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The Theory, Practices and Future Perspectives of the EU Precautionary Recapitalization

by

Edoardo D. Martino*
and
Andrea Perini**

The key policy objective of the post-financial crisis is to ban bailouts, especially for solvent banks. Precautionary recapitalization is an instrument of flexibility in the post-financial crisis regulatory framework that allows solvent but undercapitalized banks to receive capital aids under strict conditions, including the temporary nature of the aid. However, this instrument confronts a credibility issue as the public ownership of financial institutions persists several years after the use of precautionary recapitalizations. We analyze the legal and economic reasons that make the temporary nature of precautionary recapitalizations de facto *unenforceable, proposing an analytical framework to approach the matter. In so doing, we challenge the consensus approach to the design of public interventions in banking, which focuses on the trade-offs between minimizing ex-ante moral hazard of bankers, preserving financial stability, and protecting taxpayers. We show that this approach is incomplete as it overlooks the ex-post effects of the intervention, jeopardizing its ex-ante credibility as well. Against this backdrop, we examine the implementation of precautionary recapitalization in the cases of National Bank of Greece, Piraeus Bank, and Monte dei Paschi di Siena. The analysis identifies the key factors undermining the temporary nature of the recapitalizations; specifically, the assessment of the bank's solvency, the timing of recapitalization, the type of instruments employed, and the political economy of the recapitalization process. Finally, we briefly confront our findings with the Commission's Crisis Management and Deposit Insurance (CMDI) proposal. We show that the CMDI wants to address the symptoms rather than the causes when reforming precautionary recapitalization, proposing an overly rigid system that is prone to abuses and political distortions.*

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1. *Introduction*

The relationship between banking, competition and public intervention during crises is complex and tense.[1] States do not want to let a bank fail for political considerations and as well as to preserve financial stability and market confidence. In turn, banks may take advantage of this expectation, engaging in excessive risk-taking and relying on implicit State guarantees. This interaction overall decreases competition in the banking market, reducing social welfare.

This tension reached its peak during the Global Financial Crisis that started in 2007. In Europe, this led to a series of massive bailouts throughout the whole Eurozone crisis, until 2012. To address this situation, the EU completely changed its policy, issuing a Banking Communication on State Aid in 2013 and establishing a new resolution framework for ailing banks, within the wider Banking Union project.[2]

1 See, for instance, *Franklin Allen/Douglas Gale*, “Competition and Financial Stability”, Journal of Money, Credit and Banking, 2004, 453; *John H. Boyd/Gianni De Nicolo*, “The Theory of Bank Risk Taking and Competition Revisited”, The Journal of Finance, 2005, 1329; *Mathias Dewatripont*, “European Banking: Bailout, Bail-in and State Aid Control”, International Journal of Industrial Organization, 34, (2014), 37; *Joaquín Maudos/Xavier Vives*, “Competition Policy in Banking in the European Union”, Review of Industrial Organization, 55, (2019), 27.

2 Communication from the Commission on the application of State aid rules to support measures in favour of banks in the context of the financial crisis (‘Banking Communica-

Under the current regime, no public aid can be granted before a substantial private sector involvement – the so called 'burden-sharing' – which aims at reducing taxpayers' exposure and ex-ante moral hazard from bankers. Moreover, any public aid to banks implies that the bank is 'failing or likely to fail' and should be resolved or liquidated accordingly.[3]

This strict 'no bailout' policy should eradicate the problem of public ownership in banks, minimizing the distortions to the competitiveness of the banking market that comes with it.[4] However, one decade later, this goal seems far to be reached, despite substantial steps forward. The recent banking turmoil of 2023 highlights that elements of flexibility in the use of public funds are perhaps unavoidable to limit financial stability concerns despite the distortions they bring about. Through these lenses, we can understand the massive emergency liquidity assistance provided by the Swiss National Bank to UBS and backed by the Swiss State to facilitate the acquisition of Credit Suisse.[5] A similar argument goes for the triggering of the 'systemic risk' exception used by the US Congress to limit the run on uninsured deposits, allowing all banks to post collateral at par value for one year – the Bank Term Funding Program (BTPF) – resulting *de facto* in a massive bailout whose fiscal consequences are, to date, unclear.

The situation is further complicated by the fact that, to date there are still several distorted incentive mechanisms that create inefficiencies in the regulatory system. In particular, on the one hand, ample evidence shows that incentives for bankers are still leading toward the immediate recognition of the gains and the postponement of losses.[6] Therefore, interventions in a distressed bank happen too late. In this regard, the recent cases of Credit Suisse and Silicon Valley

tion'); Directive (EU) 2014/59 establishing a framework for the recovery and resolution of credit institutions and investment firms ('BRRD').

3 Article 32(4) BRRD.

4 Communication from the Commission on the application, from 1st August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), para. 7.

5 *Edoardo D. Martino/Casimiro Nigro/Tom Vos*, "CoCos in Europe: What Is Wrong – and How to Fix It?" Euroepan Banking Institute Working Paper Series, 2024, available at: https://papers.ssrn.com/sol3/-papers.cfm?abstract_id=4810761 (last accessed: 4 March 2025).

6 *Natalya Martynova/Enrico Perotti/Javier Suarez*, "Capital forbearance in the bank recovery and resolution game" Journal of Financial Economics, 2022, 884. On the peculiarities of banks and on their differences with ordinary corporations, see *Marco Becht/Patrick Bolton/Ailsa Röell*, "Why bank governance is different", Oxford Review of Economic Policy, 2011, 437.

Bank are paradigmatic cases of late intervention and distorted incentives.[7] On the other hand, it is broadly acknowledged that private actors do not have incentives to take early action in the crisis.[8] Moreover, the banking market in many countries, including the Euro Area countries, is illiquid, so that private solutions through mergers are often a non-viable solution.

Departing from this unsatisfactory state of facts, this article analyses the EU 'precautionary recapitalization' tool. This tool, holding a series of conditions, allows solvent but undercapitalized banks with no potential private buyer to apply for State aid, including in the form of capital injections. While this tool provides flexibility in handling crises, it also comes with costs. Some are straightforward, and namely, the direct fiscal cost of the aid and the increased moral hazard incentives for undercapitalized banks. However, there is a further key cost that has been overlooked by the academic debate and that represents the core of our analysis: the ex-post costs of having a bank in public ownership without being able to divest from it. In fact, while EU law stresses the 'temporary nature' of the precautionary recapitalization, first implementations highlight that such a temporary clause is difficult, if not impossible, to enforce, in line with the international evidence on the persistence of public ownership in banking and the complexity of divestment.[9]

Having regard to this aspect, this paper assesses if and how – under the current regulatory framework – it is possible to enforce precautionary recapitalization's temporariness when a market solution does not seem possible. We contend that the framework's inability to ensure a prompt divestment poses a serious threat to the credibility of the whole resolution system and contradicts the principles governing the post-Global Financial Crisis regulatory system, imposing additional costs to taxpayers (a precautionary recapitalization which is,

7 An in-depth analysis of the Credit Suisse case is outside from our article's scope, but more information can be found at *Martino/Nigro/Vos* (fn. 5). On the point, see also *Enrico Perotti*, "The Swiss authorities enforced a legitimate going concern conversion", VoxEU-CEPR, 22nd March 2023, available at: https://cepr.org/voxeu/columns/swiss-authorities-enforced-legitimate-going-concern-conversion (last accessed: 21 November 2023).

8 A clear example of this lack of incentives stems from the evidence that perverse accounting standards are at the root of the Silicon Valley Bank's collapse: Reuters, "U.S. Fed may reverse rules that masked losses on SVB's securities – WSJ", 21st April 2023, available at: https://www.reuters.com/markets/us/us-fed-works-loophole-that-masked-losses-svbs-securities-wsj-2023-04-21/ (last accessed: 21 November 2023). On the same topic see also *Harry Huizinga/Luc Laeven*, "Bank valuation and accounting discretion during a financial crisis", Journal of Financial Economics, 2012, 614.

9 *Giovanni Dell'Ariccia/Deniz Igan/Paolo Mauro/Hala Moussawi/Alexander F. Tieman/Aleksandra Zdzienicka*, "The Long Shadow of Public Interventions in the Financial Sector", International Monetary Fund Economy Review, 70 (2022), 212.

in fact, a bailout, usually requires additional public support) and reproposing moral hazard problems.[10]

Therefore, this article aims at introducing new elements in the theoretical framework to analyze legal institutions dealing with State capital injection, applying it specifically to the EU precautionary recapitalization and its 'temporary' clause. The article disentangles the key junctures of such instrument, isolating the limitations that prevent the enforcement of its temporary nature.

This is relevant both from a theoretical and a policy perspective. From a theoretical standpoint, it provides a broader and better contextualized approach to State intervention in banking and, in particular, to precautionary recapitalization in Europe. To the best of our knowledge, this is the first article that clearly identifies and isolates the inability of ensuring temporariness as the key problem with the effectiveness of precautionary recapitalization. From a policy perspective, it also provides guidance on how to reform the instrument, informing the discussion over the CMDI whose first drafts appears utterly unsatisfactory from this standpoint.[11]

The remainder of the article unfolds as follows. Section 2 sets down the analytical framework. Section 3 introduces the key legal regime for precautionary recapitalization. Section 4 analyses the cases of precautionary recapitalization in Europe. Section 5 disentangles the key junctures making precautionary recapitalization *ex-post* ineffective. Section 6 analyses the CMDI framework against the findings of the analysis. Section 7 concludes.

10 For a more structural proposal to foster bank recovery, *see Edoardo D. Martino/Enrico C Perotti*, "Containing Runs on Solvent Banks: Prioritizing Recovery over Resolution", Journal of Financial Crises, 7 (2025), 1.

11 On 18th April 2023 the European Commission published a proposal to reform the bank crisis management and deposit insurance framework (the so called "CMDI" proposal), which aims at addressing the shortfalls highlighted in the ten years between the implementation of the Banking Union and the present date. The proposal consists of a set of three Directive Proposals (on minimum requirements for own funds and eligible liabilities, on the deposit guarantee scheme funds, and on early intervention measures) and a Regulation Proposal on early intervention measures). More information are available at: https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2250 (last accessed: 12 November 2023). On 24th April 2024 the European Parliament voted a resolution amending the Commission's proposal. More information are available at: https://www.europarl.europa.eu/doceo/document/TA-9-2024-0327_EN.html (last accessed: 1 July 2024).

2. *Ex-ante incentives and ex-post outcomes: public intervention in banking revisited*

In the aftermath of the 2008 Global Financial Crisis, banking legislation worldwide has been reformed under the stimulus of international standard setters as the Basel Committee for Banking Supervision (BCBC) and the then-newly established Financial Stability Board (FSB). Bank resolution was at the core of this wave of reforms, with the aim to "*make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses*".[12]

This quote highlights all the key characteristics of the post-financial crisis consensus model to treat bank distress including the role of State intervention.[13] This approach can be summarized in three key policy priorities. First, protecting the fair competition in the banking market, minimizing moral hazard of material risk-takers by limiting public intervention to the largest extent possible and, in any case, making sure that it does not excessively impact on ex-ante incentives of bankers; second, protecting taxpayers; third, protecting insured depositors and financial stability.

This approach is sensible and, despite many limitations in the implementation phase, represents a remarkable step forward in our understanding of banking and its regulation. However, this model completely overlooked the next stage, after the resolution of the distress took place, especially when public resources were involved. In other words, under the current framework it seems to be plainly assumed that the resolved bank is either liquidated or returned to the market. However, this is not the case and there is evidence that banks that received public aid in the form of capital injection tend to remain in public hands for a very long period of time.[14] This severely limits competition, exposes taxpayers to further losses and lowers systemic resilience. In this regard, current practices are not markedly different from those experienced during previous financial crises.

12 *Financial Stability Board*, "Key Attributes of Effective Resolution Regimes for Financial Institutions", 2014, 3.

13 For a more specific analysis, see *Franklin Allen/Elena Carletti/Itay Goldstein/Agnese Leonello*, "Moral Hazard and Government Guarantees in the Banking Industry", Journal of Financial Regulation, 2015, 30.

14 With the exception of the United States where, despite many limitations of the regulatory framework, banks easily transit from public to private owners. This also partly explains the almost complete disregard for what comes after the resolution action, as the US experience too often drives both the academic and policy debates.

