

BANKING CRISES IN ITALY (2015-2017)¹

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1. GENERAL INTRODUCTION. Provisions governing bank crisis management in Italy

In Italy, banks in difficulty are not subject to the same provisions as envisaged for failing companies which are subject to ordinary law (which consist, for the main part, of insolvency or debt-restructuring procedures).

Failing banks are subject to special provisions devised specifically to tackle bank crises.

There are two main reasons for this:

- a) Businesses subject to ordinary law undergo court proceedings only if they are **failing financially**, i.e. when they are in either an insolvency or pre-insolvency situation.
Banks, meanwhile, face court proceedings not only if they are failing financially, but also if they are **failing legally**, i.e. when banks have been found guilty of legal offences or of breaching regulations (of the Bank of Italy) or the Articles of Association thereof (given the particular economic importance of banking activities);
- b) even when a bank is subject to a legal proceedings due to a financial crisis, Italian lawmakers have preferred to assign the handling of the crisis to local government rather than the **law courts** (which have jurisdiction in the case of all other businesses), through a **government watchdog** authorised to oversee banking activity in general. The authority assigned to this supervisory role is the **Bank of Italy**.²

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² Article 3 of Italian legislative decree n. 180 dated 16 November 2015 - and, before that, Italian legislative decree n. 72 dated 12 May 2015 and the 2014 European delegation law, approved on 2 July 2015 - assigned the Bank of Italy the role of National Resolution Authority (NRA). Italy's resolution and crisis management unit was therefore established, which performs the investigational and operating duties of the single resolution mechanism and manages liquidation procedures for banks and financial brokers.

2. The purposes of (pre-insolvency and insolvency) composition proceedings in general

In Italy (but not only), (pre-insolvency and insolvency) composition proceedings have two main aims:

- a) the recovery of the company, when the financial distress situation is reversible; and
- b) the most satisfactory settlement of claims, when the financial distress situation is irreversible;

If there is no possibility of recovery, the company must undergo insolvency proceedings. The purpose of insolvency proceedings is to liquidate all the assets and satisfy as claims as far as possible.

The recovery aspect is important for the company concerned, but it is not of public interest; accordingly, the options envisaged by ordinary law for business recovery include various procedures, such as in-court debt-restructuring, certified recovery plans, and restructuring agreements, are available only if sought directly by the businesses in question. If the business which is failing does not seek to exercise one of these options, nobody else can do it.

This means that if a business in distress does not take any preventive action, insolvency will inevitably follow - be it sooner or later.

3. The aim of (pre-insolvency and insolvency) composition proceedings for banks.

Banks are not the same as other businesses, and therefore a bank crisis cannot be handled in the same way as a crisis situation in any other company (subject to ordinary law).

On the one hand, banks have a multitude of relationships with the saving public. A bank crisis endangers the public savings deposited within its coffers and this can cause not only financial but also **social** instability.

On the other hand, banks also have a plurality of relationships with **borrowing companies**, whose business activities and development are supported by their banks.

A bank crisis means an interruption in financial support to companies, which can cause the insolvency of such companies, followed

by contagion phenomena, in some cases to such an extent that the local - and potentially also the national - economy is at risk.

For these (main) reasons, the aims of the procedures used by banks to tackle the crisis situations include:

- (i) **prevention** of crisis situations, so that the conditions which are liable to lead to a bank crisis in particular do not exist (or are curbed as much as possible);
- (ii) **adoption of timely measures** when, despite everything, the crisis has nevertheless arisen; and
- (iii) **ensuring continuity of the bank's business activities**, even when the crisis could not be avoided.

In order to achieve these aims, provisions for bank crises differ from those envisaged in ordinary law for companies in financial distress from numerous perspectives, including:

- (i) **anticipatory nature** of the measures intended to prevent the crisis arising;
- (ii) **official nature** of the measures intended to prevent and handle bank crises, whereby even if the bank does not adopt measures to that effect, the supervisory authority **may enforce them**;
- (iii) **business continuity** as a central objective of bank recovery and resolution.

4. Provisions for bank crises following implementation of EU directives on bank crises.

Prior to recent changes stemming from the implementation in Italy of EU Directive 2014/59EU (Bank Recovery and Resolution Directive - BRRD) - cf. Italian Legislative Decree n. 181 dated 16 November 2015, different procedures were foreseen for tackling banking crises, which - based on the degree of involvement in the company's management and organisation - were distinguished, progressively, as: *extraordinary measures*, *provisional measures*, *extraordinary administration*, and *compulsory administration*.

Today, the framework of reference has changed significantly because EU legislation on the matter has innovatively introduced (accompanied by the required transposition into national law) new measures and new procedures for the prevention, recovery, and resolution of bank crisis situations, which make the bank insolvency system within the Italian regulatory system somewhat more complex.

Indeed, it now includes (as far as we are concerned here) measures which can be broken down into three categories, each one involving the application of more invasive provisions with greater impact, which can be described as follows:

- a) *crisis prevention measures*, namely the new institutions consisting of the **recovery plan** (Article 69-ter of the Italian consolidated law on banking); and of the **resolution plan** (Article 7 of Italian legislative decree n. 180/2015);
- b) *anticipatory measures*, which include the adoption, as in the past, of **extraordinary measures** (Article 78 of the Italian consolidated law on banking) and **suspension of payments** (Article 76 of the Italian consolidated law on banking), in addition to the new institutions consisting of the **Powers of intervention** relating to the bank's officers (Article 53-bis of the Italian consolidated law on banking) and the tool known as '**removal**' (Article 69-octiesdecies of the Italian consolidated law on banking);
- c) *crisis recovery or resolution measures*, which include the well-known institutions of **extraordinary administration** (Articles 70 et seq. of the Italian consolidated law on banking) and **compulsory administration** (articles 80 et seq. of the Italian consolidated law on banking), in addition to the new bank resolution measures (Article 17 et seq. of Italian legislative decree n. 180/2015).

5. Crisis prevention measures designed specifically for banks

5.1 The recovery plan.

According to Article 69-quater of the Italian consolidated law on banking "*Banks may prepare an **individual recovery plan** setting out the measures they intend to adopt in order to redress their equity and financial situation in the event of significant deterioration. The recovery plan does not presuppose or contemplate access to extraordinary public financial support. Once approved by the governing body, the recovery plan is submitted by the body to the Bank of Italy. The plan is reviewed and, if necessary, updated at least annually or as frequently as required by the Bank of Italy. The plan is also reviewed and updated in the event of a significant change in the bank's legal or organisational framework or in its equity and financial situation.*

The recovery plan undergoes assessment by the Bank of Italy, which (according to Article 69-sexies of the Italian consolidated law on banking) "*is required to assess the recovery plan in terms of completeness and adequacy on the basis of the criteria stated in the relevant European Union provisions, doing so within six months of the plan's submission. The recovery plan is sent to the resolution authority for the formulation of any recommendations relating to issues which are relevant in terms of bank reso-*

lution. If, upon completion of the assessment, there are deficiencies or impediments to the achievement of the plan's objectives, the Bank of Italy may take the following action, setting the terms required therefor:

- a) request the bank to present a modified plan;
- b) specify changes to be made to the plan;
- c) order changes to be made to the bank's activities, organisational framework, or corporate status, or order any other measures necessary to achieve the plan's objectives.

As of 2016 - 2017, therefore, every Italian bank (like any other EU bank) has begun preparing its recovery plan, which:

- simulates possible crisis situations; and
- identifies, for each hypothetical situation, what action the bank intends (and would be able) to take in order to overcome the crisis.

The period since the introduction of this measure, which is completely new for Italy, it is too short to allow any real appraisal of its effectiveness.

