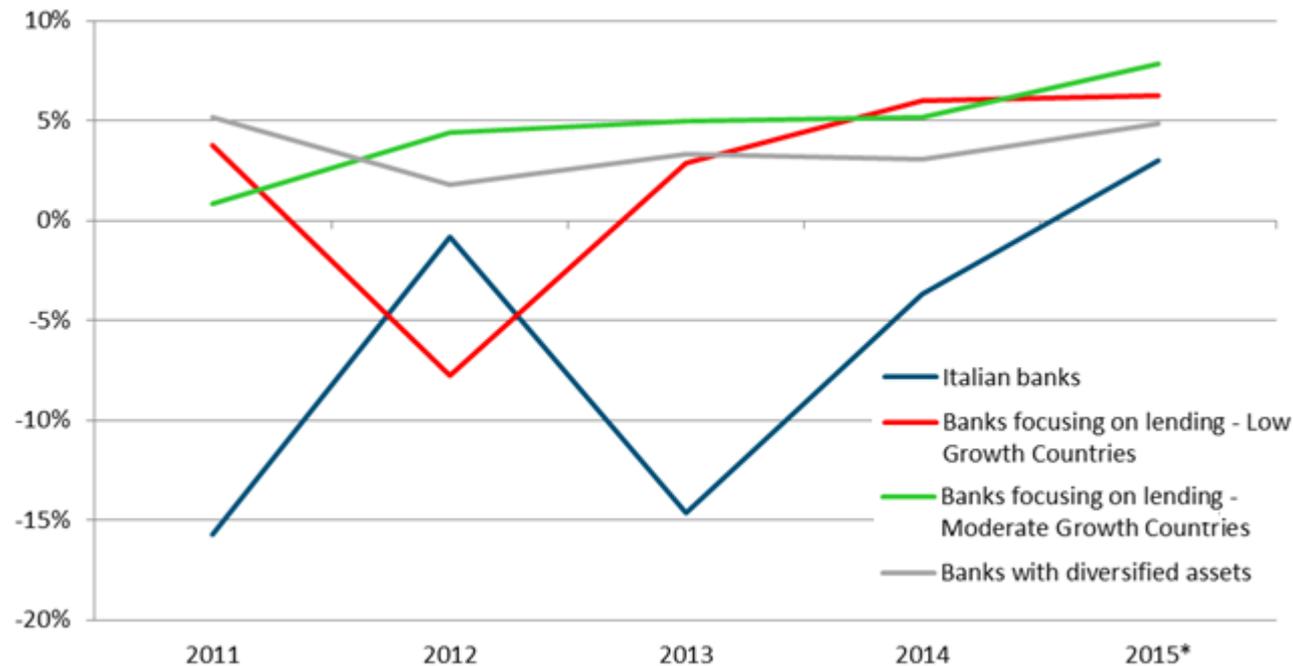
New non-performing loan rate
(per cent)



Profitability

- Average ROE of Italian banks is now closer to that of European banks focusing on lending to SMEs and households

ROE for a sample of large European banks
(by business model and country real GDP growth)



