The Crisis Management of Smaller Banks: Perspectives of Reform

by

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The current common framework for bank crisis management and national deposit guarantee schemes (CMDI) is tailored for banks which are considered too big (or too complex) to fail. Smaller banks are de facto excluded from the application of resolution, even though they are obliged to contribute to its functioning. In practice, not even the size element has been decisive and the crises of significant as well as less significant institutions have been managed at the national level instead of within the framework and conditions foreseen by the BRRD. The consequent and persistent fragmentation in the European financial market requires that the dichotomy between resolution and liquidation be overcome and that the scope of resolution also include smaller banks. The paper analyses the main reforms needed to achieve this goal, including the European Commission's recent proposal to revise the CMDI.

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1. Introduction

In June 2022, the Eurogroup published a declaration on the future of the Banking Union (BU). The document shows, on the one hand, the permanent lack of consensus on the implementation of the third pillar, i.e., the creation of the European Deposit Guarantee Scheme (EDIS). On the other hand, it indicates the need to strengthen "the common framework for bank crisis management and national deposit guarantee schemes (CMDI)" by 2024, through the adoption of regulatory measures that: 1) clarify and standardise the "public interest assessment" (PIA); 2) extend the application of the resolution tools, at the European and national levels, by including small and medium-sized banks in the scope of the resolution tool; 3) further harmonise the regulation of deposit guarantee schemes (DGSs) so as to ensure that the bank's exit from the market still preserves the value of assets while, at the same time, safeguarding a harmonised regulation of the least cost test (LCT), which allows the use of DGS's financial means for interventions other than deposit pay-out; and 4) harmonise the key rules of national insolvency regimes in order to ensure "consistency with the principles of the European CMDI framework". Finally, the statement welcomes the European Commission's launch of a review[1] of the 2013 Communication on State Aid to Banks in Crisis (BC2013).[2] The Communication was in fact introduced before the creation of the Single Resolution Mechanism (SRM) and therefore needs to be revised to guarantee consistency between the state aid framework and the renewed CMDI.

With regard to the need for action in the areas outlined by the Eurogroup, there is common consensus at the European level,[3] as evidenced by the Commission's publication, on 18 April 2023, of a proposal[4] for a revision of the

1 *European Commission*, "Evaluation of State aid rules for banks in difficulty", March 2022, at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13324-State-aid-rules-for-banks-in-difficulty-evaluation/F_en. The Commission has also previously launched a consultation on the revision of the CMDI: European Commission, *Review of the Crisis Management and Deposit Insurance Framework*, February 2021, at https://ec.europa.eu/info/files/2021-crisis-management-deposit-insurance-review-consultation-document_en.

2 Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), [2013] OJ C 216, 1-15.

3 V. *European Commission*, "Summary report of the Public and Targeted consultations on the review of the Crisis Management and Deposit Insurance (CMDI) framework Q1-2021", 7 July 2021, 3 ff.; *European Parliament resolution of 5 July 2022 on Banking Union – annual report 2021*, 2021/2184(INI), 14; *Statement of the Euro Summit, meeting in inclusive format*, Brussels, EURO 502/23, 24 March 2023.

4 *European Commission*, "Reform of bank crisis management and deposit insurance framework", 18 April 2023, at https://finance.ec.europa.eu/publications/reform-bank-crisis-management-and-deposit-insurance-framework_en. For a comment on the proposal,

Bank Recovery and Resolution Directive (BRRD),[5] the related Regulation (SRMR)[6] and the Directive on deposit guarantee schemes (DGSD).[7] The main aspects of the proposal (and of the Eurogroup's statement, as well) relate to the crisis management of smaller banks. These are the institutions which were most affected by the crises that occurred after the creation of the BU[8] and, therefore, those that experienced the greatest difficulties in applying the current regulatory framework.

The inefficiency of the CMDI is essentially due to three main factors: 1) the coexistence of a common resolution mechanism with numerous and heterogeneous national (substantive and procedural) insolvency rules that apply when the public interest requirement, within the European dimension, does not exist; 2) the rigidity of the conditions of access to resolution (Article 32, BRRD), and its internal (Articles 44(5)(a); 12d(2), SRMR) and external (Articles 44(3) and 109, BRRD) financing; and 3) the highly restrictive approach of the Single Resolution Board (SRB), which can be summarised in the well-known phrase of the former President, "resolution is for the few, not the many".[9] In essence, beyond the permanent problem of the harmonisation of bank insolvency law, the current regulatory framework, which imposes conditions that only significant banks are able to comply with, only works to remedy the problem of banks which are too big (or too complex) to fail. Smaller banks, theoretically

see *Christos V. Gortsos*, "A reform of the CMDI framework that supports completion of the Banking Union", Study Requested by the ECON Committee, PE 741.493, May 2023, 10ff.; *José Colino Mediavilla*, "The reform proposal for the European bank crisis management and deposit insurance regime: the issue of medium-sized and small banks", 10 Journal of Insolvency & Restructuring, July 2023, 189ff.

5 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations No 1093/2010/EU and No 648/2012/EU, of the European Parliament and of the Council, [2014] OJ L173/190.

6 Regulation 806/2014/EU of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation 1093/2010/EU, [2014] OJ L225/1.

7 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, [2014] OJ L 173/149.

8 See the resolution and liquidation cases notified to the European Banking Authority (EBA) at https://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/notifications-on-resolution-cases-and-use-of-dgs-funds (last accessed: 26 July 2023).

9 *Elke König*, "Completing the crisis management framework: a centralised administrative liquidation tool for banks", April 2020, at *srb.europa.eu/en/node/972* (last accessed: 26 July 2023).

posing no risk to financial stability,[10] are *de facto* excluded from the application of resolution, even though they are required to contribute to its functioning.

In practice, however, not even the size element has been pivotal. Resolution, in fact, has had a limited application. The crises of significant banks,[11] as well as of less significant ones,[12] have been managed at the national level and therefore outside the scope and conditions foreseen by the BRRD.[13] Thus, while the objective of the BU was to contribute to the creation of a single market for financial services, the first years of the application of Pillar II demonstrate the existence of persistent fragmentation.[14]

The suggestion of this paper is that, for the CMDI to be effectively applied, the scope of resolution must be extended to include smaller banks.[15] To validate this idea, the notion of a smaller bank will first be identified (§ 2), followed by a high-

10 See on this point *Luigi Scipione*, "Aiuti di stato e crisi bancarie", Turin, 2021, 72.

11 I refer to the crises of the Veneto banks and the Norddeutsche Landesbank; the former was subject to orderly liquidation, by means of state aid (see paras. 66–67, BC2013); the latter, a public bank, was recapitalised, with the approval of the European Commission (*Market-conform measures for strengthening capital and restructuring of Norddeutsche Landesbank*, 5 December 2019, SA. 49094 (2019/N) by the shareholders (led by the government of Lower Saxony) and the Sparkassen Group. On the management of these crises, see *Irene Mecatti,* "Deposit guarantee schemes and bank crisis management: legal challenges arising from the European legal framework", Rivista italiana di diritto pubblico comunitario, 2022, 755.

12 See the summary reported by *Fernando Restoy/Rastko Vrbaski/Ruth Walters*, "Bank failure management in the European banking union: What's wrong and how to fix it", in Banca d'Italia, The crisis management framework for banks in the EU. How can we deal with the crisis of small and medium-sized banks?, Rome, 2021, 38. Within the Italian system, we can recall: Banca Tercas (2015), Banca Popolare delle Province Calabre (2016), Banca Sviluppo Economico (2018), Banca del Ficino (2019), Banca Carige (2019), Banca Popolare di Bari (2020) and Aigis Banca (2021). The crises of these intermediaries were managed by one of the Italian DGS (FITD) and by the Bank of Italy outside of the BRRD, but applying the BC2013. On the crisis of Banca Carige, see *European Commission*, State Aid SA.52917 (2019/N) – Italy – Liquidity support to Banca Carige – Cassa di Risparmio di Genova e Imperia, Brussels, 18 January 2019, C(2019) 554 final; *Cristina Sofia Pacheco Dias/Jerome Jan Philippe Deslandes/Marcel Magnus*, "Recent measures for Banca Carige from a BRRD and State Aid perspective", Directorate-General for Internal Policies, PE 624.413, February 2019, 3 ff.

13 See, *infra*, §§ 4 and 7.

14 In this sense, see *Thorsten Beck/Jan Pieter Krahnen/Philippe Martin/Franz Mayer, Jean Pisani-Ferry/Tobias H. Tröger/Beatrice Weder di Mauro/Nicolas Véron/Jeromin Zettelmeyer*, "Completing the banking union: Economic requirements and legal conditions", CEPR Policy Insight no. 119, October 2022, 7.

15 In this sense *Elke König*, "Speech at the ECON Committee", 13 July 2022, at https://www.srb.europa.eu/en/content/srb-chair-elke-konig-speech-econ-committee (last acce ssed: 25 July 2023).

light of the underlying reasons for the relevance of this type of intermediary in the real economy (§ 3); and an analysis of the specific areas of the CMDI that should be subject to reform to the extent that smaller banks are to be subject to resolution, such as the notion of public interest and resolution financing mechanisms (§§ 4–6). I will conclude with some policy suggestions.

2. *Size Requirements and Resolution*

The BRRD and the SRMR do not provide a definition for "smaller bank". An explicit reference to this category can be found in the European prudential supervisory framework, which defines the small and non-complex institution, as opposed to the large one,[16] according to a series of parameters (size, interconnectedness, economic importance, complexity and risk profile) the most relevant of which is its amount of assets (€5 billion or less).[17] In the context of the CMDI, the distinction between significant (SIs) and less significant institutions (LSIs) (Article 7 SRMR), which is taken up by the Single Supervisory Mechanism (SSM), is relevant in defining the scope of competences between the SRB and the national resolution authorities.[18] Even in this case, significance

16 See Article 4(1) (146), Regulation 575/2013/EU on prudential requirements for credit institutions and investment firms (CRR) as amended by Regulation 2019/876/EU (CRR2): "'large institution' means an institution that meets any of the following conditions: (a) it is a G-SII; (b) it has been identified as other systemically important institution (O-SII) in accordance with Article 131(1) and (3) of Directive 2013/36/EU; (c) it is, in the Member State in which it is established, one of the three largest institutions in terms of total value of assets; (d) the total value of its assets on an individual basis or, where applicable, on the basis of its consolidated situation in accordance with this Regulation and Directive 2013/36/EU is equal to or greater than EUR 30 billion".

