



**EUROPEAN CENTRAL BANK**  
BANKING SUPERVISION

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*This is a non-confidential version of the ECB Failing or Likely to Fail assessment adopted by the ECB on 23 June.*

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## **‘Failing or Likely to Fail’ Assessment of Veneto Banca Società per Azioni (‘the Supervised Entity’)**

### **Introduction**

1. Pursuant to Article 18(4) of Regulation (EU) 806/2014 (the SRM Regulation – ‘SRMR’) an institution shall be deemed to be ‘Failing or Likely to Fail’ (FOLTF) in one or more of the following circumstances:
  - a) the entity infringes, or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the ECB, including but not limited to the fact that the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;
  - b) the assets of the entity are, or there are objective elements to support a determination that the assets of the entity will, in the near future, be less than its liabilities;
  - c) the entity is, or there are objective elements to support a determination that the entity will, in the near future, be unable to pay its debts or other liabilities as they fall due;
  - d) extraordinary public financial support is required (State aid) with certain exceptions.
2. The assessment of FOLTF shall be made by the ECB, after consulting the SRB, in accordance with Article 18(1) subparagraph 2 of the SRMR.

### **Status and assessment of the Supervised Entity’s capital position**

#### *Capital position before 2017*

3. Over the past eighteen months, the Supervised Entity has experienced material capital depletions, primarily driven by idiosyncratic weaknesses. As of 30 September 2015 the Supervised Entity reported a breach of capital requirements [...] and was requested to submit to the ECB a capital plan describing how it intends to restore compliance with the aforementioned capital requirements.

4. The regulatory solvency position of the Supervised Entity further decreased at the end of 2015 in light of the need to derecognise the “financed capital” from the CET1 ratio. In particular, the ECB conducted an on-site inspection<sup>1</sup> focused – among other things - on 1) the procedures for the subscription to the Supervised Entity’s 2013 and 2014 capital increases and 2) the trading on treasury shares. The on-site inspection brought to light serious anomalies and revealed that the Supervised Entity circumvented Article 28 of the CRR (‘direct and indirect financing of common equity instruments’), as parts of the subscriptions/purchases of the Supervised Entity’s shares in the 2013-14 capital increases were linked to loan transactions for the purchase of such shares. Overall, the total amount of “financed capital” derecognized from the CET1 capital as of end-December 2015 was EUR 296.2 million.
5. The capital plan submitted at year-end 2015 foresaw, *inter alia*, a public offering (IPO), which eventually did not meet a material interest from market participants. In order to avoid a failure of the capital plan Atlante Fund<sup>2</sup> acted as sub-underwriter of the capital increase in June 2016, and thereby became the majority shareholder of the Supervised Entity, holding 97.64% of its share capital.
6. [...] following the capital increase<sup>3</sup>, the Supervised Entity reported a CET1 ratio of 10.74% and a Total Capital (TC) ratio of 12.57%, against a CET1 capital requirement of 10.25%<sup>4</sup> (including 2.50% of Capital Conservation buffer (CCB)).
7. Within the six months following the aforementioned capital increase (during the second half of 2016), the Supervised Entity showed strong reductions in core revenues (primarily driven by direct and indirect funding outflows), increased needs for provisioning on loans, increased needs for provisioning due to increased lawsuits, a significant deterioration in the asset quality and higher operating costs. This in turn triggered a capital depletion [...], thus breaching the [...] requirement[...].

#### *Capital position in 2017 to date*

8. In an attempt to avoid the continuation of a [...] breach, Atlante Fund injected, in two tranches (the first in late December 2016 and the second one in early January 2017), additional funds for an overall amount of EUR 628 million. Despite of those additional investments the CET1 ratio, [...], was equal to [...]%, against a CET1 capital requirement of 10.25% (including 1.25% CCB)<sup>5</sup>, [...].
9. As of 31 March 2017, the SREP Decision 2016 has entered into force, with a Total SREP Capital Requirement (TSCR) requirement of 11% (composed of 8% P1 + 3% P2R) and CET1 requirement of 7.5% (composed of 4.5% P1 + 3% P2R). At that date, the Supervised Entity has reported a CET1 ratio of [...]%, and a TC ratio of [...]%, thus continuing with the breach of the [...] requirement with reference to the CET1 of 7.5%. [...]<sup>6</sup>.
10. As evidenced from the aforementioned facts, the Supervised Entity has, since the set-up of the Single Supervisory Mechanism on 4 November 2014, breached [...] SREP Decisions [...] and has thus demonstrated its incapacity to steadily comply with the capital requirements. Despite consecutive

<sup>1</sup> [...] from May to August 2015.

<sup>2</sup> An Italian closed-ended alternative investment fund reserved to professional investors, managed by Quaestio Capital Management SGR S.p.A.

<sup>3</sup> [...]

<sup>4</sup> See VB SREP Decision 2015 [...].

<sup>5</sup> Although the overall CET1 requirement set in the SREP Decision 2015, still in force until 30 March 2017, did not change, the [...] requirement rose to 9% due to the Banca d’Italia decision of halving the CCB down to 1.25%.

