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The revision of the banking crisis management and deposit insurance framework in Europe: Why is it important to enhance flexibility?

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Abstract

The Crisis Management and Deposit Insurance Framework - which came into force about ten years ago - is under review by the European Commission. The need for its revision stems from the identification of certain shortcomings and inconsistencies that have emerged in its application in Europe and especially in Italy. The central topics of the debate focus on how resolution should be applied and on possible innovations regarding the tools that can be used to manage the crises of small and medium-sized banks, which until now have been managed on the basis of procedures and tools decided at the national level.

The aim of this paper is to investigate the areas subject to reform, using as an evaluation parameter the objective of increasing the flexibility of the framework, as this is considered a fundamental requirement to ensure the full effectiveness of the overall banking crisis management system.

Key words

Banking crisis management; Supervision; Early intervention measures; Resolution; Deposit Insurance; Preventative and alternative measures; Public intervention; State Aid regulation

1. Foreword

Bank insolvencies are harmful events; if not addressed and managed properly, with effective tools, they can cause serious damage to various categories of stakeholders, first and foremost to depositors. Every banking crisis, be it systemic or idiosyncratic, represents a discontinuity in the regular course of relations between the various actors of an economic system, given the close link they have with the financial system.

Timely intervention is a key factor in mitigating the disruptive effects of insolvencies on other financial institutions, through contagion mechanisms, and on the real economy; in many cases, bank insolvencies may impact the public budgets, which are called upon to step in to cover the losses, ultimately passing the buck to taxpayers. This is why bank crisis management has always received the utmost attention from policymakers in all advanced countries, in order to preserve financial stability, alongside prudential regulation and banking and financial supervision. Taken together, these activities help to determine the safety net arrangements for safeguarding financial stability, which is a public good because it contributes to determining the conditions for a country's economic growth and welfare.

In Europe, the bank crisis management legislation (Crisis Management and Deposit Insurance Framework – CMDI) was introduced in 2013-2015 as a remedy to the bank insolvencies that occurred during the global financial crisis. It was based on a series of international standards issued by the Financial Stability Board[1] and other standard setters. This framework includes the Bank Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Schemes Directive (DGSD), as well as the rules on State aid (2013 "Banking Communication"[2]). Moreover, in the Eurozone, with the implementation of the Banking Union project, crisis management and, in particular, the regulation and application of the resolution procedure, has been partly centralised at European level, through the Single Resolution Mechanism (SRM Regulation, which constitutes the second pillar of the Banking Union).

Nearly a decade after its entry into force, the CMDI framework is about to be changed, as the need to address certain critical issues and inconsistencies in its application has come to the fore. Consequently, the forthcoming regulatory reform is also bound to be reflected in crisis management within the Eurozone Banking Union, through the amendment of the SRM Regulation and, hopefully, the introduction of the third pillar (European Deposit Insurance Scheme). However, this latter project is still far from being implemented due to the lack of political agreement among the participating countries.

The experience gained in implementing the European framework offers much food for thought to policymakers on some of the weaknesses of the current system and the complex fundamental choices to be made, which concern, first of all, the general structure of the crisis management model to be achieved. Reflecting on the design of the model is of the utmost importance and, one might say, unavoidable, when a new regulation is to be introduced or amended, because it leads to a critical re-examination of the overall architecture of the existing arrangements - in terms of principles, objectives, instruments and procedures - and to an assessment of their consistency with the public policy objectives to be pursued.

In particular, the banking crises that have occurred in Europe over the last decade, especially in Italy, have been a useful test of the effectiveness of the current European framework: they have shown that the present arrangements certainly represent a significant improvement over the crisis management system in place before the global financial crisis. However, certain criticalities and shortcomings in terms of organicity, clarity and efficiency have been highlighted, resulting in inconsistencies within a European banking sector that is highly diversified in terms of size, legal form, business models and organisation of intermediaries.

Among the many issues that have been raised in the current debate, key importance has been attached to the need to increase the flexibility of the regulatory model as a prerequisite for strengthening the robustness, effectiveness and efficiency of the overall crisis management system: greater flexibility could also require overcoming some notions and paradigms that characterise the present regulatory framework. The need for flexibility has been reinforced by the most recent banking crises in the United States (Silicon Valley Bank, Signature Bank, Silvergate Bank and First Republic Bank) and Europe (Credit Suisse and Getin Noble Bank), which

[1] FINANCIAL STABILITY BOARD, *Key attributes of effective resolution regimes for financial institutions (KA)*, 15 October 2014.

[2] EUROPEAN COMMISSION, *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 financial crisis*, 2013/C 216/01, 30.7.2013.

have given rise to far-reaching government interventions or evolutionary interpretations of existing regulations, motivated by the need to protect financial stability.

Similar pressures in this direction are the numerous challenges facing the European and national banking sector, which is increasingly being called upon to deal with a macroeconomic and geopolitical framework marked by growing uncertainties and vulnerabilities, thus resulting in continuous stress for the sector and insolvencies of individual intermediaries or groups of intermediaries.

Therefore, the heterogeneity and complexity of the European banking sector pose the overriding issue of identifying the most appropriate regulatory model, by choosing among several theoretical frameworks:

(i) a scheme that is the same for all types of banking institutions, regardless of their characteristics (the "one size fits all" model), or a diversified model that takes into account the specific features of the various institutions or markets;

(ii) a system based on rigid, automatic, strictly enforceable rules (based on one-to-one correspondence between objective prerequisites, type of procedures and applicable instruments) or a scheme that provides for flexibility in the use of intervention tools, in order to leave the authorities adequate margins of discretion;

iii) a scheme in which the extent of flexibility is clearly defined, i.e. the choice between a model that assigns very broad discretionary powers to the authorities, or a model of controlled flexibility, aimed at establishing the conditions (i.e.: the principles and objectives) under which flexibility can apply (purpose-bound discretion), in order to allow third parties to perform ex-post scrutiny on the choices made by the authorities.

On a general level, these models are all theoretically viable and can be modulated in various ways depending also on the institutional frameworks of the various jurisdictions; if necessary, they could be accompanied by appropriate check-and-balance mechanisms aimed at ensuring the consistency of the chosen scheme with the public policies established by the legislator.

It is evident that the extreme models (automatism-rigidity or flexibility-discretion) may give rise to issues in their actual application. On the one hand, the automatism-rigidity scheme could clash, as has been said, with a European banking system featuring extreme heterogeneity and variability in many structural and functional elements: this may entail the risk that the rules established may prove not entirely suitable to effectively resolve complex crisis situations, which may require not just a single measure, but a combination of procedures and measures. On the other hand, the flexible-discretionary scheme carries the risk of opportunistic conduct on the part of the authorities and could lead to differences in application that generate unequal treatment.

The conundrum is not new; it is typical of the phases of regulatory innovation; the debate on the regulatory model of banking crisis management in Italy reached its peak at the beginning of the 1990s following the general banking reform that led to the enactment of the Consolidated Banking Act (Legislative Decree no. 385 of 1 September 1993), also implementing the EU directive reforming the banking sector[3].

In the wake of the reform, a large body of research - conducted by academics, authorities and practitioners - on the various topics of Italian banking legislation was launched, resulting in numerous collective and individual studies. The overall consensus of scholars was that, despite the major innovations in the basic principles of banking regulation and supervision, marked to a considerable extent by market rules, the subject of bank crisis management had followed a path of substantial continuity with the consolidated administrative model dating back to the 1936-38 Banking Law (Royal Decree no. 375 of 12 March 1936), based essentially on the same rules and procedures[4], the direction and management of which was entrusted to the administrative authorities.

One of the major themes highlighted by the research concerned precisely the consistency with market rules of the administrative model of crisis management, which strongly hinges on the discretion granted to administrative authorities. In particular, the discussion focused on the implications of this model on the autonomy of banking corporations and on the protection of the rights of the various stakeholders involved, with particular reference to the search for an appropriate balance between the protection of creditors and that of shareholders[5].

The generalisation of the administrative model of bank crisis management (Special Resolution Regime) introduced at a EU level by the BRRD, which was confirmed in the second pillar of the Banking Union (SRM Regulation), once again brought these issues to the attention of regulators, within the framework of the ongoing regulatory review, in order to assess the degree of effectiveness of the current model and its adequacy in pursuing the public policy objectives stated by the legislator. The weaknesses shown by application experience call for reconsideration of certain choices made at the time, without overturning them, with the aim of regaining flexibility and create a system that can best contribute to the pursuit of financial stability.

2. The regulatory model of the crisis of the ordinary commercial enterprise.

Striking a delicate balance between automatism (greater rigidity) and flexibility (greater discretion) of rules is a topic that has always characterised the world of law, when the legal system entrusts an administrative authority or a judge with decision-making powers of various kinds on economic and legal relations between private parties.

The issue is of great relevance to the functioning of the economy, because depending on the model chosen, the expectations of the parties subject to the rules will vary and, therefore, so will the assessments to be made and the decisions to be taken in the course of

[3] Second Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC.
[4] Two main proceedings for the treatment of banking crises were applied: the special administration and the compulsory administrative liquidation.
[5] G. BOCCUZZI, *La gestione delle crisi bancarie tra discrezionalità e mercato,* in Scritti in memoria di Pietro De Vecchis, Banca d'Italia, Volume I, Rome, 1999; G. VISENTINI, *Gestione amministrativa delle crisi bancarie*, Speech given at the seminar on "*Le crisi bancarie in Italia: un approccio interdisciplinare*", Luiss-Guido Carli University, 9 December 1998, organised by CERADI and NEWFIN; G. VISENTINI, *Il governamento delle società per azioni: il caso delle banche*, Quaderni di Moneta e Credito, March 1997.

normal economic activity. Business crisis law does not deviate from this paradigm, and establishes a range of conditions for access to procedures and instruments that can be activated in crisis or insolvency situations, implying different degrees of interference by the administrative[6] and judicial authorities in business affairs.