Anecdotally, one can think of several banks which were nationalized during the Global Financial Crisis and that, 15 years later, are still in public hands. For instance, ABN AMRO was nationalized by the Dutch government on 3rd October, 2008 after Fortis Groups opted out of a merger deal because of its precarious financial situation.[15] To date, ABN AMRO is the third largest banking group in the Netherlands, and the State remains one of the main shareholders with around 40 % of the shares, 15 years after the first nationalization.[16] Another prominent example of 'sticky' public ownership is the Royal Bank of Scotland, which was also part of the failed ABN AMRO merger and was nationalized on 13th October 2008, in a £37 billion bailout decision by the HM Treasury which included also Lloyd and HBOS. In 2022, the UK shareholding of NatWest Group, the successor of Royal Bank of Scotland, decreased below 50 %. This further decreased below 40 % in 2023.[17] In March 2024 the British government ceased to be the controlling shareholder and to date holds 9.99 % of NatWest Group's shares, committed to a full divestment by 2026.[18]

Interestingly, these examples highlight that this is not merely a problem for States that are considered as the 'usual suspects', meaning countries that are commonly perceived as prone to bailouts and lax in their public finances – in Europe the so-called PIIGS.[19] In contrast, these banks are incorporated in States that are not perceived as particularly lenient or particularly prone to fiscal interventions in the financial system. Yet, these banks are still largely in public hands, highlighting that these decisions tend to have effects for a very prolonged period of time and that finding a buyer in the market for these institutions is complex also for wealthy and stable States.

In a wider perspective, a recent IMF study tracked government interventions in financial institutions in 37 countries between 2007 and 2017. The study found systematic evidence that divestments are slow and only few countries

15 *Rosalind Wiggins/Natalia Tente/Andrew Metrick*, "European Banking Union C: Cross-Border Resolution–Fortis Group", Journal of Financial Crisis, 1 (2019), 150.

16 *ABN Amro*, "NLFI announces new trading plan to further reduce stake in ABN AMRO", 15th October 2024, available at: https://www.abnamro.com/en/news/nlfi-announces-new-trading-plan-to-further-reduce-stake-in-abn-amro (last accessed: 12 March 2025).

17 *Mark Sweney/Kalyeena Makortoff*, "UK government sells £1.26bn of NatWest shares, taking stake below 40 %.", The Guardian, 22 May 2023, available at: https://www.theguardian.com/business/2023/may/22/uk-government-sells-natwest-shares (last accessed: 13 November 2023).

18 *NatWest Group*, "Equity ownership statistics", available here: https://investors.natwestgroup.com/share-data/equity-ownership-statistics (last accessed: 12 March 2025).

19 See, for instance, *Hossein Kazemi/Niloufer Sohrabji*, "Contagion in Europe: Examining the PIIGS Crisis", International Advances in Economic Research, 2012, 455.

managed to fully divest. The study also confirmed that it is easier to divest banks that are better capitalized, more liquid and more profitable.[20]

The prolonged, potentially perpetual, public ownership of rescued banks limits the objectives of any effective resolution regime for distressed banks, directly and indirectly. Directly, it limits competition, increases the probability of credit misallocation and puts taxpayer money at risk; indirectly, it makes resolution tools ineffective and is prone to the strategic abuse of such situation by regulated entities.

To address this situation, regulators could completely forbid State interventions in rescuing banks. This option would represent the 'first-best' and is the one that regulators around the world had in mind in the aftermath of the Global Financial Crisis. However, it does not seem to be practicable. Another more modest and pragmatic approach is to re-design the regulatory framework. A framework that is able to achieve this second-best outcome should not only look at what happens before and during the State intervention (meaning at moral hazard incentives and the protection of financial stability and depositors), but also at what happens after the intervention, facilitating the effective and timely transition of the rescued bank back to the market.

This might sound like slightly more than stating the obvious, but it is not. As we will see, the current design solely focuses on reducing market distortions, moral hazard incentives and public expenditures (including the necessity for the provided aid to be 'temporary'), but no attention is paid to those factors that – we argue – could ease the State's divestment, thus ensuring that the precautionary recapitalization does not become a *de facto* bailout. The result is that, to date, the temporariness of the public ownership of a financial institution is merely virtual.

According to our model, even if in a certain measure the State divestment is subject to external factors (*e.g.*, market instability or illiquidity, macroeconomic conditions and other factors like wars and global crises that cannot be foreseen and addressed in advance), there are some elements that an efficient resolution regime should take into account, in order to ease the State's exit from a financial institution. Namely, these are: *(i)* the timing of the intervention; *(ii)* the solvency of the institution benefiting from the aid; *(iii)* the instruments employed in the recapitalization; *(iv)* the political interferences related to the recapitalization and the divestment.

We choose to analyze the precautionary recapitalization tool as, under the EU framework, it is the only tool that States can use to provide extraordinary pub-

20 *Dell'Ariccia et al.* (fn. 9), 212.

lic financial support to a financial institution without triggering its resolution or liquidation. In fact, in response to the massive injection of public resources in the financial sector that happened between 2007 and 2012, the EU has made public intervention in banks particularly difficult.[21] Under the current framework, solvent banks cannot receive any public aid, with the only exception of the 'precautionary recapitalization' tool, which should be 'temporary in nature'. In line with our theoretical framework, when this takes the form of capital injection, the respect of such 'temporariness' clause is notoriously difficult (if not impossible). This incapacity to ensure a divestment has obviously serious consequences on the credibility of the resolution system as a whole, since it undermines the basic principle that a bank in need of public support should be resolved.

3. Precautionary Recapitalization under EU Law

Under the Banking Union framework, any kind of public support provided to a distressed bank triggers the 'failing or likely to fail' declaration by the competent authority, thus leading to the resolution or liquidation of such bank, depending on the determination of the resolution authority.[22] Precautionary recapitalization represents the exception to the rule. Banks that are deemed solvent (*i.e.*, not failing or likely to fail), can apply for extraordinary public support when this is aimed to "*remedy a serious disturbance in the economy of a Member State and preserve financial stability*".[23] Such precautionary recapitalization can be in the form of State guarantees backing liquidity facilities of the central bank; a State guarantee on newly issued liabilities or the outright injection of own fund or purchase of capital instrument.[24]

All three cases prompt the (contingent) deployment of public finance, exposing taxpayers at risk, but, in most cases, the capital injection has the further effect of shifting the control of the bank from private to public entities. For the

21 *Yassine Boudghene/Stan Maes*, "Relieving Banks from Toxic or Impaired Assets: The EU State Aid Policy Framework", Journal of European Competition Law & Practice 3 (2012), 562.

22 Under Article 32(4) BRRD, "*An institution shall be deemed to be failing or likely to fail in one or more of the following circumstances:* [...] *(d) extraordinary public financial support is required*". For an analysis of the pros and cons arising from the bail-out/bail-in policy change see: *Giovanni Dell'Ariccia/Maria Soledad Martinez Peria/Deniz Igan/Elsie Addo Awadzi/Marc Dobler/Damiano Sandri*, "Trade-offs in bank resolution", International Monetary Fund Staff Discussion Note, February 2018, 4.

23 Article 32(4) BRRD.

24 Respectively, article 32(4)(d) (i), (ii), (iii) BRRD.

purpose of this article, we mainly refer to the case of the injection of own funds or purchase of capital instruments for the analysis.

Precautionary recapitalization represents an element of flexibility within the rigid and – as the first years of application reveal – quite ineffective resolution regime. It serves a number of purposes. First, it was considered an instrument which could ease the transition from the bailout to the bail-in system, accommodating for the differences in the banking sector across the Member States; second, even under a credible bank resolution regime, public financial support could have been needed during periods of financial instability;[25] third, precautionary recapitalizations could work also as an early intervention measure, reducing the costs arising if the financial situation further deteriorates, potentially representing a preferable option compared to late liquidation of resolution that could be far more expensive, economically and socially.[26]

Accordingly, the European co-legislators left the wording of the provisions vague, so that implementation could be adapted to the peculiarities of the national markets and the (macro) economic conditions of the single case. This vagueness, though, created a level of uncertainty in the application of the institute, which became evident as States started to misuse precautionary recapitalizations, circumventing one of the key goals of the Banking Union, which is to sever the perverse link between the bank and its sovereign.[27] The Commission and the European Parliament aim at tackling this distortion with the proposed crisis management and deposit insurance (CMDI) framework. Section 6 assesses the merits and pitfalls of the proposals.

Before delving into the analysis of the cases and assessing the promises and pitfalls of precautionary recapitalization, it is necessary to clearly define its legal configuration. Indeed, precautionary recapitalization can be granted only if several conditions are met. These conditions represent a specific way to set the trade-off between the distortionary effects of public aid to banks and the need to have an element of flexibility within the resolution framework, and are the outcome of a political compromise.[28] We distinguish between conditions that are generally applicable to all forms of precautionary recapitalization and conditions that apply specifically to capital injections. Among the former, we

25 *Nicolas Véron*, "Precautionary recapitalisations: time for a review", In-Depth Analysis for the European Parliament, 2017, 8.

26 *Charles A. E. Goodhart/Emilios Avgouleas*, "A Critical Evaluation of Bail-Ins as Bank Recapitalisation Mechanisms", Centre for Economic Policy Research Discussion Paper, 10065, 2014.

27 *Lucia Quaglia*, "The Politics of an 'Incomplete' Banking Union and Its 'Asymmetric' Effects", Journal of European Integration, 2019, 955.

28 *Véron*, (fn. 25), 8.

further distinguish between conditions that are closely related to limiting distortions to competitions and conditions that are closely related to bank recovery issues. All conditions, in spite of their nature and scope, are discussed with specific reference to the case of direct capital injection.

The first general and competition-related condition is that the aid must be necessary "*in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability*". There is no specific definition of 'serious disturbance' as the term derives from the EU State aid framework according to which State aids are generally prohibited unless a 'serious disturbance' in the economy justifies them.[29] During the financial crisis, the Commission, in its acts and decisions, recognized that the contingent economic situation could represent a serious disturbance for virtually all the cases of public intervention.[30] Nonetheless, the absence of any quantitative or qualitative indication leaves a fair degree of discretion in determining whether or not extraordinary public financial support is needed.[31] Such discretion emerges clearly from the different breadth with which the term has been interpreted at the European level: while the Court of Justice of the European Union (CJEU) clearly defines a 'serious disturbance' as one that affects the national economy of the Member State, a view also shared by the Single Resolution Board, the Commission has adopted a more discretionary approach, granting aid even in situations where the economic disturbance impacts only specific regions.[32] In doing so, the Commission's decisions have been criticized for their lack of transparency.[33]

29 Treaty on the Functioning of the European Union, Art. 107(3)(b). On the definition of "serious disturbance to the economy of a Member State" in the context of State Aid to non-financial firms, see *EGC*, 15th December 1999, *Freistaat Sachsen & Volkswagen v European Commission*, T-132/96 and T-143/96 and *ECG*, 15th April 2021, *Ryanair v European Commission*, T-388/20, EU:T:2021:196.

30 *Elena Ghibellini*, Bank Crisis Management and State Aid in the EU: A comparative Law and Economics analysis of bank resolution, precautionary recapitalisation and bank liquidation, 2021, p. 38.

31 *Rodrigo Olivares-Caminal/Costanza Russo*, "Precautionary recapitalisation: time for a review", In-Depth Analysis for the European Parliament, 2017, 11. The situation is further complicated by the fact that, when transposing the Directive, many Member States adopted an ambiguous wording, on this point, see *Marco Bodellini*, "Greek and Italian 'Lessons' on Bank Restructuring: Is Precautionary Recapitalisation the Way Forward?", Cambridge Yearbook of European Legal Studies, 19 (2017), 144.

32 *Phedon Nicolaides*, "State aid after the Banking Union: serious disturbance and public interest", Journal of Banking Regulation, 2022, 79.

33 See *European Court of Auditors*, Control of State aid to financial institutions in the EU: in need of a fitness check, 2020, 49, according to which, with specific regard to the liquidation aid, the Court pointed out that: "*All decisions concerned banks with market shares ranging from 0.02 % to 2 %. There are a number of potential reasons why the failure of even a non-systematically relevant bank could pose a potential threat to finan-*

Moreover, the aid "*shall be proportionate to remedy a serious disturbance in the economy of the Member State*", so that the less intrusive and fiscally cheaper form should be preferred as long as it is equally capable to remedy such serious disturbance.

