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August 2020

TECHNICAL NOTE—FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

This Technical Note on Financial Safety Net and Crisis Management Arrangements for Italy was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in February 2020.

Disclaimer:
This document was prepared before COVID-19 became a global pandemic and resulted in unprecedented economic strains. It, therefore, does not reflect the implications of these developments and related policy priorities. We direct you to the **IMF Covid-19 page** that includes staff recommendations with regard to the COVID-19 global outbreak.

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TECHNICAL NOTE

FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

This Technical Note was prepared in February 2020, before the global intensification of the COVID-19 outbreak. It focuses on Italy's medium-term challenges and policy priorities and does not cover the outbreak or the related policy response, which has since become the overarching near-term priority.

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Italy. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

BdI	Banca d'Italia
BU	Banking Union
CAL	Liquidazione coatta amministrativa (Compulsory administrative liquidation)
CONSOB	Commissione Nazionale per le Società e la Borsa
CSFS	Committee for the Safeguard of Financial Stability
DG-Comp	Directorate-General for Competition
DGS	Deposit Guarantee Scheme
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ELA	Emergency Liquidity Assistance
EU	European Union
EWS	Early Warning System
FGD	Fondo di Garanzia dei Depositanti del Credito Cooperativo
FITD	Fondo Interbancario di Tutela dei Depositi
FMI	Financial Market Infrastructure
FOLTF	Failing or Likely to Fail
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
IADI	International Association of Deposit Insurers
IVASS	Istituto per la Vigilanza sulle Assicurazioni
KA	Key Attributes of Effective Resolution Regimes for Financial Institutions
LSI	Less Significant Institutions
MEF	Ministero dell'Economia e delle Finanze (Ministry of Economy and Finance)
MOU	Memorandum of Understanding
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NCA	National Competent Authority
NRA	National Resolution Authority
NRF	Fondo Nazionale di Risoluzione (National Resolution Fund)
RCMU	Resolution and Crisis Management Unit
SI	Significant Institution
SRB	Single Resolution Board
SRF	Single Resolution Fund
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TUB	Testo unico delle leggi in materia bancaria e creditizia (Consolidated Law on Banking)
TUF	Testo unico delle disposizioni in materia di intermediazione finanziaria (Consolidated Law on Finance)

EXECUTIVE SUMMARY

The Italian financial safety net and crisis-management framework has been substantially strengthened since the 2013 FSAP. Among others, the authorities have enhanced the early intervention framework, introduced a new resolution regime (including recovery and resolution planning requirements), and introduced reforms of the two deposit guarantee schemes (DGS) that are active in Italy. Further enhancements at the Banking Union level, as outlined in the 2018 Financial System Stability Assessment for the euro area (IMF Country Report No. 18/226)—including the introduction of an adequately funded common deposit guarantee scheme, a harmonized bank liquidation framework and a finetuning of state aid rules—would yield further benefits for Italy.

The review of the financial safety net and crisis-management framework took place against a backdrop of elevated risks. During the past years, the authorities have deployed the full gamut of their toolkit to protect financial stability, relying on public support (e.g., through liquidity guarantees, precautionary recapitalization and liquidation aid) and private-sector initiatives to support vulnerable institutions (e.g., Atlante I and II, voluntary scheme of the DGS)—as the lack of loss absorbing capacity and large holdings of banks' liabilities by retail investors posed additional challenges during the transition towards the euro area's new regime for bank resolution. While these efforts have helped mitigate financial stability risks by avoiding contagion, approaches taken have generally shielded senior creditors from losses through the use of fiscal resources and broader industry contributions (e.g., national resolution fund and industry-funded support measures), and generated costs—in addition to those absorbed by shareholders and subordinated bond holders—for taxpayers and the banking sector at large. As outlined in this note, greater loss absorption by unsecured and uninsured creditors—including via more consistent loss sharing across the resolution and liquidation regimes—will produce more equitable outcomes and foster greater market discipline. In the medium term, as discussed in the euro area FSAP[1], reforms at Banking Union level (including the introduction of an orderly liquidation regime for non-systemic banks) should help reduce the dichotomy between resolution and liquidation, and enable the handling of all failing banks via a unified regime under the purview of the Single Resolution Board (SRB).

Despite the authorities track-record in dealing with distressed banks, further enhancements of the financial safety net and crisis-management arrangements are needed in three key areas: the institutional framework, resolution planning, and the deposit guarantee system.

- **Institutional responsibilities are clearly assigned, but the framework for contingency planning should be further strengthened**. The Banca d'Italia (BdI) acts as central node in the financial safety net, engaging effectively with other agencies as banking supervisor and national resolution authority, including at the supranational level. However, a formal crisis management committee is needed to periodically review preparedness efforts and coordinate policy responses and communications at times of stress. Involvement of the Minister of Economy and Finance in resolution and liquidation decisions should be limited to cases that have direct fiscal impact or may have adverse implications for financial stability at large.

[1] IMF Country report 18/227, https://www.imf.org/~/media/Files/Publications/CR/2018/cr18226.ashx.

- **Resolution plans for less significant institutions (LSIs) with a higher probability of presenting systemic risks under stress market conditions should be further refined, with further consideration given to options that facilitate burden-sharing**. Following substantial progress with resolution planning for Italian significant institutions (SIs) at the SRB level, the preparation of plans for LSIs by the Resolution and Crisis Management Unit (RCMU) is advancing. To minimize the potential need for public funding going forward, a key priority will be to create conditions that allow for losses to be allocated to unsecured and uninsured creditors, including through the establishment of additional loss absorbing capacity (beyond the currently available amount of own funds) for LSI for which a resolution strategy is foreseen. Transition periods for binding Minimum Requirement for Own Funds and Eligible Liabilities (MREL) targets will need to be carefully determined in view of limited market access and profitability pressures, and the authorities will need to ensure that MREL is held by investors that can credibly be bailed-in. In liquidation, transfers of assets and liabilities with financial support from the DGS—subject to the 'least cost' safeguard—would help protect depositors, avoid contagion, ensure continuity of banking activities and prevent a loss of asset value. In the absence of a purchaser, the multi-tiered depositor preference that is now applicable would shield depositors, with losses to be first absorbed, as needed, by other (unsecured) creditors.

- **Further changes should be made to the two DGS to enhance effectiveness**. The current *ex ante* funding mechanism is helping to strengthen the DGS, but funding targets—reflecting minimum EU requirements—are not sufficiently calibrated to potential failures of a large LSI or multiple smaller failures occurring simultaneously. Stronger backstop arrangements are needed to ensure effectiveness, considering that covering shortfalls via extraordinary contributions is not credible at times of stress. Removing 'active' bankers from the DGS' Boards would help strengthen operational independence, while eventually shifting the DGS into the public sector would create conditions for greater alignment with the IADI Core Principles (e.g., exchange of supervisory information, full participation in the framework for contingency planning, public sector backstop, legal protection for staff and management). The use of DGS resources to support asset and liability transfers, conducted in lieu of payouts on a 'least cost' basis, provides a highly efficacious way of addressing distressed banks, but preventive measures (i.e., 'open bank assistance') outside of resolution or liquidation should only be used in exceptional cases, with strong prospects for ensuring successful rehabilitation and long-term viability.

Care needs to be taken that reliance on special administrators does not delay the initiation of more decisive action for weak banks that lack tangible recovery prospects. Transposition of the Bank Recovery and Resolution Directive (BRRD) has expanded the BdI's range of early intervention powers, and triggers for their deployment have been aligned with guidelines from the European Banking Authority (EBA). The authorities have a long-standing practice of using special administration to rehabilitate distressed banks, help facilitate mergers and acquisitions, and effect transfers of assets and liabilities in liquidation. However, diminishing market interest in bank branches may reduce effectiveness of the instrument going forward. While the use of special administrators has diminished post BRRD transposition, care needs to be taken that reliance thereon does not delay more decisive action if rehabilitation prospects remain elusive, given the prospect of higher costs and legal and reputational risks for the BdI. Elevated risks of adverse market responses—as the appointment of an administrator could be perceived as a sign of non-viability—also underscore the importance of reticence in using the instrument.

Further enhancing the operational capacity for bank resolution remains important. The BdI's RCMU is well positioned to discharge its mandate as national resolution authority, thanks to a direct reporting line to the Governing Board; a strong contingent of competent staff; adequate budgetary resources; and real-time access to supervisory information. The simultaneous resolution of four small banks in 2015 has helped establish operational capacity for planning and executing resolution actions, as the RCMU successfully managed a complex process that included provisional valuations, the preparation of many legislative and administrative acts, and the execution of sales processes for the bridge banks—all of which under tight time constraints. Informed by these experiences, as well as ongoing efforts at SRB-level, internal policies and manuals should be finalized as soon as possible to ensure that operational aspects of the resolution tools are adequately documented. Periodic crisis simulations, initially limited to officials and senior management of the BdI but in due course also involving other stakeholders, can help test the adequacy of procedures and supporting documents.

Further consideration needs to be given, together with the competent EU authorities, to mechanisms for meeting liquidity needs in resolution. Elevated uncertainty surrounding resolution actions can quickly erode access to market funding, and thus undermine effective implementation of resolution strategies. Hence, resolution plans for LSI whose failure could present systemic risks should consider, among others, (i) capabilities for monitoring, reporting, and estimating funding needs in resolution; (ii) readiness for identifying and rapidly mobilizing assets that can serve as collateral, factoring in encumbrance and legal obstacles; (iii) the authorities' approach to assessing potential liquidity stress in the run-up to, during, and after resolution; and (iv) the preconditions and operational procedures for accessing available backstop mechanisms. The availability of central bank liquidity support during resolution, and associated risk mitigants (e.g., government indemnities), would benefit from further review by the BdI and the Eurosystem.

While past experiences have confirmed operational readiness for providing ELA on short notice, there is scope to strengthen the framework. The policy framework for ELA has been aligned with practices in the Eurosystem, as documented in the ECB's website and published ELA Agreement[2], and places strong emphasis on liquidity monitoring and effective collateral management. However, it is advisable to promote a review of policies and procedures for (re)confirming bank solvency and viability at the time of an ELA request, keeping in mind that the latest (supervisory) assessments of the bank may no longer be accurate and/or available information may not fully reflect additional uncertainties that may have arisen since the last supervisory assessment. An up-to-date forward-looking assessment of the bank's viability (possibly required with scant advance notice) would provide more assurances about the bank's capacity to settle its obligations and can thus better inform lending decisions. In addition, a review by the Eurosystem of disclosure practices is advisable to help minimize the risk of premature signaling of ELA operations.

[2] https://www.ecb.europa.eu/mopo/ela/html/index.en.html.

Table 1. Italy: Key Recommendations on Financial Safety Net and Crisis Management

Recommendations	Responsible Authority	Timing[1/]
Institutional Framework		
Limit the Minister of Economy and Finance's role in resolution and liquidation (¶11).	MEF	I
Early intervention and recovery planning		
Fully align toolkit for corrective actions with international best practices (¶24).	MEF	ST
Ensure that reliance on special administration does not delay timely resolution or liquidation of unviable firms (¶28).	BdI, MEF	ST
Provide further recovery planning guidance and require periodic testing (¶33-34).	BdI	ST
Resolution regime and resolution planning		
Refine resolution plans for LSIs whose failure could present systemic risks, with further consideration being given to setting binding MREL targets (¶45).	BdI	ST
Further expand resolvability assessments (¶47).	BdI	ST
Finalize ongoing efforts to develop a comprehensive resolution manual (¶49).	BdI	I
Deposit guarantee schemes and resolution funding		
Remove active bankers from DGS governance (¶59).	FITD, FGD	ST
Review adequacy of funding targets and strengthen backstop arrangements (¶61-62).	BdI, FITD, FGD, MEF	ST
Shorten statutory payout period for the *Fondo di Garanzia dei Depositanti del Credito Cooperativo* (FGD) and establish the necessary operational capacity (¶63).	BdI, FGD	ST
Avoid the use of DGS resources for failure prevention outside of resolution or liquidation as much as possible, only using it in exceptional circumstances with strong prospects for ensuring successful rehabilitation and long-term viability (¶67).	FITD, FGD	I
Clarify mechanisms for providing liquidity as part of resolution planning for LSI whose failure could present systemic risks (¶73).	BdI	ST
Official financial support		
To better protect fiscal resources, strictly limit the use of public funds to exceptional events that could undermine system-wide financial stability (¶76).	MEF	I
Promote a review of Eurosystem policy guidance for (re)confirming bank solvency and viability immediately upon receipt of an ELA request (¶81); as well as disclosure practices for ELA operations (¶84).	BdI	ST
Contingency planning and crisis management		
Operationalize an inter-agency forum for crisis management (¶87).	All agencies	I
Strengthen role of DGS in the financial safety net's coordination arrangements (¶88).	BdI, FITD, FGD	MT
Develop a program for periodic crisis management exercises (¶90-91).	All agencies	ST
Legal safeguards		
Extend legal protection to DGS' board members and staff, as well as directors and officers of an entity in resolution (¶98).	MEF	ST

Note: 1/ "I–immediate"; "ST–short-term" is one to three years; "MT–medium-term" is three-five years.

INTRODUCTION

1. **This note[3] elaborates on the findings and recommendations of the Financial Sector Assessment Program (FSAP) for Italy regarding the financial sector safety net and crisis-management arrangements**. The findings are based on a desk review of relevant legal and policy documents, as well as extensive discussions with the Italian authorities and private sector representatives during December 3–10, 2018 and March 11–29, 2019. The analysis was guided by relevant international good practices and standards (notably, the Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs), and Core Principles for Effective Deposit Insurance Systems), even though formal assessments of observance against these standards were not undertaken. The note focuses on the banking sector, and the authorities' framework for dealing with distressed LSI in particular (aspects pertaining to the resolution framework for SI, under the leadership of the SRB, are discussed in IMF Country Report No. 18/232). It does not express any views on the recovery and resolution of individual firms, as the confidential nature of institution-specific materials precluded the sharing thereof with the FSAP team.

2. **Substantial enhancement of the supervisory and regulatory framework in recent years has strengthened the authorities' oversight capacity**. The Italian financial sector is bank-dominated, with banks accounting for almost 54 percent of total financial sector assets (and about 215 percent of GDP (down from about 261 percent at end-2012). Financial system regulation has been bolstered via the implementation of the Capital Requirements Directive IV and Capital Requirements Regulation, Solvency II, the Markets in Financial Instruments Directive II, and the Bank Recovery and Resolution Directive (BRRD).[4] The establishment of the euro area's Single Supervisory Mechanism (SSM) has helped improve supervision of systemic banks, and the authorities have taken important measures to strengthen banks' capital buffers and improve asset quality.

3. **The Italian bank resolution framework has evolved substantially since the 2013 FSAP**. Legislative developments were driven by the transposition of the BRRD, among others, resulting in enhancements of the early intervention framework; the introduction of a new resolution regime; and the establishment of recovery and resolution planning requirements—thus addressing many of the recommendations from the 2013 FSAP (Appendix I). Moreover, the framework has been shaped by the European Union's (EU) state aid requirements, which have led the Italian authorities to encourage the establishment of voluntary and additional industry-funded mechanisms to provide support to troubled institutions. While these mechanisms have helped mitigate financial stability risks, they have imposed costs on the banking industry at large, with mixed results. With the exception of four regional banks that were intervened in November 2015, before the bail-in requirements became effective, the euro area's unitary regime for bank resolution has not yet been utilized in Italy.

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[3] Prepared by Constant Verkoren (MCM) as part of the 2019 FSAP Update for Italy. The author would like to thank the Italian authorities for their excellent engagement, open dialogue and warm hospitality throughout the FSAP process.

[4] Directive 2004/59, published in May 2014.

4. The review of the financial safety net and crisis-management arrangements has been conducted against a backdrop of elevated risks and, to some extent, regulatory change. Following a modest recovery in recent years, the Italian economy entered a technical recession in Q4-2018, which poses risks for the still fragile financial sector as bank capitalization, asset quality (in part, reflecting high indebtedness of the corporate sector) and profitability remain below peers, and banks' high (and increasing) exposure to the sovereign leaves them vulnerable to sovereign shocks. At the same time, the euro area framework for bank resolution and crisis management remains incomplete (e.g., no common deposit guarantee scheme, transitional challenges relating to the build-up of funding arrangements and bank-specific loss-absorbing capacity) and fragmented across national lines (e.g., absence of a unified bank liquidation regime, national transposition options discussed in Appendix II). Recovery and, notably, resolution planning continues to evolve at the international level, and further improvements are needed to enhance the effectiveness and feasibility of bank resolution and crisis management at the European level (Box 1).

Box 1. Main Findings of the 2018 Euro Area FSAP on Bank Resolution

In July 2018, the IMF concluded its first euro area FSAP, praising the euro area authorities for establishing a considerably strengthened bank resolution framework at the EU-level while highlighting room for further improvement.

- **A financial stability exemption is needed to help mitigate critical constraints in the framework**. The SRM requires bailing in a minimum of 8% of total liabilities prior to access to public (including deposit and resolution) funds in resolution. Building loss-absorbing capacity will take time. In the interim banks may be cut off from public funds. Similarly, banks not expected to be resolved (but rather liquidated) are not required to build additional loss-absorbing capacity and may have no access to public funds in a system-wide crisis when such support may be needed to preserve financial stability. A financial-stability exception—to be used only in times of euro area-wide or country wide crisis—subject to strict conditions and appropriate governance arrangements, would bring much needed flexibility into the SRM.
- **Despite the establishment of the SSM and the SRM, fragmentation along national lines persists**. In the EU, resolution requires an assessment against potential outcomes under significantly heterogeneous national insolvency regimes. This is exacerbated by diverging national supervisory powers and securities regulation practices, various national discretions in the directives for bank resolution and deposit insurance, and SRB decisions being executed by national resolution authorities under diverging national laws (e.g., administrative and labor laws). Heterogeneous national (bank) insolvency regimes, with more generous public-funding options and less stringent loss-sharing requirements under EU state aid rules than in the SRM, deliver substantially different outcomes for bank creditors, and strongly incentivize national solutions.
- **Many banking union countries have not availed themselves of essential powers available under EU directives**. For example, most countries have not established powers for public equity support and temporary public ownership (i.e., 'government stabilization tools'); almost two-thirds of the countries have not authorized the use of deposit insurance funds in liquidation proceedings, preventing the use of time-tested and cost-effective purchase and assumption ("sale of business") transactions in liquidations.
- **A more unified resolution framework should vest in the SRB an administrative bank liquidation tool**. Such tool allows the resolution authority to appoint a liquidator and commence proceedings. The SRB would be authorized to apply this tool to all banks within its remit—irrespective whether the public interest test is met and whether the relevant bank is considered systemic at the time of its failure.