From time to time, one recurring question arises: is automatism or flexibility preferable? The answer is not a simple one, if the question is posed in such clear-cut and simplistic terms, because very often intermediate solutions prevail, in which automatism and flexibility can be appropriately combined, by placing appropriate limits on discretion. In some circumstances, as mentioned above, automatism ensures certainty of the behaviour of those called upon to decide on the appropriate paths to follow to resolve the crisis and to choose the most suitable instruments. This solution, however, in some real situations may prove to be an impediment to the pursuit of the most effective solution, as it may prevent the adoption of certain instruments that, although part of the available toolkit, are prescribed by law to deal with situations governed by other types of proceedings. Flexibility, on the other hand, implying a certain degree of discretion, guarantees greater capacity to find broader and more diversified solutions for cases of particular complexity and for meeting the best interests of the multiple actors involved in the crisis.

This matter becomes key in the reform process of the legal system, when policymakers are called upon to strategically assess, from a forward-looking perspective, the compliance of the principles and objectives of insolvency law with the needs of the business world and the economy at large, while ensuring the protection of rights.

By its very nature, the enterprise crisis framework tends towards automatism and rigidity, for a number of reasons. The first reason is that it affects the private autonomy of the entrepreneur and, therefore, the rules of the framework must be clearly defined and circumscribed, to ensure their effects do not go beyond those intended by the legislator. The room for manoeuvre for the judge is limited, except where the law expressly grants him/her certain discretionary powers. Moreover these rules must be correctly applied to ensure homogeneity of treatment of the target companies. Secondly, insolvency rules affect the rights of the different categories of stakeholders involved in the crisis, in particular shareholders and creditors, so they must be applied consistently and uniformly in order to avoid any enforcement distortions, in time and space, and thus ensure equal treatment.

To some extent, the areas of discretion are related to the nature of crisis management procedures:

(a) in insolvency proceedings these areas are normally narrower: the intervention of the courts - which are very active in the governance of the proceedings - is aimed at ensuring the correct application of the rules and the protection of the rights of the parties concerned. Significant examples are the roles played by the court in verifying the correct application of the rules established by law for the drafting of the statement of liabilities, for the realisation of assets and for the participation of creditors in the distribution of realised assets (*par condicio creditorum*).

Thus, the insolvency framework, due to its collective bankruptcy nature, is of strict application, since it deals with regulatory provisions that affect, on the one hand, the autonomy of private entities, i.e. the companies subject to insolvency proceedings, and, on the other hand, the rights of the various categories of stakeholders, in particular those of shareholders and creditors. Even the verification of the conditions for access to insolvency proceedings, despite the many complex situations that may be at the root of the failure (illiquidity, asset losses, operating loss), has very limited margins of discretion, because, in any case, a state of insolvency is based on the creditors demonstrating that the entrepreneur is unable to duly fulfil his obligations or on the entrepreneur making such declaration himself.

In Italy, insolvency is managed through the judicial liquidation procedure, introduced with the recent reform of the Crisis and Insolvency Code (Legislative Decree No. 14 of 12 January 2019), replacing bankruptcy, which was previously governed by the bankruptcy law (Royal Decree No. 267 of 16 March 1942);

(b) on the other hand, where procedures and measures aimed at the reorganisation of the enterprise, i.e. alternatives to judicial liquidation, are applied, the national legal systems offer different solutions, with wide margins of flexibility, since the initiative to open the procedure is normally left to the debtor and the settlement of the crisis to agreements, of various legal forms, between the debtor and the creditors. The European Insolvency Directive, transposed in the aforementioned Crisis Code, sets out clear guidelines for prevention, to which national laws are now conforming[7]; in many of these procedures the intervention of the courts is variously modulated and may even be absent.

These procedures therefore represent the greatest expression of flexibility, because the settlement of claims is entrusted to the company's stakeholders themselves, with limited involvement of judicial or administrative authorities. The latter may in some cases have the power of deciding which type of procedure is applicable, which implies an evaluation of access requirements, normally based on technical assessments of the company's assets and liabilities, recovery prospects and restoration of economic balance: these are, however, decisions based on appropriate expert estimates of the enterprise's situation and the factors of the crisis, to be framed in the legal categories (the objective requirements) that underlie prevention and reorganisation procedures. The discretion of the authorities, therefore, is very restricted; the flexibility lies in the assessments left to the actors involved in the enterprise.

[6] The reference is to the existence in the Italian insolvency system of a specific administrative procedure for large companies or groups of companies, subject to the "extraordinary administration of large insolvent companies". Extraordinary administration - the regulation of which has been modified many times - has the primary objective of pursuing 'the preservation of productive assets, through the continuation, reactivation or reconversion of entrepreneurial activities' (Article 1 of Legislative Decree 270/1999). It therefore aims to reconcile different interests: on the one hand, satisfying the creditors of the insolvent company, and on the other, saving the productive complex and preserving employment, thus avoiding liquidation solutions that inevitably have disruptive effects on the company and jeopardise important private and public interests connected to the preservation and recovery of the company.

[7] DIRECTIVE (EU) 2019/1023 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 June 2019 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)

In Italian insolvency law, this part of the regulation has been progressively extended by the reforms of the last two decades. The new procedures introduced by the 2005 reform (composition with creditors in the two forms of business continuity and liquidation, debt restructuring plans, certified reorganisation plans, moratorium agreements), crisis management has been entrusted to the negotiating autonomy of the parties involved; the judge's intervention, if required, is essentially limited to verifying the conditions for access to the procedures and possible endorsement of the agreements reached, in various ways and with varying intensity in the different types of agreements.

The reform process has continued in recent years, by expanding procedures and instruments aimed at the early detection of the crisis and the reorganisation of the enterprise. The new Business Crisis and Insolvency Code[8] has introduced a more proactive approach to strengthen the warning measures for an early emergence of the crisis, which for the first time is defined by the legislator as 'the state of the debtor that makes insolvency likely and is manifested by the inadequacy of prospective cash flows to meet obligations in the next twelve months'.

This definition essentially transposes business logic, based on ex ante assessments, which are the only possible way of identifying an economic phenomenon of such complexity and wide-ranging impacts; it defines crisis as a phenomenon that is likely to lead to insolvency and could result into an imbalance of prospective cash flows such as to make it impossible to meet obligations within a twelve-month period (the same time horizon against which the directors are called upon to assess the company's continuity in the financial statements). To this end, the negotiated crisis settlement procedure has been introduced (Decree-Law no. 118/2021 converted into Law no. 147/2021), based on reports of difficult business situations. The aim is to lead the entrepreneur to promptly initiate corrective measures to prevent the opening of formal crisis proceedings: such are the warning measures, intended as early warning systems of anomalous situations in business management, to prevent further deterioration of the economic, financial and equity situation which could lead to insolvency, in order to ensure business continuity.[9] They leverage, alongside organisational measures the entrepreneur is required to take[10], the initiatives of certain qualified bodies of the company (board of statutory auditors, auditor, auditing company) to make reports internally or externally to the company in order to stimulate the adoption of the necessary remedial measures.

A similar report must be made to the entrepreneur and, where applicable, to the supervisory body by qualified public entities (INPS, INAIL, Revenue Agency) in the presence of particular debt situations. Finally, the figure of the independent expert has been created, to facilitate dialogue between the entrepreneur, creditors and other stakeholders and stimulate possible corrective measures within the "negotiated crisis settlement". Lastly, new procedures have been introduced, such as the "homologated restructuring plan", consisting of restructuring agreements with extended effects, aimed at facilitating business continuity.

The latest reforms just described place strong emphasis on crisis prevention and business reorganisation as an alternative to judicial liquidation; to this end, they have introduced a range of restructuring tools, with different legal structure depending on whether they are consensual (meaning that they apply only to the creditors that accept the agreement), whether they are also binding on a minority of non-consenting creditors, or whether they are binding on both a minority of creditors included in consenting classes and entire classes of dissenting creditors. The new corporate crisis management system, outside insolvency, is based on a model that has a strong focus on flexibility and gives broad decision-making powers on how to resolve the crisis to the company's main stakeholders - entrepreneur and creditors - in the pursuit of business recovery.

3. Which model for banking crisis management? How to combine flexibility and discretion?

In bank crisis law, the focus on crisis prevention and reorganisation has always been very high, given the distinctive characteristics of the bank's business and the consequent risks of contagion and financial instability that its crisis may entail; these features require a crisis management system designed around principles, systems and procedures that are very different from those of the ordinary commercial enterprises, as it would be very complex to apply a regime based on agreements between the entrepreneur and creditors, given the high number of creditors in the banking business (especially depositors)[11] and the need to intervene promptly to preserve the business assets (the sooner one intervenes, the greater the chances of an orderly resolution of the crisis).

In line with this development, the involvement of the courts in the management of banking crises has also steadily decreased over time, following the general application of the Special Resolution Regime at international level: this is based on entrusting administrative authorities (the resolution authorities) with the power to manage banking crises, while limiting the courts' intervention limited to cases in which it is necessary to resolve conflicts arising within (and in connection with) the procedure.

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[8] The Business Crisis and Insolvency Code was introduced by Legislative Decree no. 14 of 12 January 2019 and was amended several times, most recently by Legislative Decree no. 83 of 17.6.2022, which entered into force on 15.7.2022, implementing the Insolvency Directive. On this topic, A.NIGRO-D.VATTERMOLI, Diritto della crisi delle imprese. Le procedure concorsuali, Quinta Edizione, Il Mulino, 2021; S. DI AMATO, Diritto della crisi d'impresa. Aggiornamento al D. Lgs. 17 giugno 2022, N. 83 (G.U. N. 152 del 1° luglio 2022), Seconda Edizione, Giuffrè Editore, 2022; A. CAIAFA-A.PETTERUTI, Diritto della crisi d'impresa e dell'insolvenza. Aggiornato con la legge 21 ottobre 2021, N. 147, e 29 dicembre 2021, N. 233, Dike Giuridica, 2022.

