

# Identifying and Calculating Available Distributable Items (ADI)

## The Example of Italian Banks



As the Italian Additional Tier 1 market is set to grow in size, we take a closer look at an area which is often inadequately disclosed and at times insufficiently understood. The calculation of Available Distributable Items (ADI) – an important element in analysing the coupon payment risk of AT1 notes – involves a deep dive into parent company accounts and national legislation. This report tries to shed some light into the ADI of Italian banks. At this time, Scope does not rate AT1 securities issued by Italian banks.

The assessment of coupon risk forms a core part of our rating methodology for Additional Tier 1 (AT1) securities. The assessment is two-pronged: on the one hand, we look at the distance between banks' CET1 levels and their requirement, including buffers, which may cause banks to be limited, in their distributions, by the maximum distributable amount (MDA). On the other end, we look at the availability of distributable items to make the coupon payments.

While disclosure around capital and capital requirements is abundant, disclosure around distributable items is patchier. This is partly due to the fact that estimation of ADI involves an ad hoc analysis of national legislation to correctly identify and separate distributable from non-distributable reserves, a process that may require specific language or legal skills.

In Italy, for example, the task is somewhat facilitated by accounting principle OIC 28, which drives a good level of disclosure by the banks and allows investors to estimate the amount of reserves available for distribution, as well as evaluate their quality. Based on such disclosure, we estimate ADI for the rated Italian banks, Unicredit and Intesa, as well as for the other major Italian banks.

In general, we find that the availability of ADI should not be a factor that affects distributions, with few exceptions. Intesa (A-, Stable) and Unicredit (BBB+, Stable), which have already issued AT1 securities, have several billion euros each in Available Distributable Items.

Among other reserves, one important item considered available for distribution is the share premium reserve, albeit with some limitations. For example, the share premium reserve arising from business combinations is only distributable for the amount exceeding goodwill.

So far, only Intesa and Unicredit have issued CRD IV compliant AT1 securities. However, we would expect other banks to follow suit: filling the AT1 bucket (up to 1.5% of RWA recognised for prudential purposes) will become a more pressing need going forward as a way to help fulfill MREL levels.

In addition, we expect that the sale of bank bonds to retail customers will face increasing challenges, both from a regulatory and a reputational standpoint. This means institutional markets would have to absorb future supply. Given the bail-in-able status of senior bonds, this could lead to higher funding costs, especially for weaker credits, for which the possibility of senior bail-in is less remote. Building a regulatory bail-in-able buffer through subordinated securities would offer further protection to senior bondholders.

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### Available Distributable Items: regulatory definition

The concept of Available Distributable Items (ADI) is defined in the CRR (Art. 4.1-128) as “the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution’s by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statutes of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts”.

The definition therefore includes:

- Profit for the year (grossed up for any dividend payment)
- Profits carried over from previous years (net of losses carried over)
- Other distributable reserves

It is important to note that the calculation has to reference the issuing legal entity’s unconsolidated accounts and not be based on group consolidated accounts.

### Country-level specificities

While the accounting definition of profits and dividends is fairly straightforward, identifying what constitutes “distributable reserves” involves a deep dive into national legislation and, sometimes, company by-laws.

In Italy, limits to reserves distribution are established by the Civil Code. The following provisions cover the most common reserves and significant amounts in banks’ net equity:

- **Legal reserve.** The legal reserve constitutes a prime example of a non-distributable reserve. According to Art. 2430 of the Italian Civil Code, banks have to maintain a legal reserve of at least 20%<sup>1</sup> of capital;
- **Share premium account** (Art. 2431). The share premium account is distributable as long as the restriction on the legal reserve is fulfilled.
- **Own shares reserve.** Art. 2357-ter prescribes the creation and maintenance of a non-distributable reserve matching the value of own shares;
- The **revaluation reserve for stakes carried at equity** (Art. 2426.4) is also considered, in our view, to be non distributable;
- The **reserve for unrealised currency gains** (Art. 2426.8-bis) is explicitly characterised as non-distributable.
- In addition, whenever, for exceptional reasons, the accounts derogate from the provisions of the Civil Code (Art. 2423.4), any profits arising from the exception must be registered in a non-distributable reserve for such derogations.

