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Table of Contents

The EU-wide stress tests: a storm before a “new order” of the financial market. The Italian case	6
---	----------

Francesco Capriglione

Mind the gap: Expectations on the role of UK non-executive directors	27
---	-----------

Jonathan Liu and Tomas Andersson

Managerial governance and transparency in public sector to improve services for citizens and companies	47
---	-----------

Nunzio Casalino and Adam Steinhouse

Bank recovery and resolution: an Italian point of view	60
---	-----------

Vittorio Santoro

The final seller’s right of recourse in a French-Italian perspective	72
---	-----------

Alejandro M. Garro and Ettore M. Lombardi

Financial information regulation and Emir principles.....	96
--	-----------

Susan Clements and Valerio Lemma

Open Review of Management, Banking and Finance

«They say things are happening at the border, but nobody knows which border» (Mark Strand)

The EU-wide stress tests: a storm before a “new order” of the financial market. The Italian Case.

by Francesco Capriglione

Abstract: European banks have been recently evaluated by the ECB *'stress tests'*, which verified their level of efficiency. The checks on the so-called 'systemic' credit institutions indicate their ability to face the difficulties caused by a possible new economic distress. Such an examination, designed 'to evaluate the health of the banks', was based on the measurement of the *capital* amount of the banks (*i.e.* amount of cash available for absorbing sudden losses), hired a benchmark for identifying the critical threshold to overcome risks. The analysis was not, however, purely a quantitative one; it also covered the quality of the assets held by the institutions at issue (the AQR). The estimates (linked to percentage calculations which's evaluations reflect an suitable consideration of risks) allow to detect the capital increases needed to avoid *impasse* situations in the event of potential, future crises. Additionally, the so-called Comprehensive Assessment (CA), conducted by the ECB, was activated: it identifies an important step towards the definition and effective implementation of the 'Single Supervisory Mechanism'; indeed, this form of prudential analysis is indirectly aimed at the restoring of banking stability conditions deemed to be equal for all the Eurozone systemically important institutions. The prudential analysis of Italian institutions creates a banking system in which – among the 15 banking groups under examination- the majority of banks have passed the tests only with very tight margins while Monte dei Paschi and Carige did fail in doing so. Therefore, we are facing a delicate moment in the history of the Italian banking sector, as it can be seen, among other things, from the obvious difficulties faced by the industry's incumbents forced (after the results were published) to proceed promptly to a large recapitalization.

Summary: 1. Introduction. – 2. The Stress Tests in the SSM logic ... – 3. *Continued:* ... the objectivity of the assessments. – 4. The results of the tests: the Italian situation. – 5. *Continued:* The Montepaschi case. – 6. *Continued:* The insufficient recapitalization of the banks participated by banking foundations. – 7. The Stress Tests and the SRM perspective. – 8. Conclusions.

1. The notification of the stress tests (on capital requirements of systemic banks) and of the AQR (concerning the qualitative evaluation of the assets) made by the ECB on the eve of the introduction of the SSM, has appeared to be catalyst for the growth of tensions that result in unjustified

reactions of the domestic supervisory authorities, unwilling to accept a judgment that disapproves their *agere*. On the one hand, we know the results of the stock market trend, which in some countries (e.g. Italy) have shown significant (negative) differences in comparison to other European «Markets»;^[1] on the other hand, we see the reactions of the national supervisory entities that may have felt the need to justify the adequacy of certain ‘supervisory policies’ adopted by them to face the «failures» of some credit institutions^[2].

For a complete evaluation of the importance attributed to the stress tests it is important to move from the identification of the objective to which are prearranged the checks imposed by the ECB at the base of its judgments on the so-called systemic credit institutions. In this regard, one should consider the need to assess the banks’ resilience to possible new economic crisis as one can acknowledge from the serious consequences of the recent financial breakdown that severely hit large part of the planet. We are in the presence, therefore, of an examination oriented towards «evaluating the health of banks, identifying those which are actually in distress»^[3]; this evaluation focuses on the measurement of the amount of “capital” of the banks (i.e. amount of cash available and usable to absorb sudden losses), taken as a parameter for the identification of the critical threshold to overcome risks.

This analysis, however, cannot be conducted purely in quantitative terms as it is extended to cover also the quality of the assets of the entities under observation (the above mentioned AQR). Such evaluations (consisting in percentage calculations in which risks are adequately weighted) allow a punctual identification of the capital increases that are necessary to avoid *impasse* situations in the event of possible future crises.

Thus, the so-called *Comprehensive Assessment* (CA) is activated: controlled by the ECB, it identifies an important step towards the definition of an ideal framework for the ‘Single supervisory mechanism’, since it aims at creating positive conditions and solid capital assets, which shall constitute a ‘starting point’ for all the Eurozone systemic institutions. Hence the close link between the need to pass the stress tests with favorable results and the possibility of a correct adhesion to sound and prudent management standards that will be indicated by the competent authority.

At the same time, there is no doubt that the evaluations in question become a crucial requirement (and appear destined to be an integral part) of the assessments designed for the proper adoption of those tools for bank crisis management and resolution set out in Directive BRRD (Bank Resolution and Recovery Directive) n. 59/2014/EU and Regulation n. 806/2014. It must be borne in mind that the European regulator has defined the link between the Single Resolution Mechanism and other measures preordained to verify the quality of the assets or the resilience of credit institutions in the event of financial and economic distress.^[4] As noted elsewhere, we seem to refer to a single *command center* on banking and monetary areas, to which follows the expectation of an optimal design of banking supervision (i.e. able to guarantee the liquidity and resilience of credit institutions even in times of market distress).^[5]

That said, the concerns recently expressed by Angela Merkel, when evaluating the challenge faced by the ECB in assuming the burden of a valid check on the health of a large fraction of the Eurozone’s banks appear justified. Additionally one should consider the ‘reputational risk’ faced by that technical authority while performing these assessments; a risk that – according to the careful analysis of the German Premier – could adversely affect the «*confidence of international markets in the European banking system*».^[6]

2. The disciplinary provisions that identify the objectives of the stress tests and regulate their application methods clearly show that the assessments in question represent a preliminary phase of the so-called “common procedures” in which all European financial intermediaries are equally involved in view of the implementation of the EBU. Hence, we recognize the inescapable *fil rouge* that binds the outcomes of these investigations to the goals that the European regulator is supposed to reach with the implementation of the European Banking Union in order to make a decisive ‘turning point’ in the ongoing integration process.

The in-depth analysis underlying the stress tests allow the ECB to improve the knowledge of the ‘adjustments’ made in the accounting departments of systemic banks and, therefore, the ‘amounts’ included in the balance sheets and/or capital requirements relevant for supervisory purposes[7]. It is clear how it becomes possible, in this way, to optimize the performance of banking supervision which ECB has undertaken since November 2014;[8] not surprisingly, in Council Regulation No. 1024 of 2013, among the tasks specifically assigned to it “concerning policies relating to the prudential supervision of credit institutions” the ECB is expected to assume – in coordination with the EBA – the evaluation of the «stress tests and their possible publication in order to determine whether the arrangements, strategies, processes and mechanisms put in place by credit institutions and the own funds held by these institutions ensure a sound management and coverage of their risks» (Art. 4, lett.f).

On this matter we highlight that, in the disciplinary logic of the mentioned regulation, the prevention of stress must result in an intervention suitable to ascertain the availability of ‘liquid assets’ sufficient to overcome difficult situations to which credit institutions may be exposed (recital. 23); intervention that takes into account the need to provide «additional capital buffers», with anti-cyclical function «to ensure that credit institutions accumulate, during periods of economic growth, a sufficient capital base to absorb losses in stressed periods» (recital n. 24). The result is a close link between the perspective of configurable structural changes required to credit institutions for purposes of prevention and the enforcement to the same, in the outcome of the checks in question, of «specific additional own funds requirements, specific publication requirements, specific liquidity requirements and other measures» (art. 4, lett.f, last part).

Certainly, the prospective analysis of banks’ solvency – built with reference to a range scenario hypotheses and subject to the use of the information provided by AQR – contributes to the identification of the ‘prudential measures’ which are adopted by the European authorities. Undoubtedly, also the possibly positive future results of the efforts undertaken by the Single Supervisory Mechanism are linked to the success of this exercise!

It goes without saying that, technically, the tests start from the rules of the regulatory package called CRD IV and CRR (consisting of the Directive 2013/36/EU and the EU Regulation no. 575/2013), in which we find the requirements imposed by Basel III (concerning capital, risk measurement, levels of leverage and liquidity, as well as organizational and management policies on the subject of *governance* and *enforcement*).[9] Similarly, the architecture of the European financial system, in doing these assessments, involves a variety of institutions (competent domestic authorities, the European Banking Authority and the European Central Bank), from whose ‘collaboration’ depends the successful conclusion of the scheduled assessments.[10]

From another perspective, it should be noted that these assessments aim at increasing the transparency

of the business reality, as it is given to understand from the ‘quality’ of the information (relating to the situation of credit institutions) taken as a requirement for the request (made by authorities) of corrective actions (necessary for the resolution of the problems identified). This hypothesis concerning the positive consequences of the stress tests is confirmed by the indications (in this field) provided by the EBA in the well-known document of the 26th October 2014 disclosing the «results of 2014 EU-wide stress test». Indeed, the abovementioned authority – after pointing out that this procedure allows «a rigorous assessment of banks’ resilience under stress» to be achieved following a «common methodology» for the definition of the ways in which «banks should calculate the stress impact of the common scenario bottom-up» – points out that the stress test is focused «on providing consistent transparency as a complement» and, therefore, does not replace the prudential supervision «of banks’ internal models for the calculation of capital requirements».

The verification of the ability to overcome situations of greater economic distress allows, in fact, the supervisory authority to evaluate in a more precise fashion the ‘truthfulness’ of the banks’ balance sheets. Having consolidated reports on the banks’ core components (i.e. the evolution of assets, credit flows, hedges) the Supervisory Authority can properly identify the total value of the exposures, the maturity and the combination of the products, activating an evaluation process that abandons the static calculus of the accounting data and uses a dynamic computation of information flows (in which the variations occurring in the presence of crisis events are reported). Hence the possibility of adopting specifically adapted prudential criteria, i.e. able to investigate connection between the projections prepared by the credit institutions and the effectiveness of the results achieved by them.

Additionally, banks may recur to capital ‘adjustments’ resulting from the assessments that have highlighted the need for remedies to be adopted despite the non-compliance with the accounting rules for credit institutions. A large part of bank statements is subject to the accounting audits of the stress tests, which can be complemented by ‘additional measures’ ranging from the use of impairment to the calculation of specific provisions (made on an individual basis), to the valuation of the guarantees. In other words, room is given to additional protective measures, aimed at correcting the discrepancies related to possible, inadequate representations of accounting records.

At a general level, there are favorable conditions for the harmonization of the ‘statistical reports’, due to the implementation of ‘unique management system of information flows’. Great importance is given to the role of the ECB, as head of the SREP (*Supervisory review and evaluation process*), allowing it to review the adequacy of the levels of capitalization and liquidity of banks and eventually request – if these levels are considered inappropriate – the assumption of appropriate corrections or directly impose (with apposite actions) corrections.[11] Then, we find the conditions for a renewed trust in the market by those who seek the introduction of market-securing protections for the management of adversities resulting from possible new financial crisis situations.

It follows the positive importance attributable to the intervention in question, intended to fix the deficiencies of a company that fails in predicting the exposure to possible future risks. This identifies a further strategy to overcome the difficulties and diversities that, nowadays, characterize the European Union; and indeed, adds a significant element to the preparation of a technical project aimed at creating a banking supervision oriented towards the harmonization of operating situations and, therefore, suitable to strengthen and improve the coordination and cooperation between the Member States.

3. The specific reference to the stress tests in EU Regulation n. 1024 of 2013 allows the identification of the latter as a structural component of the ‘single supervisory mechanism’, as we have tried to highlight in the previous pages. Therefore, the prudential estimates in question are designed to complete in the *continuum* the acquisition of the informational data provided by banks to the head-authority of the European financial system.[12]

We have already pointed out the effects of this prospective analysis, highlighting how it becomes a primary factor in the judgments, which impose «specific obligations of additional capital» to credit institutions; hence its importance in the definition of the capital plan of those who do not pass the test. It is now important to emphasize the *objective* nature of the assessments made by the European authorities, to which must follow a ‘rightful’ acceptance by the institutions affected (and the competent national authorities) without unjustified concerns. However, banks have to consider that the methodology on which the tests are based reflects the criteria of uniformity and impartiality required for the construction of an advanced supervisory mechanism, as the one introduced with the EBU’s creation.

Undoubtedly, the fairness in testing the systemic banks is guaranteed by the *independence* with which the central structures of the ECB conduct the assessments in collaboration with the NCA and the EBA, which has also defined the methodology jointly with the ECB and the European Systemic Risk Board (ESRB), as previously mentioned. Therefore, it can be said that the results are the outcome of a critical analysis in which all specific issues that may arise during the tests are taken into account. The highly skilled profiles of those professionals running the assessments should not cast doubts on the consistency between the tests’ outcomes and the real capital conditions of the banks under examination. Naturally, this form of control refers to the need for an operative logic oriented towards a correct *agere* which makes it possible to comply with the criteria of ‘management commitment’ specified by the European regulator and linked to a « banking supervision across the Euro area (that abides by high common standards».[13]

This results into a disciplinary construction highlighting the need to align the activities of credit institutions to the criterion of the “sound and safe management” which – as widely acknowledged – aims at overall stability, efficiency and competitiveness of the financial system.[14] It goes without saying that – in relation to our discussion – systemic banks are eventually obliged to cooperate in both the assessment processes and results’ collection , by following homogeneous behavioral guidelines (*i.e.* equal for all, with no time limits or exceptions whatsoever). Hence, stress tests play a crucial role in a legal system that should rely upon the seriousness of the incumbents, and the intrinsic efficiency of the technical forms (*i.e.* the mechanisms at the basis of the procedures in question) needed for the attainment of the targeted objective (the sound and prudent management).

In this context, it is clear how the *checks in question* have to capture the business reality of a specific bank only in terms of economic and capital-related data, without ; any ‘exception’.. Otherwise, the principle of equal positions of banks would be invalidated; these institutions – within the financial market outlined by the SSM – must pursue the objectives of uniformity and equality. Such a purpose relates to a prospective of higher ‘levels of competition’ (and of convergence), which should promote innovative sharing forms and, more in general, the creation of conditions of stability and progress.[15]

It follows that the *test*, having objectivity as its main feature, must not certainly take into account the fact that some banks have been able to benefit, in past times, from government ‘aids’ which allowed their bailout, protecting them from possible failures in recent assessments provided by the European

authorities.[16] Furthermore, the fact that certain banks have performed activities in an unfavorable macroeconomic situation cannot justify an hypothetical negative judgment (as contained in the test); this possibility definitely identifies the cause of a deep operative lack and cannot be taken into account in order to contain (or even exclude) a deterioration that the prudential analysis must calculate.

In such a perspective, it must be considered that in the near future banks will no longer be permitted – as instead previously used to happen- to exploit estimate methods capable of avoiding a consistent (and sometimes penalizing) transposition of capital measurements into the financial accounts.[17] More broadly speaking, it should be pointed out how the rigorous orientation imposed, through the stress tests, by the European authorities, will mark a major ‘trend change’ in the supervisory policies so far followed by some Member States (see, in particular, the ‘Italian case’). The expectations for permissive treatments, sometimes practiced by some supervisory authorities in favor of certain credit institutions (due to their big size), seem to have finally failed! Therefore, the procedures we are dealing with are assumed to produce a clear beneficial effect when applied to the modalities of banking supervision thanks to which the industry’s incumbents will be able to benefit from a real fair treatment, no longer discretionary and less linked to a slavish application of the *too big to fail* principle!

4. In light of the foregoing it is possible to examine the reactions (that follow the notification of the results of the stress tests) encountered in the ‘Italian system’, that among the countries of greatest importance, recorded the highest number of failures.[18] Of course, a thorough analysis cannot ignore that the reactions in question – though understandable for the emotional input caused by the critical level of the Italian banking sector (certainly higher than those of other Member States) – affect the way in which the national credit institutions participate to the ‘single supervisory mechanism’.

We have already mentioned the climate of *unjustified fears* (of the intermediaries subject to the new form of supervision) in the ‘Italian System’ just before the introduction of the SSM; fears that could have led to interpretation uncertainties regarding the legal criteria of the ‘Single Supervisory Mechanism’, so that the National Supervisory Authority felt the need to enact a special measure aimed at pointing out the terms of the important turning point that changed the order of the banking market.[19] Consequently, some considerations on the legislation adopted at European level were made in order to give an authentic interpretation, so as to clarify the change performed in the banking and financial sector.

This measure – published after the announcement of the results of the stress tests – seems to be, in some ways, the answer of the National Supervisory Authority that, in all probability felt questioned, wherever there is the possibility of an inadequate preventive action taken by this authority. Maybe this is the answer to the question, raised by several parties, concerning the possibility to achieve a different ‘report card’ if the authority had intervened on time, avoiding that the ‘health’ of some banks degenerated to the point of not allowing them to pass the examination of the stress tests.

For real, the subjective reference framework highlights a banking reality that is difficult to consider to be in «good health»! Although not agreeing with the critical remarks made on the subject in question, in which Italy is classified in a very negative way,[20] certainly one cannot fail to mention that the prudential analysis under examination establishes, as we have just explained, the creation of a banking system in which – from a complex of 15 banking groups monitored – in addition to the two failures of Monte dei Paschi and Carige, is detected the fact that other institutions have passed the tests only with very tight margins.[21] Therefore, we are facing a delicate moment in the history of the Italian banking

sector, as it can be seen, among other things, from the obvious difficulties faced by the members of the industry forced (as a result of the publicizing of the test) to proceed promptly to a large amount of recapitalization.[22]

In the outlined context the declarations made by members of the national supervisory authority, to which the press gave wide attention, take on the tones of an (unrequested) justification of the reasons that caused the fragility of the 'Italian system', characterized by a situation in which – it is good to recall it – «nine are the banks ... initially shot down; they become four if you exclude those which have already strengthened their assets between January and September, and then down to two when considering other asset strengthening operations computed at national level by the Bank of Italy».[23] Hence, here is the perceived need to calm down, to point out that the results of the assessments in question are «overall reassuring», since the test imposed by the ECB and the EBA has regard for a «very unfavorable scenario», also considering the fact that it is «specially constructed to be a true resistance test for banks in extreme situations».[24]

It does not seem like enough importance is given to the fact that the Comprehensive Assessment (CA) driven by the ECB identifies an important step towards the definition of conditions suitable for the activation of the 'Single Supervisory Mechanism'; and indeed, as we have pointed out previously, through this form of prudential analysis there is an inclination towards the creation of banking stability conditions equal for all the Eurozone systemically important institutions. Similarly, the tacit reference to the government support received by some banks in EU countries appears scarcely convincing, whereas the Italian system «was able to stand on its own feet without the need for substantial public interventions»; certification that neglects the objective nature of the stress tests, in which is evaluated the current information of the credit institutions in observation, without any reference whatsoever to how and when the conditions that at present allow the formulation of a positive opinion towards them have been determined.

Actually, such reassurances highlight the clear intent to instill credibility into the sector, that in itself is a difficult and problematic picture (regarding the link between the slowing down of growth and the capitalization of banks). The call for strictness in the criteria adopted towards the Italian macroeconomic reality – while responding to the 'saving logic' adopted on the occasion by the national supervisory authority – does not fully meet the needs of those who, conversely, appreciate the rigor of these tests, as a fundamental tool to adequately test the ability of credit institutions to achieve satisfactory levels of capitalization (and, therefore, their ability to overcome future crisis situations).

5. The 'Monte dei Paschi' case represents the symbolic aspect of a banking system that – despite the morphological changes underwent by its members by the Europeanization process in the recent decades – was unable to promptly free itself from the obsolete pressures of the 'politics', which – in this situation – held steady over time a link with the 'finance', that only recently seems to have finally been broken.

We hereby bypass any consideration on how the relationship between the MPS Foundation and the assignee banks has influenced the assumption by the latter of management strategies that have led to the deterioration of the economic and capital consistencies of this leading Italian banking group. We are in the presence of a story in which it is difficult to identify the responsibilities of those who have contributed to a complicated tangle that resulted in *mala gestio*, cause of imbalances and serious

business losses; the fact that the behavior of some of the Monte dei Paschi exponents is still under judiciary review (which takes advantage of a close cooperation with the Bank of Italy) that identifies the sad ending of «an uncontrolled public-private mingling that ends at the same time with the enslavement of the public interest and denying market logic».[25]

Conversely, we here want to consider the process of the events that underlie the negative results for MPS in the stress tests piloted by the European Central Bank.

It is now necessary to take look at the evaluations made by the National supervisory authority regarding the lack of «requirements» for the compulsory administration of MPS; evaluations remitted by the Italian legislator to the technical discretion of the supervisory authorities, which shall ascertain their possible existence. On this point, are detected the indications contained in a statement that some time ago the Bank of Italy made on the subject; one refers to the implicit exclusion of the requirements of the procedure in question that can be deduced from the fact that the mentioned supervisory authority considered it to be adequate and sufficient, for what concerns MPS, to proceed to « in close cooperation with the new management, which is currently implementing a comprehensive restructuring with a view to boosting efficiency and restoring adequate profit levels. ».[26]

It must be remembered, however, how this orientation of the Supervisory Authority dates back to November 2011, when the Board of the Bank of Italy, called the highest levels of the institution and of the foundation in order to make them face their responsibilities; the Bank of Italy asked these « to quickly and definitively turn around the way it conducts its business » and, therefore, to replace the top management of the bank; solution considered to be optimal in order to avoid the disruptions that would likely derive from a different interventional option.[27] Moreover, the decision to authorize the issuance of the so-called Monti Bonds was a confirmation of the will not to start the ‘special administration procedure’; the issuance of these bonds was designed to support, technically, the operations of the bank and, therefore, to allow the directors to overcome the difficulties faced at that time.

This guideline was not greeted with unanimous consent; in fact someone – since after the « highly critical » inspection report of the Bank of Italy (in which were contested to the bank, «serious shortcomings in its liquidity management») «a sanctioning procedure» started towards its management[28] – has severely criticized this behaviour. As it is easy to understand from the statements by Mr. Tremonti on the MPS case «there was neither deterrence nor repression. The judiciary... intervened, not the Bank of Italy. It is a very serious situation» as on a substantial level the Supervision «has denied being vigilant, has taken a minimalist profile»[29]; thesis to which seems to echo the survey, initiated by the judiciary, «for the possibility of failure of the vigilance by the Bank of Italy and Consob».[30]

However, this decision not to proceed with the compulsory administration of MPS, despite its undeniable capital deterioration (today implicitly recognized by the rejection by the stress tests), was, as pointed out before, conditioned by the possible reference to the inevitable critical consequences that might have had on the entire Italian banking sector following the adoption of a special administration procedure; that with the result of an obvious reputational discredit of the entire national system, therefore, an increase in extra difficulties in addition to those induced by the recent financial crisis.

That said, there is no doubt that, from the earliest evidence concerning the capital shortfall of MPS, the supervisory authority could have enabled different forms of reorganization from compulsory

administration; encouraging , for example, a merger between this bank and other financial institutions adequately capitalized. As we have already pointed out, an intervention of moral suasion of the Bank of Italy in this situation would have been in line with other practices already tested in the past and, in all probability, would have proven itself suitable to permanently solve the problems that now afflict the Sienese bank, which (through the integration with some other institution) would have expanded its level of capitalization presenting itself to the market in new ways.[31]

More complex is the position taken by the Supervisory Board in the assessment of the refinancing operation of MPS after the issuance of the so-called Monti bonds, as stated in .L. D. July 6th 2012 n. 95, converted with amendments by the 7th August 2012 Law, n. 135. In this regard it should be noted that, in accordance with art. 23-sexies of this decree, «the Ministry of Economy and Finance... on specific request by Banca Monte dei Paschi di Siena S.p.A.... and subject to the conditions laid down in Articles 23-septies, paragraph 1, 23-octies and 23-novies... subscribes, until the 31st December 2012... financial instruments... computable within the capital for supervisory purposes (Core Tier 1) up to the amount of two billion euro. Moreover, are subscribed « new financial instruments for the additional amount of one billion nine hundred million euros to fully replace» the ones issued by MPS and «subscribed by the Minister accordingly to art. 12 of the .L.D. November 29th , 2008, n. 185, converted, with amendments, by the Law 28th January 2009 n. 2 ».

The legislation just mentioned, in dictating the regulation of these «rescue tools», calls for the intervention of the Bank of Italy subordinating «procedurally, the subscription» in question to a «positive assessment» of the latter (art. 23-novies, paragraph 4). This assessment, as was pointed out by a careful doctrine, has a «complex content that invests profiles of legitimacy and intervention worthiness», having as an objective the ‘restructuring plan’ presented by Monte dei Paschi di Siena.[32] In particular, on one side, comes into consideration its compliance «to the European normative on State aid, as required by Article 23-octies and by the supervisory provisions» (see paragraph 2, letter. a); on the other, the appropriateness of the restructuring plan related to ‘the risk profile of the issuer’ (art. 23 novies, paragraph 2, letter. c) and its ‘current and future capital adequacy’ (letter. b) is evaluated.

It’s clear that the positive opinion by the Bank of Italy – on the feasibility of the restructuring plan – referring to the «current and prospective capital adequacy» of the credit institution, should have turned to an analysis intended to verify its ability to reabsorb «the capital gap... requirement for public intervention» whose «commensuration... (was in fact)... up to the Authority», as precisely noted by the doctrine mentioned.[33]

In light of this legal framework – oriented towards ensuring the correctness of the MPS ‘restructuring plan’, and the modalities of its execution – it is not understandable why, at present, the stress tests indicate a situation still deteriorated; almost as if the first analysis taken at the beginning of the recovery program was not properly carried out, as if some deficiency occurred in the implementation of the ‘plan’ or in the following phase (concerning its regular execution and, therefore, the compliance with the regulatory requirements that have disciplined the means of its implementation). In both these cases the ‘complexity of verifications’ to be made – confirmed by the intense correspondence on the subject between the Bank of Italy and the MEF[34] – certainly cannot be considered an excuse for not taking the rightful responsibility for the tasks in this case attributable to the National Supervision Authority. The clear difficulties arising from the peculiar structure of the transaction in question do not seem to be able to justify an interventional guideline that has not produced satisfactory results, as it can be inferred

from the outcome of the ‘tests’ arranged by the European authorities!

But there is more. The convertibility of the securities in question – disciplined by the legislation for the case in which the Monte dei Paschi had not been able to return the loan underlying the subscription of the Monti Bonds – was an important way out of the *impasse* situation that characterized and characterizes the bank in question. Indeed, the possibility for the State to become a shareholder could have produced the beneficial effect of limiting the amount of liabilities (considering the size of the interest payable), and would have enabled a form (albeit partial) of recapitalization.

The transformation of the MPS debt into a shareholding position introduced, therefore, an option that could solve the current problems (excessive leverage and lack of capital); hypothesis, moreover, clearly represented in literature highlighting that «Monti bonds provide an alternative solution to the research, on the market, for resources to strengthen the capital base of the Sienese Institute (and, in particular, the Core Tier 1 levels)»[35]. This suggests that the adoption of such a decision would have allowed the reach of the minimum capital required by EBA, in view of the concrete restoring of profitability. Conversely, the openness to a «nationalization» of part of the the bank- although it might have seemed anachronistic as *against* the evolutionary process of the Italian financial system[36] – would have been in accordance with what was experienced in similar interventions in some EU countries (for example, the nationalization of the Royal Bank of Scotland), as well as with some regulatory guidelines that provide for different «resolution plans» from the traditional procedures of extraordinary administration.[37]

In light of what has been said on the Monte dei Paschi case the critical evaluations formulated by several parts regarding the ‘conditions’ of the Italian banking system are definitely justified. Conversely, it is certain that the intervention of those leading the European Financial System – in presence of obvious limits in the domestic supervision – is able to ensure the controls necessary to deal with the change that the evolution of the EU regulation has brought to the process of integration among the Member States.

In this context, the stress tests seem to be needed; accepting their indications, following their suggestions, means expressing the knowledge that only the steadfast commitment to the results of the prudential analysis steered by the ECB may permit greater growth and cohesion within the Union. At the same time, it is understandable how such a behavioral guideline identifies a significant moment of the difficult path which, in the hopes of many, should lead to the essential cultural maturation for more intense forms of community participation, i.e. able to mark the transition from economic to social integration.

6. The rejection of Banca Carige (ordered by the stress tests) identifies a situation in which the current capital shortage faced by this credit institution (due to a previous *mala gestio*) has its roots in the degenerative aspects of the linkage that – following the so-called ‘Reform of the public bank’ – has characterized the relationship between the ‘foundations’ governed by the Carli-Ciampi Law (L.D. no. 153 of 1999) and their ‘assignee’ banks.[38] In the previous chapter we have already mentioned the ‘strange story’ (as defined by Giorgio Oppo) of these entities and, in particular, the negative implications of the link between politics and finance. Now should be examined the way in which these foundations – based on a distorted interpretation of their role – keep ending up with conducts that do not accord with the capitalization requirements of the ‘assignee’ banks and, therefore, become, albeit indirectly,

draining factor of their development.

We do not consider at this moment the causes which, in the recent past, have determined serious problems for Banca Carige, due to a management characterized by the hegemonic role of the chair (currently being examined by justice).[39] Conversely, it is noticeable that, according to the assessment of large losses,[40] the banking supervision authority has forced this credit institution to proceed promptly to a significant amount of capital strengthening;[41] to which, in view of such recapitalization, corresponds the proposal by the Carige Foundation to give priority to a «disposal plan», foreordained to «minimize the effort required for members to reach ... (the goal) ... imposed by the Bank of Italy», as pointed out by the press.[42] Therefore, the outcome was a renovation project of the 'assignee' bank, correlated to the expectation of a gradual reduction of its ownership shares held by the Foundation; reduced, at first, from 46% to 19% («to participate in the Carige capital increase of 800 million), whereas more recently it was suggested to «place a further 7% (already approved by the MEF) on the market, but possibly ... (a larger share) ...right up to 14 % ».[43]

The circumstance described above allows us to identify the details of a situation – unfortunately very common- which sees the banking foundations outstretched towards the preservation of an important position in the ownership of their bank, with the purpose of affecting its governance. This objective is vigorously pursued; i.e. without taking into account the difficulties which they may meet (because of their limited financial resources) or, therefore, an eventual reduction in their shares, in order to reinvest the results of the dismissing in the operations of capital increase, rather than in the reduction of existing debts (assumed with a plurality of creditor subjects).

It is clear how, in such cases, the strategic decisions to be taken are guided by the intention of exercising one's own opinion in the selection of the members of the 'assignee' bank (if necessary through 'shareholder agreements' with the purchasers of the shares sold or with subjects in possession of equally relevant investments). However, the fact that we are in the presence of options destined inevitably to conflict with the principle of 'separateness', referred to in Law n. 218 of 1990 (and in the relative implementing decree n. 356), considered by the Italian legislator as crucial in order to prevent foundations from influencing assignee banks ; principle then reaffirmed in special regulation with Legislative decree n. 153/1999 that – in completing the privatization of public banks – linked it to the way by which the foundations are placed in a reality aimed at balancing the relationship between market economy and social rights protection.[44]

More specifically, one should consider the inconsistency of these strategic decisions with the disciplinary logic of decree n. 153, in which particular importance is given to the assets of the foundations in its (functional) connection to the purposes that they pursue and, therefore, to their operations. According to a relevant doctrine, in referring to the so-called banking foundations, «the composition of the assets and the destination of the income, as well as... (the) ... administration and management criteria are defined by law» regard the fact that the application of common law rules alone would not have assured the punctual realization of their institutional goals, nor the disposition of the assets to the latter.[45]

Undoubtedly, the legislator – while regulating the foundations – wanted to assure them a financial autonomy enabling them to promote their social activities. For this reason, they are obliged to diversify «the composition of their activities»; and recently also the Governor of the Bank of Italy stressed that the foundations must accomplish such a duty even when they participate « capital-raising operations,

thereby contributing to the solidity of the banking system in the most difficult phase ».[46]

Consequently – and regardless of the evaluations regarding the economic *rationale* of the sale operations made by the institutions in question – we cannot agree upon the choices of a foundation that, arranging the sale of part of its shares (held in the assignee bank) has the objective of maintaining however a residual part (of any importance) for the purposes indicated above. . This holds true especially when that strategic line is applied in a context that does not observe the criterion (arranged by special legislation) to exclude forms of substantial ‘centralization’ of the capital (of these institutions) in the sole banking participation; in fact, often in disregard of the above-indicated principle of diversification, one fails to consider the obligation to consider for all the components of the balance sheet (without excluding the negative implications arising from debt exposures that may exist, with obvious, heavy impact on the assets).[47]

In this context, the Supervisory Authority was proven to have a ‘wait and see’ approach. Such an authority, in fact, in the Carige Bank case, should have indicated, already at the first request for a capital increase, a different, larger amount of capital (in line not only with the actual consistency of the financial statements, but also with the new AQR and *stress tests*’ perspective). Instead, by overlooking such a request, the Foundation was indirectly allowed to postpone the solution of the problem (i.e. the recapitalization of the bank), with the consequences today highlighted by the stress tests.