[9] On this topic, R. RANALLI, *Le misure di allerta. Dagli adeguati assetti fino al procedimento avanti all'OCRI*, Giuffrè Editore, 2019; A. PANIZZA, *Crisi e adeguati assetti per la gestione dell'impresa*, ebook IPSOA Guide Operative, giugno 2020; G. ANDREANI-A. TUBELLI, *Transazione fiscale nel codice della crisi*, IPSOA-Manuali, luglio 2022; P. VELLA, *L'epocale introduzione degli strumenti di allerta nel sistema concorsuale italiano*, Questione Giustizia, Rivista on line, n. 2, 2019.

[10] Reference is made, in this regard, to the introduction of a specific regulatory provision - Article 2806 of the Civil Code, referred to by Article 3 of the Crisis Code - which requires the entrepreneur to adopt an organisational, administrative and accounting structure appropriate to the size and nature of the business, this being the prerequisite for putting in place planning and control tools favouring the early detection of a state of crisis and the activation of measures to overcome it, such as the negotiated crisis settlement procedure (introduced by Decree-Law no. 118/2021 converted into Law no. 147/2021).

[11] Evidently, if one disregards depositors, especially insured depositors, one cannot exclude situations in which there is room for negotiation between the bank in crisis and its creditors for the restructuring of debts, with a view to restoring capital equilibrium. In this regard, reference should be made to Article 27(1)(e) of the BRRD, according to which the supervisory authority may require the bank's board of directors to prepare a plan to negotiate debt restructuring with all or certain creditors in accordance with the recovery plan, where applicable.

The application of a special regime in the banking sector is justified on multiple grounds, on which legal and economic doctrine has reached broad consensus. The approach advocating an ordinary regime for the banking business has remained in the minority and its application is now just a memory of the past. In essence, the special regime is attributable to the broader range of interests to be protected compared to ordinary commercial enterprises and in light of the general objectives underlying banking activities, which make the banking sector a highly regulated and supervised system with administrative authorities exercising a wide spectrum of powers of control and intervention. Consistent with the nature of the banking business are the objectives of banking crisis management: protecting financial stability, ensuring the continuity of the essential functions performed by banks, including those related to the payments system, preserving credit relationships with enterprises, and protecting depositors. The combination of these elements makes banking crisis management an intrinsic complex process, as reflected above all in the extent of the requirements for activating the various procedures, the resolution methods and the tools required for resolution to be conducted in an orderly way, in order to minimise the burden on the various categories of stakeholders.

The issue of the banking crisis management model is key in view of the fact that the direction and management of crisis procedures is entrusted to public authorities (in Europe, the resolution authorities in liaison with the supervisory authorities and the European Commission), to which the law gives broad powers and tools aimed at preventing and mitigating the consequences of failures, including: the assessment of the objective preconditions for activating the various procedures, the application of resolution proceedings and the different resolution tools, the opening of the liquidation procedure and the implementation of the various forms of orderly liquidation, the intervention of deposit insurance and application of alternative measures with respect to the reimbursement of depositors, the modalities for the use of the Resolution Fund and, in exceptional cases, public intervention.

By definition, the granting of these powers to the administrative authority implies they are granted a degree of certain flexibility and discretion; under this arrangement, the main issue is to set reasonable limits on discretion, i.e. on how it can be exercised and submitted to external control.

In the first respect, it is in accordance with a principle of reasonableness and fairness to define a system in which discretion and its scope are attributed by law to the decision-makers; discretion cannot be exercised solely in application or on the basis of the interpretation of the legislation in force, because it runs the risk of degenerating into arbitrariness; in the second respect, appropriate parameters and instruments must be established to enable the parties targeted by the Authority's measures to effectively verify the legitimacy and adequacy of the powers exercised and of the instruments used; this includes establishing the scope and limits of judicial review. It is therefore necessary to strike a delicate balance between ensuring the efficiency and effectiveness of administrative action and protecting those affected by the measures: the balance between these two objectives can be achieved by a system in which the decisions of the administrative authorities are underpinned by a clear indication of the principles and objectives governing crisis management (as in the BRRD in Articles 31 and 34, which establish the objectives and principles of resolution), to the pursuit of which the use of the available tools, all clearly identified and defined by law, must be directed. According to this approach, the choice of crisis resolution tools should be the result of careful technical analysis, on a case-by-case basis, of individual crisis situations and the measures needed to resolve them, making the best use of the available tools within the framework of the principles and objectives laid down by law.

4. Areas for regulatory review. How broad should they be?

4.1 The EU Commission's Initiative, the Public Consultation and Recent Legislative Proposal.

A few years after the introduction of the CMDI framework and on the basis of the experience gained in the management of banking crises in Europe, the EU Commission launched a specific initiative to revise the legal framework, through a broad public consultation involving various categories of stakeholders, according to the precepts of better regulation. A summary of the results of this consultation was published in early 2021[12]. The consultation covered all the major issues in bank crisis management, particularly those that proved to be the hardest to implement. The scope of the issues raised in the consultation is undoubtedly very broad; its results suggest that what is needed is not mere fine-tuning of the existing arrangements, but a significant overhaul of the framework, so as to strengthen the flexibility and effectiveness of the overall crisis management system. The proposals put forward during the consultation do not seem to lead to unambiguous conclusions. This was to be expected, given the different legal and economic systems of the various countries, in terms of the structure and solidity of the banking systems, corporate and bankruptcy systems, and regulatory and supervisory frameworks. This makes the task facing the European legislator of striking an appropriate balance among the various approaches envisaged extremely complex. At the end of this consultation process and having heard the other authorities concerned, on 18 April 2023 the EU Commission presented a proposal for the reform of the CMDI, through three legislative initiatives aimed at amending the Directive on Recovery and Resolution (Directive 2014/59/EU), the Single Resolution Mechanism Regulation (Regulation 806/2014) and the Directive on Deposit Guarantee Schemes (Directive 2014/49/EU). The package also includes a fourth legislative proposal amending the Directive on Recovery and Resolution and the Single Resolution Mechanism (the 'daisy chain' proposal), regarding the determination of MREL within banking groups. This proposal follows a review clause introduced by the European Parliament and the Council in the daisy chain Regulation of October 2022 (Regulation (EU) 2022/2036). The legislative process will require quite some time, given the sensitivity and complexity of the subject matter and the analytical scrutiny that the European Council and Parliament will need to carry out. Therefore, the Commission, in its Communication accompanying the proposal[13], asked the European Parliament to approve these amendments before the EU elections of 2024.

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[12] EU COMMISSION, *Banking Union. Review of the bank crisis management & deposit insurance framework (DGSD review)*. In particular, see *Summary Report of the Public and Targeted Consultation on the review of the Crisis Management and Deposit Insurance framework (CMDI)*, Q1 2021.

[13] EU COMMISSION, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on the review of the crisis management and deposit insurance framework contributing to completing the Banking Union, Strasbourg, 18.4.2023 COM(2023) 225 final.

The reform of legislative package does not include the revision of the State aid rules, which has been postponed by the EU Commission until the adoption of the new CMDI framework. In this regard, a separate regulatory process is underway, in parallel with the co-legislators' review of the CMDI, with the stated aim of achieving the simultaneous enactment of the relevant regulatory acts: this would be made possible by the fact that, unlike the complex CMDI legislative process, the amendment of the State aid framework only requires a Communication from the European Commission which, once approved, is immediately applicable. The simultaneous entry into force of the two regulatory packages (CMDI and State aid) is considered of paramount importance, given the need to ensure their mutual consistency.

Finally, the package of options envisaged by the EU Commission does not include other important regulatory areas, among which, in particular: i) the completion of the Banking Union through the establishment of the Single Deposit Guarantee Scheme (EDIS); as emphasised in the proposal, the design undertaken identifies the reform of the CMDI framework as an important step towards the strengthening of the second pillar, paving the way for more significant developments with a view to the realisation of the third pillar; and ii) the harmonisation of the national insolvency systems applicable to bank liquidation.

The main stated objective of the CMDI's reform is to ensure that the rules governing bank crisis management and deposit insurance in the EU are applied effectively, with the aim of better preserving financial stability, depositor confidence and minimising the use of taxpayers' resources for public intervention. Thus, what is envisaged is not a radical change of the framework, but an adjustment of some areas of the current arrangements in order to improve their functioning.

In this context, the crucial issue under review is **the treatment of small and medium-sized banks.** As pointed out by the Commission, experience has shown that in many cases of failure of these banks, national authorities have adopted solutions outside the harmonised resolution framework, applying national measures, often resorting to taxpayers' resources instead of the insolvent banks' own resources (bail-in) or private resources from the industry (resolution fund and deposit guarantee scheme funds)[14].

Thus, the amendments aim to give the authorities more effective tools to deal with crises of small and medium-sized banks, through wider use of the resolution procedure, to ensure that, when financial stability is in danger, depositors, i.e. citizens, businesses and public entities, can continue to have access to bank deposits through their transfer to another bank. The resolution procedure is therefore regarded as the key component of the crisis management toolbox, as it is considered less disruptive to the economy and local communities than the liquidation procedure.

Whether this design approach is the most appropriate for solving the problems of small and medium-sized banks will have to be investigated in depth, also to assess its effectiveness in terms of flexibility. The risk that it could result in additional rigidity and burdens for the operators concerned must be avoided. Therefore, at this stage, an analytical assessment of the robustness and effectiveness of the solutions identified, with respect to alternative hypotheses that are also viable, as well as their actual compliance with the expectations put forward during the consultation, seems premature and will require in-depth reflection, also with a view to the debate that will be opened in the context of the examination and assessments by the co-legislators (European Council and Parliament).

