To what extent is Italy trying to keep banking ownership national? A Study of Liberal Economic Nationalism in the Italian banking crisis

by

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Alla mia mamma, Alessandra, e al mio papà, Dario, che mi hanno insegnato a lavorare con passione.

Abstract

In the aftermath of the economic and financial crisis of 2008, the European Union implemented a set of financial institutions and regulations aimed to strengthen the overall financial stability of the European banking system, and in particular of the Euro-area. The most important among the new measures are Banking Union and the Single Rulebook, which includes the Bank Recovery and Resolution Directive (BRRD). Under the BRRD, and especially since the entrance in force of the bail-in rule in 2016, the use of state-aid is heavily restricted. The entrance in force of the bail-in rule was critical for three Italian banks which were in a desperate need for capital between 2016 and 2017: Monte dei Paschi di Siena (MPS), Banca Popolare di Vicenza and Veneto Banca (V&V). Despite the new rules, however, MPS and V&V crises were eventually addressed through a generous use of state-aid, and the banks were granted the possibility to avoid a bail-in. The present thesis sets out to addresses this apparent contradiction in the two case studies by answering the research question: "To what extent is the Italian government trying to keep the banking ownership national?" In order to answer the research question, the thesis hypothesizes, under liberal intergovernmentalist and sociological institutionalist assumptions, the presence of liberal economic nationalism (LEN) in the Italian government's decision-making. Two alternative hypotheses are presented, one building on classic LI assumptions of domestic preference formation to formulate what is referred to as Functional LEN; and the other claiming, under neo-functionalist expectations, that the Italian government abode by the rules and LEN was not involved in the decision-making. The Italian government's decision-making under stress is analyzed by making use of process tracing and inference testing. The outcomes decisively indicate the presence of LEN in the decision-making, albeit it remains unclear which between LEN and Functional LEN better explains the Italian government's behavior.

Keywords: *Liberal Economic Nationalism, Banking Union, Italy, liberal intergovernmentalism, sociological institutionalism, historical institutionalism, process tracing*

Acknowledgments

Writing my Master thesis has been the most enjoyable part of my student life here in Enschede. Hearing me state these words out loud, several people around me have looked bewildered: it turns out that the words *enjoy* and *Master thesis* are rarely found in the same sentence unironically. Yet, this has been true for me. During this process, I have grown as a person and as a researcher. I have learned to welcome criticism and to react to it. I have discovered that research is a reiterative work, and when it demands to throw weeks of work in the trash bin and start again, so be it.

Therefore, my gratitude goes primarily to Professor Donnelly. As a supervisor, Mr Donnelly has trusted my abilities since the beginning, and has been able to guide my work while granting me space to make independent choices, to make mistakes and learn from them. I would also like to thank Professor Matera for readily accepting to be my second supervisor, and for working with Professor Donnelly on my feedback.

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CHAPTER I: INTRODUCTION

The entrance in force of the bail-in rule in 2016 was a game changer for European banks. According to the bail-in rule, contained in the Bank Recovery and Resolution Directive (BRRD), before receiving support through government funds, an insolvent bank needs to obtain cash from its own investors for at least 8% of its total value (Official Journal of the European Union, 2014). Designed to fight moral hazard by fostering investor's monitoring over the bank and to break the vicious cycle between sovereign and private debt (Gros and Schoenmaker, 2014), the bail-in rule has encountered substantial opposition in certain Member States, with Slovenian subordinated bondholders going as far as to claim the rule was against the country's constitution, which eventually required the European Court of Justice to examine the case (Khan, 2016; Guarascio and Sinner, 2016).

Besides Slovenia, another country which has been quite vocal in its opposition to the bail-in rule is Italy. Compared to Member States such as Ireland, Germany and the Netherlands which were immediately affected by the financial crisis of 2008, Italian banks were hit only in 2011, when Italy's two largest banks lost 30% of their value (Howarth and Quaglia, 2016; Di Quirico, 2010). Thus, if the lower internationalization of the Italian banking system had at first spared them from needing state support, a combination of poor management, overall increase of non-performing loans, and connection to Italian sovereign debt eventually hit several Italian banks. If four of these bank were bailed out in 2015, that is before the entrance in force of the much feared bail-in rule (Bodellini, 2017). However, three more banks, namely Monte dei Paschi di Siena (MPS), and Veneto Banca and Banca Popolare di Vicenza (V&V) were not as 'lucky', and their destiny was to a large extent shaped by this new rule.

It is exactly on these three banks that the present research focuses on. The main reason giving way to this interest resides, on the one hand, in the way MPS' and V&V's crises were handled; and on the other hand, in the comparison with the Banco Popular's resolution, a similar case taking place in Spain. In fact, not only does the use of state-aid in the Italian cases appear to be in contradiction with the bail-in rule, but it also diverge from the way a similar crisis was handled in another Member State. As a matter of fact, if Italy was allowed to repeatedly support its banks without requiring investors to bailed them in first, Spain prided itself on not using taxpayers' money to rescue Banco Popular Español, which was first bailed in and later incorporated by Banco Santander (Banco Santander, 2017; Il Sole 24 Ore, 2017d).

RESEARCH DESIGN and RESEARCH QUESTIONS

The BRRD, which contains the bail-in rule, is only a part of the numerous changes EU Member States implemented in the aftermath of the global financial crisis of 2008. In fact, between 2012 and 2016, a set of measures were taken aiming to boost, in particular, Euro-area financial stability. The most important among these new measures were the establishment of Banking Union and of the Single Rulebook. It is therefore in a context that entails new institutions and regulations that the case studies of MPS and V&V take place.

Therefore, the present thesis begins by outlying the new legislative and institutional framework of Banking Union, including expectations for actors behavior, and postulating that the final design of Banking Union has been shaped by Member States' liberal economic nationalism (LEN), that is a form of economic nationalism which utilizes neoliberal tools (Deeg, 2012).

Following this cue, the research introduces LEN and suggests, by offering an overview of the Italian banking sector and Italy's use of state-aid across the years, that the Italian government might be inclined to use LEN tools in its decision-making.

Two case studies are therefore analyzed by adopting a primarily liberal intergovernmentalist approach with the influence of sociological institutionalist insights, and by using process tracing and inference testing to answer the research questions. The first case study concerns the oldest operating bank in the world, Monte dei Paschi di Siena, which, after several recapitalization, was bailed out through precautionary recapitalization in July 2017. The second case study includes both Veneto Banca and Banca Popolare di Vincenza. In fact, the two banks share a similar background, a set of common features, and the same fate, which brought them to be wound down together under Italian insolvency law, and purchased by Intesa SanPaolo with generous government support.

Within the two case studies at hand, the present thesis chooses to investigate the use of state-aid, and the reasons motivating the Italian government's relentless opposition to the bail-in rules. More specifically, the present study aims to answer the research question:

To what extent is the Italian government trying to keep banking ownership national?

As a matter of fact, the present research aims to understand whether Italy's opposition to the BRRD, and its prominent state interventionism even within the new, stricter legislative framework, might have been motivated by liberal economic nationalism. In order to answer the main research question, the following set of sub-questions have been addressed throughout the course of this thesis:

1. Did the Italian government prevent the participation of foreign investors in the recapitalization of the bank?
2. Did the Italian government use state-aid in order to protect investors?
3. To what extent, if at all, does the state intervention in the case study represent a case of liberal economic nationalism?
4. How did the Italian government negotiate with the European Commission and the European Central Bank in order to enjoy higher tolerance towards state-aid?

The four sub-questions address four relevant aspects of the two case studies. Sub-question one is concerned with finding out whether the Italian government or the banks refused to accept foreign investors which could have substituted state intervention. In fact, the refusal of foreign investors strongly points to the government's will to keep banking ownership national.

On a slightly different note, sub-question two addresses another critical issue common to both case studies: the high participation of mis-sold retail investors and even depositors in the purchase of the banks' bonds and shares. Since the bail-in rule requires investors to contribute to the bank's rescue, it is reasonable to explore the option that investors' protection might have been the reason behind Italy's opposition to bail-ins.

More generally, sub-question three invites the researcher to analyze Italy's interventionism on the two banks, and to determine whether they classify as Liberal economic nationalism (LEN). LEN which plays a crucial role in this thesis' theoretical and analytical framework, entails all those government intervention which aim, through neoliberal tools such as the provision of patient capital or selective liberalization, to support national firms and/or damage the foreign (Clift and Woll, 2012). The use of LEN tools is an important clue that can reveal the government's intentions and motivations, and thus deserves special attention.

Finally, sub-question four delves into the negotiations between Italian and European institutions. Such question, which would deserve a dedicated research due to its complexity and relevance, helps explain Italy's behavior, and in general contributes to the overall understanding of the case studies.

SCIENTIFIC AND SOCIETAL RELEVANCE

The novelty of the present research is to be found in its theoretical framework, which attempts to merge liberal intergovernmentalism with sociological institutionalism. This choice represents an attempt to move beyond rational choice assumptions, in an effort to test whether embracing constructivist insights can sparkle new lights in the ontological debate on the nature of the EU (Saurugger, and Mérand, 2010; Risse-Kappen, 1996). In addition to that, the present thesis contributes to the ongoing debate around the nature of the European Union, relationship between European institutions and Member States, and the role played by each of them. The research builds upon liberal intergovernmentalist (LI) expectations on Member States and European institutions' behavior, which are largely confirmed.

Further, as Merler (2017b) underlines, the allegedly inconsistent application of the BRRD across similar cases (Banco Popular on the one hand, and MPS and V&V on the other), casts doubts on the predictability of European legislations and Member States' equality before the law. Predictability, as opposed to arbitrariness, and equality before the law are among of the main characteristics of the rule of law (Bingham, 2010). It is therefore in the interests of anyone concerned with deepening the rule of law within the European Union to develop a better understanding of the events, and to set the basis for further research, which will hopefully compare MPS and V&V's events with those of Banco Popular and others to come.

Lastly, this study aims to address and verify the claims of liberal economic nationalism in one of the largest EU Member States. Economic nationalism, which had been deemed anachronistic with the expansion of neoliberalism, has in fact made a patent comeback during and after the global financial crisis of 2008. In that instance, observers were forced to notice that not only economic nationalism had not disappeared, but that it had been able to adapt to the neoliberal economy, under the form of LEN (Pickel, 2003; Helleiner, 2002). Scholars have argued that the Italian government's decision-making, too, is affected by LEN (see Deeg, 2012; Donnelly, 2018). By analyzing the MPS and V&V case studies in depth in with the aim to detect any trace of LEN decision-making, this thesis contributes to this strand of literature, and has the potential to confirm or falsify such expectations.

CHAPTER II: BANKING UNION

Until 2012, banking within the euro-zone was regulated through decentralized supervision and regulatory competition (De Rynck, 2016). In the aftermath of the financial crisis of 2008, however, the will to boost euro-zone financial stability and to break the vicious circle between sovereigns and banking failures (European Commission, 2012) brought the Member States to agree in 2012 on the establishment of a European Banking Union (Howarth and Quaglia, 2016; Donnelly, 2016; Official Journal of the European Union, 2013).

FINANCIAL STABILITY

In order to better understand the design of the European Banking Union, it is necessary to introduce the concept of financial stability, and some of the main tools that can be implemented in order to support it. Financial stability can be defined as a bank's on-going capacity to meet the demands of its depositors and creditors, including other banks. In fact, banks' ability to lend each other money on a daily basis is a crucial aspect of financial stability (Donnelly, 2013). Financial stability can be enhanced by taking a set of measures, including supervision, resolution, deposit insurance, and the establishment of a temporary financial support fund.

a. Supervision

The first tool is supervision. Through supervision, the competent authority monitors a bank to ensure that its capital requirement, internal workings and detection and elimination of toxic or non-performing assets meet sufficient liquidity and solvency criteria, with the purpose of supporting financial stability (Donnelly, 2013). In order for supervision to be effective, supervisory authorities need to have the power to enforce requirement compliance (Donnelly, 2016).

b. Resolution

Resolution, on the other hand, allows authorities to intervene in order to ensure the orderly closure of a bank (Howarth and Quaglia, 2016). In fact, when previous interventions on an insolvent bank prove insufficient to restore its health, a bank is usually wound down through normal insolvency procedures. However, certain banks are so large or so important that their closure under ordinary procedures would negatively affect financial stability. In this case, resolution intervenes to ensure to preserve the critical functions of the bank and limit negative impacts on the economy (European Court of Auditors, 2012).

c. Deposit insurance and public backstop

Lastly, a deposit insurance scheme sets out to reimburse a bank's depositors up to a given amount in case of failure. Deposit insurance schemes aim to prevent "bank runs", that is to prevent depositors from withdrawing their savings fearing a collapse. By preventing bank runs, deposit insurance schemes enhance financial stability (Financial Stability Board, 2012). Key features of effective deposit insurance include broad protection of depositors to drive down the likelihood of a bank run, with best practices including between 90% and 95% of depositors; proper information provided to depositors, which ensures their awareness on the fact that they will be reimbursed, once again with the purpose of avoiding bank runs; and timely intervention, that is the ability to reimburse depositor within a week (Donnelly, 2016).

Deposit insurance schemes can be funded ex-ante, that is by collecting fees from banks through the years in order to prepare for a potential crisis, or ex-post, that is when the crisis occurs. Ex-ante funded deposit insurance is desirable because it reduces the chances that taxpayers will be called upon to support a bank, and because it discourages moral hazard, and promotes depositors' monitoring over the bank's activity (Donnelly, 2016). In either case, however, deposit insurance schemes need to be able to access a solid financial backstop in order to be credible (Van Rompuy, 2012). In fact, no matter how well prepared, deposit insurance is not sufficient in case of a systemic crisis. Banks need therefore to be able to access an open-ended public financial backstop that is able to support failing banks and prevent the crisis from further affecting financial stability (Donnelly, 2016).

THE THREE PILLARS OF BANKING UNION

As Schoenmaker (2011, 2013) has pointed out, the current state of the international banking system produces a "financial trilemma" among three elements: financial stability, cross-border banking, and national financial policies. In fact, these three elements are unable to coexist, and one has to give in.

Banking Union therefore set out to unify financial policies within the euro-area, in order to promote financial stability. The original layout of the Banking Union included five components: a single framework for banking supervision; a single resolution authority; a common deposit insurance scheme; a common backstop for temporary financial support; and a single rulebook for on bank capital and liquidity (European Council, 2012b, c).

The first three components, that is supervision, resolution, and deposit insurance, are considered the three pillars of the Banking Union (European Commission, 2017d). Among these, the Single Supervisory Mechanism (SSM) is the only one which has proved to have strong supranational powers, although still partially relying on national supervisors. The Single Resolution Mechanism (SRM), on the other hand, still relies heavily on national discretion for both the drafting and execution off resolution plans, and lacks sufficient resources to work autonomously (Donnelly, 2018). Finally, the European Deposit Insurance Scheme (EDIS) has yet to be agreed upon, leaving deposit insurance an exclusive competence of the Member States, harmonized by Deposit Guarantee Scheme Directive (2014/49/EU) (Howarth and Quaglia, 2018).

Another fundamental element of the Banking Union is the Single Rulebook (Verdun, 2016). The Single Rulebook consists of a set of legislations which aim to harmonize supervision and resolution practices of EU banks Considered the legislative basis of the Banking Union, the Single Rulebook actually applies not only to euro-area countries, but to all EU Member States. (European Banking Authority, n.d; World Bank Group, 2017; Howarth and Quaglia, 2016).

In addition to that, a common backstop for temporary financial support was established through an international agreement under the name of European Stability Mechanism (ESM). Due to its international rather than supranational nature, the ESM is not considered part of the Banking Union (Schwartz, 2014).

Figure 1 graphically represents the Banking Union, with its three pillars supporting it, of which the EDIS is still missing; and the Single Rulebook underlying it. The ESM, which is not considered part of the Banking Union, was not included in the picture.

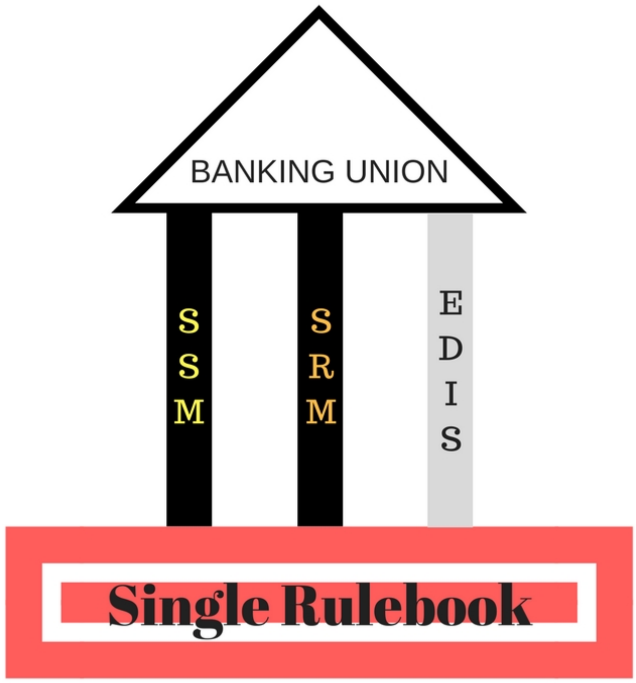

Figure 1: graphic representation of the Banking Union.

The remainder of this chapter focuses on the structure of Banking Union. In order to do so, sections 1, 2 and 3 introduce each of the three pillars of Banking Union individually, emphasizing their purpose; the role of negotiations in shaping the outline of each pillar; the institutions involved and their workings. Each section concludes by drawing a set of expectations for the case studies.

1. THE SINGLE SUPERVISORY MECHANISM

Established in October 2013 and entered in force on November 4th 2014 (Official Journal of the European Union, 2013), the Single Supervisory Mechanism transferred banking supervision from the national to the supranational level, with the purpose of ensuring consistent prudential supervision throughout the euro-area (De Rynck, 2016; European Central Bank, n.d). In fact, the mere cooperation among national supervisory authorities implemented until that moment had resulted to be unfit in times of crisis, where exchange of information and cooperation among supervisors proved to be insufficient (de Larosière Group, 2009). Furthermore, supervisors were acting on a "narrow national perspective" due to which the system was unable to "respond to the challenges of a globally integrated market (Padoa-Schioppa, 2007), which now called for European solutions (Allen et al, 2011; FSA, 2009). In addition to that, supranational supervision was introduced in order to curb national supervisors' forbearance and to prevent moral hazard, a desire voiced especially by Germany (Howarth and Quaglia, 2016: 89).

HOW NATIONAL PREFERENCES SHAPED THE SSM

Germany's concern with moral hazard, which was backed up by other Northern European countries such as the Netherlands and Finland, was not limited to supervision, but also to the introduction of the European Stability Mechanism, which was announced on the same day as the SSM (Howarth and Quaglia, 2016). As Minister of Finance Schäuble made clear, Germany's approval on the establishment of the European Stability Mechanism was conditional to the creation of a centralized supervision as a condition (Veron and Schoenmaker, 2016). It should therefore not come as a surprise that the SSM was the first pillar of the Banking Union to be established: in fact, Germany's position was held so strongly that, in the words of ECB President Draghi, the SSM was "an essential precondition for the other pillars of Banking Union" (European Central Bank, 2016c).

The difference in treatment towards systemically important banks and smaller banks was also influenced by German demands. More specifically, it was influenced by the difference between Member States' banking systems, and the governments' will to shape the new supervisory system to their advantage. As a matter of fact, within the German banking system, *Landesbanken* (regional banks) and *Sparkassen* (savings banks) are numerous and cover a significant portion of the market (European Banking Federation, n.d). Finance Minister Schäuble, reluctant to allow the ECB to directly supervise local bank, therefore opposed full supranational supervision (Epstein and Rhodes, 2016). On the other hand, direct supervision over all European banks was favored by countries such as France, the Netherlands, Italy, Spain and Luxembourg (Howarth and Quaglia, 2016). Among these, France, whose banking system was dominated by large banks, viewed the difference in supervision between large and small banks as unequal treatment (Howarth and Quaglia 2013).

The negotiations resulted in a compromise between the two coalitions. In fact, Germany reached its goal of maintaining national supervision over less important banks, but the ECB obtained the power to take over supervision of any of the 6,000 euro-area banks if it considers it necessary (Epstein and Rhodes, 2016). Curiously enough, Germany's goal to defeat supervisory forbearance was hindered by its own demand to keep small banks under national supervision, which proved to be, as will be discussed in the following section, the main obstacle standing in the way of a thorough and consistent supervision over all euro-area banks.

ECB DIRECT SUPERVISION OF SYSTEMICALLY IMPORTANT BANKS

Within the SSM, euro-area banks are divided into systematically important banks (E-SIBs), and smaller, less important banks (European Central Bank, n.d.; European Central Bank, 2016b). The first group falls under the direct supervision of the ECB. The ECB exercises its supervisory capacity through the Supervisory Board, currently chaired by Danièle Nouy. The Supervisory Board is composed by a Chair, a Vice-Chair, four members of the ECB and one representative per euro-area country supervisory authority (European Central Bank, n.d.).

The amount of E-SIBs has varied across the years, with 128 banks being directly supervised by the ECB in 2014 (European Central Bank, 2014b), and 118 in 2018 (European Central Bank, 2018). Each E-SIB is supervised by a Joint Supervisory Team (JTS). With a staff composed of a both national and ECB supervisors, JTSs have the goal of facilitating the sharing of information and enhancing the consistency of decision-making (Veron and Schoenmaken, 2016; Transparency International EU, 2017).

The ECB has proven to possess the power and the will to perform strong direct supervision upon the E-SIBs (Donnelly, 2018). Compared to national supervisors, the ECB has been more intrusive, performing more frequent on-site visits and asking more questions during investigations (Veron and Schoenmaker, 2016). However, NCAs still play an important role in the supervision of E-SIBs: NCAs are in fact the first line of communication with the banks, and are in charge of providing EU institutions with data and developing resolution plans (Donnelly, 2018). Given NCAs inclination towards national forbearance, their involvement in E-SIBs supervision calls the quality and cross-case consistency of implementation into question.

NCAs' SUPERVISION OF SMALLER BANKS

As far as smaller banks are concerned, their supervision is left to National Competent Authorities (NCAs). Due to a matter of resources and competence, most euro-area countries choose to establish their NCA within the national central bank (European Central Bank, n.d.). In this context, the ECB is in charge of monitoring the supervisory work of NCAs over smaller banks, and effectively acts as a supervisor of national supervisors (Lackhoff, 2013). Furthermore, the ECB ultimately retains the power to supersede NCAs and take over banks' supervision (Epstein and Rhodes, 2016).

If the NCAs' role in the E-SIBs supervision leaves room for discretion, its role in the direct supervision of less important banks is even more subject to loose implementation of European regulations and potential supervisory inconsistency across countries. In fact, the ECB and the NCAs are required to cooperate in good faith and exchange information, but the boundaries and obligation between the two are blurry, giving way to a complex dynamic, involving a considerable amount of discretion and unpredictability (Gren, 2017). As Veron and Schoenmaken (2016) note, national authorities are more subject to political pressure to pursue, for instance, perceived national interest over rigor. As a result, the considerable autonomy granted to NCAs may result in supervisory forbearance.

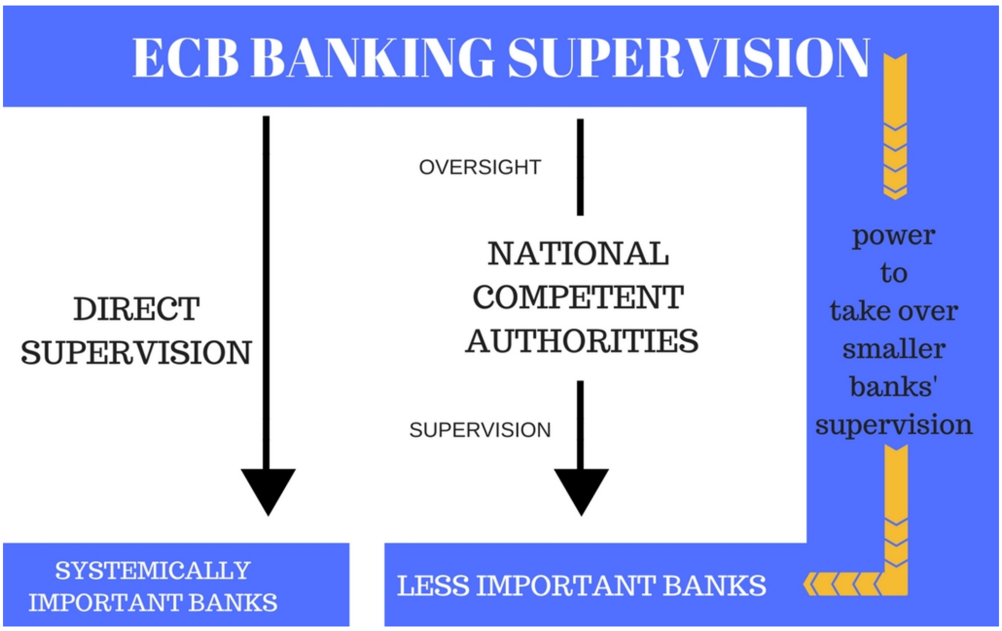

Figure 2: Schematic representation of the SSM. Inspired by Veron and Schoenmaken (2016).

SSM EXPECTATIONS FOR THE CASE STUDIES

In conclusion, the ECB can be expected to perform a supervision over E-SIBs, to engage in repeated in-site visits and detailed investigations, and to make politically-independent decisions. However, the NCAs' involvement in tasks such as the provision of data to the ECB provide them with room for discretion. As a result, a certain amount of variance can be expected in the implementation of supervision across countries.

Supervision over less important banks, on the other hand, is expected to be highly affected by national supervisors' forbearance. NCAs tendency towards supervisory forbearance therefore casts serious doubts over the quality and impartiality of their supervisory performance.

2. THE SINGLE RESOLUTION MECHANISM

The second tool for boosting euro-area financial stability to be included in the Banking Union is resolution. A resolution regime represents a political solution to distributive questions concerning the costs of a bank failure. Therefore, if during the financial crisis the bill was largely given to taxpayers, the Single Resolution Mechanism (SRM) was established with the purpose of making shareholders and bondholders responsible for the costs. By transferring the costs of a bank failure from state funds to a bank's stakeholders, the SRM set out to break the negative feedback loop between banks' and sovereign failures, and therefore ultimately boosting financial stability (Howarth and Quaglia, 2016).

The SRM was eventually established in 2014, and became fully operational in January 2015, except for the bail-in rule, which was enforced since January 2016. The SRM functions through the Single Resolution Board (SRB) and the National Resolution Authorities (NRAs). The SRM is regulated by the Banking Recovery and Resolution Directive (BRRD) and by Regulation (EU) No 806/2014, also referred to as the Single Resolution Mechanism Regulation (SRMR), as well as by Commission delegated regulations and European Banking Authority (EBA) standards and guidelines (European Court of Auditors, 2017).

However, beyond the sheer success of establishing a common resolution authority of any sort, the SRM lost several of its initial features through the heated negotiations that preceded its creation, resulting in a mechanism that fell short of what many had hoped for (Donnelly, 2016). In order to better understand the SRM and its limitations, the following sections will explore the role of national preferences, and especially of German demands, on the final design of the SRM. In addition to that, a brief legal explanation is introduced that partially explains the lack of substantial empowering of the SRB.

NATIONAL PREFERENCES AND LEGAL REQUIREMENTS

Although plans for centralizing resolution were in the making since autumn 2008, the first proposal for the BRRD was put forward by the Commission only in 2012. On the one hand, this delay can be attributed to the fact that the Commission wanted to make sure the plan would be in line with newly set international standards. On the other hand, however, resolution was a delicate subject for Member States, and was thus subject to extensive consultations, which took place in several occasions between 2009 and 2011 (Howarth and Quaglia, 2016).

Welcoming the Commission's proposal, France, Italy and Spain, insisted on the need to create a complete Banking Union in order to break the negative feedback loop between sovereign and banking crises, and therefore supported the establishment of a SRM (Agence France Trésor, 2013; Szago, 2013; Rajoy, 2012). In the same way, the Dutch government was in favor of the creation of the SRM, and together with the three main Dutch banks it advocated in favor of the complete independence of the mechanism (Netherlands Government, 2013).

On the other hand, Germany's position was dictated by concerns of moral hazard and desire to maintain national sovereignty over cooperative and savings banks. The moral hazard concerns brought Germany to support the BRRD and the bail-in rule, which they urged should enter in force, as was eventually decided, in 2016 rather than in 2018. Germany's will to protect cooperative and savings banks was mirrored in the final compromise by allowing the NRAs, rather than the SRB, to be responsible for less important banks (Howarth and Quaglia, 2016).

Beyond the role of Germany's demands, however, the delegation of resolution powers to a new body was limited by the Treaty on the Functioning of the European Union (TFEU). Under the TFEU, in fact, agencies cannot be endowed with tasks that involve a "margin or discretion" and only EU institutions, such as the Commission or the Council, can decide on matters of resolution. These limitations explain why, under the SRM, the Commission and the Council ultimately retain the power, for instance, of vetoing SRB decisions (Lintner, 2017).

THE BRRD AND THE SCOPE OF RESOLUTION

The BRRD constitutes the EU legal framework for dealing with banking crises (Bodellini, 2017). In fact, as for all the other elements of the Single Rulebook, the BRRD applies not only to euro-area countries, but to all EU Member States (European Banking Authority, n.d; World Bank Group, 2017).

