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A decade of financial regulation in the wake of the crisis;
how Italian banks responded to the economic challenges posed

Crises and financial regulation: current and future developments

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I wish to thank the Marco Biagi Department of Economics for inviting me to take part in this conference on such an interesting and timely topic.

In a sector as highly regulated as the financial one, how effective and well-designed the rules are is vital in influencing banks' strategies and the ways in which the economy is financed, helping to forestall or, if poorly constructed, facilitate the outbreak of financial crises.

The title of this conference invites us to examine the rules introduced over the last decade in response to the global financial crisis, which erupted in the United States in 2007-08. Since then ten years have passed, enough time to make an initial assessment and to draw some lessons. This is what I will try to do, focusing on the key legislative developments, their effects to date, and the challenges that lie ahead.

1. How the rules responded to the financial crisis: the new regulatory framework and its implementation in Europe

The seeds of the global financial crisis were sown during the season of deregulation and ever weaker controls that characterised the 1990s, enabling the development of risk transfer methods (*the originate-to-distribute model*) in the United States that allowed banks to increase their financial leverage exponentially.[1]

In the years immediately after the onset of the crisis there was a general realisation that the prudential rules were in need of radical reform.

The first step in this direction came from the G7/G20 and the Financial Stability Board,[2] which from that moment on shaped the reform agenda and coordinated the activities of the main actors tasked with writing the rules, starting with the Basel Committee on Banking Supervision.

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[1] In essence, this model allowed banks that granted house purchase loans to transfer them to third parties, including through toxic financial derivative products, enabling them to quickly regain access to the moneys lent. Banks could then reinvest these funds to disburse other mortgage loans to customers whose creditworthiness was assessed with increasing superficiality.

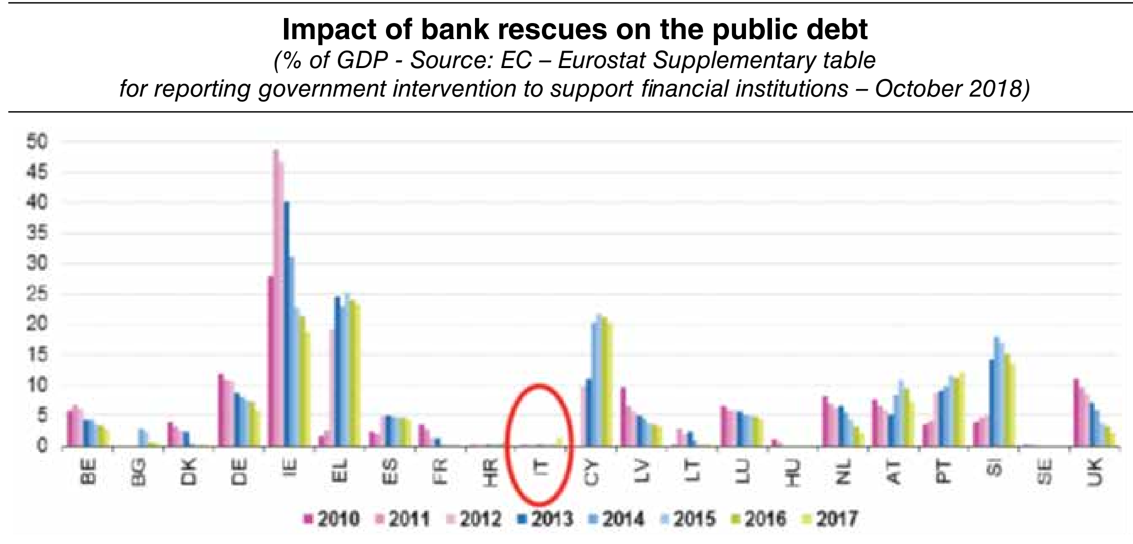
[2] In April 2009 the Financial Stability Board superseded the Financial Stability Forum.

Ten years on, much has changed. Following a wave of big bank rescues paid for by taxpayers in many industrialised countries (to a much greater extent than in Italy; see Graph 1), the rules governing banks were drastically overhauled. Prudential requirements and capital loss absorption capacity have been raised, new operating limits have been introduced, the powers of supervisory authorities have been strengthened, in the euro area supervision is now largely conducted at European level, and the crisis management system has been revolutionised to confine State bailouts to exceptional cases.

Graph 1

Impact of bank rescues on the public debt

(% of GDP - Source: EC – Eurostat Supplementary table for reporting government intervention to support financial institutions – October 2018)



Given the main causes of the financial crisis, the first area of intervention was market risk. The scope of the modifications, however, was narrow, especially by comparison with the changes introduced later on for other categories of risk.

The legislative review of July 2009 (commonly known as Basel II.5) introduced new capital requirements to counter a number of risks characteristic of the trading book and envisaged a more conservative treatment of securitisations. The approach was minimalist, with only a limited impact on the perverse incentives generated by the rules up to that point in time.

It was not until Basel III in December 2010 (*A global regulatory framework for more resilient banks and banking systems*) that the first important change was made. In Europe this took the form of the Capital Requirements Regulation (CRR), directly applicable in all member states, and the Capital Requirements Directive (CRD-IV), transposed into Italian law in June 2015. These provisions tightened up supervisory measures; raised capital levels and quality; introduced strict controls on liquidity; endeavoured to minimise risks by limiting financial leverage; increased sanctions, linking them to banks' turnover; and introduced rules on manager remuneration.

