Volume 13 – Part 1 - 2024 ISSN 2050-9014

LAW AND ECONOMICS YEARLY REVIEW

ISSUES ON FINANCIAL MARKET REGULATION, BUSINESS DEVELOPMENT AND GOVERNMENT'S POLICIES ON GLOBALIZATION

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in association with

LAW AND ECONOMICS YEARLY REVIEW

www.laweconomicsyearlyreview.org.uk

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ISSN 2050-9014

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ACCESS TO FINANCIAL DATA IN THE EVOLVING EU REGULATORY FRAMEWORK

Vincenzo Troiano*

ABSTRACT: *The essay examines the evolving regulatory landscape in the European Union as it transitions from Open Banking to a broader Open Finance framework and in the Retail Investment Strategy, evaluating the modalities of access and use of the information concerning users and clients collected by financial intermediaries, provided for by PSR, FIDA, and Omnibus Directive proposals. The analysis also focuses on the compensation issue for making available customer data to third-party service providers and the operation of the financial data sharing systems.*

SUMMARY: 1. Introduction. – 2. Open banking and transition to Open Finance: the Financial Data Access and Payments Package. – 3. Account information service (AIS) and additional related services in the PSR Proposal. – 4. Open access to financial data and financial data sharing systems in the FIDA Proposal. – 5. Compensation for making data available. – 6. Open access to banking and financial data and financial services offering. – 7. Retail Information in the Retail Investment Strategy. – 8. Conclusions.

1. This contribution aims to briefly illustrate some aspects of the 2023 EU Commission proposals of regulation on the financial data access[1] and retail

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This paper is based on a speech delivered at the Conference on The Impact of EU Regulation on Models of Banking and Finance hosted by the University of Oslo on 1-2 July 2024 and on a Seminar held at the Sri Lanka Central Bank on 9 August 2024 on the transition from Open Banking to Open Finance.

[1] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on a framework for Financial Data Access and amending Regulations (EU) No 1093/2010, (EU) No 1094/2010, (EU) No 1095/2010 and (EU) 2022/2554*, 28.6.2023, COM(2023) 360 final (the “FIDA Proposal”).

investment strategy[2], mainly focusing on the modalities to access and use the information concerning users and clients collected by financial intermediaries.

In this area, seminal questions centre on data, the "new money" in the financial sphere: what are data, what kind of data are of relevance (personal and non-personal, sensitive, financial and non-financial, pertaining to a specific means, for example, to a payment account), what kind of access should be permitted (who and how may have access), what the interaction are with data protection issues. Again, what are the legitimate uses of the data made available by the holders of the same, and what relationships should be established between holders, users, and third parties?

2. As well known, in the financial sector, regulation of data use and payment services is historically intertwined[3].

The Payment Services Directive of 2015 (PSD 2)[4] regulated specific aspects of so-called "Open Banking" (OB). This term describes the process by which third-party providers (TPPs), here, in particular, the account information service providers (AISPs), provide PSD2-regulated services to users based on accessing—upon user request—their account data held by the intermediary holding the user's payment account[5].

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[2] See European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules*, 24.5.2023 COM(2023) 279 final, (the "Omnibus Directive").

[3] OECD, *Shifting from Open Banking to Open Finance: Results from the 2022 OECD survey on data sharing frameworks*, in *OECD Business and Finance Policy Papers*, 2023; OECD, *Data Portability in Open Banking. Privacy and The Other Cross-Cutting Issues*, in *OECD Digital Economy Papers*, 348, February 2023, in *oecd-ilibrary.org*; Boot A. – Hoffmann P. – Laeven l. – Ratnovski L., *Financial intermediation and technology: what's old, what's new?* in European Central Bank, *Discussion Paper Series*, No. 11, 2023.

[4] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

[5] European Commission, *Report from the Commission to the European Parliament, the Council, the European Central Bank and the European Economic and Social Committee on the review of Directive 2015/2366/EU of the European Parliament and of the Council on payment services in the internal market*, 28.6.2023 COM(2023) 365 final, p. 4 (the "EC Report").