The above list is not exhaustive and, as a matter of fact, there remains significant uncertainty with respect to the treatment of some reserves. One example is the treatment of the share premium account arising from business combinations. This is a significant amount for the large Italian banks, often arising from the mergers which led to groups like Unicredit/Capitalia or Intesa/Sanpaolo. At least for the part corresponding to acquired goodwill in share transactions, the distributability of the share premium account is questionable. Some banks’ disclosures explicitly point to such uncertainty and our

<sup>1</sup> For Popolari banks, the mandatory attribution to Legal reserve is 10%, according to art. 32 of legislative decree 385/1993. For cooperative banks, it is 70% (art. 37).

understanding is that they exclude from the calculation of ADI the part of the share premium related to goodwill arising from business combinations.

Another area of uncertainty relates to the treatment of negative items in shareholders' equity, for example, valuation reserves related to the defined-benefit-plan actuarial valuation. While it is clear that valuation reserves, when positive, are not available for distribution, some banks deduct the defined benefit reserve from their calculation of ADI when negative – given that it reduces total equity.

Some other reserves arising from specific laws in Italy (e.g. Law 72/1983 or Law 413/1991 on asset revaluation) are considered distributable, but only in the context of a capital reduction ex art 2445 of the Civil Code, which would have to be deliberated upon from an extraordinary shareholder meeting.

### Disclosure requirements: the “ABC disclosure”

Accounting principle OIC 28 requires banks to clearly state, in the notes to the net equity, the possible destination of reserves, including restrictions to distributions. Such a disclosure is an invaluable source of information to calculate banks' Available Distributable Items and evaluate their quality, and is compulsory in Italy due to art. 2427.7bis of the Civil Code.

It is important to stress the need to look at this disclosure for the legal entity issuing the capital securities, rather than the consolidated accounts at group level. For illustrative purposes, we have reproduced the ABC disclosure for Intesa and Unicredit in the Appendix.

The table clearly identifies and classifies reserves based on their availability for distribution, also providing useful footnotes explaining the assumptions and uncertainties related to particular items. The Appendix also shows how the table allows to estimate Available Distributable Items and to evaluate their quality.

### Available Distributable Items at Italian banks

Based on the above-mentioned disclosure tables, we have estimated distributable items for Intesa and Unicredit, as well as for other major Italian banks.

**Figure 1: Summary estimates of Available Distributable Items for Italian banks**

ADI estimates	Intesa	Unicredit	UBI	Mediobanca	BPM	BP
Distributable Reserves (parent)	24,597	18,820	5,964	3,935	125	1,498
Profit for the year (parent)	1,212	80	- 918	333	225	- 2,074
Total ADI	25,809	18,900	5,046	4,268	350	- 576

Source: Scope Ratings estimates, Annual Reports

The estimates are based on 2014 annual reports and, given the banks' profitability has generally improved in 2015, should be on the conservative side when looking at future distributions. For our detailed assumptions on the distributability of the various items, see Appendix on page 4

For Intesa, we note that in the AT1 offering document, the bank discloses ADI at around EUR 24bn, which is lower than Scope's calculation of EUR 26bn. Our understanding is the bank must have made some more conservative assumptions with respect to some of the reserves. It is worth highlighting that our calculation excludes part of the share premium account (EUR 2.34bn) related to the merger reserve. For Unicredit, we calculate ADI at EUR 18.9bn.

### Appendix: Rated banks' ABC disclosure and Scope's ADI estimate

**Intesa: we estimate ADI of EUR 26bn, higher than the figure the bank has announced**

In its September 2015 AT1 offering circular, Intesa discloses ADI at around EUR 23bn.

From the below table, it discloses the non-distributable portion of reserves at EUR 5.6bn, including a portion of the share premium account related to merger reserve, revaluation reserves and valuation reserves, among others.