5.2. The resolution plan.

According to Article 7 of Italian legislative decree n. 180/2015, "*The Bank of Italy prepares a resolution plan for each bank ... This plan is prepared on the basis of the information provided [by the bank] and sets out the procedures envisaged for the application, to the bank, of the measures and powers to be put in place in the event of resolution as established by the Bank of Italy, including general measures. When preparing the plan, possible obstacles to resolution are identified and procedures are established to address them. The plan is also reviewed and updated if necessary or annually at the least, or in the event of a significant change in the bank's legal or organisational framework or in its or equity or financial situation.* In Italy, also this measure is totally new. Therefore, it is not yet possible - even with regards to the provisions in place so far - to express an opinion of whether it is satisfactory or unsatisfactory.

6. Anticipatory measures relating to bank crises.

6.1 The extraordinary measures

The Bank of Italy may take extraordinary measures against Italian banks in the event of (i) *breach of legislative, administrative, or bylaw provisions governing the business thereof*; and (ii) *mismanagement*; and - in the case of branches of non-EU banks - of (iii) *insufficient funds*. The extraordinary measures that may be taken include the "*prohibition to commence new transactions*" and the closure of the branch (Article 78 Italian consolidated law on banking.)

The closure of a branch should not produce, per se, effects on the banking relationships established with customers through the branch in question; these relationships are with the bank itself and must continue to exist in the same way, subject solely to the organisational need to decide on a replacement branch through which business therewith may continue.

The problem (which is of an organisational nature only) may arise in more or less complex ways, depending on the type of banking relationship in place - in some cases the effects of the closure of the branch will be practically non-existent, such as for example in those concerned with exchange rate risk hedging or interest rate risk hedging, which are most likely to be assigned to the bank's central departments - and in any case does differ in any way from a closure of the branch simply by decision of the bank, in the event that the management deems it no longer profitable to maintain a branch in a specific location - an event which, in principle, has no effect on banking relationships established at the branch subsequently closed, which will continue to exist between the customer and the bank exactly as before.

6.2. Suspension of payments.

A suspension of payments could be ordered by the Bank of Italy in the event that it had already ordered the bank's provisional management, i.e. with the directors replaced **provisionally** by one or more extraordinary court-appointed administrators.

However, the temporary management tool has since been abolished. A suspension of payments can still be ordered, but only in the event that an extraordinary administration procedure is begun.

This measure, therefore, will be examined in the observations on the extraordinary administration provisions, with specific referencing - therefore - to the said measure (see below, Section 8).

6.3. Powers of intervention, and powers of removal.

According to the provisions of Article 53-*bis* of the Italian consolidated law on banking, the Bank of Italy may:

- a) *"convene the directors, the auditors, and the bank personnel;*
- b) *order the convening of the bank's boards, setting the agenda for the meetings thereof, and putting certain motions thereto;*
- c) *directly convene the bank's boards bodies when the competent bodies have not complied with the provisions of section b);*
- d) *take specific measures against one or more banks ... also concerning: the restriction of activities or of the geographic framework; the prohibition to carry out certain operations, including those of a corporate nature, and to distribute profits ...*
- e) *order the removal of one or more of the bank's officers, if their remaining in office is prejudicial to the sound and prudent management of the bank.*

Pursuant to Article 69-*octiesdecies* of the Italian consolidated law on banking, the Bank of Italy may order **"the removal of [the bank's] officers**

in the event of serious breaches of legal, regulatory, or bylaw provisions or of serious acts of mismanagement, or when the bank's situation has deteriorated particularly significantly. It is then specified (Article 69 - *vi-cies-semel* of the Italian consolidated law on banking) that "*the Bank of Italy may order the **removal** and the **replacement** of all the members of the bank's governing and supervisory bodies The Bank of Italy calls a meeting of the bank, placing the replacement of the governing and supervisory bodies on the agenda The Bank of Italy may also order **the removal of one or more members of a bank's senior management**. The Bank of Italy **approves the members of the new bodies** or of the new senior management appointed by the competent body of either the bank or the parent company. . . .*".

7. Bank recovery and resolution measures.

Prior to the recent regulatory innovations arising from the transposition in Italy of the of the aforesaid BRRD Community Directive, bank recovery and resolution measures consisted of **extraordinary administration** and **compulsory administration**.

The aim of the first was to restructure the bank,

while the second was geared towards **winding up the bank's activities** and settling creditors' claims through the distribution of the proceeds of the bank's assets liquidated during compulsory administration (or through the assumption of the bank's liabilities by another bank with proven solvency).

The aforesaid two procedures have been maintained, although with some changes (in particular, with regards to the requirements to be met in order for compulsory administration to be ordered), however provisions governing bank crisis management have also been supplemented by the introduction of brand-new bank **crisis management procedures**, which include an actual insolvency procedure, known as "**bank resolution**", which offers an alternative to compulsory administration.

8. Extraordinary administration of the bank.

Article 70 of the Italian consolidated law on banking stipulates that the bank may be subject to *extraordinary administration* by the Bank of Italy, through the termination of the governing and supervisory bodies (and consequent replacement thereof, respectively, with one or more **extraordinary court-appointed administrators** and with a monitoring committee. the functions of the meeting bodies, meanwhile, are merely suspended, when (i) there are "*serious breaches of laws, regulations, or bylaws*"; and (ii) "*serious loss of assets are expected*".

In principle, provisions for the extraordinary administration of banks do not include the production of particular effects in relation to third parties, i.e. with regards to legal relationships with third parties (customers, suppliers, employees, savers, borrowing businesses, etc.) **In principle, no changes are caused by the bank's subjection to the procedure.**

Administration and business proceed as normal, both as regards the establishment of new legal relationships and the performance of pending legal relationships, except that both are now entrusted to the committee and not to the ordinary governing body, as it has been terminated.

This leads to the conclusion that the extraordinary administration of a bank is not a composition procedure³ of the kind inherent to an insolvency procedure, or an in-court debt-restructuring procedure, or the compulsory administration (even that applied to the banking industry), since it does not produce the effects typical of the prohibition of individual enforcement measures, prohibition of payment of past debts, etc.

Furthermore, it is envisaged that in exceptional circumstances and if the need arises to protect creditors' interests, **a suspension of payments** (of debts outstanding at the time the procedure is started) may be ordered, pursuant to Article 74 of the Italian consolidated law on banking. However the suspension may be ordered for one month only (extendable for a maximum of two more).

The effects of the suspension of payments (which also extends to the suspension of the repayment of financial instruments to customers) may depend, in part, on the *provisions for the implementation* [of the suspension measure] which the Bank of Italy is authorised to issue.⁴

In the past, the purpose of the extraordinary administration was to:

- a) **remove** the governing and supervisory bodies;
- b) **subject the bank's operations to state control**; – through the appointment of new governing and supervisory bodies designated by the Bank of Italy -;

³ Furthermore, it will have to decide, even only in general terms, whether the suspension of payments concerns only the cases in which the bank's payments would constitute a discharge of its own obligations - and could therefore potentially jeopardise the equal treatment of all the bank's creditors -; or whether it would also concern payments which would result in the discharge of other parties' obligations, as when the bank carries out payment orders to third parties received from third parties, thereby performing a merely intermediary activity in the settlement of obligations between third parties. The second option would appear to be preferable, based on the specification (in Article 74, section 2) that, during the period of suspension of payments, no interim or enforcement actions may be begun or continued, not even in relation to customers' financial instruments.

c) *ensure continuation of current company operations* (ruling out, therefore, the standard effects of in-court debt-restructuring proceedings", such as payments being frozen, a hold being placed on all new transactions (including new loans); enforcement or interim action against the failing company etc.);

d) assess whether the performance, equity, and financial conditions exist for the bank to return to ordinary management, subject to the appointment of **new directors** and new supervisory bodies (a situation which does not occur often);

e) **identification of another bank willing to acquire the bank subject to the extraordinary administration** (the most common solution).