The aid "*shall be of a precautionary and temporary nature*". These two concepts are quite blurred. The European Commission stated that 'precautionary' refers to the preparation "*for possible capital needs of a bank that would materialize if economic conditions were to worsen significantly*", while 'temporary' means that "*the State should be able to recover the aid in the short to medium term*".[34] To date, the temporariness is the trickiest condition for capital injections, since of three cases in which banks have been recapitalized with a public intervention, the public ownership of the bank lasted for several years or is still ongoing. This inability to divest, notwithstanding the willingness of the European co-legislators, is at the core of our analysis, as it affects the functioning of the resolution system as a whole. In requiring the 'temporariness' of the measure, in fact, *(i)* the provision does not provide any tool to achieve or ensure such temporariness, *(ii) sic et simpliciter*, it seems to assume that the market is always liquid and ready to respond to the divestment; *(iii)* it does not consider the relevant factors which could, in fact, ease the public divestment and thus a limiting in time the public ownership. We contend that the problem of the temporariness in precautionary recapitalizations is directly related to the way in which the recapitalization is carried out and thus, to the design of the provision and of the regulatory framework. In this sense, a precautionary recapitalization that takes place in the early stage of the crisis is more efficient and allows for a swifter divestment.

The aid "*shall be conditional on final approval under the State aid framework*". The Commission approves a precautionary recapitalization only after the submission of a restructuring plan and the implementation of the necessary burden-sharing.[35] In practice, the burden-sharing takes place immediately after the adoption of the State aid decision and always prior to the aid's injection into the bank. This condition wants to ensure that the disruption to the competitiveness of the EU banking market is minimized. The approval follows compliance with all other substantive competition-related conditions, especially the existence of a serious disturbance in the economy of a Member State and its proportionality, the lack of unfair advantages for the ailing banks vis-à-vis

cial stability. For the cases we examined, we consider that the Commission did not explain these reasons in the published decisions".

34 *European Commission*, "State aid: How the EU rules apply to banks with a capital shortfall – Factsheet", 25th June 2017 (the same day as the decision on the liquidation of Banca Popolare di Vicenza and Veneto Banca).

35 In line with the 2013 Banking Communication, recital 50.

the competitors, the temporary nature of the State intervention as evidenced in the restructuring plan attached provided by the bank.

Moving to the general conditions that are more closely linked to bank recovery, the aid "*shall be confined to solvent institutions*". This represents the quintessential condition to grant precautionary recapitalization, differentiating it from any other tool of the resolution framework. The determination of the solvency is, however, not straightforward and not immune from discretionary decisions, as it involves the assessment of the value of banks' assets which are opaque by construction.[36] However, in order to be effective, the recapitalization must intervene really early in the crisis.[37] An intervention which takes place when the bank crisis is so deep that it is difficult to tell apart solvency and insolvency consists of a *de facto* bailout which postposes the bank's problems and prolongs its 'zombie' status.[38]

Relatedly, the precautionary recapitalization "*shall not be used to offset losses that the institution has incurred or is likely to incur in the near future*". This is open to various interpretations. If the notion of 'losses incurred' can encompass all the losses incurred prior to the stress test resulting from the last reporting period (*i.e.*, the last published audited or verified financial statement),[39] it is more challenging to define the future ones. This clearly relates to the necessity

36 *John Armour/Dan Awrey/Paul Davies/Luca Enriques/Jeffrey N. Gordon/Colin Mayer/Jennifer Payne*, Theory of Banking in: John Armour/Dan Awrey/Paul Davies/Luca Enriques/Jeffrey N. Gordon/Colin Mayer/Jennifer Payne (ed), Principles of Financial Regulation, 1st ed., 2016, p. 275, 276. For a formal demonstration, see *Tri Vi Dang/Gary Gorton/Bengt Holmström*, "The Information View of Financial Crises", Annual Review of Financial Economics, 12 (2020), 39. The European Banking Authority (EBA), in its Q&A, has specified that a bank is solvent if currently and in the near future, the institution: (a) does not and is not likely to infringe the conditions for the authorization; (b) does not and is not likely to hold fewer assets than liabilities; (c) does not and is not likely to be unable to pay its debts as they fall due. See *EBA*, Q&A 2015_1777.

37 *Véron* (fn. 25), 12.

38 The term 'zombie bank' usually refers to those banks with negative tangible capital or market value. For the purposes of this article we consider 'zombie banks' those "*banks that meet the capital requirements based on the book value, and even adjusted for economic value, but would have insufficient buffers to withstand economic worsening and/or lend to good borrowers*" (the definition is taken from *Willem Pieter de Groen*, "Precautionary recapitalisations: Time for a review", In-Depth Analysis for the European Parliament, 2017, 11). Zombie banks cause an inefficient allocation of loan intermediation, lending to distressed borrowers and constraining economic growth, In addition, they generally suffer from relatively high non-performing loans, in this sense, see *Christopher Gandrud/Mark Hallerberg*, "How not to create zombie banks: lessons for Italy from Japan", Bruegel Policy Contribution, 6 (2017), 2.

39 *Véron* (fn. 25), 12.

of private sector involvement not only to limit competition distortions, but also to limit moral hazard of the ailing bank. However, the issue is more complex than it may seem at first sight as the recognition of bank losses largely depends on accounting standards, bank disclosure and supervisory practices and – anecdotally – such recognition is significantly lagged in time.[40] The wording of the law seems to include also losses that have been incurred but are not recognized. However, the practical enforceability of this clause is doubtful, as the matter is difficult to verify, especially considering the tight timeline for granting the aid. Véron defines them as the ones that the institution is likely to face before the end of the current reporting period; while this represents a valuable guideline for the regulator, it does not solve the fundamental issues discussed above.[41]

With regard to the specific conditions for capital injection, the law specifies that the aid can take the form of "*an injection of own funds or purchase of capital instruments*". This phrasing refers to Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments, as defined and regulated in the Capital Requirement Regulation.[42] As better detailed in Section 4, practice shows that in two cases out of three in which precautionary recapitalization has been implemented, the State used a mixed percentage of shares and hybrid instruments considered as CET1, while in one case it purchased only ordinary shares.[43] Nonetheless, the main function of precautionary recapitalizations is to address the capital shortfall by injecting high-quality capital in the ailing institutions.

The aid must be granted "*at prices and on terms that do not confer an advantage upon the institution*". In interpreting this rule, the Commission referred to 'undue advantage' as "*an advantage incompatible with the internal market under State aid rules*".[44] Nevertheless, it should be noted that any 'undue advantage' can be controlled using the level of remuneration for the aid (which should align with the requirements under State aid rules) and the depth of the bank's restructuring. Therefore, the 'advantage' is inherent to the construction as the remuneration for the State is necessary lower than the premium that private

40 *Robert M. Bushman/Christopher D. Williams*, "Delayed Expected Loss Recognition and the Risk Profile of Banks", Journal of Accounting Research 2015, 511.

41 *Véron*, (fn. 25), 12.

42 See Article 2 (38) BRRD referring to Article 4(1)(118) of Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms ('CRR').

43 To date, precautionary recapitalization has been used only in three cases: for the National Bank of Greece and the Piraeus Bank (in which the State used also hybrid instruments) and for Monte dei Paschi di Siena.

44 *European Commission*, Decision SA.43365 (2015/N) – Greece Amendment of the restructuring plan approved in 2014 and granting of new aid to National Bank of Greece, para. 173.

market participants would have charged. However, one interpretative solution is to consider the advantage ‘undue’ only if it is not compensated in terms of private sector involvement in losses. In this regard, Article 59(3)(e), expressly lists precautionary recapitalizations among the cases in which the resolution authority can convert or write down capital instruments outside of resolution.

Finally, the capital injection form of precautionary recapitalization can be authorized only if a stress-test or asset quality review highlights a capital shortfall. The law does not specify if such a shortfall should materialize in the baseline or stressed scenario. This additional requirement is crucial and tightly relates to the solvency requirement. In a world in which banks are perfectly transparent, the value of their asset is perfect, and the stress-tests are exactly calibrated, this requirement would ensure that only solvent but undercapitalized banks receive capital aid early on as a going-concern precautionary tool. However, this scenario rests on a number of assumptions which do not match the reality we live in, so that the signal provided by capital shortfall highlighted in the stress-test can be quite noisy and fails to capture effectively the banks that are in the condition such that precautionary recapitalization is welfare-improving.

This latter observation tightly relates with a broader reflection on the temporariness of the capital injection form of precautionary recapitalization. Unlike the other conditions discussed in this section – which are, albeit imperfectly, verifiable at the time the aid is granted – this requirement is ‘prognostic’ in nature. Furthermore, one might question the conceptual coherence of deeming aid ‘temporary’ when it takes the form of perpetual capital instruments that can be unwound only with the contractual agreement of a third party. There is an additional level of uncertainty impacting on the enforceability of the ‘temporary’ clause which is the macroeconomic conditions at the time in which the public participation should be dismissed. These problems promptly materialized in the three cases in which precautionary recapitalization was granted, as detailed in the coming Section.

4. *Precautionary recapitalizations in practice*

To date, precautionary recapitalization has been implemented three times: in 2015 to recapitalize two Greek banks – the Piraeus Bank[45] and the National

45 A commercial bank founded in 1916 and listed on the Athens Stock Exchange in 1918, historically its core business was the lending to SMEs, it also possesses particular know-how in the areas of agricultural banking, consumer and mortgage credit, green banking, capital markets, investment banking, leasing and electronic banking, More information at *Piraeus Holding*, “Piraeus Banks SA”, available at: https://www.piraeusholdings.gr/en/group-profile/groups-presence/piraeus-bank (last accessed: 29 October 2023).

Bank of Greece[46] – and in 2017 to recapitalize the Italian bank Monte dei Paschi di Siena.[47] Despite heterogeneous schemes in implementing the recapitalizations, the divestment phase followed a similar timeline for all banks: after several years of substantial immobilism, divestments paced up following the raise in the interest rates in 2023. In particular: *(i)* Piraeus Bank has been fully divested in March 2024;[48] *(ii)* similarly, National Bank of Greece has been almost completely privatized in October 2024;[49] and *(iii)* in November 2024, the Italian State managed to sell almost all its stake in Monte dei Paschi di Siena, but retains still an 11,7 % stake in the bank.[50] These divestments took place almost ten years after the original recapitalization. Although some claim that these times are physiological, in reviewing the cases, this Section focuses on the enforceability of the 'temporary' clause. The results of the analysis will then be discussed in Section 5.

46 A commercial bank founded in 1841 and listed to the Athens Stock Exchange in 1880, it offers financial products and services for corporate and institutional clients along with private and business customers. Its business include banking services, brokerage, insurance, asset management, shipping finance, leasing and factoring market, More information at *National Bank of Greece*, "Our National Bank of Greece", available at: https://www.nbg.gr/en/group/activities/bank (last accessed: 29 October 2023).

47 A commercial bank founded in 1472, Monte dei Paschi di Siena is known to be the world's oldest bank still in operation.
The Montepaschi Group is active across Italy and in the major international financial markets with operations centered around traditional retail and commercial banking services and with a particular focus on households and small and medium enterprises. The Group operates through its own specialized companies in all key business areas: leasing, factoring, corporate finance and investment banking. More information at *Montepaschi Group*, "Presentation", available at: https://www.gruppomps.it/en/about-us/presentation.html (last accessed: 11 November 2023).

48 See *Reuters*, "Greece's Piraeus Bank $1.4 bln stake sale secures strong demand", 4th March 2024, available at https://www.reuters.com/markets/deals/greeces-bank-bailout-fund-initiates-stake-sale-piraeus-bank-2024-03-03/ (last accessed 3 August 2024).

49 After concluding a 10 % stake sale in October 2024, the Hellenic Financial Stability Fund – an SPV created with the task of rescuing and managing the Greek banks' recapitalization – owes now a 8,39 % stake in National Bank of Greece, that will be transferred to Greece's sovereign wealth fund. See *Reuters*, "Greece concludes post-crisis bank privatisations with 10% stake sale in National Bank", 3rd October 2024, available at: https://www.reuters.com/business/finance/greece-concludes-post-crisis-bank-privatisations-with-10-stake-sale-national-2024-10-03/ (last accessed 12 March 2025).