Box 1. Main Findings of the 2018 Euro Area FSAP on Bank Resolution (concluded)

A supranational liquidation tool would help reduce destruction of value, level the playing field for creditors, and reduce the risk of member states "gaming" the system. Such a regime would be especially useful for ensuring that cases involving cross-border banks are dealt with at a euro area level, facilitating needed consistency. Arguably, NRAs should have a similar administrative liquidation tool to deal with banks deemed non-systemic at the point of failure.

- **The banking union needs a more effective deposit insurance system (DIS)**. Many national DISs are underfunded and lack effective backup lines. A common deposit insurance system for the euro area is missing. Greater risk pooling would help avoid disruptions that may overwhelm countries' individual capacities and would help address host countries' risk-sharing concerns.

Source: IMF Country Report No. 18/232 (https://www.imf.org/~/media/Files/Publications/CR/2018/cr18232.ashx).

5. Going forward, creating conditions that allow for greater loss absorption by creditors remains a key priority. To date, unsecured and uninsured creditors have generally not been required to absorb losses due to contagion concerns—notwithstanding the emphasis placed on burden-sharing (i.e., through bail-in) in the euro area's unitary regime for bank resolution. Instead, costs—in addition to those borne by shareholders and subordinated bond holders—have been absorbed by taxpayers (e.g., through precautionary recapitalizations, liquidity guarantees and liquidation aid) and the banking sector at large (e.g., via Atlante I and II, and the voluntary scheme of the DGS). While such interventions have helped alleviate near-term financial stability concerns, continued reliance on public funds and mutualization of losses across the banking industry cannot be easily reconciled with the need for fiscal consolidation and ongoing efforts to further improve the health of the banking system. In this context, greater loss absorption by unsecured and uninsured creditors—leveraging the multi-tiered depositor preference regime to protect depositors—will become increasingly important to produce more equitable outcomes and help foster greater market discipline.

6. This note is structured as follows. The next section summarizes the existing institutional framework underpinning the Italian financial safety net and crisis-management arrangements. The authorities' prudential framework for early intervention and prompt corrective action is discussed next, together with steps taken in recent years to operationalize recovery planning requirements. The note continues with a review of the domestic regime for bank resolution and liquidation, followed by an analysis of the DGS and resolution funding arrangements. Next, arrangements for official public support (including the provision of emergency liquidity assistance) and contingency planning and crisis management (domestic and cross-border) are discussed, and the note concludes with observations on legal protection and the role of the judiciary.

INSTITUTIONAL FRAMEWORK

7. Institutional arrangements underpinning the Italian financial sector safety net crisis management comprise four public sector entities, with *ad hoc* engagement with the two privately operated DGSs. Roles and responsibilities are clearly assigned and the interaction between the various domestic entities and main interlocutors at the European and/or euro area level (European Central Bank (ECB); SRB; European Commission's (EC) Directorate-General for Competition (DG-Comp)) has been tested in practice. Domestic collaboration is mandated by law (Consolidated Law on Banking (TUB), and Consolidated Law on Finance (TUF))[5] and further operationalized through Memoranda of Understanding (MOUs). BdI interacts with the two DGSs in its capacity as "designated authority" (which, in the Italian legal framework, entails supervision of the DGSs rather than administrative responsibilities). However, the DGSs are not formally embedded in arrangements for interagency coordination, as discussed later.

8. The BdI fulfills a key role in the financial sector safety net, combining traditional central bank functions with responsibilities for banking supervision, macroprudential policy, and resolution. Under the SSM, the BdI is the National Competent Authority (NCA) in charge of the day-to-day supervision of banks designated as LSIs; supervisory powers for SIs are exercised by the ECB in the context of the SSM. It also supervises certain financial intermediaries and financial market operators (FMIs), conducts systemic risk monitoring as part of its overarching objective to safeguard financial stability, and has been designated to take macroprudential measures to prevent or mitigate financial stability risks. Acting as national resolution authority (NRA), it exercises resolution powers for LSIs (to the extent that such powers are not directly exercised by the SRB) and holds liquidation powers over banks and certain other financial institutions (e.g., investment firms, asset management companies, financial intermediaries). The BdI is also responsible for formally recognizing and overseeing DGSs. Finally, the BdI acts as lender of last resort for solvent banks that face temporary liquidity needs.

9. Within the BdI, tasks of the NRA have been assigned to the RCMU. The RCMU carries out the preparatory operational tasks envisaged by the EU's Single Resolution Mechanism (SRM), including the exercise of resolution powers for SIs and cross-border LSIs, in cooperation with the SRB, and directly for other LSIs and investment firms under its remit. It reports directly to the Governing Board, which is the competent body of the BdI for measures pertaining to early intervention and resolution. It is also responsible for carrying out compulsory administrative liquidation; managing the *Fondo Nazionale di Risoluzione* or National Resolution Fund (NRF) (including the transfer of resources to the EU's Single Resolution Fund, as needed); and conducting oversight on the Italian DGSs. It operates in coordination with other Directorates of the BdI and coordinates with the competent EU bodies (ECB, SRB, DG-Comp) as needed. See Box 2 for further details.

[5] Testo unico delle leggi in materia bancaria e creditizia and Testo unico delle disposizioni in materia di intermediazione finanziaria, respectively.

Box 2. The BdI's Resolution and Crisis Management Unit—A Closer Look

The BdI's RCMU was created in 2015 to execute the BdI's tasks as NRA, including (i) preparatory and operational activities for resolution, as envisaged under the Single Resolution Mechanism; (ii) cooperation with the SRB; and (iii) the management of liquidation procedures for banks and investment firms. To ensure operational independence and prevent potential conflicts of interest, it reports directly to the Governing Board.

The RCMU has been entrusted with the resolution powers and instruments set forth in the BRRD and is responsible for the liquidation of failed banks. Functions connected with early intervention, including the appointment of special administrators (which no longer requires consent from the Minister of Economy and Finance) remain within the scope of responsibilities of BdI's supervision function.

The RCMU has real-time access to supervisory information via the BdI's Supervisory Monitoring and Reporting Tool that contains dossiers for each supervised entity (company profile, key financial data, economic results, and risk data resulting from the supervisory assessments). The tool also grants access to early warning indicators calculated for the bank, and to market data and financial accounts.

The RCMU is comprised of three divisions, i.e., Resolution Divisions 1 and 2 (tasked with resolution planning and execution for SIs and LSIs, respectively), and the Liquidation Division (responsible for compulsory and voluntary liquidation proceedings, oversight of the two DGSs, and management of contributions to the resolution fund). All divisions contribute to the development of policies, standards, and methodologies, including at the international level (e.g., EU, Financial Stability Board). At end-2018, the RCMU had 51 staff members, and staffing is expected to increase to about 60—with the possibility to source additional resources from other BdI functions as needed.

Most of the staff members have a supervisory background, but the RCMU also employs other disciplines (e.g., expertise in legal matters and with regard to financial market infrastructures). Budget resources of the RCMU allow for the engagement of external experts (e.g., lawyers, financial advisors, appraisers) as needed.

To foster coordination among the relevant functions of the BdI, an Advisory Committee for Resolution and Crisis Management has been established. The Committee is chaired by the BdI's General Legal Counsel and otherwise comprised of the Director of the RCMU and the Head of the Directorate General for Financial Supervision and Regulation. The Committee provides non-binding opinions on resolution proposals submitted by the RCMU to the Governing Board, thus supporting the Board in its deliberations.

10. **The *Ministero dell'Economia e delle Finanze* (MEF) endorses key decisions adopted by the BdI and otherwise decides on the provision of fiscal resources to maintain financial stability**. The MEF carries out the tasks and responsibilities of the Italian state in the areas of economic and financial policy, budgeting, and tax policy. With regards to bank resolution and crisis management, the minister fulfills a key role as decisions adopted by the BdI, in its capacity as NRA, can only become effective upon his/her approval—irrespective of whether public funds would be needed to effect the envisaged resolution scheme, or whether the BdI's decision may have systemic implications.

11. **Limiting the role of the Minister of Economy and Finance in bank resolution procedures would help strengthen operational independence of the BdI and enhance alignment with international standards**. As acknowledged in KA 2.5 and the BRRD, operational independence of resolution authorities is essential to avoid the politicization of resolution decisions. In the BdI's capacity as supervisor, operational independence is safeguarded by law and in practice, with the BdI having full autonomy to take actions and a governance framework that is not

susceptible to political interference in operational decisions. The BdI statute explicitly cites the principle of the BdI independence in performing its functions and in managing its finances and reaffirms that it may not seek or accept instructions from other public or private sector entities. The minister's responsibility, however, to approve the initiation of resolution proceedings and compulsory liquidation, sits uneasily with the principle of operational independence, as it may influence and or delay technical decisions that the BdI is otherwise well positioned to take—notwithstanding that the minister has thus far followed the BDI's advice. To maintain legitimacy, a central bank cannot commit government funds, but it should be able to effect decisions that do not require public funding and/or are not expected to have systemic implications (e.g., resolution or compulsory liquidation of smaller LSIs) without *ex ante* involvement of elected officials.[6]

12. **The *Commissione Nazionale per le Società e la Borsa* (CONSOB) is the competent authority for regulating and supervising the Italian financial markets**. In this respect, CONSOB regulates the provision of investment services and activities by intermediaries; oversees disclosure and transparency requirements; monitors the trading of listed securities, with the aim to identify regulatory violations, insider trading or market abuse; sanctions entities as needed; and communicates with operators and investors with a view to enhance effectiveness of financial services and improve financial awareness of investors. It conducts market surveillance, carries out investigations, and seeks to ensure the resilience of the trading infrastructure.

13. **The *Istituto per la Vigilanza sulle Assicurazioni* (IVASS) is the authority responsible for regulation and supervision of the insurance industry**. IVASS performs microprudential supervision, aimed at verifying the sound and prudent management of individual undertakings and insurance groups, conducts macroprudential supervision (including the analysis of macroeconomics factors and their possible impact in the insurance industry as a whole). IVASS also conducts liquidation procedures of undertakings subject to its supervision, as well as foreign insurance undertakings pursuing business in Italy that are placed into compulsory liquidation.

14. **Depositor protection is provided by two privately administered deposit guarantee schemes**. The FITD provides limited protection to depositors of (i) all commercial banks established in Italy and (ii) Italian branches of banks domiciled outside the European Union (EU);[7] while the FGD covers banks that form part of the Italian cooperative banking system. While the two DGSs are privately managed, they are subject to public regulation (notably TUB, which has been duly aligned with EU Directives) and oversight by the BdI.

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[6] See KA 2.5. In its opinion (CON/2015/35) on the draft legislative decree that transposed the BRRD in Italian legislation, the ECB observed that involvement of the Minister in all resolution decisions, irrespective of direct fiscal impact and/or systemic implications, would result in the Minister de facto acting as joint resolution authority alongside the BdI, requiring safeguards to ensure operational independence of the MEF's resolution funding. https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2015_35_f_sign.pdf. The authorities have noted during discussions with the FSAP team that, in practice, the MEF is not involved in technical analyses underpinning the BdI's decisions on resolution and liquidation and that government endorsement—albeit only in the final phase of the decision-making process—is important in view of the profound impact on the individual rights of shareholders and creditors.

[7] As per EU Directives, deposits held by branches of banks domiciled within the EU are insured by the DGS established in the home member state.

15. In addition to the DGSs, various protection schemes for policyholders and investors have been established. Italy does not have generic protection schemes for non-life or life insurance, but two specialized schemes offer protection to select groups of policyholders (dealing with accidents involving certain vehicles and property damage or personal injuries caused by hunting activities). Regarding investor protection, the *Fondo Nazionale di Garanzia* provides limited protection to investors (up to EUR 20,000 per investor) in the event of compulsory administrative liquidation or bankruptcy of investment firms, asset management companies and banks. It is authorized by the MEF, upon advice of the BdI and CONSOB.

Recommendations

- **The role of the Minister of Economy and Finance in resolution and liquidation should be limited to reduce the scope for political influence over the BdI's decisions**. To safeguard operational independence of the BdI, *ex ante* approval of envisaged resolutions or liquidations by the minister should only apply to cases that have direct fiscal impact or may have adverse implications for financial stability at large.

EARLY INTERVENTION AND RECOVERY PLANNING

16. To preserve financial stability, supervisory authorities need to be able to remedy mounting problems at an early stage, before institutions reach the point of non-viability. To achieve this, comprehensive frameworks are needed to guide the supervisory review of banks, combining a risk-based approach with analytical techniques that support robust analysis of pertinent information. By combining information obtained from onsite inspections, offsite analysis (supported also by early warning indicators), and surveillance of the banking system as a whole, supervisors need to continuously gauge the main risks and vulnerabilities of banks' business models, review the effectiveness of their governance and risk management framework, and assess the resilience of individual banks—and in turn, devise corrective actions that seek to remedy any identified regulatory breaches and/or financial weaknesses. The adoption of such a framework is premised on the availability of a sufficiently broad range of supervisory powers, and the authorities' ability to deploy these in a timely manner.

17. Early intervention frameworks should work hand in hand with recovery planning requirements. If carefully designed, recovery plans provide banks with a mechanism for establishing and maintaining capabilities to restore their financial soundness in the face of sudden shocks. In this regard, recovery plans are expected to be an integral part of a bank's risk management framework, closely linked to its risk appetite, Internal Capital Adequacy Assessment Process (ICAAP) and liquidity management. Assuming recovery plans are implemented without undue delay—and supervisors play an important role in ensuring their timely activation—they can help reduce the probability of bank failures.

A. Corrective Action and Early Intervention[8]

18. The BdI utilizes a mix of offsite analyses and onsite inspections to ensure continuous monitoring of banks under its supervision. An early warning system (EWS) has been developed that seeks to estimate the point-in-time probably of a default within 12 months. The model has been calibrated on the basis of a wide range of distress events, and contains micro variables related to capital adequacy, asset quality, management capability, earnings, and liquidity. In addition, a system of Early Intervention Indicators (EII) has been developed within the BdI's business analysis system, raising warning flags in real-time, as appropriate. The system generates alerts for the competent offsite Supervisory Unit that triggers follow-up and/or more in-depth analysis. Analysis from the EII is supplemented by findings from onsite inspections—including qualitative observations on the adequacy of banks' governance and risk management frameworks—and macroprudential analysis that is prepared by the BdI's Regulations and Macroprudential Analysis Directorate.

19. An important component of any early intervention framework is the ability to conduct forward-looking analyses of banks' financial positions. Forward-looking analysis is important for a range of purposes, including to (i) determine the need for, and nature of, corrective actions and early intervention measures; (ii) demonstrate the viability of banks requesting liquidity support; and (iii) determine whether banks are failing or likely to fail (which is a precondition for the initiation of resolution proceedings). The BdI performs stress tests on LSIs at aggregate and individual levels, using a top-down approach based on models developed inhouse. The tests typically envisage a three-year horizon with projections for operating income, estimated credit risk losses, and losses that emanate from other risk classes (e.g., market, interest rate and operational). Results from the BdI's supervisory stress testing framework are used in the Supervisory Review and Evaluation Process (SREP) in order to both gauge banks' vulnerabilities and to challenge the outcomes of "internal" stress tests undertaken by individual banks as part of their ICAAP procedures.

20. The TUB provides the BdI with a broad range of legal powers for remedying regulatory breaches and addressing unsafe and unsound practices. Broadly speaking, available measures comprise *"strengthening measures"* that seek to improve banks' corporate governance, business organization, internal controls, and risk management; *"risk reduction measures"* that seek to reduce an institution's exposure to certain risks with the aim to prevent an irreversible deterioration in its condition (e.g., portfolios limitations, restrictions on the bank's operations and branch network, limits on variable remuneration); and measures aimed at *conserving or strengthening bank capital* (e.g., restrictions on dividend distributions and variable remuneration, imposition of additional capital requirements). Moreover, the BdI can suspend voting rights or order divestitures of bank shares that have been acquired without prior authorization.

21. Transposition of the BRRD has further expanded the BdI's toolkit with the EU's harmonized provisions on early intervention. The new powers introduced via Legislative Decree 180/2015 ("Resolution Decree") include orders to implement recovery plans (see section on

[8] Also see the TN on Banking Regulation and Supervision, Bank Governance, Treatment of Problem Assets and Legal Aspects of NPL Resolution.

Resolution Regime and Resolution Planning) and the removal of members of banks' management bodies and/or senior officials. In case of serious infringements of law, regulations, or the statutes of the institution; serious administrative irregularities, or significant deterioration of the financial situation of the bank or banking group, the BdI is empowered to appoint a special administrator who assumes all functions and exercises all powers of the bank's management body. Unless otherwise provided in the special administration decree, the administrator shall (i) ascertain the bank's financial position; (ii) seek to eliminate irregularities; and (iii) promote solutions that are in the interest of the depositors, and of the sound and prudent management of the bank. Special administration shall last up to one year and may be extended, more than once, if the conditions for imposing special administration remain applicable.

22. The power to grant and revoke banking licenses is vested exclusively in the ECB. In accordance with the regulations governing the SSM, the ECB—after consultation with or at the proposal of the BdI—shall revoke a banking license if (i) licensing conditions are no longer fulfilled; (ii) the license was obtained through false statements; (iii) the bank has not made use of the license within six months; or (iv) if the bank has been put into a liquidation procedure (compulsory administrative liquidation) by the BdI. Against this backdrop, the BdI may submit a proposal to the ECB to withdraw a license in case it observes that revocation conditions have been met.

