BANKING SUPERVISION, PRUDENTIAL SUPERVISION, AND THE SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

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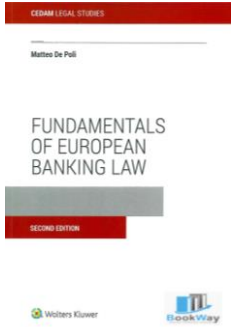

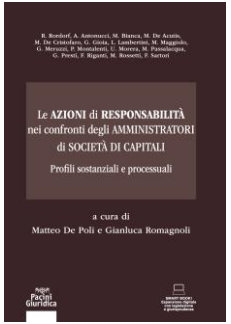

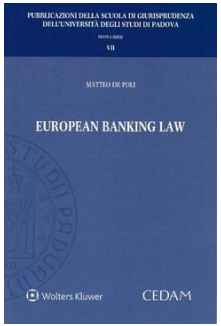

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1. INTRODUCTION TO BANKING SUPERVISION

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THE RATIONALE OF BANKING SUPERVISION

1) Banks perform several activities, as:
   - "**Banking**," which consist of the collection of deposits from the public and the granting of credits for its own account;
   - The provision of **investment services**;
   - The provision of **payment services**; etc.

2) These activities involves different **risks**, as
   - Credit risk;
   - Liquidity risk;
   - Operational risk;
   - Systemic risk; etc.

3) These risks may threat:
   - The capability of the bank to reimburse **depositors** and other creditors;
   - The **bank's viability**;
   - The whole **financial system**.

4) Therefore, as far as banks carry out very risky activities, they shall be publicly **regulated** and **supervised**.

“REGULATION” AND “SUPERVISION”

(Prudential) regulation

Banks shall comply with a broad range of very detailed and technical rules to minimize the risks they usually face (so-called “risk-based approach”).

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Governance arrangements and **prudential requirements** concerning capital, liquidity, and leverage.

(Prudential) supervision

Public Authorities shall monitor banks:

- To verify whether they comply or not with the relevant regulation; and
- To promptly identify and address any potential source of threats to the viability of the bank concerned (**micro supervision**) and the financial system as a whole (**macro supervision**).

2. THE SOURCES OF EU LAW AND ITALIAN LAW REGULATING BANKING SUPERVISION

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INTRODUCTION TO EU BANKING LAW: THE "LAMFALUSSY APPROACH"

Level 1	**Regulations** and **directives** are adopted by the EU Parliament and the Council to establish a general framework on a specific topic. In particular: ▪ Regulations are directly applicable in all Member States and prevail on national legislation (**maximum harmonization**); ▪ Directives are not directly applicable and shall be transposed into national legislation (**minimum harmonization**).
Level 2	**Delegated and implementing regulations** are adopted by the Commission with the advice of the European Supervisory Authorities*. These acts establish technical and detailed rules which specify the content of Level 1 acts. They are **binding** and **directly applicable** in all Member States.
Level 3	Guidelines and recommendations issued by the European Supervisory Authorities are not binding (so-called "**soft law**"). However, they are subject to the: ▪ "Comply or explain" principle; ▪ "Name and shame" approach.
Level 4	**Enforcement** by the Commission. In particular, the Commission: ▪ Checks Member States compliance with EU law; ▪ Takes legal actions against Member States in case of breach of EU law.

*The European Supervisory Authorities are: i) The European Banking Authority (EBA); ii) The European Securities and Markets Authority (ESMA); iii) The European Insurance and Occupational Pensions Authority (EIOPA).

THE SOURCES OF EU LAW CONCERNING BANKING SUPERVISION

The **Single Rulebook** consists of several regulations and directives, as well as the related Commission's delegated and implementing regulations and EBA's guidelines, regulating different facets of the banking business. The European Banking Authority (EBA) is responsible for its consistent application throughout the whole **European Union**.

The **Banking Union** consists of two regulations establishing common systems of banking supervision and crises management for **Eurozone** countries only.

IN PARTICULAR, THE SINGLE RULEBOOK

The **Single Rulebook** is composed by:

- The "CRD IV Package:"
  - The **Capital Requirements Directive IV** (CRD IV, as amended by the CRD V and the IFD), on banking authorization, freedom of establishment and to provide services, governance arrangements, capital buffers, and prudential supervision of credit institutions;
  - The **Capital Requirements Regulation** (CRR, as amended by the CRR II and the IFR) on prudential requirements (capital, liquidity and leverage requirements) for credit institutions;
- The **Bank Recovery and Resolution Directive** (BRRD, as amended by the BRRD II) on the prevention and the management of banks' crises;
- The **Deposit Guarantee Scheme Directive** (DGSD) on depositors' protection
- The Anti-Money Laundering Directive IV (AMLD IV, as amended by the AMLD V), the Payment Services Directive II (PSD II), etc.
- All the Commission's delegated and implementing regulations and ESAs' guidelines related to the acts just mentioned.