Consistently with the overall objectives of resolution, the BRRD has the goal to promote the orderly resolution of failing banks while avoiding significant adverse effects on the financial system and to allow for banks to continue performing their critical functions. Another priority of the BRRD is that of breaking the negative feedback loop between private debt and sovereigns, especially by avoiding the use of taxpayer money in tackling failing banks. At last, the BRRD also sets out to protect insured depositors, client funds and client assets (Art 31 BRRD). In order to reach these goals, the BRRD set the rules for the prevention, early intervention, and resolution of failing banks within the EU (European Council, n.d.).

Overall, the BRRD sets a framework for crisis prevention and preparation, in order to avoid last-minute, uncoordinated and ad hoc measures, as was the case during the financial crisis (Lintner, 2017). Therefore, the BRRD's scope is not limited to the very last phases of a crises, but includes measures that call for early intervention through the implementation of recovery plans for troubled banks or of the other measures aiming to stabilize the bank (European Council, n.d.). Furthermore, under the BRRD, the default option for banks that are failing or likely to fail is to go through normal insolvency proceedings. This can be changed only if the competent resolution authority decides that normal insolvency proceedings are likely, in the specific case of a specific bank, to negatively affect financial stability. In this case the bank is put through resolution procedures (European Commission, 2017e).

THE SRB AND THE NRAs

As already mentioned, the structure of the SRM mimics that of the SSM. In fact, the Single Resolution Board is the resolution authority for more than 140 significant banks and cross-border banking groups, whereas the NRAs are responsible for the remaining, less important banks (Single Resolution Board, n.d.).

However, unlike the ECB, the SRB has proven unable to be a strong, centralized authority, lacking both the autonomy and the means to do so. In fact, the most important decisions concerning resolution are left to the ECB and the Commission, whereas the Council and the Commission retain veto power on certain crucial aspects of resolution. Therefore, rather than a being a strong, independent authority able to centralize euro-area resolution, the SRB is a system of coordination of national resolution authorities, which relies on the Commission and the Council for the most critical decisions concerning financial stability (Donnelly, 2018).

1. SRB's tasks

First of all, the decision to deem a bank failing or likely to fail (FOLTF) is left to the ECB. As a matter of fact, as stated in article 18 of the SRMR, the SRB can declare a bank FOLTF only in specific situations, and only if the ECB does not react within three days (Lintner, 2017).

Once a bank is declared FOLTF, the SRB is in charge of assessing whether winding the bank down under normal insolvency proceedings would have negative effects on financial stability (European Commission, 2017e; World Bank group, 2017). If it decides that a resolution is necessary in order to protect the public interest, the SRB produces a resolution proposal, which includes the actions the bank should take in the context of resolution (European Commission, n.d.).

Nevertheless, the Commission has the power to object or amend the proposal within twenty-four hours, and ask for the Council's involvement. In case of objection, the SRB has eight hours to modify the resolution proposal. However, the final decision rests upon the Council: if the Council decides to veto the resolution procedure, the bank will be wound down under normal insolvency proceedings (Lintner, 2017).

Apart from tasks directly related to resolution decisions, the SRB is also in charge of drafting the recovery plans for the banks within its remit, in consultation the NRAs, which are later to be assessed by the ECB (European Commission, 2017e); developing a framework for assessing whether a bank is failing or likely to fail (Veron, 2018); administering the Single Resolution Fund, although, since these decisions directly concern financial stability, the Council has the right to veto on them (Lintner, 2017); and ultimately ensuring consistency and harmonization within the SRM (European Court of Auditors, 2017).

2. SRB's shortcomings

On top of the severely limited autonomy granted to the SRB, the European Court of Auditors (2017)'s report underlined a set of shortcomings in the fulfillment of the SRB tasks. These shortcomings can be attributed to the fact that the SRB was set up from scratch in a short period of time and entrusted with considerable responsibility while still in a "start-up phase". In addition to that, the board was largely understaffed and overall lacking the necessary resources needed to perform its tasks (European Court of Auditors, 2017).

Due to these reasons, as of 2017, the SRB had not yet completed the resolution plans for the banks within its remit, whereas the plans submitted in 2016 did not fully meet the Single Rulebook requirements (European Court of Auditors, 2017). The creation of proper resolution plans is important for systemic financial stability because it has the potential to avoid lengthy resolutions through a court-order liquidation, and allows for banks to be resolved through an orderly administrative process instead (Veron, 2018).

Secondly, the SRB failed to develop a framework assessing whether a bank is failing or likely to fail (European Court of Auditors, 2017). In regards to this specific issue, concerns have been raised as to whether or not the SRB actually played its role in the precautionary recapitalization of Monte dei Paschi di Siena (Veron, 2018). In fact, assessing whether or not a bank is failing or likely to fail is of critical importance because it can determine whether or not it will be wound down. The lack of clear criteria upon which to base such a decision threaten to result in arbitrary and inconsistent decisions across similar cases (Merler, 2017b). At last, the European Court of Auditors (2017) lamented the lack of an efficient and timely flow of information from the ECB to the SRB, as well as the lack of a clear division of tasks between the SRB and NRAs.

3. NRA's tasks

Under the SRM, each Member State is required to establish an NRA. Each NRA is in charge of drafting resolution plans for the banks within its remit, and to assist the SRB in drafting resolution plans for the remaining banks (Magnum and Mesnard, 2016); to perform, where needed, an early intervention on troubled banks by requiring the implementation of reforms and restructuring plans, or by implementing changes within the bank's board and even appointing special figures and temporary managers (European Council, n.d).

In addition to that, the NRAs are in charge of executing the resolution plans for E-SIBs and cross-border banking groups when required by the SRB; and to provide the SRB with information regarding the banks (Magnum and Mesnard, 2016). As far as resolution decisions are concerned, each NRA can decide in autonomy whether or not to resolve a given bank, as provided under the BRRD (Lintner, 2017). The resolution of banks under the NRA's remit always occurs under normal insolvency proceedings (Single Resolution Board, n.d.).

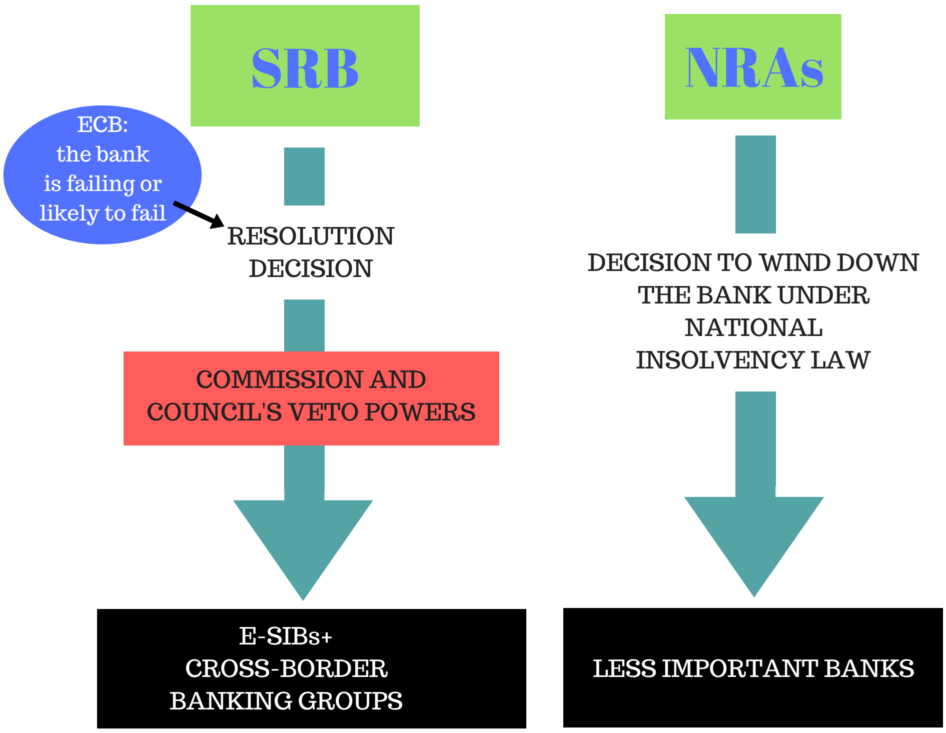

Figure 3: Schematic representation of the SRM.

THE SINGLE RESOLUTION FUND

A third element of the SRM is the Single Resolution Fund (SRF). The Single Resolution Fund was established through the SRM Regulation, and it has the purpose of providing temporary support in case of bank resolution, stakeholder compensation, and recapitalization (European Council, n.d).

The SRF is funded through annual contributions of the 19 euro-area Member States, with the goal of reaching an amount equal to 1% of all covered deposits within the Banking Union by 2023. The SRF cannot be used to recapitalize banks or cover their losses. However, in exceptional circumstances, the fund can be used to be used to contribute to a credit institutions under resolution, provided that the contribution does not exceed 5% of the bank's total liabilities, and that a bail-in of at least 8% of the bank's core equity capital has taken place (Single Resolution Board, n.d.).

SRM EXPECTATIONS FOR THE CASE STUDIES

Due to severe limitations in its design, the SRB decision-making and action relies on the NRAs, on the Commission, and on the Council. As far as the determination of banks which are failing or likely to fail, the SRB is expected to follow ECB indications. All in all, the SRB is a weak institution, unlikely to play a central role in the case studies

The NRAs, on the other hand, have more freedom of action. Taking into account national supervision's record of forbearance, however, national resolution authorities can also be expected to cede to internal pressure and act with less objectivity as compared to a supranational authority.

3. THE EUROPEAN DEPOSIT INSURANCE SCHEME

The original design of the banking union was supposed to entail a third, unrealized pillar: the European Deposit Insurance Scheme (European Council, 2012a). During the financial crisis, and until 2014, deposit insurance was in fact regulated through the DGS directive of 1994 (94/19/EC), which introduced minimum harmonization among national DGS. Such directive required all member states to cover at least 90% of deposited capital, for a minimum of €20,000 per person. This minimum was however exceeded by most Member States (Howarth and Quaglia, 2018). The Directive left room for a considerable amount of variety among Member States. For instance, Member States could choose whether to protect deposits per depositor, per account, or "per depositor per institution"; and whether to fund the DGS ex ante, that is to collect premium in preparation for a possible crisis, or to fund it ex post, that is to collect resources from surviving institutions in the event of a bank's failure (Howarth and Quaglia, 2018).

CALLS FOR A COMMON DEPOSIT GUARANTEE SCHEME

However, the global financial crisis underlined the importance of a strong deposit guarantee in improving financial stability (Financial Stability Board, 2012). As a result, several international and European observers supported the idea of establishing a European common deposit insurance scheme (International Monetary Fund, 2012**;** Van Rompuy, 2012; Constancio, 2014). The Van Ronpuy report (2012) for instance, commented that the establishment of a European deposit insurance scheme would "strengthen the credibility of existing arrangements and serve as an important assurance that eligible deposits of all credit institutions are sufficiently insured".

Critically, though, Member States were split in their position towards the EDIS: France, Italy and Spain expressed their support for the establishment of a EDIS, which they saw as a necessary step to towards completing the Banking Union (Szego 2013, 7; Rajoy 2013); whereas Germany and Austria, strongly opposed the idea.

In fact, when the establishment of the EDIS was first proposed by the Commission in 2010 (Commission, 2010), Germany and Austria immediately rejected it. Germany's opposition in particular pushed the EDIS out of the agenda until 2015, when the Commission made one last attempt at presenting a draft proposal (Howarth and Quaglia, 2018), which until the time of writing, however, the proposal has yet to be agreed upon.

The following paragraphs seek to explain the reasons behind Austrian and, in particular, German opposition to the EDIS. Eventually, the section concludes by presenting the DGS directive of 2014, and by drawing expectations for the case studies.

OPPOSITION TO THE EDIS

Opposition to EDIS was mainly motivated by the fear that the costs of bank failures or insolvency would fall on those countries with more stable banking system; and by concerns for moral hazard. The first set of concerns were expressed by Germany, the Netherlands, Austria, Finland, which, as summarized by the Finnish Government (2016) feared that in a European deposit insurance scheme benefits and costs unevenly distributed. In addition to these countries, non-Eurozone Member States, such as the UK and Sweden, saw no benefit in joining such a scheme: being outside the Eurozone, in fact, their central bank already provided them with fiscal backstop (Howarth and Quaglia, 2018).

The concerns of moral hazard, on the other hand, were expressed mainly by Germany. In fact, although other Member States such as the Netherlands had made similar statements (Dutch Government, 2012), Germany engaged in a full-frontal opposition, supported by all German political parties (Koalitionsvertrag 2013) and voiced most notably by Minister of Finance Schäuble (Howarth and Quaglia, 2018).

Although Member States opposing the EDIS explained their opposition based on the the two reasons discussed above, Howarth and Quaglia (2018) convincingly argue that the underlying reason for this position can be ultimately found in the difference between national banking systems, which in turn substantially shaped national preferences regarding deposit guarantee schemes. In fact, in Germany and Austria, multiple DGS and institutional protection schemes were in place, most of which were funded ex-ante (Howarth and Quaglia, 2018). German banks therefore opposed the creation of an EDIS, both because they feared it would harm the existing protection schemes (Handelsblatt, November 7, 2012; Kaiser 2012); and because, just like Minister Schauble, they did not trust ex-post funded DGS, which were in use in other Member States, such as the UK, Italy, and the Netherlands (Howarth and Quaglia, 2016).

DGS DIRECTIVE (2014/49/EU)

In the lack of a common deposit insurance scheme, deposit insurance in the EU in currently regulated by DGS directive (2014/49/EU), approved in 2014, which substitute the previous 1994 directive. The new requires DGSs to cover deposits for up until €100,000. Furthermore, following German requests, certain types of banks, such as credit unions, cooperative and saving banks, are exempted from these requirements. In addition to that, DGSs can be used during resolution, but inter-state borrowings remain voluntary, with the risk that the Member States which are most in need might lack sufficient funds (Donnelly, 2016).

DGS EXPECTATIONS FOR THE CASE STUDIES

Due to the failure to establish a common deposit guarantee scheme, deposit insurance remains an exclusive competence of Member States. Deposit insurance schemes are required under the 2014 DGS directive to cover deposits for up until €100,000. Even before the entrance in force of the directive, Italian deposit insurance coverage was already higher than the new European requirement (Howarth and Quaglia, 2016). Italian DGSs are therefore expected to intervene and satisfy the directive's requirements when needed.

4. REFLECTIONS ON BANKING UNION

In conclusion, Banking Union is incomplete, leaves several crucial tasks within the remit of national institution, and overall falls short of the its original design and of the suggestions of experts (Donnelly, 2016). As seen throughout the chapter, the gaps in the architecture of Banking Union can be largely attributed to negotiations between Member States (see Howarth and Quaglia, 2016). The point has therefore been made that the deficiency in the current state of Banking Union is motivated by liberal economic nationalism (LEN) (Donnelly, 2018). Through LEN, nation-states use neo-liberal tools to provide national firms or banks with comparative advantage towards the foreign (Clift and Woll, 2012; Deeg, 2012). Based on the assumption that Member States are, at least in part, driven by LEN, the following chapter theorizes LEN; presents how state-aid is regulated under the BRRD; and eventually explains how countries can exploit the loopholes in the law to their advantage.

Proposition 1: Banking Union presents a set of lacunas, which originated in highly intergovernmental negotiations, where Member States were driven by LEN

CHAPTER III: LEN AND STATE-AID UNDER THE BRRD

1. Liberal Economic Nationalism

AN INTRODUCTION TO ECONOMIC NATIONALISM

Before discussing LEN, it is worth presenting its predecessor: economic nationalism. Economic nationalism can be defined as the will to promote the national economy and to prevent it from helplessly fluctuating with the ebbs and flows of the international markets (Pryke, 2012). Tightly related to the concept of nation-state and motivated by nationalist concerns (Nakano, 2004; Helleiner, 2002), with the rise of globalization and neoliberalism, economic nationalism was increasingly deemed anachronistic (Pickel, 2003; Harmes, 2011), and belonging to a past era where nation-states used to have control over the national economy (Hobsbawm, 1992). The demise of economic nationalism was ever-more evident in the 1990s, when the alleged success of neoliberal policies brought scholars of diverse backgrounds to accept the 'apparently unstoppable rise of economic imperatives, heralding the demise of politics' (Clift and Woll, 2012).

Despite all this, nation-states might still have a reason to engage in some form of economic nationalism. In fact, in a globalized economy, politicians are faced with the paradox of neoliberal democracy, that of being given the task to pursue the economic interests of their nation, while being very limited in their actions due to the economically and legally interconnectedness of markets (Crouch, 2008). Moreover, such latent paradox became ever-more patent when the crisis hit in 2008, and national governments had additional reasons to protect national companies and banks, even through new and untested measures. In fact, in this instance governments adopted measures aiming to stimulate consumption, prop up credit markets, and prevent the overall failure of the national and international financial system by using quantitative easing, issuing state guarantees, taking on large chunks of private debt, and so forth (Grossman and Woll, 2014; Clift and Woll, 2012).

STATE INTERVENTIONISM AND PROTECTIONISM

It is however important to notice that state intervention per se is not necessarily a symptom of economic nationalism, but can also be largely found in neoliberal economies. In fact, although neoliberalism is founded on the conviction that state intervention on market is to be avoided because governments do not dispose of enough information to be able to manipulate the market in a virtuous way (Hayek, 1944), liberal markets actually "need constant state intervention" (Polanyi, 2001). Within this thesis state interventionism per se will not be considered economic nationalism whereas protectionism will.

Before deeming a case of state intervention in the economy an episode of economic nationalism, the observer needs to analyze the scope and purpose of such intervention. In fact, both state interventionism and protectionism provide national firms and banks with subsidies or support of different kinds; nevertheless, while simple state intervention is limited to providing help to the national, protectionist policies also actively aims to: (1) harm the foreign, or at least put the national in an advantaged position; (2) maintaining the status quo, such as the national presence in the company or bank and opposing foreign acquisitions (Clift and Woll, 2012).

LIBERAL ECONOMIC NATIONALISM

As scholars have observed, economic nationalism has been able to survive and adapt to neoliberalism (Pickel, 2003; Helleiner, 2002). In so doing, economic nationalism has taken a new shape and acquired a new set of tools, that together are referred to as liberal economic nationalism (LEN).

LEN is liberal in that it "fosters market competition and cross-border openness", but nationalistic, because it does so in order to "enhance the competitive advantage of domestic firms vis-à-vis non-domestic competitors" (Deeg, 2012). According to Clift and Woll (2012), just like for protectionism, LEN policies aim to favor domestic firms and hinder the foreign ones, albeit through different measures, which usually include the selective and strategic use of neoliberal tool, such as liberalization. It is worth adding that, according to the authors protectionism and LEN should be considered a continuum rather than clearly divided categories, and can, under certain circumstances, coexist.

LEN AND STATE-AID

In European Union law, state-aid is an objective notions defined in Article 107 of the TFEU. Article 107(1) in fact defines state-aid as "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods […], in so far as it affects trade between Member States".

Countries engage in state-aid in order to support national firms or banks. As a consequence of state-aid, the firm or bank in question receives a competitive advantage as compared to the other firms or banks on the market. Therefore, exceptional situations aside, state-aid is can be directly connected to LEN.

Proposition 2: state-aid and LEN are tightly related.

LEN AND PATIENT CAPITAL

A more specific example of LEN and state-aid within the financial sector is the provision of patient capital to insolvent banks. The term patient capital, also known as long-term capital, refers to the provision of economic resources on market basis, thus with low interest rates, to be returned in the long term (Deeg, Hardie and Maxfield, 2016).

Patient capital can be provided by private firms as well as by the government. An example of government provision of patient capital can be found in the UK, where the necessity of state support of start-ups through patient capital has been publicly stated (UK Industry Panel, 2017). State provision of patient capital also applies to the banking sector. Following the same logic as the one used by the UK towards start-ups, governments provide patient capital to insolvent banks that would otherwise be unable to access to loans on the market, and in so doing act as lender of last resort (Donnelly, 2018).

2. Liberal Economic Nationalism in Italy

The present section addresses the likelihood of encountering LEN in the specific case of the Italian banking crisis. In order to do so, it first places the case into the context of the Italian banking sector. After that, it presents examples of how Italy has used state-aid through the years. Eventually, it draws expectations for the case studies.

THE CONTEXT OF ITALIAN BANKING SECTOR

For a long time, Italian banks were often thought of as a public good, and therefore treated as such. This may be due to the fact that, in 1991, Italian state-owned banks counted around 80% of all deposits, and gave out 90% of all loans (Marrelli and Stroffolini, 1998), so much so that a court decision even considered banking as 'objectively having some of the characteristics of a public service' (Ciocca, 2005).

Nevertheless, during the 1990s and the early 2000s, the Italian banking sector went through a series of important reforms, leading to the privatization of state-owned banks and the transformation of savings banks into commercial entities (Gazzetta Ufficiale, 1990). This resulted in a series of mergers, that eventually led Intesa SanPaolo and Unicredit to become the two most important banks, covering together 47% of the Italian market (Schoenmaker and Veron, 2016; Deeg, 2012).

When the global financial crisis eventually hit the Italian banking system in 2011, Italy's two largest banks, Unicredit and Intesa, which held at the time €228 billion of Italian sovereign debt, lost almost 30% of their market value. In the same period, the amount of non-performing loans owned by Italian banks increased dramatically, as they had been at least since the outbreak of the financial crisis. The Comprehensive Assessment of 2014 took on a stricter definition of non-performing loan, with the purpose of fighting forbearance. The test saw four Italian banks fail (Howarth and Quaglia, 2016).

Although the Italian problem with non-performing loans was identified in 2014, a series of events prevented a timely solution to the problem (Transparency International EU, 2017). It is in this period that the Italian banking crisis began its most acute phase.

LEN AND STATE-AID IN ITALY

As far as generic protectionism is concerned, Italy has a history of state intervention and support of national champions. Examples of governmental support to private firms can be found in the subsidies granted to the Fiat Group (Germano, 2012); and in the use of the golden rule share within Telecom Italia (Ansa Italy, 2017).

Furthermore, and more importantly, Italy has a record of recent interventions in the banking sector. In fact, at the end of 2015, that is right before the entrance in force of the BRRD bail-in rule, Banca delle Marche, Cassa di Risparmio di Ferrara, Banca Popolare dell'Etruria e del Lazio, and Cassa di Risparmio della Provincia di Chieti were resolved. The Italian Resolution Authority made use of a combination of tools to resolve these four local Italian banks, such as asset separation, bridge bank and burden sharing. On top of that, the Italian Resolution Fund provided financial resources. In total, the Italian Resolution Authority bailed out these small banks by €3.7 billion, a remarkable amount of cash if compared to the €870 million which was bailed in. In order to supply the banks with such a large capital, the Resolution fund needed to borrow considerable sums from the three largest Italian banks (Bodellini, 2017).

Lastly, the point has been made that the tight connection between Italian banks and the government is unchanged. In fact, Italy's two largest banks, Unicredit and Intesa Sanpaolo, supported Italy by buying significant portions of its debt in the aftermath of the financial crisis, in exchange for the government's previous support to the banks (Deeg, 2012).

LEN EXPECTATIONS FOR THE CASE STUDIES

This section has underlined the tight relationship between Italian banks and the government. It has furthermore showed Italy's record of using state-aid to support national champions. As a consequence, the Italian government can reasonably be expected to be willing to use state-aid to support failing banks.

Proposition 3: Italy has a record of using state-aid, and therefore of LEN.

3. State-aid under the BRRD

One of the main purposes of the BRRD is to heavily reduce the use of state-aid within the EU (Donnelly, 2018). In order to do so, the BRRD builds on Article 107 of the Treaty on the European Union, according to which any sort of state-aid which threatens to distort competition must be avoided. In addition to that, the BRRD introduces the bail-in rule, which makes the use of state-aid even less accessible.

However, both in the TFEU and in the BRRD, a set of exceptions are made to this general disposition that aim to account for natural, social, or economic calamities. In particular, Article 107.3(b) of the TFEU allows for state aid when it aims to 'remedy a serious disturbance in the economy of a Member State. In the same way, the BRRD allows for state-aid in exceptional situations, such as in the case of a systemic crisis, or of a severe disturbance of the economy.

These loopholes tend to the necessity of crisis management legislations to retain enough flexibility to be able to account for the specificities of different scenarios (Veron, 2017). Nevertheless, a secondary consequence of such loopholes is the room left to Member States to lobby European institutions in order to satisfy their nationalistic goals. The remainder of this chapter presents how state-aid is regulated under BRRD.

EXCEPTIONS TO THE RULE

In order to prevent the use of state-aid, under the BRRD banks reporting a capital shortfall are urged to raise capital on the market or from other private sources (European Commission, 2017). Nevertheless, state-aid is still allowed under the BRRD, under specific conditions, namely:

- in the context of a *resolution* procedure, conditional to burden-sharing and to the compliance with the bail-in rule;
- is in the form of *emergency liquidity assistance (ELA)*, provided by national central banks;
- in the case of a systemic financial crisis, through the *public equity support tool* or through the *temporary public ownership tool*, and still conditional to burden-sharing and compliance with the bail-in rule;
- in case of a serious disturbance of the economy, under the form of a *precautionary recapitalization*, and solely conditional to burden-sharing.

Due to the fact that their use is conditionally to the truly exceptional nature of a systemic crisis, the public equity support tool and the temporary public ownership tool have not been used since the entrance in force of the BRRD. The bail-in rule, emergency liquidity assistance, and precautionary recapitalization, on the other hand, are relevant both for the case studies at hand and for the new resolution regime as a whole. The following paragraphs will therefore focus on them.

THE BAIL-IN RULE

If a bank's shortfall persists and the bank is put through resolution procedures, Member States can decide to provide it with state-aid, by notifying the Commission. Nevertheless, the provision of state aid is conditional to burden-sharing, which consists in the reduction of shares and subordinate bonds' value, followed by the conversion of subordinate bonds into shares (Bank of Italy, n.d); and, since January 1st 2016, to the compliance with the bail-in rule.

A bail-in consists in the imposition of the losses resulting from a bank's failure on its shareholders and creditors. Unlike liquidation, a bail-in aims to keep the fundamental functions of the bank working (Bodellini, 2017).

The bail-in rule requires creditors and shareholders to bear losses for a minimum of 8% of the bank's core equity capital before the bank can resort to other funds, such as resolution funds. The BRRD aims to protect natural persons and small and medium-sized enterprises holding accounts of up to €100,000, which are put at the end of the bail-in sequence and possibly exonerated from it. Compliance with the bail-in rule is a precondition for accessing state-aid or SRF funds during a resolution procedure (European Council, n.d).

The bail-in rule fulfills two goals: on the one hand, it aims to break the vicious circle between private and sovereign debt, while on the other it aims to curb moral hazard by motivating investors, creditors and depositors to hold the bank accountable for its actions (Gros and Schoenmaker, 2014).

More pragmatically, due to its high cost for shareholders, creditors and investors, the bail-in rule has the effect of motivating banks to seek private capital rather than immediately recurring to state-aid failing banks. Furthermore, the bail-in rule drastically changed the European financial framework especially with regards to investors. In fact, for the first time investors are called upon to bear the costs of a failing bank, with the possible -and intended- effect of moving investors away from risky deals. Lastly, by making state-aid conditional to a bail-in, the bail-in rule curbs the overall use of taxpayer money in banks' failures, with positive effects for financial stability.

A CRITIQUE OF THE BAIL-IN RULE

Despite its potential benefits, the point has been made that the bail-in rule could actually foster the very financial distress it is meant to prevent. In fact, if writing down the bank's liability results in a transfer of insolvency from the bank to its creditors, or if a significant portion of the liabilities are held by other banks, a bail-in can create or accelerate contagion and generate a domino effect. This issue is addressed by Article 44 of the BRRD, which allows resolution authorities to exempt some liabilities from bail-in if in risk of generating financial instability. In addition to that, Article 8 of Commission Delegated Regulation (EU) 2016/860 requires that in such delicate situations resolution authorities meticulously assess the interconnectedness of the credit institution and exclude risky liabilities from the bail-in process (Bodellini, 2017).

Another problematic aspect regards the use of resolution funds. In fact, under Article 44 of the BRRD, a bank can resort to a resolution fund only if a bail-in for a minimum of 8% of the liability has previously taken place, and the fund can cover only up to 5% of the liabilities. This rule can be problematic if the bank finds itself in the particular situation described above, that is in case a bail-in would risk triggering contagion (Bodellini, 2017; European Council, n.d.).

EMERGENCY LIQUIDITY ASSISTANCE

Emergency Liquidity Assistance (ELA) has the goal to provide struggling solvent bank in the Eurozone with liquidity under exceptional circumstances, (European Central Bank, n.d.). ELA is provided to the struggling bank by the country's national central bank. In order for ELA to be carried out, the ECB must be notified two working days before the provision of state-aid (European Central Bank, 2013).

An example of ELA can be found in the V&V case study. In fact, on January 19th 2017 the Bank of Italy received the Commission's approval to provide Vento Banca and Banca Popolare di Vicenza with state-aid in the form of public guarantees on subordinate bonds (Banca Popolare di Vicenza, 2017a; Gruppo Veneto Banca, 2017a; Corriere del Veneto, 2017).