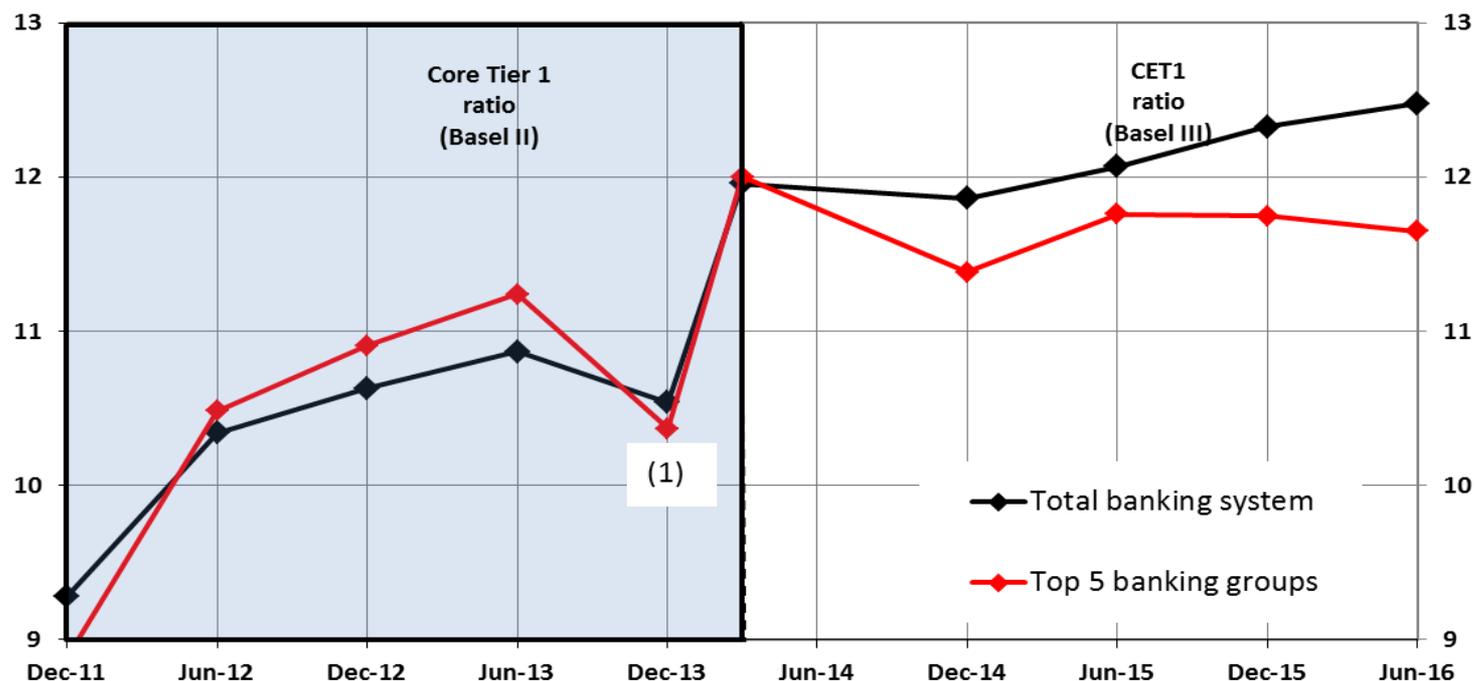
Source: SNL Financial. Average weighted by equity. Figures are based on a sample of 77 EBA significant banks including 13 Italian banks. Banks focusing on lending are banks with loans representing at least 50% of assets; others are banks with diversified assets. Low growth countries include Finland, Ireland, Portugal and Spain. Moderate growth countries include Austria, Belgium, Denmark, France, Germany, The Netherlands, United Kingdom.

*Data for 2015 are available only for 45 banks including all the Italian ones.

Capital adequacy

Capital strengthening for Italian banks proceeds, thanks to capital increases and some revival in profitability.

Capital ratio
(end of period; per cent)



(1) In December 2013 the CET1 ratio of the top five banking groups went down by 80 bp, owing to the large volume of write-downs, a development common to many euro area banks. In the first half of 2014 the funds raised on the market (11 billion) fostered capital strengthening.

LSIs in a nutshell

LSIs (*not far from SIs*):

- higher capital buffers
- weaker profitability
- similar pattern for asset quality

End-2015 figures		SIs	LSIs	of which: BCC	Total (1)
Capital adequacy	CET1 ratio - transitional	11,6	15,8	16,5	12,3
	CET1 ratio - fully loaded	11,3	15,5	16,8	12,1
	Total capital ratio - transitional	14,8	17,0	17,0	15,1
Profitability	ROE net of goodwill impairment	3,5	1,8	-0,4	3,1
	Cost income	64,2	63,7	61,2	63,9
	Net interest income on gross income	47,3	43,8	50,1	47,8
Asset quality	Net NPL ratio	11,0	12,6	12,7	10,8
	NPL Coverage ratio	45,6	42,6	40,5	45,4
	Net bad loan ratio	4,9	5,4	5,2	4,8
	Coverage ratio on bad loans	58,6	57,1	54,8	58,7

(1) Total refers to the overall Italian banking system, including SIs, LSIs and all subsidiaries of foreign banking groups; the latter – which are classified neither as LSIs nor as SIs – account for around 8 per cent of total assets of the Italian banking system.