The EBA's website hosts an "interactive Single Rulebook" which collects all the regulations and the directives just mentioned, as well as the related Commission's delegated and implementing regulations and EBA's guidelines and Q&As.

IN PARTICULAR, THE BANKING UNION

The Banking Union consists of three “pillars:”

EUROPEAN CENTRAL BANK
EUROSYSTEM

The **Single Supervisory Mechanism** (SSM) is a centralized system of banking supervision for Eurozone countries. It has been established in 2013 by the Single Supervisory Mechanism Regulation (SSMR) and operates since 2014. It is led by the **European Central Bank** (ECB).

Single Resolution Board

The **Single Resolution Mechanism** (SRM) is a centralized system of banks’ crises management for Eurozone countries. It has been established in 2014 by the Single Resolution Mechanism Regulation (SRMR, as amended by the SRMR II) and operates since 2016. It is led by the **Single Resolution Board** (SRB).

Single Resolution and Deposit Insurance Board (?)

The **European Deposit Insurance Scheme** (EDIS) is a project devoted to create a centralized system of depositors’ protection for Eurozone countries. It is not yet in place.

THE RELEVANT PIECES OF ITALIAN BANKING LAW

In addition to the Single Rulebook and the pillars of the Banking Union, the Italian banking system is regulated by:

- Legislative Decree 1st September 1993, No. 385 (so-called "**Testo Unico Bancario**" or "TUB"), that is, the Italian Banking Act;
- **Legislative Decree 16th November 2015, No. 180** (link), concerning the resolution of credit institutions (it transposes part of the BRRD);
- Legislative Decree 24th February 1998, No. 58 (so-called "**Testo Unico della Finanza**" or "TUF"), regarding the provision of investment services;
- **Legislative Decree 21st November 2007, No. 231**, as amended (link), on the prevention of money laundering in the financial system;
- The **Italian Civil Code** (link). As far as credit institutions are companies, they shall comply with Italian company law.

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Those acts are sources of "**primary law**"

CONT'D: THE RELEVANT PIECES OF ITALIAN BANKING LAW

The Italian banking system is regulated also by several sources of "**secondary law**," as

- Circolare No. 285/2013 by Banca D'Italia, as amended. It transposes many provisions of the CRD IV as those concerning the freedom of establishment and to provide services, governance arrangements, capital buffers, etc.
- Circolare No. 269/2008 by Banca D'Italia, as amended. It regulates the Supervisory Review and Evaluation Process, intervention measures by Banca D'Italia, etc.
- Provvedimento 29th July 2009 by Banca D'Italia, as amended. It regulates the content of several banks' contracts as loan agreements, customer loan agreements, current account agreements, etc.
- The regulations issued by Consob regarding financial intermediaries, financial markets, issuers, crowdfunding, etc.

3. BANKING SUPERVISION IN PRACTICE:

I. THE AUTHORITIES IVOLVED IN BANKING SUPERVISION, THEIR TASKS AND POWERS

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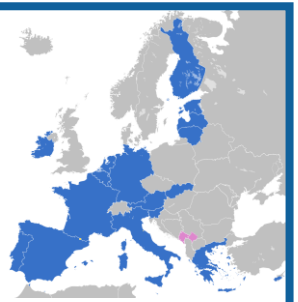
A “CROWDING” OF SUPERVISORY AUTHORITIES

EU level:

- The European Systemic Risk Board (ESRB);
- The European Supervisory Authorities (ESAs), which are:
  - The European Banking Authority (EBA);
  - The European Securities and Markets Authority (ESMA);
  - The European Insurance and Occupational Pensions Authority (EIOPA).

Eurozone level:

- The European Central Bank (ECB).



Italian level:

- Banca D’Italia (link);
- Consob (link);
- IVASS (link).

THE EUROPEAN SYSTEMIC RISK BOARD

The European Systemic Risk Board (ESRB) is responsible for the oversight of the whole EU financial system and, thus, for identifying any potential source of systemic risk (**macro supervision**). To this purpose, the ESRB collects and analyzes lots of data from EU Institutions, supervisory Authorities, and statistics Authorities.

