‘Bail-In’ fiasco in Italy

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As tremors continued to rattle major Italian banks, it was announced late last week that the European Commission (EC) had made a deal with the Italian government to shift the burden of €370 billion in toxic debt currently on the banks’ books. The deal allows Italian banks to package up non-performing loans (estimated to be 30-40 per cent of the entire Italian banking system) and sell securities based on them with government backing.

Italian pensioners protest in December 2015 outside Banca Etruria—one of four banks that were bailed-in—with signs identifying their losses. Photo: Il Tirreno

The government will issue, and guarantee, credit default swap (CDS) insurance on senior securitised bank debt, allowing it to remain on the books of the banks. In doing so the government knowingly agreed to a bet they have already lost, akin to selling fire insurance on a building that is already burning down. This deal effectively turns the Italian government into a “bad” bank, so the private banks can continue to operate.

Executive Intelligence Review Counter intelligence Director Jeffrey Steinberg explained in the 29 January LaRouchePAC webcast why the deal was made: “Major Italian banks were on the verge of a complete blow-out; and had that occurred, the entire euro system, the European Monetary Union, would have disintegrated. … And so what was worked out instead was a deferred bail-out, where the Italian government will basically issue insurance against the defaults by the Italian banks.”

The move is a desperate measure which will make matters worse in the near term. It is the same practice which triggered the 2007-08 global financial crisis—where subprime and delinquent mortgages were packaged with various other mortgages of up to AAA ratings, bundled together and sold, resold, and speculated upon. The instruments were especially created by banks to allow speculators to make money off collapsing mortgage-backed securities.

Likewise today: Vulture funds, which have long been eyeing off the Italian debt market, will buy the CDSs, making money as the system disintegrates. The London *Financial Times* of 27 January reported that “distressed debt investors, such as Cerberus and Apollo, have been circling Italian banks for years, trying to buy portfolios of bad loans. But there has been only a slow trickle of deals … the government guarantee could break this logjam…”

The debt being insured and gambled on mostly comprises commercial loans, including for building construction, farming and manufacturing, as well as mortgages. The real rot, i.e. derivatives, of which CDSs are an example, is not being addressed at all.

The Italy deal is acceptable to the EC because it is not “officially” a bail-out, as the value of the newly created CDS contracts will be set by prevailing market rates. When Italy launched a combined ‘Bail-in/bail-out’ operation to rescue four insolvent commercial banks in late November 2015, the EC demanded Italy cancel the bail-out portion of the operation, calling it “state aid” and a violation of EC rules.

The backlash against ‘Bail-in’—confiscation of deposits and investments over €100,000—in Italy has been immense. Tens of thousands of people lost their savings, and the suicide of a pensioner as a direct result of those losses has been heavily publicised. There have been public protests, and numerous high-level calls for resistance to the new EU ‘Bail-in’ regime, or at least its reform. Governor of the Bank of Italy Ignazio Visco called for a review of the ‘Bail-in’ rules in a speech at the 22nd Annual Congress of the Financial Markets Operators (Assiom Forex) in Turin on 30 January. He argued that ‘Bail-in’ should not be “retro-active”, and only owners of bonds who are aware they can be bailed in should be involved, not those who purchased bonds prior to the new rules coming into effect.

The head of the Italian Court of Auditors, Claudio De Rose, has spoken out saying that ‘Bail-in’ laws are unconstitutional. The Italian constitution declares that “The Republic encourages and safeguards savings in all forms.”

Prof. Paolo Savona, a former Italian cabinet minister who was for many years head of the Italian Interbanking Deposit Guarantee Fund, has called for a moratorium on the ‘Bail-in’ agreement in Italy. In an op-ed in the online Italian publication *Formiche* he demanded Italy set the conditions of its membership in the EU, or else hold a referendum on its continued participation in the grouping as the UK is doing.

In other developments on the ‘Bail-in’ front, Spain’s Bankia, touted to be next in line for another ‘Bail-in,’ is facing the consequences of a new court decision requiring it to pay back thousands of small investors after the bank’s 2011 stock market launch brochure was found to contain “serious inaccuracies” concerning the true state of its finances. The bank may be up for €819.2 million. (Bankia was created out of the merger of seven savings banks, all of which suffered big losses when the Spanish real estate bubble burst. It was taken over by the government at a cost of €22 billion in May 2012.)

Even Russia’s Finance Ministry is looking at the option of bailing in deposits of over 100 million roubles (around US$128,000), according to a 29 January Reuters wire. The Russian central bank just revoked the licence of a bank with many wealthy clients, Vneshprombank, due to an estimated 187.4 billion rouble hole in its balance sheet.

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