The shortcomings of the supervision system of banking foundations, due to the limits of the legal framework in force (oriented, predominantly, primarily towards the verification of the modalities with which the foundations pursue the statutory purposes) are to be considered. The legislator will have to intervene, in the short run, in order to avoid misleading interpretations concerning the relationship between the so-called banking foundations and their assignee banks . The events herein examined urge a more complete definition of this relationship, so as to prevent unacceptable discordances of the *agere* of the foundations and conform actions to guidelines more consistent with the objectives targeted by the Italian legislator since twenty years ago, when the reform of public banks was launched.

7. A theoretical link between the assessments carried out by the stress tests and the application of the management and resolution tools for banking crisis, as said in Directive BRRD (*Bank Resolution and Recovery Directive*) n. 59/2014/EU and Regulation No. 806/2014, has already been discussed. At this point, It must be explain the way in which, according to the European legislation, the ‘assessments’ at issue assume a correct use of the aforementioned procedural schemes.

In this regard, it is necessary to keep in mind that the resolution mechanism set out by the latest EU regulation is designed to outline the different reactive capabilities of credit institutions, by using a range of tools against actual events of pathological situations encountered among the EU Member States. As pointed out elsewhere, the European regulator aimed at preventing that the domestic nature of the authoritative interventions might be indirectly cause of their inadequacy in addressing the criticalities of an operational reality predominantly consisting in a cross border arena. In the light of this perspective, the setting up of a unified guidance appears makes possible the achievement of the enforcement of the crisis prevention options.[48] Therefore, the SRM plays a major role amongst those regulatory innovations that, through the harmonization of practicable procedures, redefine the prevention techniques, ensuring greater stability to the financial markets.

Besides these premises, we acknowledge how the systemic setting up of such remedies is based upon the identification of certain scenarios, characterized by events of crisis, in order to «minimize the negative repercussions», as stressed in recital. 41 of Directive BRRD. Not surprisingly, the legislation provides that the mechanism at issue can only be started when the competent authority assesses that «the institution is failing or likely to fail»; and that the implementation of alternative measures will allow to avoid «in a reasonable timeframe» this possibility (recital n. 41). Hence, on one hand, it follows the specification of factual hypotheses in which situations of instability can be figured out , as well as the representation of a wide range of cases (arranged to give substance to the objective of outlining a «credible recovery framework») where a number of difficulties in which a credit institution may incur are highlighted (i.e. the possible violation of the requirements to maintain the authorization, the likelihood in the near future of being unable to pay its outstanding debts; need for an extraordinary public financial support, etc.). On the other hand, it is now possible to figure out scenarios that justify the application of such instruments .

As a matter of fact, this legislation is clearly focused on the effectiveness of cognitive processes that allow the collection of informational data to which is the activation of the procedure at issue is reconnected. In the same direction is oriented the timely provision of art. 32 of the Directive n. 59/2014, in which the concrete satisfaction of the procedural requirements is subject to the acquaintance (by the authority) of the ‘conditions for its resolution’. In particular the fourth paragraph of that provision is deemed to specify the variegated ‘situations’ that make it possible to consider an «institution failing» or exposed to this risk; situations characterized by the presence of objective factors triggering (in perspective) possible violations of the requirements needed to maintain the authorization, thereby justifying the authority intervention for revoking.

There is no doubt that, once faced this disciplinary reality, the stress tests application assumes special significance. Indeed – as it can be understood from the previous pages –the prudential analysis, underlying them, brings a significant contribution to the cognitive process referred to above. This is further confirmed by the European regulator itself, given that the use of such tests is even recalled in its capital adequacy assessments to prevent the likely risk of «instability».

In other words, it appears likely that in the regulatory order of the SRM the reference to the scenarios drawn by the tests is at the basis of the assessments needed for the application of the ‘single resolution mechanism’ and ending with the adoption of the latter. But there is something more. The insights giving substance to the ‘assessments’, according to the objective that qualifies its essence, are – in our opinion – an inescapable *prius* in the research (belonging to the macro-prudential authorities) of measures (or rather: tools) capable to preserve the financial stability in the context of systemic crisis, which results in the possibility of a negative impact on the solvency of credit institutions.

On a general level, the link between the stress tests and the new legal framework arranged by the EU regulation for the resolution of banking crisis, allows for a further enhancement of the positive impact that these are able to exercise on the balance sheets recovery of those institutions belonging to the financial sector. This applies, specifically, to the possibility, allowed by the SRM, to use alternatively the «sale of business tool» , the « asset separation tool» (bad bank), the establishment of a «bridge institution» (bridge bank) and the adoption of the «bail-in» (art. 37 of Directive no. 59/2014); all these measures are applied independently from any interventional logics based on the discretion of the

supervisory body; this consideration proves alone the conceivable benefit disposed by the application of these remedies in helping to depict the objective reality of the credit institutions business under observation.

The above innovations brought by the European legislation to manage banking dysfunctions denote a significant convergence with the object of our examination. Indeed, the latter – being intended to survey the operational distortions that may determine capital deteriorations – responds to a purpose mostly similar to the one underlying the regulatory mechanisms of the SRM; that is, the aim to limit the externalities of *mala gestio* and, therefore, «to restore its economic sustainability after its re-organization and restructuring».[49] This means taking a significant step forward in getting rid of those ‘events of socialization of losses’ that, characterized, in the past, the ways in which the Italian supervisory authority used to close the procedures of banking crises management!

8. At the beginning of the 1980s, in addressing the issue of ‘Banking Supervision’ and assessing its purpose in the pursuit of «optimal functioning forms» for the credit system, I stressed the need for an adequate «coordination between the interventional instances and the respect of the autonomy of the banking business» as essential corollary of a viability consistent with principles of the competitive environment.[50]

At that time, it seemed to me that this objective had to be related to the exercising procedures of the supervisory power, stressing the need to firmly grasp «a principle of non-interference of the Bank of Italy within the choices of the banker». In an historical moment characterized by a significant incidence of supervision «on the overall subjective position» of those institutions belonging to the Italian banking sector, I considered it only right for a researcher (at that time ‘lawyer’ of the mentioned institution) to exclude the possibility of authoritative interventions capable to leave room for some sorts of «direct interference» in the management of banking institutions; this behavioral principle is still valid if one considers that the operational independence of these institutions is linked to it and, more generally, to the balance of the overall financial organizational arrangements (based on the free choice of corporate management criteria).

That said, it is clear that many things have changed over time in the evaluation of the guidelines on the supervisory function ascribed to the aforementioned national supervisory authority. Indeed, as it is inferable from the above consideration, while in the past Bank of Italy played its role in a way to some extent pervasive of the subjective realities subject to its supervision, today – in the light of the indications provided by the stress tests – a different interventional orientation is to be registered; this orientation could be considered as opposing the one adopted by an high exponent of the central bank when clarified that the supervisory activity «cannot fail to reverberate... its effects both on business management and on the organizational structure»[51] of its recipients.[52]

The scenario highlighted by the stress tests is characterized by the referability to a supervisory action that was not, perhaps, sufficiently severe in respect of certain ‘big banks’! As pointed out in the previous pages, if compared with an attitude that appears too permissive in some cases, a delaying logic in other circumstances can be found; this guideline–without mentioning otherwise – is perplexing, not convincing, especially where it is compared to the results of a systemic rationalization, that the Bank of

Italy today seems determined to implement through the use of regulatory instruments relating to banking crises (project clearly deductible from the significant number of 'extraordinary administration procedures' recently issued by the Italian supervisory Authority against banks of medium/small size).[53]

Hereby are identified the conditions to obtain a gradual erosion of trust in a system of interventions that shows itself to be 'weak with the strong and strong with the weak'. We are questioned about the reasons for this change, perhaps due to the feeling of identity loss that this institution is experiencing as a result of the ongoing Europeanization process and, more fundamentally, to the loss of monetary and banking supervisory powers.[54] The belief that only the application of the SSM will ensure those forms of banking supervision aspired by those caring about the fortune of the Italian financial System is spreading. In the meantime we can only turn our thoughts, with a hint of melancholy, to the words pronounced by Aeneas from the walls of Ilium: *Hei mihi, qualis erat! Quantum mutatus ab illo Hectore*.

Reference

[1] See also the steep fall of Mps (-21.5%) and Banca Carige (-17.2%), to which the ECB has asked to find 2.1 billion and respectively 814 million euro of capital; see, in this regard, some of the editorials of the specialized press (in which, in fact, is highlighted the thud of the banking sector) including «*Borse negative dopo i risultati degli stress test. Crollano Mps e Carige, Milano è maglia nera*» viewable at http://www.lastampa.it_2014_10_27 and «*Piazza Affari chiude a -2,4%. Mps cede il 21,5%, vietate le vendite allo scoperto*», viewable at http://www.ilsole24ore.com_2014_10_27.

[2] See for example, the Bank of Italy's provision «*Entrata in funzione del Single Supervisory Mechanism. Effetti sui procedimenti amministrativi di vigilanza di competenza della Banca d'Italia*», . n. 1088399/14 of the 04/11/2014.

[3] See *Cosa sono gli "stress test" by the ECB*, published by Il Post on October 30th 2014, viewable at http://www.ilpost.it_2014_10_27stress-test, where it is highlighted how the four banks that, at European level, did not pass the stress tests two are Italian.

[4] See *recital n. 6* of Directive 2014/59/EU

[5] See CAPRIGLIONE – TROISI, *L'ordinamento finanziario dell'UE dopo la crisi*, Kluwer-Utlet, Turin, 2014, p. 90

[6] See – on this argument – ENGELEN, *Stress Test Blues. The trials and tribulations of European banks*, in *The international economy*, 2014, p. 38 ff, in which are contained certain considerations made by A.Merkel while speaking in Berlin in the "Conference of German Co-operative Banks".

[7] See extensively on this issue the '*Aggregate Report on the Comprehensive Assessment*', published by the

European Central Bank, October 2014, pp. 3 and 4, viewable at www.ecb.europa.eu/pub/pdf/other/aggreatereportonthecomprehensiveassessment.pdf.

[8] See among others WYMEERSCH, *The European Banking Union. A first Analysis*, Universiteit Gent, Financial Law Institute, WP, 2012-07, October 2012, p. 1; VV.AA. *Dal testo unico bancario all'Unione bancaria: tecniche normative e allocazione di poteri* (Proceedings of the conference organized by the Bank of Italy, Rome, September 16, 2013), in *Quaderni di ricerca giuridica della Banca d'Italia*, n. 75; SARCINELLI, *L'unione bancaria europea e la stabilizzazione dell' Eurozona*, in *Moneta e credito*, 2013, p. 7 ff; CAPRIGLIONE, *L'Unione Bancaria Europea*, Turin, 2013; ID., *L' applicazione del 'Meccanismo unico di supervisione' bancaria: una vigilia di ingiustificati timori*, in *Aperta contrada* of October 10th 2014.

[9] See ECB, *Guida alla vigilanza bancaria*, September 2014, where for the implementation of the SSM, the new Financial Supervision System is outlined, highlighting both its architecture (European Central Bank and national central banks), and the operative forms (as the ones defined by the CDR IV).

[10] See on the subject the *Preface* of the '*Aggregate Report on the Comprehensive Assessment*'.

[11] See FERRANDO, *Banche, BCE vuole i conti in anticipo*, published in *IlSole24Ore* of November 27th 2014.

[12] It is surprising, therefore, the reaction – as described by the specialized press (see. FUBINI, *BCE, in rivolta le banche di nuovo sotto esame*, viewable at <http://www.repubblica.it> of the 22nd November 2014) – of some systemic banks, which after the recent stress tests see as a threat the prospective of new ECB interventions, highlighting a climate of tension that is ill concealed with the transition to the forms of supervision of the 'Single Supervisory Mechanism'.

[13] See *Report* on the proposal for a regulation of the European Parliament and of the Council, document COM(2012), par. 1;

[14] See on the issue MOTTURA P., *Modelli di governance e sana e prudente gestione*, Report held at the ADEIMF (Associazione Docenti Economia Intermediari Mercati Finanziari), Bergamo, January 2009; BRESCIA MORRA, *La disciplina dei controlli pubblici sulla finanza*, in Vv. AA., *L'ordinamento finanziario italiano*, Padova, 2010, first book, pp. 303 ff; CAPRIGLIONE, *Commento sub art. 5 tub*, in Vv. AA., *Commentario al testo unico delle leggi in materia bancaria e creditizia*, Padova, 2012, first book, pp. 49 ff.

[15] See CAPRIGLIONE, *L'applicazione del 'Meccanismo unico di supervisione' bancaria: una vigilia di ingiustificati timori*, in *Apertacontrada*, 10th October 2014.

[16] See *Bankitalia*: "*Banche italiane penalizzate in stress test Bce. E non hanno avuto aiuti*", viewable

at www.ilfattoquotidiano.it of 24th October 2014, in which is remembered that, unlike Italian banks, German ones «since the crisis have received government aid for nearly 250 billion».

[17] See FUBINI, *BCE, in rivolta le banche di nuovo sotto esame*, where with regard to the position of MedioBanca is argued that «in 2015 the stress tests of the ECB will be repeated, and so in 2016. Piazzetta Cuccia is risking.. to be asked by the Eurotower to recapitalize itself ».

[18] See «*Gli stress che non stressano: come stanno davvero le banche italiane?*», viewable at www.vincitorievinti.com/2014/10/gli-stress-che-non-stressano, where is stated: “The ECB’s results show that Italian banks are those that have mostly suffered the stress simulation conducted by the ECB.. In fact, one should notice that –among the banks which failed the test – 9 are Italian, while only 3 banks are Greek, 3 are Cypriot, 2 are Slovenian, 2 are Belgian, one each from Germany, France, Spain, Portugal, Ireland and Austria”. On the subject, among others, see also GRASSIA, *La Bce: Mps e Carige devono ricapitalizzare*, viewable at <http://www.lastampa.it/2014/10/26/economia>; VERGINE, *Stress test, banche italiane peggiori d’Europa. Bocciate Mps e Carige. “Ma sistema è solido”*, viewable at www.ansa.it/sito/notizie/economia/2014/10/26.

[19] See *Provvedimento della Banca d’Italia. Entrata in funzione del Single Supervisory Mechanism. Effetti sui procedimenti amministrativi di vigilanza di competenza della Banca d’Italia*, n. 1088399/14 of the 4th November 2014, viewable at www.bancaditalia.it, for a commentary to this rules see CAPRIGLIONE, *Considerazioni a margine di un provvedimento della Banca d’Italia sull’«entrata in funzione del Single Supervisory Mechanism»*, in *Apertacontrada* of 18th November 2014.

[20] See for all «*Stress test, Bce boccia 25 banche europee: per l’Italia anche Mps e Carige*», viewable at www.ansa.it/sito/notizie/economia/2014/10/26, where is stated: «the Frankfurt’s tests show a gap in Europe that – caused also by the recession in South and the presence of State bonds in the bank’s financial statements – made Italy, Greece and Cyprus the most affected countries».

[21] See GRECO – RICCIARDI – SCOZZARI, *Stress test: le pagelle di tutte le italiane. Bocciate Mps e Carige*, viewable at <http://www.repubblica.it/economia/2014/10/26>.

[22] See on the subject the Editorial published by *La Stampa* with the title: ‘*Bce: Mps e Carige devono ricapitalizzare*’, viewable at www.lastampa.it/2014/10/26/economia where it is argued that the results of the stress tests indicate that «Siena is missing 2,1 billion, Genova 814 million» whereas «Italy..(has).. the European record for AQR devaluations: 12 billion»

[23] See GRECO – RICCIARDI – SCOZZARI, *Stress test Bce: a 13 banche mancano 9,5 mld di capitale. In Italia chiesti 2,9 miliardi a Mps e Carige*, at <http://www.larepubblica.it> of the 26th October 2014.

[24] See GRECO – RICCIARDI – SCOZZARI, *Bankitalia, Panetta: “Scenario italiano degli stress test molto*

severo”, viewable on www.repubblica.it/economia/2014/10/26.

On the subject see the comments of BOERI, *Le tre regole per stare in Europa*, in *La Repubblica* of the 6th November 2014, where this scholar highlights: «even if we assume that the tests were artificially made in favour of Germany, where our supervisory authorities and ministerial practitioners were when these rules were defined and adopted? ».

[25] See CAPRIGLIONE – MONTEDORO, *Brevi note sulla vicenda MPS e sul ruolo delle cd. fondazioni bancarie*, in *Apertacontrada* of 7th February 2013.

[26] See BANCA D’ITALIA, Research note transmitted to the Minister of Economy and Finance, in relation to the testimony given on 29th January 2013 by the Minister before the Finance Committees of the Chamber and the Senate in joint session.

[27] See BANCA D’ITALIA, *Main supervisory activities with regard to the Monte dei Paschi di Siena Group*, document available at http://www.bancaditalia.it/media/approfondimenti/documenti/Interventi_MPS_en.pdf?language_id=1

[28] See BANCA D’ITALIA, *Main supervisory activities with regard to the Monte dei Paschi di Siena Group*, loc. cit.

[29] See, «*Quattro ore di scambi d’accuse. Tremonti attacca Bankitalia*» published on January 30th 2013, viewable at <http://www.ilsole24ore.com/art/notizie/2013-01-30/quattro-scambi-accuse-tremonti-063741.shtml>.

[30] See «*Mps: procura Trani indaga per omesso controllo*», published on January 30th 2013, viewable at <http://www.ilsole24ore.com/art/notizie/2013-01-30/procura-trani-indaga-omesso-160217.shtml>.

[31] See CAPRIGLIONE- MONTEDORO, *Brevi note sulla vicenda MPS e sul ruolo delle cd. fondazioni bancarie*, in *Apertacontrada* 7th February 2013, par. 2.

[32] See SEPE, *La sottoscrizione dei ‘monti bond’. Ruolo delle autorità e compatibilità con la disciplina comunitaria degli aiuti di stato*, in *Riv. trim. dir. ec.*, 2013, II, p. 53.

[33] See SEPE, *La sottoscrizione dei ‘monti bond’. Ruolo delle autorità e compatibilità con la disciplina comunitaria degli aiuti di stato*, in *Riv. trim. dir. ec.*, 2013, II, p. 55.

[34] See SEPE, op. cit., p. 54, where the m.d.. MEF 26.02.2013 n. 14729 is recalled, «in which’s premises, with reference to the positive opinion released by the Bank of Italy, it is mentioned a prolonged correspondence between it and the Ministry ».

[35] See LEMMA, *La vicenda Mps. L'acquisto di Antonveneta tra regolarità degli adempimenti e problematicità degli esiti* (ord. TAR Lazio, 8th February 2013) in *Riv. trim. dir. ec.*, 2013, II, p. 20.

[36] Herein we consider the disciplinary system that starting from Law. n. 218 of 1990 defined the process of privatization of public banks, at first only formal and, then, with the legislative decree. n. 153 of 1999, also substantial; see – for all- TROIANO, *Gli intermediari finanziari*, in Vv AA, *L'ordinamento finanziario italiano*, edited by Capriglione, Padova, 2010, second book, p.513 ff.

[37] See. *infra* paragr. 7.

[38] See for all I.M.F. *Reforming the Corporate Governance of Italian Banks Prepared by Nadège Jassaud*, working paper, September 2014, where it is stated: «Foundations are major shareholders in Italian banks, either through large participations or the capacity to appoint the majority of the Board.. However, the financial position of several foundations has weakened, raising concerns about their capacity to provide further support. As foundations are also subject to political influence, their ownership in banks influences the composition of the decision-making bodies and banks' activities».

[39] See on the subject the work by GRAZIANI, entitled *Un'operazione trasparenza che il mercato apprezzerà* in *Ilsole24ore* of the 23rd May 2014.

[40] Relevant on this subject are also the evaluations by Consob that according to what the press said (see. *Advisor* of the 5th February 2014) – would have shown «624 million more losses... in the financial accounts of Banca Carige, relating to the financial statements of 31st December 2012 and the interim condensed consolidated financial statements as of 30 June 2013», in addition to including «among the allegations also that of having violated international accounting standards».

[41] See, among the other indications given by the press on this subject, '*Carige, oggi lo scontro sul patrimonio*', published by *Il secolo XIX* of 20th February 2014, where is stated that «what said by Bankitalia imposes Banca Carige with a capital reinforcement of 800 million».

[42] See FERRARI, *Patrimonio, braccio di ferro in Carige*, in *Il secolo XIX* 19th February 2014.

[43] See de FORCADE, *Fondazione Carige pronta a scendere nella banca*, in *IlSole24Ore* 27th November 2014.

[44] See CAPRIGLIONE, *Commento del decreto lgs. 17 maggio 1999, n. 153*, in *Commentario breve al codice civile, Leggi complementari*, edited by Alpa e Zatti, Padova, 2009, third book, p. 1042 ff.

Recently, in *subiecta materia* has emphasized the need to « to reinforce the separation between foundations and banks », the Governor of the Bank of Italy, see. *Report of the Bank of Italy for*

2013, *Concluding remarks*, p. 18.

[45] See ALPA, *Il patrimonio delle fondazioni bancarie*, in Various Authors, *Le fondazioni bancarie*, a cura di Amorosino e Capriglione, Padua 1999, p. 48 ff; ID, *Realtà economica e forme giuridiche. Interrogativi su classificazione e qualificazione delle fondazioni di origine bancaria*, viewable at <http://www.consiglionazionaleforense.it>.

[46] See Report of the Bank of Italy for 2013, cit. p. 18.

[47] See BOERI – GUIISO, *Fermateli*, viewable at <http://www.lavoce.info/archives/31254/fondazioni-bancarie> where is stated: “If Carige Foundation had followed the directions of the Ciampi Law instead of concentrating 90 percent of its assets in Banca Carige, if had not indebted itself rather than come down below 46 per cent of the capital for many years, today we would have a well capitalized bank, open to accommodating a modern management rather than leadership imposed by the foundation, of strict political appointees. Instead, the foundation is so determined to oppose itself to the increase of capital required by the EBA putting at risk the survival of the institution».

[48] See CAPRIGLIONE – TROISI, *L'ordinamento finanziario dell'UE dopo la crisi*, cit, p.87.

[49] See on the subject the *Report on the proposal for a directive COM(2012) 280 final* (so called BRRD), p. 14.

[50] See CAPRIGLIONE, *Controllo bancario e stabilità delle strutture finanziarie*, in *Foro it.*, 1980, V, c. 169 ff., where in referring to the indications of general theory offered by GIANNINI M.S. (*Controllo: nozioni e problemi*, in *Riv. trim. dir. pubbl.*, 1974, p. 1263 ff) there is an attempt to reconstruct the pattern of ‘control’ in the credit system, re-defining a specific direction.

[51] See CASALINO, *Simulations and Collective Environments: New Boundaries of Inclusiveness for Organizations?*, *International Journal of Advances in Psychology (IJAP)*, Science and Engineering Publishing, USA, vol. 3, issue 4, pp. 103-110, 2014.

[52] So DESARIO, *Controlli di vigilanza e loro riflessi sulla organizzazione delle aziende di credito*, book n. 14 of the of the *Associazione per lo sviluppo degli studi di banca e borsa*, p. 20 ff.

[53] We refer, in particular, to the significant number of “procedures of extraordinary administration” existent as of 29th September 2014, as it is shown at http://www.bancaditalia.it/vigilanza/avvisi/elenco/Amm_straord.pdf

[54] See CAPRIGLIONE, *Considerazioni a margine di un provvedimento della Banca d'Italia sull'«entrata in funzione del Single Supervisory Mechanism»*, cit., par. 4.

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«They say things are happening at the border, but nobody knows which border» (Mark Strand)

Mind the Gap: Expectations on the Role of UK Non-Executive Directors

by **Jonathan Liu** and **Tomas Andersson**

Abstract: Notwithstanding the important role non-executive directors' play in corporate governance and the increasing attention they receive from regulators, research on non-executives is still in its infancy. UK Corporate Governance Code does not specify how the roles of non-executive directors should be carried out, but yet the importance of such roles is crucial to the notion of governance. In conjunction with the gap of knowledge of what non-executives actually do, and the absence of a conducive environment for non-executives to fulfil their responsibilities, this may result in unrealistic expectations of their role. However, no study has previously examined the existence of possible expectations gaps regarding the role of non-executive directors. This study fills the void and reports the results of a survey of non-executive directors, executive directors and institutional investors from the UK. Whilst previous research has indicated the existence of an expectations gap regarding non-executive directors in the context of China and the Netherlands, a possible gap concerning non-executives in the UK has remained unexamined so far. This study fills the void and complements and extends previous studies of McNulty and Pettigrew (1999), Stiles and Taylor (2001) and Long et al., (2005) by considering the views of stakeholders on non-executives and providing evidence of the existence of an expectations gap. The paper reports the findings of an online survey conducted in the summer of 2012 to ascertain the opinions of British non-executive directors, executive directors and institutional investors regarding the role and effectiveness of non-executives. It complements and extends previous research on non-executive directors in the UK by considering the views of various stakeholder groups and providing evidence of the existence of an expectations gap.

Summary: 1. Introduction. – 2. Literature Review on Corporate Governance. – 3- Research Methodology. – 4. Findings and Discussion. – 5. Conclusion.

1. Over the past two decades, the UK government has been sponsoring committees to advise on specific issues of corporate governance. This has resulted in the publication of numerous reports in an attempt to improve governance practice in the country by recommending codes for best practice (Cadbury, 1992; 1995; Hampel, 1998; Turnbull, 1999; Higgs, 2003; Walker, 2009). Initially, the reports

were concerned with internal financial controls and disclosure of information (Cadbury, 1992; 1995). Later, committees focused on the broadening of internal control of information beyond simply financial controls and looked at the role and effectiveness of the non-executive director (Hampel, 1998; Turnbull, 1999; Higgs, 2003; Walker, 2009). As a consequence, more emphasis is placed on non-executive directors to scrutinise the behaviour of organisations in order to safeguard the interests of shareholders. However, in spite of the fact that the reports have resulted in non-executives having more demanding and influential roles, they fail to specifically outline what the roles of non-executives actually are. Consequently, the UK Corporate Governance Code offers no guidance on the roles of non-executive directors (Financial Reporting Council, 2012).

With recent high-profile corporate scandals, the board of directors is under more scrutiny and this has impacted public confidence in governance. Corporate failures and scandals such as BCCI, Robert Maxwell and the collapse of the banking sector have highlighted the need for better control mechanisms to reduce abuse and self-interest within corporate management. As a consequence, the role of independent non-executive directors has been emphasized and attracted much of the attention of regulators. Governance reforms have progressively increased the number of non-executives on UK boards and insisted that they should dominate on audit and executive remuneration and nomination committees in order to safeguard corporate accountability (Financial Reporting Council, 2003). However, in spite of the important role non-executive directors have come to play in corporate governance, research on the impact they have on corporate affairs and how they can ensure effective board operations is still in its infancy. UK Corporate Governance Code does not specify how the roles of non-executive directors should be carried out (Financial Reporting Council, 2012). In conjunction with the gap of knowledge of what non-executives actually do, and the absence of a conducive environment for non-executives to fulfil their responsibilities, this may result in unrealistic expectations of their role. As a result, non-executive directors may be facing an 'expectations gap'. That is, a gap between what is expected of them and their actual performance. Whilst previous research has found an audit expectations gap (e.g. Porter, 1993; Humphrey et al., 1993; McEnroe and Martens, 2001), there is a paucity of evidence identifying and analysing possible expectations gaps on the role of non-executive directors. Only a very limited number of studies can be identified. Hooghiemstra and Van Manen (2004a) undertook a survey of over 1000 non-executive directors, employee representatives and institutional investors in the Netherlands. Although they did not find an expectations gap regarding non-executives' main function, gaps were found with regard to stakeholders' satisfaction with the functioning of non-executives, non-executives' roles concerning directors' remuneration and the interests non-executives should serve.

In a more recent study, Li et al., (2011) explored the existence of an expectations gap in the control, strategic and resource provision roles of non-executive directors in Chinese listed companies. Having interviewed Chinese non-executive directors, executive directors, institutional investors and stock exchange regulators, they found gaps relating to the perceived effectiveness of non-executives' control and strategic roles. Whilst these two studies provide pioneering evidence of the existence of an expectations gap on the role and effectiveness of non-executives in the context of China and the Netherlands, a possible expectations gap regarding non-executive directors in the UK has remained unexamined so far. Against this background, the purpose of the study was to investigate whether non-executive directors in the UK are facing an expectations gap in their effectiveness.

2. According to the Cadbury committee, corporate governance is ‘the system by which companies are directed and controlled’ (Cadbury, 1992, para. 2.5). Basically, it is concerned with the distribution of power between different participants in the corporation, mainly between executive and non-executive directors and shareholders. The legal framework shapes much of the power arrangement between these actors in the UK. Shareholders appoint directors whose responsibility is to run the company on their behalf. Every public company is required to have at least two directors, however, no distinction is made between classes of directors; for instance, between executive and non-executive directors (Great Britain, 2006a). There is no requirement for companies to have a board of directors, although directors tend to meet in committees known as ‘board of directors’ (Charkham 1994).

In contrast to the European system of corporate governance which typically separates the responsibility for running the company between a management and a supervisory board, the UK board structure is unitary, which means that directors have a collective responsibility for both the running and the control of the company (Higgs, 2003). However, being based upon common law, the legal framework does not regulate the roles and structures of boards in detail. Nevertheless, over the past two decades it has been supplemented by ‘Codes of Best Practices’, which has resulted in a combined regulatory ‘Corporate Governance Code’ to help boards to discharge their duties in the best interests of their companies (Financial Reporting Council, 2012). The Code sets out good practices covering issues such as board composition and effectiveness, the role of board committees, risk management, remuneration and relations with shareholders (Financial Reporting Council, 2012). The emphasis lies on guidelines rather than directives to reduce the cost to global businesses of introducing procedures to comply with detailed regulations, which is considered to constrain business practice and innovation (Financial Reporting Council, 2010a). According to the Code, the board’s role is to set the company’s strategic aims, provide the leadership to put them into effect and supervise the running of the company. The primary responsibility of executive directors is to set these aims and take care of their implementation, whereas the role of non-executives is to supervise the executives.

The role of non-executive directors

The role of non-executive directors is only described in the most general terms in the Codes of Best Practices (Cadbury, 1992; 1995; Hampel, 1998; Turnbull, 1999; Higgs, 2003; Walker, 2009). It is described as having two key functions; the first function, the importance of which has been highlighted as a result of recent corporate turbulence, is to supervise and monitor executive activity in order to combat abuse and self-interest; the second function is to contribute to strategy development, which is allegedly achieved by bringing a broader perspective, more background and a wider range of skills into the boardroom (Higgs, 2003; Tyson, 2003). The UK Corporate Governance Code lays down the role as follows:

“As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in

appointing, and where necessary removing, executive directors, and in succession planning.” (Financial Reporting Council, 2012, para. A.4)

From this paragraph, it is clear that the role of non-executive directors is both to support executives in the leadership of the company and to monitor and supervise their conduct. However, it is unclear how they should perform this role. Neither the paragraph nor any other provision of the Code outlines specifically how the role is supposed to be carried out (Financial Reporting Council, 2012). Furthermore, neither does the guidance notes to the Code provide any assistance (Financial Reporting Council, 2011).