Besides the minimum capital requirements (4.5 and 8 per cent of risk-weighted assets in terms of CET1 and total capital, respectively), banks were called on to maintain additional reserves such as a capital conservation buffer of 2.5 per cent, and other buffers to counter macroprudential risks (such as the countercyclical capital buffer (CCyB) and that for global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) at national level). To these measures were added binding and non-binding discretionary requirements for supervisors (binding Pillar 2 Requirements, for risks not included in the first pillar, and non-binding Pillar 2 Guidance for risks revealed by stress tests). At the same time, rules were introduced for the remuneration of management and risk-takers in order to promote prudent risk taking and a plan was drawn up to revise a number of accounting principles to reduce the procyclicality of budgetary assessments.

From an institutional vantage point, Europe's response to the crisis was even more striking and ultimately resulted in a considerable transfer of power to European institutions.

Initially – between 2010 and 2011 – these interventions were confined to monitoring systemic risks for the entire financial system of the Union and to promoting the convergence of supervisory practices in the banking, financial and insurance sectors. These objectives were pursued through the establishment of the European System of Financial Supervision (ESFS), which had two main components. First, macroprudential supervision by the European Systemic Risk Board; and second, microprudential supervision by the three European Supervisory Authorities (ESAs) i.e. the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

With the emergence of the sovereign debt crisis the project took a decidedly ambitious turn, that of creating a *bona fide* Banking Union, to be established rapidly and given an especially wide-ranging mandate.

The decision to act as swiftly as possible reflected the need to give an immediate sign of willingness on the part of Eurozone countries to pursue an ever closer union in order to combat growing distrust in the single currency. The speed of its implementation, however, cancelled the inherent benefits of a more gradual transition which, in addition to facilitating smoother adaptation by the national authorities, could have cushioned the blow administered to banks that were less well capitalized. This problem emerged very clearly for Italy's banks – which had not attained the capital levels reached thanks to the State aid granted in many other European countries – at the end of the 2014 comprehensive assessment, which was heavily focused on credit risk.

The intensity of the crisis also explains the decision to pursue sweeping change and not just do the bare minimum required to restore trust. Indeed, it was not enough to aim for greater convergence of national supervisory authorities or, alternatively, the pooling at European level of the supervision of cross-border

banking groups only. The choice was far more radical: at the end of 2014 controls at Eurosystem level were extended to the entire banking system and concerned both supervision *tout court* (through the Single Supervisory Mechanism) and crisis management (through the Single Resolution Mechanism).

It could be objected that the changes were ultimately not so radical, given that supervision (and crisis management) for 'less significant' banks have remained at national level. Yet it is worth remembering that all the key authorization procedures for all banks were centralised in Frankfurt, including for the less significant banks, over which the ECB exercises ample discretion in its interaction with the national authorities.

In the meantime, the European Commission had introduced (in its August 2013 Communication) strict limits on public bailouts in the banking sector, which surprisingly considered as a possible form of State aid the interventions by the national deposit guarantee funds other than the reimbursement of insured deposits, following a case-by-case assessment.[3] This was a vital step, insofar as from that moment onwards State aid was admissible only *after* involving shareholders and junior debtholders in burden sharing. Moreover, the need for approval by the Directorate-General for Competition of the European Commission of every measure entailing the use of public resources – including, if necessary, the presentation of a specific restructuring plan by the beneficiary bank – ultimately conferred on the DG powers that were *de facto* analogous to those of an additional supervisory authority in the cases submitted to its scrutiny.

In Italy this did not come to the public's attention until the end of 2015 when, based on a particular interpretation of the abovementioned Communication, the Commission blocked the use of the Interbank Deposit Protection Fund for managing crises at four small- to medium-sized Italian banks.

Following on from the 2013 Communication, in May 2014 the Bank Recovery and Resolution Directive (BRRD) was approved and transposed into Italian law in November 2015. This law also signalled a sea change, this time round in the approach to crisis management, which was separated from supervision. I will now highlight the most important of these changes.

The adoption of 'early intervention' measures in the event of a rapid deterioration in the conditions of the supervised entity, transforming the extraordinary administration insolvency procedure enshrined in Italian law from a legal to a supervisory measure.

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3 See par. 63 of Commission Communication 2013/C 216/01, which *inter alia* states that 'Whilst the funds in question may derive from the private sector, they may constitute aid to the extent that they come within the control of the State and the decision as to the funds' application is imputable to the State'.

To apply the special 'resolution' procedure, designed to 'ensure the continuity of critical functions' when there is a 'public interest' in doing so, now requires a declaration that a bank is failing or likely to fail; in the absence of this interest the ordinary resolution procedure applies. Resolution funds are established to help meet the resolution objectives.

The principle whereby the cost of bank rescues must no longer be borne by taxpayers but by banks' creditors other than insured deposit holders (*bail-in*) has been formalised and is much broader in scope than burden sharing, though on paper it has been counterbalanced by the introduction of the Minimum Requirement for own funds and Eligible Liabilities (MREL), along the lines of the Total Loss Absorbing Capacity (TLAC) foreseen instead by the Financial Stability Board for global systemically important banks.

Exceptional State intervention is subject to a series of conditions that constitute a genuine obstacle race: i) it can only be made in favour of solvent banks and only when required to counter a serious economic shock in the country and to preserve financial stability; ii) it is confined to 'extraordinary public support measures', i.e. to guarantees or an injection of own funds (*precautionary recapitalisation*), when required to plug capital shortfalls revealed by stress tests; iii) it is subject to approval by the European Commission under the rules on State aid; and, iv) it must not be used to compensate for losses already recorded or likely to be so in the near future.