The AISP provides the user with aggregated online information on one or more payment accounts accessed through intermediaries' online interfaces (APIs)[6]. Thus, the payment service user can have an overall view of its financial situation derived from analysing the relevant payment accounts immediately at any given moment.

PSD2 gave Open Banking a stable regulatory framework with safeguards for users; before PSD2, TPPs operated largely unregulated and widely as screen scrapers[7].

PSD2 obliged intermediaries to facilitate TPP access to payment data without any mandatory contractual obligations.

The implementation phase of PSD2 showed less expansion of the account information service than expected. This outcome is undoubtedly due to technical difficulties connecting the financial intermediaries and the TPPs via APIs. Still, it is useless to hide that this also reflects commercial problems between the different players in the market[8].

The European Banking Authority's Opinion on the possible review of PSD2 recalled prominent issues related to impediments and obstacles to access to and use of payment account data in relation to AIS and proposed specific measures to overcome such difficulties[9], most of which were subsequently adopted by the European Commission.

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[6] See Geva B., *Payment Transactions under the E.U. Second Payment Services Directive – An Outsider's View* (2019). 54 Tex. Int'l L.J. 212, Available at SSRN: https://ssrn.com/abstract=3292313; Babina T. - Bahaj S. - Buchak G. - De Marco F. - Foulis A. - Gornall W. - Mazzola F. - Yu T., *Customer Data Access and Fintech Entry: Early Evidence from Open Banking* (September 7, 2023). Stanford University Graduate School of Business Research Pape, Available at SSRN: https://ssrn.com/abstract=4071214 or http://dx.doi.org/10.2139/ssrn.4071214; Lin X. - Zhang S. – Zacharidis M., *Open Data and Api Adoption of U.S. Banks*. Available at SSRN: https://ssrn.com/abstract=4907505 or http://dx.doi.org/10.2139/ssrn.4907505

[7] See EC Report, p. 5.

[8] See EC Report, p. 5. TPPs claimed that the interfaces designed to facilitate their data access vary in quality and performance. The intermediaries reported significant implementation costs for developing APIs and regretted that they were prevented from charging TPPs to facilitate customer data access via APIs.

[9] See EBA, *Opinion of the European Banking Authority on its technical advice on the review of Directive (EU) 2015/2366 on payment services in the internal market (PSD2)*, EBA/Op/2022/06, 23 June 2022, p. 99, and EBA, *Opinion of the European Banking Authority on obstacles under*

In 2023, the Commission issued a comprehensive Data Access and Payments Package consisting of two proposals for revising PSD2: a new Directive (PSD3)[10] and a regulation (PSR)[11]. Together with the two proposals revising PSD2, the Commission presented the FIDA Proposal, aiming at extending the obligation to provide access to financial data beyond payment account data (this is what now is called "Open Finance")[12].

A preliminary question arose as to transferring the regulation of the account information services from PSD to the FIDA framework. The Commission, while admitting that such a transfer could make sense, given the nature of AISPs' business, expressed a significant risk of disruption and data access rights interruptions for the AISPs if such a transfer were to be carried out before the existence of a "scheme", which will be a pre-requisite for Open Finance to take place[13]. For those reasons, a staged approach appeared more appropriate, possibly calendaring such a transfer when the FIDA framework will be fully operational.

Article 32(3) of the RTS on SCA and CSC, EBA/OP/2020/10, 4 June 2020, where, in particular, EBA stressed the existence of obstacles in terms of authentication procedures that ASPSPs' interfaces are required to support, mandatory redirection at the point-of-sale, multiple SCAs, 90-days re-authentication, additional checks on consent and additional registrations (the "EBA 2020 Opinion"). See also Pellitteri R. - Parrini R. – Cafarotti C. – De Vendictis B., *L'Open Banking nel sistema dei pagamenti: evoluzione infrastrutturale, innovazione e sicurezza, prassi di vigilanza e sorveglianza*, in Banca d'Italia, *Mercati, infrastrutture, sistemi di pagamento. Questioni istituzionali*, no. 31, 2023, p. 26.

