Press Cutting

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Bonds in two rescued Italian banks surge

EU allows Rome to skirt rules that would have forced losses on senior debtholders

Senior bonds in Veneto Banca and Banca Popolare di Vicenza had been trading at steep discounts to face value © Bloomberg

by: **Robert Smith** in London, **Claire Jones** in Frankfurt and **Jim Brunsden** in Brussels

Senior bonds in the two Veneto banks rescued by the Italian government at the weekend surged on Monday after Rome shielded the notes from losses in its wind-down of the lenders.

The senior bonds in Veneto Banca and Banca Popolare di Vicenza had been trading at steep discounts to face value, reflecting investors' fears that they could be "bailed-in" — a process whereby losses are imposed on private creditors to lessen the cost to the taxpayer.

Instead, the two banks' senior bonds will become liabilities of Intesa Sanpaolo, which was given €4.8bn by the Italian government to take over the healthy assets of the two failing banks. Rome has guaranteed an additional €12bn, meaning Italian taxpayers are potentially on the hook for €17bn to rescue the banks.

Under the EU's post-crisis "banking union" rules, designed to avoid saddling taxpayers with multibillion-euro bank bailout tabs, private investors were supposed to be wiped out before any taxpayer money is pumped into a rescue.

Senior bondholders, who have the highest priority for repayment, are the last creditors to be wiped out before deposits are raided for rescue cash. But Rome was able to skirt the rules by invoking a "public interest" clause, arguing that the banks' failure would have wrecked the economy in the prosperous Veneto region.

It stands in contrast to the resolution of Spain's Banco Popular earlier this month, in which losses imposed on junior bondholders and shareholders were sufficient to avoid any cost to the Spanish taxpayer.

The move has already sparked anger in Germany, which led the charge for the new banking rules after domestic outrage at German taxpayers being on the hook for rescuing other countries' banks through the crisis-era bailouts in Italy, Spain and Cyprus.

"With this decision, the European Commission accompanies the banking union to its deathbed," said MEP Markus Ferber, an ally of German Chancellor Angela Merkel who is vice-chair of the EU parliament's economics committee. "The promise that the taxpayer will not stand in to rescue failing banks any more is broken for good."

A German finance ministry spokeswoman said that while it was "better to have [banks] leave the market" than to keep them "alive artificially" through recapitalisation, Berlin would continue to insist "state resources should be avoided as far as possible".

Friederike von Tiesenhausen, the ministry spokesperson, declined to comment on the individual cases of Veneto Banca and Banca Popolare di Vicenza. But she said Brussels was responsible for "reducing state support to a minimum" and preventing the "de facto bypassing of liquidation" through national insolvency procedures.

The Italian rescue has "unearthed a formidable loophole" in the eurozone's new bank rescue system, said David Benamou, managing partner of Axiom Alternative Investments, a Paris-based investor in bank debt that had no exposure to the two Veneto banks.

"What the Italian government has achieved is nothing short of extraordinary," said Mr Benamou. "Any country willing to protect senior bondholders — preferred or not — now has a legal route to do so."

The unexpected fillip took the financial markets by surprise. Vicenza's €750m 2020 senior note was trading around 85 cents on the euro on Friday, but soared up to 102 cents on Monday morning. Veneto's €500m 2019 senior bond surged from 88 cents to 103 cents over the same period.

Intesa Sanpaolo's share price was up 3.9 per cent by mid-morning, leading a broader rally across Italian bank stocks.

Mr Benamou said Italy's move was "good news for senior debt" as it made it more likely that this class of debt would be protected. If a bank is systemically important enough, it can be exempt from the EU's rules requiring losses to be imposed on senior bondholders. If it is not, like the

Veneto banks, it can be subjected to national bankruptcy proceedings and senior debtholders can be paid off with state aid.

Clemens Fuest, head of Germany's Ifo economic think-tank, said the Italian move would damp hopes of moving forward with the last leg of the EU's banking union — a common eurozone deposit guarantee scheme, which would again call on German taxpayers to help back up deposits at all eurozone banks.

"It is impossible to introduce anything like common deposit insurance in the eurozone at this stage," Mr Fuest said.