**Figure 2: Net equity disclosure for Intesa Sanpaolo**

	Amount as at 31.12.2014	Principal	Portion of net income	Portion of net income subject to a suspended tax regime (a)	Portion available (b)	Uses in the past three years
(millions of euro)						
<b>Shareholders' equity</b>						
– Share capital	8,725	6,386	1,336	1,003	-	
– Share premium reserve (c)	27,508	11,689	15,372	447	A, B, C	9,123
– Legal reserve	1,710	465	1,245	-	A(1), B	
– Extraordinary reserve	774	45	729	-	A, B, C	4,494
– Concentration reserve (Law 218 of 30/7/1990, art. 7, par. 3)	232	-	-	232	A, B(2), C(3)	
– Concentration reserve (Law 218 of 30/7/1990, art. 7)	302	-	-	302	A, B(2), C(3)	
– Legal Reserve Branches abroad	14	-	14	-	A, B, C	
– Reserve for stock option plans	13	-	13	-	A	
– Oper. reserve under common control	61	-	61	-	A, B, C	
– FTA tax rate revision reserve on property	25	-	25	-	A, B, C	
– Other reserves	420	67	344	9	A, B, C	-
<b>Valuation reserves</b>						
– Revaluation reserve (Law 576 of 2/12/1975)	3	-	-	3	A, B(2), C(3)	
– Revaluation reserve (Law 72 of 19/3/1983)	143	-	-	143	A, B(2), C(3)	
– Revaluation reserve (Law 408 of 29/12/1990)	7	-	-	7	A, B(2), C(3)	
– Revaluation reserve (Law 413 of 30/12/1991)	379	-	-	379	A, B(2), C(3)	
– Revaluation reserve (Law 342 of 22/11/2000)	455	-	-	455	A, B(2), C(3)	
– AFS valuation reserve	224	-	224	-	(4)	
– CFH valuation reserve	-1,268	-	-1,268	-	(4)	
– Defined benefit plans valuation reserve	-540	-	-540	-	(4)	
– Treasury shares	-17	-17	-	-	-	
<b>Total Capital and Reserves</b>	<b>39,170</b>	<b>18,635</b>	<b>17,555</b>	<b>2,980</b>	<b>(5)</b>	
Non-distributable portion (d)	5,614	-	-	-	-	-

Source: Intesa Annual Report (Parent Company)

Based on this disclosure, and adding the parent company's net profit of EUR 1.2bn, we actually estimate ADI of EUR 26bn – higher than the amount announced by Intesa.

As one can see very quickly from the table above, the calculation of available distributable items at Intesa revolves around the key assumption on the distributability of the share premium reserve. A more detailed analysis of the disclosure, which we provide in Figure 3, allows us to make some considerations on the quality of Intesa's ADI.

Our understanding is that the share premium account is largely distributable, although we subtract EUR 35m – to supplement the legal reserve to reach 20% of share capital and EUR 2,340m which is related to a merger reserve.

Other non-distributable items include the legal reserve, revaluation reserves, the employee stock option plan (ESOP) reserve and part of the concentration reserve.

Valuation reserves (when positive) are also non-distributable. In our calculation of distributable items we deduct valuation reserves when these are negative (e.g. cash flow hedge reserve).

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Figure 3: Scope Ratings detailed analysis of Intesa's ADI