The long season of international legislation reform neared completion with the 'finalisation' of Basel III (Finalising post-crisis reforms) *in December 2017. The agreement is designed to reduce the excessive variability of risk-weighted assets and to increase their transparency and comparability, to enable a more accurate assessment of banks' risk profiles.*[4] *As we shall see later on, some measures go towards introducing elements of proportionality into the rules. In May of last year the European Commission started to prepare for the transposition of the agreement, calling on the technical support of the EBA, also in order to assess in advance the impact on the banking system and on Europe's economy.*

Though not a strictly legal intervention, regarding the main changes to the rules it is also worth noting the ECB's initiative of March 2018, namely the addendum to its guidance on non-performing loans.[5] In January 2019 it emerged

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4 The measures approved aim to restore market confidence in the methods for calculating risk-weighted assets, by: i) limiting the use of internal models; ii) improving the robustness and risk sensitivity of standard calculation methods for credit and operating risks; iii) introducing an *output floor* for the risk-weighted assets of banks that use internal models.

5 With reference to the flows of new non-performing exposures, the addendum envisages increasingly high coverage ratios of up to 100 per cent at different points in time, which can vary depending on whether exposures are secured or unsecured (*calendar provisioning*).

how, in the course of its annual bank by bank assessments, the ECB had expressed similar expectations with reference to the disposal of the stock of non-performing loans, albeit on a case by case basis.

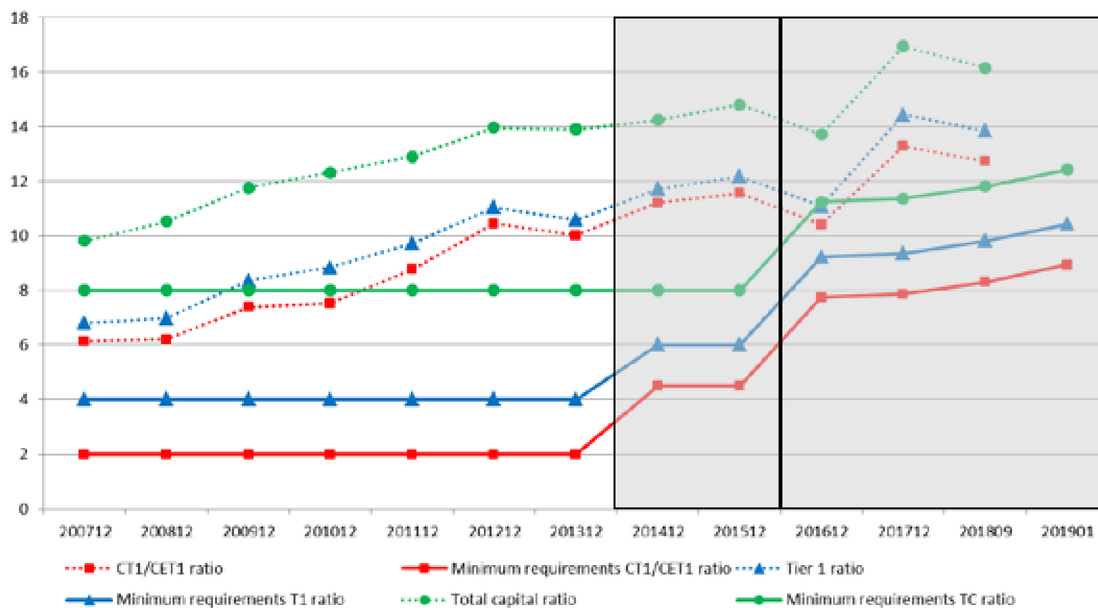
2. The impact of the new rules on the equilibrium of banks’ finances and capital structure

Among the main positive outcomes of the new rules that deserve mention, at least as far as European banks are concerned, are their sounder capital structures and the reduction in credit risk.

This is especially true of Italian banks, which have successfully responded to the progressive ‘raising of the bar’ of capital ratios since 2014 imposed by the implementation of Basel III, by doubling their capital, notwithstanding the enormous difficulties caused by the global financial crisis (see Graph 2, which relates, as do the following graphs, to significant banks only, accounting for three quarters of the banking system’s total assets).

Graph 2

Comparison between actual capital ratios and the minimum requirements
(significant banks; end-of-period data and per cent)

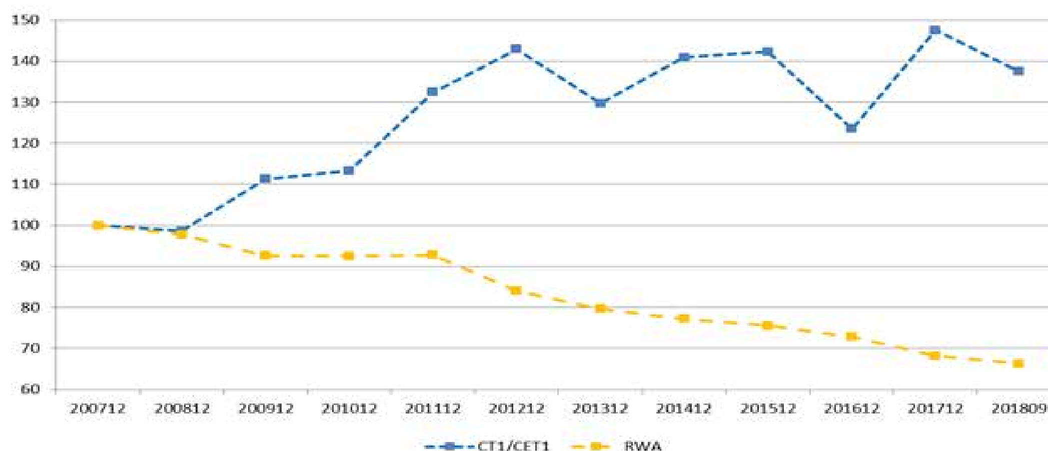


The shaded area highlights the transition to Basel III (1 January 2014). Prior to that, the highest-quality capital was called ‘Core Tier 1(CT1)’ (or Tier 1 net of hybrid/innovative instruments); this became ‘Common Equity Tier 1 (CET1)’. The black vertical line indicates the period in which the second pillar requirements entered into force (P2R) under the SSM (starting in 2016). More than half of the reduction in the CET1 ratio observed between December 2017 and September 2018 is ascribable to the reduction in the prices of government securities.