17 See Article 4(1) (145) CRR. The European system, as well as those of the United States and Hong Kong, establish tailored criteria for the application of specific requirements (disclosure, liquidity ratio, large exposure limits, etc.) for a subset of prudential standards, according to a specific standard approach to proportionality, SSAP (see *Ana Paula Castro Carvalho/Stefan Hohl/Roland Raskopf/Sabrina Ruhnaup*, "Proportionality in banking regulation: a cross-country comparison", FSI Insights on policy implementation No 15, August 2017, 5 and 13 ff.; *Bart Joosen/Marco Lamandini/Matthias Lehmann/Kitty Lieverse/Ignacio Tirado*, "Stability, Flexibility and Proportionality: Towards a Two-Tiered European Banking Law?", 21 February 2018, European Banking Institute Working Paper Series 2018 No 20, 3 ss., at SSRN: https://ssrn.com/abstract=3128304 or http://dx.doi.org/10.2139/ssrn.3128304 (last accessed: 22 July 2023); *Raihan Zamil*, "Proportionality in banking regulation: who, what and how?", SUERF Policy Briefs No 147, August 2021, 3).

18 In substance, resolution can apply regardless of whether the requirements of "significance" are met, with the difference that for SIs the SRB will be competent, whilst for LSIs, the national resolution authority will be in charge.

is related to the same criteria as above, with the particularity that those institutions which received public financial assistance directed by the European Financial Stability Facility or the European Stability Mechanism *shall not* be considered less significant.[19]

In essence, the current regulatory framework, in classifying banking intermediaries, values size, operational complexity and/or systemic relevance. However, the first application of the CMDI has shown that these parameters are not sufficient to identify *ex ante* and apply *ex post* the best crisis management strategy, i.e., the choice between resolution (and concomitant preparation of the relative plan) or liquidation.

Ex ante. It is well known that banks are required to hold a Minimum Requirement of Eligible Liabilities (MREL),[20] specifically intended to absorb losses and restore capital requirements. MREL levels are calibrated in a way that, according to the strategy indicated in the resolution plan, allows either the orderly liquidation of the failing bank (loss absorption amount), or its recapitali-

19 Article 6(4) of Regulation 1024/2013/EU (SSMR): "a credit institution or financial holding company or mixed financial holding company shall not be considered less significant, unless justified by particular circumstances to be specified in the methodology, if any of the following conditions are met: (i) the total value of its assets exceeds EUR 30 billion; (ii) the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below EUR 5 billion; (iii) following a notification by its national competent authority that it considers such an institution of significant relevance with regard to the domestic economy, the ECB takes a decision confirming such significance following a comprehensive assessment by the ECB, including a balance-sheet assessment, of that credit institution. The ECB may also, on its own initiative, consider an institution to be of significant relevance where it has established banking subsidiaries in more than one participating Member State and its cross-border assets or liabilities represent a significant part of its total assets or liabilities subject to the conditions laid down in the methodology. Those for which public financial assistance has been requested or received directly from the EFSF or the ESM shall not be considered less significant. Notwithstanding the previous subparagraphs, the ECB shall carry out the tasks conferred on it by this Regulation in respect of the three most significant credit institutions in each of the participating Member States, unless justified by particular circumstances".

20 See Articles 45 ff., BRRD. On the MREL, see for all *Tobias H. Tröger*, "Qualitative capital requirements and their relationship with MREL/TLAC", in *Bart Joosen/Marco Lamandini/Tobias H. Tröger* (eds.), Capital and Liquidity Requirements for European Banks, Oxford, 2022, 111 ff.; *Iacopo Donati/Lorenzo Stanghellini*, "Il principio di proporzionalità nell'ambito del SRM: la prospettiva italiana", in *Mario Chiti/Vittorio Santoro* (eds.), Il diritto bancario europeo, Pisa, 2022, 117 ff.; *Irene Mecatti/Tobias H. Tröger*, "Who should hold bail-inable debt and how can regulators police holding restrictions effectively?", in *Rivista italiana di diritto pubblico comunitario*, 2023, 106 ff.

zation (recapitalization amount).[21] In performing this calibration, the resolution authority (RA) must consider, *inter alia*, "the business model, funding model and risk profile of the institution".[22] These latter elements may be independent of the bank's significance but relate to the actual activity carried out, which in turn affects the risk profiles. This approach is consistent with the fact that resolution applies to all banks, regardless of size and complexity.[23]

Up to this point, the current regime appears correct and proportional,[24] as the setting of the MREL seems 'adaptable' to the characteristics of the bank. In reality, the calibration of MRELs is ostensibly adjustable for two reasons. First, the current framework grants wide discretionary powers to the RA, the exercise of which incidentally led to the judicial challenge of an MREL decision in the light of the principle of proportionality, in so far as the SRB failed to take into account the effect of resolution on the size and business model of the bank in question.[25] Second, it is envisaged that institutions aiming to access external financing arrangements or to resort to government funds must hold relevant capital instruments and other liabilities subject to bail-in of at least 8% of total liabilities, including their own funds (TLOF).[26] In other words, if they want to guarantee themselves the use of the resolution funds, all banks, irrespective of size, must build up a level of MREL to ensure the 8% TLOF requirement.[27]

This threshold is, however, difficult for smaller banks to meet, as they generally have a traditional business model based, in terms of funding, on deposits.[28]

21 Article 45c(3), BRRD.
22 Article 12d (1)(d), SRMR.
23 See *Elke König*, "The crisis management framework for banks in the EU: what can be done with small and medium-sized banks?", in *Banca d'Italia*, The crisis management framework for banks in the EU. How can we deal with the crisis of small and medium-sized banks?, Rome, 2021, 136. See also fn. 18 above.
24 As regards the principle of proportionality within the SRM, see *Iacopo Donati*, "La gestione delle crisi bancarie: verso una maggiore (e desiderabile) proporzionalità, in *Banca, impresa e società*, 2023, 215 ff.
25 See the case *BNP Paribas v. SRB* (T-71/2022), where the bank contested the SRB's decision on the resolution plan and the related decision on the MREL requirement.
26 See Articles 37(10)(a), 44(5)(a)(b), 45d, and 56(1), BRRD; Article 12d(4), SRMR.
27 In any event, resolution funding may not exceed 5% of such liabilities. See on this point *Iacopo Donati* (fn. 24), 335 ff.
28 See *European Central Bank*, "Contribution to the European Commission's targeted consultation on the review of the crisis management and deposit insurance framework", May 2021, https://www.ecb.europa.eu/pub/pdf/other/ecb.consultation_on_crisis_management_deposit_insurance_202105~98c4301b09.en.pdf, 9: "the current resolution framework may not be suitable for banks which are heavily reliant on deposits as a source of funding"; "Opinion of the European Central Bank of 5 July 2023 on amendments to the Union crisis management and deposit insurance framework", (CON/2023/19), 10.

Since these intermediaries have difficulty accessing the market at sustainable rates,[29] they find it challenging to issue and place sufficient MREL instruments[30] and, in the past, they did so to the detriment of their customers through the unfair practice of mis-selling.[31] It is true that recent reforms have imposed stringent conditions on the placement of MREL claims with retail customers.[32] However, such limitations – appreciable from the point of view of preventing mis-selling practices – have further aggravated the difficulties for smaller banks to comply with the TLOF requirement. According to recent studies,[33] banks

29 See *Ioannis G. Asimakopoulos*, "Self-placement. Mitigating the silo effects between banking regulation and investor protection rules", in *Katalin Ligeti/Kei Hannah Brodersen* (eds.), Study of Enforcement in Multilevel Regulatory Systems, Baden-Baden, 2022, 270; *Ignazio Visco*, "Indirizzi di salute del Governatore della Banca d'Italia", in *Banca d'Italia*, Le crisi bancarie: risoluzione, liquidazione e prospettive di riforma alla luce dell'esperienza spagnola e italiana, Quaderni di Ricerca Giuridica della Consulenza legale, No 5, April 2023, 13.

30 V. *Francisco Sotelo*, "A proposal to fund crisis management in deposit taking institutions", in *Banca d'Italia*, The crisis management framework for banks in the EU. How can we deal with the crisis of small and medium-sized banks?, cit., 143; *Fernando Restoy/Rastko Vrbaski/Ruth Walters*, "Bank failure management in the European banking union: What's wrong and how to fix it", 15 FSI Occasional Papers, June 2020, 13 ff.; *Iacopo Donati* (fn. 24), 337.

31 As it happened in Italy: see *Irene Mecatti/Tobias H. Tröger* (fn. 20), 101 ff.; *Tatiana Farina, Jan Peter Krahnen/Irene Mecatti/Loriana Pellizzon/Jonas Schlegel/Tobias H. Tröger*, "Is there a 'retail challenge' to banks' resolvability? What do we know about the holders of bail-inable securities in the Banking Union?", SAFE White Paper No 92, 2022, 10 ff.; on the issue of mis-selling that has emerged following the recent banking crises, see *Pierre-Henri Conac*, "Mis-selling of Financial Products Subordinated Debt and Self-placement", Study Requested by the ECON Committee, PE 618.994, June 2018, 25.

32 I refer to Article 44a BRRD on the retail sale of subordinated liabilities, implemented in an even more restrictive manner in Italian law by Article 12-*ter*, T.U.B. The regulation provides for a minimum nominal amount, not only for second-tier unsecured instruments (senior non-preferred), as required by the BRRD, but also for subordinated bonds and subordinated debt securities issued by a bank, equal to at least €150,000 for the former and € 200,000 for the latter liabilities. On this discipline, see *Iacopo Donati/Lorenzo Stanghellini* (fn. 20), 121; *Iacopo Donati*, "Le discutibili scelte italiane per a patrimonializzazione delle banche: i limiti alla commercializzazione delle pretese MREL dopo il recepimento della BRRD2", Rivista italiana di diritto pubblico comunitario, 2022, 691 ff.; *Irene Mecatti/Tobias H. Tröger* (fn.20), 111 ff.

33 *European Banking Authority*, "Call of advice regarding funding in resolution and insolvency", EBA/REP/2021/31, 39 and 41; see also the Explanatory Memorandum to the EC proposal for amending the BRRD of 18 April 2023, 15 and slide No 15 of Technical presentation by Directorate General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) on the review of the CMDI framework, available at https://finance.ec.europa.eu/publications/reform-bank-crisis-management-and-deposit-insurance-framework_en (last accessed: 15 October 2023); moreover see *Single*

with traditional funding will have to apply the bail-in even to unprotected deposits to reach the 8% TLOF or, in particularly adverse scenarios, may not even be able to meet this requirement, thus jeopardising their ability to access external resources to manage resolution. Such aspects, which have nothing to do with the size, complexity or systemic characteristics of the bank (probably absent in the case of a smaller one), should also necessarily be considered *ex ante* in the choice between resolution or liquidation.