[10] European Commission, *Proposal for a Directive of the European Parliament and of the Council on payment services and electronic money services in the Internal Market amending Directive 98/26/EC and repealing Directives 2015/2366/EU and 2009/110/EC,* 28.6.2023, COM(2023) 366 final. See van Praag E., *European Payments: Faster, Cheaper, More Digital and More European, but Leave No One Behind* (August 09, 2024). Available at SSRN: https://ssrn.com/abstract=4920419

[11] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on payment services in the internal market and amending Regulation (EU) No 1093/2010*, 28.6.2023, COM(2023) 367 final (the "PSR Proposal").

[12] See European Commission, *Financial data access and payment package*, available at https://finance.ec.europa.eu/publications/financial-data-access-and-payments-package_en#details. In literature, see Falce V., *Verso l'Open Finance. Open Finance. The way forward*, in *Assicurazioni*, n. 2/2024, p. 252.

[13] See EC Report, p. 5.

3. The PSR Proposal modifies certain PSD2's definitions in order to accommodate the new open banking-based business models, better define the features of the relevant concepts and specify the scope of the regulation.

The *payment account* definition now specifies that the account must be used for the execution of payment transactions and must consent to sending and receiving funds to and from third parties[14]. Consequently, savings accounts that are not used for sending and receiving funds to or from a third party, are excluded from the definition of a payment account[15].

The amendments to the *account information service* definition aim to "clarify that the information aggregated by the authorised account information service provider may be transmitted to a third party to enable that third party to provide another service to the end-user, with the end-user's permission"[16]. Accordingly, it is specified that such a service consists of *collecting, either directly or through a technical service provider, and consolidating* information held on one or more payment accounts of a payment service user with one or several account servicing payment service providers[17].

In addition to that, the main revisions to the account information service PSD2 framework (now transposed in the PSR Proposal) include the imposition, with limited exceptions, of a *dedicated interface* for open banking data access[18] and the *removal*, except in authorised circumstances, of the requirement on the intermediaries holding the payment accounts to maintain a *'fallback' interface* permanently[19].

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[14] See PSR Proposal, Article 3(15).
[15] See PSR Proposal, Recital 20.
[16] See PSR Proposal, Recital 26.
[17] See PSR Proposal, Article 3(21).
[18] See, in this respect, ECB, *Opinion of the European Central Bank of 30 April 2024 on a proposed Regulation and Directive on payment and electronic money services* (CON/2024/13), C/2024/3869 p. 3.3.4.
[19] See PSR Proposal, p. 10.

To guarantee high-level performance to the account information service providers, the *dedicated interface* should, at a minimum, ensure 'data parity' with the customer interface provided by the intermediary to its users[20].

The intermediaries holding the payment accounts shall ensure that their dedicated interface does not create obstacles to providing account information services[21]: the proposed regulation lists some prohibited obstacles leveraging on the EBA 2020 Opinion on the matter[22].

Finally, to enable open banking users to manage their permissions conveniently, the intermediaries holding the payment account must offer a "dashboard" that allows them to withdraw data access from any given open banking provider[23].

4. Moving to the FIDA Proposal, such intervention underlines how customers of financial institutions should effectively control their *financial data*, be empowered to decide how and by whom their financial data are used, and have the option to grant firms access to their data to obtain financial and information services[24].

The FIDA Proposal builds upon the measures in PSD3, establishing a regulatory framework for sharing customer data across the financial sector *beyond payment account data*[25]. In this respect, a new financial intermediary, the

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[20] See PSR Proposal, Recital 59.
[21] See PSR Proposal, Recital 60.
[22] See PSR Proposal, Article 44. In particular, preventing the use by AISPs of the credentials issued by intermediaries to their customers, requiring additional checks of the permission given by the payment service users to an AISP, requiring additional registrations by AISPs to be able to access the payment services user's payment account or the dedicated interface, or providing a dedicated interface that does not support all the authentication procedures made available by the AISP to the payment service user are considered, amongst others, prohibited obstacles.
[23] See PSR Proposal, Recital 65.
[24] See FIDA Proposal, p. 1 and Recital 2.
[25] See FIDA Proposal, Recital 4.