PRECAUTIONARY RECAPITALIZATION

The ECB defines precautionary recapitalization as an exceptional measure that provides the injection of state funds into an insolvent bank in case of serious disturbance of the economy (European Central Bank, 2016a; Official Journal of the European Union, 2014). Through precautionary recapitalization, Member States provide the insolvent bank with patient capital (Donnelly, 2018). In order for precautionary recapitalization to be lawful under the BRRD, Article 32 requires a set of conditions to be met:

- the bank must be solvent, and therefore deemed not to be failing or likely to fail;
- the precautionary recapitalization must be approved under the EU state aid framework, the amount of capital provided to the bank through the precautionary recapitalization must be limited to covering the shortfall assessed by the competent authority and it must not confer an advantage upon the institution;
- the precautionary recapitalization needs to address a severe disturbance in the economy of a Member State in an effort to preserve financial stability, and it must be of temporary nature (Veron, 2017).

Precautionary recapitalization is the only option available to Member States which allows them to provide banks with capital without performing a bail-in, but only a burden-sharing (Olivares-Carminal and Russo, 2017).

A SERIOUS DISTURBANCE OF THE ECONOMY

Among the requirements for a precautionary recapitalization enlisted above, a few more words deserve to be spent on the phrase "a serious disturbance of the economy". The reason behind this requirement is that the BRRD aims to curb the incurrence of moral hazard, and builds on the principle that state-aid needs not be used unless strictly necessary. Therefore, state-aid is allowed only in extraordinary circumstances, as the case of a serious disturbance of the economy (Official Journal of the European Union, 2014).

In fact, during a serious disturbance of the economy, other credit institutions are likely to be short of liquidity, and therefore the state needs to act as a lender of last resort. Furthermore, in this case, precautionary recapitalization does not foster moral hazard, because a severe disturbance of the economy is likely to be beyond the control of a bank's board (Olivares-Carminal and Russo, 2017).

Critically, however, the criteria for determining a serious disturbance of the economy are not clarified within the BRRD. Although crisis management legislations need to leave enough room for discretion to allow for each case to be tended to in its specificities (Veron, 2017), the haziness around such a critical term makes the territory surrounding precautionary recapitalization more uncertain that it is desirable (Olivares-Carminal and Russo, 2017).

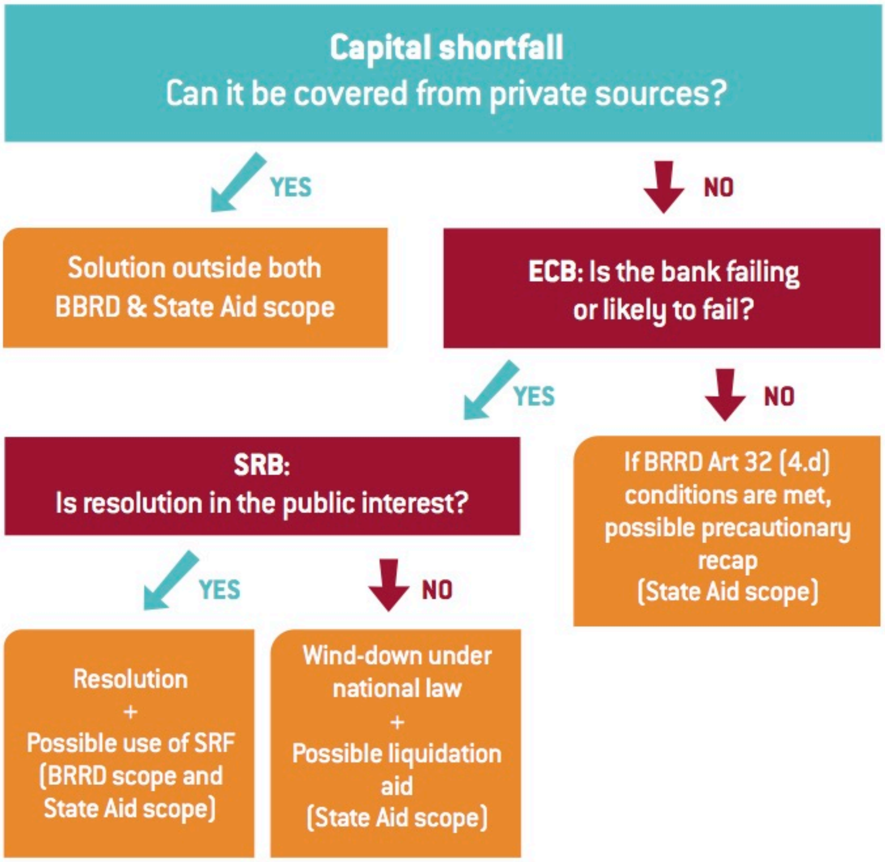

Figure 4: Schematic representation of the conditions for accessing state-aid under the BRRD. Retrieved from Merler (2017).

PATIENT CAPITAL: A LOOPHOLE

As explained in the beginning of this section, when banks present a capital shortfall, they are urged to recapitalize on the market or from private sources. However, Member States are also allowed to satisfy the bank's need for capital themselves, as long as the capital supply is in line with market conditions. An example of this has taken place in Portugal in March 2017, when the government recapitalization of the fully state-owned bank Caixa Geral on market terms was not considered state-aid (European Commission, 2017e).

It is worth noticing that, although this kind of state intervention is not considered state-aid under EU law, it fits the definition of patient capital provided by Deeg, Hardie and Maxfield (2016). Therefore, this can be considered the first way through which Member States can support their banks without breaching EU law.

STATE-AID EXPECTATIONS FOR THE CASE STUDIES

As seen throughout this section, despite generally forbidding state-aid, the BRRD presents several loopholes the Member State could potentially exploit in order to serve LEN purposes. Given Italy's record of providing state-aid to both firms and banks, it is reasonable to expect that the Italian government will at least attempt to make use of these loopholes in order to support its national (and regional) champions.

Proposition 4: the BRRD presents a set of loopholes due to which Member States with sufficient relative power could potentially lobby European institutions in order to make use of state-aid.

CHAPTER IV: THEORETICAL FRAMEWORK

This chapter aims to build a theoretical framework solid enough to support the hypotheses, variables, and eventually outcomes that are used to analyze the case studies. In order to do so, a literature review of integration theory is first provided, with the purpose of choosing the most fitting ontological approach to the EU and to build expectations for Member States and European institutions' behavior. Secondly, the limitations of integration theory are bridged by various types of new institutionalism. Eventually, the hypotheses are presented and explained.

1. INTEGRATION THEORY

When addressing ontological questions concerning the EU, scholars traditionally choose between a neo-functionalist or an intergovernmental approach. In fact, neo-functionalism and intergovernmentalism (together with its newer versions such as liberal intergovernemntalism) constitute the two main theories of European integration. Such theories set expectations on actors behavior, and generally serve as a backbone for European studies researches (Rosamond, 2016).

Therefore, this chapter offers an overview of integration theory and of how they serve to analyze EU post-crisis developments, including Banking Union. While doing so, it makes use of the propositions and observations drawn from the previous chapters, in order to choose which one, among the theories presented, is better able to explain the study at hand.

1.1 Neo-functionalism

Based on the work of Ernst B. Hass (1958), neo-functionalism is the very first theory of European integration. Such theory is centered around the conviction that the European Union is bound to an ever-closer union, and will ultimately constitute some sort of political union (Jensen, 2016). This process is expected to happen through three phenomena: elite socialization, supranational interest groups, and the spillover effect

1. Elite socialization

Firstly, the elite socialization hypothesis postulates that, after spending a considerable amount of time involved in the European decision-making, national leaders develop loyalty towards the EU. Once such loyalty is developed, national actors are expected to promote supranational interests in their country of origin. Furthermore, as a result of said process, negotiations between Member States are expected to become less politicized and more technocratic. In fact, the continued contact and negotiations between national leaders will make it more problematic for them to support political arguments, and will therefore make it more likely for them to debate more technical issue where an agreement can be reached (Haas, 1958).

2. Supranational interest groups

Secondly, the supranational interest group hypothesis postulates that interest groups are also expected to shift their interest from the national to the supranational level. Driven by personal interests, once interest groups come to realize that integration brings them benefits, they will organize at a European, cross-country level and lobby their country of origin for more integration, contributing, in so doing, to an increase in supranationalism (Stone Sweet and Sandholtz, 1997).

3. The spillover effect

Lastly, the spillover hypothesis expects political cooperation among Member States to expand beyond the initially intended issue. The outcomes of the spillover effect is the generation of new, common goals, and, in general, the transfer of sovereignty from the national to the supranational level (Schimitter, 2005).

Neo-functionalism identifies three types of spillover: functional, political, and cultivates spillover. Functional spillover occurs when Member States collaboration on one issue requires further collaboration in order to fully achieve the original goal. An example of functional spillover is the single market, where the original goal of facilitating trade led to the adoption of a number of working environment regulations at the European level (Jensen, 2016).

Political spillover takes place when national governments realize that a given issue cannot be addressed at the national level, but requires a supranational approach (Turkina and Postinikov, 2012). Political spillover is closely related to the elite socialization hypothesis (Jensen, 2016).

Finally, cultivates spillover concerns the role of supranational institutions in promoting integration. This hypothesis is based the neo-functionalist believe that, once created, supranational institutions are not under the control of Member States, but act as policy entrepreneurs in the pursue of an ever-closer integration (Haas, 1964).

NEO-FUNCTIONALISM AND PATH DEPENDENCE

A substantial part of neo-functionalist assumptions, especially functional and political spillover, are highly related to the theory of path dependence and increasing returns. Path dependence refers to how, in particular social contexts, once an institution or a country takes up a path, it becomes more and more costly to change direction. What makes changes in institutional arrangements particularly difficult and unattractive is the fact that actors are reluctant to modify their behavior and expectations to the new path. This way, even sub-optimal institutional arrangement are likely to survive as, over time, a switch to previously considered alternatives results more and more inconvenient. On the contrary, keeping on moving on the same path results much less costly and even beneficial. The benefits of continuing on the same path are called increasing returns, and can be considered as positive feedback processes (Pierson, 2000).

As Niemann and Ioannou (2015) underline, path dependence has been explicitly acknowledge by some European leaders. As a matter of fact, German Finance Minister Schaüble warned that the collapse of the euro would destroyed much of what the EU has achieved (Der Spiegel 2012); even more explicitly, Spanish Prime Minister Rajoy argued that the euro is a path of no return (Rajoy 2012).

Therefore, path dependence, just like functional spillover, means that Member States are not likely to be in control of the integration process. In fact, although some countries might deliberately agree to delegate parts of their sovereignty for mere national interest, and then find themselves in a situation where further delegation of powers is the most convenient solution (Schimitter, 2005) as, arguably, is the case of Banking Union.

NEO-FUNCTIONALIST EXPECTATIONS ON ACTORS' BEHAVIOR

This being said, in the scenario painted by neo-functionalism Member States are attributed the important role of initiators of regional cooperation in the 1950s, and an active role in the writing of the Treaties such as the Treaty on European Union of 1992 (Schmitter, 2005). Nevertheless, once such cooperation is in place, Member States lose their centrality, and turn into not much more that just one of the actors playing on the European field (Risse-Kappen, 1996). In fact, as the newly created supranational institutions and the interest groups and social movements that revolve around them gain more power and importance, nation-states lose their ability to control the evolution of the organization they have initiated.

Among the actors of the European scenario, supranational institutions play the role of promoting integration and further delegation of powers to the supranational level, with the goal of establishing a supranational political unity (Jensen, 2016). Moreover, supranational institutions are expected to make full use of their power in order to pursue an ever closer union.

NEO-FUNCTIONALISM AND BANKING UNION

Scholars embracing neo-functionalism explain the establishment of Banking Union as a response to functional dissonances, amplified by the occurrence of the economic crisis (Niemann and Ioannou, 2015). These authors underline supranational interest groups' and supranational institutions' proactive role in giving momentum to the maintenance of the euro in the most critical phases of the crisis, including open advocacy in favor of a complete Banking Union in several occasions (Niemann and Ioannou, 2015; Epstein and Rhodes, 2016). nudging elites towards maintaining the euro, and increasing integration (Niemann and Ioannou, 2015).

In particular, Niemann and Ioannou (2015) underline the ECB's proactive role in implementing several monetary policy measures to address the situation, and openly advocating in favor of a complete Banking Union. In addition to that, the authors argue that, despite initially taking on a rather passive role, the Commission and the Parliament successfully pushed in the direction of delegating supervisory and resolution powers to the EU level.

Epstein and Rhodes (2016), on the other hand, emphasize the ECB's and the Commission's role in promoting Banking Union, and how supranational institutions managed to achieve a further step towards an ever-closer union. Furthermore, they point out how analysts tend to emphasize Germany's victories in the Banking Union negotiations, and to forget all the concessions Germany and its allies were forced to make as a result of supranational pressures produced by a coalition of supranational institutions, Member States, and private actors.

All in all, neo-functionalism has the merit of linking path dependence and increasing returns to European integration. In fact, this phenomenon is rather clearly observable in the development of Banking Union, where the existence of the common market first motivated Member States to create a common currency, which in turn created the need for the harmonization of economic policy at first, and later for the establishment of common institutions such as the SSM and the SRM.

Nevertheless, the neo-functional approach largely downplays the role of Member States, and therefore fails to fully account for their behavior. In fact, neo-functionalist literature on the Banking Union acknowledges, but overlooks, the prominent role of Member States in the negotiations. For instance, Niemann and Ioannou (2015) write: "In the talks on the Fiscal Compact, the Commission managed to position itself on the 'winning side', but whenever its interests diverged from that of the 'coalition' headed by Germany, it failed to (fully) realize its preferences", and again: "the Commission […] played a more proactive role once the heads of state broadly agreed to move ahead with further integration".

Beyond the lack of consideration of and explanation for Member States' behavior, these quotes reflect neo-functionalism's inability to address the power dynamics between Member States in order to explain, as mentioned, the leading role of Germany in the coalitions.

Neo-functionalism inability to explain Member States' preferences and behaviors, and the power dynamics between actors therefore falls short of being a complete theory of European integration. In an effort to address these issues, the following sections first present the main rival theory of neo-functionalism: intergovernmentalism.

1.2 Intergovernmentalism

The main alternative to neo-functionalism within integration theory is intergovernmentalism. This approach fundamentally differs from neo-functionalism in that it assumes that Member States are powerful, rational actors, which are for the most part in control of the integration process, or rather, of European cooperation. Drawing from a neo-realist approach to International Relations, intergovernmentalism regards nation-states as self-interested, rational actors that try to achieve zero-sum gains in the anarchic international arena through the use of power (Cini, 2016).

According to intergovernmentalists, nation-states are the only actors to retain sovereignty (Hoffman, 1966). Sovereignty is crucial for Member States because it provides them with relative power and control of their fate in the international field. As a consequence, its maintenance is at the core of their concerns (Keohane, 1984), and countries are expected to engage in international organizations only if it allows them to strengthen, and not lose grip of, their control over domestic affairs (Moravcsik, 1993).

Therefore, Member States are expected to use European institutions to better achieve goals without losing sovereignty, creating a principal-agent dynamic arises between themselves (principal) and EU institutions (agents). In this dynamic, when MS delegate tasks to EU institutions, they make sure to keep them under strict monitoring in order to avoid losses. As a consequence of such concerns, the design of international institutions needs to reflect state concern with safeguarding sovereignty (Pierson, 1998).

In a scenario with such strong-willed and powerful Member States, European institutions are here conceived as nothing more than instruments used by Member States to and facilitate their goal achievement in the international arena. In fact, countries build and make use of international institutions because they provide them with a set of benefits: they drive down transaction costs, reduce information asymmetries, monitor compliance and reduce the chances of withdrawal (Pierson, 1998). As a result, European institutions appear as weak, subordinate instruments of the Member States, which remain in control of the process, pooling and sharing sovereignty, rather than transferring it to supranational institutions (Keohane and Hoffman, 1991).

INTERGOVERNMENTALIST EXPECTATIONS ON ACTORS' BEHAVIOR

According to intergovernmentalists, European cooperation is possible, but pragmatic: Member States understand that it is more convenient to solve common problems with common solutions (Cini, 2016). As a consequence, countries will engage in cooperation for selfish purposes, weighing up perks and losses and making use of their power in order to strike convenient deals, going as far as to engage in threats or in actual withdrawal from the negotiating table. An example of this can be found in the empty chair crisis of 1965.

All in all, intergovernmentalism paints a much less idealistic image of European integration than neo-functionalism: from the intergovernmentalist perspective, Europe is not bound to an ever closer union, but to a series of either mutually beneficial collaborations or zero-sum games. In other words, according to this theory, there is nothing intrinsically different in the EU that distinguishes it from other international organization. The following paragraph summarizes intergovernmentalist expectations over the behavior of Member States and European institutions:

THE RELEVANCE OF INTERGOVERNMENTALISM IN THE CURRENT LITERATURE

Although it is hardly used in its original form in current literature, intergovernmentalism has been able to adapt through the years, and to transform into two varieties of intergovernmentalism, which are still widely popular: liberal intergovernmentalism (LI) and new-intergovernmentalism. As a matter of fact, these two versions of intergovernmentalism have been used, among other things, as a basis to analyze the establishment of the Banking Union. Therefore, the next two sections provide an overview of both LI and new-intergovernmentalism.

1.3. Liberal intergovermentalism

Just like classic intergovernmentalism, liberal intergovernmentalism (LI) builds on the assumption of rational state behavior (Cini, 2016). In fact, according to LI, European integration is a set of rational choices made by rational leaders in response to international interdependence (Schimmelfennig, 2015).

On top of that, however, LI sets out to address issues of preference formation and interstate negotiations; of relative power and asymmetrical interdependence; and to explain the establishment of supranational institutions (Moravcsik, 1998). In order to do that, LI draws together aspects from liberal theories of national preference formation, and intergovernmentalist theories of inter-state relations.

As a result, LI builds a more complete framework, which offers a tripartite explanation of integration, composed of:

1. economic interests, determined domestically and negotiated internationally;
2. relative power, which is shaped by asymmetrical interdependence;
3. and credible commitments, the need of which may result in the establishment of supranational institutions.

These three factors are responsible for the form, substance, and timing of the most important steps in the integration process (Moravcsik, 1998). All in all, LI considers the EU to be a "successful intergovernmental regime designed to manage economic interdependence through negotiated policy coordination" (Moravcsik, 1993). The next few paragraphs present the main characteristics of LI in detail.

1. PREFERENCE FORMATION: A TWO-LEVEL GAME

LI's understands preference formation as a two-level game, similar to the one described by Putnam (1988): governments first define their interests domestically (level I), and then engage in international negotiations to satisfy those interests (level II). In this two-level game, economic and commercial interests of Member States are found to be the main driver of integration, and the raison d'être behind the most important negotiations in the history of the European Union (Moravcsik, 1998). Within the European integration process, preference formation can be thought of as a demand for cooperation, whereas the international negotiating table can be seen as the supply for integration (Moravcsik, 1993).

Level I: liberal theories of national preference formation

On the national level (level I) liberal theories of national preference formation are used to describe how preference is formed within a country, where pressure groups compete to have their interests taken into account, and politicians aim to obtain power by forming coalitions among such groups. The set of interests outlined at the domestic levels drive governments towards seeking cooperation with other states. Thus, Level I originates a demand for cooperation (Moravcsik, 1998).

Despite the complexity of domestic preference formation, LI considers nation-states as a unitary actor. In fact, it assumes that the preferences formed by bargain and interaction between a wide range of actors at the national level eventually generate a consistent set of interests (Moravcsik and Schimmelfennig, 2009).

LI considers the understanding of domestic political dynamics as a prerequisite for the study of interstate strategic behavior. In so doing, it distances itself from those theories of international relations that consider state preferences as black boxes (Moravcsik, 1993).

The importance of domestic pressures in preference formation

The first of the two-level game underlines the importance of domestic interest groups in shaping national preferences. According to this perspective, interest groups articulate preferences, and governments aggregate them. In fact, in democratic countries, in fact, government need the support of these groups if they are to maintain their office (Moravcsik, 1993).

Level II: intergovernmental theories of interstate negotiations

Once national preferences are defined, the game moves to the international negotiating table (Level II), which aims to satisfy the demand for cooperation with a supply of integration. Here, intergovernmentalist theories of inter-state relations help understanding how national governments seek alliances and use power to strike deals that respect their domestic demands (Moravcsik, 1993). Within LI, negotiations are defined as a process of collective choice through which conflicting interests are reconciled. States are considered rational actors, and thus are expected to pursue the course of action that maximizes their gains or satisfies preset requirements (Moravcsik, 1993; Moravcsik and Schimmelfennig, 2009).

2. RELATIVE POWER AND ASYMMETRICAL INTERDEPENDENCE

As far as power is concerned, LI considers it to be of crucial importance for the outcome of international agreements (Level II). Relative power is shaped by asymmetrical interdependence, and Member States use it while bargaining in order to get the most advantages out of the deal (Moravcsik, 1998).

3. LI AND INSTITUTIONAL DELEGATION

Moreover, LI sets out to explain institutional delegation, that is the institutionalization of the European arena. LI argues that European institutions spring from the desire to (1) reduce transaction costs in negotiations; and to (2) grant governments with more decisional autonomy. In fact, as assumed by traditional regime theory, European institutions improve the efficiency of inter-state bargaining by providing a negotiating forum, establishing decision-making procedures, and making and maintaining agreements. However, European institutions also have the ability and to strengthen national leaders autonomy towards domestic interest groups. As a matter of fact, governments can bypass national opposition by striking credible deals in Brussels (Moravcsik, 1993).

In addition to that, institutions enhance the credibility of commitments. In fact, institutions drive down the possibility of withdrawal and non-compliance (Cini, 2016).

As a result, these characteristics make the establishment of European institutions desirable for Member States which seek to maximize their power in the international arena. Therefore, the existence of supranational institutions does not disprove intergovernmentalism. On the contrary, supranational institutions are an instrument of Member States, through which they achieve the ability to pursue goal otherwise unattainable (Moravcsik, 1993).

LI EXPECTATIONS ON ACTORS' BEHAVIOR

LI considers European integration to be the result of "a series of rational choices made by national leaders" (Moravcsik, 1998). Therefore, Member States are considered the drivers of integration.

In fact, Member States are powerful, rational actors which, on the basis of their domestic preferences, seek cooperation with other countries in the region. However, Member States are aware of the value of European institutions in driving down the costs of international cooperation. Therefore, although MSs favor zero-sum gains, they can be expected to accept positive-sum gains in order to maintain the fruitful regional cooperation (Cini, 2016).

As far as supranational institutions are concerned, their supposedly entrepreneurial role is dismissed: states are better informed than supranational institutions, whose influence on the negotiations is secondary. European institutions are considered as an asset to the Member States, and their existence as the supply side to states' demand for cooperation. As Moravcsik (1993) put it, the EU is 'a successful intergovernmental regime designed to manage economic interdependence through negotiated policy co-ordination'.

LIBERAL INTERGOVERNMENTALISM AND BANKING UNION

LI offers useful tools to analyze the establishment of Banking Union, its current design and the role of Member States. In fact, the design of Banking Union was largely shaped by intergovernmental negotiations, and in particular by the requests of Germany, which has the most bargaining power (Schimmelfennig, 2015a). In addition to that, LI's explanation of preference formation is largely and successfully used among scholars, even if implicitly (see Howarth and Quaglia, 2016).

Due to its focus on relative power and asymmetrical interdependence, LI is in fact able to explain how certain MSs have more leverage than others in negotiations. This insight is applicable to the case studies: in fact, being the Eurozone's third largest economy, Italy is likely to have considerable leverage on when requesting flexibility on state-aid rules.

LI AND HISTORICAL INSTITUTIONALISM

However, critics of LI have underlined its inability is unable to explain events in historical perspective, and for the integration process as a whole (Pierson, 1998). Rather, LI serves as a theory of intergovernmental bargain (Rosamond, 2016; Cini, 2016). This limit is underlined by Moravcsik (1998)'s definition of integration as a series of choices made by national leaders.

A solution to overcome LI's focus on snapshot moments, is to integrate it with historical insitutionalism (Schimmelfennig, 2015a). Historical institutionalism understands political processes as historical phenomena, and stresses how previous events shape current choices (Pierson, 1998). Historical institutionalism makes use of the concept of path dependence, which neo-functionalist authors (e.g. Niemann and Ioannou, 2015) use as a theoretical basis to explain the spillover effect. The relevance of path dependence is therefore corroborated by its recognition from both sides of the debate.

Within this theoretical framework, historical institutionalism will not be associated with LI, but with neo-functionalism, with which it is has more common features. The potential complementarity of these two theories is however noted, and will be discussed in the conclusions.

1.4 New intergovernmentalism

Finally, the new intergovernmentalism aims to shed light over a set of developments occurred within the European Union in the post-Maastricht era, and that previous theories are unable to account for (Bickerton et al, 2014). Based on an empirically driven analysis of the last two decades of European integration, the new intergovernmentalism develops six hypotheses. Each hypothesis represents an effort to understand what the authors refer to as the integration paradox, that is the occurrence of integration without supranationalism. The following paragraphs will first outline the six hypotheses of the new intergovernmentalism, and then extrapolate from them expectations regarding the behavior of Member States, European institutions, and of a new set of institutions: the de novo bodies.

H1: deliberative and consensual decision-making

The first hypothesis concerns the wide use of deliberative and consensual decision-making in day-to-day EU level politics. Deliberative and consensual decision-making has traditionally been seen at the EU level as a tool used by supranational institutions to pave the way to supranationalism (Bickerton et al, 2015:29-30). Nevertheless, deliberative and consensual decision-making as become the routine procedure even within the most intergovernmental European environments such as the European Council, the Council of Ministers, and the Eurogroup. It is in fact through inter-state deliberative and consensual decision-making that the European Union achieved further integration the last twenty-five years, including in key economic areas such as the Economic and Monetary Union (Puetter, 2012). This fact cannot be explained by existing theories of integration, and is therefore identified as the first theoretical gap new intergovernmentalism aspires to fill in.

H2: supranational institutions are not hard-wired to seek ever-closer union

The second hypothesis concerns the behavior of supranational institutions. Although both neo-functionalist and intergovernmental stances expect supranational institutions to actively seek further integration and eventually a political, supranational unity (Moravcsik, 1999) empirical research has shown how, in the last quarter century, supranational institutions such as the Commission and the CJEU have been reluctant to extend their powers. To this regard, the claim of the new intergovernmentalism is not that the ambitions of supranational institutions have shifted, but rather that their focus has been placed on projects that did not require further supranationalism. An example of this is the focus on enlargement by the Commission under the Prodi administration, or on institutional reform under the Santer administration (Bickerton et al, 2015:31). Other elements that might have contributed to supranational institutions' more cautious attitude can be found in the decrease in permissive consensus and in the preference formation at the supranational level is more complex than it was previously thought (Hodson, 2015). Either way, new intergovernmentalism challenges the widespread assumption that traditional EU institutions necessarily pursue supranationalism, suggesting instead that it is more proper to expect from them to engage in strategic behavior.

H3: delegation occurs through the empowerment of de novo bodies

Moreover, in their third hypothesis, the authors observe how, despite the remarkable increase of EU activity across the period observed, the powers of supranational institutions have stayed roughly the same. This phenomenon has happened in accordance with a principle present in the Maastricht Treaty on European Union and later confirmed by the following treaties, and it is central to new intergovernmentalism as it constitutes the integration paradox: integration without supranationalism (Bickerton et al, 2014). In fact, rather than to traditional supranational institutions, the new tasks have been delegated to newly established institutions, referred to as de novo bodies. De novo bodies can take on a more or less proactive role, are often provided with considerable autonomy and control over their own resources, and their governance structure tends to entail room for a representation of the Member States and thus their interests, as in the case of the ESM and the EEAS. More examples of de novo institutions are the European Central Bank, the European Banking Authority, and the Single Resolution Board (Bickerton et al, 2015:3, 264).

H4: problems of domestic preference formation have become inputs of integration

Hypothesis four attempts to extend the Liberal intergovernmentalist understanding of how Member States politics influence the integration process. Firstly, unlike LI, the new intergovernmentalism underlines the influence of domestic politics on EU integration beyond the interest group driven demand for cooperation. In particular, it recommends considering the important role played in the post-Maastricht period by the widespread mistrust towards the political process in general, and the EU in particular. Such skepticism and concerns around representation and legitimacy of EU institutions translate into a decrease in permissive consensus which is expected to continue to influence EU politics. Secondly, the new intergovernmentalism observes how the relationship between the diverse set of domestic interest and the representation of such interests at the political level has loosened up, resulting in a dysfunctional working of representative democracy (Bickerton et al, 2015: 33-34).

H5: The differences between high and low politics have become blurred

This last remark is linked to hypothesis five, which presents a consequence of such popular disaffection from politics: the difficulty for governments to form a coherent domestic narrative concerning which national interests need to be taken in higher regards. This can be regarded to as a historical phenomenon, stemming from the loosening of the links between interests and organizations, role which had previously been taken up by Christian, communist, and social-democratic parties. The result is the blurring of the distinction between high politics, that is matters of crucial importance for a nation-states, and low politics, that is topics where the Member States are willing to compromise. This difficulty to define and defend high politics matter is suggested as an explanation for the rarity of ultimatums and withdrawal threats in EU politics (Bickerton et al, 2015: 34).

H6: The EU is in a state of disequilibrium

Finally, as a result of the features presented in the previous five hypotheses, in hypothesis six holds that the EU is in a state of disequilibrium, lacking a coherent strategy or direction. This disequilibrium is the reflection of changing and potentially unstable European Member States, of dysfunctional democratic processes, the concerns around EU representation and legitimacy, and a rise in populism. The New intergovenmentalism refuses neo-functionalist an LI optimism, and calls for a reflection on why the EU is so prone to crises. In conclusion, the EU's disequilibrium is not conceived as a phase, but as a lasting feature at the core of the integration process, which needs to be addressed with new, creative approach (Bickerton et al, 2015: 36-39).