Ex post. When the bank is declared to be failing or at risk of failing (FOLTF) under Article 32(4), BRRD,[34] the current parameters of significance may become irrelevant. Consider, for example, the case of a SI that, as a result of public support over time, has reduced its presence in the territory as a condition, imposed by the European Commission, for the aid. The impact of the crisis on the real economy may in fact be less significant than that foreseen at the time the resolution plan was prepared, resulting in the disappearance of the public interest (in its European dimension) and the intermediary in question being subjected to liquidation.

Moreover, even the crisis of a medium-sized bank can pose serious problems for financial stability.[35] In fact, an intermediary with a large amount of deposits tied up in long-term investments is more exposed to the risk of a bank run with all its consequences in terms of contagion and its impact on financial stability.[36]

Resolution Board, "Report on Small and medium-sized banks: resolution planning and crisis management report for less significant institutions in 2022 and 2023", October 2023, 23.

34 To this regard, the EC proposed to amend Article 18(1), SRMR, to clarify the division of tasks between the ECB and the NCAs on the FOLTF assessment, by specifying that this must be performed by the ECB for SIs and by the National Resolution Authorities for LSIs, after having consulted the SRB.

35 See the considerations of *Olina Capolino*, "Prevenzione e gestione delle crisi nell'ordinamento italiano", in Le crisi bancarie: risoluzione, liquidazione e prospettive di riforma alla luce dell'esperienza spagnola e italiana. Atti del convegno Banca d'Italia, Rome, 21 October 2022, Quaderni di ricerca giuridica della Banca d'Italia, No 95, Rome, 2023, 57 ff.

36 The case of the Silicon Valley Banks is emblematic in this respect. This bank collapsed due to a massive run by corporate depositors. The danger arising from the bank run, prompted the US authorities to guarantee the above-threshold depositors (250,000.00 dollars), in order to protect "the U.S. economy by strengthening public confidence in our banking system» (Joint Statement by Treasury, Federal Reserve and FDIC, 13 March 2023, at https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312b.htm). Moreover, to prevent contagion effects, the FED sets up a Bank Term Funding Program (BTFP) to provide liquidity at par to U.S. depository institutions for up to one year. On these crisis see *Federal Reserve*, "Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank", 28 April 2023, 93 ff., at https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf (last accessed:

In addition, the factor of interconnectedness by means of participation in Institutional Protection Schemes (IPSs), cooperative structures, mutual liability agreements and cross shareholdings, may enhance the riskiness of even smaller institutions.[37]

In the situations just outlined, however, insolvency proceedings, at least in the form of piecemeal liquidations, are not always a viable alternative, as they do not guarantee "sufficient speed of intervention, the continuation of the institutions' essential functions, and the maintenance of financial stability".[38] It was no accident that the Veneto banks, for which the public interest in resolution was deemed to be absent, were liquidated by means of a major public intervention.[39]

The relevance of the business model chosen by the bank has been indirectly reaffirmed by the EBA, which has recently identified two criteria to classify banks as "large", "medium" and "small and not complex":[40] the size/complexity (according to the criteria identified above) and the bank's funding arrangements, more specifically the size of (unprotected) deposits. The EBA defines smaller banks as those that have assets of less than €30 billion and rely on (unprotected) deposits for TLOF purposes according to the following criteria:

Table 1: Depositor-reliance classification

Deposit-reliance Deposits/TLOF (%)
Low 0-60
Mid 60s-70s
Mid-high 70–80
High >80

Source EBA 2021

15 November 2023); *Florian Heider/Jan Pieter Krahnen/Loriana Pelizzon/Jonas Schlegel/Tobias H. Tröger*, "European lessons from Silicon Valley Bank resolution: A plea for a comprehensive demand deposit protection scheme (CDDPS)", SAFE Policy Letter No 98, 2023, 3; *Mathias Dewatripont/Peter Praet/André Sapir*, "The Silicon Valley Bank collapse: Prudential regulation lessons for Europe and the world", 20 March 2023, at VoxEU.org; *Enrico Pierotti*, "Learning from Silicon Valley Bank's uninsured deposit run", 5 May 2023, at VoxEU.org. (last accessed 22 July 2023); *Elisabetta Montanaro*, "Brevi riflessioni sul fallimento della Silicon Valley Bank", Ianus, 26/2022, 103 ff.

37 *Bart Joosen/ Marco Lamandini/Matthias Lehmann/Kitty Lieverse/Ignacio Tirado* (fn. 17), 21.

38 Recital 4, BRRD.

39 See, *infra*, § 4.

40 *European Banking Authority* (fn. 33), 19 ff.

In essence, the smaller bank may be significant or less significant, and has a business model primarily based, in terms of funding, on retail deposits.[41] This characteristic implies that smaller banks are supposed to rely on unprotected deposits in order to meet the TLOF requirement, as they are not able to place a sufficient level of other liabilities on the market, among those subject to bail-in.

3. *Smaller Banks and Economic and Operational Efficiency*

It is necessary to remark on the importance of smaller banks and the reasons (*rectius* the public interest) behind the need to extend resolution to them.

The global financial crisis of 2007-2008 pushed the European and national legal systems towards an increase in bank size. This trend was also incentivised by technological change, the efficient management of which is economically viable mainly for the largest intermediaries.[42] Between 2014 and 2021, at the European level – and considerably in Germany, Austria and Italy – the number of non-significant banks decreased by more than a thousand.[43] In Italy alone – where this effect has been stimulated by the reform of the cooperative banks -[44] in the last ten years,[45] the number of

41 See also *European Central Bank*, "LSI supervision report 2022", December 2022, 3, where it is noted that "deposits from households represent the key funding source for LSIs at around 45% of total liabilities (including equity)".

42 In this sense, see the study by *Davide Arnaudo/Silvia Del Prete/Cristina Demma/Marco Manile/Andrea Orame/Marcello Pagnini/Carlotta Rossi/Paola Rossi/Giovanni Soggia*, "The digital transformation in the Italian banking sector", *Banca d'Italia*, Questioni di Economia e Finanza, No 682, April 2022, 10.

43 *European Central Bank* (fn. 41), 3.

44 The reform of cooperative credit took place with Law Decree n. 18 of 14 February 2016, converted by Law n. 49 of 8 April 2016. Following the reform, as many as 228 Italian cooperative credit banks (BCCs) have become part of cooperative banking groups, qualified as SIs. The reform pursued the objectives of stability, efficiency and competitiveness of the cooperative banking sector, trying not sacrifice (more than necessary) the mutualist and localist identity of BCCs.

45 *Federazione autonoma bancari italiani*, "La desertificazione bancaria: più di 4 milioni di italiani senza banca", August 2022, at https://www.fabi.it/2022/08/12/la-desertificazione-bancaria-piu-di-4-milioni-di-italiani-senza-banca/ (last accessed: 26 July 2023); *Banca d'Italia*, "Banche e istituzioni finanziarie: articolazione territoriale", 31 March 2022, https://www.bancaditalia.it/pubblicazioni/banche-istfin/2022-banche-istfin/statistiche_STAATER_20220331.pdf (lasta accessed: 26 July 2023): *Ead.*, "Banks and Financial Institutions: Territorial Articulation", 31 March 2023, https://www.bancaditalia.it/pubblicazioni/banche-istfin/2023-banche-istfin/statistiche_STAATER_20230331.pdf. See also the data processing carried out by Firstcisl's Observatory on banking desertification, March 2023 (at https://www.firstcisl.it/osservatorio-dese

banking intermediaries has decreased by 73.6% and one branch in three has closed.[46]

The trend towards concentration in the banking system, although supported by reasons of stability maintenance and increased profitability,[47] has important negative externalities. First, even if we do not want to consider the frequent failure of merger projects (one need only think of the MPS-Banca Antonveneta merger),[48] the presence in the banking system of only (or predominantly) large institutions, strongly interconnected and with extremely complex business models, gives rise to systemic banks that are too big to fail,[49] whose rescue can

rtificazione-bancaria/ last accessed: 26 July 2023), from which it emerges that around 4 million people in Italy live in a municipality where there is no bank branch.

46 Between the end of 2019 and 2022 alone, the number of non-significant intermediaries fell from 131 to 119, including the 39 banks belonging to the only Italian Institutional Protection Scheme (IPS) (Raiffeisen Südtirol IPS). On the latter data, see *Giuseppe Siani*, "Il sistema delle Less Significant Institutions (LSI): profili di rischio e priorità di vigilanza", 13 March 2023, 1, at https://www.bancaditalia.it/pubblicazioni/interventi-vari/int-var-2023/SIANI-16.03.2023.pdf (last accesed: 26 July 2023), who notes that some marginal intermediaries have exited the market or have been acquired by other, more solid players; others have radically transformed their business model; the cases of new entrants to the sector are limited.

47 *Allen N. Berger/Rebecca S. Demsetz/Philip E. Strahan*, "The consolidation of the financial services industry: Causes, consequences, and implications for the future", 23 Journal of Banking & Finance, Issue 2-4, 1999, 135 ff.; *Dario Focarelli/Fabio Panetta/Carmelo Salleo*, "Why Do Banks Merge?", 34 Journal of Money, Credit and Banking, No 4, 2002, 1047 ff.; *Sam Langfield/Marco Pagano*, "Bank Bias in Europe: Effects on Systemic Risk and Growth", CSEF Working Papers 408, Centre for Studies in Economics and Finance (CSEF), University of Naples, Italy, 2015, 6; *Isabel Figueiras/Sándor Gardó/Maciej Grodzicki/Benjamin Klaus/Laura Lebastard/Barbara Meller/Wouter Wakker,* "Bank mergers and acquisitions in the euro area: drivers and implications for bank performance", ECB Financial Stability Review, 2021, 118 ff.

48 On the evolution of the MPS crisis, see *Commissione parlamentare di inchiesta sul sistema bancario e finanziario*, "Relazione conclusiva", 30 January 2018, Doc. XXIII No. 37, 17, at https://www.senato.it/service/PDF/PDFServer/BGT/1066723.pdf (last accessed: 24 July 2023), where it is stated that the merger "was initiated and carried out without prior due diligence, justifiable only with a view to an acquisition deemed almost obligatory for the strengthening on the domestic market characterised in those years by mergers and acquisitions of competing banking groups. This circumstance, moreover, does not mitigate the singularity of the procedure, given the economic importance of the transaction and the price set to complete it: a price that turned out, among other things, to be much higher than the real value of the Bank subsequently acquired". [The English translation is by the Author.]