Therefore, a few key points of the proposed package are analysed in the next section, postponing to subsequent reflections a more comprehensive and exhaustive evaluation of the technical profiles and operational implications of the choices made by the EU Commission.

4.2 Some reflections and indications on possible regulatory areas to be reviewed.

In identifying the areas for reform, it is first necessary to reflect on what the model of regulation should be, i.e. the general architecture of the foundational and unifying elements, the structural features, of regulation: these can be expressed in terms of principles and objectives to be pursued, which must be clearly identified in order to manage increasingly complex and variable situations. The key elements to be considered in redesigning crisis regulation are essentially two: Flexibility and Proportionality.

Why are these two elements so important?

Flexibility responds to a priority need that has emerged in the application of the current rules, which are characterised by rigidity and inefficiencies: only flexibility can enable the authorities to adequately address the diversity of national systems and the multiplicity of crisis situations that may arise in a macroeconomic scenario marked by increasing complexity and systemic crises of various kinds.

Flexibility must go hand in hand with **proportionality**, which is a cardinal principle of EU law; however, proportionality must not remain a mere statement of principle, but must be effectively applied, in order to use the procedures and instruments in a way that takes into account the diversity of the various components of the system. Specifically, proportionality should counter the risk that, in the name of uniform treatment and the level playing field - also important principles of regulation – rules are established that would entail an unjustified cost for a large number of banks, especially small and medium-sized ones, which pose much lower systemic risk, leading to regulatory diseconomies. Rules, therefore, must be carefully tailored to diversity in order to increase the efficiency and effectiveness of overall administrative action.

In concrete terms, principles and objectives concur to defining the policies informing regulation (**public policy objectives**). In the BRRD they are the principles and objectives of resolution (Articles 34 and 31 of the BRRD, respectively): they represent the legal foundation underpinning the activities of the resolution authorities.

The principles establish specific guiding parameters for administrative action and the framework for verifying its legitimacy and consistency, while allowing a degree of flexibility and discretion. In this regard, the aforementioned provision of the BRRD clearly

[14] The funds of deposit guarantee schemes and the resolution fund, safety nets financed by the private sector, are estimated to reach over EUR 55 billion and EUR 80 billion respectively by 2024 in the Banking Union.

spells out the general principles governing resolution, some of the key ones being: the participation in the losses first and foremost of the shareholders and creditors of the failed bank; the replacement of the management bodies and senior management of the bank; the accountability of those liable for the failure; the equal treatment of creditors of the same class; the rule that no creditor shall incur greater losses than those it would have sustained if the banking firm had been wound up under normal insolvency rules and procedures (No Creditor Worse Off - NCWO); the preservation of covered deposits; and compliance with the safeguards laid down in the directive.

These principles are undoubtedly valid, as they express the purpose and the direction in which crisis management is moving; they can therefore be considered adequate to address the specific features and complexity of banking crises; however, it cannot be ruled out that they might need to be aligned with the new framework that will result from the current revision, not least because a hierarchy between the different principles might need to be established.

The same consideration applies to the **resolution objectives**, to the pursuit of which the use of resolution powers and tools must be oriented: a) to ensure the continuity of critical functions; b) to avoid significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; c) to protect public funds by minimising reliance on extraordinary public financial support; d) to protect depositors covered by Directive 2014/49/EU and investors covered by Directive 97/9/EC; and e) to protect client funds and assets.

Like the principles, the objectives are also placed in the context of the resolution and refer to the use of the resolution tools. In this regard, a different approach could be followed by referring the principles and objectives not only to the resolution process, but to all crisis management measures, They could therefore have a more general scope, through their application to all crisis situations, even those dealt with outside resolution, such as liquidation, precautionary recapitalisation and preventive and alternative interventions of deposit guarantee schemes. On this basis, with principles and objectives clearly enshrined in law, the use of instruments would be entrusted to the authorities in a flexible manner, with administrative discretion in the exercise of powers: the balancing of the system would be achieved through the obligation imposed on the resolution authority to strengthen the grounds for the measures taken and the tools used, by demonstrating their clear compliance with the principles and objectives and tangibly specifying their effectiveness in resolving the crises. Finally, the choice of model also includes an assessment of the completeness of the instruments and their adequacy with respect to the principles and objectives to be pursued. On this point, the innovative element of the current European framework expressed in the 2014-15 directives is to be warmly welcomed: **the integrated approach to crisis management**. The integrated approach means that the legislation aims to regulate not only the management of bank insolvency situations, to establish how to intervene when they occur, but also all the various stages in which a crisis situation may develop, with the aim of intervening proactively to avoid the failure or reduce its harmful consequences. To this end, the 2014-2015 framework was enriched with **preparatory measures** (mainly, recovery and resolution planning exercises) and **early intervention measures** (EIM). Precisely in light of this crisis prevention purpose, the set of measures should be fully confirmed, subject to their adaptation to increase their application effectiveness and compliance with the principle of proportionality, to take into account the size and complexity of intermediaries. The preparatory measures were the real innovative element of the European reform. The **Recovery Plan** is based on the bank's ability - through an appropriate governance process - to plan for and cope with any deteriorating situations that may arise in the life of the bank; they are identified through a system of indicators that reflect the most relevant management categories (capital, profitability, liquidity, asset quality, market and macroeconomic indicators). The indicators are shared by the supervisory authorities when assessing the recovery plan. Exceeding the pre-established thresholds of the indicators determines the need for corrective actions. The plan is prepared by the bank and assessed annually by the supervisory authorities. It is an extremely important tool that is fully embedded in the bank's risk management process and in the Risk Appetite Framework (RAF), which is its highest expression in terms of methodology. Both exercises, the RAF and the Recovery Plan, which are subject to the approval of the bank's strategic supervisory bodies, must be appropriately structured, in order to enable the timely activation of the operational mechanisms necessary for launching and implementing remedial actions.

Figure 1 - The content of recovery plan: the set of indicators (EBA Guidelines, 2015)

Risk category	Indicators for each category	Alter threshold	Recovery threshold
Mandatory categories			
1. Capital	*CET1 ratio; TCR; Leverage ratio*	*Activation of corrective measures*	*Activation of measures in the recovery plan*
2. Liquidity	*LCR; NSFR; Cost of wholesale funding*		
3. Profitability	*ROA; ROE; Significant operational losses*		
4. Asset quality	*NPE growth; Coverage ratio*		
Excluded if an institution justifies that they are not relevant for it			
5. Market-based	*Rating; CDS spread; stock price variation*	*Activation of corrective measures*	*Activation of measures in the recovery plan*
6. Macroeconomic	*GDP variations; CDS of sovereigns*		

- *Indicators should not be limited to the minimum set*
- *Banks can include additional indicators, based on their specific business models and risk profiles*

The **Resolution Plan** is prepared by the Resolution Authority, with data and information provided by the bank, after consultation with the relevant supervisory authority. It is a key planning document, containing an analysis of the bank's characteristics, its essential functions, the possible existence of impediments to resolvability, and the determination of the bank's MREL (Minimum Requirement of Own Funds and Liabilities), the requirement to ensure that the bank maintains a minimum amount of capital and certain eligible liabilities to support an effective resolution.

The resolution plan concludes with an indication of:

(i) the resolution strategy, i.e. whether the bank in the event of insolvency should be liquidated in accordance with national insolvency proceedings or subject to resolution;

(ii) the possibility of submitting the bank to resolution (resolvability) without serious effects on the financial system and the economy. In this regard, the legislation specifies that resolution of an institution is deemed feasible when: i) in the opinion of the resolution authority, it is considered feasible and credible to wind up the institution under normal insolvency rules and procedures or ii) to resolve the institution by applying the various resolution tools and powers to it, while avoiding to the maximum extent possible any significant adverse effects – including in situations of financial instability or system-wide events – on the financial system in the Member State where the institution is established or in other Member States of the Union – and with a view to ensuring the continuity of critical functions carried out by the institution. For this reason, the resolution authority is required to assess whether there are impediments to the resolution of a bank (impediments to resolvability).

In this matter, discretion is very wide, both because the plan is prepared by the resolution authorities themselves, and because they can impose specific measures on financial institutions if resolution is not deemed possible due to significant impediments. In this case, the authority will initiate an administrative procedure aimed at inducing the bank to remedy the relevant impediments, by submitting a plan for implementing the identified measures[15].

The latter regulatory provision is particularly critical in terms of administrative action, because under it the resolution authority may require the bank – after assessing negatively the measures proposed by the bank itself - to take specific measures of particular complexity (alternative measures). These include requiring the institution to review any intra-group financing arrangements or assessing the absence or formulation of service contracts, either intra-group or with third parties, for the provision of essential economic functions; imposing limits on risk exposure; imposing additional disclosure requirements and divestment of specific assets; requiring changes to the business model and legal and operational structure of the institution to reduce its complexity; and issuing eligible liabilities to comply with the requirements of Article 45.

These measures are distinguished by the fact that they are not taken when the bank is failing or likely to fail, but when it is in an ordinary management situation (going concern) and the existence of impediments to resolvability is the result of the authority's assessment of whether the bank may be subject to resolution. In imposing these measures, the resolution authority must take into account the threat to financial stability that such impediments may pose and the effect of the measures on the institution's business, its stability and its ability to contribute to economic activity[16].

Early intervention measures are different from preparatory measures; they fall within the competence of the supervisory authority as they refer to situations (objective requirements) occurring prior to the bank's actual crisis and are aimed at preventing its occurrence. Such measures may be triggered by actual or expected breaches of prudential requirements, serious violations of regulatory provisions or serious administrative irregularities, or significant deterioration of the financial situation (Articles 27-29 BRRD). The measures may be of varying types and scope, such as, for example: the removal of all members of the management bodies, the removal of one or more members of senior management, the removal of individual executives, the placement of the bank under extraordinary administration or the appointment of extraordinary administrators to temporarily work alongside the ordinary bodies of the bank, the implementation of the measures set out in the recovery plan, including the request to the bank to agree on a debt restructuring plan with its creditors[17].

