The restructuring of Monte dei Paschi di Siena. A controversial case in the EU bank resolution regime

The Restructuring of Monte dei Paschi di Siena. A Controversial Case in the EU Bank Resolution Regime

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Abstract

The new regulatory tools introduced in the EU banking recovery and resolution regime that aim to reduce the intervention of supervisory authorities constitute a challenge for legislators and market actors. This article examines the controversial aspects of Monte dei Paschi di Siena (MPS) rescue plans, taking into consideration the adopted restructuring options. Although MPS is not global systemically important its collapse determined a serious impact in the EU banking sector. This article argues that to benefit from financial aid MPS had to be bailed-in, measure that policymakers and regulators are not always ready to implement. MPS represented a real concern to the Italian Central Bank and the European Central Bank, and it demonstrated that banks rely on government bailout, something that it is difficult to change in the regulatory approach to failing credit institutions.

Keywords

Banking union, bail-in, non-performing loans, State aid, bailout, resolution regime, recovery plan, global systemically important banks, precautionary recapitalisation, securitisation.

1. Introduction

The creation of European Banking Union with the granting of supervisory powers to the European Central Bank (ECB) and the increased attention given by regulators to Single Resolution Mechanism (SRM) and Bank Recovery and Resolution directive (BRRD)[1] are some of the developments that in the aftermath of the global financial

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[1] EU Bank Recovery and Resolution Directive (BRRD), Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014. These resolution tools require the establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173 of 12 June 2014, p 190.

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crisis have brought the issue of financial stability back to the fore of legal and economic policy debate.[2] The intricate design of the BRRD (i.e., the harmonised regime for the EU as a whole) and the SRM for the Banking Union, i.e., the Eurozone represent the new framework of bank insolvency.[3]

The SRM contains three pillars: centralised resolution in a single authority (Board); a single set of supervisory powers and tools as defined in the BRRD; and a Single Bank Resolution Fund, which provides mutualised private financing of bank resolution tools. The Board is responsible of finding private solutions via acquisitions of crisis banks in the context of restructuring. Under the supervision head, the 'Single Supervisory Mechanism' (SSM) put the ECB directly in charge as the supervisor for the largest Eurozone banking groups.[4] The dominant part of the Eurozone's banking system is monitored by a common institution: in substance, the ECB is the direct supervisor of the significant banks for the entire Eurozone and it has the right to inspect smaller banks that does not supervise directly.[5]

During the global financial crisis, the banking sector experienced a rapid rise in loan delinquencies and defaults driven by the limitations of the Basel rules and the adequacy of capital.[6] The crisis revealed that non-performing loans (NPLs)[7] played a central role in the linkages between credit markets frictions and macroeconomic

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[2] Jens-Hinrich Binder, *Resolution: Concepts, Requirements, and Tools* in Jens-Hinrich Binder and Dalvinder Singh (eds), *Bank Resolution: The European Regime*, 25-26 (Oxford: Oxford University Press, 2016).

[3] The Single Supervisory Mechanism (SSM) has been established by Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287 of 29 October 2013, p 63. The Single Resolution Mechanism (SRM) has been introduced by Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225 of 30 July 2014, p 1.

[4] The SSM is composed of the ECB and the national competent authorities, with the ECB in charge of its effective and consistent functioning (Art. 6.1). The scope of application of the SSM Regulation comprises all Euro area Member States on a compulsory basis and also non-euro area Member States that voluntarily enter into a 'close cooperation' with the ECB (Art. 7). The SSM Regulation confers 'specific tasks' related to the prudential supervision of credit institutions to the ECB. See Commission release Statement/14/77, 20 March 2014.

[5] Eilís Ferran and Valia Babis, *The European Single Supervisory Mechanism* 13 Journal of Corporate Law Studies 255 (2013). The authors note that 'designing the SSM has been an exercise in sophisticated legal gymnastics to fit within the existing Treaty framework, as well as high stakes political manoeuvring and pragmatic decision-making'.

[6] Tara Sullivan and James Vickery, *A Look at Bank Loan Performance*, Federal Reserve Bank of New York, 16 October 2013. It is pointed out that 'at the start of 2007, only about 1 percent of bank loan balances were "nonperforming", meaning that the loan was at least ninety days past due or in nonaccrual status. By late 2015, however, the average level of NPLs across the EU banks is 5.9 percent while NPL ratios for the United States and Japan is less than 2 percent. See European Parliament, Non-performing loans in the Banking Union: stocktaking and challenges, 18 March 2016, 2. See also World Bank, *Bank nonperforming loans to total gross loans* <http://data.worldbank.org/indicator/FB.AST.NPER.ZS> (accessed 25 May 2018).

[7] NPL is generally defined as a loan that is more than 90 days past due.

vulnerabilities.[8] The lack of a proper regulatory treatment of NPLs highlighted the fragility of the banking system. The main problem is the absence of a harmonised framework to estimate the obligors' ability to repay and whether it has deteriorated. In this context, some countries such as Italy and Greece registered a sharp rise of NPLs and large losses among national banks.[9] The Italian banking sector reported an outstanding stock of €225 billion of gross NPLs mostly accumulated during the financial and sovereign debt crisis although recently this figure has significantly decreased.[10] In addition, the local dimension of the Italian banking sector and frequent political instability face obstacles to the development of NPLs market, as observed 'uncertainties in recovery values can result in substantial gaps between book and market values, creating disincentives for banks to write-off NPLs'.[11] The deterioration of past-due loans triggered in the aftermath of the crisis has been accompanied by the negative performance of banks' portfolio such as Unicredit, Monte dei Paschi di Siena (MPS), Banca Popolare di Vicenza and Veneto Banca. However the regulatory intervention adopted for the Veneto banks and the precautionary recapitalisation approved for MPS boosted investors' confidence in the Italian banking sector.[12]

On July 2017, MPS reached an agreement for a public rescue in a form of a precautionary recapitalisation – according to Article 32(4)(d)(iii) of the BRRD and Article 18(4)(d)(iii) of the SRM – after a long negotiation between the Italian authorities and the Commission. However, the public rescue of MPS can be considered the outcome of legacy problems that should have been resolved prior to implementation of BRRD and Banking Union. This article argues that the rescue plan of MPS gained from the Italian government circumvented the EU resolution regime as the bank could not be considered a solvent institution according to the criteria set in Article 32(4)(a)(b)(c) of the BRRD and Article 18(4)(d)(iii) of the SRM. Specifically, MPS did not meet the condition of 'long-term viability' necessary to apply for precautionary recapitalisation raising doubts whether the public support was granted to cover private losses. MPS was not qualified to access the regulatory tools provided in point (d), paragraph 4, Article 32 of the BRRD that confines the precautionary recapitalisation to solvent institutions.[13]

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[8] Mwanza Nkusu, *Nonperforming Loans and Macrofinancial Vulnerabilities in Advanced Economies*, IMF Working Paper, 4 July 2011. The author observed a negative correlation between NPLs and various macroeconomic variables.