50 The Italian Ministry of Economy owns now a 11,7 % stake in Monte dei Paschi di Siena. See *Financial Times*, "Italy sells almost all its stake in world's oldest bank", 14 November 2024, available at: https://www.ft.com/content/65fe3cc4-c8e7-4337-aae8-11ee602e5a60 (last accessed: 12 March 2023)

4.1 The recapitalization of the National Bank of Greece and Piraeus Bank

The National Bank of Greece (NBG) and the Piraeus Bank are two of the four principal Greek banks – together with Eurobank and Alpha Bank.[51] To put things in context, at the end of 2015, Piraeus and the National Bank of Greece combinedly accounted for around 53 % of Greek deposits.[52] Following the deterioration of the Greek economy, and after a first recapitalization of €15.7 billion in 2013, both banks suffered severe losses.[53]

In autumn 2015, the European Central Bank's asset quality review and stress test disclosed €4.4 billion of capital shortfall in the baseline scenario and €14.4 in the adverse scenario in the four principal Greek banks.[54] All the credit institutions managed to raise significant amounts of capital on the market; nonetheless, the NBG and Piraeus Bank only managed to address the capital shortfall in the baseline scenario. To address the capital shortfall emerging from the adverse scenario, Piraeus Bank and NBG asked for a precautionary recapitalization carried out by the Hellenic Financial Stability Fund (HFSF), an SPV owned by the Greek State but whose directors are selected also by representatives of the European Central Bank, the European Stability Mechanism and the European Commission,[55] created to help in stabilizing the Greek banking sector during the Greek government-debt crisis.[56]

51 For a more detailed analysis see *Ghibellini*, (fn. 30), 164.

52 *Piraeus Bank*, Annual Financial Report 2015, 8 et seqq. available at: https://www.piraeusholdings.gr/~/media/-Com/2015/Files/Investor-Relations/Financial-Data/Financial-Statements/Financial-Statements-2015/Annual-financial-report.pdf (last accessed: 11 November 2023); *National Bank of Greece*, Annual Report 2015, 12 et seqq., available at: https://www.nbg.gr/-/jssmedia/Files/nbgportal/reports/migrated-data/files/english/the-group/investor-relations/financial-information/annual-interim-financial-statements/documents/annual-and-interim-financial-statements/financial-report-31-12-2015-en.pdf?rev=8f3856ad3e33452e8404beb5b221acd0 (last accessed: 11 November 2023).

53 See *European Commission*, Decision SA.34824 (2012/C) – Recapitalisation and restructuring of National Bank of Greece S.A., para. 14; Decision SA.34826 (2012/C) – On the State Aid implemented by Greece for Piraeus Bank Group relating to the recapitalisation and restructuring of Piraeus Bank S.A., para. 15.

54 *European Banking Authority*, EU-wide stress testing 2014, available at https://www.eba.europa.eu/risk-analysis-and-data/eu-wide-stress-testing/2014 (last accessed: 29 October 2023); *Benoit Mesnard/Aliénor Margerit/Marcel Magnus*, "Precautionary recapitalisations under the Bank Recovery and Resolution Directive: conditionality and case practice", Briefing for the European Parliament, 2017, 3.

55 See Law 3864/2010, as last updated by Law 5092/2024 FEK [illegible] 33/4.03.2024. Available in English at: https://hfsf.gr/wp-content/uploads/2024/04/HFSF_LAW-3864_2010-04_03_2024_Unofficial-Codification_clean.pdf (last accessed: 3 August 2024).

56 See *Hellenic Financial Stability Fund*, History, available at https://hfsf.gr/en/history/ (last accessed: 11 November 2023).

The HFSF injected €2.7 billion in each of the two banks (totally amounting to €5.4 billion) in the form of hybrid capital instruments (CoCos) for 75 % of the amount and ordinary shares for the remaining 25 %.[57] In particular, the CoCos had the following characteristics, identical for both banks: *(i)* they were eligible as CET1 – interpreting in an extensive manner the law on CET1 capital;[58] *(ii)* the coupon amounted to 8 % of the nominal value payable at the issuer's sole discretion in cash or shares, no dividend could be paid on the bank's common stock if the bank had decided not to pay the previous coupon in full; *(iii)* the instruments were of 'conversion to equity' type and conversion price was fixed at €0,3, equal to the nominal value of ordinary shares;[59] *(iv)* the bank had the right, but not the obligation, to repay the CoCos; *(v)* the hybrid instrument could be transferred by the HFSF to another holder, with the bank's and the regulator's consent, as per HFSF law.

The crucial clause, though, was the on related to the conversion mechanism. The conversion could have been triggered under three circumstances: *(a)* if two annual coupon payments were missed, *(b)* if the CET1 ratio of the bank fell below 7 % or *(c)* upon the holder's request after seven years from the issuance.

For the purposes of this article, it is important to look at the Commission's consideration on the temporariness: "*the temporary nature of the aid is ensured by the fact that a high proportion of the aid (75 %) is granted in the form of a repayable capital instrument, i.e. CoCos, as well as by the overall objective of the Greek State to exit the capital of the Bank through privatization*".[60] Similarly, the precautionary nature subsisted to the extent that "[the aid injected] *will result in the creation of prudential buffers in the Bank* [and thus it] *will improve the resilience of its balance sheet and capacity to withstand potential*

57 Decision SA.43364, para. 13; Decision SA.43365, para. 30.

58 See Article 26 CRR.

59 See *European Commission*, Decision SA.43365, paras. 31–38. As it has been noted by *Ghibellini* (fn. 30), 167, the fact that conversion takes place at the nominal value instead of at market price is a non-market feature indicating that the CoCos entailed a gift component, which would materialize at the time of the conversion in case the market value is inferior to the nominal value. In addition, as the HFSF was the only subscriber of the CoCos and they were not freely tradable, their design may also have entailed a gift component. This seems to contradict the 'no creditor worse off' principle and could be subject to the claw-back under the 2008 Banking Communication and the 2010 Prolongation Communication. If this is the case, an *ex-pos*t reimbursement might be complex and subject to a costly and lengthy litigation process. In the finance literature, this is labelled as a non-dilutive CoCo, see *Jens Hilscher/Alon Raviv*, "Bank Stability and Market Discipline: The Effect of Contingent Capital on Risk Taking and Default Probability", Journal of Corporate Finance 2014, 542.

60 Decision SA.43364, para. 168; Decision SA.43365, para 177.

adverse macroeconomic shocks".[61] The statement proved correct, at least in part, about the precautionary nature of the aid but it certainly underestimated the complexity of ensuring the temporary nature of such aid.

Noticeably, the Greek State did not commit to divest at a specific date but, on the contrary, the Commission's decision seemed to consider CoCo's hybrid nature apt *per se* to ensure the temporariness of the measure.[62]

No references to the temporary nature of interventions could be found in the 'Hellenic Financial Stability Fund Law', the fundamental law regulating the functioning of this SPV.[63] Only in 2015, one month before granting the precautionary recapitalization, the law was amended by inserting, in Article 8, references to the dismission of the State's participation. [64] A second amendment to such law occurred in June 2022. This amendment included, as a new priority of the Fund's action "*the effective disposal of shares or other financial instruments held by credit institutions, which is based on a divestment strategy with a specific time horizon of definite and full implementation*".[65] This revision has been positively received by the European Central Bank.[66] The same law set the duration of the HFSF to 31st December 2025, date by which all the divestments must be accomplished.

Following the recapitalization, both banks were subjected to a series of restrictions designed to limit the distorting effects of the public financial support. Even if these measures' aim is not directly related to ensure temporariness, they are relevant as, indirectly, they affect the bank's profitability and, thus, the likelihood of a swift divestment. In particular, the Commission imposed some structural measures to both banks (*i.e.*, reductions in the number of branches, employees, disinvestment from foreign assets) and behavioral measures to cut costs and improve corporate governance (*i.e.*, salary cap, limits on the acquisition of non-investment grade securities). In addition, National Bank of Greece's restructuring plan explicitly required the disposal of the foreign subsidiaries.[67]

61 *Ibid.*

62 In contrast, in the case of Monte dei Paschi di Siena, Italy committed to sell its stake in the bank before 31st December 2021 as detailed in Section 4.2.

63 *Supra* fn. 55.

64 *Ibid.*, Article 8.

65 *Ibid.*, Article 2.

66 *European Central Bank*, Opinion on the divestment strategy, governance structure and special rights of the Hellenic Financial Stability Fund, 11th May 2022, 1.

67 This specific point was crucial in allowing the bank to redeem the CoCos one year later. In particular, NBG explicitly committed to sell its stake in Finansbank A.S. (amounting to 99,81 %) and to use the surplus to redeem the hybrid instruments, see Decision SA.43365, para. 66. Nonetheless, it should be noticed that the redemption appears to be made in derogation of the rules laid down under Article 52(1)(i) CRR.

At the end of 2015, the National Bank of Greece's CET1 ratio had increased to 17,5 %, thus fully complying with regulatory requirements.[68] Following approval by the SSM and per the applicable regulatory framework, on 15th December 2016, NBG redeemed the CoCos, following the commitments contained in its revised restructuring plan approved by the Commission on 4th December 2015.[69] After the repayment of the CoCos, the group's CET1 ratio as of 31st December 2016 stood at 16,3 %, thus confirming the solidity of the bank's capital base.[70] Even after the repayment, though, the bank remained under public control due to precedent recapitalizations.

Piraeus Bank had a more twisted history. In 2020, the ECB blocked the payment of the interest accrued on the CoCos due to a breach of the Combined Capital Buffer.[71] This was the second time that Piraeus skipped a coupon payment,[72] which triggered the conversion of the CoCos into ordinary shares.[73] At the moment, the decision to block the payment is not public, so the exact reason for the denial is not known in its details. At any rate, the denial triggered the CoCos' conversion, and, as a result, the State's holding arose from 26,4 % to 61,3 % causing a *de facto* nationalization of the bank.[74] The State subse-

68 NBG, *Annual report*, 2015, 9.

69 *Hellenic Financial Stability Fund*, "The Hellenic Financial Stability Fund returns €2bio to the Hellenic Republic following NBG's successful repayment of the CoCos", 20th February 2017, available at https://hfsf.gr/en/the-hellenic-financial-stability-fund-returns-e2bio-to-the-hellenic-republic-following-nbgs-successful-repayment-of-the-cocos/ (last accesses: 29 October 2023).

70 National Bank of Greece, *Annual Report*, 2016, 70.

71 See Directive (EU) 2013/36 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ('CRD'), Article 128. Indeed, Article 141 CRD equals the payments of coupons on AT1 instruments to dividend payments to ordinary stocks, both prohibited if the bank, in doing so, breaches the capital buffers.

72 Piraeus Bank skipped the first coupon payment already in 2018, in order to "*safeguard capital and build up further buffers vs capital requirement levels*", see *Piraeus Bank*, Annual report 2018, 16.

73 *NASDAQ*, "Piraeus Bank misses CoCo bond coupon payment, bank rescue fund to raise stake", 7th December 2020, available at: https://www.nasdaq.com/articles/piraeus-bank-misses-coco-bond-coupon-payment-bank-rescue-fund-to-raise-stake-2020-12-07 (last accessed: 29 October 2023). This relates to the ECB recommendation of 20th March 2020, during the COVID-19 pandemic banks were asked not to pay dividends or buy back shares in order to "*conserve capital to retain their capacity to support the economy*" and to "*absorb losses*", see *European Central Bank*, "Recommendation on dividend distributions during the COVID-19 pandemic", 27th March 2020.

74 *Piraeus Bank*, "Press release, of 23rd November 2020", available at: https://www.piraeusholdings.gr/en/press-office/announcement/2020/11/announcement-23-11-2020 (last accessed: 11 November 2023).

quently pushed for a new recapitalization to dilute its participation under the 30 %, carried out in April 2021, taking the State's shares to 27 %.[75]

In September 2022, the HFSF launched a tender to select the consultant who would draw up a road map for the privatization of the banks.[76]

On March 4th, 2024, the HFSH announced the intention to sell part of its stake (22 %) in Piraeus Bank a few days after announcing the intention to sell the entire stake. The initial price was set at €0,93 but a few days after was raised to €4,00 per share.[77] Shares were allocated to Greek institutional and retail investors for an amount up to 20 % while the other 80 % was sold to international institutional investors. Even if not openly stated, it is possible to imagine that the State's divestment was eased also by the favorable conditions created by the rise in the interests rate, from which the whole financial system benefited.[78]

Having regards to National Bank of Greece, in September 2024 the HFSF's board approved the disposal of 10 % of its stake in the bank, that was completed the following month. The initial price range was set between €7.30-€7.95 per share, and stabilized at €7.55 per share. The divestment took place through a private placement book building process outside Greece (amounting to 85 % of the total stake) and a public offering in Greece (for the remaining 15 %). As for the Greek public offering, 70 % was allocated to retail investors and the remainder to institutional investors, while almost 90 % of the international offering was covered by long-only funds and high-quality investors. The remaining 8.39 % should be transferred from the HFSF to Greece's sovereign wealth fund.[79]

75 *Piraeus Bank*, "Press release of 16th March 2021", available at: https://www.piraeusholdings.gr/en/press-office/press-release/2021/03/announcement-16-3-2021 (last accessed: 11 November 2023).

