Compulsory liquidation of banks using ordinary insolvency proceedings

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Introduction

In recent years, the Italian banking sector has suffered from severe difficulties, partly due to the reduction in industrial production and partly because of organisational weaknesses, fraudulent management and imprudent credit allocation policies. The Ministry of Economy and Finance and the Bank of Italy commenced a broad and complex sector restructuring, which culminated in a cooperative credit reform that will strengthen finances, promote consolidation and improve resilience to external shocks. This is the background to:

- the restructuring of Banca Monte dei Paschi di Siena;
- the November 2015 winding-up of four regional banks; and
- the rescue of two Veneto-based major national banks, Banca Popolare di Vicenza SpA (PBVI) and Veneto Banca SpA (VB), which is the subject of this update.

Administrative compulsory liquidation

Under Article 18(1)(a) of the EU Single Resolution Mechanism Regulation (806/2014), the European Central Bank (ECB) decided that PBVI and VB were "failing or likely to fail" because of their repeated breaches of the regulatory capital requirements. As a result, the Italian government considered that the conditions to place the two banks in administrative compulsory liquidation had been met. Under EU regulations, a bank that is failing is wound up using ordinary insolvency proceedings in line with the prevailing national law, unless the single resolution board (SRB) considers that there is a public interest in subjecting the intermediary to a resolution scheme. This ruling applies if ordinary insolvency proceedings "might jeopardise financial stability, interrupt the provision of critical functions, and affect the protection of depositors" (see the EU Banking Recovery and Resolution Directive (2014/59/EU)). In this case, the SRB confirmed the ECB assessment and decided that a resolution scheme was not in the public interest, as the banks' operations were not sufficiently extensive and were concentrated only in some areas of the country.

Decree-Law 99

The Ministry of Economy and Finance considered the banking sector's traditional measures for an administrative compulsory liquidation to be inadequate and insufficient. Therefore, on June 25 2017, following the Bank of Italy's suggestion, it issued Decree-Law 99 (published on the same date in the *Official Gazette* 146 and converted with amendments by Law 121 of July 31 2017, published in the *Official Gazette* 184 on August 8 2017), which placed the banks into administrative compulsory liquidation and introduced instruments to manage their financial crisis. This

measure was aimed, in particular, at avoiding a so-called 'atomistic' liquidation (ie, the gradual sale of the individual business assets which would have led to the destruction of the business value and imposed the sudden cessation of existing credit relationships). In such a case, serious national economic problems would arise, including:

- the immediate repayment of loans provided to customers; and
- the freezing of deposits exceeding €100,000 and other liabilities with negative repercussions on employment and production levels.

The decree-law set out:

- the compulsory liquidation of the two banks;
- the sale of the banks' business portfolios to Intesa Sanpaolo – an intermediary which was selected using an open, competitive and non-discriminatory procedure – which has seamlessly taken over the transferor banks' relationships with customers;
- the continuation of business and individual branch operations for the technical processing time required to implement the transfer under the decree-law; and
- cash injections of approximately €4.8 billion and the granting of state guarantees of up to €12 billion to Intesa Sanpaolo's liquidation financing to ensure the continuity of credit to the region and to manage the liquidated banks' restructuring.

The business assets sold did not include the bad loans present in the two banks' portfolios, which will be transferred to Società di Gestione delle Attività (SGA). SGA is owned by the Ministry of Economy and Finance and will carry out the management and recovery activities.

In a July 10 2017 decision, the Italian Antitrust Authority confirmed that Intesa Sanpaolo's acquisition of the two banks did not establish or strengthen a dominant market position (under Article 6(1) of Law 287/90), which could eliminate or reduce competition.

The European Commission has ruled on the compatibility of these measures with EU legislation and stated that the support measures are to be considered an application of EU law on state aid for banking (particularly the July 30 2013 banking sector communication) because:

- the existing shareholders of the two banks and the holders of subordinated bonds issued by them have demonstrated that they have fully contributed to the restructuring costs and reduced the burden of public intervention to a minimum; and
- the transferee credit deriving from the loan payment to the banks and any state recourse claim resulting from the enforcement of the banks' guarantees on the loan repayment obligations of the transferee is junior debt compared with pre-deductible credit and senior debt compared with any other credit claims against those banks.

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