23. The legal framework empowers the BdI to impose pecuniary administrative sanctions in case of identified violations. The BdI can impose administrative sanctions, with amounts up to 10 percent of turnover, on supervised institutions, their respective parent companies, external service providers, and external auditors.[9] Moreover, administrative sanctions can be applied (albeit for lower amounts, i.e., up to EUR 5 million) to corporate officers, including senior management, if the violation stems from noncompliance with the duties assigned to that individual. In determining the amount of the sanctions, the BdI is required to consider all relevant circumstances, including the seriousness and duration of the violation; the degree of responsibility; the amount of profits gained, or losses avoided; the damages to third parties; and previous banking or financial infractions committed by the same person. Moreover, individuals can be banned from exercising management responsibilities for up to three years if the identified violation is deemed particularly serious. For matters falling within the scope of the SSM, the ECB is responsible for imposing sanctions on (i) SIs for failure to comply with directly applicable EU legislation (e.g., regulations or binding technical standards); and (ii) LSIs for violations of obligations vis-à-vis the ECB itself. In all other cases, the BdI is responsible for the exercise of sanctioning powers.

24. The current range of corrective actions and early intervention measures is broadly aligned with international best practice, but some scope for further enhancement remains. Recommendations from the 2013 FSAP on the early intervention framework have largely been implemented, providing the BdI with a broad toolkit for dealing with distressed banks. However, the

[9] The amendment addressed the recommendation from the 2013 FSAP to "enhance early intervention powers by empowering the BI to (...) apply pecuniary sanctions at the bank level without needing to appoint a special administrator." See IMF Country Report No. 13/350, https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2013/_cr13350.ashx.

BdI currently lacks formal power to require increased provisioning for assets with doubtful quality[10] and cannot directly remove and replace external auditors. While CONSOB can rescind the appointment of an external auditor, e.g., in case of non-adherence to professional standards, the legal framework does not extend similar powers to the BdI.

25. **Initiation of early intervention measures is informed by clearly articulated triggers that have been aligned with guidelines from the EBA**.[11] Decisions to impose early intervention measures take into consideration: banks' overall scores obtained via the annual SREP; combination of the overall scores with scores reached in SREP areas concerning business model and profitability, governance and control systems, capital adequacy, and liquidity; and financial indicators (stock and flow). Moreover, decisions to impose measures can be based on the results of on-site inspections as well as significant events such as rogue trading; fraud; severe IT problems; unexpected loss of senior management or key staff; or significant rating downgrades by one or more external rating agencies. While reaching (or exceeding) one or more of the various thresholds does not trigger the automatic adoption of early intervention measures, these events require a supervisory assessment of the cause and potential impact of the underlying event, taking into account its severity and persistence.

26. **The framework for corrective action and early intervention is supported by a robust decision-making process**. The process for initiating corrective action and early intervention measures is clearly described in the Guide to Supervisory Activities. In short, when the competent supervisory unit verifies that the necessary conditions for taking action are met and such measures are deemed necessary and appropriate, a formal procedure is initiated that includes a notification to the affected bank and an assessment of the documentation and/or explanations provided in response to such notification. In case of urgency, i.e., when it is deemed important to immediately prevent further deterioration in the bank's situation, measures can be immediately announced. While the BdI's supervisory function is responsible for initiating the process, the RCMU is duly informed to (a) enable it to update its resolution plans, and (b) fulfill any reporting obligations to the SRB. Once an early intervention measure is issued, collaboration between the competent supervisory unit and the RCMU is intensified, with supervision monitoring the condition of the institution and the implementation status of the measures and the RCMU notifying supervision of any significant changes made to the resolution plans because of the early intervention measures.

27. **Special administration has served the BdI reasonably well in the past**. Italy has a long tradition of addressing troubled institutions through special administrators. By assuming all functions and exercise all powers of the institution's management body (administrators do not assume shareholder powers but are exclusively empowered to convene shareholder meetings and set the agenda for such meetings), they seek to either rehabilitate troubled firms or pave the way toward orderly exits through compulsory administrative liquidation. Since January 2013, 28 banks

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[10] It should be noted, however, that inspection teams do conduct credit file reviews and share their findings on provisioning adequacy with bank management, with the expectation that these are taken on board. Should banks fail to do so, the BdI may impose Pillar 2 capital add-ons to cover the identified risks.

[11] Guideline on early intervention triggers (EBA/GL/2015/03), issued in July 2015, https://eba.europa.eu/documents/10180/1151520/EBA-GL-2015-03_EN+Guidelines+on+early+intervention+measures.pdf/9d796302-bbea-4869-bd2c-642d3d817966.

have been placed under special administration, with roughly half of them returning to going concern status (in some cases following a change in ownership). Some banks that were successfully rehabilitated, however, benefited from financial support from the DGS, which helped to improve their financial strength, effect a merger or facilitate an orderly transfer of assets and liabilities to an assuming bank. With interest in bank branches diminishing as the banking industry continues to consolidate, successful rehabilitation via special administration may become increasingly difficult going forward.

28. Given inherent risks, special administration needs to be used judiciously. Cross-country experiences show that special administration can easily generate adverse market responses if the administrator's appointment is interpreted as a sign of potential non-viability, which raises the specter of loss allocation to uninsured creditors (as per the resolution regime post BRRD transposition and greater harmonization of loss sharing criteria across resolution and liquidation, as advocated in this technical note). While it is noted that reliance on special administration has diminished following transposition of the BRRD, care needs to be taken that the use of this instrument does not delay more decisive action if rehabilitation prospects remain elusive. Persistent fragilities among LSIs suggests that more decisive and escalated supervisory action—utilizing the authorities' full toolkit to effect improvements or achieve orderly winddowns, as appropriate—may be needed to underpin stability.

29. Certain features of the legal framework can exacerbate risks associated with special administration. In exceptional circumstances, special administrators can suspend the payment of liabilities and restitution of financial instruments "in order to protect the interests of creditors." Under the KA, moratoria are only intended to be used for a short period while resolution actions are being executed, for example when undertaking a transfer of assets and liabilities or bail-in of creditors. However, the moratoria that are provided for in the Italian framework are substantially broader, e.g., can be used during early intervention for up to one month (extendable for another two months). In practice, such broad payment restrictions can be disproportionate and self-defeating, as the bank's inability to meet its obligations will undermine confidence (with potential contagion effects to other banks) and accelerate withdrawals as soon as the moratorium is lifted.[12] Similarly, potential delays in the publication of duly audited financial statements (as per the TUB, possibly until up to four months after the administration has ended, can make it increasingly difficult for banks in administration to continue operating, as uncertainty about their financial position may reduce access to funding and hamper their ability to maintain client relationships.[13] While it is understood that administrators (and statutory auditors) may need more time to verify data and produce accurate statements, efforts to rebuild confidence typically hinge on the

[12] See IMF Country Report No 18/232 for similar observations on the EC's proposed amendments to the BRRD (published in November 2016) that included moratorium powers during early intervention, for up to five days. Note that the moratoria powers provided for in Italian legislation have only been used under exceptional circumstances (five cases since 2010).

[13] The BdI has reported that, to date, no such difficulty in accessing funding has been observed for Italian banks during or after special administration.

disclosure of meaningful information, including tangible measures that are being taken to address identified weaknesses.

B. Recovery Planning

30. Recovery planning requirements have been introduced via the transposition of the BRRD. Pursuant to the TUB, as amended in 2015, all Italian banks are required to prepare either full-scope or simplified recovery plans that elucidate measures that may be taken to restore financial soundness and ensure (or re-establish) compliance with prudential requirements following a significant financial shock. In accordance with international best practice, plans should not assume the availability of extraordinary public financial support and be duly approved by bank management. Recovery plans of banks designated as SIs are assessed by the ECB through the SSM's joint supervision teams that include BdI staff, while the BdI is solely responsible for the (supervisory) review of the recovery plans prepared by LSIs. More specifically, LSIs designated as "high priority" by the BdI,[14] as well as those that do not fulfil the criteria foreseen in EBA guidance on the application of simplified obligations[15] are requested to submit full-scope recovery plans, while others can submit simplified plans.

31. The BdI provided detailed guidance on recovery planning via its circular from February 2017. In short, the measure explains when to submit full-scope or simplified recovery plans and highlights the various aspects that should be covered in the plans, citing EBA guidance where appropriate. In short, the circular discusses the role of recovery plans in the bank's governance and risk management framework, including escalation—and decision-making procedures; and provides brief guidance on the components of the strategic analysis that should underpin the identification of credible recovery measures, their impact assessment, the indicators to be used to determine activation of the measures, and aspects pertaining to communication. Recovery plans of high-priority LSIs are to be updated and submitted to the BdI on an annual basis, while simplified plans are to be updated and submitted every two years (unless no material changes to the institution's business model or organizational structure occur).

32. Processes for reviewing banks' recovery plans are robust. LSIs were first required to submit plans by June 2017, reflecting guidance provided via the BdI's aforementioned general measure. At the time, 12 LSIs (out of more than 400) were preparing full-scope recovery plans, due to their high-priority designation, while the remainder prepared simplified submissions.[16] The plans were assessed by the competent supervisory units and shared with the RCMU to enable the latter to

[14] Prioritization is guided by the BdI's Guide to Supervisory Activities, which directs BdI staff to consider the risk profile and systemic importance of individual banks. Assessments of individual banks are driven by its impact on the financial system (i.e., in terms of size, interconnectedness and complexity) and intrinsic riskiness (as expressed by the last SREP score). For 2019, the BdI has identified nine LSIs as high priority.

[15] Delegated Regulation (EU) 2019/348, published in March 2019 in the EU Official Journal, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0348&from=GA , as well as EBA/GL/2015/02 on recovery plan indicators and EBA/GL/2014/06 on recovery plan scenarios.

[16] As of 2018, the number of high-priority LSIs has diminished to nine, due to mergers and acquisitions. Note that the BdI granted waivers from recovery planning requirements to a handful of small institutions, e.g., in view of ongoing takeover proceedings, compulsory administrative liquidation or ongoing resolution processes.

duly reflect information from the plans in its resolvability assessments. The assessment of LSIs' recovery plans is supported by a template-based tool provided by the ECB, which seeks to foster consistency when reviewing the plans for completeness, quality, and credibility. In case of cross-border groups, group-recovery plans are discussed in the bank-specific colleges of supervisors, with the aim to reach joint decisions on their adequacy.

33. While BdI staff confirmed that the plans were generally found to be adequate, going forward further industry-wide guidance can help further improve their quality. The review of the 2017 version of banks' plans did not highlight material deficiencies as compared to the BRRD criteria of completeness, quality, and credibility. Thus, no formal procedures were initiated under the TUB to have banks resubmit modified plans and/or require material changes or change business activities, organizational arrangements and/or legal structures. However, the BdI's competent supervisory units found room for improvement in, among others, the identification and calibration of recovery plan indicators, the description of recovery options and the assessment of their impact and the incorporation of material legal entities (in the case of group recovery plans). Similar to feedback provided by the ECB to the banking industry,[17] the issuance of further industry-wide guidance on effective recovery plans, in addition to bilateral communications with the banks, can help to foster good practices and establish clear expectations across the Italian banking sector for further refinement of the plans.

34. As a next step, the BdI could usefully consider periodic testing of full-scope recovery plans to ensure operational readiness of the high priority LSIs. Periodic testing can assist banks greatly to assess the adequacy of their recovery plans. Such tests are separate from stress tests; they are designed to simulate scenarios in which the recovery plan must be activated and should involve testing of all key elements of the plan, including governance arrangements and, notably, the role of Board members and senior management (see Appendix III for more details). Once banks have undertaken some internal testing and the BdI has reviewed the test results, the BdI could usefully consider participating in occasional further testing of banks' plans, both to assess the adequacy of the recovery plans and the banks' internal arrangements for determining their deployment, as well as to gauge the BdI's own preparedness for fulfilling its responsibilities pertaining to recovery planning. The activation of recovery plans is fully integrated in the BdI's framework for corrective actions and early intervention, so that timely action can be taken if early warning indicators are breached but envisaged recovery measures are not activated.

Recommendations

- **Fully align the BdI's toolkit for corrective actions with international best practices**. Providing the BdI with explicit powers to remove and replace external audits and require increased provisioning for assets with doubtful quality would enhance its ability to respond to emerging weaknesses.

[17] Report on recovery plans, July 3, 2018, https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.reportrecoveryplans201807.en.pdf?cf305b99ef1ddc362726523703c6b371.

- **Ensure that reliance on special administration does not delay timely resolution or liquidation of unviable firms.** While special administration should be used sparingly in view of its inherent risks, consideration should be given to shortening the initial administration period (e.g., limit initial appointments to six months), with renewals being predicated on tangible progress in stabilizing the bank. To ensure that weaknesses do not linger, the BdI should stand ready to deploy other instruments should the administrator prove unable to identify tangible rehabilitation prospects within a clearly established timeframe (e.g., 90 days from his appointment). Moratoria prior to resolution should be avoided and administrators should pursue meaningful disclosure to rebuild confidence.

- **Provide further guidance on recovery planning**. Leveraging the BdI's experiences with reviewing banks' (full-scope) recovery plans, dissemination of good practices and common weaknesses can help strengthen practices across the industry. Aspects that could usefully be included in further communications include (i) the breadth and feasibility of recovery options (including the preparation of impact assessments, circumstances that would render actions unavailable and necessary prepositioning to ensure timely implementation); (ii) necessary capabilities to ensure operational resilience amidst stress situations (e.g., collateral management, arrangements for ensuring continuity of payment, clearing and settlement activities; and (iii) the development of communication strategies with the authorities, financial market participants, and the broader public.

- **Require testing of full-scope recovery plans**. To ensure operational readiness, the BdI should request periodic (e.g., annual) testing of recovery plans for at least the high-priority LSIs. Tests can involve 'walk-throughs' of selected processes and procedures, partial simulations, or comprehensive crisis-management exercises in which the BdI's supervisory team could also participate.

BANK RESOLUTION REGIME AND RESOLUTION PLANNING

A. Overview of the Resolution Regime

35. The Italian resolution regime has undergone extensive transformation since the 2013 FSAP. Reforms were shaped by the publication of the BRRD in 2014, which required EU member states to transpose the harmonized resolution framework by end-December 2014, or apply the new measures from January 1, 2015 (bail-in rules by January 1, 2016 at the latest). In response, the Italian government (having been empowered by parliament to do so) passed the so-called Resolution Decree[18] as a stand-alone legal instrument that includes the core of the BRRD framework—i.e., resolution planning, opening and closing of resolution procedures, resolution tools, arrangements for cross-border cooperation, safeguards, and provisions on resolution funding. The regime was further impacted by the establishment of the SRM, the new system for bank resolution

[18] Legislative Decree 180/2015, published in November 2015.

in the Banking Union (BU) that centralizes decision-making pertaining to the resolution of (i) SIs; (ii) banks that are supervised directly by the ECB (which can include LSIs); and (iii) cross-border banking groups that are active in at least two different members of the BU. The SRM Regulation[19] also created the SRB as the BU's central resolution authority, as well as the Single Resolution Fund (SRF). With the exception of four regional banks that were intervened in November 2015, prior to the entry into force of the bail-in requirements, the euro area's unitary regime for bank resolution has not yet been utilized in Italy.

36. The SRB is in charge of resolution planning and execution for Italian SIs. As of January 2019, the SRB holds direct responsibilities for 12 Italian banks, i.e., 11 SIs and 1 cross-border group that is classified as LSI[20]. For these banks, resolution would be initiated via the determination by the ECB that a bank is "failing or likely to fail" (FOLTF), followed by an assessment by the SRB of whether (i) there is potential existence of alternative solutions (i.e., private sector solutions or supervisory actions) that could restore the bank to viability; and (ii) resolution is necessary in the public interest (if not, failing banks are to be wound up under normal insolvency proceedings). Upon the SRB's determination that a bank meets the conditions for resolution, it will adopt a resolution scheme that identifies the resolution tool(s) to be used, as well as the potential utilization of the SRF (in which case an assessment by DG-COMP of the compatibility with state aid rules would be necessary). The BdI, in its capacity as NRA, would be closely involved in the preparation and adoption of resolution schemes for Italian banks. Unless the EC or Council of the European Union formally objects to the SRB's resolution scheme, it will be executed by the competent NRA. The Banca d'Italia would need to implement the resolution scheme of SRB by issuing implementation orders.

37. Events surrounding two Italian SIs in 2017 have illustrated the regime's complexities. During 2015–2017, Banca Popolare di Vicenza (BPV) and Veneto Banca (VB) experienced substantial financial difficulties, driven by idiosyncratic weaknesses and adverse economic conditions. While the ECB made the FOLTF determination in June 2017, the banks were not placed in resolution because the SRB found that the "public interest" test was not met—given that the banks did not provide critical functions and their failure was not expected to have significant adverse impact on financial stability at large. Accordingly, the BdI requested the initiation of liquidation proceedings under domestic law, with the government approving a decree-law providing up to EUR 16.8 billion in liquidation support (Box 3). While the operation was successfully completed via a transfer of (part of) the banks' assets and liabilities to another institution, the proceedings highlighted various challenges with the current resolution framework for the euro area.

- **Public interest test**. Ambiguity on the public interest test generates uncertainty as to the availability of resolution powers. Diverging approaches in resolution and state aid proceedings allow for misalignments, with the latter providing scope for liquidation aid to prevent a serious disturbance of the real economy at local level, notwithstanding the SRB's conclusion that the

[19] Regulation (EU) No. 806/2014, published in July 2014.

[20] As of March 20, 2019 the SRB took over its responsibilities on the new cooperative Group Cassa Centrale Banca.

banks' failure was not likely to pose significant adverse effects on financial stability at national level.

