Institution: King's College London		
Unit of Assessment: 18 Law		
Title of case study: Rescuing Italian banks: drawing the boundary of EU State aid control		
Period when the underpinning research was undertaken: 2010 – 2018		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Andrea Biondi	Professor of EU Law	From 01/09/1997
Period when the claimed impact occurred: Jan 2016 – Jul 2017		
Is this case study continued from a case study submitted in 2014? N		

1. Summary of the impact

The global financial crisis of 2007-09 led to the collapse of a series of small and medium-sized banks in Italy. This had devastating effects on the most vulnerable depositors, who saw their savings wiped out. European Union (EU) law restrictions on State aid to businesses meant that the Italian Government was limited in what it could do to prevent further bank failures. It turned to King's College London's Professor Andrea Biondi for his expertise in State aid rules. Biondi was appointed Legal Advisor to the Italian Prime Minister in 2016 and asked to design a pioneering scheme to rescue failing Italian banks that complied with EU law. Biondi designed what became the Atlas Fund, a EUR4,000,000,000 *ad hoc* scheme, financed by large Italian commercial banks, that transferred financial risk from the government to private undertakings. The Fund rescued two medium-to-large banks and four smaller local banks. These banks returned to profitability, without any loss to the taxpayer. The scheme also compensated many individual depositors who would otherwise have lost the entirety of their savings.

2. Underpinning research

State aid is defined by the EU as any advantage given, on a selective basis, to any company by public authorities that might distort competition and trade in the EU (Article 107 of the Treaty on the Functioning of the European Union). The definition of State aid is very broad, since the 'advantage' or 'aid' given by public authorities can take many forms. Research by Biondi focused on clarifying the definition of 'aid'. In particular, his work substantially contributed to a revised international understanding of 'aid' as a legal category. Biondi explained that 'aid' is circumscribed by precise boundaries and argued that 'State aid' cannot be fully understood without taking into account the profound transformations of the role of the State and the evolution of the European model of social economy.

In a highly influential 2010 publication, cited in the UK's House of Commons Briefing Paper No. 06755 on EU State Aid Rules and WTO Subsidies Agreement of November 2018, Biondi argued (against what was then the prevailing view within the European Commission) that the rationale for State aid control should not be based exclusively on the economic assessment of market characteristics [1]. He contended that reliance on solely economic principles was inadequate to guide State aid control and inconsistent with the role of government in the social market economy that the EU embraces.

Biondi's pioneering approach was timely in making a compelling case to governments for a fresh approach to State aid rules. He argued that this could serve as a progressive tool for the promotion of social values – in particular the development of fair corporate governance and sustainable economic policies [2]. These ideas were further developed in what became the 'benchmark' publication in the academic and political debate on State aid control for post-Brexit UK [3], attracting a significant amount of media attention and described by Paul Mason of the New Statesman as *"one of the most influential articles on Brexit".*

The implications of Biondi's innovative, interpretive framework are far-reaching. Traditional analysis of Court of Justice of the European Union (CJEU) jurisprudence emphasised the tendency of case law to preclude limits on the application of EU law. Biondi's research, by contrast, interpreted the CJEU approach as receptive to such limits when dealing with the application of State aid rules to national social policies [4,5]. Biondi focused on economic transactions carried out by the State as just one of the conditions for a national measure to qualify as State aid. He argued that these do not confer a selective advantage, and therefore should not constitute 'aid', if they are carried out in line with normal market conditions (the Market Operator Principle or MOP). The MOP cannot be measured solely in terms of a quick investment return; more general context and social repercussions such as the impact on depositors and wider communities need to be considered. In summary, when dealing with social market economies, the long-term economic rationale of a reasonable private operator's conduct cannot be assessed without attention to the social and economic context in which he or she operates [4,5].

Biondi's research showed why public spending measures should in some cases be entirely excluded from review by the European Commission. He argued that measures do not satisfy the criteria to be considered State aid [1,2,5,6] if public expenditure is kept to an efficient minimum and the State transparently pursues beneficial public policies. This fine balance is particularly relevant to effective State regulation of the banking sector, since too strict an application of State aid rules could prevent EU Member States from fulfilling their social responsibility to protect depositors in banks.

3. References to the research

Publications 1, 4 and 5 have gone through strict peer-review processes. Publications 2 and 3 are now standard references in UK official publications on the future of State aid control post-Brexit (UK Parliament, European Parliament), as well as think tanks (Institute of Governments, Progress) and the media (Financial Times, BBC, The Guardian, The Times). All publications listed are widely cited in the literature and are included as further reading in all leading EU law textbooks.

[1] Biondi, A. (2010). The Rationale of State Aid Control: A Return to Orthodoxy, in C. Barnard & O. Odudu (eds), *Cambridge Yearbook of European Legal Studies,* 2009-2010 edn., vol. 12, Hart Publishing, pp. 35-52. DOI: 10.5040/9781472565327.ch-002

[2] Biondi, A. (2016). State Aid, government spending and the virtue of loyalty, in P.J. Birkinshaw & A. Biondi (eds), *Britain Alone!: The implications and consequences of UK exit from the EU*. Kluwer Law International, ch.15.