[9] EBA, *Risk Dashboard. Data as of Q4 2016* (April 2017) at 30, <http://www.eba.europa.eu/documents/10180/1804996/EBA+Dashboard+-+Q4+2016.pdf/74c92eb4-3083-47fc-bd5d-6a8ac64e8393> (accessed 15 May 2018).

[10] Bank of Italy, *Financial Stability Report* (November 2018), at n 2, 33-35. It is underlined that the coverage ratio – provisions in relation to the whole stock of NPLs – reached 54.3 percent.

[11] José Garrido, Emanuel Kopp and Anke Weber, *Cleaning-up Bank Balance Sheets: Economic, Legal, and Supervisory Measures for Italy*, IMF Working Paper (July 2016), at 15-16.

[12] Bank of Italy, *supra* n 10, at 42.

[13] The provision provides that 'extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms: (i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions, (ii)

The main concern is that the concept of solvency is not expressly defined by the BRRD nor harmonised by EU law.[14] Article 32(4) of the BRRD set criteria for the failing or likely to fail (FOLTF) credit institutions and the concept of solvency should refer to these criteria.[15] However the concepts of solvency and FOLFT do not coincide, leaving room for wide discretion in the application of preventive measures to resolve distressed banks.[16] As De Groen observed, 'taking into account that banks that are failing or likely to fail should be liquidated or resolved under the BRRD, precautionary recapitalisation should be reserved only for some solvent banks'.[17] The lack of a clear definition of solvency and FOLFT is another case of discrepancy between EU rules and private law. It can be noted that the BRRD introduced a new concept of 'failing or likely to fail' in order to avoid the implementation of national insolvency laws.[18]

Article 32(4)(a)(b)(c) of the BRRD states that the institution does not and is not likely to, in the near future: (a) infringe the conditions for authorization, (b) hold less assets than liabilities, and (c) fail to pay its debts as they fall due. None of these requirements have been complied in the restructuring of the Italian bank: (1) MPS already benefited from two state recapitalisations in 2009 and 2013, and most interestingly, the bank received a large bail-out package approved by the government in 2016, (2) the financial performance of the bank in 2016 and Q1 2017 shows that the Common Equity Tier 1 (CET1) ratio has dropped to 5.8 percent against a forecast of 11.74 percent in the baseline scenario[19], and (3) MPS recorded 33,61 percent of NPL

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a State guarantee of newly issued liabilities, or (iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Art. 59(3) are present at the time the public support is granted'.

[14] The BRRD does not regulate bankruptcy or insolvency proceedings which remain in the sphere of national competence as an alternative measure to resolution.

[15] See EBA, *Single Rulebook Q&A (2015_1777)* <http://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2015_1777> (accessed 5 May 2018).

[16] See World Bank-FinSAC, *Understanding Bank Recovery and Resolution in the EU: a Guidebook to the BRRD* (April 2017) at 106 <http://pubdocs.worldbank.org/en/609571482207234996/FinSAC-BRRD-Guidebook.pdf> (accessed 25 April 2018). It is pointed out that 'the FOLTF definition used under the BRRD is rather vague (and it will be difficult in practice to define the point of non-viability) but gives the required discretion to intervene early enough'.

[17] Willem Pieter de Groen, *Precautionary Recapitalisations: Time for a Review* (European Parliament, July 2017), at 11 <https://www.ceps.eu/publications/precautionary-recapitalisations-time-review> (accessed 20 April 2018).

[18] The author is particularly indebted to the anonymous referee for helpful comments on this point. In doctrine see Matthias Lehmann, *BRRD, the SRM-Regulation and Private International Law: How to Make Cross-Border Resolution Effective*, 17, <https://www.law.ox.ac.uk/sites/files/oxlaw/resolution_cross-border_effects_-_lehmann.pdf> (accessed 12 May 2018).

[19] Benoit Mesnard, Alienor Anne Claire Duvillet-Margerit and Marcel Magnus, *Precautionary Recapitalisations under the Bank Recovery and Resolution Directive: Conditionality and Case Practice* (European Parliament, Briefing, 16 June 2017), at 5.

ratio in 2016[20] and the amount of €28.6 billion of bad loans in 2016.[21] According to the *Banker*, MPS places in the top four of the highest losses ranking with $3.4 billion while Italy figures the largest country for losses in the banking system with $16.3 billion.[22]

This article suggests that the MPS case created a precedent to allow the granting of State bailout and minimising the applicability of bail-in to protect national interests. This can be seen as a circumvention of bail-in rules as result of a political justification which forces the determination of solvency (against insolvency), and consequently State aid can be granted according to Art. 32.4(d)(iii) of the BRRD that provides for a precautionary recapitalisation in cases of solvency assuming the other requirements are met.[23] The next section examines the state of affairs of MPS discussing the main finance transactions that determined the collapse. Section three analyses the controversial aspects of MPS rescue plans taking into consideration the possible outcomes of alternative restructuring options. Section four looks at the issues of the restructuring plan and its interaction with precautionary recapitalisation and extraordinary public support. The last section draws conclusive observations.

2. The Finance Transactions of MPS

MPS is an Italian bank that operates in the retail and investment banking offering a wide range of financial services and products to private individuals and corporations.[24]

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[20] Benoit Mesnard, Marcel Magnus and Alienor Anne Claire Duvillet-Margerit, *The Precautionary Recapitalisation of Monte dei Paschi di Siena* (European Parliament Briefing, 6 July 2017), at 3.

[21] European Commission, *State aid: Commission Authorises Precautionary Recapitalisation of Italian Bank Monte dei Paschi di Siena*, Press Release, Brussels, 4 July 2017, at 2. See also Monte dei Paschi di Siena, *BMPS: European Commission Approves the 2017-2021 Restructuring Plan*, Press Release <http://english.mps.it/media-and-news/press-releases/2017/Pages/press_release_20170705.aspx> (accessed 2 May 2018).

[22] The Banker UK Press Release, *Top 1000 World Banks 2017*, 3 July 2017 <http://www.thebanker.com/Top-1000-World-Banks/The-Banker-UK-Press-Release-Top-1000-World-Banks-2017-FOR-IMMEDIATE-RELEASE> (accessed 10 April 2018).