NEW INTERGOVERNMENTALIST EXPECTATIONS ON ACTORS' BEHAVIOR

According to the new intergovernmntalism, Member States are strong, powerful actors, capable of achieving integration without supranationalism. Nevertheless, Member States value European cooperation and supranational institution, and engage in deliberative and consensual decision-making. Thus, the MSs are expected to engage in compromises and negotiations, and to be willing to accept positive-sum games.

On the other hand, supranational institutions have been found to not always be in an active pursue of ever-closer union: if the circumstances require it, they can act pragmatically and strategically. As far as de novo bodies are concerned, they vary in form and power. They can be more or less active and strong institutions, which often enjoy autonomy in their access to their budget, and are often linked in their governance structure to Member States representatives. De novo institutions are likely to play an important role in current European politics.

NEW-INTERGOVERNMENTALISM AND BANKING UNION

Overall, the new intergovernmentalism builds on LI, and presents a set of hypotheses which aim to explain the most recent developments of European integration. In their contribution to the subject, Howarth and Quaglia (2015) argue that, out of these hypotheses, H2 and H3 are confirmed in the process of Banking Union (Howarth and Quaglia, 2015).

Hypothesis 2 helps understanding the Commission and the Parliament's behavior during the post-crisis period demonstrates that supranational institutions are not hardwired to pursuing an ever-closer union, but can act strategically if the situation requires it (H2). However, it is worth reflecting on whether or not H3 was actually confirmed within Banking

Union. In fact, out of the two pillars of Banking Union established up to this date, the SSM, which functions through the ECB and NCAs, is by far the more powerful and independent, as compared to the SRM, which functions through the de novo body SRM and the NRAs (see Chapter II). Considering the remarkable set of powers that a supranational institution such as the ECB has received through the establishment of the SSM, it is possible to conclude that hypothesis 3 was only partially confirmed.

A CRITIQUE OF THE NEW INTERGOVERNMENTALISM

As seen above, the relevance of new intergovernmentalism in the context of Banking Union is limited. In fact, only one out of its six hypotheses is fully confirmed. Therefore, the present thesis joins Schimmelfennig (2015b) in arguing that new intergovernmentalism provides useful insights into the post-Maastricht integration process, but that these alone are not sufficient in constituting a new theory in its own right. Therefore, for the scope of this study, the new intergovernmentalism's hypotheses, and especially hypothesis 2, are considered an additional instrument in analyzing the integration process through an LI perspective.

1.5 Choosing the most suitable integration theory

A useful way to decide whether to take on an intergovernmental or a neo-functionalist approach is to ask oneself whether European integration is driven by Member States or supranational institutions; and which of these two sets of actors do the institutional developments strengthen (Schimmelfennig, 2015b).

The process tracing of the negotiations behind the establishment of Banking Union, and the final design of the new institutions and legislations (see Chapter II and III) , underlined that:

1. Banking Union was established through intergovernmental negotiations, where power politics had a prominent role: Member States with most relative power (e.g. Germany) and strategic coalitions (e.g. France, Italy, Spain, at times backed by EU institutions) shaped the final design of newly established institutions;
2. the newly established institutions party gave new powers to supranational institutions, especially in the case of the SSM, where the ECB acquired strong supervisory powers; as far as resolution, deposit insurance, and a public backstop, Member States retain most, if not all, of their power;
3. the intergovernmental negotiations and the final design of Banking Union are likely to have been shaped by Member States' LEN assumptions.

The present thesis argues that, although it presents some limitations, liberal intergovernmentalism (LI) is the most suitable among the integration theories presented above in addressing post-crisis financial policies and institutions within the EU. First of all, in fact, a (liberal) intergovernmental approach is preferred to a neo-functionalist one. In fact, neo-functionalism is not a suitable approach for explaining post-crisis integration, because it fails to explain Member States' preferences and behaviors, or to account for the power dynamics between Member States, and between supranational institutions and Member States. By contrast, LI aspects such as intergovernmental negotiations, institutional creation and institutional delegation provide convincing arguments to explain post-crisis institutional and legislations creation.

LI's focus on negotiations and institutions also makes it a more compelling contender as compared to the new intergovernmentalism. The new intergovernmentalism certainly has merits: for instance hypothesis 2, according to which supranational institutions are not hardwired to pursuing an ever closer union, but can act strategically when needed, was reflected in European institutions post-crisis behavior. However, the new intergovernmentalism's focus on deliberative and consensual decision-making and de novo institutions makes it less relevant for the scope of Banking Union. In fact, the main de novo institution emerging from Banking Union (the SRB) appears to be too weak to take on an important role; whereas intergovernmental negotiations take on a remarkably more important role than deliberative processes.

1.6 LI's limitations

LI has been chosen as the framework for understanding the incidents contained in the case studies. As mentioned above, however, LI presents some limitations. LI's limitations especially concern institutions and their characteristics. The point has been made that LI pays special attention to explaining institutional formation and delegation to a rather satisfactory degree, especially compared to the other integration theories presented insofar.

Nevertheless, LI fails to explain the development of institutions over time, and the way previous choices affect and limit decision-making. For instance, LI does not explain Euro-area Member States' motivation to build Banking Union, if not in terms of individual countries' preference formation. Historical institutionalism, on the other hand, puts Member States' decision-making in the historical context of European integration. In so doing, it claims that present choices available to Member States are influenced and limited by past choices (Pierson, 1996). Historical institutionalism is therefore presented in the following section as an alternative to LI assumptions.

In addition to that, LI does not provide a theoretical basis for one of the main elements of this thesis: liberal economic nationalism. LEN has been singled out so far as possibly being an important element in shaping Banking Union. Nevertheless, LI considers national decision-making to be shaped by preferences which are put forward by interest groups and aggregated by national governments, which then negotiate, based on such preferences, at the international level. With its assumption that institutions develop their own cultures, which might entail sets of ideas similar to LEN, sociological institutionalism can therefore help fill this gap. The next section will therefore focus on new institutionalism in its different forms, and will linger on historical and sociological institutionalism.

2. NEW INSTITUTIONALISM

New institutionalism refers to a body of literature that concentrates on the role of institutions, and criticizes traditional institutionalism for its excessive focus on formalized institutions and for missing out on those crucial interactions between groups that are at the core of political processes (Rosamond, 2016). By contrast, new institutionalism approaches propose a broader definition of institution, one that includes all those continuous social interactions that form the "compliance procedures and standard operating practices" within politics (Hall and Taylor, 1996). Within new institutionalism, Hall and Taylor (1996) distinguish three types of institutionalism: rational choice institutionalism, sociological institutionalism, and historical institutionalism.

2.1 Rational choice institutionalism

Rational choice institutionalism holds that individuals behave rationally and strategically. Within this framework, institutions are considered an important element in understanding political dynamics, as they act as intervening (mediating) variables. Institutions are expected to seek policy outcomes that are consistent with their goals (preferences). Rational choice institutionalism makes use of principal-agent theory, and is particularly fitting in EU studies to explain why Member States empower institutions such as the Commission and the European Court of Justice (see Pollack, 2002). Rational choice institutionalism has been criticized for focusing mainly on formalized institutions and ignoring informal processes, which are fundamental in explaining policy outcomes. Furthermore, rational choice institutionalism tends to take preferences as given, rather than considering how external pressures can modify interests and preference formation (Rosamond, 2016).

RATIONAL CHOICE INSTITUTIONALISM'S EXPECTATIONS ON ACTORS BEHAVIOR

In its assumptions of rational state behavior, rational choice institutionalism is rather close to LI (Rosamond, 2016). As a result, rational choice institutionalism shares LI's assumptions that Member States delegate tasks to European institutions as long as it is strategically fruitful, on the basis of rational calculation, and with the purpose to maximize gains. In addition to that, rational choice institutionalism understands the dynamics between actors in the European arena under the lens of principal-agent theory, where Member States (the principal) empower European institutions (the agents) to carry out tasks.

In conclusion, rational choice institutionalism is based on the same assumptions as LI, which it applies specifically to the study of institutions. Therefore, rational choice institutionalism can therefore be coupled with LI in developing classic LI expectations.

2.2 Historical Institutionalism

Historical institutionalism, on the other hand, distances itself from LI, and aims to provides a historical perspective on the European integration process. In fact, Historical institutionalism (HI) understands political processes as historical phenomena, and therefore stresses the importance of temporality and previous events on given political events and institutions. In addition to that, HI pays particular attention to institutions, and to how political processes are embedded in them (Pierson, 1998). As a result, historical institutionalism focuses on the long-term effect of institutional choices (Rosamond, 2016).

Due to the importance it gives to historical processes and phenomena, historical institutionalism is tightly related to the theory on path dependence and increasing returns. As already defined in the section about neo-functionalism, path dependence concerns the difficulty to change direction once certain institutional choices are made, whereas increasing returns represent the advantages of continuing on the same path, which arise from a set of institutional adaptation to the selected direction. As a result, it becomes increasingly costly for institutions to undertake choices that were available at the beginning (Pierson, 2000)

Path dependence affects institutions in two ways**.** Firstly, institutions are designed in a specific time and set of circumstances, and for specific purposes. In order to comply with the given purposes, institutions develop agendas and preferences. Institutions might need to interact with other agencies, potentially giving way to a path dependent dynamic. Secondly, institutions may outlive their creators. In time, institutions may take on tasks they were not originally intended to face, but when they do so they have available the limited set of tools the original institutional design offers them. As a consequence, path dependence constrains and limits policy choice (Rosamond, 2016).

HISTORICAL INSTITUTIONALIST EXPECTATIONS ON ACTORS BEHAVIOR

Historical institutionalism expects Member States' decision-making to be heavily affected and limited by previous choices. In fact, despite Member States' initial motivation to create institutions with the purpose of maximizing their power (as assumed by LI), path dependence and increasing returns eventually influence the integration process and governmental actions, to the point where the costs of "non-Europe" are so high that they are not easily considered viable (Pierson, 1996). As a result, Member States are considered locked into a process that they initiated, but have no longer control of.

Supranational institutions, on the other hand, are created by Member States to fulfill preset purposes. However, institutional goals might change over time, due to the institution's will to survive, or due to agendas that institutions develop along the way. As a result, institutions develop their own goals, which might differ from the original ones they were created for (Rosamond, 2016). Therefore, supranational institutions have their own goals, and a certain degree of autonomy to pursue them. All in all, historical institutionalist expectations are closer to neo-functionalism that to LI, although it distances itself from the notions of ever-closer union that are pervasive in neo-functionalism (Pierson, 1996).

HISTORICAL INSTITUTIONALISM AND BANKING UNION

Although it focuses on other post-crisis events rather than the establishment of Banking Union, Verdun (2015) is an example of how historical institutionalism can be applied to post-crisis changes within the Euro-area financial domain. The author concludes by confirming the historical institutionalist assumption that past institutional choices affect present choices. In this case, they affect the way new institutions are established: in fact, new institutions tend to mimic already existing ones. An example of this can also be found within Banking Union. In fact, the choice to establish a two-layered SSM arguably influenced the final design of SRM.

Since its formulation, historical institutionalism set out to address and "challenge" the lack of historical understanding of the integration process within LI (Pierson, 1996). However, the point has been made, even among authors embracing an LI perspective, that historical institutionalism and LI can in fact complement each other in providing a thorough account of post-crisis European integration (Schimmelfennig, 2015a). Historical institutionalism and LI certainly disagree both on the amount of freedom of choice Member States retain, and on the role and autonomy of supranational institutions; nevertheless, LI notions of two-level games and institutional delegation could be combined with historical institutionalism ability to collocate them within the historical context of integration, and urge scholars to consider the effect of path dependence and increasing returns. For the scope of this thesis, LI and historical institutionalism are still considered opposing theories. Efforts to reconcile these two theories are however welcome in future research.

2.3 Sociological institutionalism

The third and last type of institutionalism is sociological institutionalism. Sociological institutionalism is based on a constructivist understanding of society. This means that sociological institutionalism understands interests as the result of social interactions between actors. Therefore, sociological institutionalist scholars focus on the role of persuasion and communication within institutions, and on the study of institutional culture (Rosamond, 2016).

The first branch of studies, concerning the role of persuasion and communication within institutions, includes empirical studies over so called 'norm entrepreneurs'. Norm entrepreneurs are individuals who are able to mold their personal believes into shared understandings (Checkel, 2001: 31).

The second branch of studies, on the other hand, focuses on institutional culture and it is concerned with the emergence of frames of reference, norms, and 'cognitive filters' within particular institutions. To this respect, sociological institutionalism holds that institutions heavily influence individuals, and go as far as to shape their most basic preferences and their very identity (Hall and Taylor, 1996: 948), and, in so doing, shape individual's understanding of who they are, what their preferences are, and what the preferences of other actors might be (Rosamond, 2016).

LEN AND INSTITUTIONAL CULTURE

Within sociological institutionalism, the study of institutional culture offers a theoretical basis to understand LEN. Although LEN manifests itself through decision-making and policies, it is primarily a set of ideas. In fact, LEN is one of the possible attributes of national economic cultures, and, just like economic nationalism, it part of a nation's ideology (Pickel, 2003).

Due to the fact that LEN is a set of ideas, and therefore one of the possible frames of references through which actors understand reality and shape their preferences (Rosamond, 2016), LEN could be found to be part of an institution's culture. As seen above, institutions develop cultures, which are widely pervasive and influence its members, and shape their preferences.

As already discussed in Chapter III, the Italian government has a record of using state-aid to support both its struggling firms and banks (Germano, 2012; Ansa Italy, 2017; Bodellini, 2017) and the point has been made that LEN is part of Italian institutional culture (Deeg, 2012). Therefore, based on the sociological institutionalist assumption that institutional culture is pervasive, influences institutional member's preferences, it is possible to conclude that LEN is part of the Italian government's institutional culture.

LINKING LI AND SOCIOLOGICAL INSTITUTIONALISM

Liberal intergovernmentalism and sociological institutionalism are not traditionally associated. In fact, the very premises of these two approaches create a gap between them: LI is based on the same rational-choice perspective that sociological institutionalism, with its constructivist approach, criticizes. However, scholars have called for an integration of sociological insights into integration theory (Saurugger, and Mérand, 2010); while others have argued in favor of moving beyond rational choice and towards a more constructivist approach (Risse-Kappen, 1996).

As argued insofar, LI is a suitable and rather complete approach to post-crisis European integration, since it is able to explain the bulk of the events, negotiations, and the establishment of Banking Union institutions and organizations. Nevertheless, LI lacks the tools for understanding phenomena such as LEN and institutional culture.

Several authors have theorized the existence of LEN within EU Member States (Deeg, 2012; Donnelly, 2018; Clift and Woll, 2012), but none of these authors has theorized a connection between LEN and LI. Therefore, the present thesis sets out to fill in this theoretical gap. In order to do that, the present thesis claims that, when aggregating interest groups preferences concerning decision-making, governments are not necessarily neutral, but can have their own preferences, which are determined by institutional culture. Institutional culture entails a set of believes that shape the government's perspective on what outcomes are most desirable for the sake of the state. In the case at hand, the Italian government institutional culture is expected to entail LEN.

In so doing, sociological institutionalism does not contradict LI's assumption that Member States aggregate preferences domestically and negotiate them internationally with strategic purposes, but it adds a layer underpinning these assumptions. Such further layer argues that governments decisions are influenced by institutional culture.

Proposition 5: Institutions develop institutional culture, which shape the world view of institutional members. Therefore, when aggregating interest groups' preferences, governments are influenced by their own believes, which can in turn influence decision-making.

3. THEORETICAL FRAMEWORK

Throughout section 1 and 2, this chapter has presented how integration theory and new institutionalism can help framing the context of the present thesis. In fact, it has been argued that liberal intergovernmentalism is a suitable theory for explaining EU and Member States' behavior in the negotiations for the establishment of Banking Union.

In addiction to that, LI's limitations have ben addressed through historical and sociological institutionalism. As far as historical institutionalism is concerned, the point has been made that this theory is able to expand the focus from the landmarks of integration to the whole process, and to put events in a historical perspective, which entails the effect of path dependence and increasing returns. Due to its expectations on actors behavior, historical institutionalism has been linked to neo-functionalism rather that to LI. Historical institutionalism is therefore used in the following section as a base for the null hypothesis, which is based on expectations that are opposite to the main claims of this thesis.

Sociological institutionalism, on the other hand, is coupled with LI in explaining the presence of LEN in government decision-making. Sociological institutionalism is chosen due to its ability to explain how institutions develop internal cultures, which in turn affect its members' preferences and decision-making. Sociological institutionalism has therefore been identified as the fundamental basis for the main claim of this thesis, that is that the Italian government's decision-making is dictated by LEN.

4. HYPOTHESES

Based on the theoretical framework, the present thesis presents three hypotheses, which address the research question: '*To what extent is the Italian government trying to keep banking ownership national?*'. Each of the three hypotheses are presented below.

HYPOTHESIS 1: LI and sociological institutionalism

The first hypothesis is based on LI expectations on Member States and European institutions behavior, but draws from sociological institutionalism's assumption that institutions develop their own institutional culture, which heavily influence institutional members. This first hypothesis is also based on the following proposition developed insofar:

- **Proposition 1:** Banking Union presents a set of lacunas, which originated in highly intergovernmental negotiations, where Member States were driven by LEN.
- **Proposition 2:** state-aid and LEN are tightly related.
- **Proposition 3:** Italy has a record of using state-aid, and therefore of LEN.
- **Proposition 4:** the BRRD presents a set of loopholes due to which Member States with sufficient relative power could potentially lobby European institutions in order to make use of state-aid;
- **Proposition 5:** Institutions develop institutional culture, which shape the world view of institutional members. Therefore, when aggregating interest groups' preferences, governments are influenced by their own believes, which can in turn influence decision-making;

which result in the following set of expectations:

Theory driven expectations: Due to its LEN institutional culture, the Italian government is expected to use its relative power to lobby European institutions into allowing it to support troubled banks through state-aid.

As a matter of fact, hypothesis one embraces LEN as the driving element of Italy's behavior. According to this hypothesis, the Italian government aims to achieve LEN goals because LEN is part of its institutional culture, and of its 'ideology'. If confirmed, this hypothesis points to the fact that Italy is going to great lengths to keep banking ownership national.

Hypothesis 1: The use of state-aid is motivated by LEN. The government hinders the involvement of foreign investors in the bank's recapitalization, and resorts to state aid in order to keep the banking ownership national.

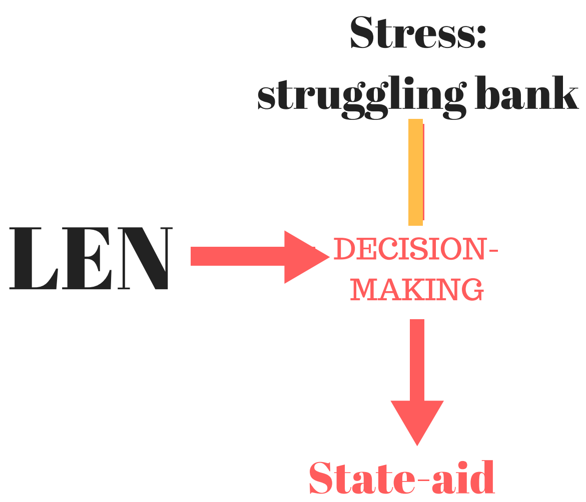

Figure 5: graphic representations of hypothesis 1.

HYPOTHESIS 2: LI and rational choice institutionalism

Hypothesis two, on the other hand, provides an alternative, theory-driven explanation. In fact, this hypothesis builds on liberal theories of preference formations entailed in the LI framework, and reiterates its rational choice assumptions concerning institutional behavior by adopting rational choice institutionalism. According to these theories, domestic interest groups develop national preferences, whereas the government aggregates them, and seeks to satisfy them in order to maintain itself in office (Moravcsik, 1993). Therefore, hypothesis two argues that the government did engage in LEN decision-making, but it did so in order to satisfy domestic preferences put forward by interest groups, rather than due to LEN's presence in the Italian government's institutional culture.

This form of LEN is from this moment on referred to as Functional LEN, in that it is functional to specific goals tied to the specific contingencies of the case study. If hypothesis two is confirmed, it indicates that the Italian government is trying to keep banking ownership national, albeit for specific reasons which might be contextual, or which might indicate a further set of goals which are served by its actions. For instance, the government might aim to achieve LEN goals because, due to the perceived or expected popular support for such goals, it considers it necessary to maintain itself in office.

Hypothesis 2: The use of state-aid is motivated by Functional LEN. Italy's LEN is in fact functional to the goal of achieving effectively nationalistic priorities, such as such as protecting investors.

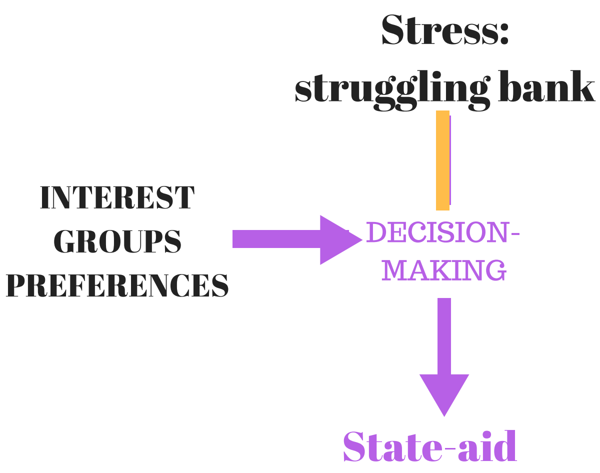

Figure 6: graphic representations of hypothesis 2

HYPOTHESIS 3: neo-functionalism and historical institutionalism

Finally, hypothesis three can be considered a null hypothesis, and its function is to account for the possibility that the assumptions and propositions for the case studies are misplaced. As a consequence, hypothesis 3 builds on neo-functionalist and historical institutionalist expectations of state behavior. Neo-functionalism largely downplays the role and power of Member States, considering them not more than one among several actors in the European arena, and concluding that they lack the power to drive the integration process in their favor. In the same way, historical institutionalism claims that Member States decisions are limited by previous choices, and their freedom of action and autonomy is restricted.

Therefore, a Member State like Italy is expect Member States to comply with European legislations, since it lacks the leverage to oppose or lobby supranational institutions.

As a consequence, full complacence with the BRRD is expected, and state-aid is expected to be used only if allowed by law. According this hypothesis, in fact, LEN is not involved in the case studies. If confirmed, hypothesis three indicates that Italy is not trying to protect banking ownership.

Hypothesis 3: The use of state-aid is not motivated by a LEN. Before resorting to state aid, the government makes serious efforts to attract private national and international investors.

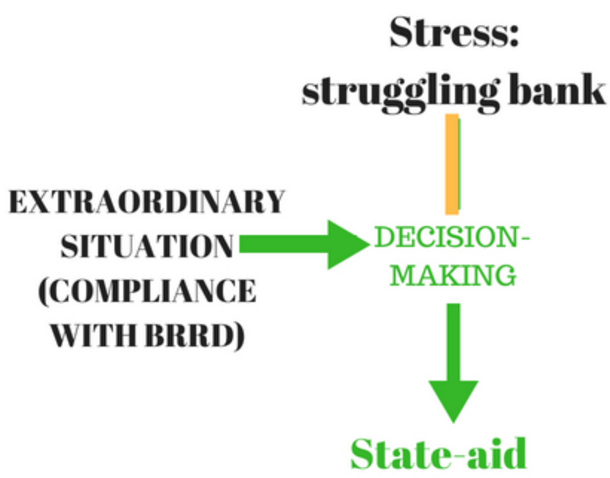

Figure 7: graphic representations of hypothesis 3

In conclusion, the table below emphasizes the connection between theoretical framework and hypotheses. It is important to notice how the first two hypothesis build upon LI expectations, whereas the third, null hypothesis builds on neo-functionalist expectations. Once again, hypothesis one embraces sociological institutionalist insights on top of LI expectations of state and European institutions behavior, whereas hypothesis two builds solely on LI theory.

Integration theory perspective	Liberal intergovernmentalism		Neo-functionalism
Institutionalism insights	Sociological institutionalist	Rational choice institutionalism	Historical institutionalist
Expectations	As part of Italian government's institutional culture, LEN affects the government's decision-making.	Government seeks to satisfy interest groups LEN requests in order to maintain themselves in office.	Member States lack the power to oppose European legislations. Italy is expected to fully comply with the BRRD.
Presence of LEN	LEN	Functional LEN	No LEN
Hypothesis	Hypothesis 1	Hypothesis 2	Hypothesis 3

CHAPTER V: METHODOLOGY

1. AIM OF THE STUDY AND RESEARCH DESIGN

As mentioned in the introduction, the present thesis aims to answer the research question: '*To what extent is the Italian government trying to keep bank's ownership national*?'. In order to address this topic and answer the research question, a qualitative research approach has been chosen. This choice is due to the nature of the topic and of the data.

First of all, the nature of the data calls for a qualitative approach. Qualitative data usually comprises of interviews, observations, or documents (Patton, 2002), and understanding this data requires it the reconstruction of rich and complex social and historical contexts (Denzin, 1989). This kind of data can hardly be analyzed through statistical software (Newton Suter, 2012). As a matter of fact, the data sources consist of newspaper articles, scientific articles, press reports, think tank reports and so on**.** Therefore, the most suitable approach is hereby a qualitative one.

In the same way, the topic addressed by the research question entails a multilayered set of European, Italian and private actors; matters of national preference and institutional culture; legislative requirements, policy implementation and monitoring; and theories of European integration. Thus, the complexity of this framework calls for an approach that is apt to understanding the nuanced complexity of the European dynamics and a qualitative research, through the use of theory driven and empirically based remarks and observation is particularly fitting (Newton Suter, 2012).

AN EXPLANATORY CASE STUDY

In particular, this thesis addresses the research questions by analyzing two case studies concerning the precautionary recapitalization of Monte dei Paschi di Siena and Banco Veneto e Vicenza. Case studies are explorations of an individual, group or phenomenon (Sturman, 1997; Hays, 2004: 218), and focus on their the environment or context (Starman, 2013). These individuals, groups or phenomena are the case, or the unit of analysis, of the study (Stake, 1995).

In the case of this thesis, the unit of analysis of two case studies is the decision-making of the Italian government under stress. In fact the aim of this research is to identify what motivations lie behind the Italian government's decision to recur to precautionary recapitalizations for MPS and V&V. As a consequence, the ones analyzed in the present thesis are explanatory case studies. In fact, unlike in the case of descriptive or exploratory case studies, the present study does not limit itself to describing the incidents, or exploring it in order to develop a first understanding of the subject, but it aims to develop a competing set of explanations for the given events and identify the most likely among them (Yin, 2003).

Since no explanation can be reached before the phenomenon of interest is properly described, explanatory case studies, too, contain a descriptive account of the events (Sage, 2010). In addition to that, reporting the events in detail serves the further purpose of identifying operational links and dynamics which need to be traced over time (Yin, 2003), and aims to understand a real-life phenomenon while paying attention to its context (Yin and Davis, 2007).

A HOLISTIC MULTIPLE-CASE STUDY

Further, according to the four-fold classification provided by Yin (2003), the present research represents a holistic multiple-case study. Multiple-case studies are researches that, just like the present one, cover more than one case. Moreover, holistic case studies, as opposed to embedded case studies, cover one and the same unit of analysis, which in this case is the decision-making of the Italian government under stress.

Furthermore, the present thesis follows a replication logic. The replication logic can be compared to the one used in multiple experiments, and can give way to either literal replication, where similar results are predicted, or theoretical replication, where opposite results are predicted (Yin, 2003). This thesis presents two similar cases, and predicts for them the same set of outcomes, and thus classifies as literal replication.

As mentioned above, multiple-case studies entail more than one case. Why then is the present study limited to two cases? The reason behind this choice is that the MPS and V&V cases have a set of common characteristics that could not be found in previous cases, and has not been repeated after them. In fact, action towards rescuing both banks was taken after the full entrance in force of the BRRD, and both cases ended in a precautionary recapitalization. Adding further cases that do not share this characteristics would not add value to the research.

2. PROCESS TRACING

This thesis aims to assess the extent to which the Italian government aims to keep banking ownership national. In order to address this question, an analysis will be conducted that examines the decision-making process of the Italian government under stress.

The method chosen to achieve this goal, and therefore to select, organize, and analyze the data, is called process tracing. Process tracing is probably the most prominent qualitative research method for detecting causality in political science (Mahoney, 2010), and it consists in the identification and analysis of the relevant steps that make up a process, in order to verify theory-driven hypotheses on the causal links between independent and dependent variables (Bennett and Checkel, 2014; George and Bennet, 2005).

The phenomena analyzed through process tracing are often, as in the case of this thesis, understood as part of a temporal sequence of events. Within this sequence, the task of the researcher is that of identifying diagnostic causal links that confirm or falsify the hypotheses (Mahoney, 2012). Such causal links can be referred to as causal-process observations (CPOs) (Collier, Brady, and Seawright, 2010).

Process tracing can have a deductive theory-testing nature, or an inductive theory-developing one (Trampusch and Palier, 2016). This studies embraces a deductive approach, which has the advantage of confining the data selection to a pre-set and theory-based scope. This aspect is particularly helpful in thwarting the risk of falling into the storytelling trap, that is to arbitrarily shape the facts into a plausible story (Schimmelfennig, 2014).