Early intervention measures - although rarely used by the European supervisory authorities - should also be confirmed, as they expand the toolbox for the prevention of bank insolvency. However, it is necessary to verify whether they may overlap with the supervisory measures envisaged in prudential regulation (CRD and Directive (EU) 2019/203419 concerning investment firms - IFD) and, if so, to identify ways to clearly distinguish them at the regulatory level, bearing in mind that some situations in which EI measures can be activated imply the existence of conditions of a certain severity (Figure 2), different from those underlying "ordinary" supervisory interventions.

These are measures whose activation must necessarily be marked by flexibility and not by rigid criteria and parameters, so that they can be initiated with the necessary timeliness and effectiveness, according to the technical and administrative discretionary assessment conducted by the supervisory authority. However, legislative clarification on when and to what extent non-compliance with prudential capital and liquidity requirements would trigger early intervention or resolution/liquidation measures would be

[15] THE SINGLE RESOLUTION BOARD, *Introduction to Resolution Planning*, 2016; EUROPEAN COURT OF AUDITORS, *Resolution Planning in the Single Resolution Mechanism*, Special Report, 01, 2021.

[16] This is one of the cases in which the Authority's discretion must be carefully calibrated in order to balance the measures necessary to simplify the structure and operations of the institution with the sole purpose of improving the possibility of resolving its crisis. Measures imposed in this regard should also comply with Union law, should not discriminate, directly or indirectly, on grounds of nationality, and should be justified in the public interest of financial stability. Moreover, intervention should be limited to the minimum necessary to achieve the desired objectives.

[17] Similar to these early measures are the preventive operations that DGSs can put in place as an alternative to the repayment of depositors and the precautionary recapitalisation or liquidity interventions with the use of public funds that the BRRD allows, under certain conditions, following supervisory stress tests.

welcome[18]. In this logic, early intervention measures must therefore remain entrusted to the prudential supervisory authority and not be transferred to the resolution authority, whose powers can only be activated in the presence of situations that denote an actual or prospective insolvency of the bank. The distinction between early intervention and resolution measures must therefore remain very clear, with no confusion between the situations underlying the two. The BRRD itself (Article 32(3)) states that the previous adoption of an early intervention measure is not a condition for taking a resolution action. To ensure effective interaction between supervisors and resolution authorities for the purpose of early intervention or resolution measures, cooperation and information exchange between the two authorities should be strengthened.

Figure 2 - Early intervention measures and their triggers

1

Infringement or likelihood to infringe regulatory requirements

- Implement one or more of the measures set out in the recovery plan
- Identify measures to overcome any problems identified and draw up an action program
- Convene a meeting of shareholders to require certain decisions to be considered
- Remove one or more members of the management body or senior management
- Draw up a plan for negotiation on restructuring of debt with creditors according to the recovery plan
- Require changes to the business strategy
- Require changes to the legal or operational structures
- Acquire all the information necessary in order to update the resolution plan and prepare for the possible resolution

2

Significant deterioration in the financial situation, serious infringements of law, regulations or statutes, serious administrative irregularities, or other measures sub 1) are not sufficient

- Removal of the senior management or management body, in its entirety or with regard to individuals. Appointment of the components done in accordance with national and Union law and be subject to the approval or consent of the competent authority

If measure sub 2) is deemed to be insufficient by the competent authority to remedy the situation

- Appoint one or more temporary administrators, based on what is proportionate in the circumstances, either to replace the management body of the bank temporarily or to work temporarily with the management body

In this sense, the objective conditions for triggering the resolution are relevant, in particular the ascertainment of the situation of failing or likely to fail (FOLF). The regulatory definition of this condition appears sufficiently clear and adequate (Article 32(4) BRRD), as it brings together all the possible conditions that can give rise to a bank's insolvency, in the sense of regulatory insolvency (capital, liquidity, non-compliance with legislation such as to require withdrawal of authorisation) and which may give rise to the application of crisis management measures (reduction and conversion of capital instruments, resolution, liquidation). There are, therefore, no sound reasons for revising these conditions, not least in light of the difficulty of capturing in a regulatory formula the highly disparate and complex situations that may indicate a state of irreversible crisis.

Figure 3 The notion of failing or likely to fail

A bank shall be deemed to be failing or likely to fail in one or more of the following circumstance

- The bank **infringes** or there are objective elements to support a determination that the institution **will, in the near future, infringe** the **requirements for continuing authorisation** including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;
- The **assets** of the bank are or there are objective elements to support a determination that the assets of the bank will, in the near future, be **less than its liabilities**;
- The bank is or there are objective elements to support a determination that the bank will, in the near future, be **unable to pay its debts or other liabilities** as they fall due;
- **Extraordinary public financial support** is required

[18] On the subject of objective prerequisites, it should be clarified how breaches of rules or serious irregularities or actual or expected violations of prudential requirements or significant deterioration of the bank's situation, established for the activation of certain early intervention measures, differ from the similar conditions (irregularities, capital losses, illiquidity situations) established for the initiation of resolution.

The concept of FOLF fully meets the objective of preventing a resolution intervention, and thus of flexibility, since the conditions it covers are not necessarily current, but may also be prospective, i.e. where "there is objective evidence to support the belief that in the near future" serious situations may occur[19], such as, for example, the loss of a significant part of the capital or the inability to pay debts or other liabilities as they fall due. Therefore, with the forward-looking view that characterises each starting requirement, the authorities are able to intervene in good time to open the resolution or liquidation procedure, before the business values are excessively reduced. Therefore, the timing of enforcement action does not depend on how the objective conditions are identified in law, but on how they are applied, because they are defined in very broad terms and from a forward-looking perspective, to enable prompt intervention for the protection of creditors. Therefore, supervisory and resolution authorities must liaise very closely in this field as well.

As a parameter innovating and clarifying the framework, the objective criterion of failing or likely to fail should be aligned with the requirements triggering liquidation in national laws, as the Italian legislator has done. In addition, on a procedural level, it should logically be for the supervisory authority (national or European, depending on competences) to determine the FOLF, given that the same authority has the powers to ascertain the technical situations of banks, including inspections, and to make assessments within the SREP.

Under current law, FOLF may also be determined directly by the resolution authority, after consulting with the supervisory authority, if it has the necessary tools to make such a determination, such as adequate access to relevant information.

The decision to align the objective requirements for resolution and liquidation should, however, be part of the process of harmonising national insolvency regimes. In this regard, as clarified by the Commission, during the public consultation 18 national resolution authorities stated that such harmonisation would be useful, possibly by aligning the factors that trigger national insolvency regimes with those that trigger resolution and, in particular, with the conditions under which a bank is declared failing or likely to fail. On this point, however, some difficulties in achieving said alignment have been pointed out, as it involves areas of law that remain within the competence of Member States, such as company law and other legislation applicable to insolvency situations.

The wide range of **resolution tools** provided by the current legislation (bail-in, sale of business, bridge bank, bad bank-good bank separation) is a positive factor, as these tools can be applied to the bank in crisis to pursue reorganisation/re-capitalisation solutions or to transfer the business to other intermediaries, depending on the actual circumstances, to be assessed individually. It is difficult to imagine other solutions outside those envisaged by the legislation.

From the point of view of the general architecture of crisis management legislation, as already observed for the principles and objectives of resolution, the tools should also more properly refer to all the ways of resolving banking crises and not only to resolution; this would overcome the current rigidity, under which the principles, objectives and tools are only applicable to large or complex banks, through resolution, and not to small and medium-sized banks, which would be destined to essentially liquidation solutions, as emphasised some years ago by the Chairman of the Single Resolution Board, according to whom 'resolution is for the few, not for the many' [20] .

This alternative proposal aims to make the principles, objectives and tools currently provided for resolution applicable to all banks, regardless of their size or complexity, thereby extending the potential application of the resolution tools (not of the resolution procedure) to all crisis situations. Indeed, in many countries restructuring measures in insolvency situations have been applied to small and medium-sized banks as well, through recapitalisation, the sale of the business, the creation of bad banks for the management of non-performing assets and the establishment of bridge banks for the temporary management of the business, when there are no banks on the market willing to take over the insolvent bank. In some cases, even small and medium-sized banks may be 'too big to liquidate' under national insolvency rules, due to the systemic impact that the failure of a small and medium-sized bank may have.

Such an approach fully reflects the principle of flexibility, under which procedures and instruments should be chosen on the basis of a technical assessment of the most appropriate solution to best pursue the principles and objectives outlined by the legislator, and not on the basis of rigid rules, laid down by law, excluding a priori the application of some instruments to certain categories of banks.

In order to achieve this result, it would be necessary to go beyond the current requirements for activating the resolution procedure, which include, in addition to the other requirements (FOLF, lack of private or supervisory initiatives to overcome the crisis), the ascertainment of the existence of a **public interest** (PIA - *Public Interest Assessment* - Article 32.5 BRRD). This requirement implies that when a bank is declared to be failing or likely to fail, in order to trigger resolution it is necessary to establish that resolution serves the public interest; according to the same provision, resolution action serves the public interest if it is necessary for the achievement of one or more of the resolution objectives set out in Article 31 and is proportionate to them, and if winding up the institution under ordinary insolvency proceedings would not achieve those objectives to the same extent.