[23] According to Art. 32.4 of the BRRD, the requirements for the precautionary recapitalisation are: (1) the institution is not failing or likely to fail (confined to solvent institutions), (2) there is a need to (avoid or) remedy a serious disturbance of the economy, (3) it is used to preserve financial stability, (4) it does not confer an advantage upon the institution, (5) it must be approved under the State aid framework, (6) shall be of a temporary nature, (7) must be proportionate to remedy the serious disturbance, and (8) it must not be used to absorb incurred losses or likely future losses.

[24] According to Art. 3 of BMPS By-laws, "the purpose of Banca Monte dei Paschi di Siena (BMPS) is to collect and maintain savings and issue loans and credit, in various forms in Italy and abroad, including any related activity permitted to lending institutions by current regulations. BMPS can carry out, in accordance with the laws and regulations in force, all permitted banking and financial activities and any other transaction which is instrumental, or in any case linked, to the achievement of the company's purpose."

Its shares are traded on the 'Mercato Telematico Azionario'[25] of the Italian Stock Exchange and on the stock market index 'Financial Times Stock Exchange, Milano Italia Borsa (FTSE MIB)'. Founded in 1472, MPS is one of the oldest credit institutions in Italy with the main functions in providing sources of lending and trading securities on both domestic and international markets. Originally established as "Monte di Pietà" with the purpose of funding and sponsoring local business activities in the city of Siena, nowadays MPS has evolved to a significant banking group in the global financial sectors.[26]

In 2014, MPS issued a variety of debt instruments (mainly tranches of notes, fixed or floating rate notes or zero coupon notes)[27] both publicly and privately placed under 'Debt Issuance Programmes'.[28] A large portion of MPS's loans is secured by collateral, a business strategy that affected the credit quality of the bank at time of the global financial crisis.[29] This notwithstanding, MPS has a business duty of diligence to enforce on time any default and periodically reassess the value of the collateral provided in case that a re-collateralisation (i.e., an increase in the value of collateral) is

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[25] Mercato Telematico Azionario is one of the main segments of the Italian Stock Exchange (Borsa Italiana S.p.A.). It is a regulated market that offers a platform for trading shares, convertible bonds, warrants and option rights and it is mainly dedicated to medium-sized and large companies that are planning to raise domestic and international financial resources from institutional and professional investors in order to fund a growth project.

[26] Under European Banking Union, MPS has been listed as significant supervised entity for the purposes of SSM regulatory framework. See European Central Bank, *The List of Significant Supervised Entities and the List of Less Significant Institutions*, 1 January 2018 <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.list_of_supervised_entities_201802.en.pd> (accessed 25 March 2018).

[27] Tranches of notes are portions of debt or structured financing notes, generally linked with other securities offered at the same time but with different structured risks, rewards and maturities. Tranches of notes are used as a method to customize structured finance products such as collateralised debt obligations. The ranking of each tranche determines the order of payments. This order is usually referred to as a 'waterfall'. The 'waterfall' can significantly affect the cash flows of each of the tranches and must be balanced in such way that investors are willing to purchase the different tranches of notes.

[28] Specifically, senior or subordinated unsecured notes issued under the EMTN "€50 billion Debt Issuance Programme" and covered bonds issued under the "€10 billion Covered Bond Programme". As stated by the Prospectus, 'in purchasing Notes, investors assume the risk that BMPS may become insolvent or otherwise be unable to make all payments due in respect of the Notes'. Each Tranche of Notes was structured in bearer form and initially issued in the form of a temporary global note or a permanent global note. Interestingly, the Prospectus provides that the 'issuer shall be at liberty from time to time without the consent of the Noteholders, the Receipt-holders or the Coupon-holders to create and issue further notes having terms and conditions the same as the Notes or the same in all respects save for the amount and date of the first payment of interest thereon and the date from which interest starts to accrue and so that the same shall be consolidated and form a single Series with the outstanding Notes'. In the aftermath of global financial crisis with persistent instability on markets, the risk of failure to repay on time loan products may deteriorate the credit quality of borrowers and affect the recoverability of loans, and amounts due from counterparties. By examining the structure of the notes contained in the Prospectus, it can be argued that the issuance of €50 billion debt instruments increased the risk to accumulate NPLs in the balance sheet of MPS. See Monte dei Paschi di Siena S.p.A., *Debt Issuance Programme*, Base Prospectus, 12 March 2015, at 90-91.

[29] Nick Squires, *Decline of Monte dei Paschi di Siena, World's Oldest Bank, Leaves City Paying the Price*, The Telegraph, 8 September 2012.

required in order to guarantee the repayment of the original obligation.[30] Further, MPS approved a restructuring plan which was part of the application process for receiving State aid in connection with the issue of new debt instruments.[31] However, the deterioration of the financial condition of MPS determined the failure to achieve the objectives set out in the restructuring plan[32], entering into a new plan under the EU bank resolution regime.[33]

As a form of State aid, MPS obtained a recapitalisation of €1.9 billion on February 2009 and a recapitalisation of €2 billion on December 2012.[34] The Italian government provided funds to MPS in exchange for equity instruments (common shares, preferential shares and hybrid capital) with the aim of strengthening the capital position of the bank. The recapitalisation exercise also aimed to deliver control over the bank to the government.[35] In principle, EU law prohibits State aid unless it is allowed in very limited circumstances being in the kind and amounts of aid that pursue common policy and do not cause excessive distortion in the markets.[36] Although the assess-

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30 MPS, *Consolidated Half-Year Report as at 30/06/2016* <http:// english.mps.it/investors/investor-relations/financial reports> (accessed 15 March 2018). The Prospectus states that 'BMPS has entered into asset swap transactions involving Italian government bonds, term-structured repo transactions and interest rate swaps. Two of such transactions were those referred to as: (1) Alexandria, entered into with Nomura, which involved Italian government bonds of €3.05 billion nominal amount, and (2) Santorini, entered into with Deutsche Bank, which involved three separate total return swap transactions of €2 billion in aggregate nominal amount of Italian government bonds' (at 20). Under the long-term structured repo transactions, the most significant risk to which MPS could be exposed is the credit risk of the Sovereign. With reference to "Santorini" and "Alexandria" transactions, treated as synthetic derivatives for accounting purposes, the purchase of the notes and the financing under long-term repo contracts were presented and measured as credit default swaps under which protection was sold against the risk of default by the Sovereign (the issuer of the underlying securities). Having entered into asset swaps to hedge interest rate risk for both the Alexandria and Santorini transactions, the position's sensitivity to interest rates is lower than its sensitivity to the creditworthiness of the Sovereign. As a result of its own estimated margin requirements in respect of Alexandria, MPS could be required to make significant cash expenditures, which could create additional liquidity stress for MPS, with a material adverse effect upon BMPS's and the bank's business, financial condition, results of operations and cash flows.