ADI - Intesa - 2014	EURm	ow distributable	Comment
<b>Net Equity:</b>	<b>39,170</b>		
Share capital	8,725	-	
Own shares/treasury shares	(17)	(17)	Negative items of shareholders' equity affect the availability and distributability of positive reserves of the shareholders equity.
Share premium reserve	27,508	25,128	Subtract 2340 due to merger reserve, 35 due to fulfilling 20% legal reserve requirement and 5 as per footnotes
<b>Reserves of profits:</b>			
Legal reserve	1,710	-	Not distributable
Legal reserve branches abroad	14	14	Distributable
Own shares reserve	-		
Statutory reserve	-		
Extraordinary reserve	774	774	Distributable
Reserve arising out of share swaps	-		
Reserve arising out of asset transfers	-		
Reserve arising out of split offs	-		
Unavailable reserve ex art. 6 D Lgs 38/2005	-		
Concentration reserve (Legge Amato 218/1990 art 7)	232	-	Distribution requires capital decrease - EGM
Concentration reserve (Legge Amato 218/1990 art 7.3)	302	-	Distribution requires capital decrease - EGM
Reserve for business combinations (IFRS3)	-		
Reserve for business combinations within the group	-		
Reserve for profit allocation via free shares (script dividend)	-		
Reserve for employee medium term plan	-		
Reserve for employee stock option plans (ESOP)	13	-	Not distributable
Oper. reserve under common control	61	61	Distributable
FTA tax rate revision reserve on property	25	25	Distributable
Merger surplus/deficit reserve	-		
Art. 22 D Lgs 153/1999	-		
Repurchase of treasury shares	-		
Art 13.6 D Lgs 124/93	-		
Reserve act. health policy	-		
Reserve for valuation of equity accounted entities	-		
Reserve for reversal of prior year D&A	-		
Reserve for supplementary pension reform	-		
Other reserves of profits or retained earnings	-		
Other reserves	420	420	Distributable
Negative components of shareholders' equity	-		
<b>Valuation Reserves:</b>			
Monetary equalisation 576/75	3		Distribution requires capital decrease - EGM
Monetary revaluation 72/83	143		Distribution requires capital decrease - EGM
Asset revaluation 408/90	7		Distribution requires capital decrease - EGM
Property revaluation 413/91	379		Distribution requires capital decrease - EGM
Asset revaluation 342/2000 art 14	455		Distribution requires capital decrease - EGM
Revaluation reserve 350/2003	-		
AFS reserve	224		When positive, is not available (art 6 of Legislative Decree 38/2005.)
Fair value reserve for adoption of FV accounting	-		
Cash flow hedges	(1,268)	(1,268)	Negative items of shareholders' equity affect the availability and distributability of positive reserves of the shareholders equity.
Actuarial reserves (defined benefit plans valuation)	(540)	(540)	Negative items of shareholders' equity affect the availability and distributability of positive reserves of the shareholders equity.
Other valuation reserves			
<b>Distributable reserves</b>		<b>24,597</b>	
(+) Parent net income		1,212	
<b>Total ADI</b>		<b>25,809</b>	

Source: Scope Ratings estimates

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### Unicredit: ample distributable items

To our knowledge, Unicredit has not disclosed its Available Distributable Items estimate. However, the net equity disclosure of the parent company's unconsolidated accounts points to EUR 19.6bn of available distributable reserves at the parent company level, which offers ample comfort that ADI should not be a limiting factor in the payment of AT1 coupons.

**Figure 4: Net equity disclosure for Unicredit**

#### Breakdown of Shareholders' equity (with indication of availability for distribution)

ITEMS	AMOUNT	PERMITTED USES (*)	AVAILABLE PORTION	SUMMARY OF USE IN THE THREE PREVIOUS FISCAL YEARS	
				TO COVER LOSSES	OTHER REASONS
Share capital	19,905,774	-	-		
Share premium	15,976,604	A, B, C (1) (2)	15,976,604	14,351,334	6,495,276
Reserves:	9,323,078				
legal reserve	4,050,666	B (3)	4,050,666		
reserve for treasury shares or interests	2,440	-	-		
statutory reserves	1,195,845	A, B, C (4)	1,195,845	-	
reserves arising out of share swaps	511,210	A, B, C	511,210		
reserves arising out of transfer of assets	477,090	A, B, C (5)	477,090		
reserves arising out of split-offs	15,672	A, B, C	15,672		
reserves related to the medium-term incentive programme for Group staff	108,038	- (6)	-		35,326 (15)
reserve related to equity-settled plans	419,268	-	-		
reserve related to business combinations (IFRS 3)	2,118,624	A, B, C (7)	2,118,624		
reserve related to business combinations within the Group	254,619	A, B, C (8)	254,619	3,818,208	512,535 (16)
reserve for allocating profits to Shareholders through the issuance of new free shares	794,796	A, B, C (9)	794,796	-	399,166 (17)
reserve pursuant to art. 6, paragraph 2 Legislative Decree 38/2005	11,913	B (10)	11,913		
Other reserves	45,307	A, B, C (11)	45,307	-	
Negative components of Shareholders' equity	(682,410)	(12)	(682,410)		
Revaluation reserves	1,001,110				
monetary equalisation reserve under L. 5/76/75	4,087	A, B, C (13)	4,087		
monetary revaluation reserve under L. 72/83	84,658	A, B, C (13)	84,658		
asset revaluation reserve under L. 408/90	28,965	A, B, C (13)	28,965		
property revaluation reserve under L. 413/91	159,310	A, B, C (13)	159,310		
Available-for-sale financial assets	753,563	- (14)	-		
Cash-flow hedges	238,916	- (14)	-		
Reserve for actuarial gains (losses) on employee defined benefit plans	(268,389)	-	-		
<b>Total</b>	<b>46,206,566</b>		<b>25,046,956</b>		
Portion not allowed in distribution (**)			5,485,536		
Remaining portion available for distribution (***)			19,581,420		