[3] Biondi, A. & Tarrant, A. (2017). Brexit and Labour's Political Economy: Labour's Programme and EU Law, *Renewal: A journal of social democracy,* vol. 25, no. 3-4, pp. 66-89.

[4] Biondi, A. & Righini, E. (2015). An Evolutionary Theory of State Aid Control, in A. Arnull & D. Chalmers (eds), *The Oxford Handbook of European Union Law,* Oxford University Press, pp. 670-690. DOI: 10.1093/oxfordhb/9780199672646.013.29

[5] Biondi, A. (2013). State aid is falling down, falling down: An analysis of the case law on the notion of aid, *Common Market Law Review*, vol. 50, no. 6, pp. 1719-1743.

[6] Biondi, A. & Stefan, O. (2018). The Notice on the Notion of State Aid: Every Light Has Its Shadow, in B. Nascimbene & A. Di Pascale (eds), *The Modernisation of State Aid for Economic and Social Development*, Springer, pp. 43-61. DOI: 10.1007/978-3-319-99226-6_3

4. Details of the impact

The financial and banking crisis of 2007–09 had a particularly devastating effect on the Italian banking sector, which was characterised by its many small and medium-sized banks that were trusted by citizens because of their long-established links with local communities. There was a risk of several banks becoming insolvent, with the potential for taxpayers having to compensate depositors or depositors losing their savings, as well as businesses losing access to finance. Bank failures can cause an increased risk of systemic default, having negative repercussions for the financial industry as a whole. Thus, the issue of State aid and State regulation is one of international, as well as local, concern.

By 2015, Italy had the largest number of non-performing loans in the entire European banking sector, peaking at EUR349,000,000,000. These were loans characterised by borrowers no longer paying interest to lenders. To counteract this, the Italian Government set up a mandatory deposit guarantee fund to save failing banks. The scheme was operated on behalf of the Italian Government, with banks obliged by law to participate. The Italian Government exercised considerable influence over its operation, and the Bank of Italy had to authorise any rescue loan. In December 2015, the European Commission determined that this support constituted unlawful State aid. Its view was based on its purely economic rationale for State aid, a view that had already been contested by Biondi's research outlined above [1,4,5].

The research-based solution: The Atlas Fund designed by Professor Biondi

On 5 January 2016, Biondi was appointed as Legal Advisor to the Italian Prime Minister due to his expertise on State aid and EU law and his innovative reworking of the definition of 'State aid' [1,4,5]. Judge Antonella Manzione, then Head of the Italian Prime Minister's Legislative and Regulatory Affairs Department, asked Biondi to join her committee of experts to address EU law issues in general and EU State aid law issues in particular. Biondi was tasked with assisting the Italian Government with the establishment of an EU regulation-compliant *ad hoc* fund in order to rescue the ailing banks [A]. Judge Manzione chose Biondi on the basis of his *"international standing and his numerous contributions of influential scholarship on the subject of EU State aid law"* [B].

In January 2016, Biondi was instructed to work on a new legislative framework – later named the Atlas Fund after the Titan who bore the weight of the heavens on his shoulders – to replace the scheme rejected by the European Commission. In drafting the new scheme, Biondi drew upon his research on State aid categorisation, focusing on the degree of State involvement [1,2], and on economic transactions carried out by the State to rescue failing banks. A key question was whether such transactions were carried out in line with normal market conditions (MOP) [4,5].

Biondi's novel framework and substantive recommendations for the scheme proved essential in changing the approach of the European Commission, which found the scheme compatible with EU law. The scheme had the following significant and innovative features:

i. It was based on a voluntary deposit guarantee fund, managed by a private equity fund manager.

ii. It was financed by commercial banks, to exclude involvement from the Government (except in relation to the regulatory framework of the scheme). As a result, the cost to taxpayers was kept to a minimum, being limited to costs associated with the Government's regulatory functions, rather than to its role as a financial guarantor.

iii. It contained provisions that its loans would be subject to the rules applicable to commercial loans and guarantees.

iv. It emphasised protecting depositors, through *ad hoc* guarantees or direct compensation, as a key factor in determining the scheme's legality. This was based on Biondi's argument [4,5] that social needs should be included in assessments of fair market competition.

Gaining European Commission approval and implementing the Atlas Fund

Biondi's intervention had two major areas of impact:

- it changed the Commission's view on the purely economic rationale of State aid to allow social factors; and
- the scheme devised by Biondi balanced the economic considerations of the Commission (the MOP) and social considerations [B].

The European Commission approved the new scheme on 10 February 2016 [C]. The 'Atlas decision' is one of the very few (out of around 500 Commission decisions regarding State aid to banks) that the Commission qualified as 'free of State aid' and thus lawful under EU law [D].