'financial information service provider' (FISP), a data user[26] authorised to access customer data to provide financial information services (FIS)[27], is also regulated[28].

According to the FIDA Proposal, a *customer* is a natural or legal person who uses financial products and services[29].

In the FIDA Proposal language, *customer data* are personal and non-personal data collected, stored and otherwise processed by a financial institution as part of its normal course of business with customers[30]. What is very relevant is that customer data expressly covers data provided by a customer and data *generated as a result of customer interaction* with the financial institution[31].

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[26] See FIDA Proposal, Article 2(2).

[27] Differences regard the scope of the FIS in comparison to the AIS, not only concerning the underlying data (respectively, the data contained in a payment account and a customer's financial data). PSD 2 and now PSR Proposal describe the AIS as a service consisting of collecting and consolidating information. Moving from such a core activity (which describes the service), the provider of an AIS may also offer the client other products or services that remain outside the account information service. On the other hand, FIDA Proposal uses very broad language that only provides that the data holder shall, upon request from a customer, make available to a data user (and this is, amongst the others, a FISP) any customer data "for the purposes for which the customer has granted permission to the data user" (see Article 5).

[28] The regime applicable to such an intermediary is stricter than that established for information service providers under PSD 3 Proposal and PSR Proposal, and this is also due to the larger scope of services that this new intermediary is entitled to carry out. It is important to note that the *Draft European Parliament Legislative Resolution on the proposal for a regulation of the European Parliament and of the Council on a framework for Financial Data Access and amending Regulations (EU) No 1093/2010, (EU) No 1094/2010, (EU) No 1095/2010 and (EU) 2022/2554* of 30 April 2024 (the "Draft EP Resolution") contains a clear position according to which gatekeepers pursuant to Article 3 of Regulation (EU) 2022/1925 should not be eligible to become financial information service providers. In addition, it is also stated that "[a] data user that is owned or controlled by a gatekeeper should be subject to a special assessment by the national competent authority of its registered office to ensure its eligibility under this Regulation. Where a data user is part of a group of companies in which one or more entities in the group have been designated as a gatekeeper, customer data should be accessed only by the entity of the group that acts as a data user. The data user should therefore not grant access to customer data under this Regulation to the gatekeeper that owns or controls it. Gatekeepers should not engage in behaviour that would undermine the effectiveness of the prohibitions and obligations laid down in this Regulation. The limitation on gatekeepers would not exclude them from the market or prevent them from offering their services, as voluntary agreements between gatekeepers and the data holders remain unaffected": see proposed restated Recital 10. FIDA Proposal requires FISPs to be either legally incorporated in the Union or, if incorporated in a third country, appoint a legal representative in the Union. According to Recital 36, such requirements do not amount to data localisation; FIDA Proposal does not entail any further requirement for data processing, including storage, to be undertaken in the Union.

[29] See FIDA Proposal, Article 3(2).

[30]See FIDA Proposal, Article 3(3).

[31]See FIDA Proposal, Article 3(3).

Needless to say, this broad definition opens up delicate questions of interpretation as to whether there is, and what is, the minimum threshold of customer interaction that would lead to data generated and held by a data holder[32] being qualified as customer data.

The data included in the FIDA Proposal's remit is comprehensive, including data with "high value added for financial innovation as well as low financial exclusion risk for consumers"[33], ranging from mortgages, loans and accounts *(except payment accounts)*, savings and investments to insurance-based investment products, crypto-assets, and real estate. Data collected for the purposes of carrying out a suitability and appropriateness assessment (in the investment services), for a demands and needs assessment (in the insurance products), or data that forms part of a firm's creditworthiness assessment as part of a loan application process[34] are also included.

