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The Non-Required by Law Measures by Deposit Guarantee Schemes to Protect Bank Accounts: The Case of Italian FITD

Massimiliano Celli[1]

[1] Department of Business Studies, Roma TRE University, Italy

Correspondence: Massimiliano Celli, Department of Business Studies, Roma TRE University, Rome, Via Silvio D'Amico 77, 00145, Italy. E-mail: massimiliano.celli@uniroma3.it

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Abstract

This article aims at giving a contribution to the issue of protecting bank accounts and deposits by national deposit guarantee schemes through financial assistance interventions of an optional and voluntary nature, instead of the reimbursement of only legally protected deposits in case of bankruptcy of the depository bank. Firstly, we investigate the EU framework for bank crisis resolutions. Specifically, we briefly analyze the EU rules on both prevention and resolution of banking crises pointing out the economic rationale behind the "bail-in" principle, and then identify the characteristics of the third "pillar" of the Banking Union, the EU Deposit Guarantee Schemes. Subsequently, we examine the operating procedures of the Italian Guarantee Scheme (FITD) focusing on the non-required by law interventions carried out by the latter to protect bank accounts and deposits and at the same time prevent or resolve the crises of Italian banks. Finally, some conclusions on the topic at stake will be drawn.

Keywords: deposit guarantee schemes, European deposit insurance scheme, financial assistance, banking crisis

1. Introduction

The bail out of failing banks meets both public and private interests, given the historical role played by the banking system in actively supporting the socio-economic development of industrialized Countries.

In the Eurozone, the bank account keeps representing, even in years of intense and wild financial innovation as well as in the presence of continuously rising running costs (by 17% in the period 2011-2021) and continuously falling profits, the main and most widely utilized banking "product" not only for liquidity transfer operations but also as a "safe" alternative to more sophisticated financial instruments.

A key contribution to the confidence placed by a wide audience of investors in this instrument, and therefore to ensuring the stability of the banking systems (the collection of savings and the exercise of credit are, in fact, functions of primary public interest), is undoubtedly the provision of a required by law protection regime of bank accounts and deposits implemented through the Deposits Guarantee Schemes (Dgs), that play a crucial role in banking crises management. In cases of bank insolvency, DGS intervene to reimburse depositors and account holders who are the weakest subjects in the creditor category and often do not possess adequate information tools to assess how robust their bank might be (Boccuzzi, 2016).

In Italy, moreover, in the last 40 years the domestic guarantee scheme (called Fondo Interbancario Tutela Depositi – FITD) has rarely taken action to directly guarantee the holders of deposits and bank accounts held with banks in crisis, while much more often it has sustained the costs of bailing out such institutions (in any case guaranteeing, albeit indirectly, the relative bank account holders).

These non-required by law measures performed by the FITD to protect bank accounts and deposits before the default of a failing bank have rarely been studied by researchers and practitioners. Instead, in our opinion, the role played by FITD in preventing or resolving the crises of many small and medium-sized banks should be properly recognized and valued within the scientific literature, given the high amount of costs incurred by it over the past decades to preserve the good trust not only of all depositors and bank account holders (as we shall see that amount is in any case incomparably less than what it would have cost the FITD to refund guaranteed by law deposits and bank accounts in the event of bankruptcy of the same banks as above) but also of all creditors of a bank that is failing or at risk of failing, also preventing probable phenomena of systemic contagion and likewise protecting the reputation of the national banking system.

The article is organized as follows. In the following paragraph we investigate the EU framework for bank crisis resolutions. Specifically, we briefly analyze the EU rules on both prevention and resolution of banking crises pointing out the economic rationale behind the "bail-in" principle, and then identify the characteristics of the third "pillar" of the Banking Union, the EU Deposit Guarantee Schemes. In paragraph 3, we examine the operating procedures of the FITD, focusing on the non-required by law interventions carried out by the FITD to protect bank accounts and deposits and at the same time prevent or resolve the crises of Italian member banks. In paragraph 4, we draw some conclusions on the topic at stake.

2. The EU Framework for Bank Crisis Resolutions

The institution of the European Banking Union has introduced precise and coordinated regulations for all banks located in EU Countries in terms of surveillance, resolution of crisis and protection of depositors and bank account holders by reimbursing a defined amount of deposits to depositors whose bank has failed (the so-called three "pillars" of the Banking Union).

Postponing the analysis of the three pillars of the Banking Union to specific contributions, it should be noted that the new EU rules on both prevention and resolution of banking crises (Single Resolution Mechanism as per Regulation 806/2014/EU which came into force on January 1, 2016, itself based on Directive 2014/59/EU - Bank Recovery and Resolution Directive - BRRD), are particularly severe and restrictive.