Limitations of non-executive directors

Academic literature on corporate boards indicates that there are several barriers which stand in the way for non-executive directors to fulfil their role effectively. First, a number of studies emphasize the information asymmetry between executive and non-executive directors and the fact that non-executives are forced to rely on information prepared by executive management to fulfil their monitoring and supervisory function (Leighton and Thain, 1997; McNulty and Pettigrew, 1999; Stiles and Taylor, 2001; Hooghiemstra and Van Manen 2004b). A survey of non-executives in the Netherlands, for example, found that ‘although non-executive directors are expected to perform their duties independently from the executives they supervise, in practice they are unable to do so because they are dependent on the information those same executives provide’ (Hooghiemstra and Van Manen, 2004b, p. 321).

Another issue of concern is non-executive directors’ time commitment to their role. Non-executive board membership is a part-time function. According to a recent survey, non-executives commit 15 to 30 days a year to their role (Higgs, 2003). Given their limited commitment, a number of studies question whether they devote enough attention to their board responsibilities (Lorsch and MacIver, 1989; Carter and Lorsch, 2004; Price Waterhouse Coopers, 2011). A recent survey of non-executive directors in FTSE 350 companies, for example, found that lack of time to debate issues hinders non-executives significantly from performing their role effectively (Price Waterhouse Coopers, 2011).

Limited time commitment to their role raises the question of their competence. The literature indicates that in order to be effective, non-executive directors need to invest time and effort to gain knowledge about the company’s business strategy (Charan, 1998; Higgs, 2003; Buchanan et al., 2003; Carter and Lorsch, 2004; Steele, 2008). However, a number of studies question whether they have this knowledge (Carter and Lorsch, 2004; Brennan, 2006; Steele, 2008; Stiles and Taylor, 2001). Non-executives have been described as ‘part-timers who lack expertise, knowledge and information about the firm’s business’ (Brennan, 2006, p. 586); views which have been confirmed by empirical evidence (Carter and Lorsch, 2004; Long, et al., 2004; Li et al., 2011). For example, a recent survey of American CEOs found that board members need a clear understanding of the firm’s strategy in order to be effective. However, it shows that non-executive directors do not spend sufficient time to gain this knowledge (Carter and Lorsch, 2004).

Insufficient time commitment to their role raises the question whether they are appropriately incentivised to commit themselves fully to perform their duties. Shen (2005) emphasizes the lack of appropriate incentives for non-executive directors to commit themselves truly to improving board

effectiveness. He suggests that stronger incentives are needed for non-executives to become fully engaged in corporate governance and remain independent of executive influences. On the other hand, advocates of agency theory argue that the more non-executives are paid, the more closely their interests are aligned with executive management, and consequently they become less independent (Fama and Jensen, 1983). Zattoni and Cuomo, for example, note that 'if non-executive directors are well paid, they have little incentive to oppose the policies of the CEO and top management because in some way they are dependent on management' (2009, p. 66). Nevertheless, a recent survey of non-executive directors in FTSE 350 companies shows that nearly half of the respondents considered their remuneration to be too low given their time commitment and reputational risk (Price Waterhouse Coopers, 2010). Indeed, with their monitoring role in mind, and the huge potential for personal liability, it seems reasonable to conclude that the financial rewards for non-executive directors do not match the risks and liability associated with their position (Steele, 2008).

Finally, non-executive directors' appointment process has been criticized for being inadequate (Higgs; 2003; Tricker, 2009). According to Tricker (2009), nomination is often based on close personal relationships with board members. In a recent survey of non-executives on UK listed boards, nearly half of the respondents were recruited through personal contacts or friendships (Higgs, 2003). Whilst it is arguable whether this undermines their independence, it seems reasonable to conclude that it does undermine meritocracy in the boardroom, which in turn may weaken board performance.

Despite the recent developments in the regulatory codes of best practice, the role of non-executive directors remains unclear. The description of their role in the Corporate Governance Code is surprisingly vague. Whilst their two key functions are clearly defined, they are only described in the most general terms. The lack of clarity of their role raises the question whether there are different expectations of how they should carry out their responsibilities. It has been noted that their work is 'almost completely invisible to all but fellow board members and as a result poorly understood' (McNulty et al., 2005, p. 11). Furthermore, it has been recently observed that there is still little known about what non-executives actually do (McNulty and Pettigrew, 1999; Stiles and Taylor, 2001), which further aggravates the problem. In an era of corporate collapses and failures where high expectations are being placed upon non-executives, these expectations and assumptions may not match their actual conduct and effectiveness. Indeed, many barriers stand in the way for non-executives to perform their role effectively: they are forced to rely on information prepared by executive management; they have limited time to spend on their directorship; limited time to gain knowledge and understanding of the firm; and their appointment process is often inadequate. This raises the question whether there are realistic expectations of what non-executive directors can actually achieve. Much of the focus of governance reforms in the UK has been on non-executive directors' control function and there is a great risk that their strategic function could suffer as a result. It is apparent that the development has resulted in increased pressure on non-executive directors to live up to the high expectations placed upon them to monitor directors and at the same time contribute to corporate strategy. Given the high barriers faced by them to fulfil their role effectively, it is questionable whether they can meet these expectations within the current corporate governance framework. As a result, they may be facing an 'expectations gap'. That is, a gap between what is expected of them and their actual performance.

3. The concept of an expectations gap concerns differences in opinion. To examine differences

between various stakeholder groups, the research needs to be conducted in a structured manner: each group needs to answer the same specific questions, and the answers need to be recorded numerically in order to determine the extent to which opinions differ amongst the groups. Whilst a qualitative survey could explore opinions in greater depth, it would not provide the comparative data needed to examine the existence of an expectations gap. Therefore, a quantitative survey is used in this study. Self-completion questionnaire is used as the main data collection instrument. Furthermore, questionnaires can be filled out anonymously, ensuring fairness of the answers provided. Various studies have also shown that the characteristics of interviewers (such as gender or social background) may affect the answers of respondents (e.g. Robson, 2002). By using self-administered questionnaires, the potential of bias due to the observer effect is eliminated. Online questionnaires are used to collect the data in this study.

A questionnaire using questions from a prior study was developed as the research instrument. Hooghiemstra and Van Manen (2004a) had examined the existence of an expectations gap regarding non-executive directors in the Netherlands. As the authors gave permission for their questions to be used and the functions of non-executive directors in the Netherlands are largely the same as in the UK, the questions were used. The questionnaire included two main sections. The first section contained a series of questions about respondents' position and background. In order to differentiate the responses between non-executive directors, executive directors and institutional investors, respondents were first asked to state their profession. Non-executive directors were asked, for example, to indicate the number of years of their experience and the number of directorships they held. The purpose of these questions was to test whether various factors such as if they served on the board of a listed or an unlisted company influenced their responses. The second section of the questionnaire consisted of a series of questions to elicit respondents' opinions on the role and effectiveness of non-executive directors. In order to identify a possible expectations gap, respondents were asked to rate their answers. They were asked to indicate how strongly they agree or disagree with a series of assertions on a five point Likert scale, ranging from 5= strongly agree, 3=neutral (neither agree nor disagree), to 1=strongly disagree.

Four main areas were addressed in the questionnaire: the performance of non-executive directors, their roles and responsibilities, the importance they attach to employees and the circumstances under which they resign. These were considered the most important areas in exploring the presence of an expectations gap. The first area concerned respondents' opinions on the performance of non-executive directors. Whilst academic research shows that non-executive directors are limited in what they can achieve (McNulty and Pettigrew, 1999; Hooghiemstra and Van Manen, 2004b; Price Waterhouse Coopers, 2011), stakeholders may not be aware of these limitations. Consequently, they may have different perceptions of non-executives' performance. Therefore, respondents were asked a series of questions designed to elicit their satisfaction with the quality of non-executives' practices. The second area comprised of a series of questions regarding non-executive directors' roles and responsibilities. As previously discussed, non-executives' roles are only described in the most general terms in the Corporate Governance Code and little is known about what they actually do, which may lead to different expectations.

Survey sample

The survey was set up on a website and three stakeholder groups were chosen for the purpose of this research: executive directors, non-executive directors and institutional investors. Executive directors were chosen because they have the most direct experience with non-executive directors and are therefore in the best position to evaluate their effectiveness. Furthermore, they are key players in the UK corporate governance arena and together with non-executive directors are responsible for promoting the success of the company, which makes their views highly significant in improving board effectiveness (Great Britain, 2006a; Financial Reporting Council, 2012). Institutional investors – including pension funds, insurance companies, pooled investment vehicles (for example investment and unit trusts) and other financial institutions such as charities and endowments – are also important players in corporate governance. It is estimated that domestic institutional ownership comprises more than half the equity capital in UK listed companies (Office for National Statistics, 2010), making institutional investors very powerful stakeholders of corporate governance. Furthermore, institutional investors are becoming more influential. The UK government has been trying to promote a culture where institutional investors are more actively involved in corporate governance (Higgs, 2003; Financial Reporting Council, 2010b). As a result, the Institutional Investor Committee has now a set of obligatory ‘comply or explain’ principles for institutional investors to follow, strengthening their responsibilities to promote the interests of their beneficiaries (Institutional Investor Committee, 2009). Similarly, the Financial Reporting Council has also recognised the importance of institutional investors’ governance responsibilities and published a ‘Stewardship Code’ for institutional investors to follow to further strengthen their responsibilities in the engagement with investee companies (Financial Reporting Council, 2010b).

Details of the distribution of the questionnaire among the three groups and the responses obtained are provided in table 1.

Table 1. Survey distribution and response

	Distributed	Responses	Response Rate (%)
Non-executive Directors	400	168	42.0
Executive Directors	200	40	20.0
Institutional Investors	20	5	25.0
Total	620	213	34.4

The survey was distributed to some 600 members of a British executive placement firm. This resulted in 208 responses, 168 of them were from non-executive directors and 40 from executive directors. The non-executive directors participating in the research had a considerable number of years of experience: 75% of them had served for 6 or more years as a non-executive director. They were also well experienced in terms of the number of boards they served on: 50% of them served on 2-5

boards, while 25% served on 6-9 boards. Also the variety in types of companies was considerable: two thirds served on the board of a listed company, while one third served on the board of an unlisted company. The executive directors participating in the research had a considerable number of years of experience as well: 80% of them had served for 6 or more years as an executive director. The variety in types of companies was also considerable: 80% served on the board of a listed company, while 20% served on the board of an unlisted company. To obtain opinions from institutional investors, the survey was distributed through personal and professional contacts to 20 fund managers in the UK. This resulted in 5 responses. The participating fund managers were quite experienced: 80% of them had been active in their position for 6 or more years. Their funds can be considered relatively small with invested capital up to £250

4. In dealing with non-interval data – responses were provided on a 5 point Likert scale – all statistical analysis was undertaken using non-parametric tests. More specifically, the Kruskal– Wallis one-way analysis of variance by ranks was used as the primary statistical test of significance. This test is regarded as particularly powerful for analysing non-parametric data, such as that collected in this survey, to decide whether a number of independent samples (in this case three samples) are different from populations (Siegel and Castellan, 1988). As many of the survey questions produced significant differences at the 5% (and even 1%) level of significance, the value of chi-square was included which serves as an indication of the relative scale of the differences across the groups. The results are presented and discussed in the following sections.

Non-executives' performance

In order to obtain a first indication of a possible expectations gap regarding non-executive directors, respondents were asked about their opinions on non-executives' performance. The results are presented in table 2 and discussed below.

Table 2. Non-executives' performance

	NEDs	EDs	IIs	χ^2
Generally speaking, I am satisfied with the way non-executive directors in the UK are currently functioning.				
3.50				
2.90				
2.80				
3.70				
Within the current corporate governance structure supervision of executive directors is of adequate quality.				
3.25				
3.20				

2.80

1.44

Within the current corporate governance structure independence of non-executive directors vis-à-vis executive directors is adequately ensured.

3.25

3.00

3.00

11.01***

Non-executive directors are given sufficient time to perform their role effectively. 3.00

2.00

3.80

7.86**

Non-executive directors have adequate knowledge and understanding of the company's business to perform their role effectively.

3.00

2.20

3.40

14.41***

Non-executive directors are recruited through an informal recruitment process based on personal and professional networks. 3.75

3.70

3.80

1.16

Average scores on a five point scale: 5 = strongly agree, 3 neutral, and 1= strongly disagree.

*, **, ***: significant at the 0.1, 0.05, and 0.01 level, respectively.

Three major expectations gaps were found when non-executive directors on one hand and executive directors and institutional investors on the other hand differed in their views regarding the effectiveness of non-executives. First, non-executive directors have a stronger belief in their own functioning than both executive directors and institutional investors: 75% of them said they were satisfied with the way non-executive directors currently function, while only 30% of the executive

directors and a mere 20% of the institutional investors shared that satisfaction. Second, non-executive directors have more confidence in the quality of supervision: 50% of them claimed that supervision of executive management is of adequate quality, while only 20% of the executive directors and 20% of the institutional investors shared that view. They are also more confident in their independence from management: 75% of them considered their independence vis-à-vis management to be adequately ensured, while neither the executive directors nor the institutional investors shared that opinion. Institutional investors' doubts regarding non-executives' independence seem to be in line with previous research in the Netherlands. Hooghiemstra and Van Manen (2004a) found that a mere 15% of the institutional investors they approached believe that non-executives' independence from management is adequately ensured in the Netherlands.

The results suggest that executive directors' and institutional investors' doubts regarding non-executives' effectiveness are related to two factors. The first concerns non-executives' independence vis-à-vis management. Indeed, independence from management is strongly emphasised in the Corporate Governance Code. According to the Code, non-executive directors should comprise at least half of boards and dominate audit, remuneration and nomination committees (Financial Reporting Council, 2012). However, the results suggest that, notwithstanding these recommendations, non-executives' independence is not adequately ensured in the eyes of executive directors and institutional investors. The second factor concerns non-executives' appointment process. According to the Code, there should be a formal and rigorous process for the appointment of directors to boards (Financial Reporting Council, 2012). However, the results suggest that, notwithstanding this recommendation, executive directors and institutional investors perceive non-executive directors as being recruited informally through personal contacts (70% of the executive directors and 80% of the institutional investors had this view). Their perception confirms the findings of Higgs (2003), who found in a survey of non-executives on UK listed board that nearly half of the respondents were recruited through personal contacts or friendships.

The results further suggest that executive directors' doubts regarding non-executives effectiveness are related to additional factors. The first factor concerns non-executives' time commitment. In the opinion of many executive directors, non-executives do spend sufficient time on their role (60% of the executive directors claimed that non-executives do not have sufficient time to perform their role effectively). This perception supports the research of Price Waterhouse Coopers (2011), who found that lack of time to debate issues hinders non-executives from performing their role effectively. The second factor concerns non-executives' understanding of the company's business. Executive directors seem to think that non-executives lack knowledge and understanding of the firms' business (80% of them claimed that non-executives do not have adequate knowledge and understanding of the business). This perception is in line with previous research in the US. Carter and Lorsch (2004) found in a survey of American CEOs that non-executives were perceived as not spending sufficient time to gain knowledge of the company's strategy.

Overall, the results suggest that non-executive directors have greater confidence in their own performance than both executive directors and institutional investors. Although most non-executive directors share executive directors' and institutional investor' view that non-executives are recruited informally through personal networks (75% of the non-executive directors shared this opinion), they do not seem to think that it undermines their independence. Furthermore, most non-executives do not

share executive directors' doubts about non-executives' time commitment (only about 33% of the non-executives felt that they do not commit sufficient time to their role), which is a possible explanation for their higher level of confidence in their effectiveness.

Non-executives' roles

After having obtained respondents' opinions on the performance of non-executive directors, their views on non-executives' specific roles and responsibilities were surveyed. First, respondents' views on non-executives involvement in strategy were examined. The results are presented in table 3 and discussed below.

Table 3. Non-executives' involvement in strategy

	NEDs	EDs	IIs	X ₂
Non-executive directors leave initiation of new plans to executive directors.				

3.50

3.60

3.80

0.25

Non-executive directors leave execution of plans to executive directors. 4.75 4.60

3.80

8.42

Average scores on a five point scale: 5 = strongly agree, 3 neutral, and 1= strongly disagree.

*, **, ***: significant at the 0.1, 0.05, and 0.01 level, respectively.

No expectations gap was found with regard to non-executive director's involvement in strategy. There was a strong agreement between the groups that initiation of new plans is a task of executive directors: 75% of non-executive directors claimed that they left initiation of plans to executive directors, while 70% of executive directors and 80% of institutional investors shared that view. Regarding the implementation of plans, the agreement was even stronger: all non-executive directors agreed that they were not involved in the execution of plans, while 80% of the executive directors and 80% of the institutional investor shared that view.

Overall, the results suggest that non-executive directors have a limited role in strategy development and execution. The results are in line with the findings of McNulty and Pettigrew (1999), which suggest that initiation and generation of strategy is mainly a task of executive directors.

After having obtained respondents' opinions on non-executive directors' involvement in strategy, their views on non-executives' monitoring role were examined. The results are presented in Table 4 and discussed below.

There was a strong agreement between the groups that non-executive directors prevent executive directors from misusing corporate funds (nearly 82% of the total sample agreed, while about 18% were neutral). There was also a strong agreement that non-executive directors monitor that executive directors' remuneration is not excessive (85% of the total sample agreed, while 15% were neutral). However, two expectations gaps came to light with regard to non-executives' roles in dealing with inefficiency. The first concerned discovery of inefficiency: whereas 75% of the non-executive directors claimed that it is not their responsibility to ensure that inefficiency is discovered in a timely fashion, 80% of the institutional investors perceived that is. The second concerned elimination of inefficiency: whereas 75% of the non-executive directors claimed that it is not their responsibility to ensure that inefficiency is brought to an end in time, 60% of the institutional investor had the opposing view.

Table 4. Non-executives' monitoring tasks

	NEDs	EDs	IIs	X2
Non-executive directors ensure that executive directors do not abuse their position of power (e.g. do not				

4.25

4.10

4.00

0.66

Non-executive directors monitor that executive remuneration (including share options) is not higher than necessary. 4.25

4.00

4.00

1.10

Non-executive directors ensure that inefficiency is discovered in a timely fashion. 2.25

3.00

3.80

19.00***

Non-executive directors ensure that once inefficiency has been discovered it is brought to an end in time. 2.25

2,50

3.40

7.37**

Average scores on a five point scale: 5 = strongly agree, 3 neutral, and 1= strongly disagree.

*,**,***: significant at the 0.1, 0.05, and 0.01 level, respectively. ***Importance of employees' interests***

After having obtained respondents' opinions on non-executives directors' roles and responsibilities, their views on the importance non-executives attach to employees were surveyed. As previously discussed, non-executive directors are legally obligated to take the interests of employees into account in their decision-making process. However, the law is unclear as to what extent these interests are supposed to be considered, which may result in different expectations. Therefore, respondents were asked to rate a number of statements on the importance non-executives attach to the interests of employees. The results are presented in table 5 and discussed below.

No large differences in opinion were detected regarding the importance non-executive directors' attach to the interests of employees. All three groups agreed, more or less, that non- executives approve of dismissal of personnel to substantially improve earnings (about 92% of the total sample agreed, while 8% were neutral). There was also a strong agreement that non- executives approve of dismissals even if there is no redundancy scheme for the personnel involved (85% of the total sample agreed, while 15% were neutral). However, the agreement between the groups somewhat disappeared in case of dismissals aimed at maintaining earnings-per-share above a certain minimum level. While 40% of institutional investors agreed that non-executive directors approve of dismissal of personnel in order to prevent earnings- per-share dropping below a certain minimum level, the number of non-executive and executive directors agreeing was somewhat lower (25% and 20% respectively). With regard to wage policy, there was a fairly strong agreement between the groups that it is not the responsibility of non-executive directors to ensure a fair wage policy for all levels (about 68% of the total sample agreed, while about 32% were neutral).

Table 5. Importance of employees' interests

	NEDs	EDs	IIs	X2
Non-executive directors agree with forced lay-offs if these are necessary to substantially				

4.00

4.80

4.00

9.70***

Non-executive directors only agree with forced lay-offs if there is a redundancy scheme for the personnel involved.

2.25

2.20

2.00

1.43

Non-executive directors agree with forced lay-offs if these are necessary to prevent earnings- per-share dropping below a certain minimum level.

3.00

2.70

3.00

0.09

Non-executive directors assure that there is a fair corporate wage policy for all levels. 2.25 2.30

2.40

1.95

Average scores on a five point scale: 5 = strongly agree, 3 neutral, and 1= strongly disagree.

*, **, ***: significant at the 0.1, 0.05, and 0.01 level, respectively.

Overall, the results suggest that non-executive directors attach little importance to the interests of employees. This finding is of importance in view of recent discussions about whether there is a move in the UK towards a stakeholder approach to corporate governance. As mentioned in the introduction, the traditional business objective in the UK is shareholder value maximisation. However, it has been suggested that there has been a move in recent years towards a more pluralistic approach where the interests of stakeholders are taken into account (Keay, 2011). This view has been fuelled by the introduction of a provision in company law (Section 172.1 in the Companies Act 2006) which requires directors to have regard to a range of stakeholder interests in their decision-making process (Keay, 2013). However, in his recent examination of the legislative development, Keay (2011, p.1) found that legislation only appears to provide greater stakeholder focus but in reality 'add little in a drive towards stakeholderism'. The results from this survey confirm Keay's findings, showing that the legislative development has not led to directors attaching any significant importance to the interests of employees.

Reasons for resignation

Lastly, respondents' opinions on the circumstances under which non-executive directors resign were

surveyed. The results are presented in table 6 and discussed below.

Table 6. Reasons for resignation

	NEDs	EDs	IIs	X ₂
Non-executive directors resign if the company has violated company law in the UK.	2.33			

2.20

4.00

15.43***

Non-executive directors resign if the company has violated company law in the UK and executive directors will take no action to avoid recurrence. 3.00

3.00

3.80

1.65

Non-executive directors resign if measures which need to be taken to ensure the continuity of the company are not being undertaken.

3.00

2.90

3.00

0.35

Non-executive directors resign if measures which need to be taken to ensure the continuity of the company are not being undertaken, and they have no confidence in executive directors taking adequate actions in the future. 3.67

3.10

4.60

10.46***

Average scores on a five point scale: 5 = strongly agree, 3 neutral, and 1= strongly disagree.

*, **, ***: significant at the 0.1, 0.05, and 0.01 level, respectively.

A number of expectations gaps were detected regarding non-executive directors' reasons for resignation. The first concerned whether non-executives resign if the company has violated company law: whereas about 67% of the non-executive directors and 80% of the executive directors claimed that non-executives maintain their position on the board even if the company has violated company law, all of the institutional investors disagreed with that view. The second concerned non-executive directors resigning in case the company has violated company law and management takes no action to avoid recurrence: whereas about 33% of the non-executive directors and 40% of the executive directors agreed that non-executive directors resign if the company has violated company law and management takes no action to prevent reoccurrence, the percentage institutional investors agreeing was significantly higher (80%). With regard to whether non-executives resign if measures which need to be taken to ensure the continuity of the company are not being undertaken, no major differences in opinion were detected as the three groups were more or less neutral in their opinions.

The results suggest large differences in opinion between non-executive directors and institutional investors regarding the circumstances under which non-executives resign from their position. This is unsurprising considering that the Corporate Governance Code does not give any guidance on the circumstances under which non-executive directors should resign. The major gaps were between the opinions of non-executive directors and institutional investors. Institutional investors seem to think that non-executive directors resign from the board more easily than they do in reality. A possible explanation is that non-executive directors feel constrained from resigning too easily by their fiducially duty to act in the company's best interest.

5. Whilst previous research has indicated the existence of an expectations gap regarding non-executive directors in the context of China and the Netherlands, a possible gap regarding non-executives in the UK has remained unexamined so far. This study fills the void and complements and extends previous studies of McNulty and Pettigrew (1999), Stiles and Taylor (2001) and Long et al., (2005) by considering the views of stakeholders on non-executives as well.

The results reveal a wealth of information of how non-executive directors on one hand and executive directors and institutional investors on the other hand differ in their views regarding the responsibilities of non-executives. The large number of statistically significant differences indicates the existence of an expectations gap regarding non-executive directors in the UK.

Notwithstanding the fact that non-executives' roles are described in the most general terms in the Corporate Governance Code and little is still known about what non-executives actually do (e.g. McNulty and Pettigrew, 1999; Stiles and Taylor, 2001), executive directors and institutional investors were quite able to assess non-executives' roles. This may have to do partly with the direct experience they are said to have with non-executive directors (Hooghiemstra and Van Manen 2004a). However, a significant gap was found regarding non-executive directors' monitoring role. Institutional investors seem to believe that it is the responsibility of non-executive directors to see to that inefficiency is discovered and brought to an end in time, whilst in reality non-executive directors do not seem to assume this responsibility. A possible explanation for this gap is that institutional investors are not fully aware of non-executives' inherent limitations. As previously discussed, non-executives are limited in what they can achieve because of, for example, their limited time and exposure to information

asymmetry.

Although it seems that executive directors and institutional investors are fairly aware of non-executives' main duties, they are not very satisfied with the way non-executives function. Doubts about non-executives' time commitment and independence from management seem to be major causes of this dissatisfaction. Furthermore, it seems that institutional investors do not have any idea of the circumstances under which non-executives resign from their position. This is unsurprising given that the Corporate Governance Code does not give any guidance on the circumstances under which non-executive directors should resign.

In conclusion, it seems that notwithstanding regulatory initiatives such as Cadbury (1995) and Higgs (2003), which were aimed at improving corporate governance, executive directors and institutional investors still place question marks over the effectiveness of non-executive directors. Furthermore, it seems that despite that the role of non-executive directors has become clearer as a result of these initiatives, there is still a wide divergence of opinion on many aspects of their role. More specific guidance in the Corporate Governance Code on non-executives' monitoring role and reasons for resignation would help bridge this gap.

Somewhat surprisingly, no gap was found regarding non-executives' involvement in strategy. However, only a few questions were posed on the subject. It would be interesting to obtain more in-depth responses on non-executives' involvement in strategy to see whether divergent expectations occur.

Whilst this study has helped remedy a significant void in the literature, it is explorative in nature and was carried out with a very small sample, which makes it difficult to generalize the results. A replication using a larger and more comprehensive sample would help confirm the research findings and overcome the limitations of this small convenience sample.

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Open Review of Management, Banking and Finance

«They say things are happening at the border, but nobody knows which border» (Mark Strand)

Managerial governance and transparency in public sector to improve services for citizens and companies

by **Nunzio Casalino** and **Peter Bednar**

Abstract: Recent debate and associated initiatives dealing with public sector innovation have mainly aimed at improving the effectiveness and efficiency of the delivery of public services and improved transparency and user friendliness. Beyond typical administrative reforms, innovation is expected to help address societal challenges such as the aging population, inclusion, health care, education, public safety, environment and greenhouse gas emissions reduction. The public sector consists of a complex open system of organizations with various tasks. Therefore, decision-making can be slower than in the private sector because of large chains of command. Innovations here will often have an impact across this complex organizational structure, and thus must be supported by a robust strategy. To strengthen democracy, promote government efficiency and effectiveness, discourage wastes and misuses of government resources, public administrations have to promote a new stronger level of openness in government. The purpose of this manuscript is to describe an innovative approach for the governance of public systems and services, currently applied in the Italian public administration domain, which could be easily replicated in other countries as well. Two initiatives, to collect and provide relevant public information gathered from different and heterogeneous public organizations, to improve government processes and increase quality of services for citizens and companies, are described. The cases adopted have been validated through a case analysis approach involving the Italian Agency for the public administration digitalization to understand new e-government scenarios within the context of governmental reforms heavily influenced by the principles of Open Government Model.

Summary: 1. Introduction. – 2. Strategic principles for e-government. – 3. The importance of data transparency for citizens and companies. – 4. Leadership influences motivation. – 5. Managing effectively open government and online services. – 6. Conclusions.

1. Public services are among the most knowledge-intensive and value added of all sectors, and thus obviously also need to be part of this mobilisation. Public services and public administration represent a significant part of the European socioeconomic activity. Europe's public services account for between 40% and 55% of GDP – compared to 32% in the United States, 26% in Japan, 16% in China or 17% in India. Public services-related employment accounts for between one quarter and one third of the total EU working-age population, and public employment (civil servants) represents more than 15% of the

total employment in the EU [1]. In last two decades, the public administration sector has been affected by several deep and radical changes. In this period, different approaches to the government of public life and services emerged.

Openness can make a democracy stronger in several ways. Where citizens can observe the workings of government, they become more invested in what government does. Government openness empowers citizens as well, as they are more able to express their views about policy decisions that affect them. Openness makes democracy stronger also by encouraging government officials to perform better, for where government is more open, they are more likely to be held accountable for their decisions, both good and bad. Similarly, a more open government makes it easier for the media and watchdog groups to expose, and therefore deter, improper or otherwise undesirable influences on policymakers. In short, openness enhances democracy by giving citizens a greater voice in what government does, and promoting government action that advances the interests of all, not just a privileged few. Openness promotes a more efficient and effective government too. When government is more open, bad ideas more readily yield to good ideas. After all, not all expertise resides within government. These were the New Public Management [2, 3, 4], the New Public Governance [5, 6, 7] and, last but not least, the Open Government Model [8, 9, 10]. All of these approaches have contributed in different ways to manage the large complexity of the public sector. This means that public administration is constantly looking for ways to improve its performance. Inside this wave of changes, new approaches and forms of knowledge management systems are gaining predominance in the public sector scenario. Now the challenge is how to organize a proactive disclosure so that information can easily be found by users. New technological opportunities and the increasing information demand make it imperative for public authorities. The open access to public information and data can be a powerful approach to support a reorganization of public services, a real innovation and achieve well-motivated civil servants. Therefore, the easy and immediate access to public information can be a significant driver of economic growth to obtain new services and applications [11]. The first objective of this paper is to present a model to assess the open government initiatives: Open Government Implementation Model (OGIM) [12]. The main idea of this model is to adopt a tool to organize and classify open government efforts. This model is focused on the outcomes, specifically on the open government websites and on open government development path. According to this idea, a first step to develop and evaluate Open Government could be the user's perspective, that it is a precondition for implementing the following steps. We analyse some Italian and international experiences related to central transparency web portals, to describe the benefits and complaints of open data around openness. Then the paper focus on a case study of public knowledge management systems, that can bring many advantages to provide relevant public information and produce inside the public administrations involved in a processes' reorganization and, in general, in better performance goal.

2. The development of ICT and the information society has created a vast variety of potential applications for the public sector. The resulting notion of e-government encompasses applications that aim variously at:

- Pushing information over the Internet;
- Communicating between public agencies and citizens, business or other government agencies;
- Conducting transactions and registration;
- Improving governance and direct democracy (online consultation, petitioning, polling, voting, and campaigning).