<sup>6</sup> See VB SREP Decision 2016 dated 8 December 2016.

capital increases performed by its shareholders, the Supervised Entity has depleted a significant amount of its own funds since 2014, thus demonstrating the inadequacy of its business model to ensure medium and long term profitability.

11. The Supervised Entity has very high operating costs compared to its core income, as confirmed by the cost-to-income ratio [...]. [...] **[Assessment of the sustainability of the business model, including profitability and of the capacity to produce internal capital proportionate to the risks taken]** This is in line with the results of 2016, where a consolidated net loss of EUR 1,579 million followed an operating income of only EUR 36 million. The assessment of the business plan of the Supervised Entity, and of the related documentation provided as part of the pre-application for precautionary recapitalisation, has reiterated this conclusion, confirming that, upon plausible prudential assumptions, the institution remains structurally non-profitable and therefore unable to comply with the capital requirements.
12. [...] **[Description and assessment of capital situation against supervisory capital requirements and loan loss provisioning]**

*Proportionality and absence of timely alternative measures*

13. As outlined above (paragraph 10), the Supervised Entity has demonstrated a structural inability to comply with the capital requirements established in the past [...] SREP Decisions.
14. The Supervised Entity had sufficient time to find a solution after being requested at several occasions in the past years to address its capital shortfalls. Since 2014 it has predominantly only been able to do so via the subsequent implementation of alternative options not involving the raising of capital in the “open” market: firstly, through “direct and indirect financing of shares”, secondly through the system-wide intervention of Atlante due to the failure of the Initial Public Offering (IPO) and lastly, through seeking a way to access precautionary recapitalisation.
15. The Supervised Entity was requested in the SREP Decision 2016 to submit to the ECB an updated strategic plan as well as a new funding plan. The Supervised Entity subsequently submitted to the ECB, on 31 January 2017, a combined business plan (Tiepolo) which envisages the merger with Banca Popolare di Vicenza S.p.A. by the end of 2017. The plan identifies a total capital need of EUR 4.7 billion [...].
16. In its submission of the strategic and funding plan of 31 January 2017, the Supervised Entity has proposed the abovementioned merger. [...], with letter of 1 March 2017 the Supervised Entity was required to resubmit to the ECB a new [...] plan, including an individual (standalone) capital conservation and raising plan, in alternative to the merger, and an adequate assessment of all possible actual, [...] options to provide for the capital needs identified.
17. In reply to the aforementioned letter the board of directors of the Supervised Entity submitted on 16 March 2017 an individual budget [...] covering the first half of 2017, and reiterated its intention to pursue a merger [...].
18. [...] **[Assessment of the capability to raise own funds from private investors]**
19. [...] **[Interaction with the Supervised Entity and Italian authorities]**
20. Following the above interactions with the ECB in the context of the business plan assessment, but also interactions with the European Commission in the context of the assessment of eligibility for a

precautionary recapitalisation, the Supervised Entity submitted a second version of the Tiepolo plan [...], the assessment of which has been concluded by the ECB on 19 June 2017.

The ECB has concluded that the effective and timely implementation of the plan in order to recapitalise the Supervised Entity and Banca Popolare di Vicenza S.p.A., merge them and create the conditions for a new viable business model in the future is implausible. [...] **[Assessment of the business plan]**

Against this backdrop, and given the inability of the Supervised Entity to raise additional private capital, irrespective of the ongoing assessment of eligibility for precautionary recapitalisation, the revised Tiepolo plan is not [...] credible [...].

21. Additionally, there are no other effective supervisory measures or early intervention measures available which would restore the compliance [...].

#### Information exchange with the SRB

22. The deteriorating situation of the Supervised Entity was early communicated to the SRB, and information exchange with it has been intensified already since end-2016, when

- SRB received all supervisory decisions related to the Supervised Entity,
- SRB access [...] for the specific Supervised Entity has been enhanced.

Information exchange intensified further in the course of the first half of 2017 with numerous individual items, including regular liquidity monitoring, financial statements, items related to the application for precautionary recapitalisation, ICAAP/ILAAP, items related to Onsite Inspections, stress test results, data to underpin the valuation of assets and many other categories of data and information. These data/information has been provided mostly in February and March for one-off items, but for regular items, e.g. liquidity monitoring, sharing of information is extending to the present. [...].

#### Overall Supervisory Assessment

23. The capital situation of the Supervised Entity has been deteriorating [...]:
- (i) the breaches of [...] requirements have been persisting [...], despite measures taken by the Supervised Entity to address them; currently, the Supervised Entity is in breach of [...] requirements;
  - (ii) [...]. **[Forward looking assessment of capital situation]**
24. The Supervised Entity was requested on several occasions in the past years to address its weaknesses; however, the measures presented by the Supervised Entity proved to be ineffective.
25. Currently, the Supervised Entity has no credible options to restore its capital position, taking into account that it is not in a position to generate capital or raise the capital needed [...]. **[Forward looking assessment of capital situation]**

26. Therefore, on the basis of the above, there is material evidence to conclude that the Supervised Entity infringes the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority<sup>7</sup>.