This procedure produced good results as long as other banks were interested in acquiring the banks in difficulty. Since the global economic crisis marked by the bank crisis that occurred first in the United States and subsequently in the major European countries, banks have no longer been interested in increasing their number of branches (which were already too numerous) or employees (who were already being laid off due to the increased computerisation of banking services), extraordinary administration procedures have no longer been able to find buyers for failing banks. The measure has become less useful and its future use would appear to be much less significant.

One reason for this stands out in particular and that is **the difficulty in remaining on the market in the absence of a full operational management (and specific skills)**. A bank under the control of a court-appointed administrator for a few months, pending the takeover of a new, stronger and more competitive bank, can maintain a certain value and a reason for existing; a bank placed in the hands of a 'conservative' manager (as a court-ordered administrator inevitably is) for a lengthy period (sometimes lasting up to two years or more) is destined to lose its best customers and market shares to the rival banks, with the result being that the temporary period of difficulty it was experiencing when the procedure was started has turned into an **irreversible** crisis.

9. Crisis management procedures designed specifically for banks.

When a bank finds itself "*in distress*" or "*at risk of distress*", as defined by Article 17 of Italian legislative decree n. 180/2015 (which will be examined in more detail later on) and "*no alternative measures appear reasonably possible ...*", the following procedures are ordered (alternatively) (**Article 20 of the aforesaid Italian legislative decree**):

a) the **reduction or conversion of shares**, or other equity instruments; or

- b) the **resolution** of the bank "*when the Bank of Italy has ascertained that it is in the public's interest to do so, which occurs when the resolution is necessary and proportional to the achievement of one or more [of the following] objectives ... : continuity of the bank's critical functions ...; financial stability; minimal public financial support; to protect depositors and investors ... as well as customers' funds and customers' assets*", and subjecting a bank to compulsory administration would not achieve these objectives to the same degree." or
- c) **compulsory administration.**

Provisions for bank crisis management procedures originating from the implementation of the EU's BRRD directive include the following aspects:

- A) **common conditions:** according to Article 17, section 1, of Italian legislative decree n. 180/2015, a bank is subjected to one of the measures stated in Article 20 [reduction, compulsory administration, resolution] when a series of common conditions exist (as stated herein);
- B) **functional alternatives:** *when the aforesaid conditions have been proved to exist for the bank in difficulty:*
- B1) the measures consisting of the **reduction** or **conversion** of the bank's shares, shareholdings, and equity instruments, "*when this makes it possible to remedy the distress situation of risk of distress*"; otherwise:
- B2) the **bank resolution** measure if the said measure "*makes it possible to remedy the distress situation of risk of distress*"; or, finally,
- B3) the **compulsory administration** measure "*if the measure stated in section a) [bank resolution] does not make it possible to remedy the distress situation or risk of distress*";

The conditions required in order for a bank to be subjected to one of the banking crisis management procedures refer back to the dichotomy of 'financial failure' versus 'legal failure' underlying the previous legislation.

Following implementation of the BRRD, the prerequisites in question - which must **co-exist** - consist of:

- (i) the bank must be '*in distress*' or '*at risk of distress*'; and
- (ii) there must be no "*alternative measures*" available with which to overcome the distress or risk of distress "*in sufficient time*" (said alternative measures consisting of "*intervention by one or more private parties or an institutional system or supervisory action, such as anticipatory measures or the extraordinary administration measure envisaged in the Italian consolidated law on banking*").

The condition of being '*in distress*' or '*at risk of distress*' is understood as encompassing one or more of the following situations;

- a) in the event of **mismanagement** or breaches of legal, regulatory, or by-law dispositions regulating the bank's activities serious enough to justify revocation of its licence to trade;
- b) in the even of **capital losses** so serious that the bank loses its entire assets or a significant amount thereof;
- c) the bank's **assets are less than its liabilities**;
- d) the bank is **unable to meet its debts when due**;
- e) objective factors indicate that one or more of the situations specified in sections a), b), c) and d) **will arise in the near future**;
- f) the provision to the bank of extraordinary public financial support, subject to the provisions of Article 18.

9.1 The reduction or conversion of the equity instruments.

The measure consisting of the reduction or conversion of the bank's shares, or the shareholdings issued by the bank, or the equity instruments, may be adopted by the Bank of Italy:

- (i) **regardless of the adoption of other measures**, if this measure alone is sufficient to allow the bank to redress the balance of its performance, financial situation, and its assets and liabilities; or
- (ii) **if this is not the case, combined with one of the other resolution measures.**

The measure examined here may involve:

- a) the conversion of the bank's liabilities (where amenable to such measures and known as equity instruments, such as convertible bonds, for example) into risk capital, with a consequent reduction in indebtedness to third parties; and/or
- b) the reduction (via **cancellation**) of the bank's shares, thereby allowing new shareholders to join the ownership structure without any financial or managerial interference from the old shareholders.

9.2 Bank resolution.

The bank resolution mechanism is implemented:

- (i) when the "**distress**" or "**risk of distress**" conditions (as defined by Article 17 of Italian legislative decree n. 180/2015) exist, and
- (ii) the Bank of Italy has ascertained "**the existence of the public interest**" (envisaged in the cases specified in Article 21, section 1, of the aforesaid Italian legislative decree); and furthermore
- (iii) "**the subjection of a bank to compulsory administration would not achieve these objectives to the same degree.**" (Article 20, section 2 of the aforesaid Italian legislative decree).

Once the resolution procedure has been decided, the following **resolution measures** can be adopted (Article 39 of Italian legislative decree n. 180/2015):

- a) the **assignment** of assets and legal relationships to a **third party**;
- b) the **assignment** of assets and legal relationships to a **bridge bank**;
- c) the **assignment** of assets and legal relationships to a **special purpose entity** for the management of the assets (but only following one of the other measures);
- d) **bail-in**.

9.2. A. Assignment of assets and legal relationships to a third party

In normal circumstances, a bank's shares are sold (only) if decided by the shareholders.

In normal circumstances, a bank's assets and rights are sold (only) if decided by the said bank.

However, if the bank is undergoing resolution, the **Bank of Italy** can decide to take the following action, without consulting the shareholders and without taking into account the preferences of the bank's bodies (removed from office in the meantime):

- (i) arrange for assignment of the bank's **shares** to a third party;
- (ii) arrange for assignment of the bank's **rights, assets, and liabilities** to a third party.

In this way the resolved bank may continue its operations, either because the ownership has changed, or because its assets have been merged with the assets of another bank.

The assignee of the shares, or the assignee of the bank's assets, will pay the price consisting of the difference between the total of the resolved bank's assets and the total of all liabilities to be taken on by the assignee (which will be managed, therefore, by a more reliable party than the resolved bank).

In the event of sale of the shares in the bank, the amount paid will be passed on to the shareholders.

In the event of sale of the bank's assets, the amount received will be paid directly to the bank. The bank's shareholders will then have to decide on its future, which cannot be to continue trading i) because all its rights, assets, and legal relationships have been assigned (sold to the third party) and ii) because the bank resolution mechanism involves **revocation of the bank's licence to trade**.