In reality, experience has shown that the assessment of the existence of this condition is fraught with problems, and has given rise to different interpretations and implementation practices; it has often led to the non-application of the resolution procedure, with the result that national solutions have been adopted that have also involved the use of public money for fear of triggering the bail-in of certain categories of creditors and depositors, in the absence of adequate loss-absorbing capacity on the part of the insolvent bank. Therefore - as demonstrated by some banking crisis events - the definition of public interest should be reconsidered and clarified, as it does not consider that public interest might also apply to small and medium-sized banks, when they have certain structural and functional characteristics, such as, for example, being rooted in a certain local or regional area, the degree of credit assistance provided to small and medium-sized enterprises in the local economy, entailing the need to ensure continuity of the essential

[19] G. BOCCUZZI, *Il regime speciale della risoluzione bancaria. Obiettivi e strumenti*, Cacucci Editore, 2018, pp. 132 ss.
[20] E. KOENIG, *Developments in the SRB: Setting MREL and Safeguarding Operational Continuity*, Speech to the BPFI in Dublin, 29 January 2019.

functions performed, or significant participation in the payment system; these banks also imply the objectives of protecting depositors and clients' funds and assets, which are independent of the banks' size.

In this regard, there could be essentially two ways forward:

(i) broadening the concept and scope of public interest so as to allow the application of the resolution process and related tools also to small and medium-sized banks, depending on the specific circumstances of individual cases. This option implies that, compared to the current definition of PIA, an additional number of banks, previously subject to the liquidation strategy, would be eligible for resolution. The number of these banks would not be determinable in advance, as assessment of the existence of public interest would be made on a case-by-case basis by the resolution authorities at the time of insolvency, based on the bank's financial situation and its ability to access internal and external funding (the bank's loss-absorbing capacity and the use of private safety net funds, respectively). This is the approach followed by the Commission in its legislative proposal[21]; however, it remains to be assessed whether this solution is the most appropriate one, as the application of resolution to small and medium-sized banks could lead to unjustified burdens on them (MREL, application of bail-in, reporting requirements), which are currently not applicable or are applicable to a lesser extent;

(ii) alternatively, the concept of public interest might be removed altogether, on the assumption that the management of banking crises always implies the pursuit of a public interest or, better, a general interest. Under such a model, the choice of crisis management measures and tools, as mentioned, would not be linked to conditions rigidly predetermined by law, but to the specific features of the banks' financial conditions at the time of the crisis and to assessments of a predominantly technical nature assigned to the authorities. Consistent with this approach, the resolution tools would be potentially applicable to all banks, with the consequent possibility of activating restructuring measures or transferring the company or business, with recourse to external funding provided by the banking industry (Resolution Fund and DGS).

In conclusion, the regulatory definition of principles and objectives referable to all banks and not only to certain categories of banks (large, small and medium-sized banks; international, national and regional banks) is of crucial importance, because it constitutes the legal basis for giving to the administrative authority the power to take the most correct and consistent decisions in terms of the instruments that can be used in concrete cases. The proposed approach aimed at flexibility recognises a certain margin of discretion for resolution authorities, provided that its exercise is tied to clear principles and objectives, which thus constitute the limit to the discretionary power itself and the most effective way for third parties affected by measures of the authorities to review their legitimacy.

Here lies the **distinction between resolution and liquidation**. Both are procedures involving the insolvency of the bank (failing or likely to fail), but the operational mechanisms are different. In its current legislative configuration, resolution constitutes a measure for the restructuring of the insolvent bank, either through recapitalisation with the bank's internal resources (bail-in - going concern) or sale of the business (gone concern), together with other resolution tools. In both operational perspectives, resolution allows for the continuity of essential functions of the failing bank, i.e. those activities, services and operations whose interruption could jeopardise financial stability or the performance of certain services of key importance to the real economy. If, on the other hand, the failure poses no risk to financial stability (because the bank is small and does not serve a public interest), the bank is liquidated according to national insolvency laws. This distinction does not appear fully satisfactory and should be overcome, through a process that aims primarily at the restructuring/disposal of all banks in FOLF situations and in all cases where this is feasible in terms of both economics and market conditions, leaving winding up as a last resort.

In any case, even where liquidation proceedings are opened, they should be conducted in such a way as to minimise risks for creditors and safeguard the continuity of credit relationships, through - as far as possible - the transfer of assets and liabilities (preferably all deposits, covered and uncovered) to another bank (**Orderly Liquidation**). In this configuration, resolution and orderly liquidation would have many aspects in common and the distance between the two procedures would be very short. OL leads to the termination of the liquidated bank's business and its exit from the market, but its assets and liabilities are sold in a lump sum, in the same way as the sale of business in resolution, possibly accompanied by the establishment of a bridge bank and/or the separation of bad and good banks. Thus, OL is also a form of resolution, if one looks at the economic substance of the operation. It would differ from resolution in that only the latter makes it possible to recapitalise the bank through bail-in (open bank bail-in). Orderly Liquidation (OL) is a crisis management procedure already applied in many jurisdictions, including Italy since 1936.

On the other hand, pure and simple liquidation, so-called **'atomistic' liquidation**, would remain different. It would maintain its own physiognomy as a procedure that determines the closure of the bank's activity and the intervention of the deposit guarantee system to reimburse depositors within the limits provided for by law. It would constitute a last resort, applicable to small banks for which a 'resolution' operation cannot be achieved through a business transfer, also due to the lack of interest from potential buyers.

The approach outlined above would have inevitable repercussions in the drafting of the resolution plan, for the purpose of identifying the applicable resolution strategy, since - despite the difference between the two procedures from a legal point of view - substantial identity of the solutions that can be implemented in the context of resolution and liquidation could be achieved, with the

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[21] Under the Commission's proposal, resolution authorities would determine on a case-by-case basis whether a bank should undergo resolution or liquidation, based on an assessment of the public interest and of how the two alternatives would serve the objectives of financial stability, protection of depositors and taxpayers. To this end, the proposal clarifies that the effects of the bank's critical functions on financial stability should be assessed at the regional level and not only at the national level, and that the resolution framework should be applied appropriately to banks of any size when it is capable of achieving the objectives of orderly crisis management, reducing the likelihood that the choice made by the resolution authority in the planning phase may change at the time of failure.

exception of internal recapitalisation through bail-in, which is exclusive to resolution; the other tools, in fact (transfer of business, bridge bank, bad bank-good bank separation), are also applicable in the context of liquidation.

In theory, both procedures (resolution and orderly winding-up) should converge in the determination of losses; should this parity not be achieved, the **No Creditor Worse Off (NCWO)** principle would be triggered in the resolution, which provides for the intervention of the Resolution Fund to indemnify creditors who have been treated less well in the resolution than they would have been in the winding-up procedure, had it been applied.

A further point is the definition of the objective extent of the transfer, i.e. the determination of the scope of the transferable assets and liabilities; in this field, flexibility should be maximised: there should be no limiting regulatory provisions, given that the scope of the compendium to be transferred (assets, in whole or in part, total deposits, only protected deposits, other liabilities, all liabilities) may not depend on the rules but on the concrete technical situation of the insolvent bank and the objectives to be pursued, subject to compliance with the principle of *par condicio creditorum*, taking into account the loss coverage that may be provided by the deposit guarantee scheme or by public support for larger and more complex banks.

Another area of flexibility concerns the modalities of **intervention of deposit guarantee schemes**[22], for which the European experience presents different institutional and operational architectures: some are limited to the simple reimbursement of depositors (pay-box function), others include further operational modalities aimed at intervening to avoid the insolvency of the bank (preventive measures - Article 11(3) DGSD) or as part of liquidation proceedings through the transfer of assets and liabilities of the liquidated bank to another bank (alternative measures, similar to the OL - Article 11(6) DGSD). Both types of measures, as mentioned, could be defined as quasi-resolution.

The way forward to increase the flexibility and effectiveness in the use of DGS funds should be to privilege, as far as possible, the intervention of DGSs to implement preventive and alternative measures with respect to the reimbursement of depositors, if such intervention is less costly than a payout[23]. However, the least cost parameter should be more clearly defined at regulatory level, especially in qualitative terms, leaving the quantitative technical assessment and the underlying parameters to the DGSs. On the other hand, the actual achievement of least cost depends on the ranking accorded to depositors and to the deposit guarantee scheme in the creditor priority scale in insolvency and resolution proceedings (depositor preference); moreover, these interventions should not be qualified as State aid, since they are supporting operations carried out with private funds from the banking sector.

Under the current framework, deposits of less than EUR 100,000 are protected by law, regardless of their position in the hierarchy of creditors in insolvency proceedings. The treatment of deposit guarantee schemes that are subrogated to reimbursed depositors is also highly privileged (super depositor preference). The current regime provides for a three-tier ranking of depositors (three-tier depositor preference): 1. at the highest tier are protected deposits and the claims of deposit-guarantee schemes subrogated to reimbursed protected depositors; 2. after tier-1 creditors, are the unprotected deposits of households and small and medium-sized enterprises; 3. at the third tier, after tier-2 deposits, are the other unprotected deposits. The configuration of depositor preference differs in the EU Member States: in most countries, unprotected deposits have the same priority as ordinary unsecured claims (e.g. senior bonds); in other countries, unprotected deposits are placed above ordinary unsecured claims.

There can be several options for modifying depositor preference, depending on the solutions to be favoured, including for the application of the least cost parameter. The legislative proposal put forward by the Commission, accepting the suggestions made by some countries, aims to eliminate the super-preference of protected deposits and deposit guarantee schemes and to create a single-tier for all deposits (protected deposits and deposit guarantee schemes, unprotected deposits of households and small and medium-sized enterprises and other unprotected deposits). In particular, by removing the super-preference of DGSs, the proposal aims to eliminate one of the main difficulties in the current system in using DGSs for non-payout transactions (in particular, business transfers), given the difficulty in overcoming the least-cost constraint; indeed, under the least-cost principle, a DGS, for preventive and alternative interventions, can only cover charges up to the amount of the losses it would incur in the event of a hypothetical payout of protected deposits in insolvency proceedings, losses that would be equal to the difference between the amount disbursed to repay depositors and the amount a DGS would recover from the realisation of the liquidation assets. A two-tier depositor preference option could also be considered, eliminating only the super-priority of protected deposits and DGSs in the creditor hierarchy.