Source: Intesa Annual Report (Parent Company)

Figure 5 overleaf offers more details on the different items, to help gauge the quality of the reported distributable items as well as our assumptions with regards to distributability.

As in the case of Intesa, we note how the share premium reserve comprises a large portion of Unicredit's ADI. From it we deduct EUR 691m related to goodwill arising from the Capitalia acquisition.

It is worth noting that our calculation is slightly lower than the bank's, as we prudently exclude from our ADI estimate those reserves for which a shareholder deliberation would be needed.

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Figure 5: Scope Ratings detailed analysis of Unicredit's ADI

ADI - Unicredit - 2014	EURm	ow distributable	Comment
<b>Net Equity:</b>	<b>46,207</b>		
Share capital	19,906	-	
Own shares/treasury shares	2	-	Non distributable
Share premium reserve	15,977	15,286	EUR691 m non distributable as arising from capital's acquisition. Legal reserve exceeds 20% so no further deduction.
<b>Reserves of profits:</b>			
<b>Legal reserve</b>	<b>4,051</b>	<b>-</b>	<b>Not distributable</b>
Legal reserve branches abroad			
Own shares reserve			
Statutory reserve	1,198	1,198	Distributable
Extraordinary reserve			
Reserve arising out of share swaps	511,210	511	Distributable
Reserve arising out of asset transfers	477	262	Remaining EUR 215 m would require capital decrease
Reserve arising out of split off	15,672	16	Distributable
Unavailable reserve ex art. 6 D.Lgs 38/2005	12	-	Not distributable
Concentration reserve (Legge Amato 218/1990 art.7)			
Concentration reserve (Legge Amato 218/1990 art.7.3)			
Reserve for business combinations (IFRS3)	2,118,624	1,406	Partly distributable
Reserve for business combinations within the group	255	255	Distributable
Reserve for profit allocation via free shares (scrip dividend)	795	795	Distributable
Reserve for employee medium term plan	108	-	Could be rendered distributable via a shareholder meeting
Reserve for employee stock option plans (ESOP)	419	-	Not distributable
Oper. reserve under common control			
FTA tax rate revision reserve on property			
Merger surplus/deficit reserve			
Art. 22 D.Lgs 153/1999			
Repurchase of treasury shares			
Art. 13.6 D.Lgs 124/93			
Reserve act. health policy			
Reserve for valuation of equity accounted entities			
Reserve for reversal of prior year D&A			
Reserve for supplementary pension reform			
Other reserves of profits or retained earnings			
Other reserves	45	45	Distributable
Negative components of shareholders' equity	(682)	(682)	Negative items of shareholders' equity affect the availability and distributability of positive reserves of the shareholders equity.
<b>Valuation Reserves:</b>			
Monetary equalisation 576/75	4		Distribution requires capital decrease - EGM
Monetary revaluation 72/83	85		Distribution requires capital decrease - EGM
Asset revaluation 408/90	29		Distribution requires capital decrease - EGM
Property revaluation 413/91	159		Distribution requires capital decrease - EGM
Asset revaluation 34/2000 art.14			
Revaluation reserve 35/0/2003			
AFS reserve	754		When positive, is not available (art.6 of Legislative Decree 38/2005.)
Fair value reserve for adoption of FV accounting			
Cash flow hedges	239		When positive, is not available (art.6 of Legislative Decree 38/2005.)
Actuarial reserves (defined benefit plans valuation)	(268)	(268)	Negative items of shareholders' equity affect the availability and distributability of positive reserves of the shareholders equity.
Other valuation reserves			
<b>Distributable reserves</b>		<b>18,820</b>	
<b>(+) Parent net income</b>		<b>80</b>	
<b>Total ADI</b>		<b>18,900</b>	

Source: Scope Ratings estimates





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