9.2. B. Assignment of assets and legal relationships to a bridge-bank

If, when a failing bank goes into resolution, the prospects of its assignment to a third party are inexistent (or of the assignment of its assets), the Bank of Italy can adopt a **provisional solution**, including:

- (i) the establishment of a **Newco** (the bridge bank);
- (ii) the assignment of the resolved bank's shares to the bridge bank, or the resolved bank's rights, assets, and liabilities;
- (iii) the bridge bank obtaining a licence to trade for the activities and services previously carried out by the resolved bank;

Subsequently, **within a period of two years** (extendable for one or more periods of one year each, in particular cases), the following situations may occur:

- (i) assignment of the shares in the bridge bank to a third party;
- (ii) merging of the bridge bank with another bank;
- (iii) assignment of the bridge bank's rights, assets, and liabilities to a third party;
- (iv) liquidation of the assets of the bridge bank and payment of creditors, with winding-up of the bank's activities.

9.2. C. Assignment of assets and legal relationships to a special purpose entity

In the event that a bank undergoing resolution owns **business units** with particular features, the Bank of Italy may:

- (i) establish a Newco (**special purpose entity**);
- (ii) assign the special purpose entity a set of assets and/or legal relationships, **with a view to maximising the value**;
- (iii) subsequently assign the special purpose entity to a third party.

This measure must be adopted **in association** with some of the other measures.

9.2. D. *Bail – ins*

A bail-in consists of the **reduction** (via **cancellation**) or the **conversion** (into risk capital) of the bank's liabilities to third parties. By cancelling a number of liabilities, or converting them into capital, the bank's debts decrease accordingly until the assets included in the equity are sufficient to cover the remaining liabilities (excluding risk capital).

Once this equity balance has been achieved, the bank could be sold to a

third party, and thus continue trading and safeguard the (remaining) creditors and the customers in general.

Italian law stipulates that:

- (i) **the order** in which liabilities are progressively 'sacrificed' (through reduction or conversion), starting with the **shares**; then the **junior debt**, etc;
- (ii) the items which cannot be involved in a bail-in, the most important of which are:
 - customer **accounts holding** less than €100,000.00
 - payables to employees;
 - trade payables for goods and services *"required for continuity of normal operations of the resolved bank"*;

9.3. Compulsory administration.

Article 80, section 1, of the Italian consolidated law on banking regulates the revocability of the bank's licence to trade and the compulsory subjection of the bank to compulsory administration.

Until the recent implementation of the BRRD (directive n. 2014/59/EU), the conditions for subjecting banks to compulsory administration are the same as those envisaged for the extraordinary administration measure (mismanagement, breaches, losses) of *"exceptional gravity"*.

The transposition of the BRRD into Italian law has also led to important innovations in the objective prerequisites for a bank's subjection to compulsory administration.

As seen above, the choice of measure with which to tackle a bank crisis no longer depends on the assessment of the **level of gravity thereof** when the crisis arises, but on the assessment of the ability to remedy the crisis situation, starting from the least invasive measure and then moving on to measures with increasing impact.

In particular, the compulsory administration of the bank option is only available if the conditions do not exist to begin the new procedure known as bank resolution: and more precisely, it is chosen if the bank resolution procedure *"makes it possible to remedy the [bank's] distress situation or risk of distress"*;

10. The application of bank crisis management procedures in Italy. Introduction: the effects of the delay in the emergence of the Italian banking crises.

In Italy, the banking crisis emerged considerably later than both outside Europe and in other countries in the European Union.

This was probably due to the fact that Italian banks were - and still are - predominantly based on business trade (i.e. support for corporate customers) rather than financial activities (i.e. investment in financial products). As a result, the Italian banking crisis was mainly caused by the crisis within the 'real' economy (i.e. the economy linked to the business carried out by companies), which was initially withstood by the banks through drastic decreases in revenue and - therefore - profits; while a later stage, banking crises were marked by capital failures, resulting from the huge losses incurred by banks as defaulting borrowers failed to make good on their loans.

The fact is, however, that - as already mentioned - the banking crisis emerged in Italy later on than in other countries in the European Union. *At a time, that is, when integration of EU banking legislation was already underway* and so banks were no longer able to address the situation according to Italian law, which had enabled them to overcome distress situations in the past.

As we will see, banks could no longer take the action envisaged by national legislation and were required, instead, to follow European Union provisions, resulting in hard-hitting consequences for Italy and the Italian banking system.

10.1. The "TERCAS" case: the creation of the "Voluntary Scheme" of the Italian Interbank Deposit Protection Fund (also known by the Italian acronym "F.I.T.D.").

Until one particular Italian bank failed in 2013 - i.e. the Cassa di Risparmio di Teramo (also known as Banca TERCAS) - the most widely practiced solution to overcome banking crises was to:

- (i) subject the failing bank to (industry-specific) compulsory administration;
- (ii) *immediately* assign the bank to another bank (based on interim financial statements drafted for the purpose, which would then be "consolidated" following assessments and evaluations carried out by agreement between the compulsory administrators and the assignee bank), with the assignee bank taking over virtually all the assets, liabilities, and pending relations of the bank under compulsory administration;
- (iii) initiate action by the Interbank Deposit Protection Fund ("the Fund", or FITD) to redress the deficit resulting from the sale (i.e. the imbalance between the assets received and the - higher amount of - liabilities taken on by the assignee bank) with full discharge of liabilities, by

- progressively increasing contributions until completion of activities for the preparation of the final "post-assignment financial statements"⁵;
- (iv) liquidate the remaining assets of the bank under compulsory administration (mainly consisting of liability actions against the bank's former officers) in order to settle the (marginal) liabilities not transferred to the assignee bank - such as the costs of the compulsory administration.

As of 2013, however, this solution has no longer been practicable, since the aforesaid action by the F.I.T.D. has been deemed tantamount to "state aid", and a such is, generally speaking, forbidden by European legislation applicable to the industry⁶.

The highly delicate situation that came to be created with the declaration of unlawfulness of the F.I.T.D.'s involvement in the resolution of the Banca Tercas crisis (which, applying the technique described earlier, had contributed €295 million to the Banca Popolare di Bari, as assignee of Tercas) [*a highly delicate situation because Banca Popolare di Bari is now required to return the sum received to the FITD and therefore has to shoulder the deficit resulting from the assignment of the bank*] was resolved thanks to the Fund's Voluntary Scheme, which was established (almost unanimously) by the Italian banking system, with additional private-sector resources, consisting of the amounts returned by the Banca Popolare di Bari, and made available to the banks temporarily - through the reinstated FITD - and immediately paid into the Voluntary Scheme⁷.

10.2. The "Banca di Romagna" case: when the Bank of Italy exercised its power of "removal".

As mentioned (in section 6.3 above), the Bank of Italy may adopt "anticipatory measures" with a view to guiding the management of a bank in distress towards solutions to overcome the difficulties that have emerged.

⁵ Normally, however, within a fixed maximum amount, since these intervention procedures are conditional upon assessment of the "lowest charge", for the F.I.T.D, with respect to the reimbursement of what are known as "protected deposits" (i.e. current accounts, and similar deposits, up to the current limit per account of €100,000.00) and subsequent realisation of the assets of the bank placed under compulsory administration..

⁶ On the matter, see . INZITARI, *BRRD, Bail in, risoluzione della banca in dissesto, condivisione concorsuale delle perdite (d.lgs. n. 180 del 2015)*, in *Dir. Fall.*, 2016, I, p. 629 et seq.

⁷The "Voluntary Scheme" would then have been replenished with a contribution of €700.00 million first, and then "topped up" with a further €95.0 million, to encourage the intervention of Crédit Agricole - Cariparma (still in progress) to acquire the "Three Savings Banks" (Cassa di Risparmio di Cesena, Cassa di Risparmio di Rimini, Cassa di Risparmio di S. Miniato), as part of an anticipatory measures scheme enforced by the resolution authority in response to these savings banks' failure to comply with the compulsory capital requirements established by current industry regulations.