One goal of e-government is greater citizen empowerment. Through the Internet, people from all over a country / region / locality should be able to interact with policy-makers and make their voices heard. In addition, these technologies should create more transparent governments and administrations [13]. E-government can play an essential role in revealing to the public the policies governments are adopting or the actions policy-makers are taking. The spread of Web 2.0 technologies based on social networking allows us to create genuinely new kinds of connections between citizens and the public sector. Government 2.0 goes far beyond merely adopting Web 2.0 tools for the public sector as it is a philosophy and culture that reflects society's radically new way of interacting and communicating. The cost of implementing new working processes into existing organisations is also often underestimated. For example, the resources required for Web 2.0 type policy and decision-making is often underestimated. In particular, in terms of the facilitation, tailoring of information, monitoring, moderation, feedback to participating citizens and stakeholders required to ensure value-adding and successful ePetitions, eConsultations etc. Public services could even become a comparative advantage for Europe competitiveness, by creating innovation-conducive environments. World challenges such as demographic change, pollution, and security concerns are creating new demands for public services, and the public sector may be a strong driver for EU leadership in these domains too. Statistics indicate that the demand for public services in many advanced countries is growing faster than the rest of the economy – even before the onset of the recent economic crisis. As the GDP is increasing more slowly than public expenditures, the public sector is subject to major budget constraints – and the economic crisis exacerbates this. Meanwhile public services are facing higher expectations from their users (especially e-government services) [14]. Hence, innovation is vital for increasing public sector efficiency (value for money, more for less) and for delivering new and better quality services. As mentioned, some of these services affecting the whole economy or key sectors within it, as well as being important for quality of life more generally. It is possible to summarize six principles related to the potential of e-government:

1. Innovative services and their online delivering can improve the public sector role to surpass definitely the economic crisis;
2. Citizens and businesses have to be really at the centre of public services;
3. Public services should be delivered through the most appropriate channels;
4. E-government should reduce the administrative burden for citizens and businesses;
5. E-government projects should reflect business process improvements, delivering demonstrable efficiency, effectiveness and value for money gains;
6. Public bodies should understand and ensure that the online channel is the most effective and attractive option for the services delivering.

Impacts and benefits can be monetary or non-monetary for both the public service customer and the public service provider [15]. Measureable impacts and benefits have to be reported to ensure value for money. Mechanisms will be put in place, including the use of social media, to get feedback from citizens and businesses on e-government services [16, 17].

3. Governmental organizations manage several kinds of data during their daily activities [18]. All these data are used by government functions but they could also be handy for citizens and other actors in society. In many countries, the public data are now being viewed not as private government property, but as public assets to be leveraged by citizens, businesses and experts' communities. Actually many of these organizations currently are reviewing and rearranging their processes, information and data to improve policies, services, enhance legitimacy and openness toward outside parties and citizens. The development of web portals and search services to support citizens and business companies in finding

information and e-services in the Public Administrations' websites is a very challenging organizational issue. Indeed, over the latest years the number of PAs digital services, mainly on the web channel, and of sources of e-government data [19] increased at an impressive rate. By merely considering Italian Public administrations, there is an estimated number of about 50.000 websites, with millions of pages. Digital public services can be defined as the view of public entities (and their services) in the virtual world (web, social networks, e-mail channels, mobile devices, etc.) and is the result of the work of thousands of autonomous (public) entities organised in a sort of huge federated enterprise. In this context, many countries are developing their strategic plans for Open Government initiatives launching pilot portal that manage the knowledge published over the Internet by public administration on a national scale to support stakeholders in finding the information they need within the digital public administration. The search.usa.gov site provides a notable example of this kind of portal: it provides an interface, which allows performing traditional keyword-based search queries with a simple and easy interface. Search.usa.gov integrates the web search service provided by means of a well-known public search service with other specialised search services, such as, for example, the recall search service, which makes it possible to find recall announcements (i.e. request returns of a product to the manufacturer, for necessary repairs or adjustments) published on several governmental websites [20]. Transparency and open data can be powerful tools to stimulate and support public services' improvements, faster innovation and empower citizens' rights. The easiness and the immediate access to relevant public information, government processes and better performance can be a significant driver, with open data increasingly enabling the creation of valuable new services and applications [21, 22]. It is important to differentiate between "access" and "availability" from the users point of view – because for example a technical system might be available for citizens to use –but some citizens might not be able to use it due to specific circumstances – e.g. people on benefits could have access to internet based applications and payment, they might even have access to Internet – for example by using computers made available to unemployed people in community centres, etc. However to get state benefits via the eGovernment system the citizen might need to have a bank account – in UK case it turned out that many people on state benefits did not have any bank account for the simple reason that the banks do not want to give people who have no jobs an account. Until the new eGovernment system was put in place all these people on state benefits were able to get their money via the Post Office with the use of a personal post check. With the new system, the checks were not used anymore as no one had considered that there were (adult) citizens in the UK who could not get a bank account. So here is an example of people having access and some availability – but the actual availability of the service is not truly possibly to realize and so the intended benefits were not achievable – even if the technical system was developed on time. On budget and within specification – "and" the availability issue had been addressed – still this was not enough. The reasons for "failure" are not within the "functional specification" and also not within the "structural problem space" but instead the problems are completely within the space of the human activity system. To better understand Table 1 it identifies a sequence of monetary (economically quantifiable) and non-monetary (not economically quantifiable) benefits and threats not only for business and citizens users, but also for the public administration itself [23].

Impacts inside the public administration			
Benefits		Threats	
Monetary	Non-Monetary	Monetary	Non-Monetary
Publication of government data possible at low cost	Cultural shift to openness begins	Improved data quality: accuracy, consistency and regular updating	Cultural shift to openness
Reduced cost and time to develop new services	Foundation for performance improvement	Focus on high-value and high-impact data such as costs and performances	Cooperation agreements between government agencies
	Foundation for value-added online services	Investing in the right data analysis software	Data management responsibility
	The public is engaged through data	Integrating several data from government websites and databases to fine-tune and increase effectiveness	Data stored in government websites in compatible formats
	Increased customer satisfaction	Feedback on the data usefulness and quality	Reduced processing time
	Empowerment of the procedures	Fight to frauds by combining and analysing social and financial data	
		Proper resources committed to setting up or expanding proactive disclosure	

Table 1.

An elaboration of benefits and threats of data transparency inside the P.A.

Internet enables public organizations to connect datasets to their portals and enable stakeholders (citizens, companies and communities) to improve transparency (see Table 2) have access to several data in a wide variety of ways. Broadband networks and mobile technologies are also facilitating the gathering of public data. Every government operation generates new data, which can be useful for stakeholders. The free movement of information within a digital society offers immediate, practical benefits and the promise of future opportunities that are yet unseen [24]. In an information-driven age, the ability of government leaders to realize the opportunities presented by unlocking public data may ultimately spell the difference between success and failure [25].

Impacts outside the public administration			
Benefits		Threats	
Monetary	Non-Monetary	Monetary	Non-Monetary
Reduced cost and time for innovation	Increased public awareness and knowledge of data, process, and policy	Digital divide	Privacy
Public data usage by businesses for investment decisions	Increased government accountability	Time to develop new applications and services	Cultural shift to openness begins
Material resource saving (e.g. paper)	Easiness of compliance to access and manipulate data		
Improved economies	Speed		
Potential reduction of fees	Certainty of decisions		
	Empower citizens		

Table 2.

An elaboration of benefits and threats of data transparency outside the P.A.

4. Openness likewise discourages waste and misuse of government resources by revealing where scarce government resources are used to poor procedure, open government promotes the efficient

reallocation of those resources. In turn, a more democratic and efficacious government improves the lives of its citizens. Information provided by government can help inform the electorate. Information from federal agencies can help the public make more informed choices about daily decisions, from the choice of consumer products to decisions affecting their health, housing, and transportation concerns. In addition, this is the true test: a more democratic and effective government is one that truly improves the well-being of those whom government is supposed to serve. By making open government a high priority, the administration has sought to improve the everyday lives of citizens more inclusively, more effectively, and more economically. Profound changes in the nature of technology, demographics, politics and the global economy are giving rise to new model of democratic government. We are entering a new age in which citizens take part in service delivery, decision making and policy making like never before. The steadily improving quality of information and communication technologies (ICT) has changed not only the daily lives of people, but also the interactions between governments and citizens. The e-government has started as a new form of public organization that supports and redefines the existing new information, communication and transaction-related interactions with stakeholders (e.g., citizens and companies) with the purpose of improving government performance and processes [26]. Today the public administration must move beyond e-government to forge governance webs capable of meeting rising expectations for openness, accountability, effectiveness and efficiency in the public sector. The transition to “Open Government” begins with opening up formerly closed processes, embracing transparency and renovating tired rules [27] that inhibit innovation [28, 29, 30, 31]. The “Open government initiative” of US federal government is based on the implementation of three principles for a government: transparency, participation, and collaboration. Transparency promotes accountability by providing the public with information about what the Government is doing. Participation allows people to contribute ideas and expertise so that they can make policies with the benefit of information that is widely distributed. Collaboration improves the effectiveness of Government by encouraging partnerships and cooperation within different levels of government, and between the Government and private institutions. Placing the principles of Open Government within the current public administration context in which are inserted, it is useful to observe that, the open access to information and data, can transform deeply the idea of public government. In this way, functional data silos and distinction between “inside” and “outside” will disappear. “Government as a platform”, is the idea of the government data becoming feasible and accessible to citizens through information systems [32]. The general vision of Open Government Implementation Model [33] supposes that the use of information and communication technologies (ICT) can enhance efficiency, policy effectiveness, service quality, accountability and democratic value in public sector. OGIM model is a new paradigm in public administration that needs of four specific implementation stages: increasing data transparency, improving open participation, enhancing open collaboration, realizing ubiquitous engagement (figure 1). The main key point of OGIM model is that public authorities should advance their open government initiatives gradually, focusing on one implementation stage at a time. Besides data transparency [34] is a required precondition and an enabler for implementing better services in each phase. One important aspect of innovation management is the rationale or motivation for innovation. It has often been argued that the lack of competition (to drive organisations) and limited financial incentives for improvement (to drive individuals) would hinder innovation within the public sector. It has however been demonstrated that there can be many sources of motivation for innovation. The Table 3 indicates the differences (and similarities) in the importance of motivation between the two

sectors [35].

Motivations for innovation in the public sector /Individuals <ul style="list-style-type: none"> o Career o Idealism o Professional recognition o Power o Self-fulfilment o Money (salary) o Prestige o Potential for spin-off business 	Motivations for innovation in the private sector /Individuals <ul style="list-style-type: none"> o Money (salary, profits, bonuses) o Career o Self-fulfilment o Prestige o Power o Job security (via enhanced profitability or imposed requirement) o Idealism
Motivations for innovation in the public sector /Organizations <ul style="list-style-type: none"> o The propagation of a policy, idea or rationality o Increased funding o Problem solving (in order to reach objectives) o More staff o Public relations 	Motivations for innovation in the private sector /Organizations <ul style="list-style-type: none"> o Profits o Problem solving (in order to reach objectives) o Pre-empt competition o Market-shares o Growth (in size) o Public relations

Table 3.

The motivation in public and private sector (Miles & Røste, 2005).

It is important to understand that if evaluation of benefits is made from a “functional” perspective – qualitative benefits will not only be invisible but impossible to identify – and this means they will not be achievable, as failure to address them will not be directly linked to the experience of failure and success. In addition “structural” evaluation of benefits will not be able to see failure and success for what it is in the context of real world socio-cultural experience of citizens – as a structural evaluation has similar weaknesses as hard systems thinking [36]. So if we wish to be able to not only promote qualitative benefits, we need to incorporate a systems view which is treating the eGovernment projects as “human activity systems” or else we will be blind by the IT functionality and the data and object structures and so will not be able to manage or achieve intended real world benefits.

Recent debate and associated initiatives dealing with public sector innovation have mainly aimed at improving the effectiveness and efficiency of the delivery of public services and improved transparency and user friendliness [37]. Beyond typical administrative reforms, innovation is expected to help address societal challenges such as the aging population, inclusion, health care, education, public safety, environment and greenhouse gas emissions reduction. The public sector consists of a complex open system of organizations with various tasks. Therefore, decision-making can be slower than in the private sector because of large chains of command. It is widely reported that without licence from the top, few people in hierarchical organisations are willing to take risks [38]. Political and official leaders can establish a culture in which innovation has seen as natural. Several writers thus see leadership as a key

link between individual creativity and knowledge and organizational innovation [39]. Leadership should come from the highest level, but middle management can also be very important. Leaders need to dedicate resources to innovation and to act on employee suggestions. They should also protect innovative employees from internal and external critics and at the same time convince politicians of the need for innovation.

5. According to the most public directives implementing transparency and open government plans, it is important to do not preclude the legitimate protection of information whose release would threaten national security, overrun personal privacy, breach disclosure, or damage other honourably compelling interests. In the same time, managing public knowledge and extract info from tens of thousands of data sources is a challenging task [40]. Our aim is the study of the possibility of designing an economically viable information system able to manage the knowledge in open data and over the Internet by public administrations on a national scale. The approach we are following is based on the following operating steps [41]:

- the knowledge base is built starting from the contents of centralized (institutional) sources of data;
- the institutional data are the basic to develop ad hoc solutions to discovery, analyse the unstructured contents over the web by digital administrations;
- the knowledge extracted from the unstructured contents enriches the knowledge base (e.g. with new classified entities and new relationships);
- the uncertain knowledge cannot be extracted automatically, so human operators are to be engaged to disambiguate the situation;
- the explicit and implicit feedback coming from operators is also used to improve the knowledge of the system;
- the previous steps should be continuously repeated to improve the knowledge of the system and update the contents.

A web search engine can be essential to offer the best way for public organizations to find information between their big databases, partners' archives, and citizens/SMEs email and documents. The search engine used in the project is built by using open-source software tools, is highly extensible, thus allowing the integration of ad-hoc search components and making it possible to fully exploit additional information (e.g. linguistic resources such as list of acronyms, or formalized knowledge such as, organization charts, the institutional mission of PAs and their jurisdictional boundaries). Besides e-government refers to a series of technical tools commonly used for interacting with public administration, such as electronic signature, PEC, e-procurement and on-line forms. All these instruments are codified in a single act: the digital administration code (CAD). The code, approved in 2005 and reviewed in 2011, establishes a number of normative innovations, which affect administrative practices and the quality of the supplied services. Italy's programs on e-government are the result of the implementation of strategies and guidelines set by the European Union, which entails the improvement of the network bandwidth, the diffusion of digital contents, research and development activities, and the spread of digital administration services. The shift towards digital administration requires the development of a variety of well-suited solutions aimed at improving the internal organization, a comprehensive process generally known as re-engineering. Case-based research can be incredibly expensive in terms of direct cost and time expended. Nothing is more frustrating than incurring the cost of identifying information, reports or statistics only to find that they will probably provide no contribution to the research question. In our case, we had the possibilities to examine all the aspects of a project, in each phase of its timeline, and for this reason, we selected Yin's methodology [42] that was appropriate for the current level of knowledge [43, 44] and the state of the research problem.

6. Innovative e-government services can represent a tangible evolution of valuable public services. Against public sector complex situation, we have to keep going the evolution of services in the hands of civil servants. Our future research activities will be focused to find the proper balance between the costs of human operators and the quality of the results the public sector as a whole can reach. The e-participation support needs of information access to foreign speaking users and gathers feedbacks from final users about the quality of the services and the information provided. For what concerns communication channels, they allow the development of new applications on mobile systems, tablet PCs, and, possibly, digital TV widget. Apart from explicit feedback, the one gathered through an explicit interaction with the user (such as, for example, question answering), the front-end module will provide mechanisms for implicit feedback collection (for example, through user click recording). Feedback analysis will be applied with different objectives, such as auditing, user profiling, suggestion techniques implementation, service improvement, and new services identification [45, 46, 47]. The front-end module interacts with the content management module by exchanging contents to be published. The content management module allows the structured organization of portals, manages all processes related to data gathering, approval and publishing. It also manages all information relevant for end-user personalization. At the functional level, the e-participation module auto-feeds its content by interacting with the underlying knowledge management system [48, 49, 50]. These tasks can be performed by new public managers, monitoring and providing functionalities related to several public data sources, including the services' monitoring of each public administration, the knowledge contents [51, 52, 53, 54], the citizens participation and their suitable feedbacks [55, 56, 57].

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«They say things are happening at the border, but nobody knows which border» (Mark Strand)

Bank Recovery and Resolution: An Italian Point of View

by **Vittorio Santoro**

Abstract: The author examines the main legal aspects of the Single Resolution Mechanism as provided by the Directive no. 59 of 15 May 2014 and the Regulation no. 806 of 15 July 2014. After finding a definition tailored on the term “resolution”, the author pays particular attention to some important aspects as: recovery plan, preventive measures, early intervention measures and the resolution. As regards the latter one, the author examines especially all resolution instruments like the “sale of business tool”, the “bridge institution tool”, the “asset separation tool” and the “bail-in tool” noting in particular the effects of the application of those tools on stakeholders and their impact on the Italian banking legal system. Finally, considering the drastic nature of the last tool, the author put in the light an important doctrinal debate, i.e. the compatibility of that tool (and more generally the provisions of the Directive) with the article 47 of the Italian Constitution.

Summary: 1. Foreword. – 2. Recovery plan. – 3. Preventive measures. – 4. Early intervention measures. – 5. Resolution: an overview. – 6. Conditions for resolution and early phases. – 7. The resolution instruments.

1. The SRM (*Single Resolution Mechanism*), as the second pillar of the EU banking union, complements the first pillar, the SSM (*Single Supervisory Mechanism*)[1]. Agreement concerning the third pillar, an EU deposit guarantee system, is still lacking.

The SRM is regulated by two distinct but coordinated documents: 1) Directive no. 59 of 15 May 2014 (henceforth the “Directive”), which establishes a framework for the recovery and resolution of credit institutions and investment firms, and 2) Regulation no. 806 of 15 July 2014 (henceforth the “Regulation”), which establishes the rules and a single procedure for the resolution of credit institutions and some investment firms.

A brief terminological/conceptual remark should be made to start with: both the title and the text of the Directive and Regulation use the term “resolution” mechanisms. What does this mean? The term “resolution” expresses a linguistically obscure concept. Reference to an English dictionary does not help (this is the language in which the documents were drawn up and, above all, the language of international agreements involving the *Financial Stability Board*, in the context of which the idea and

use of the term first arose). In English “resolution” means to “solve or settle a question”, or to “adopt regular or secure way of...”: in other words, find a way of overcoming (or preventing) banking crises – thus it is a generic term used to express many things at once. Returning to the Italian, “risoluzione” means to resolve a complicated and complex situation. In everyday language it is used to express “clarification, explanation”; in juridical language, “termination”, but with reference to a contract. In medicine it means having overcome the acute phase of an illness. The word in Italian does not correspond to its use by the EU legislator, except if interpreted in the medical sense: the process of recovery following an illness, i.e. a crisis. On the other hand the term “risanamento”, used in conjunction with “risoluzione”, also recalls a medical term and corresponds to recovery.

The only help comes from the Directive itself, which in art. 2 (under “Definitions”), § 1, no. 1, states that “resolution” means “the application of a resolution tool (...) in order to achieve one or more of the resolution objectives”. Aside from the tautological nature of this definition, the important aspect to understand is that, by referring to the subsequent arts. 37, § 9, and 31, § 2, the legislator intends to clarify that “resolution” designates the set of tools necessary to prevent and overcome a crisis. These tools have some characteristics that we are familiar with, as they recall those used in the extraordinary administration or compulsory winding-up of banks. However, it should immediately be pointed out that the framework drafted by the EU legislator is far more complex.

In any case, the Directive introduces minimum harmonisation rules that must be respected by all EU Member States in order to resolve and, to a certain extent, prevent crises involving banks and certain other intermediaries. Crisis management is entrusted (under art. 3, § 3, of the Directive) to the so-called “resolution authority”, which must be a public administrative authority. This task can also be performed by national central banks (ministries, etc.). However, should the body also be entrusted with banking supervision, the offices charged with resolving the crisis must be operationally independent, to avoid conflicts of interest between supervisory functions. In particular, Member States must guarantee operative independence of the functions of resolution and supervision.

Nonetheless, regarding the eighteen countries in the eurozone and the other countries that adhere to the system voluntarily, the Regulation sets down the centralization of the decision-making process regarding resolution, entrusting it to a “Single Resolution Board” (hereafter “Board”) established pursuant to art. 42 of the Regulation. This Board cooperates with the Council, Commission and with the national resolution authorities (art. 1 of the Regulation), within the framework of the single resolution mechanism. In the eurozone the Board will act as a national authority, but benefit from the collaboration – in other words use the staff and structures – of the designated authorities of each State. Regarding Italy, it is reasonable to presume that the designated authority will be Banca d’Italia but, given the requirement of independence between the function of supervision and that of “resolution” (art. 3, § 3, of the Directive), the central bank will have to at least organize a dedicated independent internal management. The Board will also manage the Single Resolution Fund^[2], which will have a liquidity of 55 billion euros within ten years, with annual contributions from the institutions supervised amounting to 5.5 billion Euros. This fund should, first and foremost, constitute a deterrent against speculative behaviour in the credit and financial markets; secondly, it will ensure the uniform, and therefore pro-competitive, management of resources to ensure the stability of the system.

The EBA also plays a significant regulatory role in the prevention and resolution of banking and financial crises.

The Directive and Regulation apply to: banks established within the EU; financial institutions and entities established within the EU as subsidiaries of banks or investment firms; financial holding companies established within the EU; in some cases also the subsidiaries of entities established or located outside the EU (from hereon I will only refer to banks, but the regulations apply to all of these).

The purpose of both measures is to prevent bank insolvencies, or at least minimize the negative effects of insolvencies when they do occur, while preserving the functionality of the system, e.g. by guaranteeing liquidity, trust in solvency, guaranteed compliance in relation to the payment system: in short, stability. The EU legislator was prompted to take this kind of action to rectify the mistakes and shortcomings in the system, highlighted by the harsh lesson of the financial crisis, but also to encourage more virtuous behaviour among operators, in order to avoid the moral hazard that derives from the relative certainty that the State can be relied upon to help when a crisis arises.

Concerning the first matter, it should be noted that the legislator has placed the systemically important banks at the centre of attention. This begs the question of whether the other institutions are left to their own devices, thus suspending supervisory intervention concerning Italy, for example. Indeed, alarm bells have already been rung by the cooperative banks who, on 17 October 2013 before the 6th Standing Committee (Finance and Treasury) of the Italian Senate, expressed their concern that also “for local banks (...) the resolution measures in the event of a crisis will be decided by the SRB [in Brussels], in exactly the same way as for the systemically important banks under the supervision of the ECB. Analogously, the contributions of local banks will be paid directly into the European Resolution Fund, like those of the systemically important banks. Regarding the principle of proportionality, there is therefore a clear lack of coherence between the two mechanisms.”

Concerning the second matter, it is important to underline that, in my opinion, the intention to prevent taxpayers’ money from being used to save banks marks a drastic change for the Italian banking and finance system, which will imply a review of our regulations, even at the constitutional level, but I will come back to this later.

2. The Directive and Regulation work on two levels: the prevention of crises and crisis resolution, which implies or may imply the total or partial liquidation of the institution.

The first preventive measure takes the form of “recovery plans” that the supervised institutions themselves are required to prepare, under art. 5 § 1 of the Directive. As specified in the Directive, this is a governance arrangement that all credit and financial institutions are required to implement. The content of these plans is roughly outlined by Section A of the Annex to the Directive. However, while, on the one hand, art. 5 refers to the guidelines that the EBA will have to issue on this matter by 3 July 2015, on the other hand it provides two significant pieces of information: the plans will not be able to rely on public financial intervention, and referral to the central bank (rediscount, open market operations) will only be allowed as long as suitable assets are provided as collateral, according to parameters to be established – again – by the EBA (art. 5 § 4 and 10). The plans must be approved by the competent authorities: for Italy this means the European Central Bank. The latter will forward the plans to the

resolution authority – in Italy’s case the Board (when the SRM has been fully implemented in the eurozone) – so that it can identify “any actions that may have a negative impact on the institution’s capacity for recovery”. If gaps are found, the Board will make appropriate recommendations to the competent authority.

It is important to that the provisions of the recovery plan play a role, even when the conditions for the institution’s subsequent resolution arise. In fact, in this case the resolution authority is required to take the measures included in the plan into account and apply them, unless it deems them insufficiently effective in comparison to other alternative solutions.

As can be seen, the system is a complex one, in which the EBA, competent authorities and resolution authorities play different roles. Greater simplicity would have also helped the supervisory bodies act more quickly to resolve problems emerging from crises.

3. What’s more, it is not enough for the banks and other supervised institutions to prepare recovery plans: the resolution authority itself is required to draw up a preventive recovery plan, which it submits to the other supervisory authorities and the supervised institutions themselves (art. 15, § 1 of the Directive). Moreover, if it identifies impediments to the achievement of the plan, it enjoys significant powers of intervention, which ultimately censure the management choices of the institutions supervised. In this context, art. 17, § 5 of the Directive states, amongst other things, that supervised institutions can be required to limit their exposures; to divest themselves of, limit or suspend specific activities or business lines; to change the institution or group’s management structure; or to issue financial instruments in response to asset requirements.

The above list is both partial and generic. Nonetheless, it already hints at the broad interventional authority that I feel constitutes a return to the past in many ways (at least in relation to Italy’s experience), or in other words a large scale return to interventional supervision. On the other hand, although the supervisory authorities have always exercised moral suasion to induce banks and other supervised institutions to accept more suitable solutions to ensure stability, even when formally lacking the abovementioned powers, it is of no little importance when the legislator, and this time the EU legislator, endows an authority with such broad formal powers. It remains to be seen, in the light of effective practice, how “invasive” these powers will be; for now suffice it to observe that the exercise of these powers does not need to be justified by the onset of a crisis, nor the imminent risk of a crisis breaking out, but by the fact that this bank or that institution is deemed unfit to face a hypothetical crisis.

4. In a crescendo of interventional powers, art. 27 of the Directive provides for “early intervention measures”, which range from requesting the implementation of mechanisms foreseen by the institution in its recovery plan to more drastic measures, such as the removal of upper management and administrators, based on conditions that seem to me to closely coincide with those of extraordinary administration in Italy (including the condition of administrative irregularities and the violation of laws or regulatory or statutory provisions) (art. 28).

However, in contrast to extraordinary administration in Italy, the appointment of a temporary

administrator is only a possibility, to be implemented in the worst cases and with respect for the principle of proportionality. Another, not insignificant, difference is that the temporary administrator can either substitute or work alongside the institution's own administrators (art. 29).

Among the early intervention measures another worth mentioning is the resolution authority's power to write down capital instruments or convert them into shares or other relevant capital instruments (art. 59 of the Directive). In reality these measures have a twofold purpose, as they can be used both with a pending resolution procedure (which we shall come back to later), or independently and prior to one, in the presence of the conditions provided for under art. 59. This occurs, for example, when the institution's economic situation is unsustainable, or public financial aid is necessary.

Thus, this measure can be adopted either preventively or during a resolution procedure and, in either case, adheres to the principle of the internationalization of losses. These must be incurred, first and foremost, by the holders of tier 1 primary capital instruments, then, in order of priority, by holders of additional tier 1 instruments and, following on, holders of tier 2 instruments. The latter instruments in turn can be either written down or converted into tier 1 instruments.

5. This brings us, at last, to the most serious hypothesis for the implementation of the resolution procedure regulated by Title IV (arts. 31 et seq.) of the Directive.

In this context, the EU legislator first specifies the objectives of "resolution". In reality it seems to me that the identification of the objectives goes beyond resolution alone and constitutes a general justification of the whole Directive; this impression is reinforced by a reading of the initial recitals of the Directive.

In any case, the objectives are listed in art. 31, as follows:

1. a) to ensure the continuity of critical functions;
2. b) to avoid significant adverse effects on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline;
- (c) to protect public funds by minimising reliance on extraordinary public financial support;
- (d) to protect depositors covered by Directive 94/19/EU and investors covered by Directive 97/9/EC;
- (e) to protect client funds and client assets.

The EU legislator does not explicitly state whether these objectives are all to be considered on the same level or whether, instead, they are listed according to a precise order of priority. The second hypothesis seems more plausible to me.

Note, in fact, that the objectives a) and b) complement each other and represent the ultimate reason for the legislation: preserving the functioning and stability of the credit/financial system is crucial. This confirms a constant and traditional aim of credit and financial systems in developed countries. To achieve it, they have squandered immense resources during periods of crisis.

The innovation lies, instead, in the fact that the EU legislator has decided that a limit to public spending for this type of intervention must be set^[3].

Lastly, the protection of covered deposits is guaranteed within the limit of the deposit guarantee scheme's capacity to intervene and, in any case, will not weigh on public finances but on the schemes

themselves. The protection of “client funds and client assets” will be guaranteed only if they are separate funds from those of the institution under resolution, while transferred funds, with the obligation of repayment, run the risk (as we shall clarify later) of being decimated.

In fulfilling its resolution-related tasks, the authority must comply with a series of principles laid down under art. 34 of the Directive, i.e.:

- (a) the shareholders of the institution under resolution bear first losses;
- (b) creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings...;
- (c) management body and senior management of the institution under resolution are replaced, except in those cases when the retention of the management body and senior management, in whole or in part, as appropriate to the circumstances, is considered to be necessary for the achievement of the resolution objectives;
- (d) management body and senior management of the institution under resolution shall provide all necessary assistance for the achievement of the resolution objectives;
- (e) natural and legal persons are made liable, subject to Member State law, under civil or criminal law for their responsibility for the failure of the institution;
- (f) except where otherwise provided in this Directive, creditors of the same class are treated in an equitable manner;
- (g) no creditor shall incur greater losses than would have been incurred if the institution or entity had been wound up under normal insolvency proceedings in accordance with the safeguards...;
- (h) covered deposits are fully protected;

The principles listed above under letters *a)*, *b)*, *f)*, *g)* and *h)* express the idea, underlying the whole Directive, that losses must be internalized, or in other words borne by the institution under resolution. At the same time, they constitute the other aspect of the key objective, as mentioned above, according to which public funds are to be safeguarded. However, from the point of view of recovery, penalization of the institution through its shareholders and holders of “quasi capital” alone may clearly not be sufficient: it may also be necessary to penalize the institution’s creditors, financiers, providers and employees. In relation to these figures it is no longer correct to speak of internalization. On the other hand, even if penalized, these categories, with the exception of depositors protected for up to a hundred thousand euros per deposit, will not suffer losses greater “than would have been incurred if the institution [...] had been wound up under normal insolvency proceedings”. The rule seems to be clear and provide a sufficient level of protection, but remains difficult to apply in practice, given the evident difference between real liquidation and the preventive simulation of liquidation. This difference will certainly lead to numerous disputes, which will impact the financial statement of the bridge institution and of any end purchaser of the assets and liabilities of the institution under resolution. The result will be diminished legal and bookkeeping clarity and inefficiency in the use of this tool.

Letters *c)*, *d)* and *e)*, in turn, penalize the administrators and managers. This choice is correct and appropriate, but will require the adaptation of domestic systems to ensure the existence of relevant practical consequences in terms of deterrents to bad behaviour or a too-great propensity for risk on the

part of administrators and other managers[4].

6. The condition for resolution is failure or the imminent risk of failure; this means a situation in which either: 1) the bank violates, or is likely to violate the requirements for maintaining its authorization; 2) its assets are, or are likely to be in the near future, less than its liabilities; 3) it is unable, or is likely to be unable in the near future, to be able to pay its debts as they fall due; 4) it needs extraordinary public financial aid[5]. This list reveals first that the concept of failure includes, but does not coincide, with the state of insolvency, and second, for the same reason, that failure as an objective condition for resolution has some aspects in common with the conditions for the compulsory administrative liquidation of banks.

In any case, both the supervisory authority and the resolution authority have the task of ascertaining the state of failure.

When the Directive is implemented, the appropriateness of the state of insolvency being independently ascertained by a judicial authority, as traditionally occurs in Italy in the case of compulsory liquidation, will need to be reassessed. It seems to me that it would be better to accept this independent assessment, given the consequences connected to this judicial assessment in the Italian insolvency system, especially in relation to criminal proceedings and the application of revocatory measures. This solution is not only appropriate but is also supported by clear indications deriving from the Directive. It is worth reiterating that art. 34 of the Directive states that natural persons (first of all administrators and other holders of functions within the institutional organization) will be held liable in relation to their responsibility for the failure of the institution, in compliance with the law of their Member State, under civil or, what interests us here, *criminal* law (my italics).

Article 34 also establishes that no creditor should incur losses greater than he would have if the bank had been wound up under normal insolvency proceedings. To achieve this result it is essential to be able to apply revocatory measures where the conditions arise.