31 *Ibid*., 13.

32 The European Commission ordered BMPS to offload nearly €30bn of NPLs. Rachel Sanderson and Martin Arnold, *Monte dei Paschi To Cut Jobs and Sell Assets in Survival Plan*, Financial Times, 25 October 2016.

33 Italy transposed the BRRD into law in November 2015 i.e., after the deadline of 31 December 2014 imposed by Art. 130 of the Directive.

34 As publicly recognised in Banca Monte dei Paschi di Siena S.p.A., *Debt Issuance Programme*, see *supra* n 28, 97. See also European Commission, *State aid n. SA.35137 (2012/N) – Italy Rescue aid to Monte dei Paschi di Siena S.p.A.*, C(2012) 9660 final corr. <http://ec.europa.eu/competition/state_aid/cases/246983/246983_1401709_117_2.pdf> (accessed 25 February 2018).

35 See Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (Recapitalisation Communication) OJ C 10, 15.1.2009, p 2 <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52009XC0115%2801%29> (accessed 8 May 2018).

36 Art. 107(1) of the TFEU provides for a general prohibition of any aid granted by a Member State: "save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain

ment of whether State aid is compatible with the internal market is the competence of the European Commission, the recapitalisation plan of MPS does not seem an exemption to the general prohibition according to Article 107(1) of the TFEU.[37] Article 32(4) of the BRRD regulates the precautionary recapitalisation providing that the injection of public support should be: (1) confined to solvent institutions, (2) temporary in nature, and (3) proportionate to remedy the consequences of the serious disturbance in the economy. It should not be used to cover losses that the institution has incurred or is likely to incur in the future. The amount of 'precautionary' capital that a bank can request from the State is the amount necessary to cover the capital shortfall deriving from the adverse scenario of a stress test exercise. In Italy, the banking activity has traditionally been run by the business of retail investors, depositors and account holders who own the large proportion of shares, obligations and bonds in banks.[38] The senior bondholder is represented by local entities and small investors rather than professional investors (i.e., hedge funds, mutual funds, insurance companies) as in other Member States.[39]

The domestic features of the Italian banking sector mainly reflect the presence of small and medium enterprises in the economy that control and finance the credit operations. The local function of banks shows that the credit system in Italy is not sovereign: for this reason, it is more exposed to the risk of failures and more reluctant to the use of bail-in tool. Interestingly, the State adopts public guarantees to protect bondholders from bank losses based on the assumption that 'State aids, wherever they are used, should return to the State'.[40] This mechanism allows to intervene with preventive measures however the precautionary recapitalisation does not seem confined to solvent institutions and proportionate to remedy the serious disturbance in the economy. The MPS case demonstrated that the 2009 and 2013 recapitalisations did not restore the liquidity and profitability of the bank, the sharp deterioration of equity and rapid increase of bad loans showed the long-lived problems of the institution.

The continue recourse to public support to rescue domestic banks contrasts with the aim of banking resolution and cannot be considered an exemption to State aid policies. In these terms, the precautionary recapitalisation is not a measure taken in exceptional circumstances to preserve financial stability. Further, the MPS collapse showed that the relevant competent authority i.e., ECB can use wide discretion in the supervisory powers.[41] The recapitalisation of MPS can have backlash for the sover-

undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market".

[37] Art. 107(2) and (3) of the TFEU regulate the exceptions to the prohibition of State aid.

[38] It is worth stressing that there are certain exceptions: for example, 63.5 percent of Unicredit's shareholding is held by institutional shareholders. See the shareholder structure of Unicredit <https://www.unicreditgroup.eu/en/governance/shareholders-structure.html> (accessed 6 May 2018).

[39] For instance, MPS is controlled by a foundation with directors appointed by the city of Siena and nominated by the surrounding province, the University of Siena and the archdiocese of Siena. The bank also provides funds for social and cultural events.

[40] Pier Carlo Padoan, *State Aid is the Best Way to Rescue Veneto Banks*, *Il Foglio*, 27 June 2017.

[41] See ECB opinion of 3 February 2017 on liquidity support measures, a precautionary recapitalisa-

eign debt and taxpayers' money with the risk to end up in permanent State aids. The solution adopted to restructure MPS and, generally, the Italian approach to solve banking problems are a clear example of the bail-out vicious cycle.

3. The Restructuring Plan of MPS

In 2016, MPS failed to pass the stress test exercise under adverse scenario[42] and reported negative equity with a severe reduction of CET1 capital ratio.[43] As a result, MPS announced the need to raise €5 billion from investors through a securitisation transaction and to reduce the net exposure of NPLs in the portfolio.[44] However, MPS did not succeed to find private investors and ended up to raise €1 billion by buying back subordinated securities with new shares. The failure of capital raising plan forced MPS to formally apply for a precautionary recapitalisation and liquidity support.

On December 2016, the Italian government passed the Law Decree No 237/2016 – converted into Law No 15/2017[45] – that allocated €20 billion bail-out package to aid banks in difficulty.[46] The Decree provides public financial assistance to manage banking crises and consists of liquidity support measures, and public recapitalisation measures. Liquidity measures are guarantees granted by the State on liabilities issued after the decree law's entry into force, aiming to facilitate the bank's ability to restore its own viability. The amount of guarantee needs to comply with the European Commission's guidelines on State aid and, generally, is limited to the necessary restoration of the financing capacity. Although the Italian bail-out Decree demonstrates a willingness to keep within the requirements defined by BRRD and SRM, it provides for

tion and other urgent provisions for the banking sector (CON/2017/1), 5-6 <https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2017_1_it_f_signed_.pdf> (accessed 2 May 2018).

42 Stress tests are indicators that assess the financial stability of banks. The test examines the three-year period following a recent reference date and includes a baseline macroeconomic scenario together with the adverse scenario, which assumes the impact of one or more particularly severe shocks. The European stress tests are coordinated by the European Banking Authority (EBA) that regulates the stress test exercise under the direct supervision of ECB.