- **Planning**. The non-availability of resolution instruments required immediate negotiations with third parties to effect a sale in liquidation at a time when market conditions for bank assets were unfavorable. A longer timeframe for preparations, by pre-scheduling decisions on resolution and/or liquidation, can help produce better outcomes.

- **Bank-sovereign linkages.** The handling of the failure of BPV and VB confirms that further efforts remain necessary to attenuate the bank-sovereign nexus. With the banks not having been placed in resolution, the SRF was not available to cover resolution costs and the Italian government incurred substantial fiscal costs through the provision of liquidation aid (notwithstanding the BRRD's objective to obviate as much as possible the use of taxpayers' funds to save failing institutions). In the medium-term, a unified bank liquidation regime, supported by a common DGS, could help address this.

Box 3. Failure of BPV and VB

BPV and VB were commercial banks, located in the Veneto region. As of December 31, 2016, BPV's total assets were slightly below EUR 35 billion, with a market share of ~1 percent in terms of deposits and ~1.5 percent in terms of loans (~4 and ~6.5 percent, respectively, in the Veneto region). VB had about EUR 28 billion in total assets, with a market share of about 1 percent in terms of deposits and loans (~4 and ~5 percent, respectively, in the Veneto region).

The banks had a history of financial weaknesses, with losses increasing steadily since 2012 (with negative pre-provisioning profits for VB in 2016), asset quality deteriorating (the banks' nonperforming loan (NPL) ratios reached 35.8 and 38.7 percent, respectively, in 2016). Together, both banks received approximately EUR 3.5 billion in capital from Atlante—a private equity fund financed by the Italian banking industry to help stabilize the banking system.

As a result of their financial difficulties, the banks faced substantial deposit outflows, prompting the provision of liquidity support by the Italian government while efforts were undertaken to effect a sale of the banks' assets and liabilities to third parties.

On June 19, 2017, the ECB concluded that the Venetian banks' merger proposal and associated business plan was implausible and after consulting the SRB on the draft FOLTF decision, the ECB officially informed the SRB on June 23, 2017 that the FOLTF determination was made. The SRB concluded that while there were no timely alternative measures to prevent the failure of the banks, the SRMR's public interest assessment was not met since the banks did not provide any critical functions and their failure would not have any significant adverse financial stability effects. The next day, the Italian government formally notified the European Commission that it intended to grant up to €16.8 billion in liquidation support to wind-down the Venetian banks, that Intesa Sanpaolo would buy their performing business, and that the nonperforming business would be left in the residual entity to eventually be transferred to a government-owned asset management company. Pursuant to the 2013 Banking Communication, the Commission approved the state aid the next day. Atlante's investments were effectively wiped out when the banks were liquidated.

38. The new domestic resolution regime provides the BdI with a comprehensive set of resolution powers. Where conditions for initiating resolution have been met, the BdI (subject to approval by the minister) can deploy an extensive set of powers to effect orderly resolution. Among others, it can remove and replace bank management; appoint special managers that take control of the bank; control and operate the failing bank; ensure continuity of essential services and functions; override shareholder rights; transfer and sell assets and liabilities; create and operate bridge banks; establish an asset management vehicle and manage distressed assets of the failing bank; carry out a bail-in; temporarily stay early termination rights; and impose temporary payment moratoria. In applying the various powers, the BdI is expected to (i) allocate losses to shareholders and creditors in accordance with the creditor hierarchy (exceptions to *pari passu* treatment are provided for); (ii) ensure that no creditor incurs greater losses in resolution than in liquidation ("no creditor worse off" principle); (iii) fully protect insured deposits; and (iv) ensure that resolution decisions are taken on the basis of fair, prudent, and realistic valuations. Subject to certain conditions, resolution actions can be taken against holding companies, group entities, and branches of non-EU banks.

39. Criteria for initiation of resolution under the domestic regime (applicable to LSIs) are sufficiently flexible. Similar to the BRRD, resolution is to be initiated when the BdI determines that a bank is FOLTF, and that there is no reasonable prospect that alternative measures (including private sector measures or other supervisory actions) can overcome this situation. When both conditions are met, the BdI (in its capacity as NRA) can executes a "restorative" write-down or conversion of shares and/or capital instruments (including additional Tier 1 and Tier 2 capital) if this will prevent the failure of the bank. If this is not sufficient to rehabilitate the bank, the BdI would (i) initiate a resolution procedure if this is deemed to be in the public interest; and otherwise (ii) place the bank in compulsory administrative liquidation (Figure 1). Criteria for determining FOLTF cover regulatory breaches that are sufficiently material to justify license revocation; capital losses that deplete or significantly erode capital buffers; situations that cause liabilities to exceed assets; and the inability to pay outstanding obligations at maturity. Resolution can be initiated before balance sheet insolvency (i.e., can be applied if the aforementioned situations are expected to occur in the near future), and does not require the preceding application of early intervention measures.

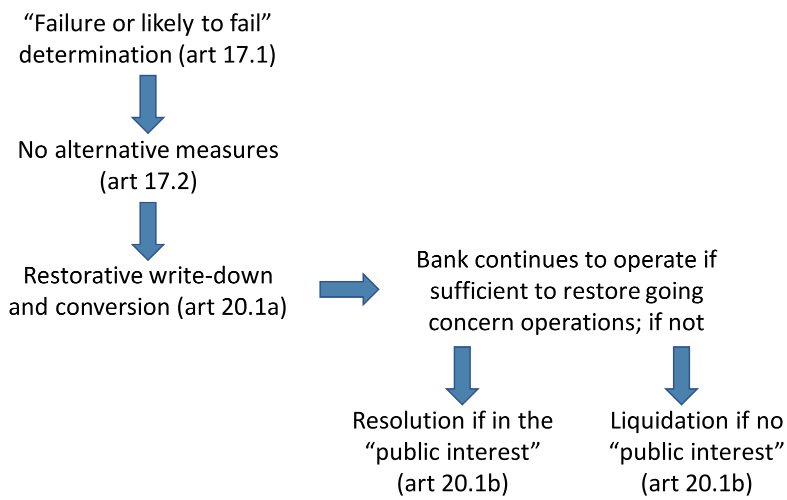
40. The new resolution powers were tested in November 2015, when four regional banks were intervened. Between 2013 and 2015, four regional banks (Banca Marche, Banca dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, and Cassa di Risparmio della Provincia di Chieti) that had been placed under administration were struggling to identify effective rehabilitation options. Capital had been substantially eroded but intervention measures involving private funds were not implemented as the EC concluded that the envisaged capital support from the FITD would comprise state aid and, therefore, that the banks should have been placed in resolution under the BRRD. In response, resolution schemes were designed—and implemented in November 2015, prior to the entry into force of the bail-in requirements—that transferred the banks' sustainable operations (branches, assets, and liabilities, with the exception of shareholder capital and subordinated debt) to bridge banks, capitalized by the NRF.[21] The schemes also entailed that NPLs were transferred to an asset management company established by the BdI; and the four original banks were placed in liquidation.

[21] Although the combined market share of the four banks was only around 1 percent, the BdI concluded that the banks were deeply integrated into the economic and financial system and were fulfilling key roles in the regional markets where they operated, notably vis-à-vis small and medium sized enterprises.

41. The resolution scheme for the four banks helped safeguard financial stability, but at substantial cost. Given the authorities' decision to protect all senior creditors, including uninsured depositors, the NRF (funded by the Italian banking system) was asked to contribute approximately EUR 3.7billion to cover capital needs of the bridge banks and the asset management company as well as the negative difference between assets and liabilities transferred. The sale of the bridge banks to UBI Banca and BPER Banca, respectively, generated further outlays that prompted the NRA to call up additional contributions from the domestic banking system.

Figure 1. Italy: Initiation of Resolution Proceedings

Decisions for initiating resolution (or liquidation) proceedings under Legislative Decree 180/2015 follow the framework that has been established in the BRRD and SRM Regulation.



Notes:

1. A FOLTF determination would typically be initiated by the Directorate General for Financial Supervision and Regulation, in its capacity as NCA, but the RCMU (as NCA) is duly empowered to (also) make an FOLTF determination if it deems this necessary in view of inaction by the BdI's supervisory function.

2. The commencement of resolution proceedings, or initiation of a restorative write-down and conversion, need to be preceded by a "fair, prudent, and realistic" valuation of the entity's assets and liabilities. The valuation is to be performed by an independent expert, appointed by the BdI and should confirm that the conditions for initiating resolution (or conducting a write-down and conversion) are met. In case of urgency, actions can be initiated based on a provisional valuation, to be conducted by the BdI or a special administrator. Provisional valuations should be followed as soon as possible by an external valuation that includes a properly substantiated estimate of further losses.

3. Public interest has been defined as "necessary and proportionate for achieving one or more of the resolution objectives" stated in the Resolution Decree (in short, continuity of critical functions, safeguarding of financial stability, containment of costs borne by public finances, protection of depositors and investors covered by guarantee or compensation schemes and protection of customers' funds and other assets). Resolution is only deemed to be in the public interest if compulsory administrative liquidation would not make it possible to achieve these objectives to the same extent.

42. The resolution of the four banks highlighted the challenges associated with retail investments in subordinated debt instruments. In line with state aid rules, the resolution schemes sought to impose losses on subordinated debt, which included large numbers of retail investors (in part incentivized by the then favorable tax treatment). Public controversy about this form of loss allocation, fueled by mis-selling concerns, led to the establishment of various compensation schemes that risk increasing moral hazard (Box 4). The introduction of more stringent market-conduct rules as part of the implementation of MiFID II has substantially curbed mis-selling risks, and the steady decline of the stock of bond holdings by retail investors makes contagion currently much less likely.[22] However, the authorities need to remain cognizant of the treatment of retail investors in resolution and carefully consider the credibility and feasibility of resolution strategies that involve bail-in. Should the presence of retail investors be deemed an impediment to effective resolution, mitigants will need to be pursued during the resolution planning stage. These may include the issuance of additional bail-in able instruments to other investors.[23]

Box 4. Compensation Schemes for Retail Investors

Since the resolution of Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara and Cassa di Risparmio della Provincia di Chieti, various schemes have been established to compensate certain investors that have been adversely impacted by burden-sharing arrangements.

- The *Fondo di solidarietà*, established at the end of 2015, enabled retail investors with assets or income below certain thresholds to receive a flat compensation (initially up to 80 percent of the purchase price of the bonds and subsequently increased to 95 percent). For other retail investors, the scheme established a special arbitration procedure at the National Anti-Corruption Authority, where the available of compensation was made dependent on whether misselling could be demonstrated. FITD was entrusted with managing the scheme.
- The *Fondo di ristoro Finanziario*, established by the MEF in 2018 with a budget of EUR 25 million per year until 2021, broadened the scope for compensation to include share purchases. The maximum amount of compensation, following a case-by-case assessment of mis-selling via arbitration or judicial proceedings, is set at EUR 100.000.
- More recently, the 2019 budget law replaced the *Fondo di ristoro Finanziario* with the *Fondo indennizzo risparmiatori,* which allows for compensation for retail investors, regardless of potential misselling, for losses associated with bonds and shares up to EUR 100.000. This latest scheme will have a budget of EUR 525 million per year until 2021.

B. Resolution Planning and Resolvability Assessments

43. Resolution plans for Italian SIs and cross-border groups are being managed at SRB-level. In accordance with the SRM Regulation, resolution planning activities for entities under the remit of the SRB are carried out with Internal Resolution Teams (IRT), coordinated by the SRB, and composed of SRB staff and representatives from NRAs. For Italy, 12 groups are subject to resolution planning of the SRB, i.e., 11 SIs and 1 cross-border LSI.[24] Most of these institutions have

[22] See Technical Note on selected issues regarding securities markets regulation and supervision.

[23] Also see statement from the European Banking Association and the European Securities and Markets Authority on the treatment of retail holdings of debt financial instruments subject to the BRRD, published in May 2018. https://eba.europa.eu/-/eba-and-esma-institutions-and-authorities-must-consider-retail-holders-of-debt-financial-instruments-in-resolutions

[24] Until the 2016 planning cycle, Veneto Banca and Banca Popolare di Vicenza were included in the list of banking groups under the SRM's remit. In 2018 planning activities for a cooperative banking group have been temporarily suspended, pending the on ongoing reorganization of the group's structure. As of March 2019, a new cooperative banking Group, Cassa Centrale Banca, has fallen under SRB's remit.

gone through multiple (annual) resolution planning processes, with BdI staff participating in the respective IRTs.

44. The preparation of resolution plans for LSIs is off to a good start. Resolution planning for Italian LSIs (and investment firms) started in the second half of 2017, following the conclusion of the resolution actions for the four banks that were initiated in 2015. Currently, there are about 130 LSIs under the BdI's remit, with assets representing about 10 percent of the total banking system; most have assets below EUR 1 billion, but 25 have assets between EUR 10 and EUR 25 billion.[25] The LSIs are focused largely on traditional banking business, but some specialized activities (e.g., payment services) warrants close attention in resolution planning. Resolution plans are prepared by the RCMU based on supervisory data and information sourced directly from the institutions. The planning process envisages consultation with the BdI's supervisory function (and CONSOB, for investment firms). Upon approval by the BdI's Governing Board, plans are shared with the SRB for its opinion. Plans prepared thus far cover about 50 percent of the LSIs total assets, with the completion of plans for all institutions foreseen by 2020.

45. Efforts to establish loss-absorbing capacity via minimum requirement for own funds and eligible liabilities (MREL), an important component of effective resolution plans, are ongoing for SIs. Binding bank-specific targets are gradually being introduced by the SRB, with increasing attention to the location of MREL in banking groups. Notwithstanding transition periods of up to four years, achieving MREL targets is expected to be challenging, due to limited depth of the internal capital market and implications for bank funding costs. The BdI, for example, estimated that the implementation of MREL could increase banks' average cost of funding (around 70 bps in June 2017) by between 10 and 30 basis points, possibly reducing banks' operating income by 2 percent to 8 percent.[26] The BdI has not yet set any MREL targets for LSIs, pending further analysis of the "public interest" test that underpins decisions on the initiation of resolution proceedings. In conducting this analysis, the BdI is assessing the regional presence of the LSIs, as well as possible contagion effects.[27]

46. The BdI is empowered to conduct resolvability assessments and impose measures that seek to overcome impediments to resolvability. The Resolution Decree specifically tasks the BdI with assessing whether banks or banking groups under its remit are resolvable, with "resolvability" being defined as the ability to place the bank in resolution or liquidation, with a view to ensuring the continuity of critical functions, while minimizing negative repercussions for the financial system in Italy, other member states or the European Union. If material impediments to resolvability are being identified, the BdI shall request the relevant bank to identify corrective actions and submit these for

[25] The number of institutions for which resolution plans are needed declined from about 400 to about 130 as a result of the reform of the cooperative banks (resulting in the creation of two cooperative banking groups currently under the direct remit of the SRB).

[26] Financial Stability Report 1/2018, published in April 2018.

[27] The authorities have noted in discussions with the FSAP team that current EU practices do not allow for MREL targets above current capital requirements for banks that do not pass the "public interest" test and thus are envisaged to be liquidated, rather than resolved. Following the forthcoming revision of the BRRD framework, however, these banks could, under certain conditions, also be subject to binding MREL requirements.

approval to the BdI. If the actions are deemed insufficient, the BdI may impose alternative measures, considering their possible impact on the bank's business, stability, and its ability to contribute to the economic system, as well as its impact on the domestic market for financial services and financial stability of other member states and the European Union. Such measures can include changes to the legal form or organizational structure of the bank (or banking group) to reduce complexity and ensure severability of critical functions; the mandatory establishment of a holding company structure; the issuance of MREL; the adoption (or amendment) of intragroup financial agreements; establishment of agreements to perform critical functions; the transfer or disposal of assets; and the limitation and suspension of ceasing of new or existing activities.

47. **Preliminary resolvability assessments for LSIs will need to be expanded as resolution plans are refined**. To date, the BdI's technical work has focused on its ability to effect orderly wind-downs via liquidation, rather than using resolution tools. However, as noted below, the feasibility thereof hinges on the ability to effect a transfer of assets and liabilities, as the Italian authorities strongly prefer to avoid so-called 'atomistic' liquidations—whereby the ordinary business of the entity is interrupted and assets are divested in a piecemeal fashion.[28] More granular analysis of potential impediments to the envisaged strategies will be important to ensure their feasibility without reliance on public funding/liquidation aid.

C. Capacity Building

48. **Experiences gained through the resolution of the four banks have become a benchmark for the preparation of internal procedures and manuals**. Among others, the exercise required the RCMU to define resolution schemes for the four banks, taking into account the 'no creditor worse off' safeguard; conduct provisional valuations based on available accounting data for the banks (which proved reasonably close to the external valuations that were performed after execution of the resolution schemes); prepare a large number of legislative and administrative acts; engage and interact with external experts (lawyers, accountants, etc.); establish bridge banks and vet their Board members; coordinate with other BdI departments, participants of the domestic safety net and EU agencies (SRB, ECB, DG-Comp); enable the carve-out of NPLs; and manage the divestiture of the bridge banks. Altogether, the resolutions involved more than 50 individuals (excluding administrators, liquidators, and management of the bridge banks).

49. **The development of a national resolution handbook is informed by the development of policy documents and templates at SRB level**. The preparation of a Resolution Planning Manual and Crisis Governance Handbook at SRB level, envisaged to provide guidance to the SRM's IRTs, is providing important input for the BdI's national resolution handbook that seeks to "regulate" its operational processes for resolution and crisis management. The handbook, which is expected to be finalized by mid-2020 (in line with the new SRB timeline), will provide operational step documents for (i) the national implementation of SRB decisions for SIs; (ii) the use of resolution tools for LSIs; and (iii) national bank liquidation proceedings. The RCMU, together with the SRB, has

[28] In doing so, the authorities seek to avoid shocks to public confidence; destruction of going concern business value; the immediate interruption of borrowing relationships and other business relationships; as well as the suspension of the access to payment systems.

initiated engagement with Italian SIs on prospective implementation of bail-in powers, including the banks' capabilities for providing pertinent information on a timely basis. In order to better understand information needs for the operational execution of bail-in powers, discussions with Monte Titoli (the Italian central securities depository) have recently also been initiated.

