Interstate banks' consolidation and group-wide capital and liquidity management to foster financial stability and deepen market integration (*)

1. Looking at the potential legislative initiatives of the next European Commission from an academic perspective (adopting what Tommaso Padoa Schioppa called "a long view"), there is little doubt that an action that is long overdue and should rank high in the EU agenda among those most necessary to complete the Banking Union (BU) and to foster the Capital Markets Union (CMU) is the removal of certain regulatory and institutional barriers that stand in the way of a deeper banking and financial consolidation for EU G-SIIs and financial conglomerates, especially in the euro area.

2. Interstate consolidation serves both financial stability and the internal market. Financial stability is furthered by geographical and business model diversification, which ensures risk dispersion across the EU. Interstate banking groups and financial conglomerates are more resilient to asymmetric shocks and less prone to the problematic sovereign-bank nexus (1). Interstate consolidation can also increase competition, quality of services, reduce market segmentation along national borders and would better sustain and promote the digital transformation of the industry. This would also be transformative for capital markets (2), in particular equity and debt markets of financial corporates, making that segment deeper and more liquid. Interstate banks' consolidation would also drive a parallel process of consolidation for captive non-bank financial intermediaries such as asset managers, mutual funds, insurances, pension funds and private equity funds, which are in a great number in Europe and often owned by banks, yet too small to compete globally.

3. Such consolidation would finally respond to the wise calls for more political ambition, among others, by regulators like Andrea Enria and Eduard Fernandez-Bollo (3) and would put at good use insightful preparatory works

(*) Speaking note for the first panel of the CIRSF Conference 2023, Lisbon, 9-10 October 2023.

(1) ECB, *Guide on the supervisory approach to consolidation in the banking sector*, 2020, para 27 (discussing the implications for a downward adjustement of P2R and P2G).

(2) For data, Bednarski, Polk, *SAFE Bank*, 4(77) 2019, 25-28.

(3) Enria, Fernandez-Bollo, *Fostering the cross-border integration of banking groups in the banking union*, Frankfurt am Main, 9 October 2020 *https://www.bankingsupervision.europa.eu/press/blog/2020/html/ssm.blog201009~bc7ef4e6f8.en.html*

made at the European Banking Authority (EBA) (4), unleashing the full potential of the 2020 Guide on the supervisory approach to consolidation in the banking sector of the ECB. This would also be in line with findings of the EU Commission itself, which in its Report 2023 on the Single Supervisory Mechanism (SSM) (5) has fairly acknowledged that "the SSM impact on the smooth functioning of the internal market remains constrained by the political challenges of the Banking Union. In practice, these translate into some degree of market segmentation along national borders and also into limited consolidation between banks based in different Member States". This is problematic also seen from the point of view of the Capital Markets Union (CMU). As the High Level Forum noted (6) a few years ago, a fundamental challenge for European financial markets is represented by "the obstacles that have discouraged EU financial operators from taking up and scaling up financial activity, especially on a cross-border basis, that have reduced the attractiveness of EU markets for foreign investors and have prevented EU financial operators from competing globally on an equal footing". Therefore, it is time to set European sails out of the perilous waters between the Scylla and Charybdis of vague aspirations towards a pan European deposit protection scheme, yet also hard to die emotional concerns over debt mutualization and fearful ring-fencing. These sentiments are backward-looking, because many risks associated to cross-border interconnectedness and contagion which at the time of the 2007-2009 financial crisis drove cross-border retrenchment and domestically oriented public policies are now addressed by resolution preparedness: a long journey, yet one now reaching its final destination with fully-loaded MREL/TLAC targets by the end of 2024. Sure, the European Deposits Insurance Scheme (EDIS) and the credit line of the European Stability Mechanism (ESM) are necessary components of the Banking Union which need to come. The sooner, the better. But the same is also true for interstate financial consolidation. Retarding the latter for the delays of the former is not good policy. Quoting the famous 1933 inaugural address of President Roosvelt, "the only thing we have to fear is fear itself — nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance".