According to Art. 16 ESRB Founding Regulation, the ESRB may issue **non-binding**:

- **Warnings** concerning significative risks; and
- **Recommendations** for remedial actions.

Warnings and recommendations may be addressed to the Union, to one or more Member States, to one or more European Supervisory Authorities, to the ECB, and to one or more national supervisors, **not to individual credit institutions**.

THE EUROPEAN SUPERVISORY AUTHORITIES

The European Supervisory Authorities (ESAs):

- Help the Commission in the issuing of delegated and implementing regulations (**level 2 acts**) and issue guidelines and recommendations (**level 3 acts**) regarding different sectors of the financial system;
- Are responsible for the **micro supervision** of different sectors of the financial system.

Sector	Competent Authority
Banking	European Banking Authority (EBA)
Investment services and activities	European Securities and Markets Authority (ESMA)
Insurance and pensions	European Insurance and Occupational Pensions Authority (EIOPA)

The ESAs **do not have direct supervisory powers** with respect to the entities they supervise*, but coordinate national supervisors in their monitoring activities.

* Only the ESMA has direct supervisory powers with respect credit rating agencies and trade repositories.

IN PARTICULAR, THE EUROPEAN BANKING AUTHORITY

The European Banking Authority (EBA):

- Has **"quasi-regulatory" powers** as far as level 2 and level 3 acts are concerned;
- Is responsible for the **micro supervision** of the EU banking sector.

More precisely, according to the EBA Founding Regulation, the EBA:

- Contributes to the issuing of **delegated and implementing regulations** by the Commission (level 2 acts);
- Issues **guidelines** and **recommendations** (level 3 acts), **opinions**, and **Q&As**;
- Ensures the **consistent application of EU banking legislation** and contributes to the establishment of **high-quality supervisory and resolution practices**;
- Contributes to the prevention of the use of the financial system for the purposes of **money laundering and terrorist financing**;
- **Coordinates national supervisory authorities** and acts as a mediator in case of disagreements between national supervisory Authorities.

Paris, EBA's headquarters

THE EUROPEAN CENTRAL BANK

The European Central Bank (ECB) is responsible for the functioning of the **Single Supervisory Mechanism** (SSM), that is, a centralized system of banking supervision for Eurozone countries.

More precisely, under the Single Supervisory Mechanism Regulation (SSMR) and the Framework Regulation (SSMFR), the ECB:

- May authorize Eurozone companies to engage in banking;
- May withdraw that authorization;
- Assesses the acquisition of "qualifying holdings;"
- Directly supervise **"significant" credit institutions** (check the list);
- Coordinates national Authorities in the supervision of **"less significant" credit institutions**.

Frankfurt, ECB's headquarters

“SIGNIFICANT” CREDIT INSTITUTIONS

Under the SSMR and the SSMFR, the European Central Bank is responsible for the **direct supervision of “significant” credit institutions**. It is up to the ECB itself to assess the significance of an entity, on the basis of its **size**, **importance for the economy** of the Union or any Eurozone country, significance of **cross borders activities**.

A credit institution is necessarily considered as “significant” if:

- The total value of its assets exceeds EUR 30 bln;
- The ratio of its total assets over the GDP of its country of establishment exceeds 20%, unless the total value of its assets is below EUR 5 bln;
- The national supervisor considers that credit institution of significant relevance with regard to the domestic economy, or it is one of the three most significant credit institution of its country of establishment;
- It required public financial assistance or it directly received assistance from the ESM.

!!! Finally, when necessary to ensure the **consistent application of high supervisory standards**, the ECB may decide, at any time, on its own initiative after consulting with the national supervisor or upon request by the national supervisor, to exercise **directly** all the relevant supervisory powers with respect to one or more credit institutions.

THE RELATIONSHIP BETWEEN THE ECB AND BANCA D'ITALIA

Banca D'Italia (link) is responsible for the supervision of the Italian banking system.

As far as Banca D'Italia participates in the Single Supervisory Mechanism, it is subject to the coordination powers of the ECB. More precisely, the relationship between the ECB and Banca D'Italia can be summarized as follows:

- The ECB has the exclusive competence to grant the banking license and withdraw it, and to assess the acquisition of "qualifying holdings;"
- **The ECB directly supervises "significant" credit institutions** established in Italy, though in strict cooperation with Banca D'Italia;
- **Banca D'Italia directly supervises "less significant" credit institutions** established in Italy (as Banca UBAE), under the oversight of the ECB (thus, the ECB may order Banca D'Italia to use its supervisory powers, etc.).