In any case, as the resolution procedure involves multiple and contrasting interests, the EU legislator has deemed it appropriate that the resolution authority, before initiating resolution proceedings (and equally before beginning to write down the value of capital instruments, or before converting credit instruments into capital), must ensure that a person independent of any public authority and of the institution supervised carries out “a fair, prudent and realistic valuation of the assets and liabilities of the institution or entity” (art. 36, § 1 of the Directive). The intention of ensuring that third party interests are not unjustifiably damaged by public “resolution” measures is commendable.

In reality the doubt remains that the EU legislator has provided an excessive level of protection for civil rights. He will have done so, on the one hand, without ensuring the independence of judgments, given that the independent assessors will nonetheless be designated by the “resolution” authority, and, on the other hand, while introducing an element of delay and complexity to a procedure that in itself already involves too many actors on the stage. Indeed, having realized this problem, the legislator himself, in the subsequent paragraph of the same article (36), affirms that the resolution authorities themselves

may carry out a provisional valuation.

The resolution authorities, under art. 35, § 1 of the Directive, have the power to appoint a special manager to substitute the management body of the institution under resolution. The initial macroscopic difference from Italy's compulsory liquidation, in which the appointment of special commissioners is a necessary step (art. 81 Consolidated Banking Law – in Italian “TUB”), is evident. At first glance the actions of this special manager would seem to be more bound by the instructions of the resolution authorities than those of Italy's special commissioners are bound by the instructions of the Banca d'Italia.

This impression is not based on a reading of the provisions, as the text of art. 35, § 4 is very similar to that of art. 84, par. 3 of the TUB. The first states that “Resolution authorities may set limits to the action of a special manager or require that certain acts of the special manager be subject to the resolution authority's prior consent”, while the second states “The Banca d'Italia may issue instructions for the execution of the procedure and establish that some categories of operations or acts require its authorization...”

It is, instead, based on the consideration that the resolution authorities are the only ones with the powers necessary to apply the so-called resolution instruments, under arts. 37 et seq. of the Directive, while the tasks of the special manager are mainly related to implementation (art. 35, § 3 of the Directive).

7. The resolution tools available to the resolution authorities in resolving crises are essentially four. They are in part similar to those already known in Italy, in part completely new. Before describing them, it should be added that, in the eurozone, the Board also has access to the Single Resolution Fund. While this is not a fund for bailing out banks, as set up to “ensure financial stability and not absorb losses or provide capital to the institution under resolution”, under exceptional circumstances and the condition that the bank's internal resources are used first (totalling no less than eight percent of the bank's liabilities and own funds), the Board can use the Fund for salvage purposes, and therefore as an accompanying measure alongside resolution tools.

In any case, the latter are:

- 1) the “sale of business tool” (art. 38 of the Directive).
- 2) the “bridge institution tool” (art. 40 of the Directive).
- 3) the “asset separation tool” (art. 42 of the Directive).
- 4) the “bail-in tool” (arts. 43 et seq. of the Directive).

1) The sale of business tool can be applied in two ways. The first is well known in the Italian banking system, as it broadly coincides with the so-called sale of assets and liabilities; the second consists in the direct sale of shares and other instruments of ownership which, evidently, belong to shareholders and the other holders of the right of ownership.

Effectively implying the expropriation of holders' instruments, this is justified by the abovementioned principle that shareholders incur the first losses, although their sacrifice – as stated in the previous paragraph – must be legitimized in advance by a transparent valuation and by public interest in avoiding normal insolvency proceedings, in order to ensure the continuous functioning of the credit and

financial market. Some commentators have claimed that the Italian system does not grant such broad powers, but it is worth recalling that Italy's anti-Mafia legislation (see, in particular, art. 41, par. 6 of the anti-Mafia code^[6]) grants broad powers regarding the management of company holdings confiscated from organized crime.

The legitimacy of this authoritative intervention and the expropriation of property rights could be questioned in relation to the Convention on Human Rights, which Italy (like the other EU Member States) adheres to. Although external to the European system, regarding pertinent aspects this Convention constitutes its juridical basis. In this context, it should be recalled that art. 1 of the First Additional Protocol to the Convention on Human Rights states, amongst other things, that "No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest ...". It is too early to be able to refer to the case-law of the Court of Human Rights, which is the competent body for the application of the provision; however, it is reasonable to presume that the Court will argue in the same way as it did in the *Grainger* case, when a Northern Rock shareholder complained of having his shares unjustifiably expropriated under the UK's special legislation issued to save the bank in question. In the *Grainger* case the Court did not, in principle, rule against the expropriation of shares, but it interpreted the abovementioned provision as a reasonable compromise between the right to possession and public interest. In fact, the judges stated that: "The Court observes that it is well established in its case-law that any interference with the right to the peaceful enjoyment of possessions must, indeed, strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights (...) there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realized by any measure applied by the State".

In reality the Court says more than this, as it deliberately does not enter into the merits of the choice between the private interest and public interest, in consideration of the following circumstances: 1) due to their more intimate knowledge of the situation "the national authorities are in principle better placed than the international judge to appreciate what is in the public interest"; 2) a certain level of discretion must also be granted to national authorities regarding the appraisal of public interest, which can be assessed considering "measures of economic reform or measures designed to achieve greater social justice", up to the point of justifying the reimbursement of shares for less than their full market value.

Lastly, the Court observed that public intervention alone prevented Northern Rock from failing: as the aim of this bailout was to protect the stability of the UK's financial system, the shareholders could not expect to benefit from such support without also bearing the negative consequences (for them) of the government's help.

It is therefore reasonable to presume that European norms would also pass the scrutiny of the Court of Human Rights, as those of the UK system have.

2) The bridge institution, instead, is an entirely or partly publicly owned temporary body, set up to administrate the shares and “other instruments of ownership” of a bank in a situation of crisis. To give effect to this mechanism, the resolution authority has the power to transfer to the bridge institution both shares and other instruments of ownership issued by one or more institutions under resolution, or all or part of the assets, rights and liabilities of one or more institutions under resolution.

As this tool is temporary, the bridge institution ceases to exist, for example, following a merger, or the sale of all shares and other instruments of ownership to a third party, as well as following (insolvency) liquidation.

3) The asset separation tool permits the resolution authority to transfer the assets, rights and liabilities of an institution under resolution or bridge institution to one or more management vehicles.

This transfer is conducted through a vehicle, better known in some countries as a “bad bank”. This has already been experimented in Italy, in order to manage the bad assets of certain institutions: the bailout of the Banco di Napoli in the 1990s is a case in point.

4) The bail-in tool is the most innovative, to the extent that the Directive will be adopted from 1 January 2015, but the provisions adopted to comply with the bail-in regulations will be applicable “at the latest” (!) from 1 January 2016 (art. 130 of the Directive). This tool was experimented during the recent banking system crisis in Cyprus.

The bail-in tool lets the shareholders and some categories of the failing institution’s creditors to incur appropriate losses and, in any case, makes them liable for an appropriate part of the costs of failure: the same two considerations regarding the legitimacy of the “sale of business” tool apply here too. To this end the resolution authority has the power to reduce, or even cancel out, the value of capital instruments, as well as the power to write down the value of credit or even convert it into capital instruments (art. 63 of the Directive). As a consequence, the institution under resolution should make a full recovery and meet the requirements for authorization to operate.

The example of Cyprus shows that the bail-in tool works when the majority of the social costs are offloaded outside the economy of the country in question: in the case of Cyprus, in fact, the costs were borne by rich investors from foreign countries (non-EU) – mostly Russian citizens. The result was so drastic that it triggered a diplomatic row with Russia. The efficacy of this tool if used in a larger country, where the savings undergoing the haircut are mainly those of nationals, is uncertain.

Considering its drastic nature, the compatibility of this tool (and more generally the provisions of the Directive) with art. 47⁷ of the Italian Constitution is subject to debate.

I would like to mention the recent opinions of two diverging but authoritative scholars regarding art. 47 of the Constitution. One (Spada) observes that the norm does not intend “to protect «anonymous» investors from the risk of investment (which would lead to the constitutionally unacceptable outcome of socializing risks undertaken in the exercise of the individual freedom of economic initiative!)” (p.212); thus, based on Spada’s interpretation, this provision has the sole purpose of favouring informed choices

on the part of investors and ensuring the fairness of intermediaries. The other scholar (Vella) maintains that operators now have an obligation of “responsibility” in relation to the client “to the extent, perhaps forcing the matter a little, of [prompting] a review of the constitutional law in order to qualify «public savings» as an «inviolable right»” (p. 220).

The contrast between these two opinions is mitigated if we maintain, as I believe we should, that art. 47 of the Constitution, precisely because it refers to “savings in all forms”, allows for differentiated forms of protection regarding those savings: this could cover naïve saving, typically by (small) depositors in a bank, whose right to the reimbursement of funds is inviolable; while other increasingly risky, and therefore more lucrative, forms of investment would enjoy a lower level of protection, aimed more at what Spada calls boosting investor awareness. We may add the observation that the contents of art. 81 of the Italian Constitution have been substituted, so it now reads: “The State shall balance revenue and expenditure in its budget, taking account of the adverse and favourable phases of the economic cycle” and that this article constitutionally justifies the aim laid down by art. 31, § 2, letter c) (and considering art. 45) of Directive no. 59/2014, intended to protect public funds by reducing the recourse to public finances to bailout failing banks to a minimum. We may even ask whether an inversion of priorities, exactly in Spada’s sense, has already been constitutionalized.

In principle, therefore, the European regulations could be considered to comply with the Italian constitutional system, as long as they rigorously safeguard against naïve investment (but can the protection of deposits only up to a hundred thousand euros really be called a rigorous safeguard?). They must, in any case, provide a minimum level of guarantee, such as through transparency regulations, even regarding the riskiest forms of investment.

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[1] The SSM attributed supervisory powers over all banks in the euro area to the ECB. In practice the ECB directly supervises the largest banks, which are deemed systemically important (approximately one hundred and twenty), while national authorities will be responsible for the direct supervision of other banks, although ultimate responsibility lies with the ECB.

[2] See the Regulation Report, p. 14 et seq.

[3] In fact this rule was followed to the letter in the Scandinavian countries during the 1990s crisis.

[4] On this point see also the following paragraph.

[5] In contrast, a lack of liquidity does not, in itself, constitute failure.

[6] Legislative Decree no. 159 of 6 September 2011.

[7] 1. The Republic encourages and safeguards savings in all forms. It regulates, co-ordinates and oversees the operation of credit.

2. The Republic promotes house and farm ownership and direct and indirect shareholding in the main national enterprises through the use of private savings.

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«They say things are happening at the border, but nobody knows which border» (Mark Strand)

The final seller's right of recourse in a french-italian perspective

by **Alejandro M. Garro** and **Ettore M. Lombardi**

Abstract: This article deals with the action of recourse stressing the importance of a comparative view. Although the main priority of Directive 1999/44/EC's is to give recognition to consumer protection, this achievement must be always considered in harmony with other targets of the aforementioned EU legislative measure, such as the modernization of the Member States' laws, the simplification of the overall discipline applicable to contracts of sale, and the approximation, at the EU level, of the Member States laws relating to the private law area. Therefore, it is on the light of the above that the action of recourse, namely a institution that does not seem to involve – primarily and directly – consumers' position but rather business parts of the contract of consumer sale (retailers and his/her predecessor), must be pondered. This approach is even more truth if the recourse is evaluated, on the one side, looking at the Italian legislature, and on the other, at the French one. Indeed, although the Italian legal system has structured the action under a right of redress in order to overcome the limitations to the accountability of the producer in accordance to art. 1495 of the Italian civil code, he has not, simultaneously, filled the gaps of protection emerging in the event of retailer insolvency. Thus, no legal action can be undertaken due to lack of the constituent elements, when the final seller in a financial state of insolvency cannot satisfy the claims of the consumer based upon proven lack of conformity. In France, instead, through the action directe, the case law, which was developed in the framework of the Code Civil, has allowed the buyer to act against any previous link in the distribution chain, and as a consequence the consumer is able to act not only against the dealer, but also against the wholesaler or retailer. All professional members of the contractual chain, therefore, are liable to the purchaser, although the seller effectively summoned to court has the right to be compensated from the part of the chain who is really liable for the defect occurred. The core idea that guides the present essay is, therefore, to reflect on the different solutions apparently adopted in Italy and France in matter of action of recourse to understand which appear to be the better orientation.

Summary: 1. Introduction. – 2. The nature of the institution as compromise: a look at the different implementation models. – 3. The action under a right of recourse: its general features, and the difficulties of systematic framework. – 4. The action under a right of recourse and its relationship with the guarantee of quality.

1. The implementation in the EU Member states of Directive 1999/44/EC on "Certain Aspects of the Sale of Consumer Goods and Associated Guarantees" ("Directive 1999/44/EC" or "EU Directive on

Sale of Consumer Goods”), as well as Directive 93/13/EEC on Unfair Terms in Consumer Contracts (“Directive 93/13” or “EU Directive on Unfair Terms”) provide a fertile source of comparison on different approaches to contractual liability and its border line with liability arising from wrongful acts. Whereas the joy of comparative law is to confirm how same problem yield in many instances similar results, not less sobering is to find out how differences in national laws may still allow for a harmonic or quasi-uniform law.

For a foreign observer, however, peeping through a looking glass outside the European Union, it is the difference in result what proves most interesting and instructive.

This article on “The Final Seller’s Right of Recourse in a French-Italian Perspective” is a good case in point.

The main purpose of the EU Directive on Sale of Consumer Goods is to ensure a minimum level of consumer protection throughout the EU member states.

The standards laid out in Directive 1999/44/EC is to ensure a “floor”, that is, a minimum standard, allowing member states to retain or adopt “more stringent provisions [which, though compatible with the Directive] ensure a higher level of consumer protection” (EU Directive 1999/44/EC, Art. 8.2).

In order to achieve this goal, member states may choose to implement the EU Directive through various means, and it is this choice what makes this comparative analysis most captivating.

General contract law may vary from country to country, making proof of fault particularly difficult in some countries. It is also by virtue of a general principle of contract law such as the need for “privity” (res inter alios acta or the principle of relativity or privity of contracts) that consumer’s rights are limited insofar as its possibility of reaching the distributor or manufacturer of the goods. Once the manufacturer is made a proper defendant, issues of burden of proof and measure of damages also play a significant role on how far the consumer is protected.

Consumers’ remedies may also be limited by more or less extensive limitation periods or the determination as to when such period starts to run or may be tolled.

The extent to which a consumer may be recovering from the manufacturer or producer may be limited by more fundamental principles, such as the contractual or extra-contractual nature of the remedy available to the consumer.

Thus, under German law, an injured consumer having no direct link with the manufacturer can sue the latter only in tort, on the basis of § 823 BGB, which clearly requires fault. It is thanks to Germany’s highest court on civil and commercial matters (the Bundesgerichtshof) improved the consumer’s task by reversing its burden, requiring the manufacturer to show that it was not at fault.

In contrast, American law, at least before the impact of Section 402A of the Restatement of Tort, developed a remedy on the basis of sales law, to the exclusion of tort law.

Similarly, French courts, relying on old provisions of the Napoleon Code seemingly aimed at protecting only the “purchaser” of goods, extended the coverage to any subsequent owner. Not only was the ultimate consumer entitled to an action directe against the manufacturer, but also the burden of proof was reversed by virtue of the jurisprudence developed by France’s highest court. Whereas the remedy against the seller was limited by the French Civil Code (Arts. 1645-1646) to the return of the purchase price and out-of-pocket expenses unless it was established that the seller was aware of the defects, the Cour de Cassation held that a seller in the business of selling goods of the same kind was presumed to know all defects, hence is always held liable for consequential damages.

Thus, although the seller's liability was formally based in fault, in the German law of torts and the French law of sales, jurisprudential developments achieved a higher level of consumer protection that came close to the result achieved under a regime of strict liability.

As shown in this essay, Italian law continued to rely on fault as the basis of liability, Italian courts proving less ready, con comparison with their German and French counterparts, to reverse the burden of proof.

Despite some scholarly opinions to the contrary, Italian courts by and large refused to extend the application of Article 2250 of the Codice civile, meant to apply in the event of harm caused by dangerous activities, imposing on the seller the burden of showing that everything possible was done in order to avoid the harm. Things changed after the adoption of Italy's Consumer Code (Law Decree No. 206 of 2005).

Fault remaining the basis of liability in a number of countries of the EU, such variations were regarded as impeding the free flow of goods across national borders, distorting conditions of competition by giving manufacturers in low liability countries an unfair advantage of those governed by a regime closer to strict liability.

This article explores the compromise solution reached by the EU Directive on Sale of Consumer Goods, exploring the roots of Article 131 of the Italian Consumer Code which, while seeking to implement Article 4 of the EU Directive, attempts to provides consumers with a direct right of action but without renouncing to the general principle of the relativity of contracts. The article explores subsequent jurisprudential developments in France and Italy, relying on a variety of scholarly opinions aimed at constructing a coherent body of product liability law favouring consumers.

Even though the EU Directive on Sale of Consumer Goods is now the point of departure, it is expected that decision law, by national courts and eventually the European Court of Justice, will continue to develop this area of the law.

It is expected that those courts will ultimately benefit from this essay as much as of similar analysis of the interaction between EU Directive 1999/44/EC and the pertinent provisions of national civil codes in general and consumer codes in particular.

2. Among all the provisions transposed in the Directive 1999/44/EC, the fulfillment of a high level of consumer protection certainly appears to be the priority that EU standards meet and from which it moves[1].

It is, however, not likely to incur forms of "overprotection" of the private purchaser. As the unbridgeable and predominant gap exists between the person and the market[2], there is the need to grant the individual means of protection that are appropriate and balanced with the new economic framework that Community legislation has intended to create and develop.

Furthermore, in spite of a full commonality of consumer purposes underlying the Directive 1999/44/EC, it should be noted that the uncertain and contradictory events, related to the Community measure implementation, have highlighted relevant operational obstacle resulting from the actual positioning of the rules in Member States and different regulatory systems.

The implementation process has been further blurred by the space that the Community rules, while seeking an even greater protection in favor of consumers, left to the variety of national legal systems. Member States are empowered to adopt or maintain, in the covered area, "more stringent

provisions, and compatible with the Treaty, to ensure a higher level of consumer protection”[3].

It is noteworthy, in fact, that the Member States already had a law applicable to the sale of consumer goods at national level before the adoption of the Directive 1999/44/EC. However, on the one hand, the European regulatory background was characterized by numerous and manifest lack of uniformity due mostly to the nature of sale that ensues from the general contract law. On the other hand, looking at the systematic areas covered by the directive, the fundamental differences between the Member States could be caught between those EU countries that, in terms of sales, had already adopted prior to the Directive legislation. Those are specifically directed to consumer protection, and those EU countries that had a general legal framework to regulate all types of sales, including the sale to consumers[4].

Within this landscape, Italy, which at first implemented the Directive 1999/44/EC by way a simple Legislative Decree (Law Decree 2004 no. 24), drives itself into (or attempt to) gather all the legislation relating to consumers together in a dedicated code by way the Consumer Code (Law Decree no. 206 of 2005). It is the latter, then, that we must examine to seize the rules under which is provided the right of redress for the last seller.

The model received by art. 4 of Directive 1999/44/EC and the corresponding internal measure of implementation can be considered as a compromise between the traditional model, so common both in civil law systems and in common law systems and focused on the principle of relativity of the effects of the contract (privity of contract), which allows to claim the contractual liability only against the immediate contractor, and the French model, which is based on the recognition of the action directe even in favour of the last seller against the initial ring of the distribution's chain.

The latter solution, which implies the automatic transfer of the guarantee for hidden defects in any intermediate transfer of the ownership, should provide a more effective protection because the guarantees of economic stability offered by the manufacturer are usually more secure than the ones of a small trader. According to the described mechanism, the transfer of the property implies ex se a simultaneous transmission of the remedies as an integral part of the sales contract, according to the brocard *accessorium sequitur principale* that art. 1615 Code civil assumes[5].

However, it seems appropriate to point out that the EU legislator, because it failed to impose a pure French model in all Member States, opted, then – as it was mentioned earlier –, for an unusual regulation that is a mixture of privity of contract and direct action. The rule, indeed, although does not provide the possibility to act directly against the manufacturer of the final seller or other parties to whom the defect is attributable, does not even require a necessary chain of recourse claims that follow, step by step, the individual contractual relationships, in order to require each buyer to make reference only to his/her predecessor.

Article 131 of the Consumer Code[6], therefore – following the provision of art. 4 Directive 1999/44/EC[7], and the example of art. 36, paragraph 4 of the Consumer Code– seeks to respond to the need to strengthen the final seller position. That provision grants him a remedy under a right of redress as against the producer or any other intermediary seller that is liable for a lack of conformity, even with no direct contractual relationship with the consumer (privity of contract).

A mechanism, which splits the position of the retailer from the manufacturer or other intermediary[8], enables reconciling the final seller claims to the needs of consumer protection[9]. Such mechanism has supported the development of the provision on the right of redress that

simultaneously meets two requirements: expanding the range of protections available to the last link in the distribution chain (Vertriebskette)[10], and, thus, countervailing the strengthening of consumer rights[11].

The final seller, which often acts with less bargaining and economic power, is not forced, then, to endure the full capital charges resulting from lack of conformity, whereas, after spreading business risks and benefits, he is given the alternative to pour on any of the previous sellers – to whom the defect is imputable – the cost of the guarantee[12], i.e. the costs incurred to satisfy the consumer claims under arts. 130 and 135, paragraph 1 of the Consumer Code[13].

Such a regulatory solution is due to the fact that he does not have the slightest chance of influencing the activity of traded goods production, whose anomalies are, in general, refer to the manufacturer.

Reasons of fairness, therefore, require that the financial consequences of the non-conformity alleged by the consumer are assigned, finally, to the subject who can control and manage the factors generating the risk of economic initiative.

Thus the last dealer should anticipate the cost of the guarantee that, in the end, is the liability of the person in charge of the lack of conformity, either producer or wholesaler.

The described regulatory mechanism would also work in favor of a constant and prompt improvement and refinement of production and distribution processes, and, consequently, the quality of the goods offered to the public. It would prevent the producer to be, in fact, risk free asset thereby charging distributors the negative economic consequences of the non-conformity he caused[14].

The final seller, hence, pursuant to art. 2058 of the Italian Civil Code, can claim under a right of regress either the equivalent[15] or the specific performance[16], where the requirements are met[17]. Therefore, if he had to replace the good purchased by the consumer, he may ask his supplier a eadem res free of any defects, against handling the good originally delivered to his customer.

Although the Italian legislature has structured the action under a right of redress in order to overcome the limitations to the accountability of the producer in accordance to art. 1495 of the Italian civil code[18], he has not, simultaneously, filled the gaps of protection emerging in the event of retailer insolvency. Thus, no legal action can be undertaken due to lack of the constituent elements, when the final seller in a financial state of insolvency cannot satisfy the claims of the consumer based upon proven lack of conformity.

Within the described case a weakened protection is afforded to the consumer that cannot directly suit the producer[19], while a privileged protection is recognized to the dealer, who can avoid the risk of insolvency of his assignor in addressing the third producer responsible for the defect.

However, a different problem arises where the final seller, pursuant to art. 131 of the Italian Consumer Code, seeks a remedy against the upper link of the contractual chain, while – purchasing the good – he knew or could not reasonably have been unaware of the defect. For instance, an importer based in Italy that supplies goods from non-EU markets where use is made of materials or techniques whose quality standards are lower than those required in Europe[20].

Part of the Italian academic writing, arguing in accordance to art. 1642 and art. 1491 of the Italian civil code, does not recognize such a remedy to the final seller[21]. In fact, on the one hand, consciously offering the public a defective thing, he would betray consumer trust and expectations

– that is the reason why he should bear the consequences of the losses arising from consumer fair claims[22]; on the other hand, the obvious lack of conformity would justify, within the relation between entrepreneurs, the final assumption of risk upon the retailer, with no recovery under the right of redress[23].

The final seller protection granted by art.131 of the Italian Consumer Code may appear as the projection of art. 9 Law no. 192 of 18 June 1998, on the abuse of economic dependence[24], as it also aims to correct the anomalies of a market system in which the hegemonic or better-organized party exercises an authoritarian power. However, the first glance clearly turns away as demonstrated by art.131, paragraph 1; notwithstanding the foregoing rules provided to offset excessive bargaining power, it allows the retailer to renounce the right to redress without limit[25].

Although the provision of art. 131 of the Italian Consumer Code is not binding whereas the principle of freedom of contract is not affected[26], yet it should be stated that alongside the legislature has allowed the presence of the necessary conditions to submit the waiver to a safeguard clause. It tacitly reserves the court the opportunity to examine contingent failures, surreptitiously underlying the conventional exemption, which unveils the abuse of power by those who conceived the agreement in their own interest[27].

Ensuring the full integrity of the principle of freedom of contract does not mean allowing the abuse of freedom of contract. On the contrary, the principle can be protected only by avoiding heteronomy or, better, situations where the weaker party might suffer any conditions, even the most grossly unfair, imposed by the stronger one[28].

In the absence of expressed limits to the freedom of contract under the art. 131 of the Italian Consumer Code, a different perspective has been given upon the final retailer aware of the lack of conformity, when there is evidence that the supply of defective material constitutes the symptomatic index of the abuse of economic dependence[29].

One can have the case of a retailer who purchases goods from a supplier, perfectly conscious of lowering quality standards, but compelled by the alternative between continuing the relationship with the same producer or contacting the competitors – facing the risk of losing his client due to the new trademark reduced attractiveness.

In such event it has to be assessed whether the diminished quality standards is attributable to normal business risk, which must necessarily meet the seller[30].

The judges of the Italian Supreme Court favor a negative response to the mentioned issue, but the question seems to engender – avoiding hypothesis of mere speculation – from a different point of view, the impairment of expected trust placed by the final seller in the prestige and level of reliability he enjoyed through the producer brand[31].

In that case, then, the factory distinctive sign seems at sudden to heavily characterize the distribution chain conditioning the activation of the same legal circulation that may create profit for the retailer, providing that he can benefit from the brand power to intercept customers[32].

3. The genuine action under a right of redress is intended to indemnify the seller with respect to all adverse consequences potentially caused by the granted complaint filed by the purchaser. Its plan is due to a contractual liability that leads to a dual relationship: the one takes place between the seller and the consumer, the other is established between the final seller the producer or any intermediary in the same supply chain.

Art. 131 of the Italian Consumer Code meets the essential need for justice in order to avoid serious economic consequences repercussions upon a subject that is not often liable for any consumer damage. Nonetheless, that provision does not widen the consumer sales warranty in favor of non-consumers, even where they may hold an objective unequal bargaining position against any other intermediary[33].

Then, in case of consumer claims based on the lack of conformity with the contract, the rule under art. 131 of the Italian Consumer Code can be applied just in two cases: in *primis*, the lack of conformity of goods shall exist where delivered from the producer to the final seller; in *secundis*, the defendants shall be part of the supply chain. Instead, the right of redress does not apply where – once the contractual chain is trespassed – the buyer purchased goods from a private individual. Such statement is made clear by the definition of seller laid down in art. 128, par. 2 b) of the Italian Consumer Code, which does not include a private individual. Whereby, in the case mentioned, required conditions for the class action are not met.

The main problem with regard to the action under the right of redress concerns the evaluation of its legal framework in order to not only the existing legal categories, but also the legislative technique. Whereas its applicability to the seller has a direct impact on the same legal and conceptual identification of consumer definition. An important role is given, indeed, to the actual imbalance of bargaining power between entrepreneurs that are differently dimensioned but bound by obligations to carry out a professional activity.

The doctrine, despite the efforts aim to draw up a general concept of recourse, has failed in its attempt, because it is hard to clarify an overall definition of redress, which uniformly collects all the variety of hypothesis that may occur[34].

The same issue arises in the analysis of redress qualification under art. 131 of the Italian Consumer Code, where the trilateral relationship elapsing between seller, professional and consumer-purchaser cannot be framed in the classic joint liability, since a different kind of obligation seems to bind seller and intermediary.

The action under the right of redress for the final seller is not rather attributable to the joint obligations only if we consider, in addition to the non-exhaustive remedies granted by article 131 of the Italian Consumer Code – the condition for subjectively complex obligations. In such legal bonds, in fact, the uniqueness and identity of performance and consideration distinguish them from all other legal relations, where a single creditor is opposed to more co-debtors (or viceversa). In parallel, a more tenuous connection would exist regards to joint obligations, although both the active and passive subject are completely different[35].

Therefore, the trilateral relationship between consumers, final sellers and intermediaries of the same contractual chain, reveals a link between different subject positions, and a broad solidarity from passive side (i.e. final seller and the previous intermediary), as a reflection of the relationship between consumer and seller. It cannot, however, be considered a classic joint obligation that would be characterized by the ability of both the consumer and the seller thereof to file a claim indistinctly against any link of the same distribution chain (producer, intermediary, or seller).

The action under the right of redress pursuant to art. 131 of the Italian Consumer Code, might be framed, at most, in a generic category of joint obligations[36] deemed atypical by the law, or attenuated for protection purposes. In this case, the latter could consist in the legislative choice to grant the consumer a direct and immediate legal relation with the last contractual series professional related to a given good[37].

Just the concept of redress would suggest the attempt to set a merely internal solidarity between the seller and another intermediary in the same supply chain[38]. Identifying a general and homogeneous definition of recourse, in hindsight, seems to be impossible[39], whereas the non-configurability of a two-way relationship between the right of redress in joint obligations, and other assumptions of recourse in which solidarity either is assumed or is regulated differently under art. 1299 Italian Civil Code[40].

It appears that the Italian legislator, in the end, wanted to use the right of redress under art. 131 of the Italian Consumer Code to achieve two goal: first of all, to remedy the absence of direct action for the consumer against the producer or other intermediary in the contractual chain[41], and, secondly, to rebalance the seller position, eventually sentenced to pay damages for a defect that is not imputable to him[42].

Then the consumer cannot suit either the seller or the producer, between whom an ordinary joint obligation does not exist. Instead, a joint obligation separated from the consumer position might be relevant in favor of the seller, when he is convict[43].

Within relations between the final seller and the consumer, therefore, continues to rely on the principle of relativity of contracts, consecrated by art. 1372 Italian Civil Code[44]; thereby the non-liability of the producer towards le particulier is not at issue, when he appeals to indirect distribution chain. On the contrary, the Italian legislator has waived the same principle in favor of the final seller. In fact, he is entitled to file an action under the right of regress against the previous link of the distribution chain, whose act or omission has been the defining event the lack of conformity and from which is derived the liability of the plaintiff to the consumer, although there is no immediate relationship between the parties. This choice is justified by the predominance of the principle of liability (Verantwortungsprinzip), which, herein, has broken the classic and rigorous coincidence between obligation and contract, and whose origin lurks in the lack of conformity descendant from the antinomy between given and due.

The first source of liability for the author of the offence, against whom the remedy is filed, coincides, then, with the fracture of the contract between the retailer and the consumer. Moreover, the chance to glimpse a commitment to protect the producer and the intermediate distributor always remains[45].

The consumer has granted an immediate protection of his rights related to the closer professional subject, i.e. the last seller. That is the purpose of the right of redress together with the exclusion of a direct remedy against the producer.

Art. 131 of the Italian Consumer Code shall not allow, in fact, the retailer to cede, by a contractual term, his right to redress the producer, neither to file legal action based on defects for which he is liable.

So that, a double effect would be obtained. Preventing the seller to escape a conviction, as much as avoiding a lack of protection for the consumer if, during the proceedings, it is found that the defect could not be causally reconnected, either directly or indirectly, to fact or behavior of the producer or other professional but to the final seller.

Art. 131 of the Italian Consumer Code, otherwise, unveils a significant problem of interpretation that concerns the figure of consumer and his concept breadth. The named provision is an expression of the need, perceived at EU level, to extend the applicability of the consumer regulation to the intermediary links of the distribution chain, i.e. the subjects between the producer and the final consumer.

In France, through the action directe, and in Belgium, through kwalitatieve rechten or droits

qualitativi, the case law, which was developed in the framework of the Civil Code, has allowed the buyer to act against any previous link in the distribution chain, and as a consequence the consumer is able to act not only against the dealer, but also against the wholesaler or retailer. All professional members of the contractual chain, therefore, are liable to the purchaser, although the seller effectively summoned to court has the right to be compensated from the part of the chain who is really liable for the defect occurred[46].

