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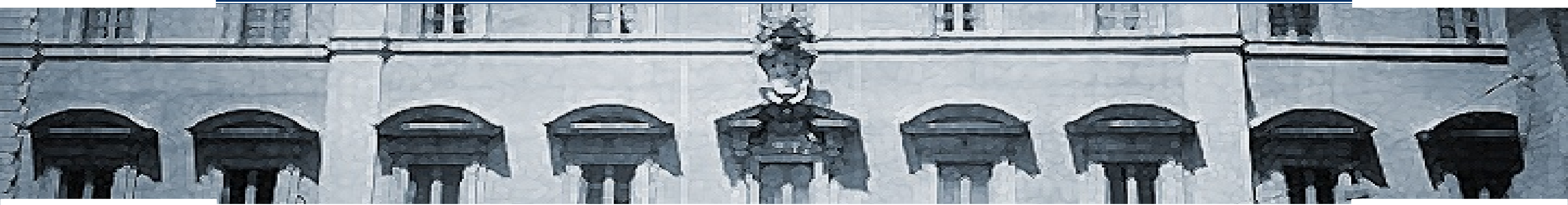

THE BANKING UNION: THE INTERIM BALANCE OF AN AMBITIOUS PROJECT

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The Resolution Funds of Banks and European State Aid Control: Comments on the TERCAS-Case

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The TERCAS case allows to make some points on the current challenges for the BU

- The recovery and resolution framework has positively raised **market players' awareness on the crisis management issues** at large, particularly stimulating banks to develop specific skills and processes in an integrated view of the business models

- Despite the progress, the recovery and resolution framework face **structural challenges,** and improvements are needed to enhance their effectiveness, efficiency and robustness

- The BRRD was too rapidly approved on the spur of the crisis moment and pressure, now there's **large consensus on its substantial inefficiency**

The Recovery and Resolution framework: main shortcomings

- **Resolution** seems **not to be fully applicable** due to its potential high costs (social, reputational, political and financial), also considering that bank failures are still traumatically perceived

- **Resolution** and **recovery planning rules require massive energies** to comply with, which do not correspond to adequate benefits especially for LSI, because they are unlikely to be resolved ("*resolution is for few, liquidation for many")*

- the EU banking rules **paradoxically risk to have counterproductive effects**: in fact, on medium/small size banks MREL determines funding needs that are often non-sustainable and can potentially hamper their financial stability (chronological inversion MREL/bail-in)

- A reassessment of **DGS ex ante interventions** (TERCAS case)
- A **review of the 2013 Commission Communication on state aids** (TERCAS case)

TERCAS case: regulatory background (1/2)

Art. 107, paragraph 1 of the Treaty:

state aid is not prohibited per se but only when it causes a distortion of competition at European level (exchanges between member states), therefore in the absence of this distortive effect, the aid can be authorized as "compatible".

BRRD:
does not exclude *tout court* any public intervention BUT gives specific conditions for its admissibility:

- it must represents a solution of last resort after having assessed and used to the maximum extent possible (...) the other resolution tools" and having assessed its inability to avoid systemic consequences (see Article 56, paragraphs 3 and 4, BRRD).
- article 37 requires that the aid be accompanied by a "burden sharing", in the form of devaluation and/or conversion of capital instruments and other eligible liabilities, "for an amount not less than 8% of the total liabilities" of the body.

Financial stability vs ***competition***

interventions needed to restore the bank's financial soundness

minimization of public intervention

TERCAS case: regulatory background (2/2)

BRRD substantially links *public interest* with *financial stability*

With the necessary safeguards to avoid the risk of moral hazard (burden sharing), where:

- **financial stability** is at stake and

- other forms of intervention cannot resolve the crisis

there is no alternative but to ensure rapid public intervention

This should be possible in the form of:
- preventive recapitalization, in cases where the bank still has the possibility to continue its activity
- intervention during the liquidation, to ensure that this can be managed without trauma, first and foremost for depositors.

TERCAS case : the European Commission's approach to state aids

In the TERCAS case, according to the Commission:

- Italian authorities had entrusted FITD with a **"public mandate"** relating to the protection of depositors. The Commission thought it was not relevant that FITD was established as a private-law consortium

- Italian authorities were able to influence all stages of the implementation of the measures in question. The Bank of Italy had the **power to authorise the intervention** of DGS and its representatives were present in all the decision-making meetings

- Italian banks **were obliged to join FITD** and contribute to the interventions which were decided by its management. The intervention in question was attributable to FITD

After the evaluation by the EU Commission on FITD/Tercas case (2015), early interventions in Italy have been possible only under the ***FITD/Voluntary scheme,*** *under which banks have the right to withdraw from* ex ante *interventions.*

The General EU Court ruling on TERCAS

On March 19th 2019, The General Court of the European Union **has annulled the European Commission's decision**:

- the European Commission ***did not have sufficient evidence*** to conclude that the measures in support of Banca Tercas entailed the use of State resources and were imputable to the State

- The cost of the suggested measures was estimated to be lower than the cost of using the DGS if Banca Tercas had been placed under compulsory liquidation. The measures, adopted voluntarily by a consortium of banks in support of one of its members, ***was therefore intended to protect their private interests***. Those private interests happened to coincide with the public interest.