Italy’s banks have succeeded in this thanks partly to the increase in regulatory capital and partly to measures to reduce risk (see Graph 3).

Graph 3

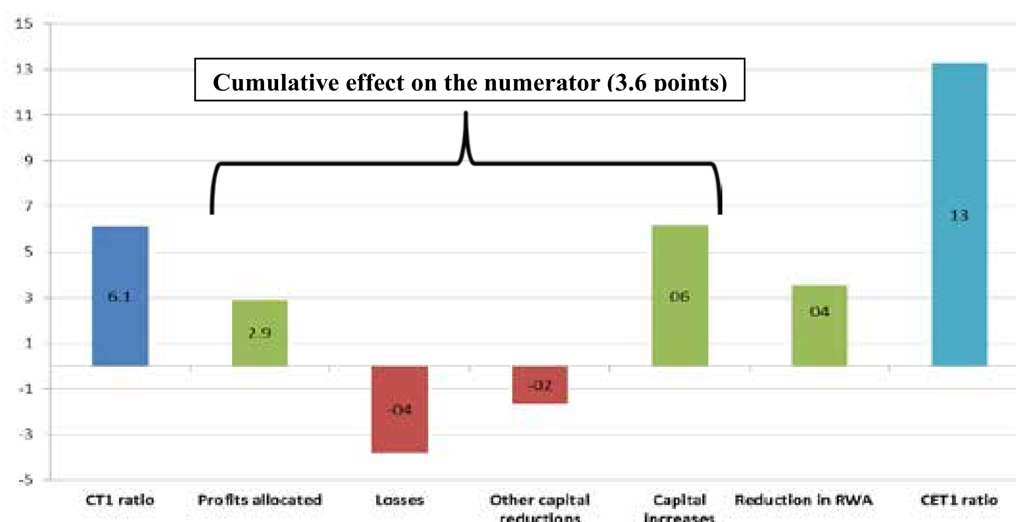
Trend in CT1/CET1 (numerator) and RWA (denominator)
(significant banks; indices; 2007=100)



As a result of the forceful action taken to reduce risk, entailing substantial loan losses, during the period considered losses (€44 billion) exceeded profits allocated to capital reserves (€34 billion). It was therefore only because numerous capital increases were made in that period (over €73 billion) that it was possible to significantly increase regulatory capital (see Graph 4, 'total numerator effect').

Graph 4

Change in CT1/CET1 ratio between 2007 and 2017
(significant banks; end-of-period data; per cent)

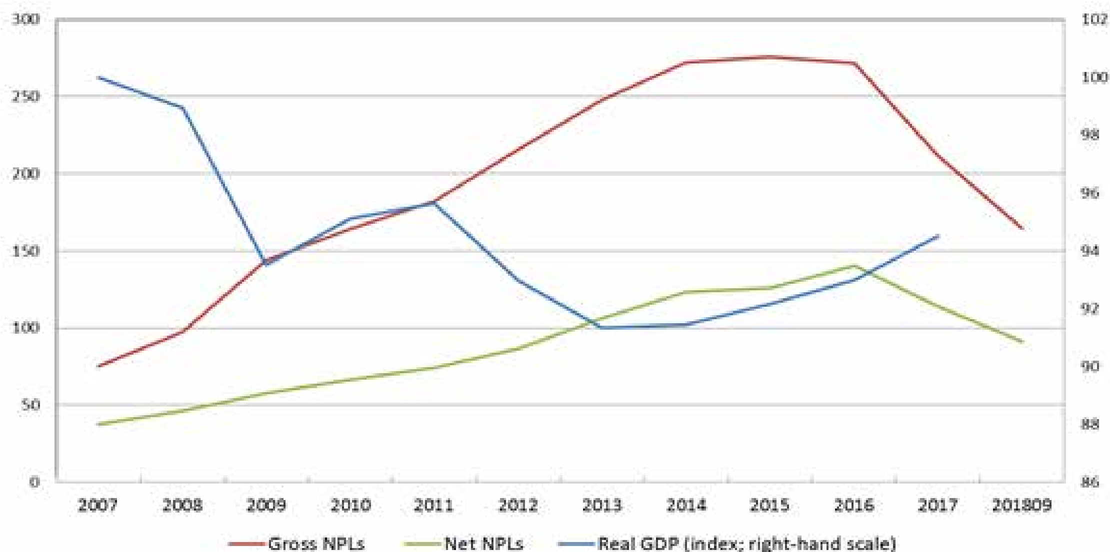


The measures to reduce credit risk – which had built up mainly owing to the double-dip recession that struck Italy[6] – began to affect the stock of NPLs starting in 2016 (see Graph 5).