49 *Luc Laeven/Lev Ratnovski/Hui Tong*, "Bank Size and Systemic Risk", IMF Staff Discussion Note SDN/14/04, May 2014, 11 ff.; see also *Ivan Gržeta/Saša Žiković/Ivana Tomas Žiković*, "Size matters: analyzing bank profitability and efficiency under the

only be achieved through public intervention. Therefore, if the aim of SRM is to prevent the cost of crises from being borne by taxpayers, ironically the drive towards concentration may lead precisely to this unwanted effect. Secondly, smaller banks, having more direct contact with the local economies, allow for banking and financial services to be within everyone's reach (even those unfamiliar with fintech)[50] and above all are better able to know and support the local economy than large banks, and in particular small and medium-sized enterprises.[51] Thirdly and most importantly, the recent Silicon Valley Bank (SVB) crisis demonstrated that a limited territorial network may not allow for an adequate fractioning of retail market deposits, thus exposing the intermediary to the bank run of large uncovered depositors.[52] In other words, reduced branch density, combined with the growth of deposits in the largest banks, can cause bank runs in the event of crisis.[53]

The survival and efficient functioning of the fragile banking ecosystem is therefore closely linked to the presence of heterogeneous intermediaries in terms of size, ownership structure and business model.[54] For these reasons, similar to that which happens in the U.S. with reference to *community banks*,[55] (although

Basel III framework", 9 Financial Innovation, 43, 2023, https://doi.org/10.1186/s40854-022-00412-y last accessed 26 July 2023.

50 The closure of branches (also stimulated by the development of fintech) leads to greater difficulties and costs in accessing credit: see *Davide Arnaudo et al.* (fn. 42), 17; on the impact of branch closures on the cost of loans, see the interesting study by *Diana Bonfim/Gil Nogueira/Steven Ongena*, "'Sorry, We're Closed' Bank Branch Closures, Loan Pricing, and Information Asymmetries", *Review of Finance*, 2021, 121 ff.

51 *Marco Onado,* "Proporzionalità va cercando che è si cara...Dalla riforma italiana delle banche popolari alla questione delle banche locali, oggi", Mercato, concorrenza e regole, 2021, 137. On the close links between regional banks and SMEs, see *Rainer Masera*, "Towards Basel 4: critical issues for banks and the economy", Bancaria, 2016, 11; *Iconio Garrì*, "The effects of bank branch closures on credit relationships", in *Banca d'Italia*, Temi di discussione, No 1254, 2019, 18 ff.

52 The SVB, despite being the 16th largest bank in the US, had only 17 branches. SVB had very concentrated by sector and unsecured wholesale deposits. See on this point, *Elisabetta Montanaro* (fn. 36), 106.

53 On the correlation between the reduction of branch density and bank runs see *Efraim Benmelech/Jun Yang/ Michal Zator*, "Bank Branch Density and Bank Run", National Bureau of Economic Research Working Paper No 31462, July 2023, 3 ff. at http://www.nber.org/papers/w31462 (last accessed: 22 July 2023). Also the European banks are expe riencing a deposit growth (see *European Banking Authorithy*, "Funding plans report", September 2022, EBA/Rep/2022/19, 22).

54 *Andrew G. Haldane/Robert M. May*, "Systemic risk in banking ecosystems", Nature, 2011, 355.

55 *Marco Onado* (fn. 51), 136. According to the FDIC, community banks are those banks that make "loans, fund those loans by taking retail deposits, and operate primarily within a delimited community" and have "less than $10 billion in assets" ("*FDIC Commu-*

under different market conditions), the role of smaller banks must be taken into account. In this respect, the link with local economies and the accentuated operations in the retail deposit collection sector may mean that liquidation according to ordinary insolvency proceedings is *not* – based on the philosophy of the BRRD – always the optimal solution.

4. *The Public Interest Assessment: the Case of the Veneto Banks*

For a bank to be subject to resolution, there, without regard to its size, must be a "public interest". This requirement exists when resolution "is necessary for the achievement of and is proportionate to one or more of the resolution objectives referred to in Article 31 and winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent".[56]

The objectives of resolution are, in order of priority:[57] to ensure the continuity of critical functions,[58] to avoid significant adverse effects on financial stability, to safeguard public funds, and to protect depositors' and clients' funds and assets.[59] The assessment of the impact of the crisis on these objectives is the responsibility of the SRB[60] or the national RA, according to the division of

nity Banking Study", 20121-1; "*FDIC Community Banking Study*", 2020, appendix A). On the role of community banks, see *Nguyen T. H. Nguyen/James R. Barth*, "Community Banks vs. Non-Community Banks: Where is the Advantage in Local Small Business Funding?", 48 Atlantic Economic Journal, 2020, 161 ff.; *Stefan Jacewitz*, "The Increasing Brick-and-Mortar Efficiency of Community Banks", 107 Economic Review, 2022, 19 ff.

56 Articles 32(1)(c) and (5), BRRD.

57 In this sense *Vittorio Santoro*, "Prevenzione e "risoluzione" della crisi delle banche", in Persona e attività economica tra libertà e regola. Studi dedicati a Diego Corapi, Naples, 2016, 2611.

58 Critical functions are defined in Article 2(1)(35) BRRD, as "activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations".

59 Article 31(2), BRRD.

60 The SRB has outlined its policy on this issue: "Public Interest assessment: SRB approach", 2019; *Id.*, "Addendum to the Public Interest Assessment: SRB Approach", 2021; *Id.*, "Addendum to the Public Interest Assessment – Deposit Guarantee Schemes Considerations", 2022, at https://www.srb.europa.eu/en/content/public-interest-assessment-0.

competences indicated above.[61] It should be noted, however, that since the SRB is a European agency, in application of the Meroni doctrine,[62] the discretionary aspects of the resolution decision are left to the European Commission.[63]

As already mentioned, the SRB has adopted a restrictive approach in ascertaining the public interest, placing only two banks in resolution so far.[64] One of the most relevant cases in terms of the exclusion of resolution is that of Banca Popolare di Vicenza s.p.a. and Veneto Banca s.p.a. For both, during the adoption of the resolution plan (December 2016), the application of national insolvency procedure was excluded due to the "potential adverse impact of liquidation of the Group on market confidence and the risk of contagion to other credit institutions".[65] Resolution was therefore considered the most suitable solution to manage the potential crisis of the two Veneto-based intermediaries. A few months later (in June 2017), following the FOLTF assessment by the European Central Bank,[66] the SRB instead ruled out the application of the resolution, for the following reasons:

a) over time, the two banks had significantly reduced their market share, no longer meeting the size requirements to qualify as significant. This, in turn, had led to a substantial migration of customers to other intermediaries, both in terms of funding and lending. Since the two institutions did not carry out activities or provide services "the discontinuance of which would be likely to lead to: (i) the disruption of services that are essential to the real economy of Italy and / or (ii) the disruption of financial stability in

61 See, *supra*, § 2.

62 This is, as is well known, the so-called 'non-delegability' theory, according to which European agencies, as administrations not established and regulated in the Treaties, cannot be holders of regulatory powers. On the Meroni doctrine and its evolution see, for all, *Filippo Annunziata*, "The Remains of the Day: EU Financial Agencies, Soft Law and the Relics of Meroni", Riv. it. dir. pubbl. com., 2022, 331 ff.

63 See Article 18(7) SRMR which provides for the communication of the resolution plan to the Commission, which is given a general power of objection.

64 At the EU level, only Banco Popular Español S.A. (Banco Popular) in 2017 and the Croatian and Slovenian branches of Sberbank Europe AG in 2022 were subject to resolution (see decisions at *srb.europa.eu/en/cases*).

65 *Single Resolution Board*, "Decision concerning the assessment of the conditions for resolution in respect of Banca Popolare di Vicenza S.p.A.", SRB/EES/2017/12, 23 June 2017, 4; *Id*., "Decision concerning the assessment of the conditions for resolution in respect of Veneto Banca S.p.A.", SRB/EES/2017/1, 23 June 2017, 5.

66 The two assessments can be found at https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170623.en.html.

Italy", there was no need to ensure the continuity of essential functions (Article 31(2)(a), BRRD);[67]

b) for the same reasons, the liquidation of the banks would not lead to significant adverse effects on financial stability (Article 31(2)(b), BRRD) at the national level. However, the SRB did not exclude that adverse effects could occur at the local level, with reference to retail customers and small and medium-sized enterprises (SMEs);[68]

c) there was no need to protect public funds (Article 31(2)(c), BRRD), because the repayment of deposits in insolvency proceedings did not qualify as extraordinary public support (para. 63, BC2013);

d) depositors and investors would in any case have found protection in insolvency procedures, even more if the sale of the bank business to a third party (foreseen in the Italian bank insolvency regime) had been implemented in those proceedings.

For the above reasons, the SRB indicated liquidation as the best solution for managing the Veneto banks' crisis. It is known, however, that the two intermediaries were not subjected to the Italian "liquidazione coatta amministrativa" (l.c.a.), as per Articles 80ff., T.U.B., but at the request of the Italian State, a specific 'orderly' liquidation procedure was provided for[69] supported by so-called 'liquidation aid'.[70] The intervention of the State was approved by the Commission pursuant to Article 107(3)(b), TFEU and BC20123 (para. 6),[71] as

67 "Essential functions" are defined as 'activities, services or operations the disruption of which would be likely to lead, in one or more Member States, to the interruption of services that are essential to the real economy or would be likely to jeopardise financial stability because of the size, market share, external and internal interconnections, complexity or cross-border activities of an institution or group, in particular with regard to the substitutability of those activities, services or operations' (Article 2(35), BRRD).

68 *Single Resolution Board* (fn. 65), 16; *Id*. (fn. 65), 15.