43 As stated by the European Parliament, 'under the adverse scenario, MPS' fully loaded CET1 capital ratio was reduced from 12.07 % at the end of 2015 to -2.44 % at the end of 2018, that is to say a reduction by EUR 10.1 billion (1451 basis points)'. See Benoit Mesnard and Marcel Magnus, *Banca Monte dei Paschi di Siena: State of Play*. (Note for the Banking Union Working Group, 8 February 2017), at 1.

44 The securitisation operation consisted in selling the junior tranche to shareholders and the subscription of mezzanine notes by the Atlante Fund.

45 According to Law No 15/2017, three Italian Government guaranteed bonds have been issued by MPS. The bonds have been fully underwritten by the Bank at issue and subsequently placed to investors or used as collateral for funding operations. See *MPS, Banca MPS: Issue of a New Government Guaranteed Bond*, Press Release, 15 March 2017 <http://english.mps.it/media-and-news/press-releases/2017/Pages/press_release_20170315.aspx> (accessed 23 May 2018).

46 The Law Decree No 237 of 2016 "Urgent measures for the protection of savings in the banking sector" provides guarantees for the public support of banks under liquidity and capital stress scenario.

a substantial degree of burden-sharing and mainly seeks to avoid bailing-in certain groups of creditors.[47]

Public recapitalisation measures allow the State to underwrite increases in bank capital in a form of precautionary intervention under the 'burden sharing' principle.[48] According to Article 32(4)(d) of the BRRD and Article 18(4)(d)(iii) of the SRM, precautionary recapitalisation may be provided to solvent institutions under specific criteria that should not distort the competition and should not confer an advantage upon the institution. The Law Decree requires that only shareholders and holders of hybrid and subordinated bank bonds are involved in the burden sharing: the main aim is to avoid the involvement of the bank's non-subordinated creditors under the bail-in rules.[49] In addition, the Law Decree establishes a compensation mechanism to protect retail investors who will receive new shares following the burden sharing.[50]

Under the Decree, the access to public support is limited to banks that are not failing or likely to fail, but to banks that need to strengthen capital in case of the crisis or adverse scenario. As noted, 'the application of the decree law to MPS represents a turning point for the bank and removes, even in the perception of the market, a high risk for the entire Italian banking system'.[51] Closer examination of the Decree suggests that the government provides a mechanism of double guarantees: the guarantee to collateralise liabilities and sell the senior tranches under the State backed-scheme 'GACS'[52], and the guarantee to inject capital by purchasing shares. The State pro-

[47] Art. 22(1) of the Law Decree No 237/2016 regulates the burdens' allocation between creditors, stating that 'the subscription of Issuer's shares under Art. 18 is made by the Minister of Economy and Finance after the burdens allocation procedure according to the terms of this article, with the aim of limiting the use of public funds'.

[48] The 'burden sharing' principle for equity and subordinated holders represents a cornerstone of the precautionary recapitalisation process of MPS. It is a mandatory conversion of all subordinated bonds issued by the Bank to both institutional and retail investors before the subscription of shares by Ministry of Economy and Finance. In this context, see Monte dei Paschi di Siena, *2017-2021 Restructuring Plan*, 5 July 2017, 4 <http://english.mps.it/investors/investor-relations/presentations/Conference%20call%20%20Wednesday%2005%20July%202017%20at%20830%20CET/Restructuring%20Plan%202017-2021_Final.pdf> (accessed 27 March 2018).

[49] Bank's shareholders accept (1) the dilution of their shares following the State's intervention, and (2) the conversion into equity of the subordinated bonds. Holders of hybrid and subordinated instruments accept the conversion into equity of these instruments, in whole or in part, as necessary.

[50] The Ministry of Economy and Finance (MEF) may intervene to purchase these shares and in exchange investors will receive ordinary bonds from the bank (issued at par by the bank or a company that is part of the same group) for a value equal to the amount paid by the MEF for the purchase of the shares. The compensation scheme can be accessed under limited circumstances: (1) compensation may only be provided to retail investors, not qualified or professional investors, and (2) the MEF may intervene in support of a settlement agreement between a bank and these investors to avoid or resolve a dispute concerning the selling of converted instruments.

[51] Carmelo Barbagallo, *Hearing on Decree Law 237/2016 Urgent Measures for the Protection of Savings in the Banking Sector*, Joint Session of the Sixth Committees of the Senate of the Republic (Finance and Treasury) and the Chamber of Deputies (Finance) (Rome, 17 January 2017), at 12.

[52] The Guarantee on Securitisation of Bank Non Performing Loans (GACS) introduced by the Law Decree No 18/2016 is an aid-free scheme aiming to assist Italian banks in securitising and moving NPLs off their balance sheets. The State guarantee consists in remunerating the senior notes at market terms

vides a double securitisation: (1) on the credit enhancement of senior notes, and (2) on the collateralised losses of the junior bondholders. On the one hand the State protects the creditors through the collateralisation of losses and recapitalisation measures, on the other hand it accumulates debts and spreads the costs of public intervention to taxpayers. Although the aim is to preserve financial stability and safeguard taxpayer's money, the guarantees mechanism seems a sort of privatization of profits and externalization of losses where the State acts as a cushion to rescue troubled banks under a 'public interest umbrella'.

Following the bail-out package, the ECB raised the capital requirements of MPS from €5 billion to €8.8 billion in light of the rapid deterioration of the CET1 ratio and liquidity position of the bank. Specifically, the MPS's capital shortfall in the adverse case scenario led to the recourse of precautionary recapitalisation approved in July 2017.[53] The capital injection of €8.1 billion[54] is the final outcome of the agreement reached on 1 June 2017[55] on the restructuring plan that showed the viability of the bank and the ability to meet capital requirements, along with the formal commitment from private investors to purchase the stock of NPLs.[56] As a result, MPS received a consistent bail-out through the recapitalisation plan in order to prevent a serious disturbance in the economy and to protect the market.

according to the risk taken i.e., in a manner acceptable for a private operator under market conditions. The Ministry of Economy and Finance ("MEF") can issue a GACS guarantee to secure the payment obligations of Italian SPVs in relation to senior tranches of asset-backed notes issued by the SPVs within the securitisation transactions of NPLs according to the Italian securitisation law No 130/1999. See European Commission, *State Aid: Commission Approves Impaired Asset Management Measures for Banks in Hungary and Italy*, Press release, IP/16/279, 10 February 2016 <http://europa.eu/rapid/press-release_IP-16-279_en.htm> (accessed 5 March 2018).

[53] European Commission, *supra* n 21, at 2.