The measure adopted in July 2016 against a bank based in Emilia Romagna (Credito di Romagna) falls within this context. For the first time, the Bank of Italy used the (new) instrument available known as "removal", i.e. the power to **change** the bank's top management (board of directors, board of auditors, and general manager).

At the same time as this measure, the Bank of Italy also:

- 1) Ordered that a shareholders' meeting be convened for the bank within 30 days;
- 2) Ordered that the shareholders' meeting elect the new board of directors and the new board of auditors, and appoint the new general manager, **subject to approval from the said Bank of Italy**;
- a) Ordered that the new board of directors quickly devise a plan to strengthen the bank, which could also include its subsequent assignment to third parties.

10.3. The case of the "Three Banks": the adoption of anticipatory measures to lessen the burden of non-performing loans (NPLs) and increase capitalisation of the bank.

In 2017, the Bank of Italy resolved the situations of three savings banks in distress (Cassa di Risparmio di Rimini, Cassa di Risparmio di Cesena, and Cassa di Risparmio di San Miniato), which shared the following similar difficulties:

- 1) high levels of NPLs, which led to the fear of significant losses in the future; and
- 2) capital capacities tendentially lower than the minimum levels required by (very strict) banking industry regulations, even (or precisely) in consideration of the feared losses linked to the high level of NPLs.

The recovery of the "Three Banks" was brought about by the Bank of Italy through the adoption of measures which the bank itself deemed "*early intervention in accordance with the provisions*" of the national legislation (i.e. the Italian consolidated law on banking):

The Bank of Italy, in particular, ordered that the "Three Banks" call an urgent meeting of the respective boards of directors, **requiring** that the following items be placed on the agenda for such meetings:

- assessment of the company situation;
- preparation of a concrete, practicable solution for re-capitalisation of the bank;
- preparation of a plan of action designed to achieve the following:
 - redevelopment of the loan portfolio (through assignments if necessary) in order to reduce the level of fixed assets;
 - reduction of risk assets and a more efficient allocation of the already scarce capital resources;
 - corrective actions aimed at quickly and sufficiently redressing income flows;

- a funding policy aimed at ensuring adequate liquidity reserves on an ongoing basis.

Following these orders, the "Three Banks" underwent a significant reorganisation, implemented through:

- a) a resolution approving significant capital increases;
- b) subscription of the capital increases by the Italian Fund for the Protection of Depositors (Voluntary Scheme);
- c) acquisition of control of the "Three Banks" by the said Fund;
- d) the sale of the "Three Banks", by the Fund, to a banking group proven to be sound (Crédit Agricole Group) and deemed capable of providing for their recovery.

10.4. The case of the "Four Banks": the initiation of the resolution procedure by the Bank of Italy.

When the Bank of Italy and the Italian banking system were forced to acknowledge that banking crises could no longer be resolved through intervention by the FITD (by assisting with the assignment of the bank in distress to other banks and providing the financial resources needed to cover the deficit resulting from the assignment and caused by the crisis situation), four banks had already been placed in extraordinary administration, namely the Cassa di Risparmio di Ferrara, the Cassa di Risparmio di Chieti, the Banca delle Marche, and the Banca Popolare dell'Etruria e del Lazio (the "**Four Banks**").

The "Four Banks" in question were therefore subjected to the new banking crisis procedure, i.e. "resolution"⁸, and their business was sold to four newly formed banks (the "bridge banks"), which were sold to two other banks (the Cassa di Risparmio di Ferrara was assigned to the Banca Popolare dell'Emilia Romagna, while the other three were transferred to UBI Banca), which subsequently merged them by absorption.

Bank resolution is based on the principle of the "old bank" ceasing to trade and then subsequently striving for recovery through a complex procedure.

In the case of the "Four Banks" the procedure unfolded as follows:

- a) declaration of the resolution of the "Four banks";
- b) cancellation of the rights of the shareholders and subordinate bondholders of the "Four Banks";
- c) establishment of four new banks ('good banks', or bridge banks);
- d) assignment of the "good part" of the four banks' business (i.e. excluding the NPLs) to the bridge banks;

⁸ Italian Legislative Decree n. 180 dated 16 November 2015, .

- e) establishment of a new bank ('bad bank' - or special purpose entity) intended to take on the "Four Banks"'s NPLs;
- f) transfer of the "bad part" of the four banks (i.e. the NPLs) to the special purpose entity;
- g) start of negotiations for assignment of the bridge banks;
- h) sale of three of the bridge banks to a leading Italian bank (UBI Banca) and of the fourth to a different bank (Banca Popolare dell'Emilia Romagna).

10.4.1. Liability of the bridge banks (and subsequently of the banks which absorbed them) for the liabilities of the "Four Banks" following resolution.

The solution adopted by the Bank of Italy for the "Four Banks" generated a first, fundamental problem: the extent of the liability of the bridge banks (and, subsequently, of the 'performing' banks that acquired control of and then absorbed the latter) for the liabilities generated within the "Four Banks", prior to the initiation of the resolution procedure.

Originally, the issue was raised by the shareholders of the old "Four Banks", in relation to the rights claimed not so much as shareholders (since their shares had been completely devalued as a result of the resolution procedures), but rather as customers (rightfully complaining about the breach of provisions governing investment services by the "Four Banks" at the time of placement of their shares).

However, the same problem applies to any claim (for example of a compensatory nature) raised against the "Four Banks" and which, today, any party may wish to raise against the bridge bank - or rather against the B.P.E.R. bank and UBI Banca now, which bought and then absorbed the bridge banks in question.

Certain rulings have already been issued on this matter, which mostly attributed liability (for the obligations originally assumed by the old "Four Banks") to the bridge banks (and the banks that absorbed them).

These rulings are justified on the following, essential grounds:

- (i) the total or partial devaluation of the shares and similar equity instruments, ordered as a result of the resolution of the "Four Banks", concerns the securities in question (and the rights incorporated therein), but not any claims for compensation which *may* have arisen, for any of these investors, as a result of the breach of provisions governing investment services in force at the time the securities in question were purchased;
- (ii) the Bank of Italy ruling that the legal relationships previously in place with the "Four Banks"⁹ remained applicable to the bridge banks and

⁹ In particular: the provision dated 22 November 2015, referenced by the ruling in question, which referred to the assignment of the business of Banca delle Marche S.p.A. bank (but the others are similar).

- envisaged the transfer of "*all the rights, assets and liabilities constituting the business of the bank undergoing resolution*" and therefore - the ruling ended - "*also the liabilities corresponding to the issuer's obligations to make good behaviour carried out prior to the sale*", since "*not expressly ruled out by the assignment*";
- (iii) regarding the solution adopted for a different crisis situation, namely that of the Banca Popolare di Vicenza and Veneto Banca (the "Two Veneto Banks", discussed in more detail in section n. ...), legislators "*specifically provided for the assignment of the business*" of banks in distress (placed under compulsory administration), stipulating (in Article 3, of Italian Decree Law n. 99/2017) that : "*the following are, in any case, excluded from assignment, even in departure from Article 2741 of the Italian Civil Code ...: payables by the banks to their own shareholders and bondholders arising from the sale of shares or subordinate bonds of the [Two Veneto Banks] or from breaches of regulations governing investment services relating to the said shares or subordinate bonds, including payables (of the kind just described) to recipients of settlement offers presented by the said banks*": thus demonstrating that "*where legislators intended to take into account claims for compensation raised (also) by shareholders, in their capacity as investors, express provision therefor had been made*";
- (iv) Article 2560 of the Italian Civil Code is not applicable to the case in hand as:
- the business of the "Four Banks" was assigned to the bridge banks in compliance with the provisions of Article 43 of Italian Legislative Decree n. 180/2015¹⁰, and in particular through the assignment of "*all the rights, assets, and liabilities*";
 - this assignment would result in "*an altogether different matter from that envisaged in Article 2560 of the Italian Civil Code*", because with the assignment of business (under ordinary law), the debts existing prior to the assignment would not be "transferred" to the assignee, but rather the assignee would become jointly liable with the assignor;
 - case law (which the ruling question declares it upholds) apparently confirms the incompatibility of the provisions of Article 2560 of the Italian Civil Code with the regulations applicable to the assignment of banks (or banking business), which are governed, instead, by the provisions of Article 58 of Italian Legislative Decree n. 385, dated 1 September 1993 (Italian consolidated law on banking)¹¹: a provision that