69 The reference is to Law Decree of 25 June 2017, n. 99 (in G.U. n. 146, 25 June 2017), later converted into Law of 31 July 2017, n. 121 (in G.U. No. 184, 8 August 2017). On the crisis of the Veneto banks see *Beinot Mesnard/Alienore Anne C. Margerit/Marcel Magnus*, "The orderly liquidation of Veneto Banca and Banca Popolare di Vicenza. Briefing", 6 July 2017, PE 602.094; *Irene Mecatti*, "La responsabilità della banca cessionaria nell'ambito della l.c.a. delle banche venete per le pretese risarcitorie degli azionisti e restitutorie dei creditori della banca cedente", Banca, borsa e tit. cred., 2019, II, 778; *Marco Ventoruzzo/Giulio Sandrelli*, "Oh Tell me the Truth about Bail-in", 190 Business, Enterpreneurship & the Law, 2019, 293ff.; *Irene Mecatti/Tobias H. Tröger* (fn.20), 104.

70 See paras. 65–78, BC2013.

71 *European Commission*, State Aid SA. 45664 (2017/N) – Italy – *Orderly liquidation of Banca Popolare di Vicenza and Veneto Banca – Liquidation aid*, Brussels, 25 June 2017 C(2017) 4501 final.

an atomistic liquidation would have entailed "a serious disturbance in the economy in the areas where VB and BPVI operate with a particular impact on interruption of SME's business activities and lending to households".[72]

The case is peculiar in two respects. First of all, the public interest disappeared within a few months: it was there at the time (December 2016) of the SRB's adoption of the resolution plan (otherwise the insolvency management strategy would have been the l.c.a), but was *de facto* absent at the time the banks were declared FOLTF (June 2017). It is true that the BRRD expressly provides that the RA's assessment may change over time[73] and that, as stated by the SRB, the plan was based on data from 2015.[74] However, in the case of the Veneto banks, most of the events which gave rise to the crisis occurred between 2012 and 2016.[75] In essence, whilst the FOLTF can materialise even in the short term (think of a sudden bank run), the public interest, in the present case, should not have changed much, given that the events that affected the "significance" had already occurred before the adoption of the resolution plan. On the other hand, although the preliminary PIA must be adapted to the time when the FOLTF occurs, the resolution decision "builds upon the outcome of the public interest assessment performed in the planning phase and follows similar steps".[76] In essence, there must be, unless there are proven reasons, a correspondence between the preliminary PIA and that to be made at the time of the

72 *European Commission*, *Ibidem*, 19.

73 Article 10(6), BRRD provides that the resolution plan must be reviewed and, where appropriate, updated, "at least annually and following material changes in the legal or organisational structure of the institution, its business or its financial situation that may materially affect the effectiveness of the plan or otherwise necessitate a revision of the resolution plan". The rule is important because it allows the RA to have an operational and swiftly enforceable plan, and the bank's creditors to monitor the bank and know *ex ante*, or at least predict, the fate of their investment or claim in the event of resolution.

74 See *supra*, fn. 68.

75 See data reported by European Commission (fn. 68), 5; the document explicitly states that "Table 2 shows the trend of BPVi's continuously deteriorating financial performance since 2012. BPVi has been loss making for the last four years. The losses in the last three years were particularly high. In 2016, BPVI was barely able to cover its operating costs from its operating income, leading to a negligible pre-provisioning profit". See *European Central Bank*, "'Failing or Likely to Fail' Assessment of Banca Popolare di Vicenza Società per Azioni", 23 June 2017, 2; Ead., "'Failing or Likely to Fail' Assessment of Veneto Banca Società per Azioni", 23 June 2017, 2-3.

76 *Single Resolution Board* (fn. 60). 13. On this point, see Marcello Clarich, "Presupposti per la risoluzione e interesse pubblico nella gestione delle crisi bancarie", in Le crisi bancarie: risoluzione, liquidazione e prospettive di riforma alla luce dell'esperienza spagnola e italiana. Atti del convegno Banca d'Italia, Rome, 21 October 2022, Quaderni di ricerca giuridica della Banca d'Italia No. 95, Rome, 2023, 114.

FOLTF. The SRB's change of position does not appear to have been adequately motivated in this respect.

The second peculiarity of the management of the Veneto banks' crisis can be found in the European Commission's authorisation of liquidation aid, both because it is based on the same elements for which the SRB excluded the public interest, and because it comes from an institution closely (and previously) involved in the decision-making process related to the resolution.[77] Basically, two different notions of public interest have emerged from the case, coming from two EU institutions,[78] with the particularity that while the SRB made its consideration within the European dimension, the Commission emphasised the impact of the crisis (*serious disturbance*) on the national and local economy.[79]

Such an approach is not, in principle, incorrect: the assessment of the public interest for the purposes of resolution does not coincide with, and should not influence, that of the existence of the conditions for state aid under Article 107 TFEU. According to the current rules, the SRB should carry out a weighing of the resolution objectives in the interest of the European Union. Such balance is, on the other hand, extraneous to the Commission, which authorises aid if it is necessary to "remedy a serious disturbance in the economy of a Member State" (Article 107(3)(b), TFEU), and thus with the aim of safeguarding the financial stability of that particular system.[80] Liquidation aid, specifically, should ensure that the bank's market exit process "takes place in an orderly manner so as to safeguard financial stability".[81]

In a nutshell, an analysis of the reasons underlying the two assessments shows that they are in fact both based on the same elements, and there is no valid reason to consider that those elements do not (or do, depending on one's point of view) constitute the public interest for the purposes of resolution, but may

77 See above fn. 63. The Commission then has specific powers regarding the assessment of possible state aid granted in the context of resolution (Articles 37(10), 56–58, BRRD; 19 SRMR) or outside resolution (Article 32(4)(d) BRRD), exclusion of certain liabilities from bail-in (Article 44(12), BRRD).

78 *Marco Ventoruzzo/Giulio Sandrelli* (fn. 69), 76 ff.; "Q&A with Andrea Enria of European Banking Authority", Politico Europe, 7 April 2017; *Seraina Grünewald*, "Legal challenges of bail-in", Shaping a new legal order for Europe: a tale of crises and opportunities, ECB Legal Conference 2017, 4–5 September 2017, 300. In essence, there is a dual dimension of public interest, one at the European level and the other at the national or regional level (thus, *Phedon Nicolaides*, "State aid after the Banking Union: serious disturbance and public interest", 23 Journal of Banking Regulation, 2021, 79 ff.).

79 *European Commission*(fn. 71), para. 48.

80 See paras. 7-11 BC2013.

81 See para. 65 BC2013.

constitute the public interest for State aid purposes. One of two things must be true: either the public interest did not exist in December 2016, or the reasons given by the SRB do not constitute reasonable grounds for holding that it did not exist in June 2017.

One might ask why, in view of the obvious contradictions in the two decisions, they were not appealed. This can be explained if one considers the procedural and substantive framework of the SRM. As to the procedural aspects, the rules governing SRB decisions may give, albeit indirectly, precedence to national interests, particularly when the resolution cannot be managed without the use of the Single Resolution Fund (SRF).[82] From a substantive point of view, it must then be considered that the BRRD, in addition to imposing the 8% TLOF as a condition for access to external resources,[83] provides for the application of the bail-in (Article 43), which, as is well known, is much broader in scope than the burden-sharing required by the State aid rules.[84] In the case of the Veneto banks, and in the light of what had already happened following the write-down of the subordinated bondholders of the so-called four banks (Banca Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, CariChieti),[85] the application of the bail-in would have been problematic,[86] due to the proven mis-selling perpetrated against retail in-

82 See on this point *Tobias H. Tröger/Anastasia Kotovskaia*, "National interests and supranational resolution in the European banking union", 34 European Business Law Review, 2023, 787 f. They point out that the division of competences between plenary and executive sessions, as well as the role of the Council in the resolution process, give national legal systems decisive power especially when it comes to the use of SRF resources; consequently "It would be irrational if the SRB in its executive session proposed a resolution scheme involving a significant SRF contribution if it already foresaw that the required approval of the plenary session could not be achieved" (p. 790).

83 See, *supra*, § 2.

84 While burden sharing in the area of State aid (para. 6.2.3, BC2013) only involves capital instruments (i.e. core equity tier 1 (CET1), additional tier 1 (AT1) and tier 2 (T2) instruments) that meet the qualitative capital requirements as set out in the CRR (Articles 26–50, 51–61 and 62–71, CRR) and the related Level 2 regulation, the bail-in tool can cover all liabilities of the bank that are not expressly excluded from loss absorption (Article 44 (1)), BRRD). On this distinction *see Irene Mecatti/Tobias H. Tröger* (fn. 20), 95 f.

85 On the crisis of the four banks, see *Camera dei Deputati, Sesta Commissione Finanze, Indagine conoscitiva sul sistema bancario italiano*, "Audizione del Capo del Dipartimento Vigilanza Bancaria e Finanziaria Banca d'Italia", 2015, 6 at www.bancaditalia.it/pubblicazioni/interventi-vari/int-var-2015/Barbagallo-09122015.pdf (last accessed: 22 July 2023); *Giuseppe Santoni*, "Tre interrogativi sull'operazione di salvataggio delle quattro banche", Riv. dir. banc., 2016, 1 ff.; *Irene Mecatti/Tobias H. Tröger* (fn. 20), 101.

86 A recent study demonstrates that the bail-in could be effective in managing bank distress, only if is additionally combined with other resolution measures like the bad bank: *Aneta Hryckiewicz/Natalia Kryg/Dimitrios P. Tsomocos*, "Bank Resolution Mechan-

vestors.[87] In substance, the current CMDI approach pushes and, in a sense, favours national crisis management (with State aid) over the application of resolution.[88]

5. Public Interest and Resolution of Smaller Banks

Broadening the scope of the resolution is therefore a *condicio sine qua non* for the proper functioning and, above all, for the concrete application of the CMDI. This solution requires, for the reasons just stated, the reform of the PIA. However, before addressing this matter, I would like to point out that the issue of public interest should not only be looked at from the perspective of including smaller banks in the resolution, but also and above all from the viewpoint of making resolution the preferable[89] and a non-negotiable choice (at FOLTF time) over liquidation. Unfortunately, the complexity and randomness of the current regime does not provide legal certainty regarding how the crisis will be managed and, as a result, deactivates the market discipline which should derive from predictable private sector involvement. In other words, if the bank is meant to be resolved, with all the consequences in terms of MREL according to the resolution strategy, investors will be able *ex ante* to assess what kind of relationship they want to enter into or maintain with the intermediary in light of the applicable resolution tool. Since the MREL calibration mechanism is so complex that it does not in itself guarantee an accurate risk assessment of investors,[90] it is crucial to know in advance at least if the resolution or liquidation will be applied, which means clarifying whether or not the public interest exists *(preliminary PIA*). In this sense, the parameters (bank size, market share, etc.) above which resolution should *a priori* under-

isms Revisited: Towards a New Era of Restructuring", Journal of Financial Stability, (pre-proof), 13 July 2023, 7 ff., at https://www.sciencedirect.com/science/article/abs/pii/S157230892300058X?via%3Dihub (last accessed: 24 July 2023).