In addition to defining suitable tools for the prevention of banking crises, especially those of a potentially systemic nature, and also defining numerous intervention tools to avoid the disruptive effects of banking failures, the main goal is to minimize the rescue and restructuring costs as well as the costs for public finances (Wojcik, 2016). To this end, a complex system of loss sharing by shareholders and creditors of a distressed bank has been introduced.

The BRRD, art. 32, states that a resolution procedure (Note 1) for an EU bank must be got started promptly by the competent authorities (domestic or European Central Bank, depending on whether the bank is a significant institution or not – Note 2) if the following equally important triggers are met:

1) The bank is failing or likely to fail, but not yet in default. This requirement is met when: *i*) there are serious administrative irregularities or violations of laws and/or of the bank's articles of association; *ii*) there are exceptionally serious losses, such as to reduce shareholders' equity by significant amounts; *iii*) the value of assets is consistently and significantly lower than the value of liabilities; *iv*) there is no guarantee that the bank will be able to reimburse debts as they fall due;

2) Alternative and "private" solutions (such as capital increases or the sale of the bank) are not adequate to avoid bankruptcy within a reasonable timeframe;

3) There is a public interest in the bail out of the bank, namely to ensure the overall financial stability (so preventing contagion to other market players), to protect depositors and to guarantee the continuity of the bank's key services such as payment services.

If these requirements are not met the bank must be put into liquidation in compliance with domestic laws.

Regardless of the financial tools actually utilized to resolve or prevent the crisis of a bank in the European Union, and regardless of whether it is a significant institution or not, in any case the termination procedure must strictly comply with the following key-criteria (Stanghellini, 2015):

- No investors or creditors must bear greater costs than those they would have borne in the event of the bank being settled according to ordinary domestic laws (the so-called *no creditor worse off* principle);

- The costs of crisis of a bank's crisis must be borne exclusively by the private sector (the so-called *bail-in* principle), and therefore, first and foremost, by those who invested in the bank at their own risk (shareholders first) and creditors, but never by the public sector as happens in the case of public bail-outs and as in fact happened in many EU Countries during the financial crisis of 2007-2009 and the sovereign debt crisis of 2011-2013.

The order of priority within the bail-in procedure is as follows:

1) The share capital (so-called "first class" capital), by writing down or zeroing out the value of the shares held by shareholders;

2) Other equity securities;

3) Unsecured receivables, by means of conversion into shares and subsequent reduction of the related value even up to zero, or direct reduction of the receivables;

4) The bank deposits and bank accounts of persons and small-medium sized entities for the amount exceeding 100,000 euros;

5) National deposit guarantee funds, which contribute to the bail-in for bank deposits and bank accounts of less than 100,000 euros (this would be, after all, one of the types of "private" bail-out).

Lastly, if the financial resources activated with the above-mentioned pecking order should prove insufficient to resolve the bank's crisis, and only when factual risks to the financial stability of an EU Country or the entire Eurozone are encountered, both the SRM Regulation and the BRRD Directive provide for the possibility of resorting to various public backstops (Note 3). Public financial assistance, however, must be granted in accordance with the rules set out by the European Commission in Banking Communication 2013/C216/01 (Note 4) and only for the purpose of protecting the public interest, so as to avoid undue distortions of competition in the EU banking market. Furtherance it is necessary that the prior use of the above-mentioned resolution tools, and in particular of the bail-in procedure, has not given the expected outcome (thus, without prejudice to the principle that financial losses must be absorbed prior by the private sector).

As far as the third “pillar” of the Banking Union, the EU Deposit Guarantee Scheme, is concerned, this will in future be based on a single and fully mutualized Pan-European Deposit Insurance Scheme – EDIS in order to reduce the potential spill-over risk of domestic bank failures on the financial stability of the economic and monetary union as a whole (Brescia Morra, 2019), but at the present time (spring 2022) its processing has been deferred to the future by the European Authorities, which have instead given priority to the establishment of a coordinated network of national depositor guarantee funds in accordance to the Deposit Guarantee Directive Scheme 2014/49/EU (Note 5).

The bank deposit guarantee systems are therefore still organized on a national basis while applying harmonizated EU standards, with the aim to safeguard deposits and strengthen overall financial sector stability by removing incentives for bank runs and thus limiting financial contagion (Payne, 2015). Specifically: *i*) an identical financial guarantee has been established for all the EU Countries up to an amount of € 100,000 per bank deposit; *ii*) the types of bank accounts that can be reimbursed have been identified precisely; *iii*) the reimbursement procedures have been simplified and the payout periods reduced and harmonized; *iv*) the possibility of mutual financing between domestic guarantee funds has been provided for (Colaert, 2015).