They are data whose collection is time-consuming for a customer and constitutes a significant cost factor for advisors and distributors of investment, pension, and insurance-based investment products[35]. One can, therefore, understand, on the one hand, the interest of data holders in maintaining such information by strictly regulating its distribution to third parties and requiring remuneration for making it available, and on the other hand, the general interest, but certainly of customers, in being able to make use of such data to acquire services and products from third parties as well, thus reduce the costs and time needed to reconstitute masses of information useful for the purpose.

Hence, the FIDA Proposal seeks to achieve a difficult balance.

In this respect, is of relevance the Draft EP Resolution, which proposes to modify the definition of customer data, deleting the reference to the data

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[32]See FIDA Proposal, Article 3(5).

[33]See FIDA Proposal, Recital 9, and thus excluding data related to the sickness and health insurance of a consumer as well as life insurance products of a consumer.

[34]According to Recital 9, FIDA should not cover data collected in a *consumer*'s creditworthiness assessment.

[35]See FIDA Proposal, Recital 11.

generated as a result of customer interaction with financial institutions[36] and including a specific recital stating that "[t]o ensure the right of investment firms, insurance undertakings and insurance intermediaries to protect undisclosed know-how and business information when distributing investment products, the scope of the obligation to share data under this Regulation should be limited to relevant data that has been collected from the customer by the financial institution in order to comply with the regulatory obligation to perform a suitability and appropriateness assessment in accordance with Article 25 of Directive 2014/65/EU and Article 30 of Directive (EU) 2016/97. This is limited to data collected from the customer by the financial institution for the purposes of assessing the customer's knowledge and experience, financial situation, and investment objectives, as provided for in those provisions. This does not include the result of the suitability or appropriateness assessment itself made by the financial institution on the basis of the data collected from the customer, the suitability report given to a customer, or any analysis or preparatory work for the purposes of such report, which should be excluded from the scope of this Regulation"[37].

Apart from the obligation of the data holder to make data available to the customer upon request submitted by electronic means, without undue delay, free of charge, continuously and in real-time[38], the FIDA Proposal provides for an obligation on a data holder to make customer data available to a data user, including a FISP.

The sharing of customer data is based on the customer's permission, which may be subsequently withdrawn. In this respect, a specific discipline on the dashboard, very similar to that to be introduced in PSR, is provided for, based on the principle that customers must have "effective control over their data and confidence in managing permissions they have granted" and that "data holders

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[36]See modified Article 3(3).
[37]See new Recital 12a.
[38]See FIDA Proposal, Article 4.

should therefore be required to provide customers with common and consistent financial data access permission dashboards"[39].

Data holders and users must join financial data-sharing schemes to enable the contractual and technical interaction necessary to implement data access between multiple financial institutions[40]. These schemes should develop data and interface standards, joint standardised contractual frameworks governing access to specific datasets, and governance rules related to data sharing. The proposal establishes general principles for the governance of these schemes, including rules on inclusive governance and participation of data holders, data users, customer organisations and consumer associations (to ensure balanced representation in schemes), transparency requirements, and a well-functioning appeal and review procedure (notably around the decision-making of schemes)[41].

The financial data-sharing scheme is provided to establish a model to determine the maximum compensation a data holder is entitled to charge for making data available to users. The model will follow specific principles, including, amongst others, that the compensation must be reasonable and directly related to making the data available to the user. It will be based on an objective, transparent, and non-discriminatory methodology and on comprehensive market data collected from data users and data holders on each of the cost elements to be considered, periodically reviewed, and monitored. Membership in financial data-sharing schemes shall remain open to new members on the same conditions as those for existing members at all times[42].

