Systemically Relevant Banks in Italy

Master Thesis in Banking and Financial Services

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Abstract

Systemically important financial institutions are a crucial issue in the current financial stability debate. This contribution aims to identify domestic systemically important banks in the Italian banking sector. Adopting a modification of the indicator-based measurement approach developed by the Basel Committee on Banking Supervision, a representative sample of 14 major Italian banks is analyzed using year-end data of 2011. Generally, the obtained results show low levels of systemic importance for individual institutions. Regulatory measures are proposed in order to enhance the banking system's resilience to negative shocks and to give banks incentives to keep under control their systemic importance.

Executive Summary

Context

The recent global financial crisis has brought to the fore the issue of financial stability. In the light of past events, contagion risk has resulted to be one of the main concerns for national and international financial authorities. The failures of large, complex and interconnected financial institutions have strongly affected financial systems and real economies. In this context, tighter regulation and supervision of systemically important financial institutions (SIFIs) have increasingly become subject of discussion among academics and practitioners. The Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) have addressed particular attention to the risks and problems associated with these financial institutions as well as to the identification of global systemically important banks (G-SIBs). Recently, the assessment and measurement of systemic importance have also gained much relevance at domestic level. Some pilot studies in this area have begun to be carried out by relevant national authorities in order to identify domestic systemically important banks (D-SIBs).

Purpose and procedure

The main goal of this thesis is to assess the stability of the Italian banking sector through the identification of those banks which can be deemed systemically important from a domestic perspective and which thus tend to be subjected to government protection. Several contributions have dealt with the assessment and measurement of systemic importance. Basically, two main strands can be distinguished: the model-based approach and the indicator-based approach. Quantitative model-based methodologies rely on financial models and regression techniques to derive information from market data. In this regard, top-down and bottom-up measures have been developed according to different measurement concepts. Systemic excepted shortfall (SES) (Acharya et al. (2010)) and conditional value at risk (CoVaR) (Adrian and Brunnermeier (2011)) are the most prominent examples of these measures. By contrast, the indicator-based approach relies on bank-level data rather than market assessment. Due to its simplicity, transparency and robustness, this approach tends to be preferred for regulatory and supervisory purposes. The Basel Committee has developed an assessment methodology based on different dimensions of systemic importance and aimed at identifying G-SIBs (BCBS (2011)). Using year-end data of 2011, a modification of this methodology is applied to a representative sample of 14 major banks operating in Italy in order to determine D-SIBs. Three main dimensions of systemic importance are selected. Besides bank size, interconnectedness is used to capture the adverse effects of a financial institution's failure on the entire banking system while substitutability takes into account those on the national real economy. Two different weighting schemes for these dimensions are proposed: the BCBS original one (Scenario 1) and the modified one (Scenario 2), more oriented to consider the main features of the Italian banking sector.

Major findings

The issue of systemically important banks does not appear to be a major concern for Italian financial authorities. Independently from the scenario considered, the majority of the analyzed banks show total scores of systemic importance ranging from low to very low. Tighter supervision should be addressed to four banks (Intesa Sanpaolo spa, UniCredit spa, Cassa Depositi e Prestiti spa and Banca Monte dei Paschi di Siena spa) whose values are quite higher. The analysis clearly points out that systemic importance does not exclusively stem from large size, but interconnectedness and substitutability also play a crucial role in determining its magnitude. However, the effective extent of systemic importance of these banks results to be underestimated. Large banking groups and relative small banks characterize the Italian banking sector (De Bonis, Pozzolo and Stacchini (2012)). Therefore, the systemic importance of Italian banks is expected to be much higher in terms of banking groups, in particular for the two largest ones (UniCredit and Intesa Sanpaolo). The proposed regulation aims to enhance the banking system's resilience to negative shocks and to give banks incentives to keep under control their systemic importance. Additional capital in form of Common Equity Tier 1 (CET1) are required to all banks according to the extent of risk posed in the system. In this way, BCBS recommendations are taken into account and, simultaneously, no single institutions is explicitly labeled with the TBTF status, thus avoiding a potential moral hazard issue.