As is known, the aim of the deposits guarantee funds is to guarantee, within the limit of 100,000 euros, the savings (and not the investments) of the depositors and the account holders of failing banks, thus fulfilling an effective public mandate even if entrusted to a private organization (Salama & Braga, 2021). The financial instruments subject to guarantee are: bank accounts, deposit accounts, certificates of deposit, savings accounts and bankers' cheques, while shares, bonds and repurchase agreements issued by a failing bank are exempted.

From the depositors’ point of view, deposit guarantee schemes protect a part of their financial portfolio from bank failure. From a financial stability perspective, the schemes prevent bank runs, thus preventing severe economic and social consequences (Arnaboldi, 2014). Guarantee schemes are the components of the financial safety net, but usually incorrectly treated not as essential but rather ancillary ones. This approach stems from the fact that primary responsibility for the financial stability is attributed to central banks and supervisory authorities (Iwanicz-Drozdowska et al., 2015). However, guarantee schemes should be treated as a substantial part of the financial safety net. This is mainly because they play an important role in building the customers’ trust in the financial institutions.

3. Non-Required by Law Measures by Italian Guarantee Scheme to Protect Bank Accounts and Deposits

The Italian deposit guarantee fund, called Fondo Interbancario per la Tutela dei Depositi – FITD, is a mutualistic consortium of private law among Italian banks and subject to supervision by the Italian Central Bank. The FITD is funded totally with private financial resources coming from the domestic banking system and is autonomously managed by the latter with equally autonomous governance, without the involvement of public money or public authorities in decision-making bodies. It was established in 1987 on an initially voluntary basis and became required by law in 1996 for all Italian banks having the corporate form of a joint-stock company with the granting of the European Directive 94/19/EEC subsequently innovated and amended by Directive 2009/14/EC and Directive 2014/49/EU (so-called Deposit Guarantee Scheme Directive). Italian Cooperative Credit Banks, on the other hand, must adhere to the equivalent Cooperative Credit Depositors Guarantee Fund, governed by the same regulatory provisions.

The FITD actively works within the network consisting of the bank deposit guarantee funds of all EU Countries. Since 2015, the required by law financial contribution required from member banks, the amount of which varies according to the size and degree of riskiness of each member bank, is of the *ex-ante* type with progressive accumulation through periodic monetary contributions by the member banks, with the aim of constituting, by 2025, a total financial provision equal to 0.8% of the total amount of guaranteed deposits of all member banks (previously, there was instead a “on call” mechanism for the provision of financial resources, for which contributions were made only when there was a real need to reimburse the deposits under protection - Bonfatti, 2017).

Even if the institutional mandate of the guarantee funds is to guarantee depositors and bank account holders from any possible default of the depository bank (within the objective and subjective limits provided for by domestic laws), in Italy this type of mandatory guarantee has been provided quite rarely by the FITD since its establishment (as we will analyse in the next section, as of 2021 in only 3 cases out of more than 94 supporting actions) and always with regard to small and medium-sized banks, while voluntary bailouts have been much more frequent either prior to the breakdown of the crisis or as an alternative to bankruptcy.

Given that the monetary amount of Italian bank deposits potentially subject to legal guarantee is about 600 billion euros, the effective capability of the FITD to refund guaranteed depositors and account holders is only for small and medium-sized banks, but it could hardly manage the required by law payouts in the case of a default of large banks and never in the case of a "systemic" crisis of the whole banking sector (as is the case in any other European Country). Therefore, it is in the interest of the member banks of the Consortium (as well as the community of depositors) to carry out alternative financial measures aimed at preventing, or resolving in an alternative way to liquidation, the crisis of national banks (for example, by transferring it to another bank in good financial standing) (Boccuzzi, 2016; Schich & Byoung-Hwan, 2008).

The partecipating banks in the FITD must contribute financially to the aforementioned voluntary interventions decided by the management of the Consortium. This obligation is not derived from laws and regulations but rather from the articles of association of the FITD itself (which, as we recall, is a private entity), that provide for the possibility of implementing alternative or preventive measures with respect to the legally required pay-box function of guaranteed depositors in the event of the default of a member bank (Cappiello, 2015). These facultative and voluntary uses of the financial resources available to the FITD are exclusively aimed at the pursuance of the private interests of the member banks (such as avoiding generalised contagion phenomena as well as maintaining the confidence of depositors and investors in the overall national banking system), the protection of which is fully consistent with the purpose of all consortia which is to preserve the common interests of all their members.