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[39] See FIDA Proposal, Recital 21.
[40] See FIDA Proposal, Article 10.
[41] See, FIDA Proposal, p. 9 and Article 10.
[42] The FIDA Proposal provides that the financial data sharing scheme shall be notified to the competent authority, which shall be determined in accordance with specific rules depending on the State of establishment of the three most significant participating data holders. The competent authority shall assess whether the governance of the financial data sharing scheme complies with the general principles laid down in the regulation and, in case of a positive assessment, shall inform the EBA. It also provides that, if a financial data sharing scheme for one or more categories of customer data is not developed and there is no realistic prospect of such a scheme being established within a reasonable period of time, the Commission may adopt a delegated act specifying the

5. PSR and FIDA proposals provide different approaches to the compensation issue connected to the financial institution's rendering of data to the user.

The PSR maintains the exclusion of compensating the data holder, while the FIDA Proposal provides the possibility of including compensation. The difference is grounded in the fact that while access to payment accounts is already established in the regulation (PSD2), there is no merit in revising such a general framework.

According to the Commission, implementing such a major change in the open banking environment might be extremely disruptive, with no certainty that the performance of interfaces would improve quickly and considerably. However, the market should be permitted to enter into agreements, backed by a compensation mechanism, for services that go beyond those regulated in the updated PSD2 (such as value-added services provided via so-called 'premium' Application Programming Interfaces). Still, any TPPs should be able to benefit from the PSD2 'baseline' services without a prior contractual arrangement of payment[43].

On the other hand, according to the FIDA Proposal, the possibility of accessing a larger amount of financial data creates a new market in which it is appropriate to let the parties accommodate the economics of their relationship, also in terms of compensation for the release of data. This would ultimately lead to a more competitive environment. In addition, it is clearly stated that "to ensure that data holders have an interest in providing high quality interfaces for making data available to data users, data holders should be able to request reasonable compensation from data users for putting in place application programming interfaces"[44].

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modalities under which a data holder shall make available customer data: see FIDA Proposal, Article 11.

[43] See EC Report, p. 5.

[44] See, Recital 29.

The Data Act's general and cross-sectoral provisions envisage both the different schemes[45].

Article 9 of such a regulation sets the principle that any compensation agreed upon between a data holder and a data recipient for making data available in business-to-business relations shall be non-discriminatory and reasonable and may include *a margin*, which should take into account, among other things, costs incurred in making the data available and investments in the collection and production of data.

The Data Act, however, expressly provides that such a principle shall not preclude other Union law or national legislation from excluding compensation for making data available or providing for lower compensation.

It is worth mentioning that the impact assessment of the FIDA Proposal expressly states that "[g]iven the limited data availability and the nature of this proposal, it is inherently difficult to make quantitative predictions about how it would benefit the economy as a whole"[46].

In this regard, mention should be made to concerns over the broad scope of the proposed mandatory customer data access rights, the lack of clarity on benefits versus risks and the absence of consideration for the impact on financial intermediaries raised by the banking industry[47].

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[45] See, Regulation (EU) 2023/2854 of the European Parliament and of the Council of 13 December 2023 on harmonised rules on fair access to and use of data and amending Regulation (EU) 2017/2394 and Directive (EU) 2020/1828 (Data Act). The Data Act stipulates wide use and reuse of data. Still, barriers such as a lack of incentives for data sharing and uncertainty about rights and obligations hinder optimal data allocation (see Recital 2). To respond to the digital economy's needs and remove barriers to a well-functioning internal market for data, the Data Act lays down a harmonised framework specifying who is entitled to use product data or related service data, under which conditions and on what basis (see Recital 4). The Data Act provides horizontal rules that could be followed by union or national law and address the specific situations of the relevant sectors (see Recital 6). It is intended to be general legislation supplemented by more sector-specific regulations governing specific data domains, such as the payment and financial data domain, which the Data Access and Payments Package will govern.

[46] See FIDA Proposal, p. 7.