76 *Business daily*, "Banks being returned to private hands: The process and challenges", 7th September 2022, available at: https://www.businessdaily.gr/english-edition/70112_banks-being-returned-private-hands-process-and-challenges (last accessed: 29 October 2022).

77 *Hellenic Financial Stability Fund*, Announcement regarding the outcome of the offering by the Hellenic Financial Stability Fund of existing common, registered, dematerialized voting shares, listed on the regulated market of the Athens Stock Exchange, with a nominal value of €0.93 each in the share capital of Piraeus Financial Holdings S.A, available at: https://hfsf.gr/wp-content/uploads/2024/03/Outcome_Announcement.pdf (last accessed: 3 August 2024).

78 In this sense, *Piraeus Bank*, Annual Financial Report 2023, 12; see also *Piraeus Bank*, Six-month Financial Report, 9, 11.

79 *Supra* fn. 49.

4.2 The recapitalization of Monte dei Paschi di Siena

Monte dei Paschi di Siena (MPS) is the fifth largest bank in Italy.[80] By the end of 2016, the Bank accounted for a total balance sheet of €153 billion in assets, with its core activities related to the retail and small and medium-sized enterprises (SMEs) segments.[81]

The undercapitalization of MPS was a well-known problem and several recapitalization attempts were carried out during the sovereign debt crisis.[82] However, in 2016 the European Banking Authority conducted an EU-wide stress test in which MPS stood out as the worst performer among the 51 institutions scrutinized.[83]

To strengthen its capital position, the institution unsuccessfully tried to raise €5 billion on the market and, in 2016, asked for a precautionary recapitalization, approved on 4th July 2017, for a total amount of €8.1 billion. This included the conversion and immediate dilution of junior bondholders for €4.3 billion, a capital injection of €3.9 billion by the Italian State, and the provision of €1.5 billion to compensate the retail investors who were victims of MPS' financial instruments mis-selling.[84]

80 *Banca d'Italia*, Identification of the UniCredit, Intesa Sanpaolo, Banco BPM and Monte dei Paschi di Siena banking groups, available at: https://www.bancaditalia.it/compiti/stabilita-finanziaria/politica-macroprudenziale/identificazione-20211119/index.html (last accessed: 30 October 2023).

81 *Monte dei Paschi di Siena*, Annual Report, 2016, 47.

82 The first public intervention support was provided already in 2009, with the subscription of the so-called 'Tremonti bonds' (a form of hybrid instruments) for €1.9 billion, aimed at sustaining the financing to the real economy also accompanied by State guarantees, while a second recapitalization occurred in 2013, for a total amount of €4.1 billion. Between 2009 and 2022 MPS has been recapitalized seven times, this represents a clear sign of the public authorities' conflict of interests: national regulators will always tend to save and protect the national banks, thus incentivizing a delayed emergence of the crisis.

83 *EBA*, 2016 EU-wide stress test, 2016. Under the adverse scenario, the bank's fully loaded CET1 capital ratio was reduced from 12.07 % at the end of 2015 to -2.44 % at the end of 2018, a reduction of €10.1 billion. No other participating bank reported negative equity due to the stress test scenario. The gap between the capital position under the baseline scenario and the adverse one amounted to 14.25 percentage points, against a total average of 4.5.

84 Before the injection, the burden-sharing was implemented by converting subordinated debt instruments into ordinary shares at predefined conversion rates and diluting existing shareholders. Under Article 22(4) of the Decreto Legge (Law Decree) 237/2016, any provision related to economic rights on the bank's shares or other capital instruments subject to burden-sharing that obstructed the full recognition of the shares or the capital instruments as CET1 instruments were cancelled.

In order to grant the recapitalization compliance with the BRRD conditions, the ECB deemed MPS solvent. This represented the baseline for the Commission's decision[85] The decision included burden sharing measures decided by the Italia State and communicated to the Commission. The decision was later challenged before the CJEU specifically on this point.[86] Noticeably, the Court found that the Commission, within the preliminary examination stage under Article 108(3) TFUE, could not be held responsible for the losses arising from the bail-in of unsecured bondholders, as those measures were decided at the discretion and under the responsibility of the Member State (paras. 73, 74) and merely notified to the Commission (paras. 77, 80). The Commission verified the compliance of the requested aid with Directive 2014/59 and checked that the burden-sharing measures were adequate to limit the aid to the strict minimum necessary for recapitalizing the bank. Though, it was not required to verify whether the burden-sharing measures decided by the Member State infringed the rights of the bondholders, since any violation of their right would not arise from the aid itself, but from the restructuring plan proposed by the Member State. Under this framework, in a preliminary examination stage, the

85 *European Commission*, Decision SA.47677 (2017/N) – New aid and amended restructuring plan of Banca Monte dei Paschi di Siena, paras. 128, 133. The other details of the recapitalization are the following: according to the Commission, losses incurred by the bank after the stress test were already booked in its accounts and thus were considered 'already incurred'; consequently, they should have been charged against the equity. The 'likely losses' were estimated at €4.4 billion, encompassing *(i)* losses arising from the disposal of bad loans, resulting from the difference between these assets' book value and their estimated sales price; and *(ii)* losses resulting from the ECB's on-site inspection which were not overlapping with point *(i)* or losses from the bad loans transaction and hence still to be booked by the Bank. At the same time, the bank disposed of private means, which included: *(i)* proceeds from the sale of the merchant acquiring business; *(ii)* capital generated from the conversion of subordinated debt instruments into equity, at the exclusion of those other private resources internally available. In addition, the balance sheet reduction envisaged in the bank's restructuring plan would contribute to the reduction of its funding needs. The Commission imposed structural remedies to limit competitive distortion, including downsizing the bank in terms of total assets, RWAs, geographic footprint, branches and staff and also behavioral commitments (*i.e.* bans on acquisitions, advertising the State aid and implementing aggressive commercial practices).

86 The case is "*Braesch and Others v Commission*" (T-161/18 and C 284/21 P). Braesch and Others appealed against the Commission's decision SA.47677 (2017/N) which authorized the State aid including, *inter alia*, the bail-in of shareholders and unsecured bondholders. For a comprehensive analysis of the Court's decision see *Phedon Nicolaides*, "The European Commission is not Responsible for the Bail-in of Investors in Banks", 14th February 2023, available at: https://www.lexxion.eu/stateaidpost/the-european-commission-in-not-responsible-for-the-bail-in-of-investors-in-banks/ (last accessed: 30 June 2024).

Commission, had no power to impose or prohibit any action on Member States (para. 72), consequently, States are always free to draft a plan without 'sharing the burden', "running the risk" of having their proposal dismissed. Following this reasoning, the Court found that any sanction resulting from a misuse of the aid (such as, a deviation from the restructuring plan) is justified insofar such deviation is not included in the notified measures and, consequently, is not covered by the Commission's authorization (so, it does not stem from the violation of a duty imposed by the Commission). This decision is particularly relevant, as it relieved the Commission from any responsibility for the damages arising from the implementation of a restructuring plan which limits or cancel the rights of shareholders and unsecured bondholders, and circumscribed the scope of the compatibility judgment that the Commission must carry out when assessing a restructuring plan. In doing so, it provided a strong incentive to the Commission to ensure the credibility of the bail-in and of the private sector involvement, thus concurring to the overall efficiency of the system.

The Italian State committed to divest before 31st December 2021. This date was initially omitted in EU's documents, but soon became of public knowledge.[87] Differently from the approach used with the recapitalization of the two Greek banks, Italy deployed the resources through its Ministry of Economy and Finance, receiving only common equity in exchange for the injection, without any recourse to hybrid instruments.

The Commission, in order to limit competitive distortions, imposed constraints on the bank, including a downsize in terms of total assets, RWAs, geographic footprint, branches and staff. In addition, the Commission imposed some behavioral commitments (*i.e.*, bans on acquisitions, on advertising, on implementing aggressive commercial practices, and on dividends payments, in addition, a remuneration cap).[88] The implementation of the restructuring plan led to a capital increase that destroyed the bank's value. Following the conclusion of the recapitalization, MPS experienced a period of low profits, which recovered in the year immediately after the measures but then dropped again in 2019.

87 See *Financial Times*, "Talks over UniCredit's acquisition of Monte dei Paschi hit impasse", 18th October 2021, available at: https://www.ft.com/content/64a9b39e-d9df-4410-937b-859a0ab4c20e (last accessed: 29 October 2023).

88 According to the Commission's decision in case of the disposal of the public participation, only the following commitments would have applied: a ban on aggressive commercial strategy eased by the State aid, the closure of specific foreign branches and a series of operational limits on the financial markets, see *European Commission*, SA.103450 (2022/N) – Italy Banca Monte dei Paschi di Siena – Second amendment to the list of commitments related to the aid granted to Banca Monte dei Paschi di Siena in 2017, 9.

After several attempts to sell the public stake in the bank, of which no one was successful,[89] and with the approaching deadline for the divestment, the Italian State asked for a review of the commitments undertaken in 2017, asking also for an extension of the deadline to divest its participation.[90]

In August 2022, the Commission approved a list of amendments to the commitments related to the aid granted to MPS in 2017 and extended the previous deadline.[91] In applying for these amendments, the Italian authorities explicitly attributed the inability to meet all the existing Commitments, by the end of the restructuring period, mainly to contingent circumstances worsened by the outbreak of the COVID-19 pandemic and the consequent deterioration of the Italian and European economy.[92]

In granting the extension, Commission noticed that the "*aid in the form of a precautionary recapitalization* [...] *was of temporary nature, as ensured by the fact that the Italian authorities committed to divest all their shares in the Bank by [omissis].*[93] *The Commission considers that the prolongation of the restructuring period to [omissis] and the prolongation of the deadline* [...] *for the State to divest of the shares acquired as a result of the precautionary recapitalization, do not affect the assessment regarding the temporary nature of the aid. In particular, the Commission notes that the prolongation is limited in time and proportionate to the aim of completing the restructuring process*".[94]

This can be read in many ways, some more and other less benevolent. Irrespective of the judgement on the actions of the Italian State and of the Commission, the fact that the enforceability of the 'temporary' clause is limited and problematic remains irrefutable. Such limitation has broader implications in terms of

89 In particular, Mario Draghi's government tried to sell the bank to a unique buyer, UniCredit spa. Nonetheless, after months of negotiations, the Italian State and the institution could not find an agreement: most of the divergencies arose from different opinions about the quantity of capital that the State should have injected in MPS before the selling: UniCredit asked for a €7 billion recapitalization (lower from the €10 billion originally asked), against a State's projection of €2.5–€5 billion. See *Financial Times*, (fn. 87).

90 See Decision SA.47677, para. 50.

91 *European Commission*, Decision SA.103450 (2022/N) Banca Monte dei Paschi di Siena – Second amendment to the list of commitments related to the aid granted to Banca Monte dei Paschi di Siena in 2017. Noticeably, on 13th October the Italian Minister of Economy and Finances, asked about the privatization of Monte dei Paschi di Siena, stated that "*there is no date on which we depend*" see *Reuters*, "Italy not tied to any deadline to exit Monte Paschi, FinMin says", 13th October 2023, available at: https://www.reuters.com/business/finance/italy-not-tied-any-deadline-exit-monte-paschi-economy-minister-says-2023-10-13/ (last accessed: 13 November 2023).

92 Decision SA.103450, para. 22.

93 *Ibid.*, para. 55.