In order to carry out their tasks, both the ECB and Banca D'Italia are granted with several **supervisory powers**, as:

- Investigative powers;
- Intervention powers;
- Sanctioning powers.

INVESTIGATIVE POWERS OF BANCA D'ITALIA

Banca d'Italia is granted with very invasive **investigative powers**,* as those to:

- **Request of information** (Art. 51 TUB): Banca D'Italia is entitled to require credit institutions as well as their directors, executives, statutory auditors, employees, and third parties to whom the bank have outsourced functions or activities to provide all information and documents that are necessary to carry out its supervisory tasks.
- **Carry out inspections** (Art. 54 TUB): Banca d'Italia is entitled to carry out inspections at the premises of a bank as well as the premises of third parties to whom the bank have outsourced functions or activities. N.B. On condition of reciprocity, Banca D'Italia may agree with third countries' supervisory Authorities to regulate the methods for the inspections of branches of banks established in their respective territories.

The **Board of Auditors** ("Collegio Sindacale") plays a key role as it represents a sort of Banca D'Italia's outpost within the credit institution. Indeed, this body shall immediately inform Banca D'Italia of any administrative irregularity, and infringement of the relevant legislation or the bank's statute (Art. 52 TUB).

*The ECB is granted with similar powers by Arts. 10-13 SSMR and 138-146 SSMFR.

INTERVENTION POWERS OF BANCA D'ITALIA

Banca D'Italia is granted with **intervention powers** to promptly address and remedy critical situations faced by credit institutions.* In essence, these powers have a **corrective function** and aim at **preventing banks' crises** (they will be analyzed, more in depth, shortly, after examining the Supervisory Review and Evaluation Process).

Example:

1) A credit institution sends its balance sheet to Banca D'Italia;
2) Banca D'Italia examines the balance sheet and considers that certain assets can result to be too risky. Thus, it requires to the credit institution concerned additional information regarding those assets;
3) The credit institution concerned provides the information required;
4) Banca D'Italia, after examining that information, confirms that the assets concerned are too risky and requires the credit institution to divest them prudently.

*The ECB is granted with similar powers by Art. 16 SSMR,

SANCTIONING POWERS OF BANCA D'ITALIA

Finally, Banca d'Italia is granted with **sanctioning powers** (Arts. 130 ff. TUB) devoted to:

- **Punish** credit institutions, as well as their directors, executives, statutory auditors, etc., that infringed the relevant pieces of EU and Italian banking legislation;
- **Discourage** credit institutions, as well as their directors, executives, statutory auditors, etc., from infringing the relevant pieces of EU and Italian banking legislation. Thus, sanctioning powers contribute to ensuring the **sound and prudent management** of credit institutions.

Examples of sanctions:

- Cease and desist order;
- Pecuniary penalty;
- Interdiction from managing and/or auditing functions;
- Publication of the sanction on the website of Banca D'Italia.

*Also the ECB is granted with the power to impose pecuniary penalties by Art. 18 SSMR.

OTHER SUPERVISORY AUTHORITIES IN ITALY

Consob (link) is responsible for the supervision of financial markets and, in particular, for **protecting investors** by ensuring transparency and integrity in the provision of investment services (Art. 5 TUF). To carry out its tasks, Consob is granted with **investigative powers, corrective powers, and sanctioning powers** as Banca D'Italia.

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Thus, credit institutions that perform investment services and activities are supervised by Consob as far as that business is concerned.

IVASS (link) is responsible for the supervision of the **insurance sector**.

3. BANKING SUPERVISION IN PRACTICE:
II. THE SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

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OBJECTIVES AND SCOPE OF THE SREP

According to Art. 97 CRD IV, the competent supervisory Authority reviews the arrangements, strategies, mechanisms and processes implemented by a credit institution to comply with the provisions of the CRD IV Package and evaluates:

- The risks to which the credit institution is or might be exposed;
- ~~The risks that the credit institution poses to the financial system~~;* and
- The risks revealed by stress testing taking into account the nature, scale, and complexity of the credit institution's activities;

The scope of that review and evaluation covers **all the requirements established by the CRD IV Package**.

* In 2019, the CRD V turned the SREP into a **micro-prudential tool** (thus, it is no longer a micro- and macro-prudential tool). In any case, where the review shows that the credit institution concerned may pose systemic risks, the supervisory Authority shall inform the EBA without delay.

