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Bonds with more appeal

Castelli (Banor Capital) takes a positive view of the bonds issued by Italian banks. Investing in them through a fund is the best course of action right now

By Francesca Vercesi

In Italy, according to Bloomberg's figures, there are 83.9 billion euro in subordinate bank bonds. One major boost was the Atlante fund, an instrument that provided some much-needed oxygen for two Italian banks that were running out of breath: Popolare di Vicenza and Veneto Banca. MPS is also benefiting, in terms of outlook. So how should we assess bank securities, and how much room should we set aside for them? Here's some advice from Francesco Castelli, portfolio manager at Banor Capital and an expert in the sector.

Question. The subordinate debt of the banks in greatest difficulty, with the bail-in decree of November [2015], has in some cases reached 50% of value. Without the fund, Popolare di Vicenza would have been the first bail-in case in Italy. Is it all the merit of Atlante?

Answer. The Atlante fund has played an important role, and has demonstrated the banking system's capacity to mobilise and its hidden resources. Atlante helped a bank in serious difficulty and prevented the need for resolution. In November, the Italian public paid its dues in the four banks subject to resolution. In that case, however, in addition to wiping out the shareholders, the bail-in only went as far as subordinate debt, in any case more than 800 million. Since January 2016, as a result of the new European rules on bank resolution, the BRRD [Bank Recovery and Resolution Directive], it's possible for senior creditors to be bailed in. That could have been the fate of Popolare di Vicenza, if the capital increase hadn't been completed.

Q. If a fund acts as guarantor of the capital that these banks need, it goes without saying that subordinate bonds won't be touched. But would you advise the retail segment to buy subordinate debt, through a fund, naturally, and what proportion of the portfolio should it represent?

A. Over the short term, Atlante has reduced the risk of insolvency on the part of Italian banks. We also know that the amount initially provided for the fund is running out at a worrying rate. Indeed, there's already talk of boosting its capital. In short, Atlante provided some much-needed oxygen but it doesn't have the strength to deliver a systemic guarantee. In general, we feel that subordinate bonds are a good opportunity for diversification in a fixed-income portfolio, where they could account for 10-15% of total assets. However, in a sector as complex as this it's best to avoid the DIY approach; indeed, that's the line being taken by CONSOB, which is pushing for the distribution of these products in the retail segment to be scaled right back. Our firm includes these securities both in individual accounts and in SICAV segments.

Q. Which banks do you feel most positive about right now?

A. In general, we take a positive view of the debt issued by the Italian banking system, as we feel it's unlikely that large-scale resolutions like those of November will be repeated. For the same reason, we've often invested in subordinate bonds. Allocation by issuer is consistent with the state of health of the bank: in the case of a highly reliable name like Intesa, we're willing to take on the risk of very subordinate bonds [editor's note: such as the CoCo (Contingent Convertible) products, which are technically defined as Additional Tier 1]. With other banks, like UBI Banca and Unicredit, which have lower ratings, you can still find good opportunities in the Lower Tier 2 band, where the degree of subordination is lower.

Q. What's your view of the new regulatory framework?

A. Subordinate bonds have fallen steeply throughout Europe since the start of the year, as a result of the various – and all restrictive – regulatory initiatives. Italy reacted in a disproportionately negative fashion in view of its high exposure to non-performing loans, which makes our banks more fragile, and the psychological impact of the resolution of four of our banks. Sadly, we have the impression that there's been demand in the EU for the regulations to be applied strictly. Ex-post, the BRRD looks too inflexible. It aims to protect tax-payers, but the recipe it's proposing to achieve that has not, on first application, given the hoped-for results. On the contrary: it was designed to stabilise the system but thus far has produced a lot of confusion and greater volatility.