Italian Banking Sector: actions needed

Three main areas of intervention:

NPL, Governance, Crisis management

➤ **NPL**

- Several “**structural**” **measures** have started to bear fruit
- **Atlante**, **good example** of cooperation among private investors and **trigger** for similar initiatives

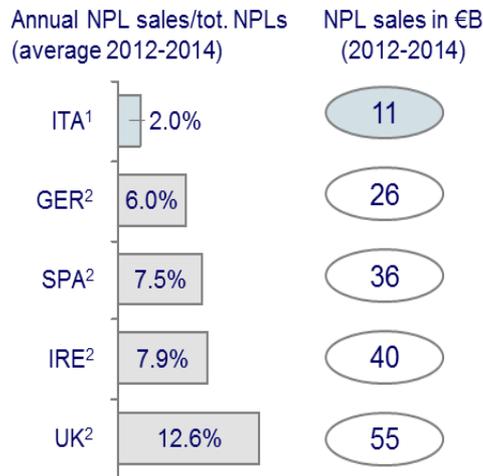
NPLs: main drivers and recent initiatives

Main drivers of NPL problem

1) Time to credit recovery

process	average length	
	ITA	EU
Recovery	3 yrs.	1,9 yrs.
bankruptcy	7,9 yrs.	2 yrs.

2) Gap between book value and market price



3) Data quality on NPLs

Reforms/Initiatives

Bankruptcy and Recovery procedures

Fiscal measures

GACS

Atlante Fund

New reporting on bad loans

Atlante fund

Potential impact

- Even if the resources available are somewhat limited, the setting up of the fund, combined with other measures, **will help to unlock the market for NPLs**, therefore contributing to the solution of the NPL issue. A solution, however, that will take place in the medium term

Italian Banking Sector: actions needed

- **Governance** - Several measures enacted:
 - **the Cooperative sector** (“Popolari”): to address weaknesses in corporate governance (*i.e. limited shareholder’s activism; self-referential management; undue influence by organized groups of interest*) and remove constraints/disincentives to capital contribution
 - **Banking foundations**: to limit their participation in banks capital and foster investment diversification by means of a *Protocol between Ministry of Economy, Italian Banking Association and ACRI - independent association of banking foundations*
 - **Mutual banks** (“BCC”): to foster aggregation in the mutual banking sector (BCCs, 365 small independent banks) while preserving the cooperative nature of the banks

Italian Banking Sector: actions needed

➤ **Crisis management:**

- Process of **triage** in place
- **Supervision is intrusive both on SIs and LSIs**
(great emphasis on **prevention** and **early intervention**):
- *Sistematically:*
 - Over 5,900 (of which 4,800 LSIs) fact-finding undertaken (off-site analysis, corrective actions), 153 (of which 105 LSIs) inspections concluded, 360 (of which 275 LSIs) administrative decisions adopted in 2015;
 - **Frequent Balance sheet review and cleaning-up** (*in case of misclassification, under provisioning ascertained by O.S.I.*);
 - **Stress Test** widely used in ongoing supervision (including LSIs) as a complement rather than substitute of other supervisory tools
- *When needed:*
 - **Consolidation**; in 2015, 26 out of 36 exits were due to merger operations
 - **Recapitalization** (*voluntary interventions: by Atlante for SIs, Interbanking Fund for LSIs, Transitory Fund for BCC*)
(*private measures are the ordinary way to solve FoLTF situations*
- BRRD-art.32.1.b)

Concluding remarks

- Bail-in is a **good** safeguard, **but must be tested in practice**
- Markets are extremely sensitive to policy actions and announcements (as triggers)
- Disproportionate market reactions might affect the soundness of viable intermediaries
- **Prudence and Flexibility** can be necessary, not to prolong irreparable situations but to resolve them in orderly manner (*private solutions whenever possible*)

... thanks for your attention!

Italian Banks

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