6 See I. Visco, *Anni difficili*, il Mulino 2018, Chapter 4 'Crisi finanziaria e banche italiane'.

Graph 5

Trend in real GDP and NPLs (gross and net)
(significant banks; billions of euros and indices; 2007=100)



In September 2018, the gross NPL ratio of Italian banks was 9.8 per cent, compared with 16.5 per cent at the end of 2015. Net of provisions, the corresponding values were 4.8 and 9.8 per cent. More than 50 per cent of net NPLs were UTP (unlikely to pay).

From that year on, the figure plummeted thanks to large market disposals and the progressive decline in the flow of new non-performing loans. The disposals were mainly of bad debts and, as mentioned earlier, had a significant effect on profitability. Their cost might have been substantially lower had the European Commission allowed the rapid constitution of an asset management company for the banking system, as other European countries had done prior to 2013.

Over the last two years, the decrease in loan loss provisions, on the one hand, and the decline in operating costs, on the other, have helped to restore profit levels. However, the downward trend of operating costs is being matched by an even sharper downturn in net revenues (see Graph 6).

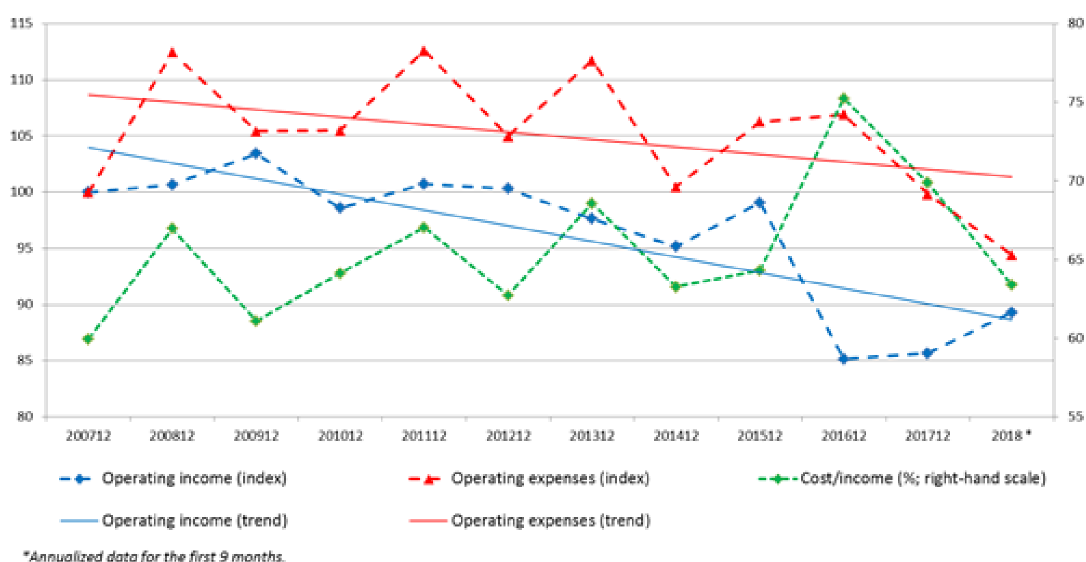
The reduction in net income – which can be put down to the decline in interest income and, more recently, to the fall in trading profits – means that the banks must continue in their efforts to reduce operating expenses and to ensure that the cost of risk continues to fall (see Graph 7), though this trend could be interrupted by the poor outlook for the country’s economy.

More generally, the ‘higher bar’ of capital ratios and the heavy pressure from the supervisor to reduce both credit and liquidity risk could trigger a structural change in the business model of banks as they are encouraged less and less to grant loans and more and more to focus on fee income in the struggle to achieve a satisfactory return on equity.

Graph 6

Trend in operating costs and operating income

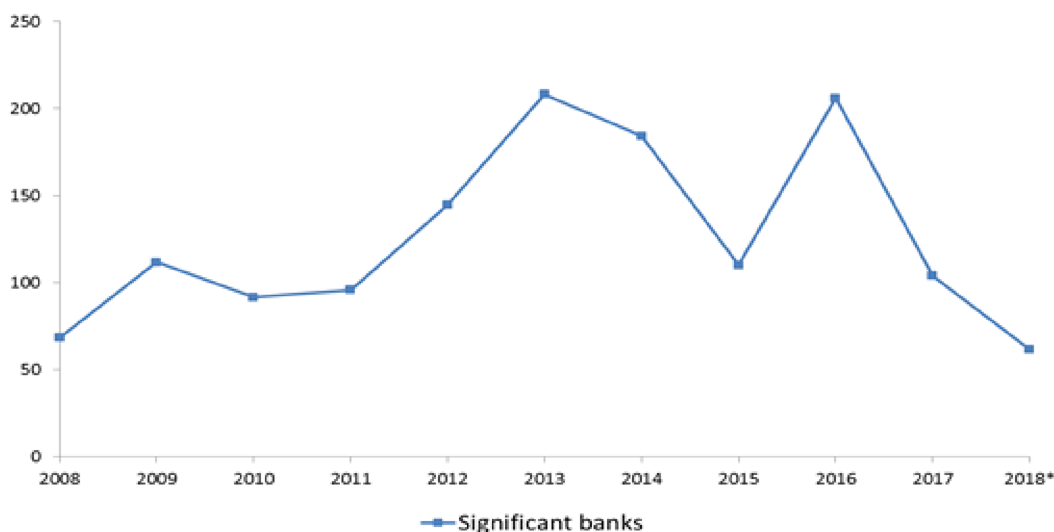
(significant banks; end-of-period data; indices (2007=100) and per cent)