D. Compulsory Administrative Liquidation

50. Failing banks that do not meet the condition for resolution can be liquidated via a special insolvency regime. The TUB prescribes that if a bank is (i) failing or likely to fail; (ii) there is no reasonable prospect of overcoming the (likely) failure on a timely basis via other measures; but initiating a resolution proceeding is *not* deemed to be in the public interest, the bank can be put into compulsory administrative liquidation (CAL).[29] The process is initiated via the issuance of a decree by the Minister of Economy and Finance, acting on a proposal of the BdI. Bank of Italy could also issue a proposal to initiate CAL following a reasoned request from the bank's management bodies, extraordinary shareholder meeting, or special administrator (if the administrator finds that the bank cannot be rehabilitated) or voluntary liquidator. Initiation of a CAL procedure crystalizes the obligation for DGS to reimburse insured deposits or support a transfer of assets and liabilities on a 'least cost' basis. [30]

51. CAL is a flexible process that has been used repeatedly to effect orderly exits of distressed banks. The triggers for initiating CAL have been aligned with those for resolution, i.e., initiation of the procedure requires an FOLTF determination, as well as an assessment that there is no reasonable prospect of overcoming the failure via alternative measures (i.e., private-sector transactions and other supervisory instruments). Proceedings are managed by one or more liquidators who operate under the auspices of an oversight committee of three to five members, with the BdI appointing and supervising the relevant individuals without court involvement. Liquidators (with the support of the oversight committee and subject to authorization of the BdI) can manage all the assets of the bank under liquidation; may assign liabilities to a third party; and can initiate legal proceedings against the former management, control bodies, auditors, and shareholders. The functions of the management and control bodies, general meetings and every other governing body of the bank shall cease. Liquidators may also engage third parties (accountants, lawyers, etc.), can continue the operations of the bank if that is needed to maximize recoveries, and can borrow funds (using the banks' assets as security) for the purpose of settling duly recognized claims. During the past 5 years, 15 banks have been liquidated via CAL.

52. The BdI has ample discretion when selecting liquidators and determining their remuneration. Selection criteria are not prescribed by law but included in a BdI guideline. Among

[29] Liquidazione coatta amministrativa

[30] The least cost calculation methodology envisages the estimation of recoveries attributable to the DGS by subtracting (i) costs of the insolvency procedure (e.g., liquidators fees, legal costs) and (ii) preferred creditor claims from the estimated value of the assets (with haircuts to be applied based on asset quality). Net payout costs are subsequently calculated as the difference between the amount of covered deposits and the estimated recoveries attributable to DGS, in turn enabling a comparison between the cost of a payout and other interventions.

others, they relate to expertise and trustworthiness of the individual(s), the size and complexity of the bank under liquidation, and the need to avoid conflicts of interest. The BdI seeks to achieve a rotation of liquidators to prevent overreliance on select individuals. Candidates are vetted by the BdI upon their application and entered into an internal database that is updated based on their performance. The BdI has complete discretion to remove or replace liquidators and members of the Oversight Committee; and to determine their remuneration (which is partly performance-based).[31]

53. The 2015 amendments of the TUB have introduced important refinements. Under the Bankruptcy Law, creditors may offset receivables (even if not yet matured) against amounts of their obligations. The 2015 amendments, however, limited this to instances in which the set-off is claimed before initiation of CAL, so that creditors subject to bail-in in resolution can no longer claim that they are made worse off than they would have been in liquidation (when set-off would reduce their losses). Moreover, the authorities introduced a multi-tiered depositor preference regime (Box 5).

Box 5. Evolution of the Creditor Hierarchy in Italy

The 2015 amendments of the TUB envisaged the introduction of a tiered deposit preference system, among others to offer enhanced protection to depositors (thus reducing "run risk") and enable differentiated treatment of creditors in resolution and liquidation proceedings (the 2013 FSAP found that the authorities' of insured depositor preference would allow for cost-effective resolution transactions by justifying differential treatment of certain creditor classes as part of the resolution scheme). Note that liquidation expenses are to be settled prior to the restitution of the claims of other creditors, as per the applicable hierarchy below.

Prior to December 16, 2015	As of December 16, 2015	From January 1, 2019 onwards
Secured liabilities	Secured liabilities	Secured liabilities
Preferential claims	Preferential claims	Preferential claims
Insured deposits and other senior unsecured claims (pari passu)	Insured deposits	Insured deposits
Subordinated liabilities	Uninsured deposits from natural persons and SME	Uninsured deposits from natural persons and SME
Equity	Other deposits and senior unsecured claims (pari passu)	Other deposits
	Non-preferred senior debt	Senior unsecured claims
	Subordinated liabilities	Non-preferred senior debt
	Equity	Subordinated liabilities
		Equity

Depositor preference (tiered)

When introducing the regime for depositor preference, the authorities decised to cover all deposits on a tiered basis, albeit in part with a deferred implemenation date (i.e., January 1, 2019 for uninsured deposits that are not held by individuals and micro, small and medium-sized enterprises). With this approach, the authorities sought to reduce the loss potential for *all* depositors and facilitate bail-in as senior creditors would no longer rank *pari passu* with depositors (reducing the risk of "no creditor worse off" challenges).

The approach taken by the Italian legislator aligns well with IMF staff's suggestion in the recent Euro Area FSAP to introduce a general (tiered) depositor preference regime (see IMF Country Report No. 18/232). That being said, the impact on funding markets of the extended preference will need to be closely monitored in view of potential increases in wholesale funding costs and enhanced collateralization demands from senior creditors (which could limit subsequent resolution options).

[31] Anecdotally, the fees for bank liquidators that the BdI typically authorizes are lower than those used under normal bankruptcy proceedings.

54. CAL has been used repeatedly to address problem banks. As noted, the Italian authorities prefer to effect orderly market exits whereby all senior creditors (including uninsured depositors) are protected via a sale of assets and liabilities, to avoid contagion and prevent a sudden interruption of banking activities and a loss of value if assets would be liquidated in an 'atomistic' fashion (whereby assets are divested over a prolonged period). The transfers effectively protect the vast majority of creditors, with funds from the DGS (subject to passing the least cost test) or in exceptional cases the government budget (e.g., in case of the two Veneto banks) being used to cover the gap between assets and liabilities; in practice, this can result in (senior) creditors being better off in liquidation than in resolution under the euro area's unitary regime for bank resolution (which prescribes stricter burden-sharing requirements). As noted later in this note, such transactions are beneficial for depositors as they retain continuous access to their funds (which is not the case with insured deposit payouts). However, they hinge on the availability of a purchaser (in the absence of which an atomistic liquidation would become unavoidable) and require strict observance of the least cost test to protect DGS resources. To the extent that a least cost DGS contribution would be insufficient to cover the gap, losses would need to be assigned in accordance with the creditor hierarchy—with depositors now benefitting from the multi-tiered depositor preference regime. The use of public funds to protect senior creditors is difficult to justify except in case of systemic shocks (in which case, inherently, the use of resolution tools is likely more efficacious than liquidation).

55. In 2018, a new scheme was introduced to facilitate the liquidation of small banks. The objective of the scheme is to establish a framework for financial support from the DGS to facilitate the market exit of small, non-viable banks (assets below EUR 3 billion) via a sale of assets and liabilities under national proceedings. It envisages (i) a decision by the BdI that an eligible institution is an FOLTF; (ii) a determination that there are no reasonable prospects that alternative private solutions or supervisory measures will prevent the bank's failure; and (iii) an assessment that resolution actions would *not* be in the public interest. Upon meeting these three conditions, the bank would be placed in CAL, with the liquidator handling the sale of assets and liabilities. However, since financial contributions from the DGS (to cover the difference between assets and liabilities on a least cost basis) were seen as imputable to the Italian government, such support would need to be notified to the EC for an assessment of compatibility with state aid rules. By obtaining EC approval for the scheme, subsequent notifications of individual transactions would no longer be necessary. In 2018, the scheme was used to effect the wind-down of Banca Sviluppo Economico (Banca Base), with Banca Agricola Popolare di Ragusa acquiring its assets and liabilities. The transaction was supported by a contribution of EUR 4.5 million from the FITD. The scheme was in place until April 2019 but has not been renewed, among others in consideration of the General Court of the European Union's ruling that support measures adopted by FITD did not constitute state aid (see paragraph 66 below).[32]

[32] https://curia.europa.eu/jcms/jcms/p1_1798522/fr/.

Recommendations

- **Further refine resolution plans for those LSIs with a higher probability of presenting systemic risks under stressed marked conditions, factoring in binding MREL targets**. Adequate loss-absorbing capacity is important to ensure that no public funding is needed if banks need to be wound down through resolution or liquidation (with the authorities' preferred liquidation strategy resembling the 'sale of business' tool in resolution). Given market-related challenges and implications for banks' funding costs, transition periods for the issuance of MREL, as applicable, will need to be carefully calibrated to allow banks sufficient time to absorb the costs associated with the issuance of such instruments—which, in turn, may require broader adjustments of banks' business models and cost structures to ensure viability going forward.

- **Further expand resolvability assessments**. As resolution plans for LSIs are further refined, additional attention will need to be given to, among others, the envisaged perimeter for asset and liability transfers; the separability of the associated activities; banks' ability to promptly provide the necessary information for valuation purposes; and the identification of potential acquirers. Further consideration will also need to be given to options for covering a potential gap between assets and liabilities, considering least cost limitations on DGS contributions and the need to prevent reliance on fiscal resources. In practice, this would require the authorities to place greater reliance on effective loss allocation to unsecured and uninsured creditors (with the general depositor preference regime now providing for effective "tranching" of banks' liabilities).

- **Finalize ongoing efforts to develop a comprehensive resolution manual**. To further enhance the operationalization of the new resolution regime, resolution policies and procedures will need to be documented as soon as possible, ensuring consistency with the materials that are being prepared at the level of the SRM. Given the relative importance of the bail-in tool in the European context, operational procedures for executing bail-in strategies, in close collaboration with CONSOB and the central securities depository (in view of securities laws implications, potential disclosure requirements and exchange mechanics) will be particularly important.

DEPOSIT GUARANTEE SCHEMES AND RESOLUTION FUNDING

A. Deposit Guarantee Schemes

56. The Italian deposit guarantee system consists of two private consortia, covering all banks active in Italy. The FITD was originally established in 1987 and offers protection to the depositors of all commercial banks, except for those of (i) Italian mutual banks; and (ii) branches authorized in Italy that already participate in an equivalent scheme in their home country. The other DGS, the Deposit Guarantee Fund of the Cooperative Credit (FGD) was created in 1997 out of the Central Fund for the Guarantee of Rural and Artisan Banks that has been in existence in 1978. Banks may withdraw from the schemes, e.g., in case of voluntary dissolution, mergers or envisaged participation in another scheme, but they are not allowed to operate without DGS protection in place. In case of exceptionally serious non-compliance with statutory obligations, banks can be excluded from the schemes, subject to BdI's consent, but such exclusion entails revocation of the authorization to pursue banking activities.

57. Both DGSs are established as private law consortia, supervised by the BdI. The activities and organization of the schemes are governed by their respective Statutes, adopted by their general meetings and approved by the BdI, in its capacity of their supervisor. They are primarily entrusted with the repayment of insured deposits in case of the commencement of an administrative liquidation proceeding under the Consolidated Law on Banking. However, their mandate is broadly worded and also allows for (i) "alternative interventions", i.e., the provision of financial contributions to asset and liability transfers within a compulsory administrative liquidation; and (ii) "preventive interventions,", that seek to prevent the failure of a credit institution through the provision of financing, guarantees, equity investments or acquisitions of assets and/or liabilities. Both options require a determination that the amounts involved would not exceed the costs that the scheme is expected to incur in case of a payout (least cost test).

58. In keeping with their establishment as private consortia, the schemes' governance structures are prescribed by their respective statutes and bylaws. In case of the FITD, all member banks participate in the General Meeting, which appoints the Chairman and the members of the Board of Directors, Executive Committee, and Board of Auditors. The General Meeting also approves financial statements, appoints external auditors, and decides on amendments of the statutes and bylaws (subject to BdI approval). The Board of Directors (comprised of senior management of the affiliated banks) decides on, among others, the accession and exclusion of member banks, the amount of ordinary and extraordinary contributions to be levied, and measures to prevent the failure of a member bank. The Executive Committee, in turn, decides on (among others) the implementation of deposit payouts and asset and liability transfers, establishes investment guidelines, and oversees the FITD's day-to-day management (as conducted by the Executive Director). For the FGD, a similar but somewhat simpler governance structure is in place, comprised of the General Meeting, the Board of Directors, and a Board of Auditors.

59. Extensive involvement of the private sector raises concern, notwithstanding steps taken in recent years to strengthen the DGS' operational independence. To foster alignment of the FITD's governance with international standards, it has sought to buttress independence via the appointment of an independent chairman (who precedes over the General Meeting, the Board of Directors and the Executive Committee); the allocation of day-to-day management responsibilities to an independent Executive Director; and the adoption of an extensive code of ethics that, among others, deals with conflicts of interest,[33] and penalties in case of noncompliance. Confidentiality requirements are prescribed in the legal framework and elaborated in the DGS' statutes. But while these safeguards are welcome, they do not fully compensate for the fact that key decisions are

[33] Members of the Board of Directors and Executive Committee with a vested interest in regard to a specific operation are precluded from participating in discussions and/or decision-making on the matter.

currently attributed to industry representatives (e.g., the specification of appropriate funding targets, factoring in the statutory minimum; financial contributions to be paid by the associated banks, etc.).

60. Coverage is set at EUR 100,000 per depositor per bank, in line with EU requirements. Pursuant to the EU DGS Directive,[34] the DGS cover repayable funds acquired by banks in the form of deposits or other forms, except those explicitly excluded (e.g., deposits made by other financial institutions for their own account; own funds; deposits arising out of transactions in connection with which there has been a criminal conviction; deposits from depositors that have not been identified for AML/CFT purposes; and debt securities and liabilities arising out of own acceptances, promissory notes, and securities). Electronic money ("E-money") is also not eligible for protection. Coverage applies equally to euro and foreign currency deposits, with repayments being made in euro (if necessary, via conversion of foreign currency using the exchange rate at the date of adoption of the compulsory administrative liquidation decree) or the currency of the member state where the account holder is resident. As of December 2018, insured deposits comprised about EUR 699 billion (out of a total of EUR 1,060 billion).

61. The introduction of an *ex ante* funding model as of 2017 addresses an important recommendation of the 2013 FSAP, but the DGS' target size may prove insufficient for dealing with a large LSI or series of smaller, simultaneous failures. The accumulation of contributions from the associated banks, proportionate to their deposit base and risk profile should, in due course, provide the DGS with a stable funding base to cover potential outlays. But while the TUB (in line with the EU DGS Directive) prescribes a *minimum* target level of 0.8 percent of insured deposits, the Italian DGS have not sought to determine whether this level is adequate, factoring in country-specific circumstances. The collection of industry contributions started in 2017 and as of end-December 2018, the two DGS had collected about EUR 1.66 billion (approximately 0.24 percent of total insured deposits). The DGS have prepared funding plans to achieve the current targets by 2024, as per EU requirements, but these targets may not prove sufficient to cover the stand-alone failure of a large LSI, or to handle multiple smaller failures occurring simultaneously.[35] The ability of the schemes to levy extraordinary contributions cannot fully compensate for this, as such contributions are highly procyclical and risk weakening the banking system at large if they are activated at times of stress.

62. Backstop arrangements should be further strengthened. If the DGS are called upon to repay insured deposits and available financial means are insufficient, affiliated banks can be required to pay extraordinary contributions—normally not exceeding 0.5 percent of their insured deposits per calendar year but higher, with the consent of the Bank of Italy, in exceptional circumstances. However, mobilizing such extraordinary contributions may not yield the necessary resources quickly enough for the DGS to promptly repay depositors. Emergency funding arrangements can address

[34] Directive 2014/49/EU, published in April 2014.

[35] For example, the two Venetian banks that were liquidated in 2017 held more than EUR 10 billion in insured deposits, while the four banks that were resolved in 2015 jointly accounted for EUR 12.7 billion (one of the four banks alone held EUR 7.5 billion).

this, but neither of the two DGS currently benefits from a back-up funding line from the Italian authorities (ideally the government, given the public policy objective of protecting insured depositors).[36] Borrowing from, and lending to, the DGS in other member states is allowed under Italian legislation and the FITD and the FGD can borrow from other financial institutions, but (i) it is unlikely that such borrowings can be arranged timely enough to comply with mandatory payout periods, especially at times of stress; (ii) the absence of state guarantees may hamper efforts to secure large amounts at reasonable cost; and (iii) operational arrangements with other DGS and/or financial institutions have not yet been confirmed.