The voluntary and discretionary measures available to the FITD include: *i*) recapitalisation procedures including "precautionary" ones; *ii*) purchase of shares (including controlling shares); *iii*) granting of guarantees and/or low-interest loans; *iv*) purchase of non-performing loans; *v*) transfer of assets and liabilities of the bank in crisis to a competitor bank with simultaneous payment to the purchaser of the "transfer surplus" by the Guarantee Fund.

Moreover, the assistance provided to the Italian banking system by the FITD, whether of a preventive or alternative nature, is to all intents and purposes part of the regulatory framework established by the DGS Directive (in addition, as mentioned above, to the required by law pay-box function in the event of the bankruptcy of a member bank) the cornerstones of which are:

1) the obligation to comply with the rules established by the European Commission on the subject of public aid to the banking sector with Banking Communication 2013/C216/01, so as to avoid undue distortions of competition in the EU banking sector. Specifically, the aforementioned Communication states that: *i*) in any case, required by law financial assistance from guarantee funds for the reimbursement of guaranteed depositors of a distressed bank does not represent State aid; *ii*) voluntary and facultative measures aimed at assisting a bank in crisis, both prior to the bank's bankruptcy itself and alternatively to the liquidation of the bank, constitute State aid only if the decision to use such funds is directly or indirectly referable to the State (in addition, of course, to the case in which the financial resources employed are of a public nature – Note 6);

2) the respect of the principle of least cost (Maccarone, 2019) i.e., that the costs of the voluntary bailout of a bank in crisis by the guarantee fund not be greater than the cost that the latter would sustain for the full refund of the guaranteed deposits in the event of the bank's distress. This requirement, moreover, is easy to pursue given that it would be very difficult for a guarantee fund to be consistent in the case of defaults of large banks and never in the case of "systemic" crises.

The choices of the FITD are, therefore, only motivated by strictly loss-minimizing criteria and certainly not by any kind of " solidarity" among its member banks, which, on the contrary, operate daily in a regime of real competition. In accordance with objective economical rationale, in fact, it is more convenient for the FITD to voluntarily contribute to the rescue of a member bank by providing the necessary financial resources than to risk its bankruptcy, given that the member banks themselves would then be required by law to refund the guaranteed depositors and account holders of the bankrupt bank. The fact that the goals of the FITD underlying the aforementioned preventive and voluntary rescue of banks in crisis may coincide with public interests must be considered merely circumstantial, since they are primarily aimed at pursuing the private interests of the member banks (in other words, the aforementioned voluntary measures are motivated exclusively by a strict cost-benefit analysis).

4. Discussion and Conclusions

In the period 1996-2021, that is, since the FITD was set up, it has never happened in Italy that the depositors and account holders of a bank have lost any money, no matter what the amount of their deposits and accounts, thanks to the voluntary and “private” measures taken by the FITD, both of a preventive nature (i.e., through the bailout of the banks in crisis before their final bankruptcy) and as an alternative to the liquidation itself.

In the above-mentioned period of time, the FITD carried out No. 94 financial assistance interventions in favor of distressed member banks, and only in 3 cases were they required by law payouts aimed at protecting only insured depositors and bank accounts and always with reference to small sized banks. The remaining No. 91 financial measures, carried out voluntarily by the FITD, contributed to resolving the crises of an equal number of banks, some of which (No. 2) could be even considered “systemic” due to their size and the characteristics of the national banking system.

As mentioned above these voluntary and facultative measures by the FITD are only motivated by strictly loss-minimizing criteria and specifically by the principle of least cost, i.e., that the costs of the voluntary bailout of a bank in crisis by the FITD not be greater than the cost that the latter would sustain for the full refund of the guaranteed deposits in the event of the bank's bankruptcy. In accordance with objective economical rationale, in fact, it’s more convenient for the FITD to voluntarily contribute to the bailout of a member bank in crisis by providing the necessary payouts than to risk its bankruptcy, given that the member banks themselves would then be required by law to refund the guaranteed depositors and the bank account holders of the bankrupt bank within the maximum financial limits contemplated.

The amount of financial resources voluntarily spent by the FITD for these private bail outs amounts to about 2.9 billion euros. This amount is incomparably less than what it would have cost the FITD to refund guaranteed by law deposits and bank accounts in the event of bankruptcy of the same banks as above (according to estimates made by the Italian Central Bank, at more than 44 billion euros). In this regard it should be noticed that insured bank deposits represent around 67% (as of December 31, 2020, up to 596 billion euros) of the total amount of domestic bank deposits eligible for refund in the event of the default of depository banks.