The underlying rationale behind the legislative proposal is to expand the **intervention in the resolution of DGSs**, whose resources may be needed to supplement the Resolution Fund's funding for interventions in favour of small and medium-sized banks. The innovative aspects contained in the proposal are many, and their implications must be carefully assessed.

Currently, the BRRD reserves a secondary role for DGSs in financing resolution, with the guarantee system being able to intervene only in limited cases and under stringent conditions; in contrast, the role of the Resolution Fund is broader since, in the event of a bank undergoing resolution, it can intervene to cover losses and replenish capital or to make it possible to transfer the business, under certain conditions (Article 101 BRRD).

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[22] The Commission's legislative proposal aims to further harmonise deposit protection at EU level, extending protection to public entities (such as hospitals, schools, municipalities) and to the holdings of customers of non-bank intermediaries (investment firms, payment institutions and electronic money institutions). Also to be harmonised is the protection of temporary high balances deposited with a bank in excess of EUR 100,000 linked to specific life events (inheritance, insurance benefits).

[23] According to the European Central Bank, each Member State has at least one medium-sized or smaller bank for which a payout of deposits would exhaust the funds of the national deposit guarantee scheme. Therefore, the implementation of payouts in case of liquidation entails the risk of a shortfall of resources for deposit guarantee schemes..

Paragraph 2 of the same Article states that the Resolution Fund cannot be used "directly" to absorb losses or to recapitalise an institution or entity referred to in Article 1(1)(b), (c) or (d). However, where the use of the resolution financing arrangement results "indirectly" in the transfer of part of the losses of an institution or entity to the resolution financing arrangement, the principles set out in Article 44 BRRD shall apply.

Article 44 stipulates that the use of the Resolution Fund for loss coverage and recapitalisation of the bank in resolution is possible, based on the assessment made by an independent valuer, if: i) there has been a contribution to losses and recapitalisation by shareholders and creditors (bail-in) to the extent of at least 8% of the bank's liabilities, including own funds; ii) the contribution of the Resolution Fund does not exceed 5% of the liabilities, including own funds, of the bank. The provisions on indirect activation of the Resolution Fund to cover losses were later clarified by the EBA[24].

Pursuant to the BRRD, the Deposit Guarantee Scheme may also be called upon to intervene on a compulsory basis for the financing of resolution, subject to certain limits and conditions; but it should be specified immediately that this type of intervention, governed by the rules established by the BRRD, is merely a possibility and a last resort.

Under Article 109 of the BRRD, the Deposit Guarantee Scheme (DGS) may intervene to cover losses resulting from resolution in those limited cases where they affect depositors' claims under ordinary national insolvency rules. In such cases, the DGS intervenes in place of protected depositors in order to hold them harmless from the effects of resolution. The Resolution Authority shall determine, in consultation with the DGS, the amount to be paid by the DGS in cash, in accordance with the assessment made by the independent valuer. Therefore, the mechanism identified consists in a loss-absorbing function at the DGS's expense, and not the function of reimbursing depositors where the bank is wound up.

Article 109 also lays down the criteria for determining the amount required from DGS to cover losses; in particular:

a. if the bail-in tool (Article 43 BRRD) applies, the amount is equal to the amount by which the protected deposits would have been written down for the purpose of absorbing the bank's losses pursuant to Article 46(1)(a), had the protected deposits been included in the bail-in and written down to the same extent as creditors having the same priority level under national insolvency law;

b. if the other resolution tools, other than the bail-in, apply, the amount corresponds to the losses that the covered depositors would have suffered if the covered depositors had suffered losses in proportion to the losses suffered by creditors with the same priority level under national insolvency law.

The same provision is confirmed by the DGSD in Article 11(2), which provides that the financial means of the DGSs are used to finance the resolution of credit institutions in accordance with Article 109 of the BRRD and that the amount to be borne by the Guarantee Scheme shall be determined by the resolution authority, after consultation with the DGS.

To summarise, the following are required to determine this amount:

- the prior application of the bail-in in the aforementioned minimum amount of 8% of liabilities, including own funds;

- the use of the resolution fund (up to the maximum limit of 5% of the same liabilities per bank);

- where losses have not been fully covered, further bail-in on other eligible liabilities, taking into account the applicable depositor preference rules[25];

- the DGS shall intervene to contribute to the coverage of losses only after all other creditors lower in the order of priority have participated in the coverage of the bank's losses and only for the portion that may remain.

Finally, DGSs also benefit from the application of the No Creditor Worse Off (NCWO) rule, under which a DGS cannot be called upon to cover losses exceeding those it would have incurred had the bank been liquidated under national insolvency rules; if this were to occur, DGS would be entitled to compensation from the Resolution Fund for the difference, in the same way as any creditor affected to a greater extent than in ordinary insolvency proceedings.

There is also an overall quantitative limit on a DGS's intervention, as it may not exceed 50 % of its target level of available resources.

The combination of these constraints means that the intervention of DGSs in resolution is limited to very few cases, and is in practice not usable[26].

A different, more flexible application of Article 109 BRRD was followed in the case of the Polish Getin Noble Bank[27], through the simultaneous use of voluntary funds injected into the resolution by the largest Polish banks in order to avoid loss-sharing on the part

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[24] According to the EBA, as a general principle, under Article 101(2) BRRD, the Resolution Fund may indirectly absorb part of the losses of the institution under resolution, applying the principles set forth in Article 44 BRRD. It is clarified that even if not all losses are absorbed by the creditors of the institution but the absorbed losses amount to at least 8 % %of total liabilities, the Resolution Fund may be used for the purposes indicated in Article 101(1): for example, to cover the difference between the assets and liabilities transferred to a bridge bank.

[25] The bail-in requires not only shareholders and subordinated creditors, but also other eligible creditors (in general, unsecured creditors, subject to expressly provided exceptions) to contribute to covering the losses of the bank in resolution, in accordance with national insolvency rules. In this regard, Article 48 BRRD establishes the sequence in which the Resolution Authority must order the write-down or conversion of the bonds of a bank in resolution; this sequence has been further specified by the EBA, which issued guidelines on this point to facilitate the application of the bail-in. On this topic, EBA, Final guidelines concerning the interrelationship between the BRRD sequence of write-down and conversion and Crr/Crd, 5 April 2017.

[26] G. BOCCUZZI, *Il regime speciale della risoluzione bancaria. Obiettivi e strumenti*, Cacucci Editore, 1998;

[27] G. BOCCUZZI, *La risoluzione della banca polacca Getin Noble: la disciplina europea alla prova della flessibilità,* Bancaria, 2023.

of depositors with funds above the protection level (so-called eligible deposits)[28]. This solution amounted in substance to bail-in through recourse to the banks' private funding; otherwise, achieving the same result would have required greater recourse to DGS resources, beyond the limits set by Article 109.

This was a case where substance prevailed over the letter of the bail-in rule, made possible through the voluntary intervention of the banks, which ensured parity of outcome, through a certain margin of flexibility in interpretation. But the question arises as to whether greater flexibility might be achieved through appropriate revision of the current rules on the joint intervention of the various sources of resolution funding.

A more structured solution is outlined in the Commission's reform proposal, which, as already pointed out, tends to extend the application of resolution to small and medium-sized banks, through broader recourse to DGSs in resolution, in order to carry out transactions to transfer the failing bank to another larger bank (sale of business), with the former exiting the market. The rationale for such an approach is that, in the absence of the EDIS, the failures of such banks can be dealt with more efficiently through resolution, if there is a public interest, through the use of the SRF, thus avoiding recourse to public intervention. The activation of such a mechanism would be conditional on compliance with the SRF access condition of a minimum bail-in of 8% of the TOFL.

This condition would be met through a DGS 'financing bridge' to cover the part of the losses not covered by the bank's loss absorption capacity[29]. As clarified by the Commission, the use of DGS funds for interventions in favour of small and medium-sized banks in resolution would only be possible (i) when the resolution authority deems it necessary to safeguard financial stability and to protect taxpayers by ensuring the exit of the insolvent bank from the market; (ii) when it avoids losses for depositors, which would be bailed-in, including those with assets above the coverage level; and (iii) when appropriate conditions and safeguards are met (minimum bail-in; that the bank concerned is eligible for resolution, as set out in the resolution plan; that the use of DGS funds in resolution as a bridging measure meets the least-cost condition, which, in turn, requires the removal of DGS super-preference).

In the current framework, resolution authorities set - bank by bank - the MREL, which constitutes the minimum amount of equity and 'bail-inable' instruments that a bank must possess to absorb losses and replenish capital in the event of resolution. In this approach, the MREL constitutes the first line of defence to ensure that the bank has sufficient internal equity to meet the cost of its failure. Even in the new perspective outlined in the Commission's proposal, internal loss-absorbing capacity would remain the primary tool for financing bank insolvency; when it is necessary to use DGS in resolution, appropriate safeguards are foreseen: (1) that the resolution authority considers that bailing-in depositors (to achieve the minimum bail-in of 8 %) could pose risks to financial stability; (2) when the resolution strategy envisages that the insolvent bank is targeted for market exit; and (3) a cap on the amount of funds to be used is provided, in order to protect the funds of deposit guarantee schemes.

Regarding, more generally, funding, the current framework is based - and would also continue to be based in the reform proposed by the Commission - on two sources: the RF/SRF in resolution and national guarantee schemes for different types of intervention (preventive measures, resolution, payout of covered deposits and alternative measures in insolvency). Access to the RF/SRF for solvency support to certain small and medium-sized banks would remain a critical issue, in view of the minimum bail-in of 8% TLOF that needs to be achieved. In a broader perspective, the question arises as to whether the banking crisis management system should use two distinct financing mechanisms - **DGS/EDIS funds and Resolution Fund/SRF** - in view of the uniqueness of the crisis phenomenon and the source of the funding, i.e. financial resources from the banks, hence private funds.