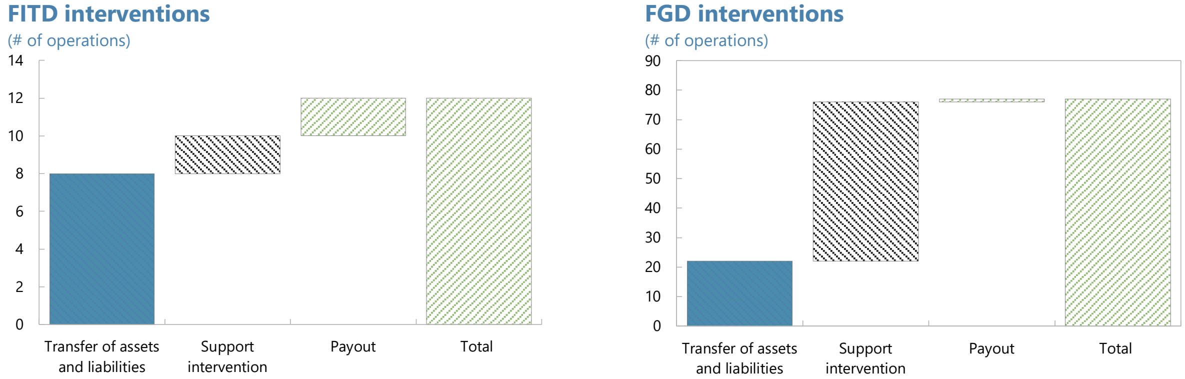
63. The FITD has adequate capacity to ensure timely payouts, but further efforts are needed to speed up payouts by the FGD. While the Decree (Legislative Decree 30/2016) that transposes the EU DGS Directive (2014/49/EU) allows for a gradual transition toward the international standard of a payout period of seven working days by 2023,[37] the FITD already meets this standard (without any transition period). Single Customer View (SCV) requirements have been established and the FITD has confirmed its operational ability to discharge its responsibilities within a timeframe through a stress testing program, run under the supervision of a steering team (including the BdI as external observer). The FGD is undertaking similar stress tests but has opted for the aforementioned transition period in its statute, implying a 15-day payout period until end-2020, a 10-day payout period from January 2021 to end-2023, and a 7-day payout period from January 2024 onward. To foster compliance with international best practices, the FGD should expedite the introduction of a seven-day payout period.

64. The Italian DGSs have substantial experience with asset and liability transfers, conducted in lieu of payouts on a 'least cost' basis. Cross-country experiences confirm that transfers of (insured) deposits and good assets, subject to a least cost test, provide the most efficacious way of addressing distressed banks. Depositors' access to their funds is not interrupted, as their funds will be available instantaneously at the branches and ATMs of the assuming bank; going-concern valuations of productive assets are preserved; and liquidation costs are reduced. With proper preparations (including bidding procedures, vetting of potential acquirers, and contract negotiations), deposit transfers can typically be executed over the course of a weekend, enabling seamless servicing of clients at the start of the next business day. Since its establishment, the FITD has participated in 12 bank interventions for a total amount of EUR 1.25 billion, with only two operations involving payouts of insured deposits. The FGD has a similar track-record (Figure 2).

[36] At the time of the mission, discussions were ongoing between the DGS and the authorities on a potential back-up credit line (to be provided by the Treasury or by BdI), to be used in case of emergency. However, the FITD has meanwhile finalized a funding agreement of up to EUR 2.75 bn with a group of large Italian banks, which could be drawn in case available resources would be insufficient to meet obligations. Such credit line would be gradually repaid, including from recoveries realized via CAL, so as to minimize adverse effect on the banking system. While being a step in the right direction, private sector backstops may still prove less reliable at times of severe stress than facilities provided by public sector agents.

[37] Principle 15 of the Core Principles of Effective Deposit Insurance Systems.

Figure 2. Italy: DGS Operations as of June 2019



Sources: FITD

Sources: FGD

65. Due to state aid restrictions, support operations for distressed banks ('open bank assistance') in recent years have been conducted via the voluntary intervention scheme of the FITD that seeks to avoid state aid requirements. The scheme was founded in 2015, following the decision by the EC that the provision of financial support by the FITD to a bank under administration (Banca Tercas) constituted unlawful state aid (Box 6).[38] The scheme operates as an autonomous legal entity with its own governance, distinct from that of the FITD. Membership by the commercial banks is voluntary and resources are collected on an *ex post* basis.[39] The scheme is designed as a preventive instrument that seeks to provide support (e.g., provision of financing, guarantees, capital support or acquisitions of assets and/or liabilities) to distressed banks, with the aim to facilitate their recovery. Governance of the scheme and scope of its interventions are governed by its statutes that, among others, prescribe that the costs of its interventions cannot exceed the costs that would be incurred by the FITD in case of a payout.[40] After an amendment of the scheme's statutes in 2018, it can no longer be used in liquidation proceedings and the scheme is prohibited from assuming control over supported institutions (in case of share purchases, control would need to be assumed by a third-party that acts alongside the scheme). As of end-2018, the scheme had carried out five interventions, for a total amount of almost EUR 1.4 billion.[41]

[38] In March 2019, the European Court of Justice annulled the EC's decision in the Banca Tercas case, see https://curia.europa.eu/jcms/jcms/p1_1798522/en/. The ruling was appealed by the EC in May 2019.

[39] As of end-December 2018, 130 banks were participating in the scheme, equal to 80.7 percent of the FITD membership. The scheme's members represented 95.4 percent of covered deposits.

[40] Also see article 11(3) of the EU's DGS Directive.

[41] i.e., EUR 271.9 million for Banca Tercas, EUR 784 million for Cassa di Risparmio di Cesena, Cassa di Risparmio di Rimini and Cassa di Risparmio di San Miniato and EUR 318.2 million for Banca Carige.

Box 6. Financial Support to Banca Tercas

Banca Tercas was a banking group mainly operating in the Abruzzo region. At the end of 2011, the main shareholder of its holding company was *Fondazione Tercas*, which at the time held a 65 percent stake. The bank had a balance sheet of EUR 5.3 billion, with EUR 2.6 billion in total deposits.

In May 2012, the bank was placed under administration, following the identification by the BdI of multiple irregularities in its governance, internal audit function, credit operations and management information processes. Initial efforts by the administrator to recapitalize the bank, including via the *Fondazione* were unsuccessful, but in October 2013 Banca Popolare di Bari expressed an interest in acquiring the bank, conditional on further due diligence and FITD covering its negative equity.

In October, FITD's Executive Committee approved a recapitalization of Banca Tercas for an amount up to EUR 280 million but a transaction was only executed in July 2014, following further discussions between the prospective acquirer and the experts of FITD on the due diligence results.

When assessing the support scheme, the EC concluded that the support provided by FITD was imputable to the Italian government due to the involvement of BdI, in its capacity as supervisor, in the FITD. Moreover, the EC found that the FITD's intervention provided Banca Tercas with a selective advantage that distorted competition and ruled that the intervention was not compatible with the state aid framework.

In response, the support by the FITD was reversed and reissued by the voluntary scheme that was created via a decision of its General Meeting in November 2015.

66. **Notwithstanding the Tercas ruling, asset and liability transfers funded by DGS and subject to certain safeguards, should be presumed compatible with state aid.** Despite tangible benefits of asset and liability transfers, potential acquirers are likely to be dissuaded from entering into such a transaction if they face state aid conditionality that is perceived to be burdensome. The ECJ's decision (if not overturned) could enable similar transactions for the privately-administered DGS in Italy, but not for *public sector* DGS, thus leaving in place a considerable barrier to (the funding of) deposit transfers in the EU context. Given that such transactions achieve a similar outcome as straight reimbursements of insured depositors (which are already explicitly excluded from state-aid rules), it should, at a minimum, be clarified in the 2013 Banking Communication that such transfers, subject to certain safeguards, would be considered compatible with state aid rules. In addition to a least cost requirement, conditions should seek to ensure fair bidding procedures to ward off competitive distortions; and prevent restrictions on depositors that prefer to withdraw their funds (including term deposits that were entered into before execution of the transaction) upon the transfer to the assuming bank.[42]

67. **Irrespective of state aid conditionality, IMF staff holds the view that the use of DGS funds for failure prevention operations should be avoided as much as possible.** While such operations, subject to certain conditions, are compatible with the DGS Directive[43] and have been

[42] Also see IMF staff's recommendations on state aid from the euro area FSAP in IMF Country Report No. 18/232.

[43] Article 11, para. 3, "Member States may allow a DGS to use the available financial means for alternative measures in order to prevent the failure of a credit institution, provided that the following conditions are met…".

used repeatedly by the Italian DGS to address weaknesses in smaller banks,[44] cross-country experiences suggest that they are seldom the least costly form of resolution—with business plans from problem banks often being overly optimistic, long-term losses typically exceeding those identified during the due diligence phase and moral hazard risks potentially distorting market incentives. Whenever possible, transfers of deposits and good assets, supported by DGS financing as needed, can provide a superior (and generally less risky) option for dealing with distressed banks, with nonperforming loans being effectively segregated through the receivership.

68. Various channels exist to foster public awareness about the benefits and limitations of the Italian DGS. In line with the EU's DGS Directive, banks are required to identify the DGS with which they are affiliated and provide (prospective) depositors with sufficient information on the modalities of the DGS protection. Communications with clients should include confirmations that deposits are insured and information on DGS protection should be included in new savings contracts (using the standard template annexed to the DGS Directive). The DGSs, in turn, are maintaining informative websites, including audited financial accounts, frequently asked questions, information about the schemes' governance, relevant legislation, and legal documents (e.g., statutes, code of ethics) and (in case of the FITD) information on the voluntary intervention scheme. The FITD has developed a communications and public awareness program, including an online survey to test the public's familiarity with the protection offered by the scheme. At the time of the mission, a comprehensive communications strategy, including periodic third-party evaluations, was being developed.

B. Resolution Funding

69. Funding arrangements fulfill an essential function in effective bank resolution regimes. Resolution authorities may require funding at different stages in the resolution process, e.g., to capitalize bridge banks; contribute resources to facilitate a transfer of (insured) deposits to a healthy bank; and to provide liquidity to firms in resolution so that critical functions can be maintained. Guided by the principle that the banking industry, rather than the taxpayer, should ultimately shoulder the burden of resolution, the KA prescribe two stylized options, i.e., (i) the creation of resolution funds (or a deposit guarantee scheme that is mandated to support resolution actions), financed via *ex ante* contributions from the banking industry; and (ii) the provision of temporary public funding with *ex post* recovery from the banking industry.[45]

70. The NRF was established in 2015, in line with EU requirements. The NRF is administered by the BdI in its capacity as NRA but has its own capital (duly segregated from that of the BdI) and maintains its own set of financial accounts. Prior to the establishment of the SRF, the BdI has full control over the use of NRF resources in resolution actions. Permissible activities of the NRF include

[44] Between 1997 and 2014, the FGD conducted 52 'preventive interventions', while the FITD has conducted five of such interventions (including three in 2019 that are still in train, i.e., Banca del Fucino, Banca Carige and Banca Popolare di Bari). Ten banks that benefited from preventive interventions by the FGD received two rounds of support, while nine (including two from the afore-mentioned group of ten) could not be recovered and were eventually placed into liquidation.

[45] Also see the Preamble of the KA, with KA 6 providing further details.

guaranteeing assets or liabilities of, or acquiring assets from, institutions under resolution; lending to such institutions; capitalize bridge banks and asset management companies; and pay compensation as per the "no creditor worse off" safeguard; with the *caveat* that the NFR is precluded from absorbing losses or recapitalizing institutions under resolution. The administration of the NRF is overseen by the BdI's Board of Auditors and its financial statements (published on the BdI website) are subject to independent audits.

71. **The NRF was called upon in November 2015 to fund the resolution of Banca della Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, and Cassa di Risparmio della Provincia di Chieti**. Confronted with substantial outlays, the NRF obtained a bridge loan from leading Italian banks of EUR 3.9 billion, which has been partially repaid through additional contributions from Italian banks. In 2016, the NRF incurred additional outlays related to the sale of the four bridge banks (e.g., recapitalization costs, outlays associated with the sale of NPLs). As a result, the NRF's endowment fund is currently reporting a negative balance, which is to be gradually recovered through industry contributions.[46]

72. **Contributions raised at the national level are gradually being pooled in the SRF, established as part of the SRM Regulation**.[47] The SRF, an essential element of the SRM, seeks to diminish the link between national sovereigns and banking sectors, while fostering uniform administrative practices in the financing of resolution. It is envisaged to be built up over an eight-year period, starting from January 2016, to reach a target level of at least 1 percent of insured deposits of all credit instructions in the BU by December 2023. At the end of the transition period, the SRF is expected to hold around EUR 55 billion, approximately 10 percent of which will have been contributed by Italian banks. Initially, the SRF (which is managed by the SRB) will consist of national "compartments" that will be used to fund resolution actions which respect to banks from the relevant member states; but these compartments will progressively be merged and will cease to exist at the end of the transition period.[48] Similar to other member states, Italy has (i) transferred contributions raised at national level to the SRF (about EUR 2.3 billion at end-2018) and (ii) concluded Loan Facility Agreement with the SRB that can be called upon in case demand on the national compartment exceeds available resources. Following the establishment of the SRF, the NRF is no longer available as a source for resolution funding.

73. **Further attention should be given to institutions' liquidity needs in resolution.** Recapitalization of distressed institutions, while necessary for orderly resolution, is not sufficient to ensure continuity of critical functions if private sector funding is not readily available. Heightened uncertainty following initiation of resolution proceedings due to market volatility, information

[46] The observed use of the NRF is in line with the conditions of KA 6, which allows for the use temporary public funding if the provision thereof is necessary to foster financial stability; will permit implementation of an orderly resolution scheme; and envisages loss allocation to equity holders, unsecured and uninsured creditors and the industry as a whole through ex post assessments.

[47] Regulation (EU) no. 806/2024 and the intergovernmental agreement on the transfer and mutualization of contributions to the SRF, dated May 14, 2014.

[48] Intergovernmental Agreement on the transfer and mutualization of contributions to the Single Resolution Fund, published in May 2014, http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%208457%202014%20INIT.

asymmetries, and a broader loss of confidence can undermine institutions' access to market funding, and thus undermine effective implementation of the resolution strategy. To alleviate these risks, banks should maintain processes for monitoring, forecasting, and reporting their liquidity needs in resolution, and identifying and mobilizing additional sources of funding, including the identification of unencumbered assets that can be mobilized as collateral. These aspects should be explored in further detail, together with the competent EU authorities, as resolution planning for LSIs under the BdI's remit progresses. In accordance with FSB guidance, resolution plans for at least systemically important banks should include the overall strategy, key actions and measures that would be employed to address liquidity stress in resolution—which may include recourse to central bank liquidity support.[49]

Recommendations

- **Remove active bankers from the governance of the DGS.** Notwithstanding additional safeguards introduced in recent years, the banking industry continues to wield significant influence over the operations of the DGS. Removal of active bankers and replacing them with a full contingent of independent Board members, would further insulate the DGS from industry involvement (thus strengthen operational independence of the DGS), and facilitate fuller involvement of the DGS in the financial safety net. In due course, shifting the DGS into the public sector would help improve the exchange of confidential information and enable their inclusion in the institutional framework for contingency planning and crisis management (also see section on contingency planning and crisis management).

- **Strengthen the funding structure of the DGS**. Funding adequacy of the DGS is of critical importance, as it is the main mechanism for funding asset and liability transfers (on a least cost basis) in resolution and liquidation. Against this backdrop, the adequacy of the DGS' current funding target of 0.8 percent of insured deposits should be critically reviewed, factoring in potential outlays in case of a large LSI failing or multiple smaller failures occurring simultaneously. Premiums should be recalculated to achieve the revised funding target within a reasonable period; and arrangements for backstop funding arrangements should be further strengthened (to avoid the need for immediately levying extraordinary contributions in case of funding shortfalls), preferably via a public sector facility (i.e., Ministry of Finance).

- **Shorten the statutory payout period for the FGD and establish the necessary operational capacity**. Prompt reimbursements are crucial to maintain public confidence and minimize the likelihood of contagion in case of bank failures. Further operational capacity will need to be established to ensure timely repayments, including timely access to accurate depositor information, organized in accordance with SCV requirements that enable the DGS to quickly option a consolidated view of all deposit accounts eligible for deposit guarantee coverage.

- **Avoid the use of DGS resources for failure prevention outside of resolution or liquidation as much as possible**. Operations to prevent the failure of banks, e.g., involving capital and

[49] https://www.fsb.org/2018/06/funding-strategy-elements-of-an-implementable-resolution-plan-2/.

liquidity support, introduce additional uncertainties when conducting least cost analyses and expose DGS to additional risks (e.g., investment risk if the supported bank does not recover and/or acquired assets cannot be divested; credit risk if financing made available cannot be repaid). Hence, such operations should be avoided as much as possible and only be considered in exception circumstances, with strong prospects for ensuring successful rehabilitation and long-term viability. Instead, DGS funds should be used for payouts or, in lieu thereof, to facilitate transfers of assets and liabilities, on a least cost basis, in resolution and liquidation, with the latter typically being a more efficacious method for protecting insured depositors. To the extent that such transactions meet certain safeguards (e.g., fair bidding procedures, no restrictions on depositors that prefer to withdraw their funds upon the transfer), they should be deemed compatible with state aid rules.

- **Together with the competent EU authorities, clarify mechanisms for providing liquidity during, and immediately after, resolution**. Heightened uncertainty following initiation of resolution proceedings due to market volatility, information asymmetries, and a broader loss of confidence can undermine institutions' access to market funding and thus undermine effective implementation of the resolution strategy. Given the *de facto* non-availability of the NRF going forward, available mechanisms for providing funding support (including the required safeguards and envisaged boundaries) should be further elucidated. In parallel, the BdI should ensure that resolution plans for at least all LSIs whose failure could present systemic risks include resolution funding plans.

OFFICIAL FINANCIAL SUPPORT

A. Official Financial Support

74. Italian legislation does not include government financial stabilization tools, as envisaged in the BRRD. The decision to exclude such tools (i.e., arrangements for providing equity support to distressed institutions, or place such instruments) seeks to avoid moral hazard and ensure that resolution objectives are not undermined. If such support were needed, an emergency decree might be considered, but such measures should only be considered under exceptional circumstances, given the need to safeguard public finances.

75. A policy instrument that has been utilized, however, is precautionary recapitalization, available under the BRRD to address serious disturbances in the economy and preserve financial stability. Precautionary recapitalization can be seen as an exception to the principle that banks receiving extraordinary public support are deemed 'failing or likely to fail' and thus should undergo resolution or liquidation. Instead, the framework allows for the injection of own funds in, and purchase of capital instruments issued by, solvent institutions to address prospective capital shortfalls identified in forward-looking stress tests or equivalent exercises. Such support, however, need to be geared toward remedying a serious disturbance in the economy of a member state (thus setting a high bar for the use of precautionary recapitalization), and the instrument cannot be used to offset losses that have already incurred or are likely to be incurred in the near future. Since precautionary recapitalizations imply public support to a private undertaking, they constitute state aid that must be approved by the EC. In December 2016, the government introduced a legal framework on precautionary recapitalization that was used to provide support to Monte dei Paschi di Siena in July 2017; a similar Decree Law was issued for Banca Carige in January 2019.[50]

Box 7. State Support to Monte dei Paschi di Siena (MPS)

During the past five years, the MPS received public support on two occasions, i.e., in 2013 and 2017.