*Therefore, the Supervised Entity is deemed to be failing in the near future, in accordance with Article 18(1)(a) and 18(4)(a) of the SRMR.*

27. According to Article 18(1) SRMR, the SRB has been consulted on [...] and replied on [...] that it concurs with the assessment of the ECB regarding the capital and liquidity situation of the bank and that it concurs with the ECB conclusion that the Supervised Entity is deemed to be failing in the near future, in accordance with Article 18(1)(a) and 18(4)(a) SRMR.

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<sup>7</sup> The reported breaches [...] justify, pursuant to Article 104(1)(a) and Article 18 of CRD IV, the withdrawal of the banking license, which is one of the circumstances according to which the competent authority may declare the institution 'failing or likely to fail' under Article 32(4)(a) of the BRRD, Article 18(4)(a) of the SRMR, and Article 17(2)(a) of Legislative Decree no. 180/2015 transposing BRRD.

**Annex 1.1: Assessment of the Supervised Entity's liquidity position***Liquidity developments*

1. A number of key indicators show a very weak liquidity situation. [...], the Supervised Entity has experienced a substantial deterioration of its liquidity position, primarily driven by idiosyncratic weaknesses and to a lesser extent also due to external factors. In an attempt to preserve its counterbalancing capacity and hence liquidity, the Supervised Entity has used its contingent liquidity reserves. The funding from customers and institutional investors has been constantly decreasing. The commercial funding has fallen [...] mainly due to corporate and retail deposits outflows [...].
2. [...] the Supervised Entity faced very material outflows from customers, both corporate and retail, mainly linked to reputational reasons. Thus, [...] % of the commercial funding was lost during this period. The Liquidity Coverage Ratio (LCR) fell below the minimum requirements set by Article 38 (1a) of the Commission Delegated Regulation (EU) 201/61 for three consecutive months from December 2015 to February 2016 and then again in May 2016. The liquidity position has temporarily improved only as a result of the capital increase (EUR 1 billion) subscribed entirely by Atlante Fund in June 2016. [...].
3. Moreover, throughout Q4 2016 the already fragile liquidity position has deteriorated even further [...]. [...].

*Liquidity position in 2017 to date*

4. [...], in order to strengthen the liquidity profile, the Supervised Entity requested – in accordance with Article 5 of Decree Law 237/16 - a government guarantee on liabilities to be newly issued (GGBs) for an amount of EUR 3.5 billion. The approval by the Italian ministry was received on 1 February 2017 and this helped the Supervised Entity in getting an immediate relief on the liquidity buffer.[...]. Moreover, Atlante Fund injected capital for EUR 332 million in December 2016 and EUR 296 million in January 2017, which also temporarily improved the liquidity position of the Supervised Entity.
5. However, in March 2017 the liquidity position has sharply deteriorated again[...]([...] % reduction of the commercial funding corresponding to EUR [...] of decrease within this period) that have been sparked off by news related to a possible resolution and bail-in published by local papers and market analysts<sup>8</sup>. [...]. **[Assessment of counterbalancing capacity]**
6. Moreover, the Supervised Entity's senior bonds and subordinated bonds have been impacted by the stressed situation which recorded a significant increase of the yields to maturity [...]. On 24 March 2017 the rating agency DBRS placed the Supervised Entity's rating of senior debt under review with negative implications.

<sup>8</sup> See Bloomberg on March 7 2017, 10:28:37: Investors should sell the senior bonds of Banca Popolare di Vicenza SpA and Veneto Banca SpA because Italy may not win European Union backing to provide aid to the troubled lenders that shields those bondholders, according to JPMorgan Chase & Co. Banks face tough tests to qualify for a so-called precautionary recapitalization that spares senior bondholders from losses, and Pop. Vicenza and Veneto Banca may not meet the requirements, said Axel Finsterbusch, a London-based strategist at JPMorgan. The lenders may not be eligible because they already have soured loans and may not be regarded as systemically important, he said. "There's no guarantee these institutions will necessarily qualify," Finsterbusch said in a phone interview. "There is a general idea that anyone can tap a precautionary recapitalization but it's the exception rather than the default option."

7. [...] on the 24 March 2017 the Supervised Entity,[...] , has requested the Italian State to guarantee the issuance of further new liabilities (GGBs) for EUR 1.4 billion in accordance with Article 5 of Decree Law 237/16. This request was approved by the Italian Ministry of Finance on 25 May 2017.
8. Moreover, further liquidity sources to face both (i) the upcoming maturities for 2017 of the Supervised Entity [...] and (ii) additional future unexpected outflows are very limited. [...].The Supervised Entity has very limited unencumbered assets of high quality to source-in liquidity, since the encumbrance ratio stood at [...] % as [...] (above the Italian average of [...] %) and the unencumbered assets comprise for large part NPLs (NPL ratio standing at [...] % which is far above the country's average of [...] %). Moreover, the overall unencumbered assets to obtain funding via regular monetary policy are very limited ([...] % of encumbrance ratio on eligible assets as of [...]).