However, process tracing is an iterative process (Trampusch and Palier, 2016), which allows and requires the researcher to ping-pong back and forth between theory and data. Thus, even within the context of a deductive approach, the present thesis makes use of inductive method when it draws alternative hypotheses from the first round of data collection.

A CRITIQUE OF PROCESS TRACING

Two are the main critiques against process tracing, the first related to the infinite regress problem and the other to the degrees of freedom problem (King, Keohane and Verba, 1994). The infinite regress problem concerns the risk of endlessly looking for intermediate causal steps between 'any two links in the chain of causal mechanisms'. The degrees of freedom problem, on the other hand, arises when the variables available are too many, and the researcher might be unable to make sense of the relations between them.

Nevertheless, both critiques miss a crucial aspect of this method: in process tracing, not all data is created equal (Bennett, 2010). The meaning of this colorful expression borrowed from Bennett (2010) is that not all data is equally important in determining causality. In fact, some data only serves descriptive purposes.

Collier, Brady and Seawright (2010) further elaborate on the issue by distinguishing between descriptive-set observations (DSOs) and causal-process observations (CPOs). According to them, DSOs are standard observations as can be found in other types of research, comparable to the variables' scores for a given case. For the sake of clarity, DSOs can, for example, provide proof of the fact that the independent variable exists and occurred at all (Mahoney, 2010). Thus, within the scope of this thesis, DSOs can be those pieces of evidence that point to the fact that the Italian government displayed LEN tendencies. Although such evidence is essential to the research, it does not imply any kind of causality per se. CPOs, on the other hand, are data that provide information as to context, processes, or mechanism that contribute to making causal inferences (Collier, Brady and Seawright, 2010:277).

3. DATA COLLECTION AND ORGANIZATION

The scope of the data collection has been limited time wise to a period between the first pleas from Italian and European authorities for the banks to raise capital, until the precautionary recapitalizations. This temporal limitation protects the data collection from the risk of falling into the problem of infinite regress.

As far as the sources are concerned, the data has been drawn from newspaper articles; journal articles; EU, think tank and NGOs reports; EU and Italian institutions, Italian central bank, MPS, and V&V press releases; Italian and EU legislative texts. The scientific articles have been searched through Scopus and Google Scholars, whereas the newspaper articles have been found through Google and through the EU and NGO websites.

Within this pool, the data has been selected while keeping in mind its double purpose to describe the incidents and to detect causality. These two different aspect have been covered in two separate phases.

During the first, descriptive phase, data has been gathered with the purpose of providing a timeline of the events, composed of a series of snapshots of the most important steps of the process. The collected data has in fact been organized into two timelines, one for each case, displaying the incidents that led to the precautionary recapitalizations. Each one of the two cases has be analyzed individually, and divided into periods, in order to provide the reader not only with a sequence of events, but also with descriptive snapshots. In fact, taking good snapshots of the steps composing a process helps analyzing change and sequence (Collier, 2011). It is during this first reconstruction of the events that the two alternative explanations, protection of investors and protection of the economy, have been identified.

Collected the first layer of data, another round of data selection has taken place. The purpose, this time, has been to detect causal-process observations that confirm or disprove the hypotheses. During this phase, the sub-questions have been used to guide the research, and special effort has been devoted to identifying CPOs that are high in necessity and sufficiency. In order to do so, the chosen strategy has been to look for as many observation points as possible, in the direction pointed at by the theory, background framework and first round of data collection. The CPOs have then first been added to the timelines, and then categorized into one of the three outcomes envisaged in the analytical framework.

4. VARIABLES AND ANALYTICAL FRAMEWORK

Good process tracing requires the researcher to present a set of plausible alternative explanations, and to be as empirically thorough on their primary explanation as on the alternative ones (Bennet and Checkel, 2014). So far, one main hypothesis and two alternative explanations have been presented. In order to test these hypotheses three independent variables and one dependent are introduced in the next few paragraphs. After that, the variables are organized in an analytical framework-

INDEPENDENT VARIABLES

The three independent variables reflect the three hypotheses put forward in the previous chapter. The first independent variable is *LEN*. *LEN* reflects hypothesis one: "The use of state-aid is motivated by LEN. The government hinders the involvement of foreign investors in the bank's recapitalization, and resorts to state aid in order to keep the banking ownership national." LEN is a form of economic nationalism, which aims to enhance and favor the national economy through neoliberal means, such as selective liberalization and patient capital. It can have the purpose of favoring national companies, resist foreign companies, or both.

The second variable, *protection of investors*, is drawn from hypothesis two: "The use of state-aid is motivated by Functional LEN. Italy's LEN is in fact functional to the goal of achieving effectively nationalistic priorities, such as such as protecting investors." The choice of *protection of investors* as an independent variable springs form the first round of data collection, which pointed to how the fate of retail investors seemed to be a driving factor for the Italian government in its negotiations with European authorities. *Protection of investors* is defined as the will to protect investors, and in particular the retail investors which were convinced to convert their savings account into bonds, from having to lose their capital.

At last, *protection of the national economy* is drawn from hypothesis three: "The use of state-aid is not motivated by a LEN. Before resorting to state aid, the government makes serious efforts to attract private national and international investors." *Protection of the national economy* reflects the possibility that Italy made use of state-aid in a desperate situation, only after trying out all the alternative solutions, and demonstrating no preference towards solutions involving national actors or funds. *Protection of the national economy* can be defined as Italy's lack of LEN tendencies, and by its believe that a lack of action would cause its economy to collapse or suffer greatly.

IDEATIONAL AND MATERIAL VARIABLES

One of the challenging aspects of the present thesis resides in fact that the main independent variable, LEN, is not a material explanation, but an ideational one. Jacobs (2014) defines an ideational theory as "a causal theory (or explanation) in which the content of a cognitive structure influences actors' responses to a choice situation and in which that cognitive structure is not wholly endogenous to objective, material features of the choice situation being explained."

This definition entails two main pieces of information. First of all, ideational theories affect actors' cognition of their choices. Ideational theories are, therefore, potential explanations to given incidents.

Most importantly, though, ideational explanations are not completely caused by and related to the objective reality of the incident at hand. This is to say that ideational variables are normative commitments, believes about the world, mental models, which are already present among actor's cognitions, or within the institutional culture, as is relevant for this thesis. It is thus this second attribute of ideational theories that distinguishes them from non-ideational, 'materialist' explanations. Non-ideational explanations are, in fact, directly connected to the objective characteristics of the events (Jacobs, 2014).

If *LEN* is an ideational explanation fitting the description above, the other two independent variables are materialist explanations. In fact, *protection of the investors* and *protection of the national economy* are alternative explanations derived from a first reconstruction of the events.

DEPENDENT VARIABLE

The dependent variable is *state-aid*. State-aid consists in the government's provision of patient capital, guarantee schemes or other LEN tools to suffering banks.

ANALYTICAL FRAMEWORK

In order to make sense of the data and clarify the relationship between variables, qualitative research often makes use of analytical frameworks (Newton Suter, 2012). Moreover, the point has been made that a process tracing is convincing as long as it can be summarized in a compelling diagram (Gerring, 2007: 181; Waldner, 2015). Thus, the present research makes use of the following analytical framework:

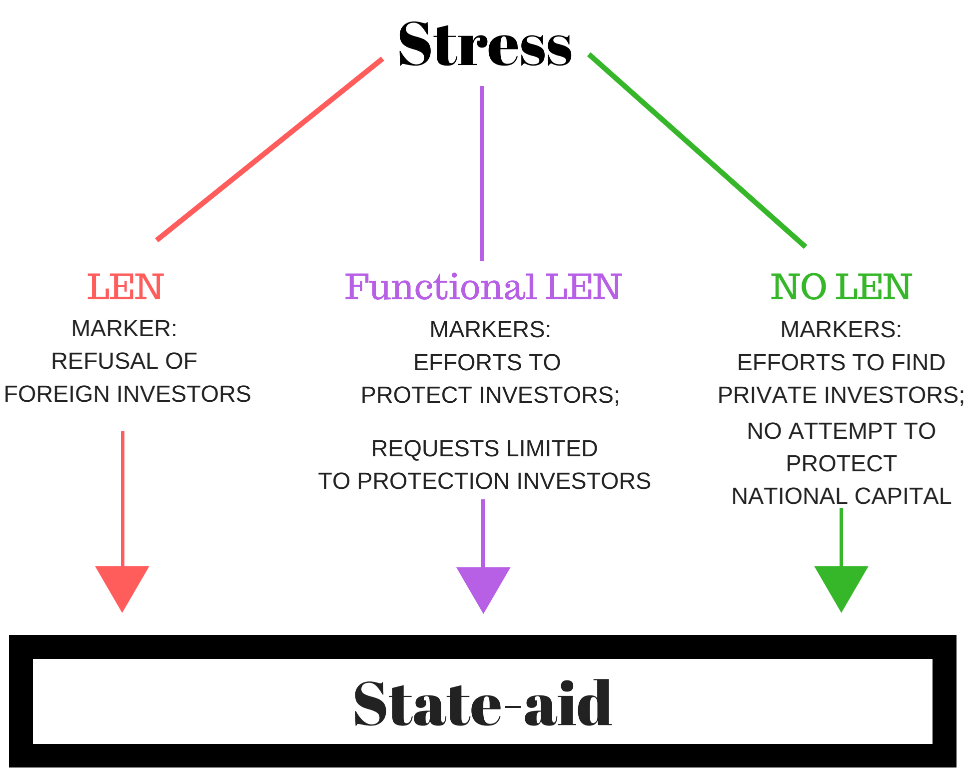

Figure 8: Schematic representation of the analytical framework.

The analytical framework introduces three outcomes. Whereas outcome one and three are intuitively called ‘LEN’ and ‘No LEN’, the second outcome reads ‘functional LEN’. This terminology is not drawn from the literature, but was coined in order to provide the outcome with a clear label, and enhance the clarity of the text.

The following table aims to further clarify the connection between hypotheses, variables, and outcomes. In fact, each outcome corresponds to one of the three independent variables, and therefore to one of the three hypotheses. In addition to that, the table specifies how each outcome relates to Italy’s abidance to the BRRD.

Causal puzzle	Hypothesis	Variable	BRRD	OUTCOME
What motivated the Italian government make use of state-aid in addressing the MPS/V&V crisis?	1	LEN	No compliance	LEN
	2	Protection of investors	Partial compliance	Functional LEN
	3	Protection of economy	Full compliance	NO LEN

It is worth noting that, under each outcome, the diagram entails one or more markers. These markers, which guide the second round of data collection, are built, on one hand, on the information drawn form the data collected during the descriptive phase, from the theoretical and background framework and, on the other, from logical reasoning around the expected necessity and sufficiency of such CPOs.

The marker for LEN is a double decisive test, which means, as will be discussed below, that it is high in both necessity and sufficiency. On the other hand, the functional LEN and no LEN present two markers each. The first marker is a smoking gun, and it is high in necessity, whereas the second is a hoop test, and it is high in sufficiency. If combined, the two strengthen the hypothesis and eliminate the alternative ones.

Once results are drawn from the data analysis, the researcher will begin a procedure called pattern matching (Trochim, 2000). Pattern matching aims to align data with theoretical expectations, where suitable. Nevertheless, it is possible that the results of the data analysis point to an outcome somewhere in between these two. In fact, economic nationalism is better understood as a spectrum, than as clearly defined categories (Clift and Woll, 2012).

5. TESTING CAUSAL INFERENCE

In order to help the data analysis, the CPOs will be collected in a table. Within such table, observations will be categorized under one of the three outcomes enlisted above, or, as might happen, somewhere in between the three.

Once categorized, the CPOs will be exposed to four tests, and classified into four groups depending on which one of the tests they pass. Such tests are known as straw in the wind, hoop, smoking gun, double decisive (Van Evera, 1997). These tests develops around the concept of necessary and sufficient condition to determine causality. Each of the four results represent a different level of certainty, and can be used to confirm, disconfirm, strengthen or weaken hypotheses.

Firstly, hoop tests set necessary but not sufficient conditions for causality, and are useful in that they can convincingly eliminate hypotheses. They present one or more pieces of evidence that contradict a given hypothesis, and thus disconfirm it. They nevertheless are not sufficient to corroborate a rival one. A smoking gun test, on the other hand, represents sufficient but not necessary conditions for causality, and can convincingly confirm hypotheses, but cannot disprove one (Bennett, 2010).

However, if for any reasons the evidence is not sufficient to convincingly confirm or disconfirm hypotheses, hoop and smoking gun tests become straw in the wind tests (Mahoney, 2012). In fact, the conditions of a straw in the wind tests are neither necessary nor sufficient to prove causality, and therefore can strengthen or weaken hypotheses, but do not represent decisive proof (Van Evera, 1997: 32).

Finally, CPOs that pass the fourth and last test, the double decisive test, are both necessary and sufficient in assessing causality. Unfortunately, though this type of test rarely occurs in social science (Bennett, 2010). The information around the four tests are summarized in the table below, which was extracted from Collier (2011).

Table 1

Process Tracing Tests for Causal Inference

		SUFFICIENT FOR AFFIRMING CAUSAL INFERENCE	
		No	**Yes**
Necessary for Affirming Causal Inference	**No**	**1. Straw-in-the-Wind**	**3. Smoking-Gun**
		a. Passing: Affirms relevance of hypothesis, but does not confirm it.	**a. Passing:** Confirms hypothesis.
		b. Failing: Hypothesis is not eliminated, but is slightly weakened.	**b. Failing:** Hypothesis is not eliminated, but is somewhat weakened.
		c. Implications for rival hypotheses: **Passing** *slightly* weakens them. **Failing** *slightly* strengthens them.	**c. Implications for rival hypotheses:** **Passing** *substantially* weakens them. **Failing** *somewhat* strengthens them.
	Yes	**2. Hoop**	**4. Doubly Decisive**
		a. Passing: Affirms relevance of hypothesis, but does not confirm it.	**a. Passing:** Confirms hypothesis and eliminates others.
		b. Failing: Eliminates hypothesis.	**b. Failing:** Eliminates hypothesis.
		c. Implications for rival hypotheses: **Passing** *somewhat* weakens them. **Failing** *somewhat* strengthens them.	**c. Implications for rival hypotheses:** **Passing** *eliminates* them. **Failing** *substantially* strengthens.

Source: Adapted from Bennett (2010, 210), who builds on categories formulated by Van Evera (1997, 31–32).

Figure 9: Table on the four process tracing tests for testing causal inference.

6. RELIABILITY AND VALIDITY OF THE STUDY

When seeking to produce quality research, four aspects need to evaluated: construct validity, internal validity, external validity, and reliability (Yin, 2003). Each of them will be addressed in the following paragraphs.

CONSTRUCT VALIDITY

When testing for construct validity, one aims to assess whether the operational measures for the concepts under study have been properly established (Yin, 2003). In other words, construct validity measures whether the interpretation of data has taken place in a logical and unprejudiced fashion (Riege, 2003).

In order to improve construct validity, the present study has made use of triangulation (Flick, 1992). Triangulation consist in comparing observations from different sources on the same subject (Dooley, 2009). In fact, cross-checking through different types of sources, contributes to counterchecking potential biases (Bennett and Checkel, 2014) and to corroborating credibility (Patton, 2002; Yin, 2003). Furthermore, construct validity has been strengthened by logically connecting the data and forming a logical chain of evidence (Riege, 2003).

INTERNAL VALIDITY

Internal validity concerns the establishment of correct causal relations (Dooley, 2009). Causality is notably a delicate and largely debated subject in research, and process tracing makes no exception. In fact, a considerable amount of literature can be found that discusses this subject in depth (Waldner, 2015; Bennett, 2010; Collier, 2011; Mahoney, 2008, 2010; Jacobs, 2014). As a consequence, a set of measures have been taken in order to enhance internal validity.

First of all, it is important to notice that the research method chosen, that is process tracing, has a positive impact on problems of spurious correlation, selectivity and omitted variables, which are among the main threats to internal validity, and thus to causality. In fact, the point has been made that process tracing can thwart these threats due to the fact that it aims to point directly at a specific causal mechanism (Mahoney, 2004). This is especially true when the causal mechanism in question passes hoop, smoking gun, or double decisive tests (Collier, 2011). In addition to that, in order to enhance clarity and cater to the explanation building process (Riege, 2003), observations have been categorized into a tables during the data analysis phase (Miles and Huberman, 1994).

AN OPEN DEBATE

At last, it is worth noting that scholars largely disagree on the basic requirements for proving causality. Jacobs (2014), for instance, delivers a detailed and demanding plan for proving the existence of, and testing the effect of, ideational variables. Such plan includes proving that the ideational theory existed before the incidents took place and that the main actors came in contact with it, using means such as tracking private communication; furthermore, the author strongly suggests proving independent variation of the ideational explanation across time, by examining cases before and after the incidents.

For persuading these suggestions are, they result impractical, and unlikely to be pursued within the timeframe of a Master thesis. In addition to that, the lack of available sources for drawing, for instance, data on private conversation, ultimately convinced the researcher to pursue inference testing through other means.

Acknowledged the demand for massive amount of data posed claims such as Jacobs (2014)'s, the question remains open at this point as to the quality of seeking causal inferences on the basis of the analytical framework and methods proposed above. What has been done from the researcher's side, has been to conduct the research with the most possible rigor in the framework of the chosen methods. Therefore, the answer to this question ultimately lies in the reader's believes and position within the ongoing debate on causality, and, possibly, on the persuasiveness of the conclusion provided in the present study.

EXTERNAL VALIDITY

External validity refers to the extent to which the results of the study can be generalized (Dooley, 2009). In the case of this thesis, high external validity would mean that the conclusions drawn on the behavior of the Italian government under stress can be generally expected to be similar to the ones under examination. Having as a central purpose that of identifying causal-process mechanisms within a case study, the trade-off between internal and external validity of process tracing is heavily skewed towards the first (Schimmelfennig, 2014). In fact, case studies allow for generalizations that are narrower and more contingent than, say, statistical research (George and Bennett, 2005).

Given this premise, the present thesis aims to enhance external validity by analyzing two case studies rather than one (Herriott and Firestone, 1983). The same outcome is in fact expected for the case studies, and the same set of alternative explanations have been presented. Therefore, were the outcome of the two cases actually to turn out to be the same, literal replication would be considered to have taken place (Yin, 2003). Certainly, a literal replication involving two cases does not guarantee complete external validity: for instance, a set of contingencies can be present that are connected to the fact that both recapitalizations happened in the same year. In conclusion, researchers might want to consider the results of this study, keeping in mind all the contextual specificities that go with it.

RELIABILITY

At last, reliability analyzes the research procedures used in the case study in order to assess their consistency and repeatability (Yin, 2003). Reliability is ensured by a clear description of the data collection methods, triangulation of the sources and pattern matching between theoretical expectations and observations.

7. POTENTIAL RESEARCH BIAS AND LIMITATIONS OF THE STUDY

As far as potential research bias are concerned, it is worth mentioning that the researcher was born and raised in Italy, that is in the country where the events take place. Nevertheless, the researcher has tried as much as possible to abandon prejudices on the topic. The diversification of sources across types, country, and political orientation have helped painting an idea of the situation that is as objective as possible. Furthermore, recursively alternating between theory and data has helped keeping a scientific outlook on the subject.

Limitations to the present study, on the other hand, can be found in the temporal limitation of a Master thesis assignment. Due to the limited amount of time, research on the period antecedent to the cases at hand have not been as extensive as they could have been.

CHAPTER IV: THE CASE STUDIES

1. MPS CASE STUDY

1.1 MPS crisis background

Established in 1472, Monte dei Paschi di Siena (MPS) is the oldest operating bank in the world, and Italy's third biggest bank. In the last ten years, MPS has had to raise capital for a total of 16 billion euros (Transparency International EU, 2017), in a journey that eventually brought it to a precautionary recapitalization in July 2017.

Although it considers the roots of the problems to have a more ancient origin, in its 2013 Financial System Stability Assessment the IMF identifies the beginning of MPS troubles in a series of transactions that took place between 2008 and 2009. In particular, the report mentions the purchase of AntonVeneta bank and a set of repo transactions as the main cause that triggered MPS illiquidity (International Monetary Fund, 2013). It is in this same period that, in order to raise capital in the aftermath of such events, MPS convinced thousands of retail investors to convert their savings into bonds for a total of €2 billion (Fior, 2016b).

In 2009, MPS, among other credit institutions, made use of the Tremonti bonds, a form subordinated and hybrid bonds named after the then Minister of Economy and Finances Giulio Tremonti. The bonds were available from February to December 2009 and had the purpose of strengthening banks' Core Tier 1 capital measure and, as a consequence, stimulate banks to issue credit for businesses and households. The Core Tier 1 is an indicator of stability of a bank's capital, generally used by regulators to assess a bank's health (Il Sole 24 Ore, n.d.).

Due to MPS' continued instability, Bank of Italy exercised an increasingly intrusive supervision on the bank, through measures such as intensified onsite inspections, close monitoring of the bank's liquidity, and a ban on bonuses and dividends. In fact, despite having no legal power to remove individual Board members or managers, in 2012 the Bank of Italy exercised moral suasion to have the Chairman, the CEO, and a number of Board members of MPS removed (International Monetary Fund, 2013).

In the same year, MPS failed the EBA recapitalization exercise. In an effort to support the credit institution, the Italian governments made available the so-called Monti bonds, adding them to the pre-existing Tremonti bonds, and bringing the recapitalization to a total of €4.1 billion (International Monetary Fund, 2013). Unlike the Tremonti bonds, issued in order to help a pool of Italian banks, Monti bonds represented an ad hoc measure aiming to rescue MPS. The Ministry of Economy and Finances bought bonds for a total of € 3,92 billion. The bonds were paid back in two phases: the most part, € 3billion, was paid on July 1st 2014, whereas the rest of the debt was extinguished in July 2015. Nevertheless, part of the interests on the bonds were converted into shares, making of the Italian state a stakeholder of 4% of MPS (Il Sole 24 Ore, n.d.).

2014-2015: TWO RECAPITALIZATIONS

On June 27 2014, Monte de Paschi started a recapitalization campaign in the form of a capital increase with subscription rights, with the purpose of raising €5 billion. MPS managed to raise 99,85% of the offer, and used part of this capital to pay back €3,5 billion of the €4,1 billion in state-aid received by the Italian government through the Tremonti and Monti bonds (Peruzzi, 2014).

One year later, MPS decided to raise capital for the second time through a recapitalization of €3 billion. 99.6% of the desired sum was subscribed by investors as of June 13th. Thanks to the capital raised, MPS was able to pay back the residual €1 billion of Monti bonds, in advance as compared to the 2017 deadline (Il Fatto Quotidiano, 2015b).

1.2 The stress

Despite collecting two successful recapitalizations, the most acute phase of the MPS crisis began in the first two months of 2016, when its share price fell by 61% (Transparency International EU, 2017). Thus, MPS headed off to the 2016 EBA stress test with dull perspectives.

This situation coincided with the entrance in force of the bail-in rule of the BRRD on January 1st 2016. Since the beginning of the year, PM Renzi and Minister of Finance Padoan expressed their concern around the rule, which they claimed would enhance financial instability rather than reducing it (Brunsden and Barker, 2016; Politi and Brundsen, 2016).

Furthermore, Italy's financial situation was coupled with the imminent constitutional referendum, which would determine the future of Renzi's government. The Prime Minister had in fact announced he would resign in case the of a negative outcome (Sky TG24, 2016; Makortoff, 2016).

observation: Renzi and Padoan expressed their opposition to the bail-in rule in January and February 2016.

THE ATLAS FUND

Preparing for a potential need to raise capital, the government required Italian banks to contribute to the newly established Atlas fund. The Atlas fund was established in April 2016 with the tasks of recapitalizing insolvent banks for up to 70% of its capital, acting as 'shareholder of last resort' and of purchasing junior tranches of securitized Italian non-performing loans for up to 30% of its capital (Schoenmaker and Veron, 2016; Il Sole 24 Ore, 2016a; Il Post, 2016). The private rescue fund was created with contributions from the majority of Italian banks, and disposed of an initial capital of €4.25 billion (Transparency International EU, 2017; Schoenmaker and Veron, 2016).

observation: Italy established the Atlas Fund in April 2016**.**

JUNE 2016: ITALY ASKS FOR FLEXIBILITY ON THE BRRD

In the aftermath of Brexit, Milan's stock market plummeted from +3.71 on June 23rd to -12.48% on June 24th, with banks' shares suffering heavily (Di Cristofaro and Maurino, 2016; Piana, 2016; The Financial Times, 2016).

At this point, while unconfirmed rumors spread in the press around a €40 billion rescue plan being prepared behind the scenes (Evans-Pritchard, 2016; Chicca, 2016; Feltri, 2016), the Italian government publicly took a stance against the BRRD rule, both in Italy and abroad. In fact, on 26 June 2016, Francesco Boccia, the president of the Committee on Budgets, stated that suspending the bail-in rule was 'not a heresy' (Boccia, 2016; Feltri, 2016).

On the same day, the Secretary of the Council of Ministers Claudio De Vincenti released an interview on Sky where he stated that the government was ready to protect depositors, and engage in 'interventions aiming to support bank's liquidity and solvency' (Bartoloni, 2016; Feltri, 2016).

Moreover, on 27 June 2016, PM Matteo Renzi met German Chancellor Merkel and French President Hollande at the Brexit Summit in Berlin. When asked about the Italian position on troubled banks in the aftermath of Brexit, Renzi regretted the lack of systemic interventions by previous Italian governments, and urged the need for 'caution, common sense and balance'. The government, he added, would do whatever necessary within the current legislative framework to address the issue (Palazzo Chigi, 2016; Karnitschnig, 2016; Evans-Pritchard, 2016). Through these declarations, Renzi seemed to be connecting the stock market shock caused by the Brexit vote to the kind of 'exceptional occurrence' during which, according to article 107.2(b) of the TFU, state aid is permitted (Il Fatto Quotidiano, 2016c; Chicca, 2016). Such declarations triggered a set of reactions from the Commission, the ECB, and the German government.

Comments from the Commission arrived during the Brexit Summit, on June 28th 2016, when Juncker stated that the Commission would do anything to prevent a bank run in Italy (Rettman, 2016; Il Fatto Quotidiano, 2016c). In that occasion, Renzi met Commission president Juncker and vice president Dombrovskis (Guarascio, 2016b). Dombrovskis stated that the Commission was monitoring the situation, and keeping close contact with Italian authorities concerning possible steps (Balestreri, 2016; Il Sole 24 Ore, 2016b).

The ECB, on the other hand, commented from the forum in Sintra, where Member of ECB's executive board Benoît Cœuré insisted on the importance of respecting the bail-in rule, stating that the failure to comply with it would result in the end of Banking Union as we know it (Il Fatto Quotidiano, 2016c; La Repubblica, 2016a).

As far as the German response is concerned, on June 29th 2016 Merkel answered to Renzi's requests by asking to respect BRRD. Rules, the Chancellor stated, 'cannot be changed every two years' (Sanderson, 2016a; Guarascio, 2016a; Il Fatto Quotidiano, 2016c).

At last, it is also interesting to notice that on June 28th Renzi visited the Party of European Socialists's headquarter in Brussels, from where he reassured Italian depositors, stating that their savings would be protected (Balestreri, 2016; Il Sole 24 Ore, 2016c).

observation: 26 June 2016, President of the Italian Committee on Budgets (part of the government) stated that suspending the bail-in rule was 'not a heresy'.

observation: 26 June 2016, the Secretary of the Council of Ministers Claudio De Vincenti released an interview on Sky where he stated that the government was ready to engage in 'interventions aiming to support bank's liquidity and solvency'

observation: 26 June 2016, Secretary of the Council of Ministers Claudio De Vincenti released an interview on Sky where he stated that the government was ready to protect depositors

observation: 27-29 June 2016, Renzi suggested state-aid. The Italian government discussed possibility of precautionary recapitalization with both German finance minister and EC

observation: 28 June 2016, Renzi visited Party of European Socialists' headquarter in Brussels, from where he reassured Italian depositors, stating that their savings would be protected

observation: 29 June 2016, Pier Paolo Baretta stated that looking at the problem from the banks' perspective, the prevailing option was the one involving the Atlas fund and the market. Nevertheless, he added, the government needed to protect depositors and deposits.

observation: Italy allegedly prepared a €40bn rescue plan for MPS

THE BANK OF ITALY ON BAIL-IN

From its side, the Bank of Italy called for a complete overhaul of the bail-in rules. At the ECB forum on central banking in Sintra, Bank of Italy's governor Visco stated that the institute would use 'every available tool to support the banking system', underlining the importance of preventing a shock as strong as Brexit from creating contagion (Chicca, 2016; Il Fatto Quotidiano, 2016a).

Further, Visco condemned the bail-in rule as anti-constitutional, claiming it infringes Article 47, which 'encourages and protects' savings (Merler, 2016b). Nevertheless, as Merler noted, such argument is 'naive and misplaced', since it 'neglects the fundamental difference between savings and investment', since investment by definition entails a risk factor (Merler, 2016a).

observation: In harmony with the government, the Italian Central Bank denounces the bail-in as inappropriate in the critical economic situation in the aftermath of Brexit

THE ECB REQUIRES MPS TO RECOVER

On July 4th MPS confirmed receiving a letter from the ECB, just a few weeks before the official publication of the stress test results. The letter contained a set of requirements to be met. MPS was required to:

a) sell on the market a minimum of €9.7 billion of NPLs by turning them into shares;
b) develop a 3-year plan, to be ready by October 3rd 2016, with the objective of reducing the ration between performing and non-performing loans (NPL ration) to 20% (Gruppo MPS, 2016a; Greco, 2016; Il Fatto Quotidiano, 2016b).