94 *Ibid.*, para. 56.

credibility and political viability of the precautionary recapitalization tool in other cases.[95]

In November 2022, the institution successfully performed a new recapitalization of €2.5 billion, required to implement the restructuring plan and strengthen the capital position.[96] It was the seventh recapitalization in 14 years, and it strongly diluted the existing shareholders' position – including that of the Italian State as main and controlling shareholder. However, Italy also committed to take part to the recapitalization for an amount around €1.6 billion. Prior to the recapitalization, one share's price amounted to €4~5; after the operation, it stabilized at €1~2.[97]

Following the rise in the interest rate, between November 2023 and March 2024 the Italian State managed to sell a part of its stake in Monte dei Paschi di Siena.[98] Nonetheless, the Italian State still owned a stake in the bank amounting to 26,7 %. Taking advantage of the prolonged high interest rate environment

95 A clear example of the measure's lack of credibility is well represented by the Carige Bank case. Carige is a small regional bank which, in the 2014 Comprehensive Assessment carried out by the ECB, showed a capital shortfall of €1.83 billion together with a CET1 ratio of 2.3 % in the baseline scenario of the stress test. Between December 2014 and September 2018, the bank incurred losses for around €1.6 billion, with additional losses for €189 million booked in the first nine months of 2018. Its profitability was weakened by a deterioration in asset quality and a decrease in net operating income. In 2018 the bank failed also the ECB's stress test, showing a significant capital depletion in the adverse scenario by the end of 2020. At the end of September 2018, the bank reported capital ratios below the supervisory review and evaluation process capital requirements imposed by the ECB. In this scenario, Italian authorities tried to push for a precautionary recapitalization (which never took place, but was authorized by the Parliament with the approval of the Law-Decree 1/2019). After the appointment of three temporary administrators and several failed attempts at recapitalizing the institution, by the end of July 2019 a rescue scheme was approved with the intervention of an interbank consortium (the FITD), two State-owned banks (Cassa Mediocredito Centrale and Istituto Credito Sportivo), Carige's shareholders.

96 See *Reuters*, "Monte dei Paschi capital talks enter final stretch after Italy vote", 27th September 2022, available at: https://www.reuters.com/business/finance/monte-dei-paschi-capital-talks-enter-final-stretch-after-italy-vote-2022-09-26/ (last accessed: 29 October 2023).

97 Data available at: https://mercati.ilsole24ore.com/azioni/borsa-italiana/dettaglio-completo/BMPS.MI (last accessed: 29 October 2023).

98 See *Reuters*, "Italy raises $1 bln from Monte dei Paschi's 25 % stake sale", available at: https://www.reuters.com/business/finance/italy-starts-sale-20-monte-dei-paschi-stake-investors-2023-11-20/ (last accessed: 3 August 2024); *Bloomberg*, "Italy Sells 12.5 % of Monte Paschi for About €650 Million", available at: https://www.bloomberg.com/news/articles/2024-03-26/italy-starts-12-5-sale-of-paschi-in-accelerated-book-building?embedded-checkout=true (last accessed: 3 August 2024).

and the consequent high profitability of the banking system, in November 2024, the Ministry of Economic and Finance managed to place another 15 % of MPS capital to private investors. With this operation, the residual State shareholdership remains around 11 % but, according to the parameters agreed with the European Commission, the bank has now been formally divested and therefore all the limitations in terms of dividends and management remuneration have been lifted.[99]

In this sense, there are three interesting factors to highlight. The first two consists of those that, according to the Italian State, sabotaged the chances for a timely divestment. Namely, these were: the failure of the negotiations with private actors, which were complicated by the approaching date for the divestment (a confidential information that soon became public and that limited the State's negotiation strategy) and the global COVID-19 pandemic. The third one consists of the fact that the raise in the interest rates eased the State partial divestment. All these facts represent a strong indicator that the current framework is not able to take into account factors that impact on the timing of the divestment, leaving the 'temporariness' clause to rely mostly on luck.

5. Critical review of the relevant factors

We saw that precautionary recapitalizations are challenging under several aspects: on the one hand, they represent an important element of flexibility in the strict resolution framework set by the Banking Union; on the other hand, they are easily used in an opportunistic way by National States, can easily distort competition and create moral hazard problems if not correctly implemented.

This ambivalent nature also reflects on the current legislation, which is mostly 'backward oriented' and focuses mainly on the limitations under which the aid can be provided (apparently, even the CMDI proposal), in an attempt to limit the use of public funds and thus moral hazard. Yet, if the aim is to avoid alteration in competition too, the juridical problem is wider and should also be consider why the divestment is so complicated.

On the point, data shows that, in many countries, public asset holdings in individual intervened banks remain significant even a decade after the original

99 For the details of the deal, see *Luca Gualtieri/Fabrizio Massaro*, "Mps, il Tesoro vende il 15 %. Comprano Banco Bpm, Anima, Caltagirone e Del Vecchio. Giorgetti: rafforzato il fronte Italiano", Milano Finanza, 13th November 2024, available at: https://www.milanofinanza.it/news/mps-il-tesoro-colloca-il-7-la-quota-vale-486-milioni-il-collocamento-seguito-da-banca-akros-202411131811209066?refresh_cens (last accessed: 4 March 2025).

intervention.[100] This is not a secondary aspect since: *(i)* public interventions come with a huge amount of taxpayers' money; *(ii)* they interfere with market functions, distorting the signaling function of assets prices and financial flows; and *(iii)* State-owned banks are often sensible to political interference and pursue other objectives than value maximization, leading to lower profits and to an excessive risk assumption.[101]

This Section analyses the relevant factors that could ensure a better application of this tool, easing the disposal of the State participation in the bank, whether with a merger or not and thus ensuring the temporariness of this instrument.

5.1 Assessing the solvency of the institution

The first key factor for a sound application of precautionary recapitalizations is the institution's solvency. Solvent institutions should be kept in the market through liquidity or – in limited case – capital aids, as in the case of precautionary recapitalization.[102] Insolvent institutions should exit the market through resolution or liquidation. Ascertaining the solvency of a bank is complex. Notwithstanding the presence of instruments such as asset quality reviews and stress tests, the banks' assets are still opaque, prone to procyclicality and complex to evaluate correctly.[103]

In addition, currently, there is a misalignment between the notion of 'solvency' applied for the purpose of precautionary recapitalization and the concept of 'failing or likely to fail' applied for the purpose of resolution. This discrepancy does not seem justified and can distort the application of precautionary recapitalizations.[104] Intuitively, the threshold for granting a precautionary recapitalization should be equal or higher than the threshold for placing an entity in resolution, but clarity is lacking in this respect. Thus, given the unverifiability of the bank's real status, we need some indicators which can help us in approximating the assessment, making sure that the aid goes only to banks that are solvent but undercapitalized.

100 *Dell'Ariccia et al.*, (fn. 9).

101 *Dell'Ariccia et al.*, (fn. 9), 214.

102 *Walter Bagehot*, Lombard Street: A Description of the Money Market, 1873.

103 On the critical aspects of the comprehensive assessment see *Sascha Steffen*, "Robustness, validity, and significance of the ECB's asset quality review and stress test exercise", in SAFE White Paper, 23, 2014; *Emilio Barucci/Roberto Baviera/Carlo Milani,* "The Comprehensive Assessment: What lessons can be learned?", The European Journal of Finance, 2018, 1253.

104 *Véron* (fn. 25), 11–12.

Following this line of reasoning, if a bank results to be undercapitalized under the baseline scenario of a stress-test, it is doubtful whether it should qualify for precautionary recapitalization. It should instead be resolved – if all the requirements for the resolutions are met – unless the breach of capital requirements is temporary. The baseline scenario is "*a set of economic and financial conditions that is generally consistent with the projection of a likely path for future economic and financial conditions*".[105] Thus, it is reasonable to say that failing the stress-test without being able to address the shortfall privately or having enough high-quality collateral to receive liquidity support from the central bank can be considered a strong indicator that the bank will soon breach the capital requirements and it can be considered 'likely to fail'.

In the silence of the law, this interpretation can be contentious and is for sure not majoritarian.[106] However, precautionary recapitalization represents an exceptional measure conceived as an element of flexibility in a framework aimed at limiting the use of public funds in saving banks to the maximum extent possible. Thus, a restrictive interpretation of the norm seems warranted.

On the other hand, if the bank fails the adverse scenario, it should first try to strengthen its capital position with its own resources by converting debt or raising the capital on the market; only after this should it be eligible for a precautionary recapitalization.

From a functional perspective, this also implies that precautionary recapitalization could only be granted to banks that are – with some level of confidence – far from insolvency, which is a key element to improve the possibility that the aid remains, indeed, temporary.

5.2 The timing of precautionary recapitalization

Related to the bank's solvency, another key juncture in ensuring the temporary nature of precautionary recapitalization is the timing of the intervention. The timing for intervention in bankruptcy and reorganization cases is an immanent problem in and outside the financial industry.[107] In banking, this problem is

105 *Patrizia Baudino/Roland Goetschmann/Jérôme Henry/Ken Taniguchi/Weisha Zhu*, "Stress-testing banks – a comparative analysis", FSI Insights on Policy Implementation, 12 (2018), 6.

106 *Ibid.*

107 See, for instance, *Lorenzo Stanghellini*, "Director's Duties and the Optimal Timing of Insolvency. A Reassessment of the 'Recapitalize or Liquidate' Rule", in: Paolo Benazzo/Mario Cera/Sergio Patriarca, Il diritto delle società oggi. Innovazioni e persistenze, 2011, 733.

amplified as expectations plays a crucial role. Banks can work and thrive because they are considered sound by depositors and investors, who believe that banks assets are sound and that, consequently, other short term claimants will not withdraw more than their average amounts.[108] Nonetheless, the deterioration of such expectations can trigger a confidence crisis (in the institution's robustness), a liquidity crisis (since all the depositors will try to withdraw all their money simultaneously) and then a solvency crisis.[109]

In this respect, precautionary recapitalizations should intervene early enough for two related but distinct reasons. First, once it is acknowledged that the bank failed a stress test in the adverse scenario, the expectations about its robustness are already compromised as the market internalizes this public information. Thus, the more time passes between the recognition of the shortfall and the recapitalization, the more the institution's position deteriorates, and the more the recapitalization may lose its 'precautionary' trait to become a sort of bailout of a *de facto* insolvent bank.

Second, the request for a precautionary recapitalization itself can trigger a self-fulfilling mechanism leading to the institution's insolvency. This happens when the aid is granted too late, because the capital shortfall's acknowledgement takes place too late or because the negotiations on the features of the precautionary recapitalization – especially its competition correctives – leave the institution in a *limbo*. In these situations, the potential consequence is that recapitalizations might not be sufficient to stabilize the situation – since a prolonged uncertainty is detrimental for the bank – thus vanishing their effectiveness and making it more likely that the institution will need further recapitalizations in the future.

This happened in the MPS case when the bank breached the capital requirements while waiting for a rescue solution to be agreed upon.[110] In particular,

108 This is the basic tenet of the classical model of banking proposed by *Douglas W. Diamond/Philip H. Dybvig*, "Bank Runs, Deposit Insurance, and Liquidity", Journal of Political Economy, 1983, 401.

109 On liquidity spirals, see *Markus K. Brunnermeier/Lasse H. Pedersen*, "Market Liquidity and Funding Liquidity", Review of Financial Studies, 2009, 2201.

110 MPS breached minimum capital requirements under Art. 92 CRR in the first semester of 2017, when the bank had a CET1 ratio of 1.5 % and a Total capital ratio of 2.8 %. See *MPS*, "Consolidated Half-Year Report as at 30 June 2017", available at: https://www.gruppomps.it/static/upload/_con/consolidated_half-year_report_2017.pdf (last accessed: 11 November 2023). It took months to reach an agreement between the Commission, the European Central Bank and the Italian government, during which the bank's liquidity position deteriorated badly. More precisely, the bank's capital shortfall was announced in July 2016; in autumn the bank tried to address it with an unsuccessful market operation that led, before Christmas 2016, to the request of a precautionary

during the negotiations for the going-concern burden-sharing of subordinated debtholders, it has been argued that the Commission's insistence on the immediate burden-sharing could make the implementation of any private solution even more problematic. Private investors considering participating in a capital-raising plan might be discouraged, knowing that if the bank's private funding is ever less than entirely sufficient, bail-in will ensure it, or public funds may still be used if financial stability is at stake.[111]

Nonetheless, there is another critical aspect under the timing profile: assessing the difference between the illiquidity of a bank and its solvency issues is complex. Before the liquidity crisis triggers a run, banks are already exposed to illiquidity vulnerabilities.[112] These vulnerabilities are often associated with the recognition of losses that could lead to undercapitalization.[113] However, the incentives of all relevant actors, the bank, the creditors and the supervisors are to delay the recognition of such status, fearing the adverse market reaction.[114]

recapitalization to the Italian government. On 23rd December the Italian government passed a decree allowing MPS to benefit from the €20 billion bail-out package approved on 21st December 2016, and the measure was approved only on 4th July 2017.

111 See *Christos Hadjiemmanuil*, "Monte dei Paschi: A Test for the European Policy Against Bank Bailouts", 2nd May 2017, Oxford Business Law Blog, available at: https://blogs.law.ox.ac.uk/business-law-blog/blog/2017/05/monte-dei-paschi-test-european-policy-against-bank-bailouts (last accessed: 14 November 2023).