[54] See Mesnard, Magnus and Margerit, *supra* n 20, at 1. It is worth noticing that the ECB calculated a capital shortfall of €8.8 billion, the difference between the €8.1 billion capital injection and the ECB shortfall calculations is covered by asserts sales. In the €8.1 billion capital injection, €3.9 billion will be provided by the Italian Ministry of Economy and Finance (MEF), whilst the remaining €4.3 billion will result from the mandatory conversion into equity of the Tier 1 and Tier 2 bonds issued by the Bank, in line with EU rules on burden-sharing. At the same time, as a form of compensation for mis-selling, eligible retail investors of the Bank's 2008-2018 Upper Tier II notes will be offered the option to sell their converted shares to the MEF, in exchange for senior bonds of BMPS, for a total estimated amount of around €1.5 billion. At the end of the recapitalisation process, the MEF is expected to contribute €5.4 billion becoming the majority shareholder of BMPS with a stake of around 70 percent. See *DBRS Maintains Review of BMPS Ratings Until Completion of Burden Sharing and Recapitalisation*, Press Releases, 11 July 2017 <http://www.dbrs.com/research/313044/dbrs-maintains-review-of-bmps-ra#> (accessed 21 May 2018).

[55] European Commission, *Statement on Agreement In Principle between Commissioner Vestager and Italian Authorities on Monte dei Paschi di Siena (MPS)*, STATEMENT/17/1502, 1 June 2017.

[56] The restructuring plan provides for a five-year restructuring period during which BMPS is committed to realign its equity capital and, most importantly, to transfer €26.1 billion NPLs to a privately-funded special vehicle with the financial support of the fund Atlante II.

On 28 July 2017, the Ministry of Economy and Finance (MEF) implemented burden sharing and capital increase measures to enhance the liquidity of MPS.[57] These measures aimed to strengthen the cash flow of bank through the conversion of financial instruments into newly-issued ordinary shares of the Bank ("Burden Sharing Decree"), and the subscription of shares by the MEF ("Recapitalisation Decree"). According to Article 22(2)(4) and Article 23(3) of the Law Decree No 237/2016, the 'Burden Sharing Shares' provides their holders with the same administrative and ownership rights as the MPS shares already in issue. The MPS shares subscribed by the MEF were issued at a price per share of €6.49, in exchange for cash from the MEF in accordance with the recapitalisation.[58] However, the State intervention is a measure to avoid the use of bail-in mechanism that should have been the practical resolving instrument for the Italian bank.[59] Although MPS was not considered a failing institution deemed into unresolvable conditions it has fallen under exceptional circumstances that required last resort actions. A controversial case that raises questions about the necessity (and compatibility) of the aid interventions to non-global systemic credit institutions in financial distress.[60]

Since the interaction of BRRD, the Single Resolution Mechanism and State aid is not well defined there might be risk of unfair practices in the choice of viable restructuring options.[61] The delineation between the BRRD and SRM regime provided for MPS an exception as it is not a global systemically important bank (G-SIB) but still is supervised by the ECB and its resolution should have been handled by the Single Resolution Board. Paradoxically, the margin of discretion left to national authorities to categorize non-G-SIBs or domestic systemically important institution (D-SIBs), and the involvement of the ECB and the Commission make the dividing line between the bank categories rather obscure. BRRD and SRM do not provide a clear distinction between the restructuring tools available for G-SIBs and D-SIBs, leaving the responsibility to adopt the proper arrangement to the resolution authorities.[62] This lack of consistency creates a grey area in which the loopholes for public financial support can affect the reorganisation actions among failing banks.[63] The suitable solution

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57 *BMPS: the Ministry of Economy and Finance Issues Burden Sharing and Capital Increase Measures for the Precautionary Recapitalization*, Financial Press Release, 29 July 2017 <http://english.mps.it/media-and-news/press-releases/ComunicatiStampaAllegati/2017/CS_decreto%20MEF_28072017_ENG%20RQ.pdf> (accessed 25 April 2018).

58 *Ibid*., at 2.

59 Lucrezia Reichlin, *The European Banking Union Falls Short in Italy*, Financial Times, 27 June 2017.

60 Francois-Charles Laprévote and Melanie Paron, *The Commission's Decisional Practice on State Aid to Banks: An Update* 14 European State Aid Law Quarterly 98 (2015).

61 See Ioannis Kokkoris, *State Aid Law v. Single Resolution Mechanism: David v. Goliath or Vice Versa* 10 International Corporate Rescue 392, 393 (2013).

62 The distinction between G-SIBs and D-SIBs is not mentioned in the EU rules. The EU distinction is between significant and not significant institutions: significant banks are supervised by SSM and their crisis is handled by SRM, the others by national authorities.

63 James R Barth, Chris Brummer, Tong Li and Daniel E Nolle, *Systemically Important Banks (SIBs) in the Post-Crisis Era: 'The' Global Response, and Responses Around the Globe for 135 Coun-*

would be a set of harmonised standards for resolving non-systemically global bank institutions and more tighter state-aid regulation, rather than the extension of the resolution toolbox to all cases of bank distress, irrespective of the systemic relevance of the failing institution.[64] This could avoid problems of legal uncertainty i.e., different national resolution policies, divergent public support strategies, inconsistent interpretation among domestic authorities as to how strict the rules on the allocation of losses to stakeholders and on exemptions from bail-in under Article 44(3) BRRD and Article 27(5) SRM should be applied.[65] One of the main aims of the new EU bank resolution regime is to avoid the recourse of taxpayers' money to save a bank, including the use of State financial support.[66] As the SRM, one of the pillars of the Banking Union, introduced special regulatory tools for dealing with failing banks there are concerns that State aid – in theory a temporary measure because of potential distortions in the markets due to moral hazard incentives[67] – may become a new frontier to avoid bail-in rules

4. An Analysis of the Restructuring Options

In an attempt to avoid a bail-in restructuring, which means imposition of losses on its creditors, the Bank of Italy tried to secure a privately backed bailout of MPS.[68] The bank considered a "voluntary" debt-for-equity offer to holders of roughly €5 billion of junior subordinated debt at a premium yet to be determined. The recapitalisation of MPS originally involved a €5 billion rescue plan with strict conditionally, guaranteed by a pool of investment banks led by JP Morgan. Specifically, the new capital would have been used to reduce gross NPLs by half (i.e., to the Italian average of 18 percent of loans) while the core tier one ratio would remain at a semi-respectable 11.4 percent.[69] As stated by the Bank of Italy, 'the 'market solution' was directed at private

tries in Allen N Berger, Philip Molyneux, and John OS Wilson (eds) *The Oxford Handbook of Banking*, 617 (2nd edn, Oxford: Oxford University Press, 2015).