A “PROPORTIONATE” AND “TAILORED” APPROACH

According to Art. 97 CRD IV, as amended by the CRD V:

- The supervisory Authority shall establish the frequency and intensity of the SREP having regard to the size, systemic importance, nature, scale and complexity of the activities of the credit institution concerned and taking into account the **principle of proportionality**;

- The supervisory Authority may **tailor the methodologies** for the application of the SREP to take into account credit institutions with a similar risk profile (such as similar business models, geographical location of exposures, etc.).

↓

Categorization of credit institutions into four categories on the basis of their size, structure, internal organization, nature and complexity of their activities, etc. (Title 2.4, par. 11, EBA SREP GL).

THE CATEGORIZATION BY BANCA D'ITALIA

Less significant credit institutions directly supervised by Banca D'Italia are divided into four categories, according to decreasing levels of intensity, frequency and scope of supervisory action (Part I, Section I, Chapter I.5.2, Circolare 269/2008):

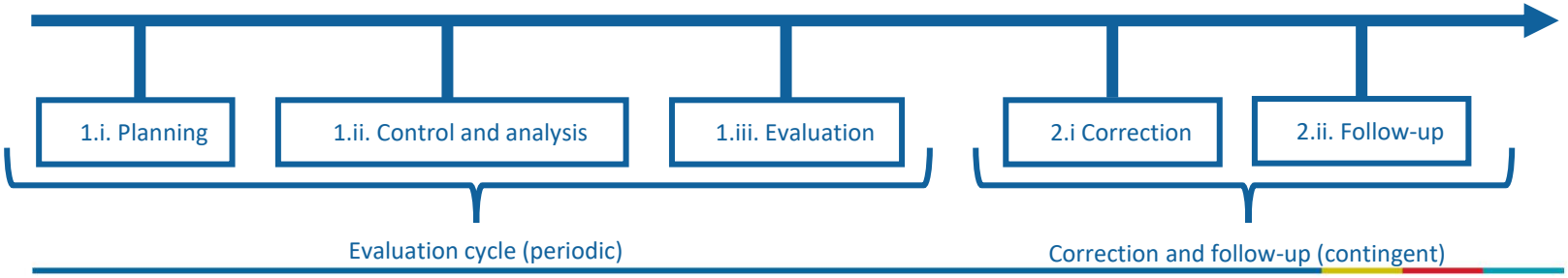
Priority	Bank
1 Very high	Other systemically important institutions (O-SIIs) and other banks having a significative size and internal organization, complex activities, etc.
2 High	Medium to large banks, operating domestically or with sizable cross-border activities, operating in several business lines, including non-banking activities, and offering credit and financial products to retail and corporate customers.
3 Medium	Small to medium banks, operating domestically or with non-significant cross-border operations, and operating in a limited number of business lines, offering predominantly credit products to retail and corporate customers with a limited offering of financial products.
4 Low	All other small non-complex domestic banks, having a limited scope of activities and non-significant market shares in their lines of business.

THE PHASES OF THE SREP

According to Part I, Section I, Chapter II.1.1, Circolare 269/2008, the SREP consists of two main phases:

1) The "**evaluation cycle**," which consist of three steps:
   i. Planning;
   ii. Control and analysis;
   iii. Evaluation.

2) The **correction** phase and its **follow-up**.



1. THE EVALUATION CYCLE: I) PLANNING

According to Part I, Section I, Chapter II.2, Circolare 269/2008, the “planning” phase consists of:

- **Strategic planning**: Banca D’Italia identifies the risks to which the credit institution concerned is exposed and the supervisory priorities.

- **Operational planning**: Banca D’Italia plans the off-site activities and inspections to be carried out with respect to the credit institution concerned.

1. THE EVALUATION CYCLE: II) CONTROL AND ANALYSIS

According to Part I, Section I, Chapters II.3 and 4, Circolare 269/2008, the "control and analysis" phase consists of:

- A "**control**" step: Banca D'Italia verifies that the credit institution concerned complies with the relevant regulation concerning **prudential requirements** (own funds, capital buffers, liquidity, leverage, great exposures, etc.), the drafting and adoption of the balance sheet, and public disclosure requirements;

- An "**analysis**" step: Banca D'Italia examines the efficiency of the arrangements established by the credit institution concerned to address the risks it is usually exposed to, as the Internal Capital Adequacy Assessment Process (**ICAAP**), the Internal Liquidity Adequacy Assessment Process (**ILAAP**), the **recovery plan**, etc.