The regulation of consumer goods sales is conceived on an extreme formalism regarding the subjective side, and neglects, at the same time, the actual position of the contracting parties. Therefore, it excludes the professional from the special protection granted to the individual purchaser, by a choice that leads us to consider so indistinct and on a level similar bargaining power, all professionals of the series contract.

The interpretation of the action under the right of redress for the final seller may even rely on a systematic approach that takes step from art. 36 of the Italian

Consumer Code. The first part of the rule, in truth, envisages hypothesis of absolute presumption of unfairness – generally referred to the exclusions of liability for the professional; but the second part recognizes the seller the right of redress against the supplier. This remedy is, then, a tool designed to rebalance the position of those weak professionals[47], also called “intermediate customers”[48], who will suffer neither judicial rulings of unfairness – which usually target the contractual clauses set by the producer – nor convictions for lack of conformity beyond their control.

By the same token, the concept of consumer gradually widens, favored by a more substantial rather than formal regulation that is aimed to enlarge, indirectly, the formal contents of provisions enacted to protect consumers in the strict sense intended. Thus, the legislation at hand highlights both the objective inequality of the contractors’ economic strength, and the injustice of a regulation that aims to restrict, a priori, the definition of consumer.

However, an underlying and, yet, not fully expressed will to change the foundation of consumer regulation is still present and would act through the transition from a subjective to an objective vision, based on the actual comparison of bargaining powers strong and weak bargaining powers.

The need for new and modern setting hermeneutics flows, at least in Italy, from the analysis of the functioning of trading market at a business level, as well as the assessment of sectoral regulations designed to protect the alleged weak professional. Among those rules, Law 10 October 1990 no. 287 (Antitrust law)[49], specifically art. 3 A), foreseen the abuse of dominant position when price or contract terms are unduly burdensome. Moreover, Law 18 June 1998, no. 192 on subcontracting in productive activities[50], which aims at protecting the weakness positions in contractual relationships between professionals with – only theoretically – similar bargaining power[51].

The same Italian Consumer Code seems to have adopted an innovative system, centered on the act of consumption as a tool for engaging and protect the professional-consumer[52]. In fact, due to stringent contractual relations between companies with different commercial skills and strengths characterize, phenomena of exploitation of dominant positions may occur in economic exchange against small distributors and retailers. The creation of economic dependence leads to the assimilation of the latter to the individual consumer.

The respective industry regulations, therefore, feel a similar need for protection, common to weak professionals and consumers. Although they formally refer to different subjects, both laws seek to ensure the forms of protection, representing a further stimulus to the reconsideration of the subjective limits in order to define the overall scope of consumer rules.

4. A right of redress enforceable without cut-off point would damage, deadly, the certainty and stability of the legal movement of goods, as well as expose the previous links in the contractual to a considerable economic risk, which is not justified by a corresponding need to protect the final seller.

His defense would not be harmed, but rather assured adequately and sufficiently, if the date of accrual is not before the retailer fulfilling the purchaser's warranty expectations.

Given the fact that the last sentence of art. 4 Directive 1999/44/EC leaves the procedures and modalities up to the national legislatures, the Italian Consumer Code in art. 131, paragraph 2, is perfectly consistent with the above described protection needs for both the market and the final seller.

Furthermore, art. 131 Italian Consumer Code adopts a solution that appears to be more favourable than the one built by the French case law on vice caché, according to which the prescription period for recovery starts when the final or intermediate seller is summoned by his/her direct buyer[53].

The wording of art. 131, paragraph 2, prescribes an annual limitation period for the action under the right of redress: the time period runs on the date when the performance begins, i.e. after the retailer carries out his duty to pay or to do to the satisfaction of the consumer's claims[54].

This mechanism makes a significant progress in the creation of a quite efficient system for the allocation of responsibility in the consumer goods distribution[55]. It is also able to ensure effective protection of dealers, which would have been otherwise compromised if their rights had elapsed before the consumer brought remedies under art. 130 of the Italian Consumer Code.

Thus, the traditional model based on a short limitation period – running from the date of delivery of goods to the final seller[56] – has been abandoned. It is true thought that the speed of movement of consumer goods, together with their rapid obsolescence, make it rarer the case of goods lying in the retailers' warehouses for too long.

The problem of the complaint for lack of conformity to the contract, however, remains unsolved. So that, ancient questions posed by the guarantee application pursuant to articles 1490 and following of the Italian Civil Code.

Two different thesis have been supported about the limitation period of eight days laid down by art. 1495 Italian Civil Code. One argument sets the date of accrual on the delivery of goods to the sub-buyer, while the other considers the beginning of the period from when the dealer is approached with a claim.

The reported hermeneutics doubts cannot find an easy solution. Either according to art. 132, paragraph 2, of the Italian Consumer Code, which cannot be implemented, because the retailer is not a consumer; or considering the assumption that the legislator, willing to ensure an effective legal arrangement, wanted to free the redress from the burden of reporting pursuant to art. 1495, paragraph 1, of the Italian Civil Code.

The Gordian knot must, thus, be disentangled not by the stiff and formal canon interpretation for which *ubi lex voluit dixit, ubi nocuit tacuit*, but in accordance with the requirements underlying the arrangement, in the light of the legal type under art. 131 of the Italian Consumer Code, read in conjunction with art. 135, paragraph 2, of the same Code, and articles. 1490 and following of the Italian Civil Code.

The rule expressed by the industry code, in fact, wanted to overcome the principle of relativity of contracts, which is the basis of the institute forged by the Judiciary, and at the same time to avoid moving on the ground of fault liability, which, instead, is unrelated to art. 1490 of the Italian Civil Code[57]. This mechanism is nevertheless in full respect with the right of redress under art. 131 of the Italian Consumer Code – enforced to rebalance the position of the seller, eventually convicted to pay damages for a defect he is not responsible for[58].

Consequently, the need arises to adopt a solution that, reading between the lines of art. 131 Italian Consumer Code, is likely to seize the reasons why the legislator has provided such rule. Moreover, it should highlight the dual difference intervening in the regulation of the same institute, between the statute of the sale of consumer goods and the common regulation.

The mentioned provision, then, just wants, on one hand, to overcome the principle of relativity of the contracts, otherwise set out in art. 1495 of the Italian Civil Code. In fact, it allows the dealer to bring a claim against any previous link in the same contractual chain. On the other hand, it wants to clarify the legal cut-off point for the action under the right of redress in consumer sales. More precisely, it aligns the two limitation periods stated in the sectoral code, and in art. 1495 of the Italian Civil Code, differentiating the date of accrual. In the case at hand, it runs after that the final seller meets a consumer claim, while, in the case of contract of sales, it begins from the delivery of the goods to the buyer.

Art. 131 of the Italian Consumer Code ultimately, has brought to light only the heterogeneity present in the regress statute. It did not bear to predict, explicitly, a repose period within which the seller should file a complaint. That is due to, in the first place, the following art. 132 of the same Code cannot be clearly applied – the subject is a professional not a consumer; secondly, it leads to art. 135, paragraph 2, which refers to “the provisions of the Civil Code on the contract of sale”, and, consequently, art. 1495 of the Italian Civil Code.

The final seller, therefore, is bound to the limitation period under art. 131 of the Italian Consumer Code and the expiry period under art. 1495 of the Italian Civil Code. He will be able to file a complaint, according to the first rule, either against his predecessor or against the previous link in the supply chain considered imputable. In fact, the right of redress can be claimed regardless of etiological profile of the remedy[59]. Even if the act or omission of the producer or a previous seller are not due to negligence or wilful misconduct, as set out in the said art. 1495.

The redress ex art. 131 of the Italian Consumer Code, then, is an autonomous presumption that slightly unfolds with regard to statute of defects, as the legislator would only dictate specific exceptions to the general rules. They are sufficiently functional to ensure consistent implementation of the sectoral code, and to simplify the exercise of the rights *ex empto*, payable to the dealer against the previous links in the distribution chain.

It follows that, besides the mentioned exceptions, the redress requires, *mutatis mutandis*, the implementation of articles 1490 and following of the Italian Civil Code, irrespective of negligence

of the defendant.

If it acted otherwise, there might be cases where only the final seller would ultimately meet faulty good claims, without any reason[60]. Furthermore – as demonstrated by art. 135, paragraph 2, of the Italian Consumer Code – it would challenge the obvious nature of “variant”[61] that the consumer goods sale has acquired in comparison to sale in general, as well as its full integration into the system as it is enshrined in art. 1470 of the Italian Civil Code and following.

In its entirety, the arrangement of redress under art. 131 of the Italian Consumer Code has not substantially moved away from the guidelines of the guarantee *ex empto*, as to which the fault, pursuant to art. 1494 of the Italian Civil Code, detects only in case of damages, and the burden of proof, in accordance of art. 1495 Italian Civil Code, also relies on the final seller who wishes to exercise the remedy devised by Community law.

The discussion reveals that the dealer will be freed from the sequential order in art. 130 of the Italian Consumer Code. So that, when he pursues a lawsuit under the right of redress against his direct supplier, the final seller shall be entitled to ask, if desirable, for the immediate termination of the contract, pursuant to art. 1453 Italian Civil Code, which fits well within the principle of substantive equality because of the consequential equal treatment between consumer and professional-retailer.

This latest survey shows genuine circularity of the sale system, able to solve all threads about the disparity of contracting parties’ statute, which often result from arrangements that fragment the legal system unity, if not welded to authentic and distinctive profiles.

* Although the article is the result of joint observations of the two authors, the abstract and the paragraph 1 have to be attributed to Alejandro M. Garro, while paragraphs 2, 3, 4, to Ettore M. Lombardi.

References:

[1] The Directive 1999/44/EC’s priority to give recognition to consumer protection fits harmoniously in the achievement of other targets that the EU bodies aimed to achieve throughout the aforementioned legislative measure, such as the modernization of the Member States’ laws that appear unsuitable for the current production and mass marketing; the simplification of the overall discipline applicable to contracts of sale; the approximation, at the EU level, of the Member States laws relating to the private law area. See Proposal for a European Parliament and Council Directive on the sale of consumer goods and associated guarantees, COM (1995) 520 final – COD (1996) 161, in OJ C 307, 16.10.1996, p. 8 ff. It is worth to notice that the Directive on Consumer Rights (Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council) replaces, as of 13 June 2014, Directive 97/7/EC on the protection of consumers in respect of distance contracts and Directive 85/577/EEC to protect consumer in respect of contracts negotiated away from business premises. Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees as well as Directive 93/13/EEC on unfair terms in consumer contracts remains in force. See, for a general analysis of the Directive 1999/44/EC’s targets, H. Albrecht, *Die Verbrauchsgüterkauf-Richtlinie 1999/44/EG und ihre Vorgaben für das deutsche Kaufrecht*, in *Zeitschrift für die Anwaltspraxis*, 2000, p. 93 ff.; P. Nocerino, *La nuova disciplina comunitaria della garanzia nella vendita di beni di consumo*, in *Dir.*

comm. e degli scambi intern., 2000, p. 315; E. Hondius, C. Jeloschek, Towards a European sales law. Legal challenges posed by the Directive on the sale of consumer goods and associated guarantees, in *Eur. Rev. Priv. Law*, 2001, 9, p. 157 ff.; C. Twigg-Flesner, EC consumer sales law: Are you being served?, in *Consumer Policy Rev.*, 2001, 1, 1 ff.; G. De Cristofaro, Difetto di conformità al contratto e diritti del consumatore, Padova, 2000, p. 1 ff.; Id., La nuova disciplina codicistica dei contratti per la fornitura dei beni mobili conclusi da consumatori con professionisti, in *Studium iuris*, 2002, p. 1174 ff.; P. Pardolesi, La direttiva sulle garanzie nella vendita: ovvero di buone intenzioni e di risultati opachi, in *Riv. crit. dir. priv.*, 2001, p. 442 ff.; A. Luminoso, Chiose in chiaroscuro in margine al d. legisl. n. 24 del 2002, in *Le garanzie nella vendita dei beni di consumo*, in *Tratt. dir. comm. e dir. pubbl. dell'econ.*, diretto da F. Galgano, XXXI, 2003, p. 10 ff.; A.-M. Leroyer, Conformité des biens – Transposition de la directive, in *RTD civ.*, 2005, p. 483 ff.; S. Patti, Garanzia legale di conformità e garanzie commerciali per i beni di consumo. Art. 129 (Conformità al contratto), in *Nuove leggi civ. comm.*, 2006, p. 362 ff.; A. Scarpa, La vendita dei beni di consumo: la conformità al contratto e i diritti del consumatore tra codice del consumo e codice civile, in *Giur. di merito*, 2008, p. 3038 ff.; P. Gentile, Il riconoscimento dei vizi e gli effetti dell'impegno del venditore ad eliminarli, in *Rass. dir. civ.*, 2010, p. 603 ff.; R. Schulze, *The Evolution of Torts in European Business Law*, in *Compensation of Private Losses: The Evolution of Torts in European Business Law*, edited by R. Schulze, Munich, 2011, p. 9 ff.

[2] N. Irti, *L'ordine giuridico del mercato*, Roma-Bari, 2004, p. 97 ss.

[3] See art. 8, § 2, Directive CE/99/44.

[4] The presence of general rules on the sale is reported, for example, in the United Kingdom, Italy, Belgium, Cyprus, France, Germany, Hungary, Ireland and Malta.

[5] See, in case law, ex multis, Cass. 1re, 26 mai 1999, in *Juris class. pér.*, 2000, p. 231; and, in the tenet, P.H. Antonmattei, J. Raynard, *Droit civil. Contrats spéciaux*, Paris, 2000, p. 176 ff. The alienating, then, can present against the sub-buyer exceptions that are based either on clauses that limit or exclude the liability or on arbitration clauses that the former could assert against his/her direct successo. See Cass. 1re, 7 juin 1995, in *Dalloz (Somm.)*, 1996, p. 14; contra, J. Calais-Auloy, F. Steinmetz, *Droit de la conommation*, Paris, 2006, p. 278, where it is believed that the consumer should be consider holder of the right of ascertaining the unfairness of the mentioned clauses. As a consequence, if the sub-buyer gets in his/her favour a preliminary redhibitory against the manufacturer, the latter will be merely convicted to return what he/she got by the first purchaser, with possible charges of the difference in compensation for the damages. See Cass. 1re, 27 janvier 1993, in *Juris class. pér. (Tabl. Jur.)*, p. 91; Cass. 1re, 8 juin 1999, in *Dalloz (Inf. Rap.)*, 1999, p. 206; nonché, P. Le Tourneau, *Responsabilité des vendeurs et fabricants*, Paris, 2001, p. 229. See, on the action directe, in case law, ex multis, Cass. comm., 17 mai 1982, in *Bull. civ.*, IV, n. 182; Cass. 1re, 27 janvier 1993, in *Dalloz (Somm.)*, 1995, p. 210 ff.; and, in the tenet, M. Cozian, *L'action directe*, Paris, 1969; C. Jamin, *Brèves réflexions sur un mécanisme correcteur: l'action directe en droit français*, in *Comparaisons franco-belges*, dirigé de M. Fontaine et J. Ghestin, Paris, 1992, p. 295 ff.; C. Jamin, *La notion d'action directe*, Paris, 2001, p. 225 ff.; J. Ghestin, C. Jamin, M. Billiau, *Traité de droit civil. Les effets du contract*, Paris, 1994, p. 852 ff.

[6] Before the entry into force of the Consumer Code, in which the art. 131 finds its raison d'être and its justification, some authors have considered stranger to a regulatory system direct to assure a specific protection of the consumer, the prevision of a right of redress. See A. Luminoso, *Appunti*

per l'attuazione della direttiva 1999/44/CE e per la revisione della garanzia per vizi nella vendita, cit., p. 128 ff.; C. Iurilli, *Autonomia contrattuale e garanzie nella vendita dei beni di consumo*, cit., 213 ff.; contra, R. Calvo, *Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo*, cit., p. 321.

[7] The Article 4 of Directive 99/44/EC originally seemed oblige national systems to provide the final seller of a right of redress against any person (i.e. manufacturer, any previous seller or other intermediary) reliable for the lack of conformity, regardless the real composition of the contractual chain starting from the final seller. However, the final text of the directive has slightly changed the previous rule, giving Member States the option to choose the preferred model of recourse. The Article 4 of the Directive has not been implemented through specific provisions by all Member States, in fact, some of them (Cyprus, Estonia, Finland, France, Greece, Italy, Latvia, Malta, Poland, Hungary) has opted for the mere inclusion in a particular article of the regulation to be implemented, while other ones (Austria, Belgium, Cyprus, Denmark, Germany, Ireland, Lithuania, United Kingdom, Czech Republic, Slovenia) have stated that in this sector the recourse should follow the general contractual principles. More to the point, with reference to the first group of countries, in France, Article L. 211-14 of the Consumer Code, provides that, in the sale of consumer goods, the recourse should follow “*les principes du Code civil*” and consequently leaves room for case law, which justifies the relaxation of the principle of conventions’ relativity by means of the rule *maximum accessorium sequitur principale* presupposed in art. 1615 Code civil; in the Netherlands and Finland (art. 31, Chapter 5, Protection Consumer Act), it is expected that the final seller may claim only against the previous link in the chain of contracts, but while in the former country it impossible to act just when the last seller was aware of the good’s defects, in the second country the action of recourse may be brought either when the lack of conformity is not derived from causes that emerged after the previous trader has already delivered the good, or the final seller does not base its action on statements made by persons other than the previous professional, or the final seller does not require a price reduction or a refund higher than the price paid to the previous professional; in Malta, Article 1431 Civil Code provides that the retailer is required to enforce the right of recourse within six months starting from the judgment favourable to the consumer; in Portugal, the recourse must be brought within two months starting from the conviction, in favour of the consumer, of the final seller, and provided that, on the one hand, a period of five years has not passed from the sale’s conclusion yet, and, on the other, the lack of conformity is not found just after the delivery of the goods to the retailer (in this case, the previous link in the chain of contracts can not be held responsible for); in Spain, the final seller must act within one year starting from the conviction, in favour of the consumer, of the professional who is currently responsible for the defect, and as a consequence, and unless the manufacturer has been convicted directly, the recourse may be brought by the latter, if the retailer is currently responsible for the defect. As for the second group of countries, while some of them (Czech Republic, Denmark, Ireland, Lithuania, United Kingdom, Slovakia, Slovenia, Sweden) has not taken any measures to implement the provisions contained in Article 4 of Directive no. 44 of 1999, but they did implicit appeal to the general rules, in Austria, § 933b ABGB recalls the rule under which the recourse have to be exercised by the final seller or other intermediary against his/her predecessor within two months starting from when the consumer or the consecutive trader have obtained a ruling favourable to him/her, unless a period of five years starting from the last sale has not passed yet and the amount requested does not exceed what was paid to the person claiming under the guarantee; in Belgium, art. 1649 Code civil, which sanctions the ineffectiveness to the consumer for any contractual clause that limits the liability of the retailer to the private buyer for defects caused by actions or omissions of the previous link in the chain of contracts, is recalled; in Germany, it is

possible to invoke the rule that the final seller can sue his/her distributor – although this rule relates more to new assets than to all consumer goods considered by the Directive –, and as a consequence the principle of relativity, which has avoided a setback per saltum in favor of a Stufenregress, is complied with.

[8] See E. Moscati, Art. 1519-quinquies, Note introduttive, in *Commentario alla disciplina della vendita dei beni di consumo*, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 462.

[9] See S. La China, *La chiamata in garanzia*, Milano, 1962, p. 44, where the A. asserts that the word “recourse” does not identify with a unitary and homogeneous category, but represents a «[...] generica etichetta, una parola buona a molteplici usi, una mera allusione al dato, grossolanamente osservato e descritto, del rivolgersi all’indietro verso qualcun altro, in conseguenza di una certa vicenda anteriore e diretta»; and, in this sense, B. Gambineri, *Garanzia e processo*, I, Milano, 2002, p. 237, where the A. affirms that «[...] il termine regresso – di solito – è usato per indicare solo la funzione economica che una serie di azioni, aventi natura giuridica diversa, perseguono e che consiste nel riversare su altri le conseguenze economiche negative derivate da un diverso rapporto giuridico corrente con un soggetto terzo».

[10] Considering the possibility to extend the entitlement of the claim of recourse, beyond the final seller who art. 131 Italian Consumer Code directly refers to, it must be considered that the solution adopted in Austria and Germany expressly allows to involve other intermediate rings of the distribution chain, but in these systems the recourse remains linked to the contractual relationship (Stufenregress). Under Italian law, although this profile is not specifically regulated, it appears normal that the power granted to the final seller to exercise the right of recourse against any previous professional step of the distribution chain is not excluded, even in absentia of a contractual relationship. Therefore, the dealer would not be banned to act against any previous ring of the distribution chain considered responsible, when he/she was forced to bear the negative economic consequences arising from the lack of conformity asserted by the consumer. See, for further details on the Austrian and German law, supra note 7.

[11] See G. Cassano, *Professionista debole e clausole vessatorie* (a proposito dell’azione di regresso di cui all’art. 1469-quinquies, 4° comma, c.c.), in *Danno e resp.*, 2000, p. 587 ff.

[12] Cfr. F. Bartolotti, *Azione di regresso e vendite a catena*, in M. Bin e A. Luminoso, *Le garanzie nella vendita dei beni di consumo*, op. cit., p. 477; G. De Cristofaro, *La vendita di beni di consumo*, op. cit., p. 1076; P. Paganelli, Art. 1519-quinquies, in *La vendita dei beni di consumo. Commentario breve agli artt. 1519-bis ss. c.c.*, a cura di C. Berti, Milano, 2004, p. 141. The recourse, however, may be brought even if a used goods was sold, while it is not allowed when it would determine a transfer from the distribution chain to the production chain. This phenomenon is due to the transformation processes that the good must cope with and that make it *alia res* compared with its previous status (for example, the retailer will not be able to act directly against the software vendor, when the lack of conformity is attributable to a design error linked to an electronic system malfunction of the manufacturer). Cfr. C. Cicala, *La dismissione del diritto di regresso*, in *Aspetti della vendita dei beni di consumo. Atti del dottorato in «Diritto dei contratti ed economia di impresa*, Milano, 2004, p. 137.

[13] See E. Moscati, Art. 1519-quinquies, Note introduttive, in *Commentario alla disciplina della*

vendita dei beni di consumo, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 462. It must be pointed out that only a mixture of contractual remedies and non-contractual remedies (derogating from the principle of relativity of the contract) appear to ensure a fully protection of the final seller. This solution, indeed, would allow him/her to choose whether to take action against his predecessor or directly against the persons who caused the defect. Such freedom of choice is assured in France, where the action directe competes with the ordinary remedies arising from the defects' guarantee. Furthermore, it is worth to notice that the latter can be exercised over an extended period of time (thirty years) in compliance with art. 1604 Code civil, and its action for l'inexécution de l'obligation de délivrance. See, for a critique of the short two-year term required by the EU directive, P.Y. Gautier, Contrats speciaux, in Droit civil, dirigé de P. Malaurie et L. Aynès, Paris, 1999, n. 400; A. Pinna, I termini nella disciplina delle garanzie e la direttiva 1999/44/CE sulla vendita dei beni di consumo, cit., 2000, p. 527 ff. Unlike the French case law, then, the Italian courts, in principle, deny the possibility of extending the effects of the warranty for defects provided by the first seller to the assignees of the buyer as well. See App. Roma, 19 dicembre 1989, in Giust. civ., 1990, I, p. 450 ff.; Cass., 6 dicembre 1995, n. 12577, in Danno e resp., 1996, p. 524; Cass., 21 gennaio 2000, n. 639, in Contratti, 2000, p. 903.

[14] Cfr. F. Bocchini, La vendita di cosa mobili, Milano, 2004, p. 504 ff. It must be clarified, however, that if the dealer would like to be indemnified for the damages resulting from the bad business reputation should act in compliance with art. 1494 and 2043 Italian Civil Code. See A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, op. cit., p. 112; contra, F. Bocchini, La vendita di cose mobili, op. cit., p. 514 ff.

[15] See, ex multis, A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, cit., p. 112; nonché G. De Cristofaro, La nuova disciplina codicistica dei contratti per la fornitura dei beni mobili conclusi da consumatori con professionisti, op. cit., p. 1184, note 45, where the A. argues that, in case the consumer has filled a damage claim against the final seller, he/she, by means of the action of recourse, could «[...] ottenere soltanto il rimborso delle somme erogate per compensare il danno consistente nella diminuzione del valore economico del bene cagionata dal difetto di conformità, non invece le somme che sia stato costretto a versare per risarcire gli ulteriori e diversi danni eventualmente derivati dall'inadempimento dell'obbligo di "consegnare beni conformi al contratti"»; contra, E. Bilotti, Art. 1519-quinquies, in Commentario alla disciplina della vendita dei beni di consumo, a cura di L. Garofalo, V. Mannino, E. Moscati, P.M. Vecchi, op. cit., p. 505, where the A. affirms that «[...] mentre sembra del tutto coerente che il venditore finale possa trasferire sui soggetti "a monte" della catena distributiva i costi della riparazione o della sostituzione del bene viziato, nonché, in caso di risoluzione del contratto, il rimborso delle spese e dei pagamenti legittimamente fatti per il contratto, trattandosi di rimedi connessi al fatto obiettivo della pregiudizievole alterazione di un interesse giuridicamente tutelato, non sembra invece affatto ragionevole consentire al venditore finale di liberarsi delle conseguenze di una sanzione risarcitoria. Il rischio cui si va incontro è quello che tale sanzione finisca per perdere gran parte del suo significato».

[16] See C. Iurilli, Autonomia contrattuale e garanzie nella vendita dei beni di consumo, op. cit., p. 212, where the A. assumes that the recoupment is «[...] da intendersi sia in natura che per equivalente, non essendo ipotizzabile una interpretazione della [...] disciplina che, in un certo senso, "costringa" il venditore a dover accettare da parte del produttore o del precedente professionista, un ulteriore bene in sostituzione, a fronte del venir meno di ogni fiducia sul comportamento contrattuale del proprio dante cause»; E. Bilotti, Art. 1519-quinquies, in

Commentario alla disciplina della vendita dei beni di consumo, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 503. See, contra, F. Bocchini, La vendita di cose mobili, cit., p. 513, ove l'Aut. afferma che «Anche con riferimento al regresso, i rimedi soddisfattori (per quanto compatibili) sono sovraordinati a quelli redibitori». Cfr., sul tema, A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, op. cit., p. 111 ss.; A. Colombi Ciacchi, Art. 1519-quinquies, in Commentario sulla vendita dei beni di consumo, a cura di S. Patti, cit., p. 308. See, on the recoupment throughout an equivalent or a specific performance, I. Pagni, Tutela specifica e tutela per equivalente: situazioni soggettive e rimedi nelle dinamiche dell'impresa, del mercato, del rapporto di lavoro e dell'attività amministrativa, Milano, 2004, p. 7 ff.

[17] See G. Gorla, Considerazioni in tema di garanzia per vizi redibitori, in Riv. trim. dir. e proc. civ., 1957, p. 1276 ff.

[18] See F. Bocchini, La vendita di cose mobili, op. cit., p. 504 ff.

[19] It seems useful to recall that, even before the entry into force of art. 131 Italian Consumer Code, the right of the buyer to recourse against the seller was peacefully recognised, so that he/she could be compensated for any sums he/she had to pay the sub-buyer for defects existing at the time of the first sale. See Cass., 23 ottobre 1959, n. 864, in Giust. civ., 1960, I, p. 1033 ff.

[20] See R. Calvo, Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo, op. cit., p. 327.

[21] See J. Ghestin, C. Jamin, M. Billiau, Traité de droit civil. Les effets du contrat, Paris, 1994, p. 804 ss.; A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, op. cit., p. 107.

[22] A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, op. cit., p. 107; E. Bilotti, Art. 1519-quinquies, in Commentario alla disciplina della vendita dei beni di consumo, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 500.

[23] R. Calvo, Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo, op. cit., p. 328, where the A. points out that «Non si può del resto escludere che il controllo esercitato dal grande produttore sulla modulistica contrattuale impiegata dal grossista sia talmente invasivo da obbligare quest'ultimo, nei rapporti con i dettaglianti, ad inserire nel corpo delle condizioni generali di contratto la clausola che li costringa a rinunciare ad agire in rivalsa contro il produttore medesimo. [...] in situazioni di questo tipo l'intermediario agisce nell'interesse del produttore contro l'ultimo rivenditore».

[24] The effect of extending the discipline of the abuse of economic dependence to the sale of consumer goods would be the possibility of subjecting the pact amending art. 131 Italian Consumer Code under the control of art. 9 Law n. 192 of 1998. See A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, op. cit., p. 117; E. Bilotti, Art. 1519-quinquies, in Commentario alla disciplina della vendita dei beni di consumo, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 511; F. Bocchini, La vendita di cose mobili, op. cit., p. 504 ff.; A. Colombi Ciacchi, Art. 1519-quinquies, in Commentario sulla vendita dei beni di consumo, a cura di S. Patti, op. cit., p. 327; G. Chiappetta, Art. 131, in La vendita dei beni di consumo. Commentario, a cura di C.M. Bianca, in Nuove leggi civ. comm., 2006, p. 512 ff.

[25] R. Calvo, Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo, cit., p. 329, where the A. affirms that «[...] pare perciò sfornito di fondamento l'indirizzo accolto da chi intravede qui gli estremi del contratto a favore del terzo siccome, così ragionando, non ci si avvede che il vantaggio del terzo è per l'appunto raggiunto tramite un negozio di rinunzia»; and, contra, C. Cicala, La dismissione del diritto di regresso, op. cit., p. 145 ff.

[26] See G.B. Ferri, Divagazioni intorno alla direttiva n. 44 del 1999 su taluni aspetti della vendita e delle garanzie dei beni di consumo, op. cit., p. 66.

[27] L. Colantuoni, M. Valcada, Art. 1519-quinquies (Diritto di regresso), in L'acquisto di beni di consumo, a cura di G. Alpa e G. De Nova, Milano, 2002, p. 52, where the A. assumes that «[...] l'esplicito richiamo al principio dell'autonomia contrattuale tra i diversi professionisti presenti nella catena contrattuale [...] potrebbe in alcuni casi intaccare l'effettiva operatività del diritto in rivalsa o regresso tra i diversi anelli della catena stessa»; A. Zaccaria, G. De Cristofaro, La vendita dei beni di consumo, cit., p. 117; G. De Cristofaro, La nuova disciplina codicistica dei contratti per la fornitura dei beni mobili conclusi da consumatori con professionisti, cit., p. 1185. See, for an in-depth analysis, O. Lando, International Trends: Requirements concerning the quality of movable goods and remedies for defects under the Principles of European Contract Law, in S. Grundmann, D. Medicus, W. Rölland (Hrsg.), Europäisches Kaufgewährleistungsrecht, Köln-Berlin-Bonn-München, 2000, p. 66 ff.; R. Mongillo, Il difetto di conformità nella vendita di beni di consumo, Napoli, 2006, p. 280 ff.; R. Calvo, Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo, op. cit., p. 329.

[28] In German law, for example, the principle of defence from heteronomy contract is explicitly risen to constitutional significance, because it is understood as an explication of the fundamental right of freedom of action provided by art. 2, paragraph 1, Grundgesetz. See A. Colombi Ciacchi, Le fideiussioni rovinose: un nuovo campo di applicazione delle clausole generali del BGB a tutela della parte debole, in Annuario di diritto tedesco 1999, a cura di S. Patti, Milano, 2000, p. 149 ff. In Germany, the right of recourse is, not surprisingly, strongly limited, so that the § 478, paragraph 4 BGB provides that the pacts in derogation from the three preceding paragraphs – which govern the conditions of action of recourse, if they are disadvantageous for the entrepreneur-buyer – can be initiated by the vendor-supplier only when the loss or limitation of the right of recourse is compensated by an equivalent benefit (gleichwertriger Ausgleich). Thus, this rule, on the one hand, does not allow any abuse of freedom to renounce the recourse – this profile was already considered by §§ 9, 11 AGB-Gesetz that protected the weaker party, although entrepreneur, if the abuse stemmed from general contractual conditions –, and, on the other, it requires also the equivalence between the benefit and the loss of compensatory advantage coming from the right of recourse.