4. Honestly, an academic looking at the unfinished work of the Banking Union may get the feeling of being roughly 70 years late compared to the US, still at the time of the political debates which in the United States laid the ground for the 1956 Bank Holding Company Act. European fearful approaches echo American taboos of the time against interstate bank branching and subsidiarization, motivated by the fear that interstate growth would allow large banks from major states to compete against state banks in minor states and would concentrate too

(4) Gardella, Rimarchi, Stroppa, *Potential Regulatory Obstacles to Cross-border Mergers and Acquisitions in the EU Banking Sector*, EBA Staff Paper Series No. 7, February 2020.

(5) Report from the Commission to the European Parliament and the Council, on the Single Supervisory Mechanism established puruant to Regulation (EU) No 1024/2013, of 18 April 2023, COM(2023) 212 final, 18.

(6) High Level Forum on Capital Markets Union, *A New Vision for Europe's Capital Markets*, Final Report, June 2020, 9.

much financial power. In addition, politicians are obsessed by the idea that their nationals may be called to foot the bill of a banking crisis in another Member State, as if the lessons from the 2010 Greek crisis, and the tens of billions of German and French wholesale funding originally at risk in that crisis had not been learnt. In this vein, our never-ending discussions on the missing third pillar of the Banking Union and the (so far ill-fated) EDIS proposal, weighed against the ninety years of the US FDIC, add a sense of futility to our European polity. As said, EDIS and the credit line of the ESM are necessary components of the Banking Union which need to come. The sooner, the better. But the same is also true for interstate financial consolidation. And it is a pity to see several EU G-SIIs successfully completing these days buy-back programs in the range of billions of Euro, promising however to cancel the acquired shares, when those very same own shares if held in treasury would be an important ammunition which could be put to good use in interstate consolidation, if only the regulatory and institutional obstacles which still stand in the way of an active interstate market for corporate control, and which I will briefly consider below, would be removed.

5. With the innocence of a law scholar, it is therefore quite fair to discuss a possible way forward. A pragmatic and bespoke legislative initiative for cross-border banking groups and financial conglomerates, in the robes of an amendment to CRR and SRMR. This should comprehensively address their three stages of life: *birth and growth*, reflecting on an additional corporate tool for cross-border consolidation and on the virtues of an unfettered market for corporate control for financial corporates; *adult life*, addressing the need for cross-border group-wide capital and liquidity management in good times; *death,* giving legal certainty to the intricacies of group-wide upstreaming of losses and down-streaming of funds in the resolution context. All this may be done with simplicity, building on the existing legal framework, with selective, well-thought adjustments.

6. As to the birth and growth of interstate banks and financial conglomerates, let me raise three rapid points.

a) General company law provisions on cross border takeovers, cross border mergers and on the European company (SE) are good in the books but, once put to work as tool of choice to accomplish a complex cross-border bank acquisition, they make the transaction unreasonably difficult, uncertain, and costly. This invites the adoption, for financial corporates, of an additional tool, in the form of the US-like share exchange as a fast-track transaction for cross-border financial consolidation. Share exchanges were studied by the services of the European Commission in the preparation of the 2019 cross border mergers, demergers and conversions directive, yet, in the end, the draft provision was dropped from the proposal, not to open another front of political discussions. Those preparatory works show, however, that the share exchange could be made available for financial corporates with one single directly applicable provision in the Single Rule Book, and a few selective references to certain aspects already regulated in the 2019 cross border merger, demerger and conversion directive

(now included in the Consolidated directive on company law 1132/2017). As noted a few years ago by Luca Enriques (7) Share exchanges would also help addressing the German obsession with employees' participation ('*Mitbestimmung*'), because, unlike in a cross-border merger, in a share exchange the target company remains subject to employees' participation. A share exchange, moreover, would not change the identity of the participating banks, and would thus facilitate the continued use of internal rating models after consolidation: a prudential hurdle to full-fledged banks' mergers (8).