64 Jens-Hinrich Binder, *Proportionality at the resolution stage: Calibration of Resolution Measures and the Public Interest Test* (3 July 2017), 20 <https://ssrn.com/abstract=2990379> (accessed 13 May 2018).

65 *Ibid*., at 21.

66 Ioannis Kokkoris and Rodrigo Olivares-Caminal, *The Operation of the Single Resolution Mechanism in the Context of the EU State aid Regime* in Jens-Hinrich Binder and Dalvinder Singh (eds), *Bank Resolution: The European Regime*, 316 (Oxford: Oxford University Press, 2016).

67 Conor Quigley, *European State Aid Law and Policy*, 403 (3rd edn., Oxford: Hart Oxford, 2015), where it is pointed out that 'rescue and restructuring aid are among the most distortive types of State aid'. See also Kelyn Bacon, *European Union Law of State Aid*, 409 (2nd edn. Oxford: Oxford University Press, 2013); Julia Flavie Collinet, *State Aid in the Banking Sector: A Viable Solution to the 'Too big To Fail' Problem?* 7 Global Antitrust Review 151 (2014).

68 Nicolas Véron, 'Italy's banking problem is serious but can be fixed', Bruegel Blog Post, 14 July 2016 <http://bruegel.org/2016/07/italys-banking-problem-is-serious-but-can-be-fixed/> (accessed 5 May 2018).

69 '*Monte dei Paschi: Something or Nothing'*, Financial Times, 27 September 2016. The new equity would cover the coupons on BMPS's bonds and protect the bondholders about the amount of loan losses.

investors and aimed to drastically reduce the bank's credit risk, thereby guaranteeing its stability in the face of the negative result of the stress test published in July 2016 by the EBA'.[70]

MPS's restructuring plan relied on capital from the private sector and government guarantees in order to: (1) increase coverage on bad loans from 63 percent to 67 percent, and coverage on other problematic loans from 27 percent to 40 percent, (2) securitise and deconsolidate all NPLs, and (3) raise €5 billion capital to reach a CET1 ratio of 11.4 percent on a fully phased-in basis.[71] Further, the restructuring aimed to: (1) avoid write-down or conversion of subordinated creditors, and (2) reduce NPLs to 18 percent, consistent with the draft request made by the SSM.

The €5 billion capital increase was subject to the completion of the securitisation and to other conditions which included the successful pre-marketing of the rights issue. The equity capital increase failed and MPS applied for State aid, which in turn resulted in the precautionary recapitalisation (i.e., write-down or conversion of the bank's subordinated debt).[72] The State guarantees envisaged under the new restructuring scenario on the bank debt, as well as other liquidity support measures, are generally directed to banks that have long-term viability.[73] It is important to emphasise that MPS already received State support on two occasions in the past. The recourse to public financial assistance increased the reliance to aids and undermined the credibility of the BRRD rules. It can be assumed that State intervention has acted as the lender of last resort for failing banks replacing *de facto* the function of central banks to solve liquidity issues.[74] In this context, Article 32(4) of the BRRD and Article 18(4) of the SRM expressly refer to the State aid regime, which incorporates both the substantive provisions of Article 107 TFEU and the corresponding powers of the Commission. The MPS case showed that the Commission tends to delegate to the national authorities the decision on the solvability of the bank's assets and liabilities which in theory, according to Article 36(1) of the BRRD, should be carried out by independent experts.[75] Without the additional equity, MPS could struggle to pay the coupons on

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[70] Bank of Italy, *The 'Precautionary Recapitalization' of Banca Monte dei Paschi di Siena* <https://www.bancaditalia.it/media/approfondimenti/2016/ricapitalizzazione-mps/index.html?com.dotmarketing.htmlpage.language=1> (accessed 25 June 2018).

[71] Moody's Investor Service, 'Global Credit Research', 8 August 2016.

[72] The market-based approach was not successful as the negative outcome of the Italian constitutional referendum of December 2016 created political instability and failed the MPS's attempts to convince private investors to recapitalise the bank.

[73] Moody's Investor Service, *supra* n 71, at 20. As observed, 'when the bank is considered not to be viable in the long-term, it can obtain support but then has to be resolved and liquidated in an orderly fashion'.

[74] Christos V Gortsos, *Last Resort Lending to Solvent Credit Institutions in the Euro Area before and after the Establishment of the Single Supervisory Mechanism (SSM)*, paper presented at the European Central Bank (ECB) Legal Conference: "From Monetary Union to Banking Union, on the way to Capital Markets Union: new opportunities for European integration" held in Frankfurt on 1-2 September 2015, 12-13 <https://ssrn.com/abstract=2688953> (accessed 5 June 2018).

[75] Art. 36(1) of the BRRD provides that 'a fair, prudent and realistic valuation of the assets and liabilities of the institution or entity referred to in point (b), (c) or (d) of Art. 1(1) is carried out by a

its outstanding debt instruments (involving Italian government bonds), given projected loan losses. Following the approved State aid, EU rules required bondholders be written down first.[76] Any rescue package should have been under the SRM, which means a bail-in where junior MPS bonds most likely are converted to shares. It is evident that the main issue between the SRM and national resolution authorities was the conditions under which the Italian government has been allowed to conduct the recapitalisation. As Donnelly noted, 'the way in which the Italian Government handled the assistance favored the Commission over the ECB regarding information and consultation, and revealed Commission accommodation for bending the rules to the breaking point'.[77] It can be argued that in the case of MPS the EU Commission adopted an exemption believing the risk of collapse of the Italian bank could trigger a systemic crisis in the domestic economy.[78] The problem is whether the risk of a collapse for a non-global systemically important bank can justify the adoption of exceptional circumstances. Specifically, the basis of Article 107(3)(b) of the TFEU, 'remedy serious disturbance'[79] under which the Commission authorized State aid measure to MPS in the past[80] can be seen as contentious as few years later faces a similar scenario.

The BRRD and the SRM state that a recovery plan should consider the systemic importance of the institution and its interconnectedness, and the degree to which support would be credibly available to address the deterioration.[81] Further, the resolution tools should be applied before any public injection of capital or equivalent extraordinary public financial support to an institution.[82] However if the recovery and resolution plans aim to avoid the recourse to bailout plans or State aid, in the case of MPS the national authorities demonstrated to rely upon government financial assistance to restore the viability of the bank. A paradoxical situation where 'the MPS episode casts a spotlight on the difficulties of keeping the tasks delegated to independent technocrats separate from politics'.[83]

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person independent from any public authority, including the resolution authority, and the institution or entity referred to in point (b), (c) or (d) of Art. 1(1)'.