¹⁰ "Article 43. Assignment 1. The assignment, in one or more instalments, to a bridge bank concerns: a) all the shares or other equity investments issued by one or more banks undergoing resolution, or a part thereof b) all the rights, assets or liabilities, which may also be grouped together, of one or more banks undergoing resolution, or a part thereof.

¹¹ Art 58 Assignment of legal relationships 1. The Bank of Italy issues instructions for the assignment - to banks - of business or business units, assets, and legal relationships which can be grouped together. The instructions may specify that more significant transactions be subject to authorisation by the Bank of Italy. 2. The assignee bank gives notice of the assignment by entering it in the local business register and publishing it in the Official Gazette of the Italian Republic. The Bank of Italy may establish supplementary forms

apparently attributes different effects to the assignment of a bank to those produced by the assignment of a company under ordinary law, since "*providing for the transfer of liabilities to the assignee ... and not simply combining the latter's liability with that of the assignor*" apparently departs from "*the provision of Article 2560 of the Italian Civil Code*" overruling it "*by virtue of the applicability of special provisions*"¹².

10.4.2. Failure to apply the provisions of the Italian Civil Code governing the assignment of companies to the assignment of banking business following resolution of a bank

Among the reasons given for the decisions of certain Italian judges who have attributed liability to the bridge banks (and, subsequently, to the banks that absorbed them) in relation to claims for compensation raised by the former shareholders (and similar parties) of the "Four Banks", the main line of reasoning is that the provisions of the Italian Civil Code governing the assignment of a company do not apply to the resolution of the "Four Banks" (Article 2560 et seq. of the Italian Civil Code).

The reasoning behind this conclusion is as follows:

- (i) the deemed applicability of the special provisions governing the assignment of a bank's business (Article 58 et seq., Italian consolidated law on banking) to the assignments of business carried out as part of the "Four Banks" resolution; and
- (ii) the deemed incompatibility of the special provisions in question (i.e. Article 58, Italian consolidated law on banking) with the provisions governing the assignee's liability for the assignor's liabilities, within the context of ordinary law (i.e. Article 2560 of the Italian Civil Code). The principle that is not apparently applicable is that part of the Italian Civil Code which states that "*in the transfer of a company, the*

of publication. 3. Liens and guarantees of any kind, regardless of who has issued them, or in any case existing in favour of the assignor, as well as the entries in the public registers of the deeds of purchase of assets acquired under finance leases included in the assignment retain their validity and their ranking in relation to the assignee, without the need for any formality or special entry. The special provisions, including those of a procedural nature, are also applicable to assigned accounts receivable. 4. With regards to assigned accounts payable, the publication requirements envisaged in paragraph 2 will produce the effects stated in Article 1264 of the Italian Civil Code. 5. Within three months of the publication requirements envisaged in paragraph 2, assigned creditors are entitled to demand fulfilment of the assigned obligations by the assignor or by the assignee. Once the aforesaid three months have lapsed, the assignee has sole liability. 6. Those who are party to agreements assigned may withdraw from the agreements within three months of publication (as per the requirements envisaged in paragraph 2) in the event of just cause, in which case the assignor remains liable. 7. The provisions of this article also apply to assignments to parties other than banks, within the scope of consolidated supervision, pursuant to Articles 65 and 109 and to the financial brokers provided for in Article 106.

¹² Cass., n. 22199/2010

purchaser thereof is also liable for the aforesaid debts [those generated prior to the transfer] if they are stated in the compulsory accounting books,": which is why the assignee of a bank would be liable for the assignor's liabilities even if not recorded in the "*compulsory accounting books*", such as administrative penalties for offences committed by the assigning company's representatives and - above all - "*revocation actions (during insolvency proceedings) which may be filed against payments received by the assignor (i.e. transfers thereto) prior to the assignment - although not yet settled at the time-*".

I, personally, do not subscribe to such lines of thought.

The first, because Article 58 of the Italian Consolidated law on banking should *not* be deemed applicable to the assignment of the business relating to the "Four Banks" - just as it does not apply to the assignment of the "Two Veneto Banks": see section n. ... - with the sole exception of paragraph 3, where claims were provided for in the assignment¹³.

Article 47, paragraph 3, of Italian Legislative Decree n. 180/2015 - which specifies "*provisions common to assignment*", including "*assignments to a bridge bank*" (Article 42 et seq..) - states that "*... if the assignment concerns a claim, Article 58, paragraph 3, of the Italian consolidated law on banking applies*": a completely useless (and therefore inexplicable) provision when, instead, it should be held - as postulated by the ruling in question - that Article 58, Italian consolidated law on banking apply *always and per se* (and in its entirety) to the assignment (also) of the business of the "Four Banks".

On the other hand, this corresponds exactly to the provisions concerning the assignment of the business relating to the banks in the case of the "Two Veneto Banks" - see section n. ... -: according to Article 3, paragraph 1, of Italian Decree Law n. 99/2017, "*the provisions of Article 58, paragraphs 1, 2, 4, 5, 6 and 7 ... do not apply to assignments*", which is equivalent to saying (in practice) that only paragraph 3 applies (in the event that the assignment includes claims).

If applicability of Article 2560 of the Italian Civil Code is ruled out on the basis of the alleged applicability of Article 58 of the Italian consolidated law on banking (and on the deemed incompatibility of the principle stated in paragraph 2 of Article 2560 of the Italian Civil Code with the aforementioned special banking law), once it has been established that Article 58 of the Italian consolidated law on banking is *not* applicable (to matter in question here), there is no obstacle to the establishment of the applicability of Article 2560 of the Italian Civil Code to the assignment of

¹³ In which case, "*the liens and guarantees of any kind, regardless of who has issued them, or in any case existing in favour of the assignor, as well as the entries in the public registers of the deeds of purchase of assets acquired under finance leases included in the assignment retain their validity and ranking in relation to the assignee, without the need for any formality or special entry. The special provisions, including those of a procedural nature, are also applicable to assigned accounts receivable.*"

the business relating to the "Four Banks" case: transactions that are subject to the provisions governing the assignment of companies - as *already established, in case law, (at least) for the assignment of the business of Cassa di Risparmio di Ferrara (CARIFE S.p.A.) to the new bridge bank CA.RI.FE. S.p.A.* -¹⁴.