Graph 7

Cost of risk

*(loan loss provisions/net loans; basis points; *the data for 2018 refer to the first nine months)*



3. Rules and pro-cyclicality

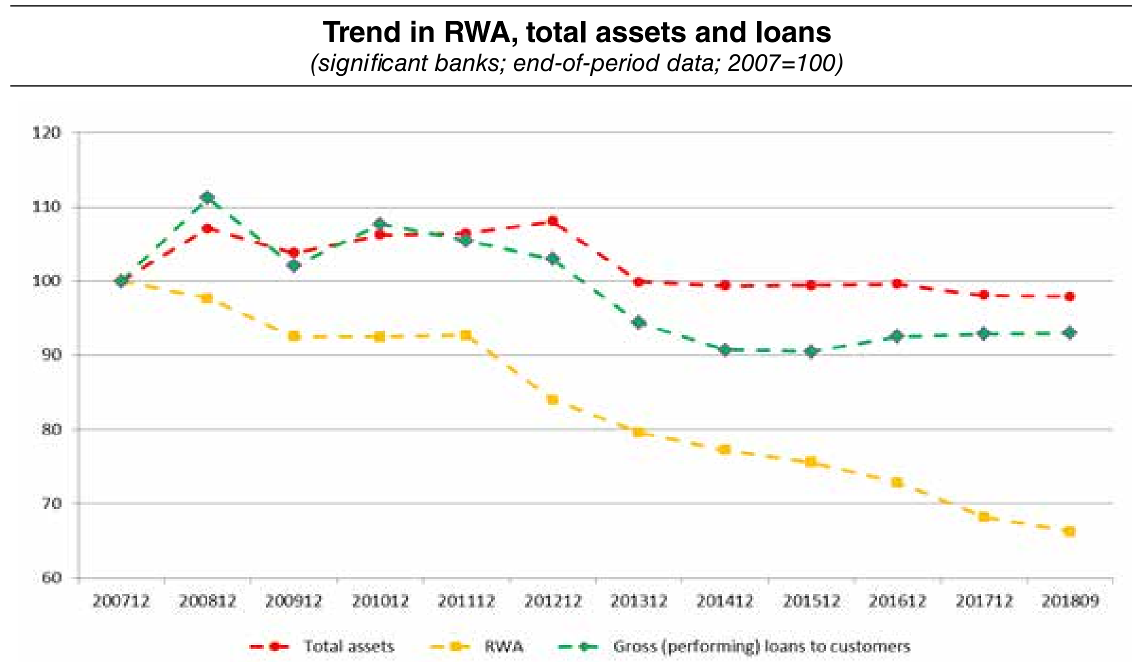
Although the introduction of the new, higher minimum capital requirements was spread over a relatively long period of time, it occurred in an adverse cyclical phase, contradicting the macroprudential spirit underlying the regulators' original intention.

In some countries, including Italy, the timing was particularly unfortunate. The tightening of the rules coincided with the worst economic crisis in the country's history. The figures are well known: between 2007 and 2013, GDP fell by 9 per cent, industrial output by almost a quarter, and investment by a little less than 30 per cent. In the following years, GDP growth has remained weak, never exceeding 1.5 per cent.

Against this background, the measures taken to reduce risk-weighted assets were also prompted by a contraction in loans to customers (see Graph 8),[7] which fell from €1,350 billion to €1,250 billion during the period in question.

Graph 8

Trend in RWA, total assets and loans
(significant banks; end-of-period data; 2007=100)



The financial crisis and the protracted recession that ensued, especially in some countries, drew the authorities' attention back to the question of the pro-cyclicality of prudential rules, a subject widely debated in the course of the preparatory work for the previous package (Basel II).

The phase-in period envisaged by the legislator certainly helped (and will help as regards that part of the package not yet transposed) to ease the cost to banks of adapting to the rules. However, several theoretical and empirical studies have shown that in the short term capital strengthening tends to curb credit supply, particularly in periods of weak growth. Recent studies by the Bank of Italy confirm

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[7] Other contributory factors were the re-composition of assets, the optimisation of RWA, and the validation of models.

that in some cases an increase in banks' capital ratios brought about – at times unexpectedly – by regulatory and supervisory measures appeared to slow the recovery of lending to households and firms and the revitalisation of economic activity.[8]

Banks' tendency to restrict the granting of credit may be offset, at least partially, by the development of the European Commission's Capital Market Union project, designed to direct an increasingly broad range of sources of funds towards business, including small and medium-sized enterprises.

To date, however, the project has not fulfilled its early promise. In Italy, in particular, bank credit has only been replaced by other forms of finance to a very limited extent and only for a small number of firms, basically leaving Italy's bank-centric financial system unaltered. As the Governor recently pointed out, 'A diversified financial system allows the economy to limit the effects of adverse shocks. In countries where market finance is more developed, the contraction in lending triggered by the global financial crisis has been more easily offset by firms stepping up their recourse to the bond market and to non-bank finance, and the negative effects on the economy have been overcome sooner'.[9]

4. Rules and proportionality

The increasingly complex rules and higher capital ratios that have followed the financial crisis in recent years have put the question of regulatory proportionality centre stage.

With some exceptions, the European Parliament has taken a 'one size fits all' approach, so that the Basel standards – though primarily directed at banks that operate globally – apply uniformly to all banks and investment companies, regardless of their size or degree of interconnectedness. The European supervisor, in turn, while leaving some autonomy to national supervisory authorities over less significant banks, has tended to bring this category of institution within the scope of the rules applying to significant banks.