The Commission also expressly acknowledged that: *"in situations where banks that have mis-sold financial instruments have left the market, it is up to Member States to decide whether to take exceptional measures to address [the] social consequences of mis-selling as a matter of social policy. This falls outside the remit of State Aid rules"* [E]. This was a significant change from the view that the Commission expressed towards the mandatory deposit guarantee fund developed by the Italian Government in 2015 and was enabled by Biondi's research-based intervention.

Mario Draghi, the then chairman of the European Central Bank, described the Atlas Fund as a first *“step in the right direction”* [G, (i)].

After receiving the European Commission’s approval, the Italian Government swiftly implemented the new scheme on 8 April 2016 [F]. Articles 3 to 13 of the Decree-Law, which Biondi drafted, were reproduced verbatim in the final text. As Judge Antonella Manzione wrote: *“Prof Biondi not only offered his advice but in some cases drafted specific provisions, deleted others and designed their replacements… I can strongly express my firmly held opinion that Professor Biondi’s contribution was of the highest quality and has had a decisive and direct impact on the outcome of several legislative proposals now fully implemented and enforced”* [B].

Beyond legislation: The real beneficiaries of the Atlas Fund

The Italian authorities launched the Atlas Fund in 2016 to support banking system stability. As explained in an International Monetary Fund Working Paper, the Atlas fund was *“aimed at backstopping the capital issuance of smaller (distressed) banks and, possibly, buying junior tranches of NPL securitization transactions ... [It was] funded by the largest Italian banks, nonbank financial institutions and banking foundations, with an 8 percent minority stake held by the largely publicly-owned Cassa Depositi e Prestiti (CDP)”* [H, (i), p15].

The Atlas Fund had initial capital of EUR4,250,000,000, guaranteed by 67 private undertakings over five years. The cost of all Atlas operations was close to EUR11,500,000,000 for 2016–19. In 2017, the Atlas Fund used around EUR2,500,000,000 to prevent the collapse of two medium-to-large banks and ensured that their depositors were protected. The Fund also purchased 99% of the shares of Banca di Vicenza [see analyses in H, (i), p15 and H, (ii), p25-26]. Matteo Renzi, the then Italian Prime Minister, stated “*thanks to Atlante [Atlas], Vicenza is saved*” [G, (ii)].

After the bailout of Vicenza, Atlas guaranteed a EUR1,000,000,000 capital call at another regional bank, Banca Veneta, purchasing around 70% of its shares, thus rescuing the bank. The Atlas Fund was later used to rescue four smaller local banks: Banca Marche, Banca Etruria, CariChieti and CariFerrara. In total, the Fund paid EUR181,000,000 in compensation to depositors who would otherwise have lost all their money [G, (iii)]. This is nearly half of the EUR340,000,000 of toxic obligations sold by the banks to depositors (or the savings that would otherwise have been wiped out) [G, (iv)].

The shoulders of the Atlas Fund proved capable of carrying at least some of the burden of the continuing impacts of the devastating financial crisis of 2007-09, which affected not just Italy, but also elsewhere in Europe and the wider international financial world. Its pragmatic approach played a role in reassuring markets by preventing financial panic from spreading. In 2017, the European Commission approved ‘Atlas 2’ to replace the Atlas Fund with an increased availability of capital [I].

5. Sources to corroborate the impact

[A] Appointment of Andrea Biondi as Legal Advisor to the Italian Prime Minister, 25 March 2016 [letter].

[B] Testimonial from Judge Antonella Manzione, Head of the Italian Prime Minister’s Legislative and Regulatory Affairs Department, 21 December 2016.

[C] European Commission (2015), *State aid — Italy — State aid SA.39451 (2015/C) (ex 2015/NN) — State support to Banca Tercas — Invitation to submit comments pursuant to Article 108(2) of the Treaty on the Functioning of the European UnionText with EEA relevance* (2015/C 136/04)

[D] European Commission memo (2017). *State aid: Overview of decisions and on-going in-depth investigations of Financial Institutions in Difficulty.*

[E] European Commission press release (2017). *State aid: How the EU rules apply to banks with a capital shortfall – Factsheet.*

[F] Decree Law 18/2016 of 14 February 2016, subsequently converted into Law 49/2016 of 8 April 2016 by the Italian Government.

[G] Media coverage of the implementation of the Atlas Fund in 2016: (i) Il Sole 24 Ore (22/04/2016); (ii) Financial Times (04/05/2016); (iii) Osservatorio Cpi; (iv) Il Sole 24 Ore (26/05/2018).

[H] Report containing International Monetary Fund papers analysing the Atlas Fund measures: (i) Garrido, J., Kopp, E. & Weber, A. (2016). Cleaning-up Bank Balance Sheets: Economic, Legal, and Supervisory Measures for Italy, *IMF Working Paper No. 16/35*, International Monetary Fund, Washington; and (ii) Jobst, A., & Weber, A. (2016), Profitability and Balance Sheet Repair of Italian Banks, *IMF Working Paper No. 16/175*, International Monetary Fund, Washington.

[I] European Commission (2017). *Prolongation of the Italian guarantee scheme for the securitisation of non-performing loans, SA.48416 (2017/N).*