1. THE EVALUATION CYCLE: III) EVALUATION

On the basis of the results of the control and analysis phase, according to Part I, Section I, Chapter II.5, Circolare 269/2008, Banca D'Italia issues:

- A score – based on a range of 1 to 4 – for **each element** covered by the SREP:
  a) Business model and strategy;
  b) Internal governance and institution-wide controls;
  c) Capital adequacy and risk to capital (which includes includes credit risk, market risk, operational risk, interest rate risk, and reputational risk);
  d) Liquidity adequacy;

1 Satisfactory	2 Broadly satisfactory	3 Broadly unsatisfactory	4 Unsatisfactory

- An "**overall SREP score**" – on a range of 1 to 4, and F – which is based on the scores just mentioned and shall reflect the overall viability of the credit institution.

1 Satisfactory	2 Broadly satisfactory	3 Broadly unsatisfactory	4 Unsatisfactory	F Failing or likely to fail

2. CORRECTION AND FOLLOW UP: THE "SCORE-ACTION" CONNECTION

According to Part I, Section I, Chapter II.7, Circolare 269/2008, in deciding the most appropriate supervisory action, Banca D'Italia shall pay due attention to situations where the overall SREP score:

- Results from the average of differing SREP elements scores; in such cases, eventual corrections shall be primarily directed to those profiles showing deficiencies;
- Is steadily negative or appears to be worsening; in such cases, supervisory controls and corrections shall be increased.

According to the **principle of proportionality**, the worse the result, the more invasive the correction and follow-up:

2. CORRECTION AND FOLLOW-UP: THE “P2R” AND THE “P2G”

According to Part I, Section I, Chapter II.4.6, Circolare 269/2008, Banca D’Italia may adopt intervention measure regarding the bank capital. More precisely, Banca D’Italia may set:

	Pillar 2 Requirement (P2R)	Pillar 2 Guidance (P2G)
It consists of…	An additional capital requirement to be satisfied mainly with CET 1 instruments.	A capital target to be satisfied mainly with CET 1 instruments.
Purpose	Addressing risks or elements of risk explicitly excluded or not explicitly covered by the capital requirements laid down in the CRD IV Package.	Dealing with forward-looking stress scenarios.
Binding?	Yes. Indeed, the P2R is a “requirement.” In case of infringements, restrictions on distributions.	No, the P2G is a capital “target,” an expectation of the supervisory Authority.

2. CORRECTION AND FOLLOW-UP: BANK CAPITAL AFTER THE SREP

The Total Capital Requirement is regulated by the CRR (as amended by the CRR II and the IFR). The Combined Buffer Requirement, the Pillar 2 Requirement, and the Pillar 2 Guidance are regulated by the CRD IV (as amended by the CRD V and the IFD), and, thus, by Circolare No. 285/2013 and Circolare No. 269/2008, which transpose its provisions.

Overall Capital Requirement (OCR)

Total SREP Capital Requirement (TSCR)

Pillar 2 Guidance (P2G)

Combined Buffer Requirement (CBR)

Pillar 2 Requirement (P2R)

Total Capital Requirement (TCR):

- Own Funds = 8% TREA;
- Tier 1 = 6% TREA;
- CET 1 = 4,5 % TREA.

*TREA = Total Risk Exposure Amount, that is, bank's exposures re-determiend in considering the different risks they hold.

Capital ratios (= Capital value / Risk Weighted Assets)	UBAE specific regulatory limits as at June 2020							Ubae Capital Ratio as at 30.06.20	
	(A) Minimum Regulatory Requirement	(B) Additional Regulatory Requirement	(C) Capital conservation buffer	(D) Component Target P2G	(A)+(B) TSCR	TSCR+(C) OCR	OCR+(D) CR	ORDINARY CONDITION VS OCR LIMIT	STRESS TESTING VS TSCR LIMIT
CET1 ratio	4,50%	1,810%	2,50%	0,000%	6,310%	8,810%	n.a.	20,097%	18,560%
Tier1 ratio	6,00%	2,420%	2,50%	0,000%	8,420%	10,920%	n.a.	20,097%	18,560%
Total Capital ratio	8,00%	3,23%	2,50%	0,000%	11,230%	13,730%	n.a.	20,097%	18,560%

2. CORRECTION AND FOLLOW-UP: OTHER INTERVENTION MEASURES

According to Art. 53-*bis*(1)(d) TUB, Banca D'Italia may adopt specific **intervention measures** to address and remedy the criticalities evidenced by the SREP.