112 This perverse mechanism was evident in the case of the Silicon Valley Bank, see *Andrew Metrick*, "The Failure of Silicon Valley Bank and the Panic of 2023", Journal of Economics Perspectives, 2024, 149.

113 The links between liquidity and solvency in the context of resolution was pointed out by *Wolf-Georg Ringe*, "Bail-In between Liquidity and Solvency", American Bankruptcy Law Journal, 2018, 18–19. Ringe, in his paper, makes his remarks referring to the bail-in tool, which use should be anticipated. The argument can be made also for the precautionary recapitalization, even if – of course – the instruments differ in conditions for the applications and nature.

114 *Natalya Martynova/Enrico Perotti/Javier Suarez* (fn. 6). In these regards, it is particularly interesting the position adopted by the General Court of the European Union in the recent case T-134/21 ('*Malacalza Investimenti srl and Vittorio Malacalza v European Central Bank*'). The action was promoted by some of the bank's shareholders with the aim to seek compensation for the damages suffered as a consequence of the ECB supervisory activity of Carige Bank. The ruling addressed the ECB's non-contractual liability concerning its prudential supervision of credit institutions, stating that, in its supervisory activity, the ECB is vested with the power/duty to pursue public interests. In this sense, the current legal framework does not confer to individuals rights such to ground a claim for non-contractual liability, under the EU law. This ruling is to be welcomed, as it better defines the competent authority's discretionary powers to take decisive action and to act preventively in the crisis. In doing so, also provides an incentive to the ECB in exercising those powers, tailoring them to the specific needs of the financial institution.

In addition, it is important to consider that banking regulators and resolution authorities have limited access to the institution's data and accounts, as well as cognitive biases, and that most of the data they receive are historical. The possibilities of carrying out a comprehensive evaluation are further limited by the time pressure and by the fact that actual incentives for banks are all pushing to maximize the recognition of gains and postpone the recognition of losses. The situation is further complicated because quantifying the institution's capital shortfall and the extent to which it is attributable to past losses is not straightforward, and it would benefit from harmonized procedures to evaluate NPLs and having in place stringent procedures for early losses recognition and capital provisioning.

Previous considerations, together with the fact that – as it has been observed – at Bagehot's time, "*stemming the panic was on the Lender of Last Resort, now this task has been assigned to the resolution authorities*", and that "*the lines between a temporary liquidity obstacle and a serious solvency problem are becoming increasingly blurred*",[115] suggest that precautionary recapitalizations must intervene early in the crisis.

Exactly quantify how early is a task that does not allow for a one-size-fits-all solution, even considering the imperfection of any metric to proxy for distress.[116] However, this implies that the law, and in particular the primary legislation, should provide a clear mandate to competent authorities in this respect and, within such mandate, these authorities should be entrusted with considerable discretion in the application of the tool, based on the bank's specific characteristics. In this sense, we argue that, under the Single Supervisory Mechanism, competent authorities, in addition to ensure the soundness of the banking system, should also be vested with the power to act preventively, especially when there are signal of an early crisis, choosing and tailoring the forms of the intervention on the specificity of the bank's crisis and on its likelihood to achieve a timely divestment.

5.3 The instruments of precautionary recapitalization

The law allows precautionary recapitalizations through 'capital instruments'. Therefore, it is not necessary – and, most likely, it is not desirable – that the capital injection takes the form of common shares.

115 *Ringe*, (fn. 113), 22.

116 *Hyun Song Shin*, "Procyclicality and the Search for Early Warning Indicators", IMF Working paper, 2013, 1.

In the cases of NBG and Piraeus Bank the HFSF operated the recapitalization through Contingent Convertible (CoCo) instruments. The Commission positively evaluated the employment of CoCos in the precautionary recapitalization of the Greek banks, seeing them as an instrument which could better ensure the measure's temporariness.[117] Some authors identified CoCos as a better suited capital instrument to ensure the temporary nature of precautionary recapitalizations.[118] However, this solution is not free from perils and bottlenecks.[119]

On the positive side, CoCos with a high capital trigger can allow for prompt recapitalization of an undercapitalized bank.[120] Moreover, CoCos can be called by the bank (if subject to the authorization of the Competent Authority) if the institution can replace them with capital instruments of the same quality.[121] Intuitively, calling CoCos – repaying at par value the aid – is easier than finding a buyer for an equity stake.

On the negative side, there are both specific problems related to the use of CoCos in precautionary recapitalization and structural bottlenecks due to the inherent flaws of CoCos. First, CoCos do not affect the governance and control structure of the bank. This is problematic if the crisis is due to mismanagement. Divesting CoCos would put back in full control those who were the first responsible for the crisis. Moreover, CoCos are capital instruments of lower quality compared to Common Equity. This correlates with the easiness to divest them. Banks applying for precautionary recapitalization are likely to be severely undercapitalized, especially under the current legal framework. From this point of view, using CoCos can be ineffective or even counterproductive, simply postponing the problem of the institution's solvency without resolving it.

117 Decision SA.43364, para. 168: "*The temporary nature of the aid is ensured by the fact that a high proportion of the aid (75 %) is granted in the form of a repayable capital instrument, i.e. CoCos, as well as by the overall objective of the Greek State to exit the capital of the Bank through privatisation and other means as set out in the Memorandum of Understanding*". The same exact wording is used in para. 177 of the Decision SA.43365.

118 *Ghibellini*, (fn. 30), 176; *Christos Gortsos/Michele Siri/Marco Bodellini*, "A Proposal for a Temporarily Amended Version of Precautionary Recapitalisation Under the Single Resolution Mechanism Regulation involving the European Stability Mechanism", European Banking Institute Working Paper Series, 73, 2020.

119 *Paul Glasserman/Enrico Perotti*, "The Unconvertible CoCo Bonds" in: Douglas D. Evanoff/George G. Kaufman/ Agnese Leonello/Simone Manganelli/Douglas W. Diamond (ed), Achieving Financial Stability: Challenges to Prudential Regulation, 1st ed., 2017, 317.

120 *Ghibellini*, (fn. 30), 177.

121 Articles 77 and 78 CRR.

From a more structural perspective, there is now ample evidence that CoCos do not work as they should, as it is extremely difficult to trigger them, especially using capital ratios (in this sense, the fact that they have been used only once, and outside from the Banking Union, is a strong element supporting these instruments' flaws). To date, the only two cases of going-concern loss-absorption are the case of Piraeus Bank discussed earlier and the recent case of Credit Suisse.[122] Crucially, under current regulation and supervisory practices it does not seem possible to convert or write down CoCos through a capital ratio trigger, but only through a regulatory trigger discretionarily triggered by the supervisor, skipping two coupons for Piraeus Bank or the provision of 'extraordinary government support' for Credit Suisse.

Ultimately, the costs and benefits of different capital instruments employed in precautionary recapitalization should be traded off. A key variable in this exercise is their specific design, as some features can be more conducive for an easy divestment.[123] One possibility could be to devise *ad hoc* capital instruments acting as reverse contingent convertibles, meaning that the capital injected moves from CET1 to more senior instruments according to pre-specified contingencies.[124] The detailed design of these securities is beyond the scope of the analysis; however, the relevant contingencies should not simply consist of capital ratios, as they are ineffective. Rather, they should be based on a clear mandate and wide discretion granted to the competent authority within such mandate. Such discretion should include the possibility to consider these instruments in capital categories partly derogating the qualitative requirements of the CRR if needed. In this sense, the legislation should be amended accordingly.

122 *Martino/Nigro/Vos* (fn. 5).

123 For instance, Ghibellini proposed an injection of CoCos with a high trigger point as equity stakes that – once the bank has regained its viability – could be converted (wholly or partially) again into CoCos and sold on the market. The conversion can be at the issuer's discretion, but in this case, the interest rate should increase over time; otherwise, the conversion could be linked to particular financial indicators (*i.e.*, the reaching of adequate capital and the ability to repay the State). In addition, an instrument with these features should act as a discipline instrument for shareholders and limit the necessity of a second further intervention of the State. See *Ghibellini*, (fn. 29), 178. However, this design could be breaching several provisions of the CRR in terms of qualitative requirements for capital instruments. On the trade off between financial contracting and qualitative requirements, see *Edoardo D. Martino*, "Bail-Inable Securities and Financial Contracting: Can Contracts Discipline Bankers?", European Journal of Risk Regulation (2019), 164.

124 A similar construction was proposed by Jeffrey Gordon for the design of incentive compatible executive compensation, see *Jeffrey N. Gordon*, "Executive Compensation and Corporate Governance in Financial Firms: The Case for Convertible Equity-Based Pay", Columbia Law and Economics Working Paper, 2010, 834.

Beyond the details, the analysis clarifies that neither common shares nor CoCos are apt to ensure temporariness. Rather, the policymaker should devise *ad hoc* securities with a design that is conducive to an easier divestment based on *(i)* an enlargement of its power and *(ii)* the tools tailoring to the specific needs and characteristics of the distressed financial institution.

5.4 The political economy of precautionary recapitalization

One of the cornerstones of the European Banking Union was to depoliticize banking supervision and resolution or, put more rigorously, to break the vicious circle between the bank and its sovereign.[125] However, a tool such as precautionary recapitalization whereby Member States can acquire a controlling stake in solvent banks re-politicize banking supervision and resolution.[126]

This has one analytical and one normative implication. From an analytical perspective, even assuming that the legal design of precautionary recapitalization is efficient and that the recapitalization is performed early enough, we expect public officials who seek re-election to be less prone to compromise on feasible divestment options. In this sense, in fact, it is widely acknowledged that politically controlled banks act following inefficient logics: they are more prone to misallocating resources, inefficiently allocating loan intermediation, lend to distressed borrowers and constrain economic growth.[127] A comprehensive assessment of the efficient level of political involvement and political accountability in banking is beyond the scope of this contribution.[128] However, looking solely at the enforceability of the temporary clause, the analysis reveals that the closer precautionary recapitalization is to the apex of political power, the less enforceable such a 'temporary' clause is.

Accordingly, from a normative perspective, the legal framework can steer this process. Specifically, the capital injection performed by the HFSF in NBG and

125 *Elizabeth McCaul*, "Enhancing banking consolidation without major legislative change in Europe", available at: https://www.bankingsupervision.europa.eu/press/interviews/date/2022/html/ssm.in220303_2~3e79c7c0b3.en.html (last accessed: 14 November 2023).

126 For a broader contextualization of the political economy problems of banks' public ownership, see *Thomas Marois*, "A dynamic theory of public banks (and why it matters)", Review of Political Economy, 2021, 356.

127 See *supra* fn. 38.

128 On this matter see, for instance, *Menelaos Markakis*, "Political and Legal Accountability in the European Banking Union-A First Assessment", in Marcel Szabó/Petra Lea Láncos/Réka Varga (ed), Hungarian Yearbook of International Law and European Law, 2016, 535.

Piraeus Bank is preferable to the capital injection performed by the Italian Ministry of the Economy. Therefore, in reforming the system, policymakers should favor solutions whose control is far from politicians and balance administrative discretion with a clear mandate for designated authorities. For instance, from the mere perspective of the enforcement of the 'temporary' clause, the use of sovereign funds not directly controlled by politicians, or even the use of deposit guarantee funds or the ESM is preferable compared to the injection of funds that comes directly from the central and apical authority of the State.

6. *Can the CMDI proposal help?*[129]

Among the many reform proposals, the CMDI attempts to reform and strictly codify the cases for 'extraordinary public financial support' by adding a new article 32c to the BRRD. This reform concerns also precautionary recapitalizations, whose discipline is significantly changed with a currently very chaotic formulation.

The Commission proposes to change the discipline of precautionary recapitalization with regard to (1) the conditions to grant precautionary recapitalization; (2) the available capital instruments; (3) the enforceability of the temporary nature of the aid and the consequences of a breach of such temporary nature.

There is no substantive innovation in the conditions to grant precautionary recapitalization, as it would still be available only for solvent institutions. However, the proposal tries to specify the concept of 'solvency' in the context of precautionary recapitalization.[130] To consider an institution 'solvent', it should not have been declared failing or likely to fail and it should not become failing or likely to fail if the aid is not granted.[131] Moreover, the competent

129 This analysis was carried out on the basis of the CMDI proposal COM(2023) 227 final and does not reflect the political agreement reached on June 25, 2025. At the moment of writing the final text of the political agreement is not available. The analysis remains fully valid and can be easily adapted to the new text, at least based on the information disclosed in the press release by the Parliament, which is available at: https://www.europarl.europa.eu/news/en/press-room/20250625IPR29172/deal-reached-on-toolset-to-address-bank-failures-and-protect-taxpayers (last accessed: 1 July 2025).