These are all issues that will emerge when the **European Deposits Insurance Scheme (EDIS)** is set up, the third pillar of the Banking Union, which is still in the planning stage despite the time that has elapsed since the proposed regulation (2015). Roadmaps of the project's path have been prepared for years, but the timetable inexorably moves further and further ahead. There are political obstacles that cannot be easily removed, because there is a tendency to make risk-sharing associated with EDIS conditional on the reduction of risks in banks' balance sheets, including sovereign risks: the issue on which the EDIS project has so far stalled. This is an issue on which attention must remain high, in light of the serious consequences that may result from imposing constraints on weaker countries in terms of bank balance sheets composition and public budget management.

Finally, an issue of crucial importance for the recovery of flexibility, efficiency and effectiveness in crisis management concerns the rules on **State aid**, established by the Commission's Communication of 30 July 2013, which lays down specific provisions for State intervention in bank bailouts. The current rigidity lies in the fact that the Commission brings under the notion of State aid certain types of intervention that do not actually give rise to the use of State funds, as they use financial resources that come from the banking sector and, therefore, have a private nature, even though they can be activated under the direction of public authorities (resolution authorities, public guarantee system).

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[28] It should be considered that, at present, the information on the Getin Noble Bank transaction is insufficient for its proper positioning in the existing regulatory framework, since the documents relating to the various components of the transaction have not yet been published: it should be noted that the case of Getin falls outside the scenario of use of the Guarantee System under the DGSD; indeed, where resolution is implemented, given the letter of the provisions, the preventive and alternative interventions provided for in Articles 11(3) and (6) of the DGSD and the least cost principle are not applicable, because, as mentioned, in a resolution the intervention of the DGS is determined by the Resolution Authority, in cash, to help cover losses after the application of the bail-in and the intervention of the Resolution Fund.

[29] The DGS would intervene to support the transfer of the bank in resolution, resulting in its exit from the market, by covering losses that would otherwise be incurred by depositors in order to meet the 8 % TLOF requirement, which is a condition for access to the RF/SRF. As pointed out by the EU Commission, evidence shows that for certain banks with a high prevalence of deposits, meeting the 8 % requirement could lead to losses for depositors, with possible serious effects on the economy, depositor confidence and financial stability. Therefore, DGS funds would contribute to supplementing the bank's loss absorbing capacity (i.e. the resources of shareholders and creditors other than depositors) in order to reach the 8 % TLOF and allow access to RF/SRF resources.

On this point, the most appropriate solution would be to separate the public nature of crisis management actors, decision-making processes and intervention methods, on the one hand, and the source of the financial resources used, on the other. This could be done by excluding from State aid rules interventions implemented with the resources of resolution funds and DGSs, given their nature as private external support interventions for financing the solution of the crisis, protecting financial stability.

On the other hand, interventions carried out through the use of State funds in resolution (public financial stabilisation instruments - Article 56-58 BRRD) and those carried out outside resolution (issuance of guarantees against liabilities and precautionary recapitalisation - Article 32(4)(d) BRRD) would remain included in the notion of State aid. However, the conditions for their implementation should be better regulated, as the lack of sufficiently precise rules in the current legislation risks generating uncertainties in interpretation and application[30].

5. Conclusions

The analysis carried out in the previous chapters aimed at providing a sufficiently broad picture of the strengths and weaknesses of the current European banking crisis management legislation introduced in the 2013-2015 period. The experience of the first decade of application of this legislation, including that of Italy, has clearly highlighted that the main instruments of the new framework have had very limited or no application (resolution procedure, bail-in, single resolution fund), resulting in the application of other tools available at national level, deemed more effective by the relevant resolution authorities.

It is from this consideration that we must start when thinking about a revision of the current legislation, enhancing all the positive aspects that national experiences have shown. To do this, it is necessary to increase the flexibility of regulation, in order to stimulate the widest application of all available procedures and tools, overcoming certain shortcomings and inconsistencies that mark the existing rules. These weaknesses have been due to some extent to rigidity, which has led to a close correlation between procedures, instruments and funding methods, often preventing a more efficient and effective resolution of the crisis. This rigidity was justified, as it was primarily aimed at remedying the excessive propensity of States, in order to cope with the chain of bank insolvencies that occurred during the global financial crisis, to rescue banks through the use of public intervention tools, passing the costs onto taxpayers.

This rigidity, when tested, has proved to be excessive and now requires correction in order to improve the functioning of the entire crisis management system. Flexibility is essential to enable the Authorities to manage increasingly complex situations in macroeconomic and regulatory contexts characterised by accentuated variability and systemic crises of various kinds[31].

The reflections in section 4.2 support the validity of the principles, objectives and instruments governed by the current framework, while outlining a different way of using them in order to increase their flexibility and strengthen their effectiveness.

The changes to be introduced are not few, as they concern essential junctions of the overall framework. In order to do so, it is necessary to break free from some of the patterns of the current legislation in order to create a new framework that makes the most of the best national experiences.

Some elements in the direction of flexibility seem to emerge from recent solutions to banking crises, as in the case of the resolution of the Polish Getin Noble Bank[32]. In the Getin Noble Bank insolvency, the European and national authorities used a comprehensive set of measures, creating a bridge bank while also using in the resolution the resources of private safety nets (the Resolution Fund, the Deposit Guarantee Scheme and the financial means made available, on a voluntary basis, by the largest Polish banks). The activation of voluntary private resources to cover part of the losses allowed a substantial application of the bail-in in the amount of at least 8% of TLOF, which was necessary for the mobilisation of the Resolution Fund. Furthermore, it has been recognised that the resources from the Resolution Fund and the Deposit Guarantee Fund - although constituting State aid - are nevertheless resources from private bank contributions that avoid recourse to public intervention. Based on this distinction, the transition to qualifying these resources as private sources of funding or as a *tertium genus* is quite straightforward, in order to exclude them from the application of the State aid rules. This would create an arrangement in which the goal of financial stability would take precedence over that of competition and the decision-making process would be speeded up, making crisis management more efficient.

In this regard, it is worth recalling the events that occurred in Italy with Banca Tercas and the four banks in resolution, in which the Commission considered the resources of the DGSs used for preventive interventions as State aid, an approach that was subsequently considered unlawful by a landmark ruling of the Court of Justice[33]. On the other hand, among the various options under study for funding banking crises, there is also that of concentrating in a single fund the private resources provided by the banking system, regardless of the type of solution to which they are applied (resolution, liquidation, DGSs' preventive and alternative measures): this would be an effective response to the problem of the failure to use the single resolution fund in this decade, with the consequent immobilisation of resources of the European banking system and the activation, instead, of national deposit guarantee funds.

Thus, the way forward would appear to be not to revise the instruments, but the manner of their application, on the basis of clear principles and objectives, to which the authorities must refer for their flexible application, according to the specificities of the cases to be resolved. This approach would be significantly different from the current one, based on the rigid correspondence between types of procedures and instruments.

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[30] On the functioning of precautionary recapitalisation, applied in Italy to the Monte dei Paschi di Siena case, see G. BOCCUZZI, Banking Crises in Italy. An Application and Evaluation of the European Framework, Palgrave Studies in Financial Instability and Banking Crisis Regulation, 2022.

[31] G. BOCCUZZI, *Il settore bancario tra crisi sistemiche e regolamentazione. Le nuove sfide della complessità nella dimensione europea*, I battelli del Reno, Bari, 2022.

[32] G. BOCCUZZI, *The resolution of the Polish bank Getin Noble: European legislation put to the test of flexibility*, Bancaria, 2023.

[33] Court of Justice of the European Union, 2 March 2021, Judgement in case C-425/19 P, Commission v Italy, Fondo Interbancario di Tutela dei Depositi, Banca d'Italia et Banca Popolare di Bari ScpA.

In this approach, in fact, it is precisely the contextual participation of financing mechanisms based on private contributions (Resolution Fund and DGS) that can be a solid motivation, from a competitive point of view, that justifies the use of the public instrument in cases of crises of greater complexity and systemic relevance. In such situations, public and private resources may effectively concur to financial stability. The CMDI reform proposal now put forward by the Commission requires careful reflection on the choices made with regard to the most sensitive aspects of the current regulation, in order to assess whether they are able to respond effectively to the critical issues encountered in application and the policy indications that emerged during the public consultation.

In the debate that will develop in the legislative fora (Council and Parliament), these choices will certainly undergo critical scrutiny and their robustness will be verified compared to other options that are equally technically and operationally feasible. In this context, particular consideration should be given to the proposal to apply the resolution to small and medium-sized banks, consequently subjecting them to the requirements and rules currently applicable to large and complex banks and centralising decision-making processes and decisions at European level (SRB). Will this institutional set-up be effective? How would the coordination between national and European authorities work? Would such a system be consistent with the proportionality principle? Would it ensure flexibility in the utilisation of tools and procedures?

On the other hand, the incompleteness of the legislative proposal raises many questions, given that the reform of the State aid rules, the completion of the Banking Union through the establishment of EDIS, and the harmonisation of national insolvency laws are left out of the package: all issues on which the debate has been extensive for years, with multiple solutions proposed. The approach that is being followed is a policy of small steps, which does not seem to adequately meet the need for a comprehensive intervention in which all components are regulated in a coherent manner. Hence the basic question as to whether the strategic approach followed by the European legislator is adequate to such a sensitive and complex subject - crisis management - involving the treatment of insolvent banking enterprises, with consequent implications in terms of the protection of third parties' rights and the effectiveness of interventions in terms of financial stability.

As has been emphasised, the complexity of the matter requires flexibility in intervention, a value that is well above other objectives - albeit significant in the logic of the European system - such as uniformity and levelling of the playing field - which are important in situations of normal management, but take a back seat to the higher objectives that come to the fore in crisis situations: to protect financial stability, depositors and the continuity of the essential functions performed by banks.