Indeed, when the stress test results were released on 29th July 2016, MPS turned out to be the worst performer among the 51 scrutinized banks, with a Cet1 ratio of 12.2% in normal condition, and of -2.44% under adverse conditions (Gruppo MPS, 2016b; Festa, 2016a; Il Fatto Quotidiano, 2016c; Mesnard, Margerit and Magnus, 2017).

JULY 2016: DEVELOPING A PLAN

Developing a plan in response to the ECB letter required concerted efforts by MPS, the Italian government, and European authorities. In this period, negotiations continued and seemed to intensify. MPS's CEO Fabrizio Viola confirmed to be working intensively with Italian and European authorities, with the goal of reaching, in a short amount of time, a 'structural and ultimate solution' to the bank's problem with NPLs (Ferrando, 2016a; Sala, 2016).

Italian authorities were busy arranging a propping up of the Atlas fund's resources. In fact, after the intervention on V&V, the fund was left with a capacity of €1.7 billion. On July 4th, a meeting took place for the Atlas Fund. Quaestio Sgr, the company administrating the fund, was given the task of raising €1 billion euro (Sanderson, 2016b; Massaro, 2016b).

On July 11th, Italian Minister of Finance visited Brussels, from where he reassured depositors, stating that their saving will be safeguarded (TG Com 24, 2016; Romano, 2016;

Sala, 2016). The Commission's position on the topic seemed to be open to different possibilities, but firmly demanding that Italy respected the BRRD rules. This was underlined on July 12th by Eurogroup President Jeroen Dijsselbloem, who insisted on the necessity to abide by the bail-in rule, since Italy's banking crisis was not acute (Cnbc, 2016a; Williams, 2016).

As far as retail investors are concerned, during a press conference on July 14th 2016, European Commissioner for Competition Vestager reminded the audience that, since the beginning of July, the EC had been ready to avoid a negative impact for retail investors, by adapting the rules to country-specific situations. The European Commission was thus in favor of a deal on Italian banking future, but in the compliance with the rules (Romano, 2016; Sanderson and Barker, 2016; Sanderson, 2016b; Sensini, 2016)

observation: On July 11th, Italian Minister of Finance visited Brussels, from where it reassured depositors, stating that their saving would be safeguarded

observation: Commission open to allowing for compensations of junior bondholders, as long as the bail-in rule is complied with.

29 JULY: MPS PRESENTS A PLAN

Eventually, MPS put together a plan which aimed to, on the one hand, sell €10.2 billion of NPLs and, on the other hand, cover the hole that the cheap sale of such NPLs would tear on the bank's balance sheet with a €5 billion recapitalization. In fact, the NPLs were to be sold at 33% of their value in order to make them attractive to investors (Festa, 2016a; Righi, 2016).

The NPLs were divided into three tranches:

1. one senior tranche of around €6 billion, to be bought by JP Morgan with a bridging loan of a year, at the end of which the Gacs government guarantee scheme will intervene;
2. a mezzanine tranche of around €1.7 billion to be absorbed by the Atlas fund;
3. and another €1.6 billion tranche, to be offered to the current investors, who can decide, if they wish, to subscribe (La Repubblica 2016b; Leardini, 2016; Graziani, 2016a).

As far as the raise of capital is concerned, MPS decided to raise €5 billion from the market. The ECB approved the plan, showing flexibility especially in regards to this last aspect. In fact, it decided to ignore that the sale of NPLs would have required to raise a further €2 billion, bringing the total cost of recapitalization to €7 billion. In accepting MPS's plan, the ECB required it to be completed under all its aspects (La Repubblica, 2016b; Leardini, 2016; Festa, 2016b; Fior, 2016a). Italian Minister of Finance Padoan expressed satisfaction around the plan presented by MPS (Leardini, 2016; La Repubblica, 2016b; Righi, 2016).

It is interesting to observe how right after the approval of the rescue plan for MPS, PM Renzi continued its campaign against the bail-in rule. In fact, in an interview on August 2nd, the Prime Minister told Cnbc he believed that the bail-in rule was a mistake, in that it would curb investors and citizens' confidence, but that he would nevertheless respect the law (Trovati, 2016; Cnbc, 2016b).

observation: Italian Minister of Finance Padoan expressed satisfaction around the plan presented by MPS.

observation: On 2 August 2016 Renzi tells Cnbc that, although he respected the rules, the bail-in rule was a mistake.

RAISING €5 BILLION

Now that the plan had been presented and accepted, MPS had two tasks left to accomplish: it needed its board to approve a three-year plan for the reduction of NPLs, and to find investors willing to contribute to the third recapitalization of the bank in three years. The first task was completed on October 25th, when MPS published the bank's 3-year plan for the reduction of NPLs (Gruppo MPS, 2016c).

The second task, that is the capital raise, resulted more difficult to accomplish. In order to facilitate it, PM Renzi decideed to offer to JP Morgan, together with Mediobanca, the position of joint global coordinator and bookrunner for MPS. The two banks had already been collaborating for a year: it is the duo which came up with the idea to create the Guarantee on Securitization of Bank Non Performing Loans (Gaacs). PM Renzi took the decision to hire JP Morgan after meeting JP Morgan Chase's Chairman, CEO and President Jamie Dimon on July 6th (Pons, 2016; Reuters, 2016a; Meletti, 2016).

Under the guide of JP Morgan and Mediobanca, MPS engaged in three parallel efforts: the first two, namely the quest for investors and the conversions of subordinated bonds into shares, aimed to raise the required capital by the end of the year; whereas the third was an effort to prop up the Atlas fund, in order to make sure it could participate in the purchase of NPLs. Each of these three parts are better explained in the three following sections.

observation: PM Renzi hires JP Morgan to find a market solution to the increase of capital

I. The quest for investors: opening to foreign investors

The quest for investors seemed to start off with momentum. As a matter of fact, at the beginning of August, JP Morgan and Mediobanca released a statement enlisting a number of banks participating in a pre-underwriting concerning the increase of capital. The institutions involved were Banco Santander, Citigroup, Credite Suisse Securities (Europe) Limited, Deutsche Bank, Goldman Sachs International and Merrill Lynch International and Banco Bilbao Vizcaya Argentaria, Commerzbank, Ing, Jefferies, and Société Général. (Pons, 2016; Reuters, 2016a; Barbaglia and Davies, 2016).

Nevertheless, a pre-underwriting is not a binding contract. Therefore, in an effort to find a secure anchor investor, MPS' CEO Morelli engaged in a promotion tour of MPS shares in London, Paris, New York, Doha, and Singapore that lasts between October 24th and November 10th (Ferrando, 2016b; Festa, 2016c). Marco Morelli was the new CEO of MPS. In fact, on September 20th, Morelli substituted Viola as the new CEO of MPS (Gruppo MPS, n.d.). Viola resigned after Minister of Finance Padoan asked him to resign through a phone call on September 7th, under suggestion of JP Morgan. The government's request was further justified by the fact that the Italian state was the main shareholder of MPS (Pons, 2016; Meletti, 2016; Graziani, 2016b; Paolucci, 2016; Il Fatto Quotidiano, 2016d).

It is important to underline that MPS seemed, in this instance, to be open towards foreign investors. In fact, Morelli's tour took place outside national territory. The highlights of his journey included: the meeting with Axa, shareholder of 3.17% of MPS shares, which took place in Paris; meetings with American funds such as Blackrock, Quantum Fund, and Paulson in New York; and with Qia, the sovereign wealth fund of Qatar. Qia seemed to be interested in buying a €1 billion share of MPS (Massaro, 2016c; Festa, 2016c).

observation: The recapitalization plan includes a tour aimed specifically at finding foreign investors.

II. CONVERSION OF SUBORDINATE BONDS INTO SHARES

Once again with the purpose of raising capital, on November 15th 2016, MPS proposed to the bank's bondholders to convert, on voluntary basis, their subordinated bonds into shares (Fior, 2016c; Kirchgaessner, 2016; Rai News, 2016). The total offer amounted to €4,288,791,663 (Gruppo MPS, 2016d). Initially valid between November 28th and December 2nd, the offer was extended from December 16th to December 21st (Gruppo MPS, 2016e).

In contrast with MPS's search for foreign investors, or perhaps as a precaution in foreshadowing a possible failure of the plan, MPS attempt to raise capital from depositor focuses on national resources. This could be interpreted as an attempt to keep capital national.

observation: The recapitalization plan includes raising national capital from bondholders.

III. Atlas II

The contribution of the Atlas fund was a crucial part of MPS's plan to get rid of NPLs. More specifically, MPS's operations involved the newly found Atlas II. Unlike its predecessor, Atlas II could only invest on NPLs, and it was founded on August 8th 2016 with a capital of €1,715 billion. The goal was to bring Atlas 2's capital up to €3 billion/€3,5 billion (Quaestio sgr, 2016b;Ansa, 2016; La Repubblica, 2016c).

THE PLAN FALLS APART

MPS' efforts yielded some results. The conversion of bonds into shares, for example, was partially successful, with MPS raising €2,44 billion of the €5 billion necessary to recapitalize the bank as of December 21st. Among the investors, Assicurazioni Generali contributed by converting bonds for a value of around €400 million (Il Corriere della Sera, 2016). However, the total amount of share value purchased by retail investors is even more impressive. In fact, it was estimated to be €1,06 (Ferrando, 2016c).

Despite the efforts, though, MPS' plan fell apart due to the lack of an anchor investor, and the subsequent inability of the bank to raise the needed capital by the deadline. The withdrawal of investors was reportedly attributed to the negative result of the constitutional referendum on December 4th, and the subsequent resignations of PM Renzi. The sovereign fund of Qatar in particular blamed the uncertainty of the political environment as the cause of its withdrawal from a €1 billion euro investment. Another factor which reportedly played against the successful implementation of the plan was is complexity. Among the concerns was the €4.7 billion bridging loan, described by a banker as 'not a tidy process' (Provenzani, 2016; Arnold and Sanderson, 2016).

At last, after expressing serious concerns around the bridge loan in the absence of an anchor investor, the Atlas fund withdrew from participating in the purchase of NPLs (Za, 2017; Go News, 2016). In fact, as Atlas fund's manager Penati underlined on December 21st, the fund accepted to intervene on the condition that a market solution be found by the end of the year (Reuters, 2016c; Gruppo MPS, 2016f). The withdrawal of the Atlas fund marked the ultimate failure of MPS' plan. In fact, as the ECB had underlined in July, for the plan to work it had to be fulfilled in its entirety.

1.3 Decision-making

PRECAUTIONARY RECAPITALIZATION

Now that the market option had been excluded, MPS, and with it the Italian government, were left with two main options: it could either wind down the bank, or bail it out. The first option does not appear to have been considered at all. Rather, the dilemma concerned the conditions under which the now imminent bail-out will take place.

As already discussed, the standard procedure envisaged under the BRRD is to perform a bail-in of 8% of the value of the bank, before accessing to any form of state aid, which can only be avoided in extraordinary circumstances in which the stability of the economy is jeopardized.

It is in this phase of the crisis that MPS, supported by the Italian government, made the decision to ask for a precautionary recapitalization. For the sake of clarity, the main steps in that brought from the failure to involve anchor investors to the request for precautionary recapitalization are summarized in figure 4.

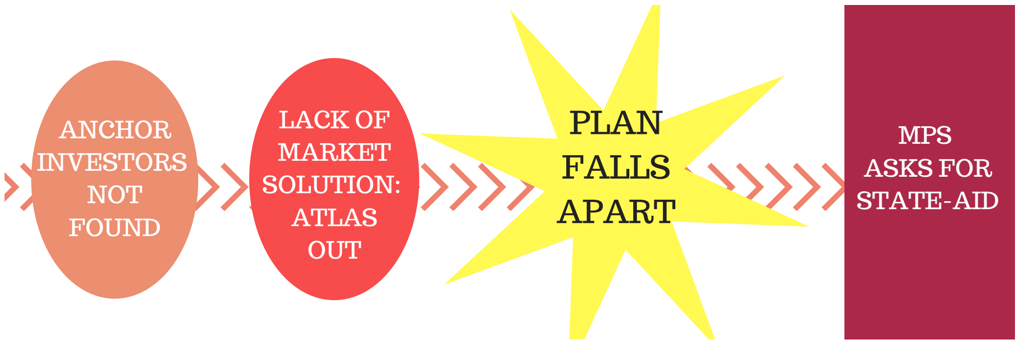

Figure 10: Schematic representation of the last few steps preceding MPS's request for state-aid.

As anticipated, on December 23rd, MPS triggered Article 32 (d) of the BRRD, requiring in so doing a precautionary recapitalization (Gruppo MPS, 2016g). On the same day, the Italian cabinet approved a €20 billion bail-out fund to recapitalize the bank, set to expire at the end of 2017. The fund was established through Decree-Law 237/2016, which new Prime Minister Gentiloni referred to as 'Decreto Salvarisparmio', which can be roughly translated as 'savings-safeguarding decree'. In a press conference, Gentiloni stated that the decree's goals were 'the broadest possible coverage of savings, and the consolidation of our banking system'. Gentiloni added that the measures had been approved by 'European authorities' (Vista Agenzia Televisiva Nazionale, 2016; Treanor and Kirchgaessner, 2016; La Repubblica, 2016d). Intervening in the press conference, Minister of Finance Padoan explained that the decree includeed a mechanisms designed to protect 100% of retail investors' savings. In order to do this, retail investors would be asked to convert their bonds into shares, and then into senior debt (La Repubblica, 2016d; Treanor and Kirchgaessner, 2016).

The ECB approved the precautionary recapitalization in two letters sent to the Italian Ministry of Economy and Finances on December 26th, in which it specified that:
-MPS was solvent, thus eligible for a precautionary recapitalization;
-MPS needed capital for around €8.8 billion,

-the bank's capacity had plummeted in the last few months. This latter fact justified the bank's increased need for capital (Il Fatto Quotidiano, 2016e; Gruppo MPS, 2016g; Transparency International EU, 2017; Politi, 2016).

The precautionary recapitalization effectively took place seven months later. In fact, on July 1st 2017, Commissioner Vestager and the Italian authorities agreed in principle on the restructuring plan of MPS (European Commission, 2017b), and eventually, on July 4th 2017, the Commission officially approved the precautionary recapitalization. Within this framework, the Italian government was allowed to inject €5.4 billion into MPS in exchange for shares bought at a discounted price. In the related press release, the EC stated that MPS was solvent and had met the supervisory requirements, as assessed by the ECB in its supervisory capacity; that a burden-sharing had taken place within the bank for a total of €4.3 billion, and that MPS had raised a further €0.5 billion by selling some activities; and finally, that the Italian government was allowed to use €1.5 billion to compensate junior bond-holders which had been victims of mis-selling (European Commission, 2017c).

observation: In a press conference, Gentiloni stated that the goals of the decree approved of December 23rd were 'the broadest possible coverage of savings, and the consolidation of our banking system'

observation: In a press conference, Minister of Finance Padoan explained that the decree included a mechanisms designed to protect 100% of retail investors' savings. In order to do this, retail investors would be asked to convert their bonds into shares, and then into senior debt.

1.4 Controversies

By approving the precautionary recapitalization, the ECB explicitly confirmed that MPS was solvent, and implicitly stated that a bail-in of junior bondholders would pose a threat to the economy, and needed therefore to be avoided. Both points remain fuzzy, and appear to have originated from arbitrary decisions rather than clear indicators.

For one, the ECB determines a bank's solvency by evaluating stress test results (Gruppo MPS, 2016g; Il Fatto Quotidiano, 2016e). The EBA's 2016 stress test showed that MPS resulted insolvent in case of a hypothetical adverse scenario, but positive under the baseline scenario. The ECB thus decided to assess MPS as solvent. Nevertheless, in accepting MPS' request for precautionary recapitalization, the ECB stated that the bank's situation had deteriorated in the previous months, making the solvency of MPS even more borderline. The threat to financial stability and serious disturbance of the economy were also not clearly defined in the legislations. Doubt have been raised with regards to this point, especially since a bail-in had already taken place in Italy in late 2015, without causing any major disruptions (Merler, 2016a).

This decision might be explained by the intensive lobbying and negotiations the Italian government entertained with European institutions in 2016. The following dedicated section aims to cast light on the negotiations, both with the Commission and the European Central Bank.

1.5 Negotiations

This section aims to provide an answer to sub-question 5: 'How did the Italian government negotiate with the European Commission and the European Central Bank in order to enjoy higher tolerance towards state-aid?'. In answering this question, evidence is gathered for the two parallel negotiations, one between the Italian government and the EC, and the other between the Italian government and the ECB.

On the one hand, there is evidence that the negotiations between the European Commission and the Italian government took place at least since June 2016, when PM Renzi met EC President Juncker and EC Vicepresident Dombrovskis in Brussels (De Francesco, 2016; Guarascio, 2016d). In the period between June and July 2016, sources repeatedly reported the Commission's frustration with the negotiations. The main reason for this frustration was the Italian government's refusal of the bail-in rule, and the claim that it would affect retail investors, despite the Commission's repeated reassurance about the possibility to reimburse junior bondholders (Guarascio, 2016c; Guarascio, 2016d; Romano, 2016). To this regard, a member of the Commission close to the negotiations stated that Rome should "stop pretending that there are no solutions other than setting the rules aside" (Sanderson and Barker, 2016). The name of the Commissioner was unfortunately not reported. The Commission thus appears to have been rather open to accommodating Italian government's requests, although it insisted, at least at the beginning, on Italy's compliance with the bail-in rule.

On the other hand, information regarding negotiations with the ECB are much scarcer. The point has been made that the Commission's willingness to bend the rule resulted in the Italian government favoring it over the ECB regarding information and consultation (Donnelly, 2018). In support of this knowledge gap, Donnelly (2017) reports that the ECB was notified of the Italian government's intention to promulgate a bail-out decree only days after its approval (European Central Bank, 2017b).

In addition to that, further prove can be found in the comments of Jens Weidmann, president of Germany's Bundesbank and member of the ECB's governing council comments on the issue. In fact, Weidmann invited the Italian government to consider winding down the bank rather than bailing it out, given its precarious conditions, adding that "the money cannot be used to cover losses that are already expected. All this must be carefully examined" (Davies, 2016; Il Fatto Quotidiano, 2016f).

Furthermore, the behavior of the ECB in the period between December 2016 and May/June 2017 appears to be inconsistent. First, it denied Italy a two-week extension to the market solution deadline (Sirletti, Speciale, and Totaro, 2016; Monaghan and Fletcher, 2017). Then, it hastily deemed MPS solvent, yet stating its needed for €3.8 billion more than expected (Gruppo MPS, 2016g). Eventually, it took months to settle matters, such as the precise amount of capital needed by MPS and the state of its finances, which had supposedly already been settled, and engaged in an exchange of letters with the Commission on the topic, coupled with visits to MPS to discern the actual state of things (Davi and Ferrando, 2017; Sirletti, Groendahl, and Totaro, 2017).

All in all, the ECB does not seem to be in control of the situation. Rather, it behaved as if it were trying to catch up with matters it had not been informed of, and to accommodate somebody else's demands. In conclusion, the ECB's behavior seems to point to the fact that a deal had been struck between the other actors regarding the precautionary recapitalization, and it had been left with the thankless job of proving MPS solvency. Nevertheless, in lack of hard proof, these are but speculations, around which further research is certainly encouraged.

observation: The Italian government insisted that a bail-in would hit retail investors, despite the Commission's reassurance of a possible reimbursement of retail investors

1.6 Drawing conclusions

In this section, the observations encountered above are classified according to which of the three possible outcome they refer to. The observations are then divided into tables, enlisting the straw in the wind, hoop tests, and smoking gun tests. For the sake of transparency, each choice of test will be followed by a brief motivation.

STRAW IN THE WIND TESTS

LEN	Functional LEN	No LEN
25 June 2016: Italy allegedly prepared a €40bn rescue plan **STRAW IN THE WIND:** Rumor unconfirmed	Renzi and Padoan expressed their opposition to the bail-in rule in January and February 2016. **STRAW IN THE WIND:** politicians' public statements around their believes not always reliable (Jacobs, 2014)	April 2016: Italian government 'forced' Italian banks to contribute to Atlas fund **STRAW IN THE WIND:** Government intent in finding solutions other that state-aid
26 June 2016, the Secretary of the Council of Ministers Claudio De Vincenti released an interview on Sky where he stated that the government was ready to engage in 'interventions aiming to support bank's liquidity and solvency' **STRAW IN THE WIND:** confirms the government's willingness to intervene.	26 June 2016, Secretary of the Council of Ministers Claudio De Vincenti released an interview on Sky where he stated that the government was ready to protect depositors **STRAW IN THE WIND:** Confirms government's concern with the issues	29 July 2016: Italian Minister of Finance, Pier Carlo Padoan, expressed satisfaction around the plan of MPS, which included the search for private investors **STRAW IN THE WIND:** politicians' public statements around their believes not always reliable (Jacobs,2014)
	26 June 2016: President of the Italian Committee on Budgets (part of the government) stated that suspending the bail-in rule was 'not a heresy' **STRAW IN THE WIND:** confirms the government's opposition to the bail-in rule.	

	28 June 2016, Renzi visited the Party of European Socialists's headquarter in Brussels, from where he reassured Italian depositors, stating that their savings would be protected **STRAW IN THE WIND:** Confirms government's concern with the issues	
	29 June 2016, Undersecretary to the Ministry of Finance Baretta stated that looking at the problem from the banks' perspective, the prevailing option was the one involving the Atlas fund and the market, but the government needed to protect depositors and deposits. **STRAW IN THE WIND:** Confirms government's concern with the issues	
	On July 11th, Italian Minister of Finance visited Brussels, from where it reassured depositors, stating that their saving would be safeguarded **STRAW IN THE WIND:** Confirms government's concern with the issues	
	2 August 2016: Renzi told Cnbc that the bail-in rule was a mistake. **STRAW IN THE WIND** confirms the government's opposition to the bail-in rule.	

	In a press conference, Gentiloni stated that the goals of the decree approved of December 23rd were 'the broadest possible coverage of savings, and the consolidation of our banking system' **STRAW IN THE WIND**	
	In harmony with the government, the Italian Central Bank denounced the bail-in as inappropriate in the critical economic situation in the aftermath of Brexit. **STRAW IN THE WIND:** Bank of Italy close to government, potentially confirms the government's opposition to the bail-in rule.	

HOOP TESTS

27-29 June 2016, Renzi suggested state-aid. Italian government discussed possibility of precautionary recapitalization with both German finance minister and EC **PASSES HOOP TEST:** evidence of the government's willingness to use state-aid months before the market operation fails. Strengthens but does not confirm hypothesis.	27-29 June 2016, Renzi suggested state-aid. Italian government discussed possibility of precautionary recapitalization with both German finance minister and EC **PASSES HOOP TEST:** evidence of the government's willingness to use state-aid months before the market operation fails. Strengthens but does not confirm hypothesis.	27-29 June 2016, Renzi suggested state-aid. Italian government discussed possibility of precautionary recapitalization with both German finance minister and EC. **FAILS HOOP TEST:** Evidence of the government's willingness to use state-aid months before the market operation fails, and not as last resort. **Hypothesis disconfirmed**

PM Renzi hired JP Morgan to find a market solution to the increase of capital. **FAILS HOOP TEST:** serious attempt to find private investors. **Hypothesis disconfirmed**		PM Renzi hired JP Morgan to find a market solution to the increase of capital **PASSES HOOP TEST:** attempt to find private investors. Necessary but not sufficient to confirm hypothesis: hypothesis relevant, but not confirmed.
The recapitalization plan includes a tour aimed specifically at finding foreign investors. **FAILS HOOP TEST:** serious attempt to find private investors. **Hypothesis disconfirmed**		The recapitalization plan includes a tour aimed specifically at finding foreign investors. **PASSES HOOP TEST:** serious attempt to find foreign investors. Necessary but not sufficient to confirm hypothesis: hypothesis relevant, but not confirmed.
The recapitalization plan includes raising national capital from bondholders. **PASSES HOOP TEST:** possible attempt at keeping capital national		The recapitalization plan includes raising national capital from bondholders. **FAILS HOOP TEST/STRAW IN THE WIND:** possible attempt at keeping capital national **Hypothesis weakened**
	July 2016: Commission open to allowing for compensations of junior bondholders, as long as the bail-in rule is complied with. **FAILS HOOP TEST/STRAW IN THE WIND:** The government is not content with a solution that protects retail investors. If considered with rigor, this observation could disconfirm the hypothesis since the purpose is not solely to protect investors. **Hypothesis weakened**	

SMOKING GUN TESTS

	In a press conference,	

	Minister of Finance Padoan explained that the decree included a mechanism designed to protect 100% of retail investors' savings. In order to do this, retail investors would be asked to convert their bonds into shares, and then into senior debt. **SMOKING GUN:** Confirms the hypothesis that the purpose of the precautionary recapitalization is, at least in part, to reimburse retail investors.	

DISCUSSING THE RESULTS

The tables above entail four important CPOs: five hoop tests and one smoking gun test. The first of them concerns the Italian government attempts to use precautionary recapitalization months before the market operation fails. This observation is in contradiction with the definition of 'No LEN'. In fact, for the 'No LEN' hypothesis to be considered, the Italian government needs not to attempt to seek state-aid unless all other options, and especially the quest for private investors, have been considered. 'No LEN' is thus eliminated.

The second and third hoop tests concern the attempt at raising capital through a market operation, and the tour aimed at attracting foreign investors. In what seems to be a sincere attempt, Prime Minister Renzi appoints JP Morgan and Mediobanca as joint global coordinators and bookrunners of MPS. There is no evidence of any attempt of the Italian government to prevent the hinder the involvement of the sovereign fund of Qatar or any other foreign anchor investors. This observation renders unlikely to conclude that the Italian government had a hardline LEN approach throughout the crisis. Thus, 'LEN' must be eliminated.

The fourth hoop test concerns the fact that the recapitalization plan included a conversion of junior bonds into shares. Given the fact that junior bonds were largely held by Italian households, this seems to disconfirm 'No LEN' and point to the will to keep the banking ownership national. As seen in the third hoop test, however, the plan also entailed a search for foreign investors. With the purpose of being extra careful, this CPO is not considered decisive: the conversion of bonds into shares might have been a back up plan in case foreign investors were willing to contribute but not to cover the whole costs of recapitalization.

The fifth and last hoop test concerns 'functional LEN'. This observation points to the Commission's willingness to protect retail investors which had been mis-sold MPS bonds. Several sources report that the Commission would have in fact been open to a reimbursement of retail investors after the bail-in. Despite all this, the government insisted on using state-aid. 'Functional LEN' has as a necessary condition the fact that the precautionary recapitalization is used to protect retail investors which would otherwise be neglected. The fact that the Italian government was not content with the compensation of retail investors indicates a strong preference towards state-aid beyond the contingencies of the case. The fifth hoop test is indicated in the table above as having a potential to disconfirm 'functional LEN', since it could be read as proof of the fact that protecting investors was not the main driver of the government. However, on the one hand, nine straw in the wind tests consistently point to the protection of investors as at least an important factor, with the Italian government opposing the bail-in several months before the precautionary recapitalization.

Secondly and most importantly, outcome two is supported by a smoking gun test. In fact, when approving the decree through which state-aid is made available, the Italian government effectively formulates a way for retail investors to preserve their savings. Thus, it can be concluded that the purpose of the precautionary recapitalization is, at least in part, to reimburse retail investors.

AN ALTERNATIVE EXPLAINATION

As stated in the methods section, it is intention of the author to remain open to alternative hypotheses which might arise during the analysis. Therefore, one further possible explanation will be presented in the following paragraphs.

In fact, one more factor arising from the analysis of MPS crisis, and that is Italy's untamed will to keep the bank afloat. In fact, the Italian government opposed the resolution of MPS with the same fervor with which it opposed the bail-in. In the arch of four years, the bank went through two recapitalization in two years for a total of around €8 billion, and reported the poorest performance of all participants at the stress test the following year. Yet, the government never considered winding down the bank, even despite the fact that the bail-out cost billions of euros to a country with a sky-high sovereign debt.

What is surprising, it must be said, is the Commission's willingness to accommodate both of Italy's requests to keep the bank afloat without going through a bail-in. This all said, MPS certainly sets a precedent that casts a confusing light on the BRRD at only few month since its full entrance in force.

ANSWERING THE RESEARCH QUESTION

In conclusion, MPS case study can be classified as 'Functional LEN'. As a matter of fact, the Italian government appears to act in order to reach two goals: to preserve the existence of the bank, and to protect Italian depositors. In fact, rather than to keep the bank ownership national per se, the Italian government uses patient capital to save MPS, and to reimburse those depositors and retail investors that had been victims of mis-selling. Furthermore, Italy's use of patient capital only takes place once the market option, which it takes into serious consideration at least for a while, fails. Therefore, Italy's LEN can hereby be considered 'functional' to these two goals, which are considered important enough to bend EU regulations where other countries had given in.

In other words, the answer to the research question 'To what extent is the Italian government trying to keep the ownership national' for the first case study is: the Italian government is trying to keep the ownership national as long as it keeps the bank afloat, and it allows it to protect depositors and retail investors.