87 In this sense, see see *Beinot Mesnard/Alienore Anne C. Margerit/Marcel Magnus* (fn. 69), 6; *Ioannis G. Asimakopoulos*, "The Veneto Banks Resolution: It Shall Be Called 'Liquidation'", 15 *European Company Law Journal*, No 5, 2018, 158.

88 In this sense see also *Michael Schillig*, "EU bank insolvency law harmonization: what next?", in Banca d'Italia, The crisis management framework for banks in the EU. How can we deal with the crisis of small and medium-sized banks?, Rome, 2021, 64 ff.

89 On this point, see § 7.

90 On the importance of risk-adequate pricing of bank capital in the perspective of resolution, see *Tobias H. Tröger*, "Why MREL won't help much: minimum requirements for bail-in capital as an insufficient remedy for defunct private sector involvement under the European bank resolution framework", 21 Journal of Banking Regulation, 2020, 71 ff.

stood to be in the public interest should be specified.[91] Such thresholds would deliver predictability in the treatment of the failing bank and further develop the playing field in the BU.

It has been held that this solution would introduce a strong "presumption of public interest for all banks"[92], whilst the conditions of the resolution may vary over time. However, in order to lessen the chance of a "false positive", the RA could maintain a margin of discretion to manage the specific case and have the option of justifying the absence of public interest. In any case, the RA should avoid completely distorting the plan[93] or even, as was the case with the Veneto banks, opting for liquidation over resolution without a justified reason. Otherwise, the function, the value and the costs of the resolution planning activities as a whole could be called into question, especially for smaller banks which are more prone to a change of strategy in terms of replacing resolution with liquidation.[94] To this end, the resolution plan (and the PIA, accordingly) should be reviewed more frequently and be based on updated in-

91 In the sense of identifying precise parameters, see *Rosa María Lastra/Costanza A. Russo/Marco Bodellini*, "Stock take of the SRB's activities over the past years: What to improve and focus on?", Economic Governance Support Unit (EGOV), Directorate-General for Internal Policies of the Union, PE 634.392, March 2019, 11 ff.

92 *Kai Gereon Spitzer/Kristina Gricaitė/Marcel Magnus*, "To resolve, or not to resolve a bank? Options for framing bank resolution vs. insolvency", Economic Governance and EMU Scrutiny Unit (EGOV), PE 741.496, February 2023, 9.

93 As the SRB did in the Sberbank Europe AG case (*Single Resolution Board*, "Assessment of the Conditions for Resolution in Respect of Sberbank Europe AG" (SRB/EES/2022/19), 21 March 2022, available at https://www.srb.europa.eu/system/files/media/document/2022-06-10_SRB-Non-confidential-version-of-the-decision-in-respect-of-Sberbank-Europe-AG.pdf, last accessed: 24 July 2023). The European Parliament press brie fing to the ECON meeting on 13 July 2022 alighted that the implemented *ex post* re solution strategy completely deviated from the *ex ante* resolution plan, according to which "applying national insolvency proceedings to the Institution was not considered credible", – though this is what actually happened – and "it was considered unlikely that the subsidiaries could survive a sudden separation from their Austrian parent due to the ir high degree of dependence to the Institution", while in fact five subsidiaries of the group found buyers and continued their operations, despite the short timeline of eve nts. The resolution plan hence expected to see the application of bail-in at the level of the group, which de facto did not happen either" (*Marcel Magnus/Cristina Sofia Dias/Kristina Grigaitė* "Public hearing with Elke König, Chair of the Single Resolution Board", PE 699.515, July 2022, 3 ff., available at https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/699515/IPOL_BRI(2022)699515_EN.pdf: last accessed: 24 July 2023). On this case, see *Leonhard Riebl*, "Resolution planning framework constraints: An analysis based on the Sberbank Europe AG resolution case", 15 *Journal of Securities Operations & Custody*, No 2, 2023, 154 ff.

94 In this sense see *Leonhard Riebl* (fn. 93), 160.

formation, as already provided for by the Commission Implementing Regulation (EU) 2021/763.[95]

Coming to the extension of the scope of the resolution to smaller banks, a key point is the definition of "critical functions" (Article 2(1)(35) BRRD). The Veneto banks cases have made it clear that size is not a decisive parameter for the purposes of excluding the public interest. In fact, the interruption of the bank's "essential functions" could give rise to financial instability and have very serious repercussions on the financial system and on other interests worthy of protection involved in the banking activity (e.g. the effects of the sudden withdrawal of credit facilities on companies and households), also if the bank operates at the regional or local level.[96] Moreover, the strict approach of the BRRD contrasts with the more flexible liquidation aid discipline which does not provide guidelines on how the local effect of liquidation (serious disturbance) should be valued. The BC2013 leaves room for governments to effectively reinstall at the regional/local level the public interest that the SRB denied at the national/European level.[97] To prevent these shortfalls, the RA should have the discretion to apply resolution also to banks that do not meet the size thresholds[98] when the interruption of the critical functions is not only relevant in the national dimension, but also at the regional or local level. The proposed reform of the BRRD on this point is to be welcomed.[99]

95 See Articles 3 ff., in OJ L 168, 12.5.2021, 1–83. Recital 10 provides that "the date of application of MREL disclosure obligations should coincide with the end of the transition period pursuant to the third subparagraph of Article 45m(1) of Directive 2014/59/EU, i.e. on 1 January 2024 at the earliest". The SRB is pushing towards more systematic reporting of the data needed to update the resolution plan ("Guidance on the Liability Data Report", 11 January 2023, at https://www.srb.europa.eu/en/content/2023-resolution-reporting#timeline-for-the-2023-resolution-reporting-data-collection-process) (last accessed: 22 July 2023).

96 The Commission (see, *supra*, fn. 4) proposed to amend Article 2(35) BRRD in the following terms: "'critical functions' means activities, services or operations the discontinuance of which is likely in one or more Member States to lead to the disruption of services that are essential to the real economy or to disrupt financial stability at national or regional level, due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations".

97 In this sense see also *Eurofi*, "Medium sized bank resolution: challenges and tools", Policy note, September 2019, 2.

98 See *Kai Gereon Spitzer/Kristina Gricaitè/Marcel Magnus* (fn. 92), 9.

99 The Commission proposed to amend Article 2(35) BRRD in the following terms: "'critical functions' means activities, services or operations the discontinuance of which is likely in one or more Member States to lead to the disruption of services that are essential to the real economy or to disrupt financial stability at national or regional level, due to the size, market share, external and internal interconnectedness, complexity or cross-

The Commission also suggests amending the resolution objectives provided for in Article 31(2) (c) "to protect public funds by minimising reliance on extraordinary public financial support" and (d) "to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC". As regards the first, the current framework does not differentiate between the use of Member States' resources and the use of industry-funded safety nets (national resolution funds, SRF, DGSs). This lack of diversification is challenging, as seen in the well-known Tercas case, when the Commission qualified as State aid the preventive measures of the Italian Fondo Interbancario di garanzia dei depositi (FITD), even though the DGS was a private body financed exclusively by the banking system.[100] The Commission proposal requires that the assessment of whether the resolution of an institution or entity is in the public interest should also reflect the difference between funding arising from private sector safety arrangements,[101] on the one side, and resources provided by Member States from taxpayers' money, on the other. This goal should be achieved by the new wording of Article 31(2)(c), BRRD where it states that the resolution objective in question aims at protecting public funds by minimising reliance on such support, "in particular when provided from the budget of a Member State". Although this clarification is important, it would be better to exclude from the scope of State aid the resources (and thus control over interventions) of resolution funds (both national and the SRF) and DGSs. In fact, the new Article 31(2)(c), BRRD combined with the proposed new Article 32c, is difficult to apply as it requires a dialogue with the European Commission on a case-by-case basis to verify whether or not the intervention of the relevant funds constitutes State aid, which is paradoxical, especially with regard to the SRF which, apart from being imposed by Union law, is managed by an agency of the Union and not by a "State".

border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations".

100 *European Commission*, State aid SA.39451 (2015/C) (ex 2015/NN) State support to Banca Tercas Italy [2015] OJ C 136/17; *General Court*, Joined Cases T-98/16, T-196/16 and T-198/16 Italian Republic and Others v European Commission, ECLI:EU:T:2019:167; *European Court of Justice*, Case C-425/19 P, Commission v Italy, Banca Popolare di Bari (formerly Tercas Bank) and others, EU:C:2021:154. On the Tercas case, see *Irene Mecatti*, "The Role of Deposit Guarantee Schemes in Preventing and Managing Banking Crises: Governance and Least Cost Principle, European Company and Financial Market Law Review", 2020, 657 ff.; *Marco Bodellini*, "The Optional Measures of Deposit Guarantee Schemes: Towards a New Bank Crisis Paradigm?", 13(1) EJLS, June 2021, 365; *Irene Mecatti* (fn. 11), 755.

101 Both the BRRD (recital 55) and article 19(1) SRMR, equate the DGSs and resolution funds interventions as regards the application of the State aid rules; see also recitals 3 and 6, DGSD; paras. 63–64, BC2013.

Regarding to the second resolution objective, Article 31(2)(d), BRRD), provides that resolution should protect depositors "while minimising losses for deposit guarantee schemes"; hence, resolution shall be favoured if insolvency would be more expensive for the DGS. The underlying justification for this reform seems to me somewhat confused, as the resolution objective values the protection of the depositors, whereas the reform of the objective values the interest of the DGS in spending less. In practice, for covered depositors there is no difference between resolution and liquidation; at the same time, the DGS also bears the same cost, since it does not have to contribute to the resolution more than the amount of losses that it would have had to bear had the institution been wound up under normal insolvency proceedings (Article 109(1), BRRD). The issue is thus not the protection of depositors, but the facilitation of the financing of resolution by DGSs, which in turn is strictly dependent on the abolition of the super-priority rule.[102]

Finally, the proposal indicates procedural changes to the comparison between resolution and insolvency, that is whether liquidation of the institution under ordinary insolvency proceedings would achieve the resolution objectives to the same extent (Article 32 (5), BBRD). In performing this evaluation, it is important to balance the potential public financial support that can reasonably be granted to the institution, both in the event of resolution and liquidation in accordance with the applicable national law. Therefore, if the liquidation procedure can only be 'ordered' or otherwise possible by means of public support, then such intervention should, according to the EC,[103] lead to a positive PIA outcome (i.e., the resolution option must be chosen).