For instance, Banca D'Italia may:

- Restrict or limit the business of the credit institution concerned;
- Require the credit institution to reduce the risks inherent in its activities, products, and systems;
- Require the credit institution to limit variable remuneration as a percentage of net revenues where it is inconsistent with the maintenance of a sound capital base;
- Restrict or prohibit distributions or interest payments by the credit institution to shareholders, members or holders of Additional Tier 1 instruments; *etc.**

*Supervisory measures and **rule of law**: The lists of measures established by Art. 53-*bis*(1)(d) TUB seems to be a non-exhaustive list…

2. CORRECTION AND FOLLOW-UP: TRIGGERING "EARLY INTERVENTION"

"Early intervention" measures (see shortly) are more invasive than other supervisory measures and, thus, may be taken only under particular circumstances (Arts. 69-*octiesdecies*(1)(a) TUB), that is, when:

- The credit institution concerned has infringed the requirements established by the CRR and by Circolare 285/2013;
- The credit institution concerned is likely to infringe those requirements due to a significative deterioration of its situation.

Moreover, EBA Guidelines on Early Intervention, identifies certain circumstance which may require the application of one or more early intervention measures:

- Overall SREP score = 4; or overall SREP score = 3, and SREP score for one ore more SREP elements = 4 (paras 12-16);
- Material changes or anomalies in the key financial and non-financial indicators (paras. 17-22);
- Significant events, as significative outflow of funds, unexpected loss of key managers, significative rating downgrades, etc. (paras. 23-28).

2. CORRECTION AND FOLLOW-UP: EARLY INTERVENTION MEASURES

If an early intervention is triggered, according to Arts. 69-*octiesdecies*(1)(a) and 69-*noviesdecies* TUB, Banca D'Italia may require the credit institution concerned:

- To implement, within a specific timeframe, one or more of the arrangements or measures set out in its **recovery plan**, or to update such a recovery plan when the circumstances that led to the early intervention are different from the assumptions set out in the initial recovery plan and implement one or more of the arrangements or measures set out in the updated plan;
- To draw up a plan for negotiation on **restructuring of debt** with some or all of its creditors according to the recovery plan;
- To change its **legal structure**.

Moreover, Banca D'Italia may exercise its **removal powers**…

2. CORRECTION AND FOLLOW-UP: THE "REMOVAL" OF THE CORPORATE BODIES

Conditions	Measure
The remaining in office of one or more members of the management body, the control body, or the senior management threats the sound and prudent management of the credit institution	Art. 53-*bis*(1)(e) TUB: Banca D'Italia may remove those members of the management body, the control body, or the senior management.
➢ Serious infringements of laws or the credit institution's statute; or ➢ Serious administrative irregularities; or ➢ Significative deterioration of the bank's (financial) situation.	Arts. 69-*octiesdecies*(1)(b) and 69-*vicies-semel* TUB: Banca D'Italia may remove one or more members of the management body, the control body, or the senior management. The appointment of the new members by the credit institutions is subject to Banca D'Italia approval.
➢ Serious infringements of laws or the credit institution's statute; or ➢ Serious administrative irregularities; or ➢ Significative deterioration of the bank's (financial) situation; or ➢ Current significative losses, or expectation of significative losses; or ➢ Request from the management body.	Arts. 70 ff. TUB: Banca D'Italia may remove the management body and the internal control body and appoint temporary administrators and statutory auditors (so-called "amministrazione straordinaria").

2. CORRECTION AND FOLLOW UP: CONCLUSION

According to Part I, Section I, Chapter II.8, Circolare 269/2008, Banca D'Italia **periodically** verifies the progress in the correction of the criticalities evidenced by the SREP, and, thus, the proper implementation of the corrective measures and their results.

In the course of this **follow-up**, Banca D'Italia may opt to:

- Conclude the corrective phase and, where necessary, remove the measures applied.
- Continue the corrective phase and:
  a) Confirm the measures already adopted; and/or
  b) Apply new and more invasive measures.

THE SREP IN THE CONTEXT OF THE COVID-19 PANDEMIC

The EBA has recently issued specific guidelines regarding the Supervisory Review and Evaluation Process in the context of the **Covid-19 pandemic**. According to those Guidelines, Banca D'Italia:

- May request to credit institutions **updated information**, in particular concerning ICAAP and ILAAP (Annex 4, para. 2);
- May adjust the **timeline** of the SREP on the basis of the evolving of the crisis (Annex 4, para 7);
- May apply **flexibility** in adapting the quality of capital that credit institutions are allowed to use to meet the P2R (Annex 4, para 10);
- May tolerate that credit institutions operative temporarily below the P2G target, but it should request the credit institutions concerned to report this without undue delay.