[47] See, *EBF position on the European Commission's proposal for a Framework for Financial Data Access (FIDA)*, EBF_046342, 11 December 2023. https://www.ebf.eu/wp-content/uploads/2023/12/EBF_046342-EBF-recommendations-on-FIDA_11.12.23.pdf

6. The new provisions follow the evolution of the business models stemming from creating open access to banking and financial data.

As underlined by the PSR Proposal, the Commission's review of PSD2 highlighted the fact that authorised AISPs sometimes provide payment account data that they have aggregated not to the consumer from which they received their permission to access and aggregate the data but to another party to enable it to provide other services to the consumer using the data[48]. Scholars have evaluated such a possibility as being consistent with the PSD2 framework[49]. There are, however, diverging views as to whether this activity falls under the regulated account information service.

Apart from the revision of the relevant definition[50], the Commission believes that the *license-as-a-service* extension of the Open Banking business model can provide new, data-driven services to the ultimate advantage of the end users[51]. Indeed, that business model – where the AISPs may also transmit the consolidated data to a third party – allows end customers to use, and in any case give access to, their payment account information to obtain non-payment services, such as financing, accountancy and creditworthiness evaluation.

However, according to the Commission, payment service users must be aware of who has access to their payment account data, for what legal reasons, and for what purpose. They should also be fully informed of and consent to sharing their information with another company[52].

In addition to that, the principle is stated that data aggregation from payment accounts should always be provided by a regulated entity based on a license, even where the data is ultimately transmitted to another service provider,

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[48] See PSR Proposal, Recital 26.
[49] See Burchi A. – Mezzacapo S. – Musile Tanzi P. – Troiano V., *Financial Data Aggregation e Account Information Services. Questioni regolamentari e profili di business*, in Consob, *Quaderni Fintech*, No. 4, 2019, p. 29.
[50] See above, paragraph 3.
[51] See PSR Proposal, Recital 26.
[52] See Recital 26.

to provide consumers with adequate protection for their payment account data and legal certainty regarding the status of entities accessing their data[53].

The final indication that can be drawn from the structure of the regulation – with reasoning extendible to the Open Finance sphere – is certainly in the sense of openness towards more advanced forms of exploitation of the opportunities offered by the evolution of the relevant models, mitigated by marked attention to bringing within the scope of the discipline the methods and subjects that intervene in these areas. In this respect, the importance assigned, albeit in a very embryonic form, to the figure of the technical service provider is significant[54]. To what extent this approach, strongly marked by the regulation of phenomena emerging from market drives, actually ends up reducing the drive towards process innovation in the context under consideration is the big question that occupies operators, users and regulators.

7. Moving to the 2023 EU Commission Retail Investment Strategy, it is well known that such an intervention addresses a wide variety of issues along the retail investor journey and touches on the more subtle features of the relevant discipline[55]. The ultimate objective is "ensuring that the legal framework for retail

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[53] See Recital 26. In this respect is also relevant the Draft EC Resolution, which proposes a new definition of 'financial information service' as the online service provided by a data user of collecting and consolidating customer data to customers and does not include the provision of services regulated under existing Union financial services legislation and reserved for financial institutions authorised under Union law: see new Article 3(6a).

[54] According to PSR Proposal, Recital 17, "[t]echnical services do not constitute payment services as such as technical service providers do not enter at any time into possession of the funds to be transferred. They should therefore be excluded from the definition of payment services. Those services should however be subject to certain requirements, such as those on liability for failure to support the application of strong customer authentication, or the requirement to enter into outsourcing agreements with payment service providers in case technical service providers are to provide and verify the elements of strong customer authentication. There should also be requirements governing the termination fees of framework contracts where payment services are offered jointly with technical services". See however *European Parliament legislative resolution of 23 April 2024 on the proposal for a regulation of the European Parliament and of the Council on payment services in the internal market and amending Regulation (EU) No 1093/2010 (COM (2023)0367 – C9-0217/2023 – 2023/0210(COD))* (P9_TA (2024)0298) that proposes to amend Recital 17 deleting the requirement to enter into outsourcing agreements. See also PSR Proposal, Article 3(36) and 2, paragraph 2(i), and PSD3 Proposal, Recital 68.

