

**UPDATE 1-Monte Paschi wins approval for \$2.8 bln state bonds**

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* Wins extension on branch sale

* Boost Tier 1 ratio to 7.6 percent

MILAN, Dec 16 (Reuters) - Italian bank Monte dei Paschi di Siena won approval to use 1.9 billion euros (\$2.77 billion) of government-backed bonds to help shore up capital ratios as it delayed again an asset sale that would raise them.

Monte Paschi, the world's oldest bank, said in a statement on Wednesday the economy ministry had approved on Dec. 14 its subscription to the convertible bonds, adding that after their issue its Tier 1 ratio would be 7.6 percent and its total capital ratio would be 11.9 percent.

Italy's biggest banks, UniCredit and Intesa Sanpaolo, have snubbed the government-backed bonds in favour of their own measures to raise capital in order to avoid government demands on lending.

Conditions for Monte Paschi's government-backed bonds include a commitment to make an extra 10 billion euros per year available to small business and suspension of mortgage payments for 12 months for first-time buyers if requested.

Instead, UniCredit is asking investors to support a 4 billion euros rights issue while Intesa Sanpaolo has said it will sell non-core assets.

UniCredit had a Core Tier 1 ratio -- a key capital measure -- of 7.55 percent at the end of September while Intesa Sanpaolo's Core Tier 1 ratio stood at 7.2 percent then.

Italian banks have largely escaped the financial storms which have pushed major U.S. and European peers to ask governments for help because their business is focused on the conservative domestic lending market.

But tighter capital requirements worldwide are putting them under pressure to bring in extra capital.

Monte Paschi agreed to sell 50 branches to Intesa Sanpaolo earlier this week for 200 million euros, adding about 15 basis points to key capital ratios.

But it must sell another 85 branches in order to meet antitrust requirements stemming from its purchase of Antonveneta bank two years ago.

Its director-general Antonio Vigni said on Wednesday the antitrust authority had extended the deadline for it to complete this sale to Jan. 7.

Monte Paschi is in talks to sell the branches with British bank Barclays and French bank Credit Agricole's Cariparma unit. (Writing by Jo Winterbottom; Editing by Sharon Lindores) (\$1=.6864 Euro)

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