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FINANCIAL TIMES

Monte dei Paschi sniffs out demand for pricey new debt

Robert Smith

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Italy's Banca Monte dei Paschi di Siena has been sounding out investors to find potential buyers for new debt, bracing itself for the possibility it may need to take the expensive step if ordered to by regulators.

Managers at the lender met with investors in London earlier this month, in meetings arranged by JPMorgan, to update them on its progress just over a year after the Italian government rescued the world's oldest bank.

Two hedge fund managers present said the bank tried to gauge their appetite for potential tier-two bonds, which get sucked into rescue bailouts and count towards key capital ratios. The bank suggested it might be willing to privately offer about €200m of such debt to a handful investors, offering juicy double-digit yields if it went ahead with a deal — a price tag inflated by ructions in the Italian bond market.

The bank has strived to get its house in order since its complex multibillion-euro rescue last year, and the heavy cost illustrates the high stakes for Italy's financial sector while the government's spending spat with Brussels hits the nation's finances. Already, Monte dei Paschi's share price has halved this year and its existing tier 2 bonds have declined, taking yields to more than 11 per cent.

Monte dei Paschi raised that €750m tier 2 debt in January to bolster its capital ratios with a yield of just over 5 per cent, after its previous subordinated debt was wiped out during its rescue.

The debt raising was part of the bank's restructuring plan agreed with the European Commission's Directorate-General for Competition, commonly known as "DG Comp". The deal specified that the bank would later raise an additional €700m as part of its commitments.

However, the government bond sell-off, which eased in early trading on Monday, has seen the gap between Italian and German government bond yields hit its widest level since early 2013. That has pumped up borrowing costs for all Italian banks, making such an issue prohibitively expensive.

Monte dei Paschi declined to comment.

Some fund managers thought it was a remote possibility such a deal would materialise this year, telling the Financial Times they expected DG Comp to show leniency. Others were not so sure.

"The only reason people think that DG Comp will be lenient with Monte dei Paschi is because they want it to be true," said Jérôme Legras, head of research at Axiom Alternative Investments. "I'm not

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saying they definitely won't, but nobody has said anything in that direction, and DG Comp has not been that flexible in the past."

While Monte dei Paschi is bearing the brunt of selling pressure, all Italian banks are in effect locked out of the unsecured debt markets. One shareholder said that this meant DG Comp was highly unlikely to punish the bank, particularly as it has made good process with other parts of its restructuring plan.

Monte dei Paschi cleared €26bn of non-performing loans from its balance sheet earlier this year through a securitisation deal that made use of a government guarantee. The bank is now in the process of selecting bidders for a further €3.5bn of bad debt portfolios, which do not depend on the government guarantee. At least €1.1bn of this is expected to close by the end of the year, according to a person involved in the deal.

Aside from DG Comp, the bank separately needs to fulfil a capital requirement set by the European Central Bank. Monte dei Paschi will comply with that requirement this year, but the ECB will not announce its threshold for 2019 until next month. A further sell-off in Italian government bonds could make it more challenging to hit those targets, given the bank's substantial holding of Italian government bonds, known as BTPs.

One of Monte dei Paschi's bondholders said there was "no chance" the bank would have to issue more debt this year, as Brussels and Frankfurt would "cut them the slack they need".

"But that won't last for ever and destiny is out of their hands," he added. "They've been doing everything right on the NPL side, but if BTPs go to 500 [basis points] they're screwed."

Ten-year Italian bonds now trade with a yield of 3.36 per cent, down from 3.73 per cent touched last week. However, the yield is up from 1.8 per cent in May.

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