2013 Measures

The June 2011 "capital exercise" conducted by the EBA identified capital needs of almost EUR 3.3 billion in order to meet the EBA's Core Tier 1 (CT1) capital target. Since no feasible market solution could be found to address the shortfall, the Italian government provided the bank with capital support through the issuance of debt instruments qualifying as CT1. The EC temporarily approved rescue aid of EUR 3.9 billion in December 2012, and issued final approval in November 2013, following the submission of a comprehensive restructuring plan. By June 2015, the bank had fully repaid the aid received.

2017 Measures

In 2016, the EU-wide stress test found capital in the baseline scenario to be adequate but noted substantial capital needs in the adverse scenario, with the bank's Common Equity Tier 1 ratio becoming negative.

In June 2016, the bank announced several measures for addressing the observed asset quality issues and capital shortfall, including the envisaged sale of its entire bad loan portfolio, an increase of the loan loss coverage for loans classified as "unlikely-to-pay" and "past-due" and a capital increase of EUR 5 billion through a liability management exercise (LME) and a rights issue. The LME, which was conditional on the completion of the rights issue, initially raised EUR 2.5 billion, but prospective institutional investors eventually did not confirm their interest in the rights issue.

In December 2016, the bank confirmed that the whole private transaction had failed. In response, the Government prepared a Decree Law setting out a framework for liquidity guarantees and precautionary recapitalizations, which triggered a request from the bank for liquidity aid and capital support. In June 2017, the Italian authorities notified a recapitalization of up to EUR 5.4 billion, with a restructuring plan to ensure the bank's return to viability by the end of the restructuring period.

In its decision from July 4, 2017, the EC concluded that the restructuring plan is apt to restore the bank's long-term viability, provides for adequate burden-sharing, and provides sufficient safeguards to limit undue distortions of competition. Moreover, the EC concluded that the aid measures are in line with the BRRD provisions on precautionary recapitalization, and thus would not trigger the FOLTF criterion. Hence, the envisaged measures could be implemented outside resolution.

76. While the support measures helped the authorities overcome financial stability risks, such measures need to be balanced against the need to safeguard public finances. In principle, public solvency support outside resolution ("open bank assistance") should be seen as a last resort measure, given that such transactions typically fail to pass the least cost test (in part due to underestimation of losses of distressed banks) and skew incentives as banks engage in increasingly risky activities as expectations of prospective support take hold. The exceptional nature of solvency support is reflected in the KA, which acknowledge that authorities may opt to introduce powers to place financial institutions under temporary public ownership to continue critical operations, but only as a last resort and for the overarching purpose of maintaining financial stability. Pursuant to

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[50] Decree Law 1/2019, published in January 2019.

the KA, such actions should provide for mechanisms to recover any losses incurred by the state from unsecured creditors or, if necessary, the financial system more broadly (e.g., through *ex post* levies).

B. Emergency Liquidity Assistance

77. When solvent financial institutions face temporary liquidity pressures that cannot be addressed through private sources, central banks may act as lender of last resort and provide ELA outside of normal monetary policy operations. This is an essential function of crisis management that aims to mitigate sudden funding pressures that could, if not addressed, jeopardize financial stability. By making liquidity support available on a temporary basis, central banks seek to prevent a systemic loss of confidence that can spread to otherwise healthy institutions. It is, however, widely accepted that provision of ELA in response to idiosyncratic needs should only be considered for solvent institutions after other funding sources have been exhausted, and only after due consideration has been given to how the provision of such support helps central banks achieve their stated policy objectives.

78. The BdI is authorized to provide ELA, which is an activity that in the European System of Central Banks (ESCB) remains under the purview of national central banks. The BdI's ability to provide ELA is derived from its broad authorization to take all actions necessary to carry out the tasks and functions entrusted to it. Its statute does not contain any specific provisions on ELA, but the main characteristics of the instrument (solvency of the requestor, collateralization of the facility, temporary nature of the liquidity needs) are clearly expressed in the (high-level) statement on ELA on the BdI's website.[51] In granting ELA, the BdI acts in accordance with the ELA agreement, published by the ECB in May 2017, which specifies certain criteria (e.g., solvency criterion) and the modalities for the flow of information from the ELA-providing NCBs to the ECB (e.g., the main features of the operation, monthly capital ratios of the ELA recipient, quarterly funding plan) and sets out the conditions for the ECB's Governing Council to assess whether there is a risk that the provision of liquidity support interferes with the objectives and tasks of the European System of Central Banks (ESCB) and, in particular, the Eurosystem's single monetary policy.

79. The BdI's framework for ELA reflects practices in the Eurosystem. The provision of ELA entails a discretionary decision by the BdI, with internal responsibilities for the assessment, oversight, and risk management of facilities having been allocated to the competent organizational units within the Directorate General for Financial Supervision and Regulation, the Directorate General for Markets and Payment Systems, and, for counterparties under its remit, RCMU). As per the published ELA Agreement, liquidity support is only available to credit institutions (i) whose capital ratios comply with harmonized minimum levels (common equity tier 1 of 4.5 percent, tier 1 of 6 percent and total capital of 8 percent); or (ii) which have credible recapitalization prospects via which harmonized minimum regulatory capital levels would be restored (in case any of the ratios mentioned under (i) are breached) within a predefined time frame.[52] ELA operations are to be collateralized, with the BdI accepting assets eligible as collateral for Eurosystem monetary policy

[51] https://www.bancaditalia.it/compiti/polmon-garanzie/ela/index.html.

[52] As specified in article 4(b) of the ELA agreement.

operations, assets that belong to similar categories but do not satisfy some Eurosystem eligibility criteria, and other assets (including nonfinancial assets). To protect the BdI's balance sheet, haircuts increase as maturities are lengthened and liquidity and credit quality diminish. ELA has typically been provided through renewable short-term operations, allowing for continuous reassessment of the necessity and desirability of continuation. All ELA operations to date have been concluded within 12 months, thus avoiding the determination of additional requirements and conditions by the ECB's Governing Council (as per the ELA Agreement).

80. **The provision of ELA is underpinned by a robust liquidity monitoring framework**. Ongoing supervisory procedures require banks to formalize policies for liquidity risk management, set their liquidity risk tolerance level and measure liquidity risk on a forward-looking basis. Regulatory reporting on liquidity coverage ratios is required on a monthly basis and is supplemented by additional metrics on a quarterly basis (e.g., harmonized maturity ladders) and enhanced Italian liquidity risk reporting, which was instituted at the beginning of the financial crisis, as the frequency of regular supervisory liquidity reporting was deemed insufficient to adequately monitor emerging liquidity strains. Reports include details on the funding structure, breakdowns of counterbalancing capacity and (on a bi-weekly basis) interbank operations, largest depositors, and potential sources of additional liquidity. The liquidity monitoring process includes weekly calls with banks' treasurers and risk managers. In case of market turmoil or idiosyncratic pressures, monitoring is stepped up to potentially (intra) daily basis. MOU's that govern cooperation and information exchange between the BdI's supervision—and market operations function are in place. The Markets Operations Department is well positioned to have banks pre-identify assets that can be mobilized as collateral, taking into account pre-existing asset encumbrance.

81. **Procedures should clearly document the approach and method(s) for (re)confirming bank solvency and viability at the time of the ELA request**. The BdI's continuous monitoring of banks under its supervision provides important inputs for the solvency assessment that needs to underpin ELA decisions. However, such input will need to be supplemented with additional analysis, to be performed immediately upon receipt of the request for liquidity support, to fully reflect additional uncertainties and challenges that may not have been fully captured in earlier supervisory activities—e.g., stemming from potential valuation adjustments of financial assets, additional provisioning requirements to cover increased credit risk (including adjustments linked to deteriorating collateral values), and other forward-looking developments that may have a bearing on solvency of the institution during the life of the liquidity support operation. While it may be possible to gather the necessary information in the phase preceding the ELA request, the BdI should stand ready to promptly reevaluate available information in cases where ELA requests materialize with scant advance warning. Assessments should also seek to confirm the continued viability of the bank's business model, including under stressed conditions, to provide additional assurances about the bank's continued capacity to repay the ELA operation without undue delay.

82. **Past experiences with ELA have confirmed operational readiness of the BdI**. Workflow documents, detailing the tasks and responsibilities of all involved units, are available and automated procedures are in place to facilitate the valuation of collateral and settlement of the loan. The BdI does not require banks to pre-position collateral per se, but the Market Operations Directorate is

able to verify banks' ability to mobilize collateral, if needed, as part of enhanced liquidity monitoring of banks deemed to be vulnerable. ELA decisions are to be taken by the BdI's Governing Board, but meetings can be called on short notice, be organized via teleconferencing and (if needed) be conducted via an urgency procedure. In the past, ELA requests have been handled within one business day.

83. **While ELA operations do not, in general, benefit from government indemnities, guarantees have been made available as part of specific, timebound schemes**. Experience across the EU indicates that sovereign indemnities for ELA operations are rare, as the provision thereof triggers notifications to the EC under the state aid framework. However, the Italian government has established special guarantee schemes on two occasions in recent years (i.e., 2011 and 2016) that allowed the MEF to issue guarantees to (i) secure newly issued debt securities of Italian banks; or (ii) collateralize ELA operations. A similar scheme was announced in January 2019, for the benefit of Banca Carige. In each case, the schemes themselves were found by the EC to be compatible with state aid requirements, with institution-specific support provided under the schemes triggering additional vetting by the EC. It could be difficult, when the institution is not able to post acceptable collateral, for the BdI to promptly obtain government indemnities on an *ad hoc* basis, e.g., in situations where the provision of ELA to an SI is critical to protect financial stability, however the BdI's Governing Board can authorize exceptional deviations from the ELA collateral framework to include additional types of collateral or less stringent eligibility requirements.

84. **Disclosure practices should be reviewed to ensure that confidence in the system is not undermined through premature signaling (or the perception thereof) of ELA operations**. Subject to certain conditions, Italian banks can delay public disclosure of inside information pertaining to liquidity problems and the need to receive ELA, consistently with the EU legislative framework. According to Regulation EU 596/2014 (MAR), prior consent (to be reassessed on a weekly basis) needs to be obtained from the NCA (i.e., CONSOB), which requires evidence that (i) disclosure would undermine financial stability; (ii) disclosure is in the public interest; and (iii) confidentiality of the information can be maintained. However, risks remain that information on ELA is disseminated prematurely through BdI disclosures, notably through monthly balance sheet data. While sudden changes in the reporting item that includes ELA operations are not indicative per se of the provision of increased liquidity support by the BdI (for example, changes can also be driven by increased volatility in the valuation of financial assets), there is a risk that they are perceived as such. While eventual disclosure is important to foster accountability, revealing information shortly after disbursement could signal the existence of liquidity pressures in the system, and thus undermine financial stability. In this context, central banks are justified in deferring disclosure of ELA information until its release can no longer be expected to have a destabilizing effect.[53]

[53] In the 2018 euro area FSAP, IMF staff suggested that "the Eurosystem should examine the routine disclosure of balance sheets, to minimize the risk of premature ELA disclosure." See IMF Country Report No. 18/229.

Recommendations

- **Barring systemic shocks, prevent the use of public funds to protect uninsured creditors**. The use of public funds should be strictly limited to exceptional events that could undermine system-wide financial stability, and only be granted under strict conditions that maximize burden-sharing, provide for strict oversight and incentivize timely repayment.

- **Review policies and procedures for (re)confirming bank solvency and viability at the time of an ELA request**. The framework should seek to validate the latest available information about the requestor's financial condition, adjusting reported data as needed and factoring in forward-looking elements that help gauge the requestor's susceptibility to near-term stress. In conducting the assessment, the BdI should aim to determine that the requestor's business model can reasonably be expected to remain sound, including under stressed conditions—i.e., that profitability can be maintained, and the institution is able to generate sufficient cashflows to ensure timely repayment of the ELA facility.

- **Avoid premature disclosure of ELA facilities**. Careful consideration should be given, in consultation with the ECB, to the timing of the disclosure and the nature of the information disclosed. To ensure that the effectiveness of the ELA instrument is not undermined, information on lending operations should only be disclosed with an appropriate time-lag.

CONTINGENCY PLANNING AND CRISIS MANAGEMENT

A. Domestic Arrangements

85. Cross-country experience indicates that inadequate crisis preparation can greatly impair authorities' ability to respond decisively to an emerging crisis. Contingency planning aims to strengthen authorities' ability to deal with unforeseen events that can cause severe systemic disruption. Various components need to be in place to ensure effectiveness, including tools to identify and monitor emerging risks, familiarity with policy options for addressing crises, arrangements for inter-agency coordination and information sharing, and crisis-management exercises that are used to periodically test contingency plans.

86. Coordination between the Italian authorities is mandated by law. Both the TUB and the TUF require the authorities to cooperate with each other by exchanging information and otherwise for facilitating the performance of their respective functions. Collaboration is underpinned by bilateral Memoranda of Understanding (MOUs), as well as a Framework Agreement between the BdI and CONSOB that seeks to strengthen cooperation between the two entities. In case of IVASS, close functional linkages with the BdI are further highlighted by the inclusion of senior BdI officials in IVASS' governance structure (i.e., senior deputy governor of the BdI as president, involvement of senior BdI and IVASS officials in the so-called Integrated Directorate). Information sharing among the authorities is not subject to confidentiality constraints. In fact, the TUB explicitly precludes the administrative authorities from invoking professional secrecy in their dealings with each other (although this provision does not apply vis-à-vis the MEF). Coordination between the BdI and the FITD is authorized by law but not formalized in practice (the current MOU solely covers the exchange of data for calculating the risk indicators needed to determine banks' annual contributions.

87. Although a multilateral forum for domestic financial stability oversight exists, its activities have been limited. In July 2008, a multilateral MOU was signed between the MEF, the BdI, CONSOB, and IVASS that resulted in the creation of the Committee for the Safeguard of Financial Stability (CSFS). The CSFS was envisaged to act as coordination body for the MEF (with the minister acting as Chair), the BdI, CONSOB and IVASS, with a mandate to discuss matters pertaining to financial stability. In practice, however, it has hardly met, as coordination and information exchange between the agencies has been primarily handled on an informal and *ad hoc* basis. As such, the Italian authorities currently lack a forum for contingency planning that could, among others, (i) periodically review the crisis preparedness efforts of the various financial safety net providers; (ii) prepare a comprehensive overview of possible crisis-management measures; (iii) organize multi-agency contingency planning exercises; and (iv) coordinate crisis responses and communication plans. To strengthen inter-agency coordination and help advance crisis preparedness, the mission recommends the designation of a formal Crisis Management Committee, either by establishing a new forum (with participation of all relevant agencies, including the two DGS), or by expanding the mandate and, as applicable, the membership of the CSFS. See Box 8 for international examples.

Box 8. Interagency Coordination Mechanisms for Crisis Preparedness and Management

While institutional frameworks vary from country to country, certain common, underlying objectives and principles can be identified. First, institutional arrangements should be anchored by a clear allocation of roles and responsibilities between the financial safety net providers and, second, underpinned by effective legal avenues for cooperation and information sharing. Cross-border experiences provide useful guidance.

- In Australia, the Council of Financial Regulators (CFR) was established in 1998 as a non-statutory body consisting of Australia's main financial regulatory agencies (Reserve Bank of Australia, Australian Prudential Regulation Authority, Australian Securities and Investments Commission, and the treasury). It has been tasked with facilitating a coordinated response to potential threats to financial stability, by serving as a platform for information sharing without legal powers on its own and ensuring the existence of appropriate coordination arrangements. The CFR has developed crisis resolution strategies (including policy and operational guidance as well as pre-drafted documentation) and conducted simulation exercises. It meets quarterly and, as necessary, on an *ad hoc* basis.
- In Switzerland, an MOU has been established between the Federal Department of Finance (FDF), the Financial Market Supervisory Authority (FINMA), and the Swiss National Bank (SNB) in an effort to further the exchange of information and cooperation in the event of a crisis. This tripartite MOU sets up a joint crisis-management organization across these agencies, empowered to prepare crisis-management measures and plans. A Steering Committee (SC), chaired by the head of the FDF, is in charge of strategic coordination in crisis management and a Committee on Financial Crises (CFC), chaired by the CEO of FINMA, is responsible for coordinating preparatory efforts and for crisis management. In certain circumstances, depending on which agency is competent to take relevant measures to handle the crisis, the SC can transfer the leadership of the CFC to the FDF or to the SNB.

Box 8. Interagency Coordination Mechanisms for Crisis Preparedness and Management (concluded)

- Germany has established a Financial Stability Committee, comprising the Ministry of Finance, Bundesanstalt fur Finanzdienstleistungsaufsicht and Bundesbank as voting members and Bundesanstalt fur Finanzmarktstabilisierung as non-voting member. The FSC's main focus is on macroprudential policy, but its tasks also seek to strengthen cooperation between the represented authorities in the event of a crisis situation. The FSC does not have any decision-making powers pertaining to bank resolution and/or crisis management, but it is well positioned to help coordinate policy responses of its members (each acting within its own competences). An internal crisis-management handbook, developed by the FSC, is available.

88. **Exclusion of the DGS from the institutional framework for crisis preparedness and management can hamper effective preparations for bank failures**. International best practices prescribe that jurisdictions establish formalized frameworks for coordination and information sharing among the participations for the financial safety net, including the DGS. Moreover, DGS should be included in contingency planning and crisis-management frameworks, and participate in simulation exercises.[54] At present, and in view of the private nature of the DGS, a formal framework for the exchange of confidential supervisory information has not been established, and information sharing with the BdI's supervisory function is limited to financial data needed to calculate banks' risk-based annual contributions. In due course repositioning the DGS as public-sector entities, duly embedded in the financial sector safety net, would help to address these issues and, in doing so, strengthen effectiveness.