The second line of reasoning put forward by the case law criticised, namely the alleged extensibility of the liability of the assignee of the business of one of the "Four Banks" to include liabilities potentially not recorded in the compulsory accounting books, is contradicted by:

- (i) the recognised applicability of the provisions of Article 2560, paragraph 2, Italian Civil Code, also to such assignments; and
- (ii) the need (recently established by the Combined Chambers of the Italian Court of Cassation)¹⁵ to adopt a restrictive interpretation of the

¹⁴ Court of Naples, 28 April 2017, in www.ilcaso.it. According to this decision, "*on the contrary, it seems rather that this case [assignment or contribution of banking business] consists of a singular succession pursuant to Article 111 of the Italian Code of Civil Procedure. In practice, the measure taken by the Bank of Italy produced an **assignment of business** which, although involving the consequent transfer of the majority of the assets of the bank undergoing liquidation to the bridge bank (i.e. the Nuova Cassa di Risparmio S.p.A.), could not result in itself, in the extinction of the legal entity CARIFE S.p.A., which therefore remains an original party to the proceeding underway; in support of this, reference may be made to the provisions, in general, governing liquidation proceedings for public limited companies (Articles 2484 et seq. of the Italian Civil Code) on the basis of which, during the liquidation stage, the company is no longer a legal entity and simply changes its representatives, replacing the directors with the liquidators; in particular, this solution was adopted by both legal literature and case law regarding both the contribution of business pursuant to Italian Legislative Decree no. 20 November 1990 n. 356, which would determine, at procedural level, a singular succession pursuant to Article 111 of the Italian Code of Civil Procedure, while the assigning bank remains in existence (n. 7079, 28 July 1994), as in the case of compulsory administration of a bank, where the assignment to another bank of rights, business, assets, and liabilities, legal relationships pursuant to Article 90, paragraph 2, of the Italian consolidated law on banking, even if it involves transfer of ownership of a set of assets or liabilities or even of the entire business, does not extinguish the assignor bank, which remains in liquidation proceedings (Court of Cassation November 22, 2003 No. 875), and therefore also Article 111 of the Italian Civil Code and not Article 110 of the Italian Code of Civil Procedure; the same solution also arises when legislators provide for one bank to take over another (Cassation, Combined Chambers, n. 1989, 6 March 1997, Cassation n. 13386, 8 June 2007, Cassation n. 12648, 17 December 1998).*"

¹⁵ Cassation, Combined Chambers, n. 5054, 28 February 2017. According to this decision "*as regards the first aspect, the main premise of the syllogistic reasoning followed by the court with geographical jurisdiction is that the standing to be sued in terms of revocation action (in insolvency proceedings) concerning payments made to a business which was subsequently contributed to a company must be attributed to the recipient company - but the same problem would arise in the event of an assignment: since, for the purposes of the joint liability provided for by Italian law, it is sufficient for information to be inferable from the compulsory accounting books concerning the previous contractual relationship between the assignor and a business which had become insolvent by the payment date: even if payment of the amount actually only falls due upon the upholding of an*

provisions of the aforesaid article, since *"the liability of the assignee must be attributed to the assignee [of the bank] within the context of direct evidence, reported in the compulsory accounting books of the bank, in order to protect its legitimate expectations, which is essential to ensure proper circulation of assets with particular business significance"*

10.4.3. Regulation of the "assignment of business" in the banking industry and regulation of the assignment of "all the rights, assets, or liabilities [belonging to a bank] which may be grouped together ... or a part thereof".

The decisions discussed, and criticised, show that I consider the provisions regulating - in general - the assignment of business (i.e. Article 2560 of the Italian Civil Code) to be incompatible with the provisions set out (regarding the assignment of a bank's business, within the framework of the resolution procedure) by Article 43 of Italian Legislative Decree n. 180/2015; this is because the article in question *"provides for the direct transfer to the assignee of liabilities already relating to the company assigned and not - as in the scenario referred to in Article 2558 of the Italian Civil Code - the mere transfer involving joint liability for pre-existing debts"*.

Likewise, these decisions consider Article 2560 of the Italian Civil Code incompatible with the provisions of Article 58 of the Italian consolidated law on banking, because the latter envisages *"the transfer of liabilities to the assignee ... and not simply the inclusion of the latter as jointly liable*

application for revocation, in the period following assignment of the business (Cass., 1st Chambers, n. 17668, 28 July 2010).

I do not subscribe to this interpretation.

In practice, it disproportionately swells the scope of application of Article 2560, second paragraph, of the Italian Civil Code, by including obligations which have not yet come to light in the joint liability provision, solely on the basis of a reinterpretation of a documented event and includes, therefore, a mere risk of a contingent liability rather than a debt that has already accrued and been recorded in the books, as envisaged in the wording of the article.

On the contrary, the assignee's liability must be attributed on the basis of direct evidence, recorded in the company's compulsory accounting books, to protect its legitimate expectations, which are essential for the proper circulation of particularly significant business assets.

The clear description given under the heading "Payables relating to the assigned business" and the wording of Article 2560 of the Italian Civil Code do not, in fact, allow the assignment of a company to extend to include liability for a debt, but rather envisage the possibility of the receiver of the insolvent company taking action to subsequently revoke payments.

These findings - which prioritise not only the content of the law (priority hermeneutical parameter: Article 12, provisions on the law in general), but also the aforesaid protective aims, rather than the implications relating to the inherent nature of the action - should be attributed to the aforesaid principle of law.

with the assignor, [and therefore] departs from the provisions of Article 2560 of the Italian Civil Code".

I do not agree with these conclusions either.

First and foremost, it would undoubtedly be wrong to assume that the bank resolution procedure does not allow the business of failed banks to be transferred to a third party through a business assignment agreement.

To this end, the following aspects must be considered first:

- (i) in general, Article 58 of the Italian consolidated law on banking expressly (also) mentions the option consisting of a '*business assignment*';
- (ii) in relation to the "Two Banks" (based in the Veneto region), Article 3, paragraph 1, of Italian Decree Law n. 99/2017 also provides for the possibility for the liquidators to "*assign ... the business*";
- (iii) with regards to the "Four Banks", on the one hand, the related provisions (Article 47 of Italian Legislative Decree No. 180/2015) make express reference to other provisions (such as the reference to Article 2558 of the Italian Civil Code) envisaging an assignment of business ("*... the purchaser of the business...*"); while on the other, measures issued by the resolution authority have repeatedly referred to the "*business assignment*" option¹⁶;
- (iv) in the measures taken on 22 November 2015 for each of the "Four Banks", the Bank of Italy ordered (under the heading "*Assignment of the bank's business*") the assignment of the "*rulings in favour of and against [the banks] ... in effect on the date of effect of the assignment ... pursuant to Article 43 and 47 of Italian legislative decree n. 180/2015 ...*" to the four bridge banks (amongst others).

If anything, this poses a restriction - on the liability of the bridge bank which has been assigned the business of the "Four Banks" - to solely claims thereagainst arising from acts or events prior to the assignment, since - regardless of whether or not they are recorded in the compulsory accounting books - any obligations linked to "*rulings against*" the bank which were not "*in effect on the date of effect of the assignment*" would not fall within the scope of the assigned legal relationships (even - I repeat - in the event that they are recorded in the compulsory accounting books).

In actual fact, first Article 58 of the Italian consolidated law on banking (accompanied by Article 90, paragraph 2, of the said consolidated law on banking, with reference to banks under compulsory administration) and subsequently Article 43 of Italian Legislative Decree n. 180/2015 and Article 3 of Italian Decree Law n. 99/2017, did not by any means intend,

¹⁶ With the provision dated 22 November 2015, the Bank of Italy ordered "*the assignment of all rights, assets and liabilities constituting the banking business* [of the "Four Banks "] *to* [the bridge banks], under the heading "**Assignment of the banking business to the bridge bank**", also specifying, at the same time, what is "*excluded from the assignment of the business ...*".

when adopting the broad formulas describing the methods for liquidating bank assets - to preclude use of the option consisting of the assignment of the business as a whole (or part thereof, i.e. a business unit or division); the intention, rather, was to allow different and further divestitures, which could not have fallen (and still could not fall) within the scope of the civil law concept of "business" (or business unit or division); nevertheless the intentions was also to permit and to regulate the use thereof as a means of disposing of the banks' assets ¹⁷.