2. V&V CASE STUDY

2.1 V&V crisis background

Veneto Banca (VB) and Banca Popolare di Vicenza (BPV) were two locally important banks which shared a set of common features and followed a similar trajectory before being wound down under Italian insolvency law in 2017. Among their common features, it is important to mention that both VB and BPV were, until 2016, cooperative banks. Italian cooperative banks are ruled under the 'one shareholder one vote' principle. Banks of this kind are not part of the stock market, therefore the price of their shares is determined through other means, such as independent experts (Bank of Italy, 2015). However, a decree issued in January 2015 by the Italian government required them to transition into joint-stock companies within eighteen months (Gazzetta Ufficiale, 2015; Il Fatto Quotidiano, 2015a). In addition to that, the two banks went through a series or recapitalizations through operations that were later subject to European and national investigations (Galbiati, 2016; Vanni, 2017).

Finally, due to their similar situation, VB and BPV were paired up by both Italian and European actors since the beginning of their crises, and an attempt was made to save them through a merger (Corriere del Veneto, 2016; Mandurino, 2017c). Therefore, it is reasonable to treat the crises of VB and BPV as one case study, and for the rest of this thesis the two banks will often addressed together under the acronym 'V&V'.

INSOLVENCY AND RECAPITALIZATIONS

Between 2010 and 2016, Banca Popolare di Vicenza's non-performing loans grew drastically. The reason behind the bank's insolvency is two-fold. On the one hand, BPV was tightly connected to local companies, and when the crisis hit the region and these were unable to pay their debts, the bank was affected. On the other hand, though, the bank was used to providing generous loans to habitual clients, family members, and the bank's council members, independently from their ability to pay back the debt (Bilotta, 2017b). In order to prop up its deteriorating capital, between 2013 and 2014 BPV engaged in several recapitalizations, raising €1.3 billion and acquiring 116.000 new shareholders (Malagutti, 2015a; Il Sole 24 Ore, 2015; Banca Popolare di Vicenza, 2015e).

In a similar fashion, the financial situation of Veneto Banca deteriorated amidst a series of loans to companies lacking a solid financial situation (such as Alitalia, the Boscolo group, Acqua Marcia, and Lotto sport); as well as to politicians, including MP Verdini which in 2012 borrowed €7.6 million to temporarily cover the debt of his real estate and editorial companies; and to his family, including his wife, which used a loan to buy a villa in Sardinia. Veneto Banca lost €96 million in 2013, and €968 million in 2014 (Bilotta, 2017b). Between June 26th and July 28th 2014, VB launched a recapitalization among its shareholders for almost €500 milllion (Davi, 2014; Il Gazzettino, 2014). The operation closed successfully, with shareholders subscribing 95% of the offer (Il Mattino di Padova, 2017).

ECB DIRECT SUPERVISION AND THE 2014 STRESS TEST

Due to their size, VB and BPV passed under the ECB direct supervision on November 4th 2014. The two banks had until then been supervised by Bank of Italy (European Central Bank, 2014b; Bank of Italy, 2015; European Central Bank, 2015). On October 26th 2014, the ECB and the EBA published the stress test results. The stress test revealed the poor performance of BPV and VB, despite their efforts to raise capital (European Central Bank, 2014a).

BPV INVESTIGATIONS

Right after taking over the bank's supervision, the ECB noticed irregularities in the way the recapitalizations have been carried out within Banca Popolare di Vicenza. Thus, between February 26th and July 3rd 2015, the ECB conducted an investigation on the bank. The results were published in a 103-pages long report according to which the bank had engaged in several unlawful behaviors (Galbiati, 2016; DBRS, 2015).

Building on the ECB investigations, the Tribunal of Vicenza started investigating BPV on September 22nd 2015 (Vanni, 2017), whereas the Italian Financial police issued a warrant for inspections in BPV offices in Vicenza, Rome, Milan and Palermo. Chairman Zonin and former CEO Sorato were themselves under investigations. The charges against the bank included stock manipulation and impediment of supervisory functions. The bank's misconduct includes overestimating the price of its shares, granting loans to support share purchases, buying back its own shares without properly notifying the competent authority, and spreading false information regarding the state of the bank (Carletti, 2015; La Repubblica, 2015; Vanni, 2017).

VB INVESTIGATIONS

The Italian Companies and Exchange Commission (Consob) began an inspection on VB in January 2015, whereas the Rome's public prosecutor office searched the bank in the February, eventually discharging CEO Consoli, who was arrested the following year under charges of impediment of supervisory functions and stock manipulation (Apponi, 2017). The investigations brought to light the fact that the bank Veneto Banca would guarantee loans in exchange for bonds. This resulted in €1 billion of liabilities more than declared on the balance sheets (Bilotta, 2017b).

Moreover, VB's 2014 recapitalization turned out to have been deeply rigged: in fact, VB had started selecting subscribers in March 2014, and before the official beginning of the recapitalization it had concluded 3.757 sales for a total value of €46 million. Thus, the recapitalization appeared not only to have been planned ahead of time, but to have involved unaware shareholders, who had not even been provided with a copy of their purchase (Bilotta, 2017a; Il Mattino di Padova, 2017).

2.2 The stress

SPRING 2016: THE (ATTEMPTED) DEBUT ON THE STOCK MARKET

Despite the recapitalizations, at the en of 2015 VB and BPV found themselves in need for capital. In December 2015, given the increasingly serious, Veneto Region's President Zaia sent a letter to PM Renzi, Minister Padoan, Bank of Italy's President Visco and ECB President Draghi. In the letter he stated that a strong governmental intervention concerning was absolutely necessary in order to safeguard depositors and companies, arguing that a bail-in would actually result in higher costs for the state and Veneto's society (Corriere del Veneto, 2015; RaiNews, 2015; Il Gazzettino, 2015a). This situation was further underlined by the ECB's annual Supervision Review and Evaluation Process (SREP), at the end of which the ECB urged the two banks to present a plan to strengthen their capital by April 2016 (Todescan, 2015; Banca Popolare di Vicenza, 2015d; Gruppo Veneto Banca, 2015).

In the meanwhile, the two banks were required to transition into joint-stock companies by June 2016. This transition proved challenging for the two credit institutions. In fact, for the first time the banks' share prices would be determined by the market, and this could result in further losses of capital, and turn the situation from difficult to dramatic. On March 5th 2016, BPV's Board of Directors approved the transformation of the institutions from a Credit Union (Cooperative Bank) into a joint-stock company (S.p.A.), in addition to raising capital and launching the bank into the Stock Exchange (Banca Popolare di Vicenza, 2016). Veneto Banca, on the other hand, had approved the transition already on December 19th 2015. During the same meeting, the Board of Directors had also approved a raise of capital for €1 billion (Bodellini, 2017; Il Fatto Quotidiano, 2015c).

observation: In December 2015, Veneto's President Zaia asked for a strong state intervention on V&V to safeguard depositors and companies.

1. UniCredit and the Atlas fund

BPV's 2016 began in a desperate need for capital (Zingales, 2015; Malagutti, 2015b). Under request of the ECB, the bank had in fact erased €1 billion from its balance sheet in early 2015 due to the heavy irregularities in the previous recapitalizations (Banca Popolare di Vicenza, 2015a; Za and Aloisi, 2015). In order to tackle the situation, on September 21st 2015 BPV had announced UniCredit Group's pre-underwriting for a €1,5 billion recapitalization, to be carried out by April 2016 in the context of BPV's debut on the stock market. UniCredit's operation would be supported by BNP Paribas, Deutsche Bank AG, London Branch, J.P. Morgan, and Mediobanca, acting together with UniCredit as joint global coordinators (La Repubblica, 2015b; Banca Popolare di Vicenza, 2015b).

However, in 2016, UniCredit's intention seemed to shift. In April, UniCredit's CEO Ghizzoni shared with the government his concerns around BPV's €1.5 billion recapitalization. In fact, UniCredit was itself in a delicate situation (Legorano, 2016), and virtually incorporating BPV would have exposed it to further problems. Given BPV's urgent need of capital, and the fact that the government was left with too little time to plan and negotiate a lawful intervention, PM Renzi, Minister Padoan, Bank of Italy's President Visco, together with Intesa, UniCredit, Ubi, Cdp an Acri, established the privately funded Atlas fund. The ECB approved the plan, requiring a minimum capital of €4 billion, and asking that the section of the fund to be used in order to purchase Npl wouldn't exceed 30% of the total resources (Greco, 2017a).

On April 19th, Questio Capital management Sgr, that is the company responsible for the establishment and management of the Atlas fund, signed a sub-underwriting with UniCredit and BPV. By signing the agreement, the Atlas fund committed to replacing UniCredit in underwriting the bank's shares in case of failure of the market operation (Quaestio sgr, 2016a; Ravallin, 2016).

As a matter of fact, when BPV made its debut on Milan's stock exchange on May 2nd, it only managed to sell 7.66% of its shares, getting nowhere near the minimum 25% set by Piazza Affari. The main investor had been Mediobanca, alone among the joint global coordinators to intervene (Massaro, 2016a; Veneto Economia, 2016a). Thus, BPV failed to enter the stock market, and the Atlas fund purchased 99% of BPV's shares €0.1 each, turning into BPV's main shareholder. In so doing, the operation nullified the €6 billion recapitalization BPV's shareholders had performed in the previous years (Il Sole 24 Ore, 2017c). Commenting on UniCredit's lack of action, now former CEO Ghizzoni later explained that UniCredit's pre-underwriting was not binding, and that BPV's deteriorating conditions drove UniCredit's participation away (Gatti, 2016).

observation: Establishment of the government-sponsored and privately-funded Atlas fund

observation: On September 21st 2015 BPV announced signing a guarantee agreement on capital increase with Unicredit, who, together with BNP Paribas, Deutsche Bank AG, London Branch, J.P. Morgan, and Mediobanca, would act as joint global coordinator, and would be in charge of a placement of bonds

observation: The highly internationalized Italian bank UniCredit did not honor the pre-underwriting signed with BPV concerning the Venetian bank's recapitalization

2. VB and the stock market

In a similar fashion, Veneto Banca, too, needed to raise capital for €1 billion in order to comply with the requests of the ECB as a result of the SREP decision, and it planned to do so during the debut on the stock exchange. Thus, during the board meeting on December 19th 2015, had decided to launch an offer of shares for shareholders up to a maximum of €1 billion in 2016 (Gruppo Veneto Banca, 2015).

In order to attract investors, VB reportedly engaged in around 250 meetings with potential investors. However, VB's perspectives looked more and more dull as the months went by, and even more so after BPV's failure to enter the stock market. Indeed when VB's attempt to enter the stock market at the end of May yielded poor results. In fact, only 3,43% of its capital was subscribed, and the price of VB shares stalled at €0.1 (Mandurino, 2016; La Tribuna di Treviso, 2016).

As a result, on the very day of VB's failure to enter the stock market, Quaestio sgr signed a sub-underwriting for a deep restructuring of the bank (Arosio, Quaglia and Za, 2016; Madurino, 2016). The raise of capital was therefore funded by the Atlas fund, which now owned 97,64% of the bank's shares. In 2016, the Bank registered a loss for €1,5 billion. The 2016 stress-test results brought the ECB to request that Veneto Banca raise capital for a total of €3.1 billion (Bodellini, 2017).

observation: In an attempt to make its debut on the stock market, VB reportedly engaged in around 250 meetings with potential investors.

AUTUMN 2016: FOREIGN INVESTORS APPROACH V&V

In Autumn 2016, a number of foreign investors, such as JP Morgan, Apax, Apollo and Jc Flowers approached Atlas' fund manager Penati in order to make an offer on V&V. Due to the banks' critical conditions, the offer could have only been low, and the cuts on personnel high. JP Morgan's offer, for instance, included a 65% cut on personnel, which the Atlas fund reportedly found exaggerated (Bennewitz, 2016; Reuters, 2016b). Although back in the day the Atlas fund was more concerned with restructuring the two banks rather the selling them, these offers importantly underline the viability of some sort of private solution for V&V.

observation: In October 2016, firms such as JP Morgan, Apax, Apollo and Jc Flowers approached Atlas' fund manager Penati in order to make an offer on V&V.

THE CHALLENGES OF 2017

V&V's new year inherited a set of challenges from 2016. As a matter of fact, the two banks were in an urgent need to raise capital. On top of that, they needed to lower their amount of Npls, while at the same time arrange a merger and try to dodge a litigation with the now angry depositors and shareholders. Let use explore them in the following paragraphs.

Recapitalization, Npls, and the merger

Despite Atlas' intervention, the situation of the two credit institutions kept deteriorating throughout 2016. As a result, BPV registered a loss for €1,9 billion in 2016 (Bilotta, 2017b; Merler, 2017a), whereas VB lost €1.5 billion (Il Fatto Quotidiano, 2017b). The two banks had even asked for government support before Christmas (Corriere del Veneto, 2017).

Due to the situation, the ECB asked the Atlas Fund to funnel €938 million into the banks (Greco, 2017a; Davi, 2017a; Caparello, 2017a). In total, VB and BPV benefitted together of a €3.5 billion capital investment by the Atlas fund (Merler, 2017b). The Atlas Fund's additional intervention was however only a temporary band-aid: the banks needed to undergo a serious recapitalization (Davi, 2017a).

In the meanwhile, on December 6th 2016, Fabrizio Viola (former manager of Monte dei Paschi di Siena) became BPV's new CEO, as well as part of the council of Veneto Banca, with the task of merging the two institutions (Corriere del Veneto, 2016; Mandurino, 2017c). The ECB had in fact required V&V to present a plan for the merger by January 31st. In the meanwhile, the goal would be to sell around €6 billion worth of Npls and to clean up the balance sheets (Mandurino, 2017a).

Avoiding litigations with stakeholders

However, before elaborating a rescue plan, V&V needed to avoid litigations with shareholders and depositors. In fact, the banks' potential involvement in legal actions would make the needed recapitalization unlikely to succeed (Graziani, 2017). The two banks thus gathered around €600 millions to address the issue. VB 15% reimbursement for around 75.000 shareholders, whereas BPV offered €9 per share (14,4% of the initial value) to 94.000 shareholders. The offer was thus directed to 169.000 shareholders, that is 82% of the total, and was made available until March 15th 2017. V&V aimed to convince a minimum of 80% of the involved shareholders to accept the deal and avoid pressing charges on them (Colombo and Trovati, 2017). Furthermore, the two banks made available a €60 million fund to address shareholders in critical situation (Il Fatto Quotidiano, 2017a; Mandurino, 2017b).

observation: The Atlas fund financed the V&V's depositors reimbursement plans

JANUARY 19TH: STATE-AID APPROVED

On January 19th, the EC approved state-aid in the form of public guarantee on V&V's new subordinate bonds (Banca Popolare di Vicenza, 2017a; Gruppo Veneto Banca, 2017a; Corriere del Veneto, 2017). This option was part of the 'Salvabanche' decree issued in December 2016, which entailed both a precautionary recapitalization fund and a the potential issuing fo state guarantees in the form of debt securities and emergency liquidity assistance (Gazzetta Ufficiale, 2016; JD Supra, 2017).

Thus, both VB and BPV emitted bonds separately, and offered them offered only to institutional investors, with an expiration date set in 2020. BPV's bond sale exceeded expectations, and sold €1,25 million worth of bonds to Banca Imi e Morgan Stanley (Mandurino, 2017d; Del Maso, 2017).

observation: Upon EC approval, the Italian government provided V&V with state-aid in the form of public guarantees on subordinate bonds.

observation: BPV state-guaranteed bonds were purchased by Banca Imi e Morgan Stanley

FEBRUARY AND MARCH 2017

On February 1st, the V&V boards met the ECB for the approval of the merger plan. The plan included a recapitalization for around €5.7 billion. Various sources expected the recapitalization plan to include interventions from the state and from the Atlas fund, in addition to a conversion of subordinate bonds for around €1 billion (Madurino, 2017d; Caparello, 2017a; Nicoletti, 2017a).

In early February, Quaestio Sgr's President Penati stated that, without Atlas' intervention, V&V would have certainly undergone a resolution. Penati described what he found inside the banks as an 'horror story', but stated that Queastio was nevertheless trying to bring the institutes to a healthy conditions, and waiting for the ECB to approve the plan (Paronetto, 2017; Caparello, 2017a). Furthermore, Penati stated his intention to use precautionary recapitalization in order to have the resources to carry out the restructuring plan. In addition to that, he commented that the Atlas fund had found more support in Frankfurt, that is at the ECB headquarters, than in Italy (La Repubblica, 2017a; Mandalà, 2017; Davi, 2017b).

On March 8th, Commissioner Vestager stated that depositors who were victims of mis-sellings could be compensated (Romano, 2017). The same position was taken by the SSM, with Danièle Nouy issuing a similar statement (Davi, 2017c). As far as the offer to shareholders is concerned, the initial target of having 80% of the involved subjects accept by March 15th was not met, leaving the risk of litigation hanging over V&V as a sword of Damocles (La Repubblica, 2017b; Fior, 2017a).

observation: In early February, Quaestio sgr President Penati stated his intention to use precautionary recapitalization in order to have the resources to carry out the restructuring plan.

THE REQUEST FOR PRECAUTIONARY RECAPITALIZATION

In February, some sources reported that the Italian government began engaging in negotiations with European authorities for a €5 billion precautionary recapitalization of V&V (Fonte and Bernabei, 2017; Chicca, 2017). On March 17th, V&V submitted a request for the precautionary recapitalization (Banca Popolare di Vicenza, 2017b; Gruppo Veneto Banca, 2017b).

In a letter sent to the Italian government and to the Bank of Italy on April 4th, the ECB calculated that V&V's overall need for capital corresponded to a total, for the two banks, of €6.4 billion (Banca Popolare di Vicenza, 2017b; Gruppo Veneto Banca, 2017b; Rai New, 2017;

Il Fatto Quotidiano, 2017b). On the topic, Veneto Banca stated that the negotiations between the competent authorities around the precautionary recapitalization had already been initiated (Veneto Economia, 2017; Il Fatto Quotidiano, 2017b).

Despite declining comments on precautionary recapitalization, the government was rather vocal about its position towards bail-in. In particular, Undersecretary to the Ministry of Finance Baretta stated that the government would 'do anything' to avoid a bail-in (Il Gazzettino, 2017; Barbera and Paolucci, 2017; Massaro, 2017).

observation: In February, some sources reported that the Italian government began engaging in negotiations with European authorities for a €5 billion precautionary recapitalization of V&V.

observation: On March 17th, V&V submitted a request for the precautionary recapitalization**.**

observation: In March 2017, Undersecretary to the Ministry of Finance Baretta stated that the government would 'do anything' to avoid a bail-in.

RAISING €1 BILLION IN PRIVATE CAPITAL

Once presented the restructuring plan and submitted the request for a precautionary recapitalization, the two banks awaited a move from the EU institutions. However, throughout April and early May, the situation seemed to stall. This might have been due to complicated negotiations not only between European and Italian institutions, but between the EC and the ECB themselves, as will be explored later in the negotiations section.

Eventually, in late May, the situation started to unravel. On May 24th, V&V's CEOs Carrus and Viola met the European Commission in Brussels. During the meeting, the Commission confirmed the necessity for the two banks to raise €1 billion in private capital in order to gain access to state-aid (La Repubblica, 2017c; Il Sole 24 Ore, 2017). The reaction among Italian actors was immediate. Intesa SanPaolo's CEO Messina stated that private companies had already lost enough resources by helping the two banks, and that a public intervention was now necessary (Vicenza Today, 2017; La Repubblica, 2017c). In the same way, the four main Italian Trade Unions (Veneto Economia, 2017b; CISL, 2017) Veneto region's President Zaia and Former Vice-Minister of Finance Zanetti urged the government not to give in to the EU rules, even at the cost of risking an infringement procedure (Fior, 2017b). Furthermore, Veneto's President Zaia, well-known for its independentist views, claimed that it would be enough to ask for one of the €8 billion granted to MPS in order to solve the problem (Libero, 2017; Soto and Pineda, 2017). All in all, the pressure on the government and the anti-European sentiment were remarkable and the bank's crisis got the more politicized and polarizing as the months went by.

On May 25th, Minister Padoan met the CEOs and chairmen of VB and BPV (Ministero dell'Economia e delle Finanze, 2017a; Nicoletti, 2017b). On the same day, Minister Padoan ruled out the possibility of a bail-in. Liquidity-wise, the Minister claimed, V&V were provided with all the resources they needed. This way, Padoan seemed to hint to the €20 billion fund established in December for the rescue of MPS (La Repubblica, 2017c).

On May 27th, Undersecretary to the Ministry of Finance Baretta stated that the government would not abandon any bank, and that the Venetian banks would be supported just like MPS had been (Sciancalepore, 2017).

observation: Undersecretary to the Ministry of Finance Baretta stated that the government would not abandon any bank, and that the Venetian banks would be supported just like MPS had been

observation: On May 25th, Minister Padoan ruled out the possibility of a bail-in.

observation: Padoan stated that V&V were provided with the resources they needed. He seemed to hint to the €20 billion state-aid fund established in December.

observation: Intesa SanPaolo's CEO Messina stated that private companies had already lost enough resources by helping the two banks, and that a public intervention was now necessary.

observation: Veneto region's President Zaia, Labor Unions, and Former Vice-Minister of Finance Zanetti urged the government not to give in to the EU rules, even at the cost of risking an infringement procedure.

THE ATLAS FUND GIVES UP ON V&V

In a letter sent to V&V on May 30th, Quaestio sgr (that is the company managing the Atlas fund) stated that the several uncertainties surrounding the two banks would prevented any responsible investor from engaging with them. In so doing, the Atlas fund officially refused to inject further capital into the two banks In the letter, Quaestio adds that Atlas 1, which could have inject capital in the banks, was left with less than €50 billion, whereas Atlas 2, which could have only invest on Npl, was already involved in a €450 million Npl purchase for the two banks (Barlaam, 2017; La Repubblica, 2017c; Gualtieri, 2017).

RUNNING OUT OF TIME

V&V's need to access additional capital became more and more urgent as the days went by. Therefore, in early June the hopes for a precautionary recapitalization were especially high (Mandurino, 2017d; Nicoletti, 2017c).

On June 6th, Undersecretary to the Ministry of Finance Baretta stated that the government would not perform a precautionary recapitalization without the permission of European institution, but it would oppose to a bail-in (Benvenuto, 2017b; CISL Veneto, 2017).

During a parliamentary interrogation on June 13th, Minister of Finance Padoan stated that a precautionary recapitalization constituted a solution that all the interested parties considered favorably (Camera dei Deputati, 2017; Madurino, 2017d). On the same day, Padoan assured that the negotiations were coming to a conclusion, which would entail the complete safeguard of depositors and senior bondholders, whereas it would exclude a bail-in (Ministero dell'Economia e delle Finanze, 2017b; Madurino, 2017d). Confirming Mr Padoan's declaration, on June 14th, Competition Commissioner Vestager stated that the Commission and the Italian government were discussing a solution which entailed a full protection of depositors and avoided a bail-in of senior bondholders (Conti, 2017).

observation: On June 6th, Undersecretary to the Ministry of Finance Baretta stated that the government would not perform a precautionary recapitalization without the permission of European institution, but it would oppose to a bail-in.

observation: Minister of Finance Padoan assured that the solution for V&V would not entail a bail-in, and that depositors and senior bondholders would be completely safeguarded.

observation: Padoan stated that a precautionary recapitalization constituted a solution that all the interested parties considered favorably.

THE QUEST FOR INVESTORS

With the Atlas fund out the game, and while waiting for an answer around a possible precautionary recapitalization, V&V sought to find private firms willing to invest in the banks. At this point, two seemed to be the alternatives involving private capital. The first solution would have entail a €6.4 billion recapitalization through state intervention, and a €1.2 billion recapitalization through private capital; alternatively, a 'Spanish style' solution could have take place, which would have meant having healthy banks absorb V&V, without state support. (Barbera, 2017; Giugliano, 2017).

On June 13th, a meeting took place between the Italian government, EU institutions and credit institutions interested in purchasing V&V shares. Among the private institutions which showed interest in V&V, there were the two largest Italian banks, UniCredit and Intesa Sanpaolo (VVox, 2017).

In the meanwhile, the Italian government and V&V were busy trying to obtain a discount on the amount of private capital to gather. Depending on the interpretation of EU regulations, in fact, the amount of capital request could have be confirmed to be €1,25 billion, or be almost halved, as the Italian actors hoped, down to €600/700 million (Madurino, 2017).

FOUR INTERNATIONAL INVESTMENT FUNDS' OFFER REFUSED

After weeks of meetings and conference calls, on May 30th 2017, four international investment funds allegedly submitted an official offer, the so-called term sheet, for the injection of €1.6 billion euros into V&V, in exchange for the ownership of 15% of the bank and and control over the bank's governance (Di Foggia, 2017). The funds, namely Point Capital, Cerberus, Attestor and Varde, reportedly asked Deutsche Bank to work on the deal. However, sources state, after briefly discussing their with the Italian Ministry of Finance in early June without receiving any answer, the four investment funds communicated to the Italian Treasury their openness to collaborate with Intesa SanPaolo and Unicredit. Once again, their interest remained unaddressed. The funds refused to comment on the issue (Barbaglia, 2017).

observation: Reuters reported that, at the end of May 2017, four international investment funds offered to inject €1.6 billion euros into V&V. However, sources stated, their offer was rejected.

PRECAUTIONARY RECAPITALIZATION DENIED

As seen before, in order for a precautionary recapitalization to take place, the bank in question needs to be solvent. On June 23rd 2017, however, the European Central Bank, in its supervisory capacity, deemed V&V failing or likely to fail (European Central Bank, 2017a). As a consequence, the European Commission rejected V&V's request for precautionary recapitalization (Banca Popolare di Vicenza, 2017c).

THE SRB

Now that the precautionary recapitalization had been denied, V&V was left with two options: resolution under the BRRD, or liquidation under national law. The decision on which of the two procedure suits a bank best is a task left to the Single Resolution Board. In fact, the SRB is in charge of assessing whether a bank provides critical functions for the economy, and whether its liquidation would threaten financial instability. If at least one of these two characteristics is true, liquidation is considered too dangerous, and an orderly resolution under European law is required (Merler, 2017b).

Thus, following the ECB's decision, the Single Resolution Board declared its decision not to initiate a resolution procedure for V&V, since 'neither of these banks provides critical functions, and their failure is not expected to have significant adverse impact on financial stability' (Single Resolution Board, 2017).

2.3 Decision-making

FORCED ADMINISTRATIVE LIQUIDATION

V&V were therefore wound down under Italian insolvency procedures, in the form of forced administrative liquidation (Bank of Italy, 2017). The liquidation of V&V presented four main elements: transfer of business, burden-sharing, state aid, and protection of depositors.

1. Transfer of business

The performing part of V&V, together part of the liabilities, such as deposits and senior debt, was transferred to Intesa Sanpaolo. On June 21st 2017, Intesa Sanpaolo's Board approved the purchase of Banca Popolare di Vicenza e Veneto Banca for the symbolic price of €1 (Merler, 2017b; European Commission, 2017a; Greco, 2017b).

Intesa's purchase of V&V guaranteed the banks' continuity, whereas the non-performing part of V&V was transferred to a bad bank, and wound down by SGA, a vehicle that had already been used in the liquidation of Banco di Napoli (European Commission, 2017a).

2. Burden-sharing

As far as burden-sharing is concerned, the main contributors were shareholders and junior bondholders (Bank of Italy, 2017; European Commission, 2017a). The biggest contributor was certainly the Atlas fund. In fact, the fund owned the overwhelming majority of shares (Merler, 2017b).

3. State-aid

In this context, Italy was still intentioned to use state-aid in order to avoid a regional disturbance of the economy. Unlike in the case of resolution procedures, where an 8% bail-in is required before accessing state funds, liquidation under national law only requires a light burden-sharing for shareholders and subordinated bondholders (Merler, 2017b).

Thus, Italy asked the Commission for permission to use state-aid. The Commission, despite the SRB decision that the liquidation of V&V would not have a significant impact on the economy, allowed Italy to facilitate liquidation through state-aid. The state-aid measures included:

- cash injections for a total of about €4.785 billion;
- state guarantees of a maximum of about €12 billion.

The state guarantees were to be used in the case in which the liquidation would not be sufficient to pay back Intesa's investment in the bank (European Commission, 2017a).

In its memoire written for the Ministry of Finance, Bank of Italy (2017) stated that Intesa was selected among 5 Italian and foreign credit institutions and one Italian insurance company (Colombo and Mobili, 2017; Banca d'Italia, 2017). Further, the Commission stated that the fact that Intesa was selected among a pool of contestants is enough not to considered the state support as aid to Intesa Sanpaolo. The process of selection was thereby described as 'an open, fair and transparent sales process, fully managed by Italian authorities, ensuring that the activities were sold at the best offer available' (European Commission, 2017a).

observation: Intesa SanPaolo was selected as V&V's rescuer among five Italian and foreign companies, in a selection process led by Italian authorities.

4. Protection depositors

The lack of a resolution procedure allowed V&V to avoid the much feared bail-in. Therefore, all deposits, even amounts higher than €100.000, remained fully protected (European Commission, 2017a; Banca d'Italia).

observation: The government used state-aid to support UniCredit's purchase of V&V .

observation: The lack of a resolution procedure allowed V&V to avoid the much feared bail-in.

2.4 Controversies

1. SRB, EC and state-aid

The last phases of the V&V crisis are covered in an apparent paradox (Bodellini). In fact, the SRB's declaration that the liquidation of V&V are unlikely to be a threat to stability, the Commission approved the use of state-aid exactly in order prevent a serious impact on the real economy of the region involved (European Commission, 2017a). Indeed, it can be argued that the SRB considered the impact at the international level, whereas Italy's request and the Commission's approval concentrated on the regional level. If the observer is to take this stance, however, they might want to consider how, quite conveniently, this trajectory leads exactly to an outcome where Italy is allowed to use state-aid while avoiding a bail-in.