102 On this issue see *infra* § 6.

103 See in this sense the Commission's proposal to revise Article 32(5), BRRD: "the resolution authority, based on the information available to it at the time of that assessment, considers and compares all extraordinary public financial support that can reasonably be expected to be granted to the institution, both in the event of resolution and in the event of winding up in accordance with the applicable national law". This assessment, absent in the decision relating the Veneto banks, is instead hinted at in the case of ABLV Bank: "[g]iven the information available at the date of the adoption of this Decision, there are no elements indicating that extraordinary public financial support, within the meaning of Article 3(1)(29) of Regulation (EU) No 806/2014, would be provided in case of initiation of normal insolvency proceedings with respect to the Institution" see Single Resolution Board decision of 23 February 2018 concerning the assessment of the conditions for resolution in respect of ABLV Bank, AS (SRB/EES/2018/09), par. 132.

6. The Problem of Financing Resolution

For resolution to be potentially applicable to smaller banks, it is not sufficient to intervene on the PIA. Rather it is necessary to ensure adequate funding including, on the one hand, the credit institutions' internal loss-absorption capacity and, on the other, the access to DGS resources and resolution financing arrangements. The current regime does not guarantee these results.

Resolution implies that intermediaries comply with MREL requirements which are calibrated, in addition to the previously mentioned parameters,[104] in consideration of the crisis management strategy. Generally, smaller banks, having a traditional business model, and therefore large amounts of retail deposits, have difficulty using internal recapitalisation, as they are unable to build up the amount of MREL necessary to make bail-in operational. In essence, the traditional business model prompts them to undertake a resolution strategy based on the aggregate transfer *en bloc* of assets, liabilities and contracts to another bank (or bridge institution).[105] A recent EBA study[106] found that, even when adopting this latter resolution tool, smaller banks are at risk of not meeting MREL targets set by the BRRD for 2024.[107] This means that in case of financial difficulties, it is unlikely that a smaller bank would have enough MREL to absorb at least 8% of the losses and would therefore not be capable of accessing external resources (as opposed to bail-in liabilities) to manage resolution, even if it passed the "public interest" test.

Alongside this limit, the current framework also hampers the use of DGS's resources. The role of deposit guarantee schemes in the resolution (and liquidation) of smaller banks is crucial. The sale of business transaction is more attractive to the buyer when all deposits (protected and unprotected) are transferred. The DGS helps to make the transfer of the banking business effective

104 See, *supra*, § 2.

105 See on this point *Marco Lamandini/David Ramos Mũnoz*, "Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework", In-Dept Analysis requested by the ECON Committee, November 2022, 11 at https://www.europarl.europa.eu/thinktank/en/document/IPOL_IDA(2022)733730.

106 See MREL deficiency data published by the *European Banking Authority*, "MREL quantitative monitoring report and impact assessment (article 45 BRRD II) as of 31 December 2021", (EBA/REP/2023/03), January 2023, 35 ff. On this point see *Concetta Brescia Morra/Alberto Franco Pozzolo/Noah Vardi*, "Completing the Banking Union. The case of crisis management of small-and-medium-sized banks", IN-DEPTH ANALYSIS requested by the ECON committee, PE 741.514, May 2023, 11 ff.

107 See also the data reported by *Marcel Magnus/Cristina Sofia Dias/Kristina Grigaitè* (fn. 93), 5.

by covering the sale deficit: the greater the liabilities, the more demanding the required contribution of the DGS will be.

Despite the relevance of the DGS's intervention in resolution, the current regime is particularly restrictive:[108] the contribution cannot be greater than half of the resources of the scheme (i.e., its target level *under* Article 109(5) BRRD), nor the cost that the scheme would incur as a result of the repayment of deposits, net of the recovery of such sums in the context of the liquidation of the bank (*no creditor worse off*, NCWO).[109] This sum is calculated according to the least cost test (LTC): "the costs of the measures do not exceed the costs of fulfilling the statutory or contractual mandate of the DGS" (Article 11(3), DGSD). The assessment is influenced by the additional rule that covered deposits (Article 108(1)(b) BRRD) rank higher than eligible deposits (Article 108 (a) BRRD), which in turn rank higher than ordinary, unsecured and non-preferential creditors (*super-priority rule*). The DGS, once the covered deposits have been repaid and subrogated to the rights of the latter in the liquidation procedure, assumes the same super-senior status (Article 9(2) DGSD). Therefore, in the absence of other parameters to be considered in the LCT, the recovery rate of the reimbursed sums will be particularly high. In other words, the combination of the two rules (NCWO and *super-priority*) entails a potential limitation of financing resolution by DGSs, as it is likely that they will incur very low, if any, costs in the event of the bank being subject to insolvency proceedings.[110]

The proposed revision of the CMDI partially addresses these problems. As regards the MREL calibration, the EC notes that the actual rules rely on the (incorrect) assumption that the bail-in tool is the preferred resolution strategy (for all banks). For this reason, the reform proposal introduces a new Article 45ca, BRRD which regulates the determination of the MREL for transfer strategies leading to market exit, providing a set of rules aimed to proportionally calibrate the recapitalisation requirement. In particular, the MREL is tailored to bank-specific features, including size, business and funding models, risk profile and the needs identified to implement the resolution analysis. Together with the new approach concerning the PIA, the positive side of the pro-

108 On this subject, we refer to *Irene Mecatti* (fn. 11), 763 ff.

109 V. Article 109(1), BRRD: "In all cases, the liability of the Deposit Guarantee Scheme shall not exceed the amount of losses it would have had to bear if the institution had been wound up under normal insolvency proceedings".

110 See *European Banking Authority* (fn. 33), 44 ff.; *Oana M Croitoru/Marc C. Dobler/Johan Molin*, "Resolution Funding: Who Pays When Financial Institutions Fail?", IMF Technical Notes and Manuals No 2018/01, 2018, 10 at www.imf.org/en/Publications/TNM/Issues/2018/08/16/Resolution-Funding-Who-Pays-When-Financial-Institutions-Fail-46124.

posed reform is that smaller banks may fall under the resolution regime more easily; this means, consequently, that they will increasingly be subject to MREL requirements.

The watering down of the MREL is not accompanied by the reform of the 8% TLOF.[111] The constraints resulting from the latter rule should, according to the Commission, be limited by several reforms regarding the DGS framework. Article 109 BRRD[112] should therefore be amended to enhance the application of transfer tools in resolution for smaller or medium-sized banks subject to a transfer strategy that leads to a market exit in case of failure.[113] In this case, all deposits may be included in the transfer provided that, for non-covered deposits, the RA assesses the reasons for their protection, that is the application of Article 44(3), BRRD (bail-in exclusions).[114] When non-covered deposits are included in the sale of business, at the discretion of the RA, the DGS financing may count as a "bridge" to fulfil the 8% TLOF, within the limits of the amount necessary to reach this requirement.[115] The use of DGS as a bridge facility would be at the discretion of the RA.

The proposed reform does not touch the abovementioned caps to the DGS interventions[116] but, in order to make the transfer strategy feasible,[117] it modi-

111 See for this suggestion *Irene Mecatti* (fn. 100), 688; *Ead* (fn. 11), 767 f.; *Concetta Brescia Morra/Alberto Franco Pozzolo/Noah Vardi* (fn. 106), 26.

112 See also the new Articles 44, BRRD and 79 SRMR.

113 Article 109(2)(2b).

114 Other liabilities may be included in the sale of business, but the resources of DGS can be used only to cover deposits (Article 109(1)(a)).

115 The new Article 109(2b), BRRD will be: "The contribution of the deposit guarantee scheme pursuant to paragraph 1, second subparagraph, shall count towards the thresholds laid down in Article 44(5), (a), and in Article 44(8), point (a). Where the use of the deposit guarantee scheme pursuant to paragraph 1, second subparagraph, together with the contribution to loss absorption and recapitalisation made by the shareholders and the holders of other instruments of ownership, the holders of relevant capital instruments and other bail-inable liabilities, allows for the use of the resolution financing arrangement, the contribution of the deposit guarantee scheme shall be limited to the amount necessary to meet the thresholds laid down in Article 44(5), point (a), and in Article 44(8), point (a)".

116 The €100,000 deposit protection level remains in place. As deposits resulting from certain events (real estate transactions relating to private residential properties, payout of certain insurance benefits), can temporarily lead to large high balance, the proposal intends to cover deposits temporarily exceeding the €100,000. In these cases, deposits are to be temporarily protected for a period of six months up to €500,000 (see amendment of Article 6(2), DGSD).

117 For a critical analysis of the current regime see *Irene Mecatti* (fn. 11), 688; *Concetta Brescia Morra/Alberto Franco Pozzolo/Noah Vardi* (fn. 106), 23; *Elke König*, "Deposit

fies the LTC by empowering the DGSD to take into account several parameters – "expected earnings, operational expenses and potential losses related to the measure" – instead of considering the simple arithmetic difference between deposit reimbursement and potential recovery in insolvency proceedings.[118] Moreover, in order to facilitate the use of DGSs in resolution under the LCT, the existing super-priority of covered deposits should be replaced by a fully harmonised general depositor preference, to the effect that all the deposits rank senior to other liabilities, but *pari passu* with each other.[119]

7. Some Policy Considerations

The revision of the CMDI is a complex operation for many reasons: the peculiar characteristics of the banking business and its genetic fragility, the lack of harmonisation of substantive and procedural insolvency rules, and the difficulties in finding convergence between Member States when it comes to sharing even if only within the banking system, losses resulting from a bank crisis. The current framework represents a compromise to meet these disparate and often contrasting situations and needs, but which has the main defect of functioning only to prevent and manage crises of intermediaries too big (or too complex) to fail. The lack of proportionality of the CMDI,[120] combined with the absence of action at the EU level for smaller banks (not necessarily LSIs), determined a *de facto* exclusion of these institutions from the mutualized safety net built around the SRF and, as demonstrated above,[121] has affected their ability to access markets and attract depositors. Moreover, national solutions (instead of European ones) have undermined the leitmotiv of the BU, that is that losses should be borne by the financial institutions' shareholders and unsecured creditors (bail-in). It is therefore essential to improve the EU crisis management

Guarantee Schemes: remove super priority, harmonise the least cost test", The EUROFI Magazine, February 2022, 119.