Having clarified this aspect, it must also be stated that the ordinary law provisions governing the assignment of business *cannot be considered entirely modified by the special provisions of banking law applicable to the assignment of the business of banks*. The departure from the ordinary law provisions concerns whether or not the assignment has a discharging nature for the assignor (where, in ordinary law, the assignee *takes on joint* liability with the assignor, while in the special banking law, the assignee *takes over* the assignor's liability): but there is no reason (or anyway there is no provision which may be referenced for the purpose) to also consider modified the *determination of the scope* (of the business assigned) or of the relationships in which the assignee is required to take on the position held by the assignor in the relationship (including therein joint with the assignor or instead of the assignor, as the sole obligee after the assignment). There is no reason - in particular - to state that the liabilities *which are not worthy of involving* the assignee (in terms of liability therefor) in the business assignment under ordinary law (as the assignee could not be aware of them, since they do not appear in the assignor's compulsory books) become worthy of involving the assignee in transactions performed under special banking law - and, if anything, the opposite is more likely, i.e. it makes more sense to better protect the "legitimate expectations" of an assignee *without recourse against the assignor* (as is the case of an assignee of a bank's business, regardless of whether or not the assignor is a 'performing' bank - as per Article 58 of the Italian consolidated law on banking - or a bank under compulsory administration - as per Article 90 of the Italian consolidated law on banking), as opposed to an assignee which is entitled to take action against the assignor (as is the case of an assignee of the business of a company governed by ordinary law - as per Article 2560 of the Italian Civil Code).

10.4.4 Establishment of the lack of liability of the (banks absorbing the) bridge banks for the hidden liabilities - in general - of the "Four Banks".

¹⁷ Consider the notion of "*legal relationships which may be grouped together*", which is designed to allow - and regulate - divestment transactions typical of the banking market, such as for example, the transfer of all mortgages to a bank specialised in mortgage loans; the assignment of all personal loans to a bank specialising in consumer loans; etc.

As already mentioned, the rulings issued so far by Italian judges are based on the limited grounds of the bridge banks' liability for claims for compensation filed by the shareholders (and similar persons) holding devalued shares etc, connected to the alleged breach of the provisions governing investment services at the time of assignment of treasury shares (and similar securities) which were subsequently totally devalued.

Doubt has been cast over the solution to this problem by the counsels for the defence of the bridge banks involved, who have asked whether the "reduction" of the claims of the shareholders (and similar parties) extends to the (compensatory) rights that such parties may have as *investors* (and therefore injured in relation to the purchase of the treasury shares from one of the "Four Banks"); or whether it should be limited - as the rulings in question concluded - to the (administrative and financial) rights incorporated into the devalued securities which they could claim as shareholders (and similar) of the resolved banks.

Without the need to take a stance on the matter - which for the "Two Veneto Banks" was settled through an "all-inclusive effect" of the reduction, based on the express provision of Article 3, paragraph 1, section b) of Italian Decree Law n. 99/2017¹⁸: *see section n. ...* - it should be stressed that the doubt raised by the counsels for the bridge bank (defendants) must be limited to investment transactions concerning *treasury shares (or similar securities)*; while it does not attribute any other (alleged) liability for the (alleged) breach of provisions governing investment services *relating to different securities*¹⁹.

Some of the rulings already issued expressly refer to claims for compensation relating to "*sums unduly charged by the [subsequently resolved] bank for interest, and so on*" and clearly hold the bridge bank (defendant) liable also for such claims for compensation when raised before a court. This demonstrates that which is stated above, i.e. that the matter cannot be considered limited to the compensation claims raised by the 'devalued' shareholders - when the assignment of treasury shares by one of the "Four Banks" breached the provisions governing investment services; however, it must be considered extended to all the *hidden liabilities*

¹⁸ "*the following are, in any case, excluded from assignment, even in departure from Article 2741 of the Italian Civil Code ...: payables by the banks to their own shareholders and bondholders arising from the sale of shares or subordinate bonds of the [Two Veneto banks] or from breaches of regulations governing investment services relating to the said shares or subordinate bonds, including payables (of the kind just described) to recipients of settlement offers presented by the said banks*": thus demonstrating "*that where legislators intended to take into account claims for compensation raised (also) by shareholders, in their capacity as investors, express provision therefore has been made*";

¹⁹ It does not exclude the sale of shares in other - equally distressed - banks (for example, the shares in Monte dei Paschi di Siena) without the due precautions and warnings concerning the investment service thus provided.

referable to acts or events carried out in the past by the subsequently resolved "Four Banks".

10.5. The case of the "Two Veneto Banks": the initiation of compulsory administration and the simultaneous assignment of the business of the two banks in distress.

The compulsory liquidation of a bank, ordered by the Ministry of Economy and Finance at the recommendation of the Bank of Italy, involves the bank ceasing to trade. The business of the bank as a whole, or of individual business units, may be assigned to one or more other banks.

The assignment of the bank's business to one or more banks may involve sacrificing part of the old bank's creditors, because otherwise there would be no other banks willing to acquire the entire business or business units of the failing bank.

In 2016, the crises of two banks, namely Banca Popolare di Vicenza and Veneto Banca (a.k.a the "Two Veneto Banks") were resolved in this way.

The procedure, led by the Bank of Italy, involved:

- a) the "Two Veneto Banks" being placed under compulsory administration;
- b) the claims of the shareholders and the subordinate bondholders of the two banks were devalued;
- c) the "good part" of the two banks (i.e. the business excluding the two banks' NPLs) was assigned to Italy's largest banking group (Gruppo Banca Intesa);
- d) the two banks' NPLs were assigned to the company (Società Gestione Crediti – SGA-) which - in the past - had managed the recovery of the NPLs of the Banco di Napoli, when (in the 1990s) the said bank was placed in compulsory administration.

10.5.1. Provisions governing liability of the assignee bank, in the case of the "Two Veneto Banks", for past liabilities to shareholders and third parties.

Unlike the "Four Banks", the "Two Veneto Banks" did not undergo the resolution procedure, as they were placed under compulsory administration.

The subsequent assignment of the business of the two banks (to Banca Intesa) was governed by Italian Decree Law n. 99 dated 25 June 2017 (converted into Italian Law n. 121/2017).

This law specifies, in Article 3, paragraph 1, section b) and section c) that the following are, in any case, excluded from assignment:

- a) *payables by the banks' to their own shareholders and bondholders arising from the sale of shares or subordinate bonds of the banks or from breaches of regulations governing investment services relating to the said shares or subordinate bonds offered by the said banks;*
- b) *any disputes relating to acts or events occurring prior to the assignment which arise following the assignment, and the related liabilities."*

Also in the case of the "Two Veneto Banks", the problem was determining the scope of the liability of the assignee bank (Banca Intesa) for the obligations of the two banks placed under compulsory administration.

For much the same reason as why it should be held that the assignment of the banking business of the "Four Banks" should be governed according to the ordinary law provisions on the assignment of business in general - according to which the assignee is only liable for the obligations recorded in the compulsory accounting books, i.e. Article 2560 of the Italian Civil Code - it must also be assumed that Banca Intesa is also only liable for the obligations of Veneto Banca and Banca Popolare di Vicenza recorded in the two banks' compulsory books **but with the exclusion of the "Two Veneto Banks"'s obligations to their own shareholders and subordinate bondholders**, for which Banca Intesa would not be liable even if they were recorded in the compulsory accounting books.