- Since the bank's capital needs were met solely with private resources, the measures ***did not circumvent the framework provided for by BRRD or rules on State aid***. As a result, the outcome is not an exception to the bail-in principle.

The TERCAS Case: rethinking the current framework

The General Court annulment paves the way for**:**

- ✓ **new ways for crisis management**: supporting interventions with procedures other than prior notification, etc.
- ✓ **operational scope of national DGS** which, when they are not executing a public mandate, must also be able to adopt early intervention measures
- ✓ a **more general revision of the rules on state aid** in the financial sector (DGS recipients of public loans) and completion of the so called "Third pillar‟ (*see further*)

De iure condendo, a comparison with the US discipline can be helpful, especially with regard to the case of the **Federal Deposit Insurance Corporation (FDIC)**

Focus: Federal Deposit Insurance Corporation (FDIC)

The FDIC plays a role in the prompt corrective action (PCA) (similar to EU-early intervention measures) and is entrusted with several powers:

- **to insure the deposits**

The FDIC maintains, manages, and controls risks to the Deposit Insurance Fund (DIF).
The FDIC pays insured deposits or, more frequently, it arranges for the transfer of accounts from the failed institution to a healthy assuming institution

- **to cooperate with other authorities in bank supervision**

It shares responsibility with other federal regulators and with state banking authorities

- **to resolve failed banks**

Resolution methods generally include P&A (Purchase & Assumption) transactions, insured deposit transfers, and straight deposit payoffs. Resolution can also refer to the assistance plan, through open bank assistance, for a failing institution.

Main takeaways from TERCAS Case

- In full respect of the EU state aids rules, a **wider scope and a more flexible application** of early intervention measures by the DGS could lead to the recovery of "first difficulty" situations
- The **harmonization** among national liquidation regimes should be pursued
- **Rethinking of the role of DGS system** (both at national and EU level) as a prominent actor in Recovery and resolution framework (not only for ex ante interventions) is of crucial importance
- The pre-requisite to enable a wider mission of DGS is a different reading/reformulation of the 2013 Commission **Communication of State aid rules**
- A critical point can be also raised on the **allocation** of European antitrust powers within the EU Commission.

Focus: the EDIS *light*

The **EDIS light** would:

- ❖ be founded on a network of national DGSs
- ❖ aim at providing liquidity support through a system of compulsory loans, and the presence of the ESM as a further financial backstop, without effective sharing (co-insurance) of the risk. A mandatory loan system - regulated ex-ante - would increase the level of protection of European deposits, mitigating some countries' concerns about risk sharing
- ❖ allow early interventions for DGS1 and IPS2/DGS (modifying the BRRD and the 2013 Banking Communication on State aid rules)
- ❖ have IPS – discounts on national DGS contribution for banks adhering to (recognized) IPSs
- ❖ avoid initiatives related to the prudential treatment of sovereign bonds

Conclusions (1)

The highlights of the new framework should therefore be:

- liquidation as the extreme rationale of the crisis management process, to be applied in the absence of less expensive alternatives (including the transfer of assets and the creation of bridge banks)

- a harmonized liquidation framework to provide a minimum level of consistency to the several national regimes

- a rethinking of the role of national DGS, similarly to the FDIC, as a prominent actor in the crisis management scenario

- the enhancement of preventive interventions aimed at avoiding liquidation also through the temporary acquisition of the bank or parts of its assets in view of a subsequent sale to another credit institution (the so-called Purchase and assumption transactions envisaged by the FDIC)

- an EDIS "light" approach providing a network for national DGS

Conclusions (2)

- review of the 2013 Commission Communication on state aids in the financial sector

- the allowance of a credit for the DGS - at market conditions (hopefully with State guarantee) - with the central bank to manage any liquidity needs without the risk of running into stressful situations

- providing the DGS with more verification tools on its members and exchanging information with the supervisory authorities, so that the intervention can actually be carried out at the first signs of the crisis

- reviewing the BRRD to make the criterion of public interest more transparent and objective, being the discriminating factor between resolution and liquidation; and exempting/reducing burdens for those banks that are not likely to go under resolution, contributions to the Single Resolution Fund and the resolution planning requirements.

Many thanks