b) As a second consideration, financial consolidation needs an unfettered market for corporate control. For financial corporates, therefore, the breakthrough rule set out in Article 11 of the Takeover Directive should be made mandatory (whereas it can remain optional for non-financial corporates). A review of the Take Over Directive is long overdue, and this may be part of it. Dual share structures as those currently envisaged by the directive proposal on multiple vote-share structure for the growth market (9) may be helpful to nudge entrepreneurs in other sectors of the economy to go public; by contrast, entrenched minority coalitions via dual-shares structures in financial corporates would prevent hostile takeovers from taking place and in this way would delay or even derail interstate consolidation. For the same reason, also national public law barriers to interstate consolidation of banks and financial conglomerates should be ruled out. To this aim, it would be enough to insert a provision in Regulation (EU) 2019/452, conferring only upon the European Commission, in line with Article 21 of the Merger Regulation, the exercise of a fairly circumscribed golden power vis-à-vis transactions leading to interstate financial consolidation, so as to pre-empt national powers vis-à-vis banks and financial conglomerates.

c) In the prudential context, the ECB Guide 2020 has clarified that interstate consolidation does not necessarily require capital adds-on (10), and this has been a right move. Yet there are other less visible obstacles. Suffice to mention the prudential treatment of the parent's holdings in financial subsidiaries which are exempted from deduction from own funds under Articles 36 and 49 CRR and yet cannot rely on parallel, uniform exemptions from large exposures limits. Once the value of the holdings in the subsidiaries exceeds those limits, the exemption from the deduction may therefore prove partially useless. On this, there is still a piecemeal set of transitory national regimes (until December 2028) based upon the discretion granted by Article 493 CRR: some Member States grant a fully-fledged exemption for intra-group exposures for banking groups and conglomerates subject to supplementary supervision; some others do not exempt intra-group exposures within conglomerates; others do not even address the issue. This problem is further exacerbated by the fact that the parallel competent

(7) Enriques, *A New EU Business Combination Form to Facilitate Cross-Border M&A: The Compulsory Share Exchange*, 35 *U. Pa. J. Int'l L.* 541 (2014).

(8) ECB, *Guide on the supervisory approach to consolidation in the banking sector*, 2020, para 36.

(9) COM(2022) 761 final.

(10) ECB, Supervisory Guide, para 25 ff.; compare however Gardella, Rimarchi, Stroppa, *Potential Regulatory Obstacles*, 25 (also as to macroprudential buffers).

authority power of exemption under Article 400 CRR is pre-empted once the Member State has exercised, fully or in part, its national discretion, until the sunset of Article 493 CRR. Also limits to related party exposures allow for exemptions, but again these are mostly national, and this adds an additional layer of complexity and fragmentation. If interstate consolidation has to be taken seriously, a uniform solution is clearly necessary, also in light of Article 507 CRR.

7. As to adult life, prudential and company law obstacles to group-wide capital and liquidity management have so far delayed the process of interstate consolidation. This is economically not desirable. (11) The starting point for a reform would quite naturally be a revival of the ill-fated amendments that the European Commission's tabled in November 2016 to Articles 7 and 8 CRR to make capital and liquidity waivers for EU banks' subsidiaries available (or more widely available as to liquidity waivers) also cross-border. Yet, the conditionalities attached at the time to those original proposals (namely a collateralized guarantee) may be dropped today, if, in the words of President Roosvelt, "unreasoning fear and terror" are no longer the beacon.