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[8] See Conti A.M., A. Nobili and F.M. Signoretti (2018), 'Vincoli al capitale bancario, offerta di credito e attività economica', Banca d'Italia, Temi di Discussione (Working Papers), 1199, 6 November.

[9] See I. Visco, 'La finanza d'impresa in Italia: recente evoluzione e prospettive', Milan, 13 February 2019, page 5.

In the United States and Japan efforts have instead been directed more towards adapting international standards to the structure of the domestic banking system, giving greater importance to the different systemic nature of their banks.

In the United States, the Basel rules apply *in toto* to only two specific categories of large banks, which are subject to 'reinforced supervision' by the authorities.[10] Small and mid-sized banks, on the other hand, have a simplified regulatory regime, which exempts them from a number of requirements (for instance, relating to liquidity and leverage).[11]

In the Mnuchin[12] report published in June 2017, the US Department of the Treasury recommended: a) exempting community banks[13] from the Basel risk-based regulatory regime and the Volcker rule and introducing a simplified ad hoc system; b) applying to all credit unions[14] a set of capital rules based solely on leverage requirements; c) totally exempting from stress tests all banks with assets below $50 billion; and d) exempting from risk-based prudential requirements, stress tests and the provisions of the Volker rule all banks with a leverage ratio above a given threshold, regardless of size or risk profile.

Japan has opted for a less structured approach than the United States, establishing just two macro categories of banks: i) international banks, which are subject in full to the Basel standards, and ii) non-international banks, subject to national rules which, though not dissimilar from the Basel standards, differ from them in some important respects. Non-international banks are in fact subject to less stringent minimum capital ratios[15] and are exempt from the rules on liquidity.

A need for greater proportionality has been voiced by the banking industry and emerges from the literature. Although the arguments in favour differ, they have a common denominator in that the costs of compliance are particularly high for small and mid-sized banks. The risk is that insufficiently proportionate rules will cause the market to become overly concentrated within a few large banking groups, to the detriment of small and mid-sized banks, which will eventually carry

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10 These are 'advanced' banking groups (i.e. banks with total assets in excess of $250 billion or with foreign currency exposure above $10 billion) and regional banks (banks with total assets from $50 billion to $250 billion).

11 Mid-sized banks are those with total assets from $10 to $50 billion and 'small' banks those with total assets of less than $10 billion.

12 *A Financial System That Creates Economic Opportunities • Banks and Credit Unions*, Steven T. Mnuchin, Craig S. Phillips, U.S. Department of the Treasury, June 2017.

13 Local banks with total assets of less than $10 billion mainly doing business with retail consumers and lending to small and medium-sized enterprises.

14 Local, member-owned cooperative banks.

15 For example, the minimum capital requirement is 4 per cent of risk-weighted assets, instead of the 4.5 per cent established by the Basel rules.

only minimal weight and abandon their support of the local area. These arguments are very strongly felt in bank-centric economic systems such of those of mainland Europe, where firms – especially small ones – have difficulty obtaining finance directly on the financial markets. It is a well-known fact that Italy is among this group of economies.[16]

In the last two years, European regulators have debated the need for increased proportionality and the best way to respond to it given the importance of the issue. For example, in re-casting the CRR/CRD-IV package of banking rules, the European legislator will introduce forms of proportionality in reporting, disclosure, the rules on remuneration, and the methods of calculating market and counterparty risk.

The changes now being finalised include a reduction in the frequency and/or granularity of information provided with reporting and disclosure, the exemption of small banks (with total assets of less than €5 billion) from the more complex rules on remuneration, and simplified methods of calculating capital requirements in respect of counterparty risk and market risk for banks that only trade in financial instruments and derivatives on a limited basis.

Compared with practices in the United States and Japan, these are only small steps towards introducing more effective forms of proportionality in Europe. In addition to a regulatory environment unaccustomed to this principle, there is a need for small banks to obtain economies of scale that will enable them to make sufficient investment in new technology and to eliminate non-performing loans more easily by activating closer forms of cooperation or processes of consolidation.

5. The difficulties of crisis management

The basic objectives of the rules for managing banking crises introduced by the BRRD are worthy ones: to discourage moral hazard and the excessive risk-taking originating in implicit public guarantees of banks' liabilities, and to ensure that bank failures can be handled in an orderly manner, with no negative repercussions for financial stability or the public finances. However, some of the solutions identified in the BRRD rules to implement these objectives have drawbacks or are difficult to put into practice.

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[16] In Italy, the banking system's central role in channelling finance to business is confirmed by data on the whole 'corporate system'. In 2017, the share of Italian firms' bank loans in total liabilities decreased to 19 per cent (compared with 25 per cent in 2011), although it is still 6 percentage points higher than the euro-area average.

The entry into force of the bail-in in 2016 – a much broader provision than the burden sharing envisaged in the European Commission's 2013 Communication – was overhasty, seeing as it long preceded one of the essential prerequisites for it to work, namely that banks must identify a set of liabilities that can be reduced or converted into new capital under the resolution procedure (MREL), preferably held by professional investors who are aware of the possible consequences in the event of a failure.[17] If this condition is not met, a bail-in is practically inapplicable and 'risks undermining confidence in banks and creating instability'.[18] These difficulties in implementation are likely to last a long time, given that that the MREL will not be fully phased in until 2024.