89. **The development of an overarching crisis-management plan would be advantageous.** Contingency planning can greatly enhance the authorities' preparedness for dealing with sudden distress, and thus is a key element of effective crisis-management frameworks. Advance planning is particularly important for the resolution authority, but also relevant for other safety net participants—notably, the MEF and the DGS. Aspects to be elaborated include (i) the roles and responsibilities of the various agencies; (ii) key processes and concise policy guidance on the agencies' powers and policy instruments; (iii) coordination arrangements and communication channels; and (iv) interdependencies between the agencies' tasks. The crisis-management plan should be updated at least once a year and reviewed for consistency with plans from the individual agencies.

90. **Crisis-management exercises should be further expanded**. During the past years, the Italian authorities have gained ample experience with handling episodes of financial distress. Coordination has been intense, both between the domestic authorities and with the European agencies (notably, the ECB and the SRB) and allowed the authorities to effectively intervene troubled institutions without jeopardizing financial stability. However, 'desk-top' exercises based on different resolution scenarios and 'live' bank-crisis-simulation exercises remain useful to maintain familiarity with the broad suite of resolution powers, including powers that have not (yet) been deployed (e.g., bail-in) and test the adequacy of available manuals and policy guidance. To maximize added

[54] See Principles 4 and 6 of the Core Principles for Effective Deposit Insurance Systems.

value, it is recommended that (internal) crisis-management exercises of the various agencies are periodically complemented by multilateral exercises coordinated by the CSFS (or similar committee if the authorities opt to establish an alternative forum for crisis management coordination and preparedness). In due course, exercises could be conducted on a cross-border basis, with involvement of relevant host authorities.[55]

91. Cross-country experiences highlight important lessons for resolution exercises. Cross-agency resolution exercises have been used by many jurisdictions (e.g., EU member states, Australia, Singapore, New Zealand, and the United States) to foster capacity building. In order to get the most value from resolution exercises, it is suggested that they include participation by senior management of the competent authorities, thus providing greater realism and ensuring added value for the key decision-makers. Exercises should be followed by debriefs of all participants, with key findings being incorporated in a detailed evaluation report. The report should summarize key challenges and identified impediments to orderly resolution, if any, and list recommended changes to resolution guidance, processes and procedures that should be considered.

B. Cross-Border Cooperation

92. Within the euro area, cross-border cooperation is underpinned by the SRM. Effective since 2014, the SRM seeks to prevent unilateral and potentially inconsistent decisions by individual member states regarding the resolution of credit institutions operating on a cross-border basis, which could otherwise increase costs and hamper effectiveness. At the heart of the SRM is the SRB, entrusted with decision making on matters pertaining to resolution planning and execution for institutions under its direct responsibility (including SI on the direct supervision of the SSM and cross-border groups)—which includes the preparation of resolution plans, the assessment of banks' resolvability and identification of measures needed to address barriers to effective resolution, and adoption of resolution measures. The BdI cooperates on a regular basis with the SRB and other NRA in resolution planning and resolution execution. Moreover, staff from the RCMU participates in relevant committees and working groups established by the EBA to define policy guidance at the European level.

93. Resolution colleges have been established for the two Italian banking groups, i.e., Intesa Sanpaolo and Unicredit.[56] These colleges are coordinated by the SRB, in its capacity as group-level resolution authority, with the BdI contributing as (i) former home resolution authority and member of the IRT set up within the SRM, (ii) authority responsible for deposit guarantee schemes, and (iii) national competent (supervisory) authority and member of the Joint Supervisory Team that has been established as part of the SSM. In this capacity, BdI staff supports the SRB with

[55] See, for example, the exercise between the US and UK authorities, conducted in October 2014 (https://www.bankofengland.co.uk/news/2014/october/key-components-for-the-resolution-of-a-global-systemically-important-bank) and the recent Nordic-Baltic crisis-management simulation, conducted in January 2019, that involved 31 authorities from eight countries (https://www.fi.se/en/published/news/2019/statement-regarding-nordic-baltic-financial-crisis-simulation-january-2019/).

[56] Unicredit has also been designated as global systemically important bank, requiring the bank to establish the total loss-absorbing capacity buffer that has been agreed at the international level.

the preparation of documents to be shared within the resolution college and/or interactions of the IRT with non-BU resolution authorities.

94. In addition, BdI staff participates in resolution colleges of five foreign banks established in the BU and active in Italy. At the time of the FSAP, these included BNP Paribas, Societe Generale, Credit Agricole, Deutsche Bank, and Santander, all of which are deemed systemically relevant for the Italian banking market. However, the BdI's role is more limited in these colleges, as it is focusing mainly on the Italian components of these banking groups, rather than on the groups as a whole.

95. The BRRD, as transposed in Italian legislation, provides a robust basis for cross-border information sharing, both within the EU and with third countries. Where the BdI acts as resolution authority (i.e., in case of LSIs), it is expected to coordinate the flow of information between all authorities involved. For third countries, the Resolution Decree empowers the BdI and the MEF to exchange confidential information as long as the recipient has confidentiality obligations in place that are equivalent to those applicable in Italy; and exchange is necessary for resolution planning and/or execution. As regards coordination with non-EU country authorities, the SRB is the duly authorized authority to conclude such agreements on behalf of the NRA, while EBA is empowered to conclude arrangements that can serve as a model for agreements signed by national resolution authorities with competent authorities from third countries. Thus far, the BdI has not observed any constraints in cross-border information sharing within the EU, nor felt the need to directly sign cooperation agreements with non-Banking Union members or non-EU countries directly (keeping in mind that cross-border activities for LSIs are relatively limited).

96. Other legal framework conditions for effective cross-border cooperation are in place. The BdI is required to duly consider the impact of its decisions or actions on financial stability in other member states; and ensure that its decisions and actions taken are coordinated, where needed, with competent authorities from other member states. Except for an obligation on the BdI to immediately apply decisions reached in resolution colleges, law and policy do not envisage automatic actions by the BdI as a result of resolution actions initiated in other jurisdictions. Actions can be taken vis-à-vis branches from third countries if the (i) branch no longer meets, or risks not meeting, prudential requirements; (ii) there are no rehabilitation prospects; (iii) the parent bank is not willing or able to fulfil its obligations vis-à-vis Italian creditors; or (iv) resolution proceedings have been initiated, or are expected to be initiated, in the bank's home country. The Resolution Decree allows the BdI to exercise its resolution powers (e.g., order asset and liability transfers, impose temporary stays) to support resolution decisions taken by third countries' authorities. The treatment of creditors (including for the purposes of depositor preference) does not discriminate based on nationality, location of the claim or jurisdiction where it is payable.

Recommendations

- **Enhance crisis preparedness and coordination via the operationalization of an inter-agency forum for crisis management**. To foster crisis preparedness of the competent authorities and facilitate coordination of policy responses at time of (systemic) distress, a crisis management committee should be created, either by revamping the CSFS or by setting up a new structure. In addition to providing a platform for information sharing and coordination, such a forum could usefully oversee multilateral contingency planning efforts, oversee crisis-management simulations and ensure that communications are fully aligned at times of crisis. To be clear, the forum would not be expected to act as a decision-making body. Decision-making powers would continue to reside in the competent agencies, as per their legal roles and responsibilities.

- **Strengthen the role of the DGS in the financial safety net's coordination arrangements**. In line with international standards, the DGS should be fully embedded in the coordination arrangements among safety net providers, with formalized information-sharing arrangements that govern the continuous exchange of (supervisory) information on distressed banks, well before they reach the point of failure. While the removal of active bankers from the DGS' governance would help strengthen operational independence, in due course, consideration should be given to repositioning the schemes as public-sector entities, as this is ultimately more consistent with their critical contribution to the fulfillment of a public policy mandate and fuller involvement in the financial sector safety net. As the consolidation of the cooperative banks progresses, an integration of the two schemes could also be considered.

- **Develop a program for periodic crisis management exercises**. Periodic crisis-management simulations can help maintain operational readiness and familiarity with prevailing procedures. In due course, when one or more domestic exercises have been successfully conducted and thoroughly evaluated, the scope of the simulations could be extended to include relevant host authorities.

LEGAL PROTECTION, SAFEGUARDS, AND JUDICIAL REVIEW

97. The BdI, its governing bodies, and its employees benefit from legal protection in accordance with best practice. Pursuant to Law 262/2005 (also known as the "Savings Law"), the BdI, CONSOB and IVASS can only be held liable for damages caused by gross negligence or actual intent. The relevant provision is mirrored in the TUB for the exercise of BdI's supervisory tasks, and in the Resolution Decree for the exercise of its responsibilities as NRA. The statutory protection is further supported by internal rules of the BdI that govern the reimbursement of legal expenses incurred by employees involved in court proceedings as a consequence of the performance of their duties. Reimbursement can be requested after the conclusion of each instance of the proceeding, but the BdI's circular also enables advance payments. Contrary to international best practices, members of the DGS' governance bodies and their staff do not benefit from legal protection.[57]

[57] Principle 11 of the Core Principles for Effective Deposit Insurance Systems prescribes that *"the deposit insurer and individuals working both currently and formerly for the deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation."*

98. No protections are offered to directors and officers of an institution under resolution for actions taken to implement instructions from the authorities. Where directors and officers of a failed institution that are retained during the resolution process for continuity reasons are required to take action in response to decisions of resolution authorities, they should be duly protected from lawsuits by shareholders and affected creditors.[58] Such protection helps to ensure compliance with resolution decisions and can foster retention of critical persons during resolution proceedings (to the extent that their removal is not warranted by their responsibility for the actions that may have prompted the resolution decision). Legal amendments could be informed by the protection already extended to special administrators, liquidators and (managers of) bridge banks and asset management companies, whose liability is currently limited to instances of willful misconduct and gross negligence.

99. The resolution framework provides for legal safeguards for shareholders and creditors ("no creditor worse off") in line with international best practices. Upon taking a resolution action, the BdI is required to procure an independent valuation that seeks to compare the treatment of creditors and shareholders under the resolution scheme with the (theoretical) losses that they would have incurred in ordinary liquidation proceedings, without taking any public support into account. Should the valuation determine that their treatment in resolution has resulted in greater losses than what they would have otherwise incurred, they are entitled to monetary compensation for the difference.

100. *Ex post* judicial review is restricted to the legitimacy of resolution actions. The resolution framework does not envisage *ex ante* involvement of the Italian courts in resolution proceedings but recognizes the constitutional right of affected persons to judicial review of legal acts on an *ex post* basis. Cases submitted to the court for review focus on the legality of the measure(s) taken, rather than the assessment of facts by the resolution authority, and the Resolution Decree sets a high bar for temporary suspensions by explicitly deeming these to be contrary to public interest until proven otherwise. Moreover, courts can decide that annulment of a decision (e.g., if the original decision was found to be *ultra vires*) does not adversely affect subsequent administrative acts taken or transactions completed by the BdI or special managers on the basis of the original decision. Thus, a transfer of assets and liabilities to a third party acting in good faith, for example, would not be reversed if the original resolution decision would be annulled. Experience to date suggest that legal challenges are not likely to be successful. During the past five years, courts ruled in favor of plaintiffs in only 5 out of 73 cases that challenged intervention actions taken by the BdI.[59]

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[58] Key Attribute 5.3.

[59] All five cases relate to the same institution (Banca Popolare di Spoleto and the cooperative that was de facto controlling it, Spoleto Crediti e Servizi). Both entities were put under administration in 2014, prompting former managers to initiate legal proceedings against the BdI. While the court of first instance confirmed the legitimacy of the actions taken, they were reversed by the administrative court of second instance based on procedural deficiencies. In response, the BdI and the MEF renewed the intervention measures with retroactive effect, prompting another wave of legal challenges that were dismissed by the competent courts of first instance. Currently, only one judicial procedure is pending before the Italian Administrative Court of last instance.

Recommendations

- **Extend legal protection to DGS board members and staff, as well as directors and officers of an institution under resolution, to the extent that they remain in function to ensure continuity during the resolution process**. A further extension of the legal protection already provided to other actors in a resolution or liquidation context (e.g., special administrators, liquidators, and managers of bridge banks and asset management companies) would help mitigate litigation risks during a resolution process. Such protection is particularly important for actions taken in compliance with instructions from the BdI, as well as actions taken by the DGS.

Appendix I. Status Recommendations on Crisis Management and Bank Resolution—2013 FSAP[1]

Recommendations	Priority	Timeframe	Status
Domestic and cross-border institutional framework			
(i) Refocus the Committee for Financial Stability on crisis preparedness and management.	M	MT	NI
(ii) Remove legal obstacles to sharing information with finance ministries (both domestically and overseas) and other cross-border safety net authorities.	M	MT	I
Crisis preparation			
(iii) Require by statute recovery and resolution plans to be prepared for all firms of systemic importance and provide detailed guidelines.	H	NT	I
Early intervention and resolution tools			
(iv) Enhance early intervention powers by empowering the BI to replace Board members, managers, and auditors, and apply pecuniary sanctions at the bank level without needing to appoint a special administrator.	H	NT	I
(v) Augment resolution tools with powers to selectively transfer assets and liabilities, bail-in creditors, establish bridge-banks, recapitalize and transfer ownership (including overriding caps on ownership, voting and pre-emptive rights); and remove courts' ability to suspend/ reverse resolution measures.	H	NT	I
(vi) Ensure that triggers allow all existing and new tools to be deployed at an early juncture when the institution is no longer viable or likely to be no longer viable, including when liquidity requirements are seriously breached.	H	NT	I
(vii) Provide a statutory basis for the least cost test.	H	NT	I
Bank liquidation and insolvency			
(viii) Provide for depositor preference in legislation.	M	MT	I
Deposit guarantee schemes			
(ix) Remove active bankers on Boards and Executive Committees of DGS and extend legal protection to DGS.	M	NT	NI
(x) Provide for ex-ante funding for the DGS and back-up credit line from the MEF.	M	NT	PI
(xi) Enhance public education on deposit insurance coverage.	M	MT	I

[1] Priority: M=medium, H=high; Timeframe: NT=near term, M=medium term; Status: I=implemented, PI=partially implemented, NI=not implemented

Appendix II. National Transposition Options in Italy

Bank Recovery and Resolution Directive	Option used?
Art 1(2): stricter/additional rules	No
Art 4: simplified obligations	Yes
Art 19(5)-(6): group financial support arrangements	Yes
Art 32(2): FOLTF determination by NRA	Yes
Art 37(9): additional resolution tools and powers	No
Limits on liability:	
Art 3(12): safety net and staff	Yes
Art 29(9): temporary administrators	Yes
Art 40(12): bridge banks	Yes
Art 42(13): assess management vehicles	Yes
Art 45(2): additional MREL criteria	No
Art 56-58: government financial stabilization tools	No
Art 85(1): ex-ante judicial review	No
Art 100(6): additional resolution financing arrangements	No
Art 102(1): higher target level for resolution fund	No
Art 109(5): higher DGS liability cap	No
Annex A: extra information for recovery plans	No
Annex C: extra information for resolvability assessments	No

DGS Directive	Option used?
Art 5(2): coverage pension schemes and local authorities	No
Art 5(3): immovable property loans excluded	No
Art 7(5): set-offs repayable amounts	Yes
Art 7(8): social purpose deposits excluded	No
Art 8(3): longer repayment period some deposits	No
Art 9(3): repayment claim period limited	Yes
Art 10(2): target level deadline beyond 2024	Yes
Art 10(6): target level below 0.8%	Yes
Art 11(3): using DGS for alternative measures	Yes
Art 11(6): using DGS in liquidation proceedings	Yes
Art 12(1): lending to other EU DGS	Yes
Art 13(1): lower fees for low-risk sectors and IPS	Yes
Art 19(4): grandfathering higher coverage through 2018	No

Source: Euro Area 2018 FSAP, technical note on Resolution and Crisis Management (https://www.imf.org/~/media/Files/Publications/CR/2018/cr18232.ashx)

Appendix III. Testing of Recovery Plans

There are several different forms of testing for recovery planning purposes. The options can include 'walk-through' tests of processes and procedures for several scenarios, partial exercises that target components of recovery plans, and full-scale live simulations to test the entirety of the recovery plan. For any substantive testing, it is imperative that the members of senior management are involved in the tests, especially for live simulation exercises, with each member of senior management playing his/her own role. For some tests, it will also be appropriate for members of the Board to be included in the exercise. Of particular importance is the testing of senior management and Board members' capacity to communicate effectively with role-played news media and financial markets, including under time pressure.

To ensure operational readiness, it is critical that tests are robust and conducted recurrently. Testing can focus on various issues, depending on objectives and scope. For example, they can be structured to evaluate:

- the bank's ability to detect emerging stress, such that the triggers for the recovery plan can be invoked on a timely basis;
- the process for triggering the recovery plan, and the ability of the bank's management to effectively steer and oversee the recovery process;
- to the extent possible given practical constraints, the bank's ability to implement recovery actions relating to the various risk categories (e.g., pertaining to capital, liquidity, asset quality, profitability), considering the necessary operational, administrative and/or legal prerequisites;
- the bank's ability to generate the necessary risk-management information to guide, and the adequacy of management information systems required for effective monitoring of the recovery process;
- the availability of supporting documentation needed to implement certain recovery actions;
- the degree of integration of the recovery plan with the bank's risk management framework, ICAAP, business continuity plan and governance arrangements; and
- aspects pertaining to communications with relevant stakeholders (including the supervisor).

The recovery plan should set out the framework for the regular testing, including the envisaged frequency. This should include the objectives and scope of testing, the parties responsible for organizing and conducting the tests, the associated processes and procedures, and the means by which the test results will be documented and reviewed by the Board. Insights obtained via the tests, and corrective actions undertaken to address any deficiencies identified, should be disclosed to, and closely reviewed by, the supervisory authorities.