[76] Resolution tools are regulated in the EU Bank Recovery and Resolution Directive.

[77] Shawn Donnelly, *Liberal Economic Nationalism, Financial Stability, and Commission Leniency in Banking Union* 21 Journal of Economic Policy Reform 166 (2017).

[78] In October 2008, the Commission acknowledged that the crisis was severe enough to qualify as a "serious disturbance in the economy" of the Member States as a whole and that aid to remedy the consequences of the crisis could therefore be declared compatible on an exceptional basis under Art. 107 (3)(b) of the TFEU.

[79] See Case SA.34032, *Reintroduction of the Italian Guarantee Scheme* <http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_34032> (accessed 10 April 2018).

[80] European Commission, *State Aid: Commission Authorises Restructuring Aid for Italian Bank Monti dei Paschi di Siena*, Press Release, Brussels, 27 November 2013 available at: <http://europa.eu/rapid/press-release_IP-13-1174_en.htm> (accessed 5 April 2018).

[81] Recital 21 in the preamble to BRRD Directive and Art. 10(2) of the SRM.

[82] Recital 55 in the preamble to BRRD Directive.

[83] Benjamin Braun, *Two Sides of the Same Coin? Independence and Accountability of the European Central Bank*, Transparency International EU 25 (2017) <https://transparency.eu/wp-content/uploads/2017/03/TI-EU_ECB_Report_DIGITAL.pdf> (accessed 2 April 2018).

The rescue of MPS replayed the troubles of Portugal's *Novo Banco*, where the largest investors took the hit while retail bondholders were shielded, resulting in a collapse in investor sentiment and capital flight.[84] However, the problems in the Italian banking sector are not solved by the State bailout of MPS. Bailing out MPS through the precautionary recapitalisation without the proper implementation of the long-term viability plan would just allow to maintain alive a "zombie bank".

In MPS there has been a market dissemination of subordinated bonds to retail investors who were not presented with a full disclosure of potential risks.[85] As result, the Italian government introduced a compensating scheme for affected retail investors whereby they would be able to convert the subordinated debt securities into equity.[86] Even if such a political strategy might be desirable[87], it can be considered as a circumvention to the applicability of bail-in on junior debt holders, which according to the burden sharing principle applies when granting State aid.

The rules contained in the BRRD are largely flexible to allow member states to adopt the policy measures necessary to protect the public interest, even if the directive does not define the boundaries of 'public interest' in case to provide public support.[88] Specifically, the competition between State aid rules and BRRD rules opens room for wide interpretation of the applicable regime in a way that it could not be consistent with the public interest. The recapitalisation of MPS could create a major impact on risk management with the possibility of having to face unintended consequences, particularly a roll-back to the pre-BRRD era.[89]

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[84] This resulted in litigation in the UK (see *Goldman Sachs International v. Novo Banco SA* [2015] EWHC 2371 (Comm)). The main issues in *Novo Banco* case were the following: (1) re-transfer of liability from bridge bank (*Novo Banco*) to insolvent old bank (*Banco Espirito Santo*), (2) no stay of proceedings (parallel Portuguese proceedings in public law are likely to take years), (3) not in conformity with the description of resolution powers in the BRRD, and (4) settlement of English dispute.

[85] European Commission, Press Release dated 1 June 2017 titled *Statement on an Agreement In Principle between Commissioner Vestager and Italian Authorities on Monte Dei Paschi di Siena (MPS)*.

[86] The financing to buy the equity from the original retail investors is obtained from new secure senior debt instruments. The Commission understands that such compensation scheme is an entire separate consideration to burden sharing under the State aid framework. See European Commission, Press Release dated 1 June 2017 titled *Statement on an Agreement In Principle between Commissioner Vestager and Italian Authorities on Monte dei Paschi di Siena (MPS)*.

[87] Martin Sandbu, *Banking Union Will Transform Europe's Politics*, Financial Times, 26 July 2017, who observed that in the recent banking failures 'Spain offered a glimpse into the future of bank regulation, while Italy clung to the bad habits of the past. On this discrepancy, Italy demonstrated greater ability to lobby for its case, however power is not all; it matters what one uses it for'. Further, banks in Italy are run by politically embedded foundations a scenario that show an incestuous relation between state and credit institutions. This phenomenon can determine the following effects: 'deep confusion between the national interest and that of the banking sector; hidden subsidies from taxpayers to banks, protecting both their managers and their investors; and gross inefficiencies in an allocation of capital driven more by political and personal priorities than economic logic'.

[88] Stefano Micossi, Ginevra Bruzzone and Miriam Cassella, *Fine-tuning the Use of Bail-In to Promote a Stronger EU Financial System*, CEPS Special Report No. 136 (April 2016), at 16-17.

[89] Case C526/14, *Kotnik*, opinion of AG Wahl, 18 February 2016. The Commission's Banking Communication examined the status of burden-sharing (bail-in) as a condition for the provision of State aid to failed banks.

5. Concluding Remarks

MPS constituted a real concern to the Italian Central Bank and the ECB. To reduce the likelihood of authorities' intervention and increase the role of creditors, the process of resolution and rehabilitation represents the potential challenges investors and policymakers may face.[90] MPS tested the suitability of the SSM and the new resolution regime to resolve failing banks in an orderly fashion.[91] However the case of MPS demonstrated that banks rely on government rescues and it is difficult to predict a change in the regulatory approach to bailout programmes. It could be said, in philosophical terms, another failure of "Vichian memory".[92]

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90 Moody's Investors Service, *Rated Bank Defaults and Government Support During the Crisis: A New Database and Study*, 1 August 2016.

91 Matthias Haentjens, *New Bank Resolution Regime as an Engine of EU Integration*, Oxford Business Law Blog, 14 June 2017 <https://www.law.ox.ac.uk/business-law-blog/blog/2017/06/new-bank-resolution-regime-engine-eu-integration> (accessed 19 May 2018).

92 The terminology refers to Giambattista Vico, an Italian philosopher of the eighteenth century who developed, in his famous work the *Scienza Nuova*, the cyclical theory of history "the corsi e ricorsi", in which 'obscure beginnings, slow development, rise to fame and influence, followed by an inevitable decline and fall, after which the entire cycle is repeated once again-we cannot be sure how soon or how often'. See Giambattista Vico, *Unabridged Translation of the Third Edition (1744)* (Cornell University Press, Third Edition, 1984). Also see the comment of Isiah Berlin, *Corsi e Ricorsi* 50 Journal of Modern History 480 (1978).