In the end this *modus operandi* for preventing or resolving banking crises has ultimately made it possible, since the establishment of the FITD, to preserve the good trust not only of all depositors and bank account holders, regardless of the financial amounts deposited therein (thus including those who, in the event of the bank's bankruptcy, would not have been covered by the guarantees required by law), but also of all creditors of a bank that is failing or at risk of failing, also preventing probable phenomena of systemic contagion and likewise protecting the reputation of the national banking system as a whole and the trust placed in it by a vast public, as well as guaranteeing employment levels and preserving the tangible and intangible assets of Italian banks.

The non-required by law measures performed by the FITD to protect bank accounts and deposits before the default of a failing bank have rarely been studied by researchers and practitioners Instead, in our opinion, the role played by FITD, and more generally by other domestic deposit guarantee schemes, in voluntary preventing or resolving the crises of many small and medium-sized banks should be properly recognized and valued within the scientific literature. Furthermore, in light of the findings in this article and based on future studies aimed at quantifying the lower costs actually incurred by the FITD in financing its voluntary support policies for banks in crisis than what it would have cost the FITD to refund guaranteed by law deposits and bank accounts in the event of bankruptcy of the same banks, we believe that the European institutions (ECB and European Commission first and foremost) should recognize this important role of a private nature played by the domestic deposit guarantee schemes and therefore seek to assist them adequately with ad hoc tax and regulatory legislation.

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Notes

Note 1. Operationally, the European banking resolution mechanism is based on numerous resolution instruments identical for all the European Countries, including the following:

- The sale of the bank in crisis en bloc to a competitor bank;
- The transfer of part of the assets and liabilities of the bank in crisis to a competitor bank or to a temporary vehicle that will subsequently sell on the market;
- The separation of the performing assets from the impaired assets (in particular non-performing loans) and the transfer of the latter to a special vehicle company (so-called "bad bank") owned by one or more public authorities, whose management have the sole mandate of managing their liquidation within a reasonable period of time. On the other hand, the performing assets (customer deposits, current accounts, etc.) are kept in the original bank which may or may not be sold to a competitor bank or temporarily moved to a "bridge bank" in anticipation of a subsequent sale on the market;
- The sale on the market of one or more branches of the bank in crisis.

Note 2. To be considered Significant Institutions, banks must meet at least one of the following requirements: 1) total assets greater than 30 billion euros; 2) play an important role in the economy of the Country they belong to or in the Eurozone; 3) have applied for/received funds from the Esm or Efsf (Laviola, Loiacono & Santella, 2015).

Note 3. These include: *i*) the temporary nationalization of the bank in crisis; *ii*) the issuing of public guarantees to support new operations of the bank in crisis; *iii*) the granting of public guarantees for the injection of new capital into the bank in crisis; *iv*) temporary recapitalization interventions in order to deal with capital shortfalls of the bank in crisis (but, in any case not in a state of insolvency).

Note 4. According to the European Justice Court, and on the basis of art. 107 TFEU, in order for there to be state aid it is necessary to combine the following conditions: *i*) it must be an intervention attributable to the State with the use of public funds, or even of a private nature, but which in any case fall within the availability of the State; *ii*) this intervention must grant a selective advantage to its beneficiary; *iii*) this intervention must distort, or threaten to distort, competition.

Note 5. The European Commission has proposed the introduction of a single European Deposit Insurance Scheme (EDIS) to be implemented in stages based on the progressive mutualization of financial resources and centralization of decisions, with the aim of achieving by 2025 a budget equal to 0.8% of total European guaranteed bank deposits. On the basis of 2021 data, this would be an endowment of around 44 billion euros, sufficient to provide for the necessary payouts even in situations as serious as the global financial crisis of 2007-2009. Unfortunately the institution of a Pan-EU Deposit Guarantee Scheme is currently excluded due to difficulties in reaching a political compromise. In this respect, some EU Countries were concerned about the creation of a moral hazard in those participating Countries that had less strong banking systems (Howarth & Quaglia, 2018).

Note 6. In light of European Court Ruling C-482/99 of May 16, 2002 (the so-called "Stardust Ruling"), and based on art. 107 TFEU, in order for there to be State aid, the following conditions must be met jointly: *i*) there must be a discretionary measure that can be ascribed to the State and aimed at achieving a public interest, with the use of State resources or private resources but in any event at the disposal of the State; *ii*) the management of the private guarantee fund is not free to define the nature and characteristics of the measure; *iii*) the contributions paid by the members of the guarantee fund in relation to rescue measures of a voluntary and discretionary nature must not only be imposed but also at the disposal of the State; *iv*) the measure must distort market competition.