As regards the new MREL rules, drawn up as part of the revision of the BRRD, it is doubtful whether, despite the generous transition period, they can strike a balance between the need to ensure full resolvability for banks with that of avoiding negative repercussions on banks' financing capacity, which is equally worthy of protection. This is because the amount of loss-absorbing capacity, especially of subordinated debt, that will be required of European banks has been set at a particularly high level, in some cases even higher than that decided by the TLAC for the larger banks. It is therefore to be hoped that the SRB makes wise use of the discretionary powers conferred on it by the new rules, taking account of the market's limited capacity to absorb the potentially high amount of new liabilities that will have to be placed by European banks.

Another critical aspect of the BRRD is its requirement of the existence of a 'public interest' in order to initiate a bank's resolution, which leaves ample room for interpretation. In practice, the very narrow interpretation given to it by the SRB means that, if a declaration of 'failing or likely to fail' is made, only a hundred or so banks out of around 3,000 in the Eurozone would be put into resolution, while the only possibility for the others would be liquidation, to be carried out according to non-harmonised national rules. In the absence of a buyer to which to transfer the assets and liabilities of the bank to be liquidated – ideally within the space of a weekend – the only option is an 'atomistic' liquidation procedure, which destroys value for all the stakeholders of the liquidated bank, undermining public trust in the banking system. The destruction of value linked to fire sales would actually be passed on to the bank's creditors, including uninsured deposit holders. The

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17 The Bank of Italy has remarked on more than one occasion that the introduction of the bail-in should have been preceded by a longer preparatory phase than that envisaged by the BRRD, in order to allow the banks to assemble an adequate amount of eligible liabilities. See, in particular, *Italy non-paper on bail-in*, 12 March 2013, https://www.bancaditalia.it/pubblicazioni/interventi-governatore/integov2016/BRR_ITALY_nonpaper_bail-in.pdf and page 39 of the *Financial Stability Report*, November 2016.

18 See F. Panetta, *Credito e sviluppo: vincoli e opportunità per l'economia italiana*, Bologna, 30 January 2019, page 5.

probable tightening of credit that would follow the dispersion of information on customers' credit history and dealings could have negative consequences for the local economy.

This 'two-track' regulatory regime ends up by segmenting the banking system and could give rise to inefficient processes for reallocating customers and disintermediating small and medium-sized banks. This risk could be mitigated by permitting the use of deposit guarantee schemes – by means of interventions other than reimbursing insured deposits based on the 'least-cost' principle – both in the phase preceding the announcement of a failure, and in the event of liquidation, following the example of the Federal Deposit Insurance Corporation (FDIC).[19]

Vice versa, the nature of the State aid attributed by the European Commission to such interventions means that the failure of a bank is declared automatically and, therefore, that liquidation begins for those banks for which no 'public interest' exists. In this way, a longstanding national tradition of crisis management has come to an end – one which could have been used, for example, to make the resolution of the four banks much less costly – and yet no alternative but equally effective instruments have been provided.

In addition, the room for manoeuvre of the institutions governed by the same European regulations is still unclear and overly narrow and sometimes the European Commission's tasks and powers are confused with and overlap those of the other authorities. For example, less uncertainty would be opportune in the use of particularly important instruments, such as precautionary recapitalisations, for which the margins of interpretation seem fairly broad, or declarations of 'failing or likely to fail'.

Lastly, the issue of the European Deposit Insurance Scheme (EDIS) remains unresolved. The requests to significantly reduce some of the risks found on banks' balance sheets before their mutualisation have so far hindered the establishment of the EDIS. Conversely, the two objectives should have been pursued in parallel, bearing in mind that the mutualisation of risks necessarily involves their reduction. Furthermore, those who emphasise the need to reduce risks insist on championing a

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[19] As F. Panetta points out (*op. cit.* p. 6), the Agency has dealt with a large number of bank crises – over 500 in the last decade – with negligible repercussions for the economy and for savers. See I. Visco, 'Speech by Governor Visco at the 25th Congress of ASSIOM FOREX', Rome, 2 February 2019, page 10.

distorted proposal, which completely neglects market risks, while there is evidence that these risks are similar if not greater than those implied in NPLs.[20]

6. Conclusions

As has already been indicated, the global financial crisis produced a strong and extremely incisive regulatory response in the Eurozone, thanks also to the centralisation of the supervision and management of banking crises. This has considerably improved the soundness of banks' capital positions and has helped to significantly lower credit risks, though it has not proven equally effective in keeping market risks under control.

Raising the bar for capital ratios and the strong pressure from the supervisory authorities to reduce credit and liquidity risks are changing the DNA of the business model of commercial banks, which are increasingly fee-based and oriented towards cost-saving, in the difficult pursuit of an adequate return on capital.

The capital strengthening process, which was introduced at a particularly adverse moment in the economic cycle, has probably contributed to holding back the recovery in lending to Italian households and firms; nevertheless, the lesser amount of bank credit available has yet to be adequately replaced by alternative forms of funding, which would be desirable in order to create a more diversified financial system.

Another aspect that has characterised the reform of the rules in Europe is the application of the 'one size fits all' principle, even though corrective measures of this kind are beginning to make headway.

Lastly, I have highlighted the limitations of the rules for crisis management, calling for increased synchronicity between the bail-in and MREL, greater attention to crisis resolution procedures for small and medium-sized banks and the need to rethink the assimilation to State aid of alternatives to deposit protection funds.

In short, the reform of the rules following the financial crisis has undoubtedly been extremely useful, but at the same time there is considerable room for improvement, which should include a discussion that is open to international input and that prioritises financial stability and economic growth.

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[20] See 'Risks and Challenges of Complex Financial Instruments: an Analysis of SSM Banks', R. Roca, F. Potente and others, Questioni di Economia e Finanza (Occasional Papers), Banca d'Italia, December 2017, page 25.

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