[29] See R. Mongillo, Il difetto di conformità nella vendita di beni di consumo, op. cit., p. 264 ff. and p. 268, where the A. affirms that «Sembra, in definitiva, che la conoscenza o la conoscibilità del difetto da parte del venditore finale rilevi, diversamente che nella disciplina tradizionale delle azioni edilizie, non per escludere il diritto di agire nei confronti del proprio dante causa, bensì per valutare le rispettive responsabilità di produttori e distributori tenendo conto dei loro diversi ruoli al fine dell'immissione dei prodotti sul mercato e della circolazione»; P. Paganelli, Art. 1519-quinquies, in La vendita dei beni di consumo. Commentario breve agli artt. 1519-bis ss. c.c., a cura di C. Berti, op. cit., p. 69.

[30] R. Calvo, *Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo*, op. cit., p. 332.

[31] R. Calvo, *Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo*, cit., p. 333, where the A. assumes that «Siamo oramai prossimi a delineare in capo al concedente un obbligo di protezione del prestigio del marchio, al fine di non pregiudicare, per mezzo di condotte negligenti o malaccorte, la capacità del marchio stesso di catturare l'attenzione del consumatore». See, furthermore, O. Cagnasso, *Scambio e collaborazione quali «elementi» fondamentali del contratto di concessione di vendita*, in *Giur. it.*, p. 1653.

[32] Cass., 22 febbraio 1999, n. 1469, in *Giur. it.*, 1999, fasc. 8-9, p. 1653 ss., with note of O. Cagnasso, *Scambio e collaborazione quali «elementi» fondamentali del contratto di concessione di vendita*, where the A. affirms that «[...] è connaturato con le caratteristiche proprie della concessione di vendita l'obbligo, per il concedente, di non pregiudicare con la propria condotta nell'esecuzione del contratto il prestigio del proprio marchio, sì da evitare che il concessionario possa subire danni economici. E tale pregiudizio può indubbiamente verificarsi per la reiterata fornitura di prodotti affetti da vizi di produzione, che, pregiudicando l'immagine del marchio, si risolve in un fatto negativo per la produttività dell'impresa commerciale del concessionario e, conseguentemente, per la sua redditività».

[33] See A. Zaccaria, G. De Cristofaro, *La vendita dei beni di consumo*, op. cit., p. 108; E. Moscati, Art. 1519-quinquies, in *Commentario alla disciplina della vendita dei beni di consumo*, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 499.

[34] See F.D. Busnelli, *L'obbligazione soggettivamente complessa*, Milano, 1974, p. 60, 85 ff. e 451; C.M. Mazzoni, *Le obbligazioni solidali e indivisibili*, in *Obbligazioni e contratti*, in *Trattato di diritto privato*, diretto da P. Rescigno, IX, t. I, p. 731 ff.

[35] R. Calvo, *Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo*, op. cit., p. 322, where the A., in footnote 5, points out that «Più esatta di rivela la locuzione “diritto di rivalsa”. Ciò in quanto il diritto di regresso, a stretto rigore, pare presupporre la responsabilità solidale tra i coobbligati, che nel caso di specie manca, non essendo legittimato il consumatore ad agire – sulla base del difetto di conformità – contro il produttore o altro rivenditore intermedio diverso dall'immediato dante causa»; G. De Nova, *La proposta di direttiva*, op. cit., p. 28; A. Colombi Ciacchi, Art. 1519-quinquies (Diritto di regresso), in *Commentario sulla vendita dei beni di consumo*, a cura di S. Patti, op. cit., p. 292 ff.; E. Bilotti, Art. 1519-quinquies, in *Commentario alla disciplina della vendita dei beni di consumo*, a cura di L. Garofalo, V. Mannino, E. Moscati, P.M. Vecchi, op. cit., p. 484 ff.; C. Cicala, *La dismissione del diritto di regresso*, in *Aspetti della vendita dei beni di consumo*, a cura di F. Addis, op. cit., p. 132; E. Moscati, *Note introduttive*, in *Commentario alla disciplina della vendita dei beni di consumo*, a cura di L. Garofalo, V. Mannino, E. Moscati, P.M. Vecchi, op. cit., p. 464 ff. See, in case law, ex multis, Cass., 11 agosto 1990, n. 8202.

[36] The main features of the so called obligations subjectively complex are three, such as 1. the number of subjects composing the same part of the relation; 2. the performance intrinsically and originally only-one and identical for the various debtors; 3. the indivisibility of the cause from which steams the relation, or, in other words, the indivisibility of the legal fact from which steams the contractual bond. See A. Ciacchi Colombi, Art. 1519-quinquies, in *Commentario sulla vendita*

dei beni di consumo, a cura di S. Patti, op. cit., p. 292 ff.

[37] See D. Rubino, Delle obbligazioni. Artt. 1285-1320 c.c., in *Commentario al cod. civ.*, a cura di V. Scialoja e G. Branca, Bologna-Roma, 1957, p. 130.

[38] C. Iurilli, *Autonomia contrattuale e garanzie nella vendita dei beni di consumo*, op. cit., 217 ff., where the A. affirms that «[...] alla luce dell'ampiezza della figura delle obbligazioni solidali e dei numerosi istituti che ad essa sono stati ricondotti (le c.d. obbligazioni solidali spurie), la fattispecie di cui all'art. 1519-quinquies c.c. (author's note, now art. 131 Italian Consumer Code) potrebbe essere ricondotta ad altre ipotesi di rapporti obbligatori, sussumibili nella citata categoria, in quanto finalizzati ad assicurare una maggiore tutela alle parti del rapporto obbligatorio: si pensi, ad esempio, alla previsione di cui all'art. 54, l. 14 dicembre 1933, n. 1669 (la c.d. legge cambiaria), ove ex lege si individua espressamente una obbligazione solidale esistente tra il traente, l'accettante, il girante e l'avallante nei confronti del portatore del titolo. Ma sul punto, parte della dottrina rilevava che la solidarietà, più che effetto diretto della struttura del rapporto, avrebbe trovato la sua ratio in una maggiore esigenza di tutela e di rafforzamento del titolo astratto». See, furthermore, A. Ravazzoni, voce *Regresso*, in *Novissimo dig. it.*, XV, Torino, 1968, p. 358.

[39] See F.M. Andreani, voce *Regresso (azione di)*, in *Enc. dir.*, XXXIX, Milano, 1988, p. 704, where the A. defines "recourse" as «[...] l'istituto mediante il quale il legislatore persegue l'obiettivo di redistribuire un sacrificio patrimoniale fra una pluralità di soggetti a vario titolo cointeressati»; A. Ravazzoni, voce *Regresso*, op. cit., p. 356, where the A. describes "recourse" as «[...] il diritto e la conseguente azione riconosciuta a colui che abbia adempiuto l'obbligazione, di riversare in tutto o in parte su altri le conseguenze dell'inadempimento»; G. Sicchiero, voce *Regresso*, in *Dig. civ.*, XVI, Torino, 1997, p. 549 ff.

[40] D. Rubino, Delle obbligazioni. Artt. 1285-1320 c.c., in *Commentario al cod. civ.*, op. cit., p. 193; G.F. Campobasso, voce *Regresso (azione di)*, in *Enc. giur.*, XXVI, Roma, 1991, p. 1 ff.

[41] The choice of the Spanish legislature was, however, in the way to pave the way to the direct action of the consumer against the producer, against whom, under art. 10 *Ley de Garantías en la venta de bienes de consumo* no. 23 of 2003, he/she could request the repair or replacement of dissimilar, where it is impossible or very costly to act against his/her predecessor in title. The consumer can use a remedy usable only when it is justified by the stringent requirements set out by law. See M. Vérguez, *La Protección del Consumidor en la Ley de Garantías en la Venta de Bienes de Consumo*, Cizur Menor, 2004, p. 117 ff.; R.M. Méndez, A.E. Vilalta, *Garantías y acciones derivadas de las ventas de bienes de consumo*, Barcelona, 2004, p. 14 ff.; P. Represa Polo, *Los derechos del consumidor ante el incumplimiento de la obligación de conformidad*, in S. Díaz Alabart, *Garantías en la venta de bienes de consumo (Ley 23/2003, de 10 de julio)*, Madrid, 2004, p. 174 ff.; D. Mezquita García-Granero, *Los plazos en la compraventa de consumo. Estudio comparativo de la cuestión en el derecho español y portugués*, in *Rev. der. priv.*, 2005, p. 113 ff.; F.J. Sánchez Calero, *La obligación de saneamiento por vicios o gravámenes ocultos y la ley de garantías en la venta de bienes de consumo (Ley 23/2003, de 10 de julio)*, in *La compraventa: ley de garantías*, Madrid, 2006, p. 79 ff.

In Portugal, the legislative option was even more radical, because art. 6, paragraph 1, of the *Decreto-lei* no. 67 of 2003 recognizes the consumer freedom to choose between action against his predecessor in title and action against the manufacturer, from who he/she may require repair or replacement of a dissimilar good. See D. Mezquita García-Granero, *Los plazos en la compraventa*

de consumo. Estudio comparativo de la cuestión en el derecho español y portugués, op. cit., 99 ff.; J. Calvão Da Silva, *Compra y venda de coisas defeituosas*, Coimbra, 2006, p. 174 ff. In Latvia, then, according to art. 28, paragraph 1, of the Consumer Rights Protection Law, as well as in Lithuania, in presence of a defect, the consumer can act also against the manufacturer. In Slovenia, although generally the producer can not be directly sued by the consumer for any lack of conformity, with reference to an extensive list of so called technological goods it is provided a parallel system of conventional guarantees, lasting one year at minimum, which allows him/her to report the defect both to the producer and the retailer.

[42] T. Pasquino, Art. 1469-quinquies c.c., in *Le clausole vessatorie nei contratti dei consumatori*, in *Commentario agli artt. 1469-bis – 1469-sexies c.c.*, a cura di G. Alpa e S. Patti, Milano, 1997, p. 729 ff.

[43] G. Alpa, *Autonomia privata e “garanzie” commerciali*, in *Vita not.*, 2002, p. 15; A. Zaccaria, *Riflessioni circa l’attuazione della direttiva n. 1999/44/CE «su taluni aspetti delle vendite e delle garanzie dei beni di consumo»*, op. cit., p. 269.

[44] According to art. 1372 Italian Civil Code, in the sales chain characterized by a sequence of transaction with the same good, the principle of relativity of the contract prevents the sub-buyer to act for hidden defects directly against the first seller. See, for example, Cass., 28 luglio 1986, n. 4833, in *Nuova giur. civ. comm.*, 1987, I, p. 241 ff., with note of M. Moretti, where the A. affirms that «[...] nelle vendite c.d. “a catena” ciascuno dei successivi acquirenti agisce in materia di garanzia per vizi, in regresso contro l’immediato dante causa in forza del proprio e distinto rapporto contrattuale, senza che fra l’azione principale ed il rapporto obbligatorio che sta alla base della successiva domanda di regresso si costituisca alcun vincolo di interdipendenza». See, contra, Cass., 15 dicembre 1969, n. 627, in *Riv. giur. circ. trasp.*, 1972, p. 144 ss., with note of F. Molfese; Cass., 22 febbraio 2000, n. 1960, where the Italian Supreme court states that « in caso di vendite successive dello stesso oggetto, qualora uno dei venditori venga meno al suo obbligo primario, nascente dalla norma ex art. 1477 c.c., di consegnare i titoli e i documenti relativi alla proprietà e all’uso della cosa venduta, il danno si ripercuote su tutta la serie dei trasferimenti successivi, e il contraente in buona fede è legittimato a pretendere il risarcimento nei confronti del primo venditore inadempiente, nonostante l’autonomia dei singoli contratti, sulla base dei rapporti obbligatori di garanzia che legano a catena i vari contraenti».

See, for further in-depth analysis, C.M. Bianca, *La vendita e la permuta*, op. cit., p. 945 ff.; R. Calvo, *Patologie contrattuali e vendite a catena*, op. cit., p. 1477 ff.

[45] See C. Castronovo, *Problema e sistema nel danno da prodotti*, op. cit., p. 480.

[46] See S. Whittaker, *Liability for Products*, Oxford, 2005, p. 96 ff.

[47] See, for an extensive analysis of recourse that, in case of unfair contractual clause, includes any professional exposed to a contractual duty, F. Di Marzio, *Clausole vessatorie nel contratto tra professionista e consumatore – Prime riflessioni sulla previsione generale di vessatorietà*, in *Giust. civ.*, 1996, II, p. 513 ff.; G. Romagnoli, *Clausole vessatorie e contratti d’impresa*, Padova, 1997, p. 156.

[48] See, further, G. Cassano, *Professionista debole e clausole vessatorie (a proposito dell’azione di regresso di cui all’art. 1469-quinquies, 4° comma, c.c.)*, in *Danno e resp.*, 2000, p. 587 ff.

[49] See M.G. Falzone Calvisi, *Garanzie legali della vendita: quale riforma?*, op. cit., p. 453; A. Colombi Ciacchi, Art. 1519-quinquies, in *Commentario sulla vendita dei beni di consumo*, a cura di S. Patti, op. cit., p. 328.

[50] See G. De Nova (a cura di), *La subfornitura*, Milano, 1998; M. Granieri, *Subfornitura industriale: riflessi in ambito distributivo e concorrenziale*, in *Discipl. comm.*, 1999, p. 61 ff.; G. Alpa, R. Leccese, *La disciplina della subfornitura di cui alla l. 18 giugno 1998, n. 192*, in *Obbligazioni e contratti*, in *Trattato di diritto privato*, diretto da P. Rescigno, Torino, 2000, p. 213, where the subfornitura is considered as a «[...] strumento di riequilibrio contrattuale da applicarsi in situazioni di relativa debolezza di un'impresa rispetto ad un'altra [...]». The discipline of subfornitura has thus represented an important innovation in the Italian legal system, especially in an economic perspective. Indeed, it has transformed in regulation a phenomenon that already characterized the Italian organization and that was worth to protect and valorise.

[51] See IV.A. – 6:101 DCFR, which, defining the «consumer goods guarantee», seems to extend its application to the subsequent professional in the distributive chain. This rule provides, indeed, that such a kind of guarantee is applicable both «(a) by a producer or a person in later links of the business chain», and «(b) by the seller in addition to the seller's obligations as seller of the goods». The last hypothesis, therefore, could also be considered as if the previous professional of the distributional chain (seller) guarantees the subsequent professional of the same distribution chain (buyers, although not formally consumer), who could consequently enjoy the rights provided in a contractual clause shaped, originally and formally, in favour of the consumer.

[52] Because the Italian Consumer Code has adopted an approach that enhances the act of consumption, it helps to resolve the uncertainties related to the applicability of the rules concerning the protection of consumers in favour of the same professional-consumer. The expression “per scopi estranei all'attività imprenditoriale o eventualmente svolta” – not surprisingly – could be considered either as if the act of consumption should not involve a specific knowledge of the self-employed, or as if it should not be contemplated among those that are included in the business risk.

[53] Cass. 3ème, 4 novembre 1971, in *Bull. civ.*, III, n. 535; Cass. com., 19 mars 1974, in *Bull. civ.*, IV, n. 102, and in *Dalloz*, 1975, p. 628, with note of P. Malinvaude, in *JCP*, 1975, II, n. 17941, with note of J. Ghestin.

[54] See, ex alii, Calvo R., *L'attuazione della direttiva n. 44 del 1999: una chance per la revisione in senso unitario della disciplina sulle garanzie e rimedi nella vendita*, op. cit., p. 475 ff.; A. Pinna, *I termini nella disciplina delle garanzie e la direttiva 1999/44/CE sulla vendita dei beni di consumo*, op. cit., 2000, p. 532 ff.; A. Zaccaria, G. De Cristofaro, *La vendita dei beni di consumo*, op. cit., p. 109; G. De Cristofaro, *La nuova disciplina codicistica dei contratti per la fornitura dei beni mobili conclusi da consumatori con professionisti*, op. cit., p. 1184, note 46; E. Bilotti, Art. 1519-quinquies, in *Commentario alla disciplina della vendita dei beni di consumo*, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 508, where the A. underlines that «Una simile scelta, del resto, è pienamente conforme ai principi (art. 2935 c.c.) ed è l'unica coerente con la qualificazione del regresso del venditore finale quale pretesa autonoma di rimborso. Una pretesa di rimborso, infatti, può essere fatta valere soltanto dopo che le somme di cui si chiede la

restituzione siano state effettivamente spese; prima di quel momento, invece, la decorrenza del termine di prescrizione sarebbe priva di qualsiasi significato»; finally, F. Bocchini, *La vendita di cose mobili*, op. cit., p. 516 ff.

[55] To consider the moment in which the final seller has fulfilled the remedies invoked by the consumer as the starting point of the prescription period of the right of recourse means that the previous links in the distribution chain can not objectively and clearly forecast a reasonable time after which they can not be accountable to the final seller anymore. These professionals, in fact, may not know either if or when the final seller will sell consumers the purchased goods and, therefore, when the latter will be able to eventually enforce the remedies for lack of conformity towards their assignor. As a consequence the condition of subjection to the claim for reimbursement of the final seller will persist for a period whose duration is practically not predictable by the debtors of the claim of recourse. Unlike the Italian one, the German legislature has considered such a problem, setting a term of five years “from the moment in which the supplier has delivered the thing to the entrepreneur” (§ 479 , II , BGB), and, thus , avoiding the risk, which would be poorly tolerated by the market, to make absolutely uncertain prescription period of the right of recourse. See F. Bortolotti, *Azione di regresso e vendite a catena*, in *Le garanzie nella vendita dei beni di consumo*, a cura di M. Bin e A. Luminoso, in *Tratt. di dir. comm. e di dir. pubbl. dell’econ.*, diretto da F. Galgano, XXXI, Padova, 2003, p. 484.

[56] See, on the consequences of the short-termism previewed art. 1495 Italian Civil Code, Cass, 21 novembre 1979, n. 6063, in *Giur. it.*, 1980, I, 1, c. 1068 ff., with note of M. Garutti, and in *Giust. civ.*, 1980, I, p. 324 ff.

[57] See E. Bilotti, Art. 1519-quinquies, in *Commentario alla disciplina della vendita dei beni di consumo*, a cura di L. Garofalo, V. Mannino, E. Moscati e P.M. Vecchi, op. cit., p. 485 ff.

[58] See, in this sense, DCFR, where the Contents of the DCFR, point 18, Promotion of solidarity and social responsibility, affirms that «[...] the promotion of solidarity and social responsibility is not absent from the private rules in the DCFR. In the contractual context the word “solidarity” is often used to mean loyalty or security».

[59] Reference is made to the «nesso eziologico tra condotta attiva od omissiva del produttore o fornitore e difetto di conformità trascinandosi nei vari passaggi intermedi della filiera distributiva». R. Calvo, *Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo*, op. cit., p. 344.

[60] See, in this sense, A. Zaccaria, G. De Cristofaro, *La vendita dei beni di consumo*, cit., 107; A. Luminoso, *Chiose in chiaroscuro in margine al d. legisl. n. 24 del 2002*, cit., p. 47; P. Paganelli, Art. 1519-quinquies, in *La vendita dei beni di consumo. Commentario breve agli artt. 1519-bis ss. c.c.*, a cura di C. Berti, cit., p. 68.

[61] See E. Gabrielli, *Il contratto e le sue classificazioni*, in *Riv. dir. civ.*, 1997, p. 716, where the A. affirms that «Le variazioni dello schema legale [...] non sembrano rappresentare altro che i riflessi riportati sulla delineazione formale dello schema, delle modificazioni della funzione. Quando queste modificazioni non assumono un’entità tale da produrre una vera e propria alterazione causale dell’atto di autonomia, esse saranno compatibili con l’originario schema tipico e non

determineranno, di conseguenza, una deroga dalla sua disciplina. Non altrettanto potrà, invece, avvenire per le ipotesi in cui, rispetto allo schema tipico, non sia ravvisabile una variazione, ma una vera e propria alterazione. [...] Il limite, oltre il quale la disciplina del contratto non può essere derogata senza alterare il tipo legale, può essere appurato e segnato solo con riferimento al significato dell'operazione economica espressa dal contratto tipico». See, further, C.M. Bianca, *Diritto civile. 3. Il contratto*, Milano, 2000, p. 476 ff.; G. De Nova, *La scelta sistematica del legislatore italiano, in L'acquisto di beni di consumo. D. lgs. 2 febbraio 2002, n. 24*, a cura di G. De Nova, Milano, 2002, p. 5; A. Luminoso, *Chiose in chiaroscuro in margine al d. legisl. n. 24 del 2002, in Le garanzie nella vendita dei beni di consumo*, a cura di M. Bin e A. Luminoso, in *Trattato dir. comm. e dir. pubbl. dell'economia*, diretto da F. Galgano, XXXI, Padova, 2003, p. 17 ff.; R. Calvo, *Vendita e responsabilità per vizi materiali. II. Il regime delle «garanzie» nelle vendite al consumo*, Napoli, 2007, p. 12, where the A., making direct reference to the consumer sale, affirms that «[...] la nuova disciplina informante di sé il "sottotipo" non solo non è d'ostacolo all'applicazione delle regole – in quanto compatibili – plasmani il soprastante tipo contrattuale, ma negli stessi termini presuppone la disciplina di diritto comune valendo qui il principio di specialità».

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«They say things are happening at the border, but nobody knows which border» (Mark Strand)

Financial information regulation and Emir principles.

by Susan Clements and Valerio Lemma

Abstract: This paper analyzes the provisions of (EU) Regulation No. 648 of 2012 (EMIR), in relation to the need to avoid certain practices of negotiating – privately and on the basis of information available only to the contracting parties – some types of financial instruments (and, in particular, derivatives). The Authors focus on the rules that aim at increasing the transparency and the safety of the capital markets, in line with the evolution of communication processes, centralizing data in warehouses available to any financial operator.

Today, this centralization sets the stage for a new set up of the financial transactions. The implementation of the EMIR provisions (and, therefore, of appropriate clearing and reporting mechanisms) affects also the organization of an industry that will ensure a more effective protection of the «right to information».

In conclusion, the research highlights the key factors of a ‘market for financial information’, which is not yet considered as a reality by the EU regulator. We remain, then, with the *unsatisfied expectation* that the EU has not considered (and regulated) all the activities related to the demand and supply of information about market trends and financial instruments features.

Summary: 1. Introduction. – 2. *Clearing, bilateral risk management and reporting* in EU rules. – 3. The impact of EMIR on transactional costs. – 4. Legal matters in the consolidation of financial information. – 5. Exceptions in the EMIR regime. – 6. *Reporting mechanisms* and other tools to prevent the systemic risk. – 7. Emir, financial information and the capital market. – 8. Elements of a ‘market for financial information’ in the EMIR.

1. In searching for greater safety in the movement of capital, a new narrow trend finds its foundations in the recent European financial regulation. This direction is based on more rigorous financial reporting standards and, in particular, on the centralization of the data concerning the movement of the financial instruments (even when traded outside regulated markets).[1] Therefore, our analysis will focus on the regulatory approach that seeks the more general purpose of avoiding certain adverse effects detected in a competitive system, like the one that affirmed itself after the overcoming of the stock exchange concentration principle, due to Directive 2004/39/EC and which is at the center of the framework laid down by Directive 2014/65/EU.[2]

Moreover, after the proliferation of trading venues, it soon became clear that the competition between them hindered the efficient meeting of supply and demand, which could disappear (or replicate) in multiple (different and not communicating) locations.[3] Therefore, there is the need to bring together all the people having access to the market, in order to avoid its fragmentation and then ensure the stability of the capital circulation.[4] This does not mean the imposition of political limitations to the freedom (or rather: competition) of regulated markets and other multilateral or bilateral trading systems.

In the past, the over-the-counter industry has led to an uncontrolled proliferation – and circulation – of risks and, in particular, of the liquidity and counterparty risk (as evidenced by the Initial investigation conducted by the Working Group led by Jacques de La Rosiere). Therefore the reform (and standardization) of the safeguards related to trading of financial instruments outside the regulated markets appears to be shareable.

Undoubtedly, the provisions of (EU) Regulation No. 648 of 2012, the so called EMIR, seem to respond to the above instance. These provisions are against certain practices of negotiating – privately and on the basis of information available only to the contracting parties – some types of financial instruments (and, in particular, derivatives).[5] As we shall see, the mentioned EMIR aims at increasing the transparency and the safety of over-the-counter markets, attempting to impose operational methodologies compatible with those qualifying the traditional circuits of the Stock Exchange, to all the operators.

In addition to the above, we must take into account the option – on which European legislation is based – to contrast the practice of taking opposite positions – in buying and selling – on derivatives. Such practice cannot be compatible with the EU market structure, where the presence of consequential operations seems to be able to generate systemic problems (in case of a single failure), able to overcome the bilateral relationship on which the derivatives traded are based.[6]

Ultimately, the legal orientation seeking to avoid the creation of operations characterized by a complex web of interdependence appears to be predominant; in this wired context, we cannot find the information necessary to evaluate the nature and the risks underlying any derivative.

Therefore, it is worth considering the possibility of extending certain (clearing, bilateral risk management and reporting) duties beyond the boundaries of regulated markets. This approach can find a common answer – at European Level – to different inputs, as the EU rules intervene in an area (over the counter) that, being developed in the shadows of the regulated markets, has different anomalies (identified by the indefinite nature of certain operators and by the opacity of financial instruments).[7]

2. The EMIR Regulation outlines a new legal order for a specific section of the financial market, regulating in innovative ways the trading of OTC derivatives, the functionality of the central counterparties, and the data repositories' role. These rules are characterized by the goal of assuring the regularity of payments and information circulation (both relating to the over the counter negotiations). This goal has been pursued after the identification of the subjects and the functions at the basis of the relevant markets. In fact, the achievement of this goal passes by the clearing obligation (Art. 4) or, alternatively, the adoption of a Risk-mitigation technique for OTC derivative contracts not cleared by a CCP (Art. 11), as well as the specific Reporting Obligation (to a trade repository, Art. 9).

Despite this, we are in the presence of regulatory options conditioned by certain characteristics of the markets for derivatives (and, therefore, of a specific supervisory intervention on the «products of creative financing»).[8] In particular, it should be noted that trading derivative contracts over the counter determines – in general – a bilateral structure subject to the so called counterparty risk, so that the most common safeguards should be oriented to avoid that, facing the failure of any individual operator (or certain sections), the events of insolvency come to determine liquidity issues (or lack of confidence in the system), as it happened at the beginning of the recent financial crisis.[9]

It goes without saying that the search for (market) stability and (operation) transparency leads to the regulatory choice of giving special importance to the central counterparty (referred to as «CCP »), referring to the legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets (becoming the buyer to every seller, and the seller to every buyer; Art. 2, Reg. 648/2012).[10] This causes the centralization of the organizational and informational functions within the hands of a supervised party (the CCP).

In this context we find the requirement of a specific authorization for a CCP – after the verification of the minimum capital requirements (Art. 15, Reg. 648/2012)[11] – to which corresponds both the possibility to offer «clearing services» (Art. 14, Reg. 648/2012) under national and ESMA supervision (Art. 22, Reg. 648/2012), and the burden of preserving the appropriate data (and to make them available to the competent authorities; Art. 29, Reg. 648/2012).[12]

Firstly, we can highlight that this is linked to the need to adopt governance measures able to handle the clearing and, therefore, the exposure to the individual counterparties (Art. 40); hence the provision of a system of «margins» (and of «margin requirements» to limit credit exposures, Art. 41) and a «default fund» (in the form of a pre-funded default fund to cover losses that exceed the losses to be covered by margin requirements, Art. 42).

Secondly, our investigation comes to the «interoperability arrangements» between the CCPs (or rather, to the case where a CCP may enter into an interoperability arrangement with another CCP). We must consider that EU rules focus on the aim to provide services to a particular trading venue, or to access the data needed to perform their functions (according to the requirements of Articles 51 and following, Reg. 648/2012). At the same time, these arrangements must be aligned with the implementation of the risk management functions, and then with proper functioning of the internal systems able to cover the risks arising to these arrangements (among which is detected the provision of additional margins, ex Art. 53, Reg. cit.).

In brief, a new model of risk insurance corresponds to the clearing system introduced by EMIR Regulation. It is focused on the calculation of margins, and on the contribution to a default fund. Hence the need to provide rigorous *stress tests* to assess its «resilience» (in extreme, but plausible market conditions)[13], as well as specific procedures to handle the cases of non-fulfillment by the participants (Art. 48, Reg. 648/2012).

3. There is no doubt that the above organizational structure (for trades and for the relative central counterparty) increases transactional costs within the derivatives market (due, precisely, to the centralization of the payments). If this structure, on the one hand, is justified by the need to manage the risks at the base of the recent financial crisis in innovative ways, on the other, it is difficult to measure

the benefits of a system that – ultimately – does not mitigate the risks, but centralizes them in the hands of the CCP.

Moreover, if the CCPs are interdependent (among themselves) then all the parties become amplifiers of systemic risk. Hence, we can identify the need to assess whether the market structure is sustainable and, therefore, if the monetary and supervisory authorities are able to cope with the default of such subjects.

That said, with regard to the new reporting requirements, it is useful to dwell upon the option – of the EMIR Regulation – to introduce a specific form of supervision on the data sharing (concerning the derivative transactions), by adjusting their production, brokering, processing and – ultimately – circulation.

All this considered, this disclosure regime shall not be governed together with the transaction to which it relates, but it shall be subject to specific and further duties.[14]

Indeed, the European regulator attributes to a specialized subject – *i.e.* the trade repository – the activity of collecting and storing the records regarding the derivative financial instruments negotiated over-the-counter.[15] This goes together with the involvement of the ESMA, under a registration procedure (Art. 56 ff., Reg. 648/2012), as well as specific powers related to the inspection and information supervision (Arts. 61 and ff., Reg. cit.), and the power to impose fines, in case of violations (Art. 65, Reg. cit.).

Even in this case, it goes without saying that the involvement of individuals also imposes the verification that the corporate governance structure of the trade repositories presents a clear organizational structure with well-defined responsibility guidelines, and adequate internal control mechanisms, which shall prevent any disclosure of confidential information. In fact there is the risk that the subject in question might want to abuse its position or, rather, to use the advantage of managing the information flows mentioned (manipulating the balance of the market). The same has to be said for the operational risk, since the fact that an error in the management of the collected data could affect the regular trend of negotiations.[16]

In fewer words, it can be said that – in terms of information – we are in the presence of an intervention that aims at increasing the reliability of data on the derivatives' transactions through their registration in a centralized system. To this intervention should correspond a general improvement of the transparency in which, until now, OTC derivatives have been negotiated. In particular, in the EU rules we may find a regulatory framework able to link the effectiveness of the above safeguards (for the smooth functioning of the capital market) to the need to ensure the accuracy (in the production and processing phase), transparency (in the case of provision of services), and the integrity of information on the trading of financial instruments (during its consolidation and subsequent circulation).[17]

This suggests the possibility that the rules concerning the consolidation of information will take into account the global financial system (in its entirety), whence the prospective to configure a single archive (resulting from the aggregation of the data collected by any individual trade repository) or to organize a form of coordination (based on the centralized indexing of the information or on a network of bilateral agreements between trade repositories and supervisors). Having regard to the incidence of such data on the transactions that take place within the regulated markets, we can say that the Emir Regulation sets

the stage for the creation of a ‘single information circuit’, able to involve all the relevant data in the price formation process (considering all the trading venues, and then the whole derivatives market).

However, it should be indicated that the reality under observation is still conditioned by the presence of a single European capital market against a plurality of sovereign systems. Not surprisingly, a different national qualification of the financial instruments can determine an unequal legal treatment – (also in accounting) of the latter – able to affect the rules on reporting and, therefore, to lead to an inconsistency of the relevant information (with an obvious negative impact on the reliability of aggregate data).

Thus, only a careful and vigilant reconciliation (and, therefore control) activity may lead to a *true representation* of the OTC market and, at the same time, to the identification of a correct reference parameter for the measurement of systemic risk.