130 *European Commission*, Proposal for a Directive amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action ("BRRD reform proposal"), Articles 1(18) and (19), introducing Articles 32c (1)(a)(iii) and 32c (2) second paragraph.

131 Respectively Article 32(4) and 59(3) BRRD.

authority should conclude that no breach has occurred, or is likely to occur in the twelve following months, of any of the capital requirements provided under the European law, including the institution-specific Pillar 2 Requirements.[132]

This reform aims to anticipate the moment when precautionary recapitalization is granted, making sure that it is truly a precautionary measure and not a *de facto* bailout. This attitude is to be welcome. However, the formulation and the structure of the norms are terribly convoluted and the conditions to ascertain solvency should be simplified to ensure their exact application. Moreover, a more subtle hurdle of this reform is that it is doubtful whether banks will have incentives to apply early on for precautionary recapitalization, as they may avoid acknowledging problems soon enough and delay interventions trying to force a laxer interpretation of the norms, similar to what has happened so far.[133]

Concerning the type of instruments which should be used in carrying out the recapitalization, the Commission proposes to ban the acquisition of CET1 instruments, clearly favoring hybrid contingent convertibles.[134] However, if the shortfall is highlighted in the adverse scenario of a stress test, the injection of CET1 instruments is still allowed.[135] In any case, the amount of acquired CET1 instruments cannot exceed the 2 % of the institution's risk-weighted assets. Such change aims "*to ensure that the support remains temporary in nature*".[136] Based on the analysis of this article, it is unclear whether these rigid rules can achieve their goal. In fact, there is no direct link between the type of instrument used in carrying out the recapitalization and its temporary nature.[137]

132 See Article 92 CRR and 104a CRD. It is quite interesting to notice that the twelve months period seems to align the discipline on bank insolvency to the one prescribed for other companies, following the implementation of the Insolvency Directive. See Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 ("Directive on restructuring and insolvency"). The requirement of not being likely to breach these requirements in the coming twelve months is also in line with the threshold for empowering the Competent Authority to take prompt corrective actions established in article 102 CRD. On the problematic overlap of supervisory and resolution-related tools and provisions, see *Edoardo D. Martino/ Katarzyna M. Parchimowicz*, "Go Preventive or Go Home–The Double Nature of MREL', European Company and Financial Law Review, 2021, 608.

133 *Martin Friedrich. Hellwig*, "Precautionary recapitalisations: time for a review", In-Depth Analysis for the European Parliament, 2017, 26–27.

134 BRRD reform proposal, Article 1(19), introducing Article 32c (1) (a) (iii).

135 *European Commission*, BRRD reform proposal, Article 32c.

136 *European Commission*, Explanatory Memorandum to the BRRD reform proposal, 19.

137 *Supra* 5.3.

Finally, concerning the enforceability of the temporary clause, the Commission requires "*stronger and more explicit requirements on determining in advance the duration and exit strategy for the precautionary measures*".[138] In particular, a predefined exit strategy should be approved by the competent authority and such strategy should include a clearly specified divestment date.[139] This seems to crystalize the current practice, making it mandatory to establish a divestment date as it is already the case for MPS. The real change relates to the consequences of the breach of such requirements. If the support is not terminated by the divestment date, the bank should be considered failing or likely to fail and be resolved or liquidated. If the support measures are not redeemed, repaid or otherwise terminated pursuing the terms of the exit strategy, the institution should be deemed as failing or likely to fail and thus liquidated or resolved. This dire consequence seems to directly descend from the fact that public financial support is a sufficient condition to declare the bank failing or likely to fail, unless it is temporary in nature.[140] Failing to divest by the established date would *de facto* integrate this condition. However, this represents a rather static understanding of banking activities and banking regulation and is prone to severe unintended consequences.

First, setting a hard deadline risks generating self-fulfilling prophecies. Close to the divestment date, counterparties will be unwilling to acquire capital instruments in a bank that is about to be declared failing or likely to fail or they will apply a significant discount to the price of these instruments. Similarly, if hybrid capital instruments should be redeemed and substituted by others of at least the same quality, private investors may disproportionately increase the cost of capital.

Second, and relatedly, this approach does not take into account adverse material changes, such as macroeconomic instability, wars or natural disasters that have nothing to do with the resilience and solvency of the single institution. For instance, the initial deadline for the divestment of the public stake in MPS was set at the end of 2021 which happened to be amid the COVID-19 pandemic.

This approach assumes that the market is always liquid, meaning that there will always be a buyer for (the capital instruments of) solvent institutions. However, this has been disproven during the Global Financial Crisis and by the following academic literature.[141] The result of this rigidity may well be to force

138 Explanatory Memorandum to the BRRD reform proposal, 19.

139 Article 32c (2) (b).

140 Article 32(4)(d) BRRD.

141 For a theoretical explanation, see *Katharina Pistor*, "A Legal Theory of Finance", Journal of Comparative Economics, 2013, 315, 318.

into resolution or liquidation solvent banks. This would further imply that the public financial support would be subject to the rules governing liquidation and resolution. Since capital instruments are deeply subordinated, this is likely to bring about losses for taxpayers.

To avoid all these absurd unintended consequences, *ex-post* extensions or formulation of the initial conditions are likely to happen. Under the current formulation of the proposal, these adjustments seem to be allowed. However, *ex-post* renegotiation would make the credibility of the temporary clause fade, so that the temporary nature of the recapitalization would still be unenforceable.

To conclude, the CMDI proposal would transform precautionary recapitalization from an instrument of flexibility to a rigid instrument that has no actual use to address the crisis of solvent but undercapitalized banks. The reform makes some steps forward in the definition of banks' solvency, despite the bad and convoluted formulation, and the early timing of the intervention. However, it does not consider the other key junctures that made the current precautionary recapitalization regime ineffective, including the proper design of the recapitalization instrument, and the political economy consideration.

On 24th April 2024 the European Parliament adopted the resolution P9_TA (2024)0327, "*on the proposal for a directive of the European Parliament and of the Council amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action (COM (2023)0227 – C9-0135/2023–2023/0112(COD))*".[142]

Following the CMDI proposal, the European Parliament most relevant amendments aim at *(i)* further specifying the conditions under which the aid can be granted; *(ii)* designing an effective way to ensure the temporariness of the aid.

Referring to point *(i)*, the Parliament intervenes in specifying the requirements for the intervention, stating that the aid shall be directed "*to remedy a serious disturbance in the economy of a Member State of an exceptional or systemic nature and to preserve financial stability*". With this amendment, the European Parliament aims at reducing the uncertainties highlighted also in the present paper in assessing the magnitude of the 'serious disturbance' which allows for a precautionary recapitalization. This amendment does not seem too relevant, as it states that precautionary recapitalization is not the 'common tool' to deal

142 *European Parliament*, "Legislative resolution of 24 April 2024 on the proposal for a directive of the European Parliament and of the Council amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action (COM(2023)0227 – C9-0135/2023–2023/0112(COD))", whereas 17.

with financial crises and it burdens Member States with the obligation to justify the necessity for the aid.

Further, the Parliament tries to address the assessment of the institution's solvency, stating that, in order to be eligible for extraordinary public financial support, an institution is considered solvent if, "*based on current expectations*" the competent authority "*has concluded that no breach has occurred, or is likely to occur in the 12 following months*" of the regulatory requirements. With such amendment, the Parliaments aligns this judgment with the Supervisory Review and Evaluation Process.

Under point *(ii)*, the Parliament amends the CMDI in order to address several shortfall highlighted during these years. Following the approach already used in the CMDI, the European Parliament requires that, for the aid to be granted, the Member State should submit, jointly to the State aid notification and the restructuring plan, a "*strategy to exit the support measure*". Such strategy should clearly state a "*termination date, sale date or repayment schedule for any of the measures provided*". In order to prevent the problems already incurred in the MPS case, and outlined in paras 4.2 and 6.1, the amended CMDI proposal requires that those dates "*shall not be disclosed until one year after concluding the strategy to exit the support measure, or the implementation of the remediation plan, or the assessment under the seventh subparagraph of this paragraph*". This amendment does not seem to be particularly innovative, but it is relevant insofar it transposes into the primary legislation a confidentiality duty.

The final, and perhaps most interesting amendment relates to the consequences of a breach of the exit strategy plan. If, under the CMDI proposal, failing to comply with the divestment plan entailed *ipso facto* a condition for the 'failing or likely to fail' declaration, the European Parliament seems to have a less strict, and perhaps more realistic approach. Under the amended version of the proposal, if after a precautionary recapitalization the institution is unable to comply with the predetermined exit strategy, the competent authority should request the submission of a "*one-time remediation plan*". Such remediation plan "*shall describe the steps to be taken in order to maintain or restore compliance with supervisory requirements, the long-term viability of the institution or entity and its capacity to repay the amount provided, as well as the associated timeframe*". In fact, this is what happened in the Monte dei Paschi di Siena case, when – after failing the first deadline – the Italian Republic asked for an extension of the plan, undertaking additional measure to ensure the compliance with the State aid measures and with the new deadline. If the second deadline is also missed, or if the competent authority deems that the one-time remediation plan is not credible or apt to restore the institution's long-term viability, "*an assessment of whether the institution or entity is failing or likely to fail shall be conducted in accordance with Article 32*".

Such approach certifies the current practice and seems more reasonable and flexible than the one adopted by the Commission in the original CMDI proposal, as it leaves some margin for addressing external factors (*e.g.*, global pandemics, wars, or market illiquidity) which are not under the financial institution's control. In addition, having a 'second chance' can prevent the risks showed in para. 6.1, concerning ex-post renegotiation following the original formulation of the CMDI proposal. Under the amended version, in fact, it is the system itself which provides for the possibility of an ex-post renegotiation, acknowledging that there are circumstances under which a recovering bank can fail to meet its obligations due to external factors.

7. Conclusions

This contribution analyzed the causes and implications of the State's challenges in reintegrating rescued banks into the market. We established a novel theoretical framework for precautionary State interventions in banks and, specifically, for precautionary recapitalization under EU Law. This framework served as the basis for scrutinizing the practical implementation of the measure and identifying relevant factors influencing precautionary recapitalizations. Furthermore, we conducted a preliminary analysis of the impact of the CMDI proposal original version and of the CMDI as amended by the European Parliament.

The existing framework, and unfortunately, the CMDI proposal, predominantly adopts a 'backward oriented' approach, primarily focusing on the constraints for providing aid to limit moral hazard. While this is necessary and praiseworthy, it completely overlooks the costs brought about by the events following the intervention, in particular the 'stickiness' of public ownership in the rescued banks. On the contrary, the amended version of the CMDI proposal seems to be more flexible and reasonable, but it is still extremely vague and insufficient in assessing whether an institution is solvent or insolvent. In addition, in several parts it reiterates the same approach (thus, the same criticalities) of the original CMDI proposal. Accordingly, a definitive solution to ensure a smooth re-entry of banks into the market is still elusive. Notably, the nature of the capital instrument (ordinary shares or hybrid instruments) appears to have minimal inherent impact on the State's divestment prospects. Instead, the design of the capital instrument, such as the use of instruments like reverse contingent convertibles, or other instruments specifically designed and tailored on the peculiarities of the single distressed institution, emerges as a more effective strategy.

Another critical determinant of a successful market re-entry is the timing of recapitalization. Precautionary recapitalizations prove most effective when applied to solvent institutions early in a crisis. However, practical implementation faces challenges, as banks are incentivized to delay loss recognition, and distinguishing between solvency and liquidity crises in distressed financial institutions is complex. Moreover, the mere request for precautionary recapitalization can worsen the bank's position, creating a self-fulfilling prophecy. In general, banks failing stress tests or equivalent assessments under baseline scenarios should be ineligible for precautionary recapitalization. For these reasons, we propose that primary legislation should be amended in order to *(i)* vest the SSM with the power to act preventively in the crisis and *(ii)* grant the SSM a broad discretion in deciding and tailoring the instruments of the recapitalization. None of the proposals takes into account such aspect, though.

Our findings underscore the need for a 'forward looking approach', combining well-designed capital instruments and timely interventions tailored to the unique circumstances of each financial institution: clear legal mandates and regulatory discretion are crucial for addressing the intricacies of the market re-entry process in the aftermath of banking rescues.