2. State-aid and Intesa SanPaolo

Another major controversy concerns the sale of V&V shares to Intesa San Paolo. In fact, in order to intervene, Intesa San Paolo enjoyed a large amount of support form the Italian government, both in the form of cash and guarantees. Surprisingly enough, especially since the strict resolution of Spanish banks just before V&V, the Commission endorsed Italy's use of state-aid to support Intesa, creating a confusing set of precedents that application of the BRRD unpredictable (European Commission, 2017a).

Two assumptions can be derived from the Commission's support of state-aid: first of all, it is safe to conclude that the EC, which had long been engaging in negotiations with the Italian government, was aware and complacent with Italy's intentions to use state-aid; secondly, it appears that the Commission's interest in avoiding state-aid is rather circumscribed to nominally abiding to the rules, whereas its flexibility in negotiations and willingness to find creative solutions comes across as rather remarkable.

3. Alleged inconsistences across similar cases

Comparing the Santander case to the V&V case, Merler (2017, V&V) argues that the definitions of critical functions and public interest should be clarified, and wonders whether, under the current regulations, similar banks can expect similar treatment in case of failure. In fact, despite several similarities, the Spanish bank was eventually involved in a resolution procedure, and absorbed by Banco Popular, which did not enjoy the same state support as V&V. Further research on the topic is therefore necessary.

2.5 Negotiations

As far as the negotiations are concerned, the press repeatedly speculated on a fundamental difference in views towards precautionary recapitalization between the EC and the ECB. In the picture painted by the financial press, the ECB appears more accommodating, whereas the EC seems determined to find a solution that remains within the boundaries set by European legislations (Il Sole 24 ore, 2017a).

What appears to be clear is the ECB's urgency to solve V&V's situation on the one hand, and the Commission's repeated delay on the other. In fact, in late March 2017, after an unexpected delay in the response to V&V request for precautionary recapitalization, Nouy states that the wait-and-see attitude of the past must not be repeated, and that all parties involved need to act quickly (Il Sole 24 Ore, 2017b). Subsequently, Nouy stated that the SSM had already evaluated the two banks and sent the information to the Commission which was now in charge of making a decision (Merli, 2017; Smiderle, 2017). Reportedly, already in 2016 Nouy had expressed its openness to the precautionary recapitalization of one of the two Venetian banks (Greco, 2017a). The ECB's openness towards precautionary recapitalization seems to be in line with Mr Penati's statements. In fact, while discussing its plan to use precautionary recapitalization to restructure V&V in February 2017, Penati had stated that he had found "more support in Frankfurt than in Italy" (La Repubblica, 2017a).

In April 2017, Veneto Banca declared that negotiations around the precautionary recapitalization had already been initiated (Veneto Economia, 2017; *Il Fatto Quotidiano, 2017b*) although, as already mentioned, the talks kept proceeding at a slow pace, and the precautionary recapitalization was eventually denied.

However, considering the Commission's following behavior, the following question arises: is the EC ready open to virtually anything as long as it appears to be within the rules? Let us look at the facts.

First of all, despite its alleged opposition to precautionary recapitalization, the EC approved state-aid in the form of guarantees on V&V bonds (Banca Popolare di Vicenza, 2017a; Gruppo Veneto Banca, 2017; Corriere del Veneto, 2017). Moreover, be it because of the Italian government's relentless lobbying or because of the specific contingencies of the case, the EC (and ECB alike) showed flexibility towards the reimbursement of depositors (Romano, 2017). From this, it can be assumed that the Commission's opposition to precautionary recapitalization was not due to an overall opposition of LEN tools, but rather by a concern with respecting the BRRD.

Eventually, in June the SSM deemed V&V failing or likely to fail. However, according to Nouy, the SSM had provided the Commission with its decision on the precautionary recapitalization already in March. The Commission's long waiting period generates a set of assumptions. Among these, it is possible to suppose that the Commission was busy negotiating a solution that would both remain within the law and satisfy the Italian government. In conclusion, the V&V case points once again to the Commission's openness to negotiations, and to its fundamental willingness to bend the rules in order to accommodate Italy's requests. The ECB, on the other hand, also displayed a certain degree of openness, which seemed in the first stages of negotiations to be even higher than the Commission's. The ECB, however, did not play a central role in the final decisions, which seem to have been engineered ad hoc by the Italian government and the Commission. Finally, due to the lack of sufficient evidence, the present answer to sub-question 4 contains a certain amount of speculation. Further research on this specific topic is certainly welcome.

2.6 Drawing conclusions

The present section will follow the same steps as those taken in the MPS case study analysis. The observations encountered above will therefore be classified into straw in the wind, hoop tests, and smoking gun, and double decisive tests. Furthermore, each choice will be briefly motivated.

STRAW IN THE WIND TESTS

LEN	Functional LEN	No LEN
In May 2017, Intesa San Paolo's CEO Messina stated that private companies had already lost enough resources by helping the two banks, and that a public intervention was now necessary **STRAW IN THE WIND**: external pressure on government. Does not directly prove government motivation.	In December 2015, Veneto's President Zaia asked for a strong state intervention on V&V to safeguard depositors and companies. **STRAW IN THE WIND:** external pressure on government. Does not directly prove government motivation.	On September 21st 2015 BPV announced signing a guarantee agreement on capital increase with Unicredit, who, together with BNP Paribas, Deutsche Bank AG, London Branch, J.P. Morgan, and Mediobanca, would act as joint global coordinator, and would be in charge of a placement of bonds **STRAW IN THE WIND:** The foreign companies eventually do not participate
Veneto region's President Zaia, Labor Unions, and Former Vice-Minister of Finance Zanetti urged the	The Atlas fund financed the V&V's depositors reimbursement plans **STRAW IN THE WIND:** The	April 2016: Italian government 'forced' Italian banks to contribute to Atlas

government not to give in to the EU rules, even at the cost of risking an infringement procedure. **STRAW IN THE WIND:** external pressure on government. Does not directly prove government motivation.	Atlas fund is government sponsored and privately funded. The Management, in charge of Quaestio sgr, could have been autonomous.	fund **STRAW IN THE WIND:** Government intent in finding solutions other that state-aid
The highly internationalized Italian bank UniCredit did not honor the pre-underwriting signed with BPV concerning the Venetian bank's recapitalization. **STRAW IN THE WIND:** Nothing suggests that the government intervened in any way to keep the capital national. There are on the other hand tangible signs of UniCredit's financial struggles.		BPV state-guaranteed bonds were purchased by Banca Imi e Morgan Stanley **STRAW IN THE WIND**: Involvement of a foreign firm (Morgan Stanley), but through an LEN instrument (guarantees on bonds)
In early February 2017, Quaestio sgr President Penati stated his intention to use precautionary recapitalization in order to have the resources to carry out the restructuring plan. **STRAW IN THE WIND** On March 17th, V&V submit a request for the precautionary recapitalization**:** Penati was in tight contact with both the Italian government and the ECB		In an attempt to make its debut on the stock market, VB reportedly engaged in around 250 meetings with potential investors in 2016. **STRAW IN THE WIND**: Seemingly sincere attempt to find a market solution. However, this happens in a less acute phase of the crisis
In February 2017, some sources reported that the Italian government began engaging in negotiations with European authorities for a €5 billion precautionary recapitalization of V&V **STRAW IN THE WIND:** News unconfirmed		Intesa SanPaolo was selected as V&V's rescuer among five Italian and foreign companies, in a selection process led by Italian authorities **STRAW IN THE WIND:** Lack of sufficient information on the topic
On March 17th,		

V&V submitted a request for the precautionary recapitalization. **STRAW IN THE WIND:** The state was most likely aware of the upcoming request.		

HOOP TESTS

June 13th 2017: Padoan stated that a precautionary recapitalization constituted a solution that all the interested parties considered favorably **PASSES HOOP TEST/STRAW IN THE WIND:** Shows government's interest in p. r.	June 13th 2017: Padoan statef that a precautionary recapitalization constitutef a solution that all the interested parties considered favorably **PASSES HOOP TEST/STRAW IN THE WIND:** Shows government's interest in p.r.	June 13th 2017: Padoan stated that a precautionary recapitalization constituted a solution that all the interested parties considered favorably **FAILS HOOP TEST/STRAW IN THE WIND:** The government's lack of interest in preserving national capital/using LEN tools is a necessary condition for No LEN. **Hypothesis disconfirmed**
Upon EC approval in January 2017, the Italian government provided V&V with state-aid in the form of public guarantees on subordinate bonds. **PASSES HOOP TEST:** The government uses LEN tools.	Upon EC approval in January 2017, the Italian government provided V&V with state-aid in the form of public guarantees on subordinate bonds. **PASSES HOOP TEST:** The government uses LEN tools.	Upon EC approval in January 2017, the Italian government provided V&V with state-aid in the form of public guarantees on subordinate bonds. **FAILS HOOP TEST:** The government uses LEN tools. **Hypothesis disconfirmed**
In May 2017, Padoan stated that V&V are provided with the resources they need. He seemed to hint to the €20 billion state-aid fund established in December. **PASSES HOOP TEST:** Demonstrates government's willingness to use state-aid	In May 2017, Padoan stated that V&V were provided with the resources they need. He seemed to hint to the €20 billion state-aid fund established in December. **PASSES HOOP TEST:** Demonstrates government's willingness to use state-aid	In May 2017, Padoan stated that V&V were provided with the resources they need. He seemed to hint to the €20 billion state-aid fund established in December. **FAILS HOOP TEST/STRAW IN THE WIND:** The government seems openly intentioned to use LEN tools. **Hypothesis weakened**

May 27th 2017: Under Secretary to the Ministry of Finance Baretta stated that the government would not abandon any bank, and that the Venetian banks would be supported just like MPS had been **PASSES HOOP TEST:** Demonstrates government's willingness to use state-aid	May 27th 2017: Under Secretary to the Ministry of Finance Baretta stated that the government would not abandon any bank, and that the Venetian banks would be supported just like MPS had been **PASSES HOOP TEST:** Demonstrates government's willingness to use state-aid	May 27th 2017: Under Secretary to the Ministry of Finance Baretta stated that the government would not abandon any bank, and that the Venetian banks would be supported just like MPS had been **FAILS HOOP TEST:** Demonstrates government's willingness to use state-aid **Hypothesis disconfirmed**
The government used state-aid to support UniCredit' s purchase of V&V **PASSES HOOP TEST:** Demonstrates government's determination to use state-aid		
	On May 25th 2017, Minister Padoan ruled out the possibility of a bail-in **PASSES HOOP TEST:** Necessary condition for Functional LEN	
	June 2017: Minister of Finance Padoan assured that the solution for would not entail a bail-in, and that depositors and senior bondholders would be completely safeguarded. **PASSES HOOP TEST:** shows government interest in safeguarding depositors	
	The lack of a resolution procedure in the final solution of the V&V crisis allowed the government to avoid the much feared bail-in. **PASSES HOOP TEST:** shows government determination in safeguarding depositors	
		In October 2016, firms such as JP Morgan, Apax, Apollo and Jc Flowers approached Atlas' fund manager Penati in order to make an offer on

		V&V. **FAILS HOOP TEST/STRAW IN THE WIND:** Evidence of private firms' interest on V&V **Hypothesis weakened**
		Reuters reported that, at the end of May 2017, four international investment funds offered to inject €1.6 billion euros into V&V. However, sources state, their offer was rejected. **FAILS HOOP TEST/STRAW IN THE WIND:** Strong proof of LEN, albeit unconfirmed by official sources. **Hypothesis weakened**

SMOKING GUN TESTS

	On June 6th, Undersecretary to the Ministry of Finance Baretta stated that the government would not perform a precautionary recapitalization without the permission of European institution, but it would oppose to a bail-in. **PASSES SMOKING GUN TEST/STRAW IN THE WIND:** Shows the government firm intention to oppose a bail-in **Hypothesis strengthened**	
	In March 2017, Under Secretary to the Ministry of Finance Baretta stated that the government would 'do anything' to avoid a bail-in **PASSES SMOKING GUN/STRAW IN THE WIND:** Shows government interest in safeguarding depositors and its will to act upon it **Hypothesis strengthened**	

In October 2016, firms such as JP Morgan, Apax, Apollo and Jc Flowers approached Atlas' fund manager Penati in order to make an offer on V&V. **PASSES SMOKING GUN/STRAW IN THE WIND:** The refusal of foreign company's offers is a strong proof of LEN, albeit unconfirmed by official sources. **Hypothesis strengthened**		
Reuters reports that, at the end of May 2017, four international investment funds offered to inject €1.6 billion euros into V&V. However, sources state, their offer was rejected. **PASSES SMOKING GUN/ STRAW IN THE WIND:** The refusal of foreign company's offers is a strong proof of LEN, albeit unconfirmed by official sources. **Hypothesis strengthened**		

DISCUSSING THE RESULTS

As can be noted from the hoop test table, a substantial amount of cues and evidence has been collected that seems to heavily disconfirm No LEN. In fact, evidence falsifies two of the necessary conditions for this hypothesis to be considered: the government's lack of interest in keeping the capital national, and the government's serious commitment to evaluate private and foreign investors before using state-aid. As a matter of fact, the Italian government seems to have been rather openly in favor of utilizing state-aid measures. Already in January 2017, after receiving the Commission's green light, the Italian government issued state guarantees on V&V bonds: a textbook LEN tool. Furthermore, the press reported Italy's refusal of several foreign investors' offers to purchase parts of LEN. Although the actors involved unfortunately declined to comment on the remarkably detailed press reports, it can be argued that No LEN has been weakened enough not to be taken into further consideration.

Established that some sort of LEN is indeed present in the V&V crisis, let us have a closer look at which of the two remaining hypotheses is the closest to the facts. To begin with, the government, and especially Minister Padoan and Under Secretary Baretta, repeatedly mentioned the possibility of a precautionary recapitalization. Moreover, various national actors, from labor unions, to Veneto Region's President and UniCredit's CEO, exercise a remarkable amount of the pressure on the government, urging it to intervene. Thus, both LEN and Functional LEN appear to be valid hypotheses: none of them is disconfirmed, and both have sufficient support. In addition to that, the final solution of the crisis entails both state-aid and measures for the protection of depositors.

Continuing the analysis, it shall be noted that Functional LEN is strengthened by Mr Baretta and Mr Padoan statements, wherein they reassured national actors that V&V's solution will entail no bail-in whatsoever. In Particular, Mr Baretta stated in two different occasions that the government would go at any length to prevent a bail-in, and that it would respect the EU's decision on precautionary recapitalization, but oppose a bail-in. Indeed, throughout the crisis, the compensation of depositors played a central role in the use of state-aid. Functional LEN meets both the necessary and sufficient conditions entailed in the analytical framework's markers: the government goes to great lengths to assure the safeguarding of depositors, and appears to be satisfied and ready to give up on other requests when the protection of depositors is granted by EU institutions.

On the other hand, LEN also meets the necessary and sufficient conditions to be heavily strengthened. In fact, there seems to be proof of the Italian government's refusal of foreign investors' offers in Autumn 2016 and May 2017. These facts were not confirmed by the actors involved, who declined to comment. However, the rather detailed press reports, the lack of denial from the potential investors' part and the reiterative nature of the news strengthens the likelihood of the events. Were the news to be confirmed, they could be considered a double decisive proof of the government's intention to keep the banking capital national. In fact, as Bennett and Checkel (2014) argue, actors' preferences can be inferred by the high cost they are willing to pay in order to pursue a given path. Italy's refusal of such an offer indeed cost billions of euros of taxpayer money. Thus, such alleged refusal signifies a remarkable commitment to the goal of keeping banking ownership national.

AN ALTERNATIVE EXPLANATION

Finally, a comment shall be made on Italy's willingness to preserve Italian banks. In V&V's case this aspect is particularly interesting: in fact, it is in order to address their crisis that the government urged Italian banks to pull together capital and establish the Atlas fund. As the frustrated words of Quaestio's CEO and Atlas' manager Penati underline, the two Venetian banks would have most likely been resolved, had it not been for the government-sponsored fund (Paronetto, 2017; Caparello, 2017a). Thus, it appears as if until a certain point, the government tried with all its means to rescue two banks that had virtually turned into black holes constantly churning away millions and billions of euros, which together squandered €11,25 billion (Madurino, 2017b).

Indeed, the banks were eventually wound down under Italian insolvency law. Thus, it could be concluded that either the maintenance of V&V was functional to other ends (e.g. protecting investors); or that keeping the banks afloat was initially a major government's goal, but that it was later given up on in order to protect other priorities (e.g. keeping the capital national); or, finally, that the banks' conditions were by the end so disastrous that the government gave up on them. Beyond the speculations, it is left to further research to cast light on this issue. In the scope of the present thesis, may it suffice to conclude that this alternative hypothesis does not show the same explanatory potential as LEN and Functional LEN do.

ANSWERING THE RESEARCH QUESTIONS

Before providing a final answer to the main research question, a comment on Italy's relationship with European institutions is in order. In fact, throughout the negotiations, the

Italian government seemed on the one hand to push the Commission, in particular, to bend the rules in its favor, and come up with custom-tailored solutions. However, never did the Italian government make an important move without the EC or ECB's approval. Italy set conditions and lobbied European institutions, but was somehow always able to work out a solution where it obtained both partial gains and the support of the Commission.

Finally, the answer to the research question 'To what extent is the Italian government trying to keep the ownership national' for the second case study is, as discussed above, somewhere in between LEN and Functional LEN. In fact, the Italian government is with all likelihood trying, even at high costs, to keep the ownership national, while at the same time it is using LEN tools in order to protect depositors.

CHAPTER V: CONCLUSIONS

1. RESULTS: A SUMMARY

The present thesis has analyzed two cases studies in order to answer to the research question: *'To what extent is the Italian government trying to keep the banking ownership national?'*. The first case study focused on Monte dei Paschi di Siena (MPS). The data analysis' results for MPS' case study pointed to hypothesis 2: 'The use of state-aid represents an effort to protect investors'. In fact, on the one hand, Italy made a serious effort to engage with foreign investors, which disconfirms hypothesis 1 (LEN). On the other hand, however, Italy's attempted to push the Commission to approve the precautionary recapitalization of MPS months before the failure of the market operation, which disconfirms hypothesis 3 (No LEN). Furthermore, from the empirical analysis of the events an alternative hypothesis, not previously envisaged in the analytical framework, has arisen: Italy's will to keep the bank afloat. Therefore, the overall answer to MPS's case study is: Italy tries to keep the ownership national as long as it allows it to protect investors and keep the bank afloat.

The second case study focused on Banca Popolare di Vicenza (BPV) and Veneto Banca (VB), two Venetian banks often referred to in the text under the acronym V&V. The answer to the main research question for the V&V's case study lies somewhere in between hypothesis 1 and 2, that is somewhere in between pure LEN and Functional LEN. In fact, rather convincing evidence points to Italy's refusal of foreign investors, which, if confirmed, would constitute solid proof of the Italian government's willingness to keep the banking ownership national even at a high cost. In the same way, though, abundant proof underlines the government concern with protecting investors, and its radical and stubborn opposition to the bail-in rule.

1.1 Reflections on the results and limitations of the study

As mentioned in the methods section, by applying the same theoretical and analytical framework to both case studies, the present thesis aims to pursue literal replication. Nevertheless, the case studies can only be considered successfully replicated in case they produce the same outcome (Yin, 2003). As a matter of fact, the two case studies' outcome are similar: they both detect the use of LEN tools and the government's will to safeguard investors.

However, if MPS' case points to the preservation of the bank as the government's other fundamental motivation rather than the will to keep the bank's ownership national, V&V's case does exactly the opposite. One of the assumptions that can be drawn from Italy's alleged will to keep V&V's ownership national more than MPS's, could be due to the regional nature of the Venetian credit institutions, and to the considerable amount of pressure and lobbying that was registered in the data collection. Similarly, Italy's untamed will to keep MPS alive could be due to the bank's prestige, which might also, at a critical stage, have weighed more than the will to keep the bank completely Italian.

For the scope of this thesis, the two case studies can be considered partially replicated. In fact, a set of patterns, such as Italy's resistance to bail-ins, and its way of negotiating with the Commission, can be identified across the two cases. It is indeed left to further research to look into these differences and explain the motivations behind them. It is furthermore hoped that follow-up studies will engage in a cross-case comparison involving the four small banks (Banca delle Marche, Cassa di Risparmio di Ferrara, Banca Popolare dell'Etruria e del Lazio, and Cassa di Risparmio della Provincia di Chieti) resolved in 2015. In fact, although these events took place before the entrance in force of the bail-in rule, they could inform the researcher on the Italian government behavior and preferences across the years, and provide the research with further depth.

2. IMPLICATIONS OF THE STUDY

ITALY'S BEHAVIOR

The outcome of the case studies pointed to hypotheses one and two, which were based upon LI assumptions of state and EU institutions behavior. On top of that, the behavior of the Italian government throughout the two crises further confirms LI assumptions. In fact, the Italian government held strong positions, and approached both EU institutions and other Member States (especially Germany and France) with the purpose of striking deals. Eventually, taking on a strategic behavior that allowed it to take advantage of the loopholes for state-aid within the BRRD, Italy eventually achieved its goals, or at least part of them.

Neo-functionalist expectations of state helplessness in the European arena are therefore largely disconfirmed. In fact, Italy proved to have considerable leverage on European institutions.

Nevertheless, Italy did not completely bypass European institutions nor laws. On the contrary, it worked closely with the Commission to reach a compromise. From an LI point of view, this could be explained by the fact that Italy is aware of the value of European institutions in driving down the costs of international cooperation; and of their usefulness in solving problems that are beyond its reach, such as supranational supervision and resolution within the Euro-area.

On the other hand, another explanation worth considering springs from historical institutionalism's concept of path dependence: Italy is aware that, due to the scope and advantages of European integration, opposing the EU entirely would overall be extremely costly. As a result, Italy considers this option unfeasible, and collaborates with the Commission.

Within this thesis, LI and historical institutionalism have been considered, as by tradition, opposite theories. However, as already mentioned in the theory section, LI and historical institutionalism can contribute to each other in portraying a more complete picture of European integration. As Schimmelfennig (2015a) argues, LI is "best embedded in a long-term theory of path dependence development of integration".

Building on Schimmelfennig (2015a)'s comments, on the analysis of the establishment of Banking Union and on the case studies, the present thesis concludes that a combination of LI and historical institutionalism serves to best explain Italy's behavior. As a result, the present thesis claims that Italy's choices in terms of decision-making are heavily influenced and limited by previous choices; within these available choices, however, Italy has relative freedom of action, and uses its relative power to bargain in order to achieve its goals.

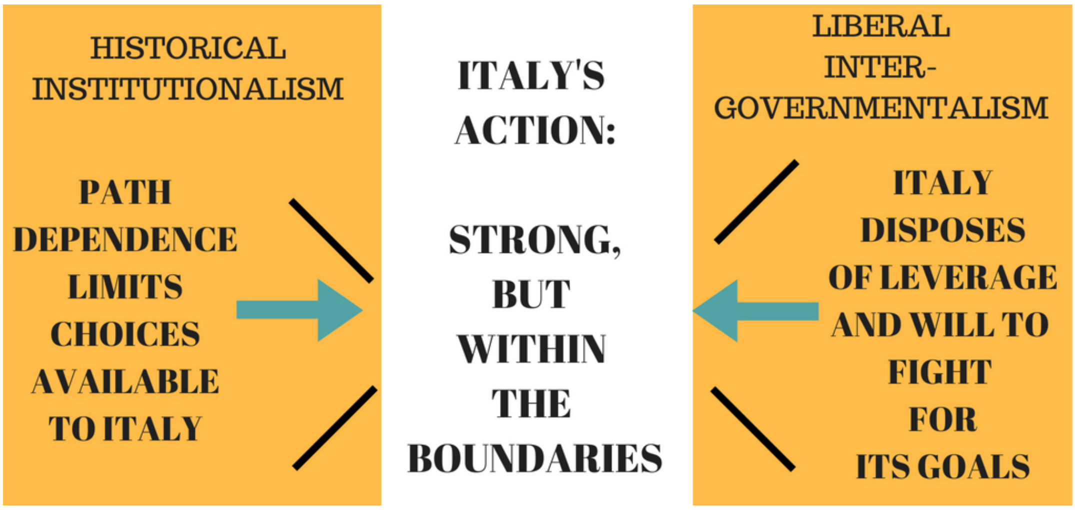

Figure 11: graphic representations of Italy's expected behavior and of the elements influencing it.

SOCIOLOGICAL INSTITUTIONALISM AND LI

This thesis has also attempted to combine LI expectations on state and European institutions behavior with sociological institutionalist insights on institutional culture. As far as LI is concerned, liberal theories of domestic preference formation are largely confirmed: the Italian government was under pressure from several interest groups to protect investors: Bank of Italy, labor unions, local government. LI therefore expects the government to aggregate such preferences. This is a convincing explanation, which points to functional LEN. As a further confirmation of the validity of this approach, functional LEN was effectively detected in both case studies.

However, there is evidence that Italian LEN interests were not limited to protection of investors. In the MPS case study, a secondary explanation for Italy's behavior is its will to keeping the banks afloat. In addition to that, the V&V case study also detects, almost until the very end of the crisis, an effort to keep the two Venetian institutes open, first by establishing the government sponsored Atlas fund, and later by asking for a precautionary recapitalization. Italy's will to keep the banks afloat was not included in the analytical framework, and therefore it was not taken into consideration when assessing the outcome of the case studies. Nevertheless, the will to keep MPS alive can be considered LEN. In fact, it falls into the category of preservation and promotion of national champions (Clift and Woll, 2012).

The second factor which points to the existence of LEN within the Italian government is the will to keep the capital national detected in V&V case study through the refusal of foreign investors, and in the MPS case study through the attempt to recapitalize the bank through the conversion of junior bonds into shares. Whereas this latter case was coupled with what seemed to be a sincere attempt to find foreign investors, the V&V refusal or foreign investors was included in the analytical framework, and resulted in the ambiguous outcome of the second case study, which was assessed as being somewhere in between LEN and Functional LEN.

In conclusion, these factors can be explained both by a classic LI approach, and by a combination of LI and sociological institutionalism. Under LI assumption, these two preferences can be linked to interests expressed by interest groups and aggregated by the Italian government. Adding sociological institutionalism's insights to LI, on the other hand, the point can be made that the Italian government itself leaned towards LEN, and that its institutional culture influenced the decision-making.

Deciding among these two options on the basis of the available data is difficult, and requires an arbitrariness that goes beyond scientific research. Despite its LEN decision-making, in fact, the Italian government might indeed be simply acting strategically, responding to what it perceives to be the requests of important national actors. Let it therefore suffice to conclude that the Italian government is willing to engage in LEN decision-making, may it be out of institutional conviction, or strategic political calculation. Further research disposing of more data across multiple case studies is welcome to determine which of the two explanations is likely to be correct.

EUROPEAN INSTITUTIONS' BEHAVIOR

Within the two crises, the Commission appears to be Italy's preferred channel of negotiations. In fact, the case studies portray a Commission that is more open to compromise and to bending the rules than the ECB. This behavior echoes hypothesis 2 of the new intergovernmentalism, which expects European institutions to not necessarily hold on to their pre-scripted position, but to act strategically.

On the other hand, the ECB's main concern is to carry out its supervisory tasks according to the rules and in support of financial stability. Loyal to its mandate, the ECB distances itself from political decisions, to which it has however to give in in both crises.

Overall, neo-functionalist expectations of powerful supranational institutions which are in control of integration and able to rule over helpless Member States is disconfirmed. Italy is in fact able to negotiate and bend the rules in its favor, confirming LI expectations on both state and supranational institutions behavior.

However, Italy did not manage to have all of its requests fulfilled. In fact, although the bail-in was avoided and depositors were reimbursed in both cases, V&V were not allowed to be kept afloat; whereas in the case of MPS Italy's will to support the bank with state-aid was heavily delayed by ECB and Commission's demands. European institutions' ability to make themselves heard by a Member State seem once again a consequence of path dependence. As the previous section has concluded, path dependence and increasing returns have limited Italy's options, and the advantages of integration have shaped Italy's relationship with European institutions. As a result, path dependence has leveled the field, and allowed supranational institutions to negotiate with Member States almost as peers.

3. SUGGESTIONS FOR FURTHER RESEARCH

Within this thesis, the answer to the research question has been found to lie somewhere in between LEN and Functional LEN. In fact, due to the limited amount of time, the present thesis has not been able to gather sufficient data to determine which of these two outcome, if not both, is more accurate. Further research is invited to address this limitation by comparing multiple case studies and observe the Italian government's behavior under stress across time. Observing the dynamics that result in decision-making through process tracing, and comparing them across case studies can help determine whether LEN is in fact an endogenous factor in the Italian government, or rather a set of societal expectations that the government is willing to satisfy in order to maintain itself in office.

Furthermore, from a theoretical point of view, the findings of this thesis, both concerning LEN and the behavior of the Italian government, call for a new formulation of integration theory. Further research is encouraged to formulate a more solid theoretical basis for the integration of constructivist insights into traditionally rational choice integration theory. In fact, if LEN is to be considered part of Member States institutional culture while maintaining an LI approach, a reformulation of the theory is needed.

In addition to that, this study has concluded that Member States behavior can best be understood as powered by Member States prominence in the European arena, as suggested by LI; but restricted by path dependence and increasing returns, as assumed by historical institutionalism. This suggests that these two theories are complementary. Researchers are therefore urged to use both theories when building expectations on Member States behavior.

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