8. This as such, however, would not be enough. A growing number of cases before the SRB's Appeal Panel and the General Court (12) has shown that there is a need for more, and namely few fairly detailed, directly applicable provisions to be inserted in the CRR and SRMR that could specify the precise legal undertakings, and safeguards, to be adopted at group level to ensure, in the words of Articles 7 and 8 CRR, 45(f)(3) BRRD and 12g and 12h SRMR that "there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities within the group". This should acknowledge the value-enhancing organizational gains embedded in interstate group structures, as already recognized by the CJEU in connection with the objectives of the internal market (13). This would also be in line with Principle 5 of the Basel Committee's Principles on Corporate Governance for banks (14) and would finally dispel serious ambiguities in national contract, company and insolvency laws, which have so far been an almost insurmountable obstacle even for domestic waivers. Confronted with the subtleties of highly relevant, yet not at all convergent, minute details of domestic laws the boards are often afraid to face liability in engaging in intra-group asset transfers under an entity-centric national company and insolvency law and the authorities are uncertain on the enforce-

(11) Le Maire, EUROFI Conference, April 2019.

(12) Compare in particular SRB Appeal Panel decisions in cases 2/2021; 3/2021; 1/2022; 2/2022 accessible at srb.europe.eu and pending Case T-540/22, France v SRB as well as pending cases before the SRB Appeal Panel 1/2023 and 5/2023.

(13) C-528/12, Mömax, ECLI:EU:C:2014:51, para 21; C-292/16, A Oy, ECLI:EU:C:2017:888; C-386/14, Groupe Steria, ECLI:EU:C:2015:524; C-524/04, Test Claimants in the Thin Cap Group Litigation, ECLI:EU:C:2007:161; C-311/08, Société de Gestion Industrielle, ECLI:EU:C:2010:26; C-382/16, Hornbach Baumarkt, ECLI:EU:C:2018:366. For an insightful discussion, Schön, 'Organisationsfreiheit und Gruppeninteresse in Europäischen Konzernrecht', *Zeitschrift für Unternehmens- und Gesellschaftrecht*, vol. 48, no. 3, 2019, pp. 343-378

(14) Basel Committe, *Guidelines on Corporate Governance Principles for Banks*, July 2015.

ability of intra-group support in the form of parent guarantees or similar arrangements under national contract and insolvency law. These uncertainties amplify tensions between home and host authorities and quite naturally translate into conservative supervisory approaches. An idea for a reform, bearing in mind the findings of the Joint Forum 2012 Report on intra-group support measures, would be to expand the scope of the legislative framework set out in Articles 19-26 BRRD for intra-group financial support agreements beyond the limited scope of early intervention and liquidity assistance of a solvent, yet liquidity constrained subsidiary. This would clarify a large number of substantive and procedural aspects, including necessary safeguards for minority interests and creditors. It is however also necessary to simplify and add flexibility to such provisions because both the 2020 EBA study and anecdotal evidence suggest that, so far and as they stand, there has been no great use of such arrangements by banking groups under Article 19-26 BRRD.

9. It is time to conclude. Let's briefly address therefore how interstate G-SIIs and financial conglomerates should die. Currently capital and liquidity waivers granted by supervisors are sometimes not mirrored by internal MREL waivers granted by resolution authorities. Indeed, impediments to asset transferability in a going concern may be different from those in a gone concern. Group resolution plans may therefore inadvertently add additional obstacles to interstate consolidation, and this would be exacerbated if tomorrow a group-wide integrated capital and liquidity management could be considered a potential impediment to resolution. Fear for the death may become an obstacle to live a life at its full potential. Article 12 g and 12 h SRMR should therefore better harmonize the specific conditions for the group arrangement necessary to ensure the validity of group-wide upstreaming of losses and down-streaming of funds in a resolution context, ultimately in the interest of creditors and of financial stability.

10. Let me conclude by saying that, as I dare to have shown, the only fear the next Commission should have is fear itself to complete the Banking Union and to foster the Capital Markets Union. Interstate consolidation of financial corporates has been so far a missed opportunity and one which would convert, in the words of President Roosvelt again, "retreat into advance". However, to prompt interstate consolidation, from a legal perspective, what is needed is a bespoke reform done with simplicity, building on the existing legal framework, with selective, well-thought adjustments. To my mind this is not out of reach.

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