4. In light of the foregoing, it is possible to consider that the EMIR Regulation answers two (distinct but related) issues: a) the knowledge acquiring activity of the trade repositories; b) the centralization of the settlement risk within a CCP. It goes without saying that the origins (from different legal systems) of the over-the-counter transactions (and, therefore, the risk of dealing with situations not always fully compatible with all the involved national laws) amplify both these issues. Therefore, we must consider the need to identify the international standards for the relevant counterparties, the financial instruments, and the types of relationships that give content to the financial sector under investigation.

In other words, it is evident the need to find certain unique keys of representation for this information, in order to avoid an *insignificant* aggregate data (and, therefore, the detriment for the transparency of the capital market).

It should be noted that the European regulator has attempted to solve the major discrepancies promoting the adoption of a specific methodology to describe derivatives transactions (also in terms of transmission rules, standards and formats). The provisions of the Implementing Regulation (EU) No. 1247/2012 are oriented in this direction, which deals with – and, using a unique key, solves – the problem consisting in the fact that OTC derivatives are not always uniquely identifiable (using the codes experienced in the financial markets, i.e. International Securities Identification Numbers – ISIN), nor can be described by applying the ISO classification code for financial instruments (i.e. Classification of Financial Instruments – CFI).[18]

Undoubtedly, a regulatory intervention appears to be – globally – necessary, in order to promote the adoption of common rules in the treatment of the constituent elements of the derivatives, as well as in the qualification of the subjects required to communicate relevant information. Despite this, we shall consider that the global financial system requires equal access to the signage proceedings introduced by the Emir Regulation to ensure the smooth functioning of market allocation mechanisms.[19]

Conversely, the financial information system is penalized by the fact that some operators have not yet found their own subjective definition within their national legal order. An example of this problem is the experience of mutual funds that – in a criticized decision of the Italian Court of Cassation – have been defined as ‘separate assets’ of the Management Company who instituted them, without recognizing a minimum level of own subjectivity (that is necessary to ensure the smooth functioning of the financial markets).[20]

In fact, this decision raises additional problems in the whole EU capital market, which are linked to the need – expressed by Emir Regulation – for a census of the derivative transactions of each fund (or,

indeed, of each sub-fund) and, therefore, to attribute to the latter full ownership of the negotiations in question.[21] The same is true for the alternative investment funds (mentioned in Directive 2011/61/EU), pension funds, and internal funds of insurance companies (related to index-linked or unit linked policies). In these cases, we should consider these entities/undertakings independently from the subject which manages their assets (and, therefore, as owners of a specific legal position in the presence of derivatives transactions made with their own resources).

5. It is also necessary to highlight the peculiar position of local authorities involved in derivative transactions when referring to the changes introduced by the Emir Regulation.[22] In fact we are in the presence of public entities that, although prove themselves to be *prima facie* excluded from its scope (ex l. 448 of 2001 and l. 147 of 2013[23]), are called to integrate themselves within the system under consideration (so that their negotiation counterparts can fulfill the reporting obligations of the negotiation towards trade repositories; hence the need to proceed in identifying these subjects, by attributing the provided unique code). Even in the context of exhaustion of derivative transactions of public bodies, the introduction of an obligation to adapt to the centralized management of negotiations could trace back to a unified set of contracts that, even today, is exposed to the bilateral risk of the regulation (and then lack of adequate warranties).

Furthermore, we cannot appreciate the option – contained in the Emir Regulation – to exempt the central banks and government agencies involved in the management of sovereign debt from the clearing and reporting obligations applicable to OTC derivatives, even if it is aligned with the rules previously introduced in Japan and in the United States of America.[24]

Consequently, more than an exception is determined. We are in presence of an exclusion that allows – Member States – to remove certain derivative transactions from the scope of the safety system introduced to improve the transparency of information.[25] Moreover, in these cases, the absence of a centralizing duty exposes operations related to public finance to the full counterparty risk. Hence, this is an exception that increases the distance to the goal of harmonizing the derivative market through the diffusion of efficient and reliable compensation systems (subject to the financial supervision).

More generally, it should be noted that – even after the adoption of the Emir Regulation – a structure not able to protect the position of the State persists. In fact the latter can operate without having access to a centralized system (for information and payments), carrying out wholesale transactions on the basis of «non-public prices» and, therefore, in the absence of a full «pre-trade disclosure».[26]

From another perspective, we shall analyze the goal of avoiding relationships that increase counterparty risk, so that a possible «indirect compensation agreement»- involving multiple parties – must necessarily present a negotiation structure of the kind envisaged by Article 2, Reg. No. 149 of 2013.[27]

In light of the foregoing, it seems possible to identify a first conclusion related to the limits of the Emir Regulation, which seems to be not oriented to resolve certain asymmetric conditions able to produce both *errors* in the functioning of the allocation mechanisms (and, therefore, failures in the market), and *losses* by the investors (and, therefore, subjective positions fractures). However, we remain with the hope that these asymmetries will be overcome by increasing the ability (of the operators) to assess the risks that – systemically – weigh on capital markets, following the possibility to use open information (due to the intervention of the trade repositories).

6. The centralization of reporting identifies a solution to the information problems raised by the competition of trading venues imposed by MiFID.[28] In the light of the foregoing, the EU rules (following the MiFID) should structure new markets, able to ensure the global availability of the information arising from the consolidation process of the data (related to orders for buying or selling financial instruments placed in any venues).

Obviously, we are not dealing with the economic planning, nor the limitation of the free market. EMIR and other rules seek only solutions to prevent the systemic risk. The EU regulator, in fact, is aware that the option for a system of alternative trading venues resulted in a general misalignment of prices (due to the simultaneous release, in several locations, of purchase or sale orders[29])[30]. Hence, we can understand the economic determinants of the need to introduce specific controls, designed to prevent that the simultaneous trading (in multiple locations) could lead to the detriment of the entire financial sector (in terms of efficiency and equity).[31]

Therefore, it can be said that the enhancement of the specific reporting function – at the base of the EMIR (and its implementing regulations) – should not be attributed only to the goal to promote the quantitative increase in the levels of market knowledge.[32] In fact, the publication of aggregates (in classes of financial derivatives) also allows the evaluation of the systemic consequences of certain possible *infection* (even those due to the insolvency of any individual operator).

In this perspective, it is very important to outline that the centralization of information – in the hands of trade repositories – reduces some uncertainties (related to the previous lack of consolidated data), performing a private control aimed at ensuring the proper functioning of the financial market.

But there is more. It is clear that the reporting mechanisms (and, in particular, those related to OTC derivatives) require specific identification of the content and format of the data (collected by CCPs). In this case, (the validity of this choice and the compulsory character of) common standards correspond to the possibility for the CCPs to perform their functions effectively and, at the same time, to the possibility for the authorities to analyze comparable values and information.[33]

That said, it is necessary to dwell on the choice – made by the European Commission – to identify the «minimum information» to be reported (according to (EU) Reg. no. 148 of 2013). In this context, the indication of the ‘value of the contract at current prices’ allows the analysts to measure each exposure attributable to a single derivative and, therefore, to assess the overall impact of the OTC trading in function of the financial stability of the market.[34] Hence we can understand the regulatory option to report any subsequent compensation – by a CCP – of the existing contracts (Art. 2, Reg. no.148, cit.).

Therefore, the specification of the «information to be published» (brought by the EU Reg. no. 151 of 2013) appears to be of central importance. To this specification – and to the simultaneous selection of operating standards for the aggregation and comparing of the information – we reconnect the possibility for supervisory authorities (and central banks) to monitor – and thus safeguard – the financial stability of the EU capital market.

Concluding on this point, it should be noted that the rules of EMIR – and its implementing regulations – unify the system of clearing and of reporting, in order to limit the counterparty risk, with the effect of multiplying the information (about the derivatives negotiations). The result should be a system aimed at measuring and managing also systemic risks and other issues that affect the financial industry (as a whole). This entails an extension of the scope of the current supervision and, therefore, a substantial

exclusion of the OTC derivatives from the «shadow banking system», with obvious benefits in reducing the risk of the well-known market (and capitalism) failures.[35]

That said, we should also consider the ways in which financial operators produce information (intended for trade repositories and, therefore, for the supervisory authorities). In fact, this is the basis of the reporting mechanisms provided by EMIR, where all operators participate to the production of a piece of the final aggregate data, but only the trade repositories have a full information (in order to consolidate, clean and square the numbers of relevant financial transactions).

From a regulatory perspective, then, we must take into account the need for protection of those who are unable to verify the accuracy of the consolidation process.[36] We are aware that this set up shall end in the possibility of information asymmetries able to produce an «unfair advantage».

So, the smooth functioning of the financial market is closely linked not only to the performance of the trade repositories, but also to ESMA's ability to supervise the entities that hold more information.

7. According to the above, we can outline specific problems due to the regulatory option that affects the link between information and market, touching the general interests related to the efficient movement of capital. Therefore, we shall highlight that the *good* starting point (set by the EMIR) does not avoid all the negative consequences due to the asymmetries that penalize the current set up of the EU financial market. These asymmetries, in fact, in addition to adversely affecting bilateral relations, produce the risk of certain failures in the 'market for information' (to which follows the inability to determine the quantity and the quality of products circulating in all the involved trading venues).[37]

All this is confirmed by the findings of ESMA's Opinions on financial products,[38] and in particular by the interpretation of the Italian competent authority (i.e. Consob, (which has taken them narrowly, such as to integrate the principle of transparency with some rules of conduct that must be followed by the intermediaries in the distribution of complex financial products to retail customers).[39] In particular, we must consider that the Communication of December 22, 2014 expresses Consob's will to use its supervisory powers to ensure that the intermediaries will act in line with the above restrictive approach; and this, by explicitly stating that the decisions taken by the intermediaries will help the current (*severe*) Consob's supervisory directions.[40]

In confirmation of the restrictive intent indicated above, the Italian approach (towards the aforementioned Opinions expressed by ESMA) shows that the EU financial market is characterized also by the obligation to provide, not only specific and substantial checks on the appropriateness and suitability of the financial instruments, but also specific information regarding the negative evaluation expressed by public supervisors.

In the long run, the regulatory environment of the MiFID (and, to some extent, the anticipation of the MiFID 2) shall request the intermediaries (which provide investment services and to those who carry out the placement activities of financial products issued by banks and insurance ex 25a, Legislative Decree no. 58/1998), to redefine corporate policies by providing the duty to conduct independent evaluations for the delimitation of the scope of the offer of financial products, by also identifying *ex ante* the products that do not lend themselves to the realization of the investment needs of its customers'.[41]

We are in the presence, therefore, of specific directions that affect both the organizational profiles and the internal management procedures (of intermediaries and issuers).[42]

That said, it is useful to point out that this Italian regulatory framework requires any intermediary to carry out a 'proper due diligence' on complex products (that it intends to offer), taking into account the customers' interests, and the possibility of knowing information enough to assess the main characteristics and risks. This assessment will, obviously, be founded on the data provided by any issuer (*i.e.* any entity that produces and then places these complex products on the market).[43] In other words, these rules require any operator to carry out a sort of mapping of the information related to the offering, on the basis of the current data, by considering any possible feature useful to understand the level of complexity of the financial instruments.[44]

At this stage of the analysis, it is appropriate a concluding remark in order to question the reasons that prevented the competent authorities to introduce a total ban on the distribution of complex products. This refers, in particular, to the market structure outlined in MiFID (and refined by Directive 2014/65/EU), which – in light of the EMIR – should provide a procedure for the cases in which the intermediary, under its own responsibility, decides to distribute a product because – although the competent authority considered the latter unsuitable for the distribution – it contemplated the product as an adequate investment for the realization of his customers' interests, and that the information available is sufficient to assess its main features and risks.[45]

8. In light of the foregoing, it can be said that the intervention made by the EMIR is oriented towards the protection of customers, by safeguarding their information needs and decision-making processes. As we have seen, the EU regulator tries to reach this goal by intervening on the transmission of data in innovative ways,[46] on the meaningful collection of information and, ultimately, on the proper functionality of the market and its supervision mechanisms.[47] And it aims also at ensuring a cognitive activity properly carried out, in order to support a conscious determination of demand and supply (based on comprehensive information data).[48]

This regulatory framework appears in line with the fairness and transparency principles that inform the European financial system.[49] And this leads us to dwell on the scope of the innovations brought by the EMIR Regulation. In fact, it seems that these innovations do not always consider the information together with the related financial instrument (and, therefore, with the relevant contractual relationship). And this, both in *pre* and *post* negotiation phases.

Undoubtedly, the characteristics of Emir trade repositories seem to be in line with the evolution of communication processes, centralizing data in warehouses linked to the operators. This means that, since the stage of the product's design, the negotiation of an OTC derivative may be followed by the activation of a specific information channel. For this reason Emir circulation mechanisms seem to be designed to evaluate the quality of the information itself, and to be preordained to trace their collection (and significance for supervisory purposes).

Today, the centralization of obligations – together with the upgrade of the previously existing structure of regulated markets – sets the stage for a new set up of the financial market. The implementation of the EMIR (and, therefore, of appropriate clearing and reporting mechanisms), in fact, gives us a glimpse of the possibility of a system able to ensure the integrity and transparency of the financial market (including the OTC segment).[50] This affects not only the improvement of the bilateral relationships'

system (interacting on the disclosure duties), but also the organization of an industry that will ensure a more effective protection of the «right to information».[51]

At the same time, we shall highlight that these elements are the key factors of a ‘market for financial information’, which is not yet considered as a reality by the EU regulator. This helps us to understand the reasons for the lack of rules for the operators that produce, share and elaborate financial information (and in particular for those of them that are not financial intermediaries). We remain, then, with the *unsatisfied expectation* that the EU will consider (and regulate) all the activities related to the demand and supply of information about market trends and financial instruments’ features.

In conclusion, it can be said that EMIR must be framed between the safeguards designed to avoid market disturbances, as well as among the remedies for harmful expansions of the shadow banking system. These goals should, therefore, be linked to the implementation of new models of regulation and self-regulation (that Emir introduces). Therefore, if a fast and full alignment of the operators to these principles will reflect the prevalence of a non-formalistic approach, then the positive effects of the new market structure can influence the performance of the business functions that produces financial information, the disclosure practices and the risk management mechanisms.

References:

[1] This analysis follows the commitment of JUNCKER, *Political Guidelines for the Next Commission*, in *A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change*, Strasbourg, 15 July 2014 where he assumed that ‘To improve the financing of our economy, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for SMEs, and help reduce our very high dependence on bank funding.’

[2] See CAPRIGLIONE, *Evoluzione della disciplina di settore*, in VV.AA., *L’ordinamento finanziario italiano*, Padova, 2014, p. 118 ff.; SEPE, *Borsa e Mercati. In generale*, *ibidem*, p. 967 ff.

[3] See DOLGOPOLOV, *High-Frequency Trading, Order Types, and the Evolution of the Securities Market Structure: One Whistleblower’s Consequences for Securities Regulation*, in *University of Illinois Journal of Law, Technology & Policy*, Vol. 2014, p. 145 ff.

[4] See DEGRYSE – DE JONG – VAN KERVEL, *The Impact of Dark Trading and Visible Fragmentation on Market Quality*, in *TILEC Discussion Paper*, 2014, No. 2011-026; O’HARA – YE, *Is Market Fragmentation Harming Market Quality?*, in Cornell University – Samuel Curtis Johnson Graduate School of Management and Hewlett-Packard Laboratories working paper, 2009.

[5] See MASERA – MAZZONI, *Derivatives’ pricing and model risk*, in *Law and economics yearly review*, 2013, p. 296 ff.; SAVONA, *Do we really understand derivatives?*, *ibidem*, p. 280 ff.; see also AVGOULEAS, *Regulating Financial Innovation: A Multifaceted Challenge to Financial Stability, Consumer Protection, and Growth*, and FERRARINI – SAGUATO, *Regulating Financial Market Infrastructures*, both as forthcoming draft chapters in *The Oxford Handbook on Financial Regulation*, edited by Ferran, Moloney, Payne, Oxford, 2015, *passim*; LEHRBASS, *Corporate Production and Hedging Decisions Under Dodd-Frank and EMIR*, in *USAEE Working Paper No. 14-170*, 2014.

See also CAPRIGLIONE, *I «prodotti» di un sistema finanziario evoluto. Quali regole per le banche?* (Riflessioni a margine della crisi causata dai mutui sub-prime, in *Banca Borsa Titoli di Credito*, I, p. 20 ff.

[6] See Recital no. 4 of the EU Regulation 648 of 2012.

[7] See LEMMA, *The shadow banking system*, London, 2015, *passim*.

[8] See ENGST – TROISI, *ESMA supervision. Specificity of the intervention in the derivatives market*, in *Law and economics yearly review*, 2013, p. 347 ff.; see also MOELLERS, *Sources of Law in European Securities Regulation – Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to Larosière*, in *European Business Organization Law Review*, 2010, Vol. 11, p. 379 ff.

[9] See GIESECKE, *Credit Risk Modeling and Valuation: An Introduction*, in *Credit Risk: Models and Management*, Vol. 2, London, 2004; see also ZHU – PYKHTIN, *Measuring Counterparty Credit Risk for Trading Products under Basel II*, in *BASEL II HANDBOOK*, 2006, p. 1 ff.; ID., *A Guide to Modeling Counterparty Credit Risk*, in *GARP Risk Review*, July/August 2007, p. 16 ff.

See also CRÉPEY, *Bilateral Counterparty Risk Under Funding Constraints — Part I: Pricing and Part II: CVA*, in *Mathematical Finance*, Vol. 25, Issue 1, 2015, p. 1 ff. and p. 23 ff. on the valuation and hedging of bilateral counterparty risk on over-the-counter derivatives.

[10] Previously, in fact, the absence of a complete market discipline on information only opposed the regime of transparency, intended as a legal criterion of general application in savings' markets. Indeed, in conducting the circulation of any data within the contractual relationship (including pre and post contract phases), a form of protection (mainly oriented towards the protection of the investor) was carried out, able to extend its beneficial effects over the bilateral environment, i.e. such as to contribute to the efficient movement of capital.

[11] See, in particular, the Commission Delegated Regulation (EU) No. 152/2013 by the Commission of the 19th December 2012 that re-integrates (EU) Regulation No. 648/2012 of the European Parliament and of the Council with regard to the regulatory technical standards on capital requirements for central counterparties.

[12] For the purposes of this investigation it should be considered that the data and information collected by the CCPs must be made available to the competent authority, to ESMA and to the members of the ESCB; Art. 29, Reg. 648/2012.

[13] With regard to the reliability of the methodologies adopted by CCPs, the obligation for an «independent validation» of the method adopted to communicate with the supervisory authorities also comes into account (Art. 49, Reg. 648/2012); see DUFFIE – ZHU, *Does a Central Clearing Counterparty Reduce Counterparty Risk?*, in *Rock Center for Corporate Governance at Stanford University Working Paper No. 46, Stanford University Graduate School of Business Research Paper No. 2022*. See, on this topic, JORDAN – JAIN, *Diversity and Resilience: Lessons from the Financial Crisis*, in *University New South Wales Law Journal*, Vol. 32, 2009.

[14] So that the relevant piece of information is not treated as an accidental element of another legal relationship (i.e. the investment service, asset management...), but is considered worthy of independent consideration.

[15] See (EU) Implementing Regulation No. 1248/2012 of 19 December 2012 laying down implementing technical standards regarding the format of the application for the registration as a trade repository where the option for a tool allows to store the information in a durable medium.

[16] See, on this matter, the Commission Delegated Regulation (EU) No. 150/2013 regarding the regulatory technical standards specifying the details of the application for registration as a trade repository on negotiations.

[17] See PELLEGRINI, *Regole di comportamento e responsabilità degli intermediari*, in VV.AA., *I contratti del risparmiatore*, Milan, 2013, p. 187 ff., in which are explored the recent European guidelines on policy configuration of the adequacy of operations, identifying a growing attention to the typical problems of behavioral finance. Economically, see LEUZ and WYSOCKI, *Economic Consequences of Financial Reporting and Disclosure Regulation: A Review and Suggestions for Future Research*, in SSRN paper no. 1105398, in which they identify «the firm-specific (micro-level) and market-wide (macro-level) costs and benefits of firms' reporting and disclosure activities and ... the potential costs and benefits of regulating these activities in various forms».

[18] Hence the appreciation for the option of identifying the underlying via a unique identifier (ISIN) and, at the same time, to identify the derivative by a unique product identifier, together with the counterparties and other entities involved in the operation (Articles. 3 and 4, Reg. no. 1247 cit.).

[19] Therefore, the only reference to the regularity of the transactions is exceeded; transactions that have developed in order to ensure not only the legitimacy of the bilateral relationship, but also the protection of general interests (such as the economic freedoms and the protection of social utility) recognized by our Constitution.

[20] See LEMMA, *Autonomia dei fondi comuni di investimento e regolazione della gestione collettiva del risparmio*, in *Banca borsa e titoli di credito*, 2011, II, p. 417 ff.

[21] As well as – at technical level – the Legal Entity Identifier, so called LEI, different from the one for management companies.

[22] For a general discussion on the question, see CAPRIGLIONE, *The use of «derivatives» by Italian local authorities in public finance management. Still an issue*, in *Law and economics yearly review*, 2013, p. 399 ff.

[23] See CAPRIGLIONE, *The use of «derivatives» ...*, cit., p. 401.

[24] See Recital no. 2, of EU Regulation 1002/2013

[25] In stating that the aforementioned obligations are not required for the bodies in charge of the management of sovereign debt (Art. 1, paragraph 4, letter. A, Reg. Cit.), it should be noted that this restriction of the scope of the special rules if, on the one hand, appears to be justified by the desire of some Member States to protect their prerogatives, on the other does not seem appropriate to reduce the risks assumed by the central government. This, with obvious negative effects on the overall transparency of the financing operations of economic policies (and, in particular, the issuance of government bonds); see LEMMA, *The derivatives of Italy*, in *Law and economics yearly review*, 2013, p. 480 ff.

More generally, it should be noted that the results of the Pittsburgh Summits on 26 September 2009 (G20) have suggested to re-conduct standardized OTC derivative contracts to a central counterparty (CCP), following their reporting to trade repositories on the negotiations in an internationally consistent and non-discriminatory way; commitment reaffirmed in June 2010, at the G20 in Toronto.

[26] On this matter should be noted the results of the FLEMING – JACKSON – LI – SARKAR – ZOBEL, *An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting*, in *FRB of New York Staff Report No. 557*, 2012; which «examines the over-the-counter (OTC) interest rate derivatives (IRD) market in order to inform the design of post-trade price reporting. Our analysis uses a novel transaction-level data set to examine trading activity, the composition of market participants, levels of product standardization, and market-making behavior».

We can also refer to the Italian experience on the use of derivatives by municipalities and other public entities; see the analysis published in *Law and economics yearly review*, 2013, part. II, by PELLEGRINI, *Financial derivatives. Regulation and disputes in the Italian legal order*; PASSALACQUA, *Derivatives financial instruments and balanced budgets: the case of the Italian public administration*.

For a discussion of similar issues, but in the American context, see SGARLATA – CHUNG, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, in *Albany Law School Research Paper*, 2013.

[27] Which, in addition to the CCP, involve the direct participant, the customer's direct participant and the indirect customer that allows the direct participant's customer to offer the clearing services to the indirect customer; see Art. 1, paragraph 1, letter. b) (EU) Implementing Regulation No. 149/2013.

[28] It seems appropriate to point out that, in Directive 2004/39/EC, different types of trading venues (investment orders given by the customers) have been provided: regulated markets, multilateral systems and systematic internalisers. This makes the competition even more complex, involving subjects of different types competing with each other "for the market" (or rather, to increase their market share which is the number of transactions that take a particular location as a reference).

[29] See, in general, FIORAVANTI – GENTILE, *L'impatto della frammentazione degli scambi azionari sui mercati regolamentati europei*, 2011, in *Quaderni di finanza Consob*, n. 69, p. 31 ff.

[30] In other words, the efficiency of the financial market – after the adoption of the MiFID -, appeared penalized by the absence of mechanisms responsible for the consolidation of information. This applies,

in particular, to the loss of leadership by regulated markets (in the process of price formation), and to the impossibility of price discovery; see YAN – ZIVOT, *The Dynamics of Price Discovery*, in SSRN Papers, 2007, n. 617161.

[31] It should however be kept in mind that the search for concrete solutions to the problems indicated in the text led to the formulation of a revision proposal of the MiFID based on the centralization of data and information (via a «data communication service» and the use of authorized publication mechanisms, so called. APA); see Articles. 61-68 of the proposal cited.

Certain assessments that emerged during the preparatory work for the revision of the MiFID Directive should also be mentioned; in which the distribution of benefits arising from the increased competition between the trading locations for financial instruments has been critically evaluated; see Report on the Directive Proposal by the European Commission relating to markets of the financial instruments; repealing Directive 2004/39/EC, Brussels, 20 October 2011, p. 2. Consequently, it can be said that some of the news in question may represent the assumption of a substantial equivalence of regulated markets with systems alternative to them (also on the information surveillance information and therefore accountability level).

[32] Hence, the option, according to the Emir Regulation, to consider the objective significance of market data (that is, their ability to correctly indicate the economic sense of the operation that is going to be carried out).

[33] See (EU) Implementing Regulation No. 1249/2012 of 19 December 2012.

[34] This, in a context of operational flexibility ensured by the authority to delegate the reporting operations, see Recital no. 1, (EU) Implementing Regulation no. 148/2013.

[35] See also POSNER, *A failure of capitalism*, Cambridge, 2009, p. 41 ff. on the banking crisis of 2008 and the descent into depression.

[36] See SABATINI – TAROLA, *Transparency on Secondary Markets. A Survey of Economic Literature and Current Regulation in Italy*, in *Quaderni di finanza Consob*, 2002, n. 50, p. 4, where it is stated that «the issue of market transparency refers to the clarity with which market participants (and the public at large) can perceive the process of securities trading».

[37] For this matter we must quote the famous AKERLOF, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism*, in *Quarterly Journal of Economics* 1970, p. 488 ff., starting point for the problem mentioned in this work.

[38] See *Opinion of the 7 February 2014 with “MiFID practices for firms selling complex products”* and *Opinion of the 27 March 2014 with “Structured Retail Products – Good practices for product governance arrangements”*.

[39] See ‘Comunicazione sulla distribuzione di prodotti finanziari complessi ai clienti retail’ adopted by Consob on the 22 December 2014.

[40] It is clear that Consob intends to proceed in the path traced by the recent Opinions expressed by ESMA on the subject, even if the high levels of protection of retail clients translates into the establishment of specific rules of conduct to be followed by the intermediaries.

[41] A similar recommendation is made towards the ‘qualified entities that issue financial products then distributed to customers through other intermediaries’. (Communication no. 97996/14, p. 4).

[42] See BOCCARDELLI – SUPINO, *Institutions and financial markets: an institution-based view of derivatives*, in *Law and economics yearly review*, 2013, p. 312 ff.

[43] The client will also be notified with specific information on the costs of the product (including implicit or mark-up), on the fair value and on the relevant risks.

[44] The preparation of a list of examples of some types of products considered very complex by Consob also identified; for these products Consob requires intermediaries to pay “increased attention”, also with regard to the possibility that the distribution agreements (between issuer/producer and intermediary/distributor) may produce a conflict of interest of the intermediary with those of the clients. Also important is the Consob call for the “profiling of the customer” that the intermediary must carry out with special care and depth.

A list of products considered by Consob as “normally” not adequate to retail customers comes to mind; these products are subject to a specific recommendation according to which the following products “are not recommended nor distributed directly... to retail customers”: i. financial products resulting from the securitization of credits or other assets; ii. Financial products for which, when certain conditions occur or by initiative of the issuer, the conversion to shares or the curtailment of the nominal value is provided; iii. The credit linked financial products; iv. The derivative financial instruments mentioned in Art. 1 paragraph 2, Letter d-j of the TUF not negotiated in trading venues, for purposes different from hedging; v. the structured financial products, not traded in trading venues, whose pay-off does not ensure the full repayment at maturity of the capital invested by the client.

[45] Hence, the duty (for the intermediary) to establish adequate safeguards against a decision that, in the opinion of Consob, raises the risk of conformity (of the same). In addition to the burden of proceeding to the formal adoption (by the top management of the intermediary) of a specific and reasoned decision on the commercialization of these types of products, after the investigation and opinions from bodies and control functions for the competent profiles, in compliance with the specific limits set out in the Communication no. 97996/14 with regard to socio-economic characteristics of the potential customer, the quantitative thresholds (investment and concentration) and how to offer the product.

[46] With regard to the transmission of information it is useful to distinguish the one that occurs in close environments to the legal relationship considered by the financial system from the one that is completely alienated by it; in fact, if the first type is directly linked to the communications carried out by the counterparty (present and future) of a financial services contract; to the second type are linked all

those carried out by mass media. This because, to date, the protections provided for information that accesses the contracts in question are not extended to those that freely circulate within society.

See also BARSELLA, *Insider trading e obblighi di divulgazione delle informazioni sui mercati finanziari*, in *Quaderni di finanza Consob*, 1990, n. 1, *passim*, where particular aspects of the problem regarding the circulation of privileged information are identified. As well as VV.AA., *Lavori preparatori per il Testo unico della finanza – Servizi e strumenti di impiego del risparmio*, in *Quaderni di finanza Consob*, 1998, n. 28, p. 12 ff, where it is stressed that, at that time, the transparency and investor protection objective was assuming an increasing importance in the orientations and in the praxis of financial system regulation. That said, it is useful to point out that the current Consumer Code sets a specific provision for the information of the consumer-saver in the event of distance commercialization of financial services to consumers (Art. 67a et seq. D. Decree 206 of 2005).

[47] With regard to the errors in the reasoning and in the preference and for the importance of the studies related to the so-called behavioral finance; see MARCHISIO – MORERA, *Finanza, mercati, clienti e regole ... ma soprattutto persone*, in *Analisi Giuridica dell'Economia*, 2012, p. 19 ff.

See also CAPRIGLIONE, *Etica della finanza mercato globalizzazione*, Bari, 2004. p. 79 ff.; ID., *Intermediari finanziari, investitori, mercati: il recepimento della MiFID: profili sistematici*, Padova, 2007, *passim*

[48] It appears to be useful to re-affirm that, in replacing the known to the unknown, the information assumes a double importance as the result of the communications (of the informative agents) and the assumption of the necessary knowledge for the management (in aware modalities) of the capitals owned by the savers (intended as cognitive operators); see LEMMA, *Informazione finanziaria e tutela del risparmiatore*, in VV.AA., *I contratti del risparmiatore*, Milan, 2013, p. 259.

[49] It goes without saying that the regulation of the market must be re-conducted to the duties of the financial regulator, where the protection of the information acquisition process is functionally related to the regularity of the price formation process (because of its effect on the progress of supply and demand). Thus, the public intervention placed as a guarantee of the correct flow of information rises as a safeguard element for the savings entered in the financial markets and therefore, directly attributable to the provision of Art. 47 of the Italian Constitution.

[50] Ultimately, in addition to the consolidation of the financial data (as required by the Emir Regulation), hopefully one will have to proceed towards the supervision of the subjects that – for various reasons – set and elaborate the information about the capital market (as a whole) and the individual transactions (in particular).

[51] In other words, against such a reality, a regulatory re-ordering becomes desirable, aiming at coordinating the regulation of the information related activities taking place in different areas of finance; intervention that appears even more necessary where the special regulations and sectorial ordinances have the same objectives (for example, that of avoiding behaviors that bear upsets to the equilibrium of the economic system); see SANTONI, *Giornalisti. Profili costituzionali*, in the Enc. Giur. Treccani, Rome, where are examined certain constitutional problems that appeared in the praxis of this

profession. See, also, the Italian document *La Carta dei doveri dell'informazione economica*, *Decisione Consiglio Nazionale dell'Ordine dei Giornalisti*, 28th March 2007, referring to Art. 114 D. Lgd, no. 58 of 1998 and Art. 69 g of CONSOB Regulation no. 11971 of 1999.

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