OTHER RELEVANT MEASURES IN THE CONTEXT OF THE COVID-19 PANDEMIC

In the context of the Covid-19 pandemic, the ECB adopted different measures to ensure that credit institutions continue to **finance the real economy**. In particular:

- **Capital relief measures** (link).The ECB allowed credit institutions to operate temporarily below the level of capital defined by the P2G, the capital conservation buffer (CCB), the countercyclical capital buffer (CCyB), and the level of liquidity defined by the liquidity coverage ratio (LCR). Credit institutions will also be allowed to partially use capital instruments that do not qualify as CET 1 capital (for instance, AT 1 and Tier 2 instruments) to meet the P2R.

- **Restrictions on distributions** (link). The ECB recommended that, until 1 January 2021, no dividends are paid out and no irrevocable commitment to pay out dividends is undertaken by credit institutions for the financial years 2019 and 2020 and that credit institutions refrain from share buy-backs aimed at remunerating shareholders.

!!! These measures regard **all credit institutions**, not just the significant ones.

WHAT IF THE BANK IS “FAILING OR LIKELY TO FAIL”?

As said, one of the outcome of the SREP may be an “**F**,” meaning that the entity concerned is “**failing or likely to fail**” (FOLTF)

According to Art. 17 D.L. 180/2015, a bank is deemed as FOLTF if:

a) It infringes or there are objective elements to support a determination that it will, in the near future, infringe the requirements for continuing **authorization** in a way that would justify its withdrawal; or
b) It has incurred or it is likely to incur **losses** that will deplete all or a significant amount of its own funds; or
c) Its **assets** are or there are objective elements to support a determination that they will, in the near future, be less than its **liabilities**; or
d) It is or there are objective elements to support a determination that it will, in the near future, be **unable to pay its debts or other liabilities as they fall due**; or
e) Extraordinary **public financial support** is required (except under particular circumstances).

CONT'D: WHAT IF THE BANK IS "FAILING OR LIKELY TO FAIL"?

FOLTF assessment

↓

Any "alternative measure"?

Banca D'Italia evaluates whether the failure of the entity concerned may be avoided through:

- An intervention of the **private sector** (capital injection, M&A, etc.);
- An intervention by an Institutional Protection Scheme (IPS: in Italy, the ''Schema Volontario'' of the "**Fondo Interbancario di Tutela dei Depositanti**" (FITD)).
- Any **supervisory or early intervention measure**, including the "amministrazione straordinaria" of the entity;
- The implementation of the **write-down and conversion** of capital instruments and eligible liabilities (WDCC) power to absorb losses (Arts. 27 ff. D.L. 180/2015).

CONT'D: WHAT IF THE BANK IS "FAILING OR LIKELY TO FAIL"?

FOLTF assessment

↓

Absence of alternative measures

↓

Public interest test

Banca D'Italia evaluates whether the resolution of the entity concerned is in the "public interest" (Art. 20 D.L. 180/2015), that is:

- The resolution action is necessary and proportionate to achieve one or more **resolution objectives**, which are, according to Art. 21 D.L. 180/2015:
  - Ensuring the continuity of the **bank's critical functions** (that is, the functions which are essential for the Italian or the Union economy);
  - Protecting **financial stability** and minimizing the use of **public funds**;
  - Protecting **covered depositors**, as well as **clients' funds and assets**.
- The "liquidazione coatta amministrativa" under Arts. 80 ff. TUB would not be capable to achieve those objectives in the same way of a resolution action.

RECAP: WHAT IF THE BANK IS "FAILING OR LIKELY TO FAIL"?

FOLTF assessment

Any **alternative measure** to prevent the failure o the entity?

No: absence of alternative measures

Public interest test: Is a resolution action in the public interest?

- Yes: The entity is subject to resolution;
- No: The entity is subject to liquidazione coatta amministrativa.

Yes

Private sector interventions, supervisory and early intervention measures, application of the WDCC power, etc.

THE OUTCOME OF A RESOLUTION ACTION

The bank will **exit form the market**?

Not necessarily, but…

- In case of application of the **bail-in tool**, shareholders' rights are cancelled and other creditors' claims are converted into new shares or even cancelled (Art. 48 ff. D.L. 180/2015);
- In case of application of a **transfer tool**, the ownership of the bank or part of its business is transferred to another entity (Arts. 40-47 D.L. 180/2015). In case of partial transfer, the residual entity shall be subject to liquidazione coatta amministrativa (Art. 38 D.L. 180/2015).

THANKS!

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