118 The specification of how the LCT is calculated is left to the EBA (Article 11(e)(5), DGSD).

119 The current Article 108(1), BRRD should be replaced by the following: "Member States shall ensure that in their national laws governing normal insolvency proceedings the following have the same priority ranking, which is higher than the ranking provided for the claims of ordinary unsecured creditors: (a) deposits; (b) deposits made through branches located outside the Union of institutions established within the Union; (c) deposit guarantee schemes subrogating to the rights and obligations of covered depositors in insolvency".

120 Proportionality has been an essential part of the impact assessment accompanying the EC proposal (at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52023SC0225, last accessed: 10 July 2023).

121 See, *supra*, § 3.

model for smaller banks in order to safeguard financial stability and achieve the BU's main objectives.

The EC's recent proposal for reforming the CMDI is certainly welcome as, through its intervention on the PIA[122] and on the DGS framework (in particular, with reference to the LCT and the revision of the super-priority rule), it makes the CMDI more feasible for smaller banks. However, the BU remains incomplete.

First, the issue of implementing the third pillar has not been addressed but rather postponed. In reality, the creation of the EDIS is a fundamental step for the completion of the BU and will be even more so when (and if) the resolution is extended to smaller banks and a single-tier depositor preference is introduced. The latter reforms will increase the likelihood and amount of intervention by the DGS, the effect of which could exhaust its resources. The EDIS would have the fundamental role of granting liquidity support once national DGS has drained its funds. This would allow not only DGSs to better contribute to crisis management, but also to avoid that possible shortfalls in DGS funding would have to be financed by public money.

Secondly, although the proposed legislative package will make access to resolution financing arrangements more feasible, it does not intervene on the 8% TLOF. Therefore, the constraints resulting from the latter rule remain. Smaller banks, due to their business and financing model, will still face difficulties in issuing and placing this amount of MREL (*ex ante*), which means, *ex post*, the inability to access the resolution funds. This might happen in systemic crises simultaneously involving multiple credit institutions or, more simply, where the bail-in of a certain category of creditors may seriously undermine the financial stability. This issue has been recently addressed by the ECB, which suggested to introduce a financial stability exemption to access resolution financing arrangements prior to a loss absorption of 8% TLOF in exceptional circumstances, subject, however, to strong precautions.[123] This exemption, whose conditions are not specified, would operate only *ex post* and does not solve the problem of building the MRELs at resolution planning stage. According to the Author's opinion, a more proportional approach would require that the 8% TLOF be calibrated in consideration of the size and composition of the inter-

122 See, *supra*, § 4.

123 *European Central Bank*, "Opinion of the European Central Bank of 5 July 2023 on amendments to the Union crisis management and deposit insurance framework", (CON/2023/19), 2 ff. A similar and very interesting proposal, but with the involvement of national DGSs, was made by *Thomas F. Huertas*, "Reset Required: The Euro-area Crisis Management and Deposit Insurance Framework", Journal of Financial Regulation, 2022, 8, 197 ff.

mediary's balance sheet and, more specifically, the number of unsecured deposits held.[124] Resolution financing arrangements and DGSs should consequently absorb losses to a greater extent. In this regard, in the Author's view, the new "bridge" role of DGSs in accessing resolution funds marks a significant and welcome departure from the current framework. However, this "role" is not provided for as a general rule but is subject to assessment by the RA on a case-by-case basis, according to a complex procedure which lacks the degree of predictability essential in any bank crisis prevention and resolution planning.

Thirdly, the dichotomy between resolution and liquidation implies not only that resolution is not negotiable at time the FOLTF, which requires more efficient and update resolution planning,[125] but also that liquidation becomes less attractive. The current regime instead stimulates the use of liquidation because State aid burden sharing is less restrictive than bail-in, as it only requires a contribution to loss absorption of equity, capital instruments and subordinated debt.[126] Moreover, there is no cap on the amount of public money that can be used, and only a minimum requirement of loss contribution by investors. This major difference, coupled with resolution decision rules that are the result of compromises made among Member States,[127] makes liquidation the most preferable choice and, not surprisingly, the one that is in fact most widely adopted. Therefore, the differences in the burden-sharing requirements should be reduced[128] within the revision of the BC2013.

Fourthly, resolution decisions taken by the SRB are too complex, as they require the consent of other authorities (the European Commission and the Council of the EU) and involving questions of national bias. This fragmented architecture effectively creates numerous veto players and may allow Member States' interests to prevail. Therefore, a reform of the institutional profiles of the SRM should be undertaken, as well, giving this body greater decision-making autonomy, both vis-à-vis other European institutions and vis-à-vis national interferences.

Finally, broadening the resolution does not remove the need to revisit, at least partially, the liquidation framework[129], both in terms of substance and procedure.[130] In fact, resolution would still not be available for smaller banks which

124 Unprotected deposits account for a large part of the MREL stock in banks with assets between €10 billion and €5 billion (see *European Banking Authorithy* (fn. 106), 52).

125 See § 5.

126 See, *supra*, § 5, fn. 84.

127 See *supra*, § 5, fn. 82.

128 *Irene Mecatti/Tobias H. Tröger* (fn. 20), 117.

129 See *Ignazio Visco* (fn. 29), 12; *European Central Bank* (fn. 28), 3.

130 On the differences among Member states see *Michael Schillig* (fn. 88), 70; *Jens-Hinrich Binder/Michael Krimminger/Maria J. Nieto/Dalvinder Singh,* "The choice between judicial and administrative sanctioned procedures to manage liquidation of banks: a

are heavily reliant on deposits as a funding source, and for those whose crisis does not pose problems for financial stability. These intermediaries must exit the market and be liquidated according to the national insolvency procedure. Liquidation is also relevant within the resolution, as it is a parameter to evaluate the NCWO principle and represents the instrument to manage the residual entity when the sale of business (or bridge bank) tool is used. Then, differences among Member States, giving rise to uneven solutions, are a source of uncertainty and inefficiency.

The Commission proposal addresses some of the key aspects which should be harmonized. Here I am referring to "limbo" situations (that is, whether insolvency proceedings can start), providing that the FOLTF assessment is a condition for the withdrawal of the bank's authorisation pursuant to Article 18 CRD IV, thereby allowing the relevant national (administrative or judicial) authorities to initiate without delay the applicable national winding-up procedure in an orderly manner.[131] It also improves the harmonisation of the ranking of creditors with reference to depositors (and DGSs subrogated to their rights)[132] and the claims arising from a resolution financing arrangement which have supported a transfer resolution tool (i.e., sale of business or bridge bank).[133]

The complex implications of the harmonisation of the bank insolvency procedures are outside the scope of this paper. The most ambitious option from the perspective of European integration would, of course, be to establish a comprehensive national and European orderly winding-up regime in parallel with the resolution procedure. This solution requires a wide consensus on policy objectives and the level of harmonisation, which does not currently exist, and

transatlantic perspective", 14 Capital Markets Law Journal, 2019, 201 ff.; *Sophie Buckingham/Svetlana Atanasova/Simona Frazzani/Nicolas Véron*, "Study on the differences between bank insolvency laws and on their potential harmonisation – Final Report", Directorate-General for Directorate-General for Financial Services, November 2019, 13 ff., at https://finance.ec.europa.eu/publications/study-differences-between-bank-insolvency-laws-and-their-potential-harmonisation_en (last accessed: 21 July 2023; *Giovanni Majnoni/Gabriele Bernardini/Andreas Dal Santo/Maurizio Trapanese*, "The EU bank insolvency framework: could less be more?", Banca d'Italia, Questioni di economia e finanza, No 594, February 2021, 15; *Jens-Hinrich Binder*, "The next step: Towards harmonised frameworks for the liquidation of non-systemically relevant credit institutions in the EU? A discussion of policy choices and potential impediments", EBI Working paper series No 89, 2021, 7 ff.

131 See new Article 32b(3)(4).

132 See, *supra*, § 6.

133 See new Article 108(8)(9). Member States shall ensure that the claims of the resolution financing arrangement have, in their national laws governing normal insolvency proceedings, a preferred priority ranking, which shall be higher than the ranking provided for the claims of deposits and of DGSs.

it is unlikely to be reached in the imminent future. In view of the complexity of that goal it would be better to follow a functional approach[134] that considers the specificities and public interests involved in banking crises. This is essentially the approach that the European Legislator is following in the field of business restructuring and insolvency. The new framework does not, in fact, apply to credit institutions.[135]

As regards the objectives, value maximisation is the core goal of the general business insolvency regime but is not the only relevant one within the banking liquidation. In this context, other specific objectives count (and should be fixed) such as: 1) the protection of systemic stability and depositors; 2) the preservation to the extent possible of value of the failing bank's assets; and 3) the general avoidance of State aid, with exceptions based on the reasons set forth, *sub 1*).

With reference to procedural aspects, it would be particularly desirable to harmonise a special administrative procedure to manage bank insolvency. The administrative nature of this procedure, like the Italian l.c.a., would be justified by the fact that maintaining financial stability is part of the mandate of the administrative authorities, as banking supervisors generally are.[136] This reform should be supplemented by the harmonisation of the transfer tools to be used within the liquidation context (sale of business, bridge bank, bad bank), as they are recognized as the best instruments to preserve value, ensure continuity of access to banking services, protect depositors and maintain confidence in the banking sector.[137] The road is long and uphill. To this regard, Unidroit's current Project on Bank Insolvency[138] constitutes an important opportunity to make progress towards an internationally shared regulatory model.

134 Suggesting this approach, see *Jens-Hinrich Binder* (fn. 130), 20; see also *José Luis Colino Mediavilla*, "El régimen de la inviabilidad bancaria en la unión europea: cuestiones clave y expectativas de reforma", Banca d'Italia (fn. 29), 87 and therein *Ignacio Tirado/Myrte Thijssen*, "Unidroit's Project on Bank Insolvency: how to deal with the failure of small- and medium-sized banks", 131.

135 Article 1(1)(b), Directive 2019/1023/EU on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

136 *Ignacio Tirado/Myrte Thijssen* (fn. 134), 134. The special powers necessary to override the generally applicable law (e.g. the power of transfer shares, rights, assets and liabilities) are more compatible with an administrative (instead of court-based) procedure (on this point see *Michael Schillig* (fn. 88), 77).

137 *European Central Bank* (fn. 28), 3.

138 The documentation for this project is available at https://www.unidroit.org/work-in-progress/bank-insolvency/#1631778452950-20a21187-49af (last accessed: 22 July 2023). On this project see *Ignacio Tirado/Myrte Thijssen* (fn. 134), 125 ff.