[55] See Omnibus Directive, p. 2-3.

investments sufficiently empowers consumers, encourages improved and fairer market outcomes", growing the retail investor participation in capital markets[56].

The strategy's goal is to ensure a modernised and simplified framework for retail investment that is aligned and coherent across the different sectors: it is proposed as a package including the Omnibus Directive and a proposal for a new Regulation amending the PRIIPs discipline on key information documents.

The proposal describes its consistency with other Union policies and underlines its alignment with the objectives of other Commission initiatives, seeking to facilitate data sharing within the financial services sector (and here, reference is made to an upcoming, at that time, initiative for a framework for Open Finance).

In particular, the focus is on the provision of a standardised report on information collected by a firm on its client for the suitability or appropriateness assessment. Such a new requirement is expected to facilitate, if the client requests that report, "more seamless and cost-effective data sharing and re-use of such information by other firms selected by the client. In turn, this should benefit consumers through improved more efficient and innovative products and services and should facilitate competition by increasing transparency and reducing switching costs"[57].

The Omnibus Directive proposes to amend Article 25 of Directive 2014/65/EU (MiFID2) concerning the assessment of suitability and appropriateness and reporting duties to clients[58]. According to the proposal, the assessments are to be determined based on information about the client or potential client as obtained by the investment firm, which shall, upon request of the retail client, provide them with a report on the information collected for the purpose of the suitability or appropriateness assessment. The report is to be presented in a standardised format. In order to make such a requirement effective, ESMA is

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[56] See Omnibus Directive, p. 1

[57] See Omnibus Directive, p. 4.

[58] Similar provisions are included to amend Article 30 of EU Directive 2016/97 (IDD).

entitled to develop draft regulatory technical standards to determine the format and content of the report.

It is clear that the goal of such a provision is to facilitate the retail client's access to the information collected by the investment firm, including possibly reusing such information and streamlining future similar assessments by other intermediaries. The provision applies to retail clients only; no indication concerns possible costs, if any, related to the availability of such a report. In any case, the requirement opens the door to more effective use of data pertaining to the client directly provided by the investment firm in a predefined format.

Therefore, it is not surprising that this aspect attracted attention during the current examination of the Commission proposal[59]. While the Parliament's report[60] maintains the Commission's framework, the EU Council's position[61] differs in a very relevant aspect. According to the Council, the investment firm shall, upon request of the retail client, provide them with a report on the information collected for the purpose of the suitability or appropriateness assessment. No reference is made to the creation of a standardised report, and accordingly, ESMA's power to develop draft regulatory technical standards does not include any indication of such a report.

8. Undoubtedly, the road to creating an organised system for acquiring and using data in the financial field to render further services to the entity to whom the data relate or to third parties is still long.

The convergence of rules between account and financial information services is mapped out, and it would be preferable to be undertaken immediately.

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[59] See, with reference, in general, to the current examination of the Commission proposal, Di Carlo and Gobbo, *Retail investment package: il confronto su product governance, value for money e inducements*, in *Dorito Bancario. Approfondimenti*, July 2024.

[60] Report on the proposal for a directive of the European Parliament and of the Council amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules | A9-0162/2024 | European Parliament (europa.eu). The same position is maintained as far as regards the amended Article 30 IDD.

[61] See Retail investment package: Council agrees on its position - Consilium (europa.eu). The same position is maintained regarding the amended Article 30 IDD.

The creation of standardised reports available by retail clients in the MiFID and IDD remit may accelerate the process of reusing data collected by intermediaries.

Similarly, it is inescapable that an appropriate compensation discipline must be defined for financial data holders (possibly distinguishing between retail and non-retail clients) and account payment data holders if the financial data market is to be smoothly activated[62].

[62] In this respect, the rules provided by the FIDA Proposal on financial data-sharing schemes seem too elaborate at present. On the contrary, the Draft EP Resolution apparently further elaborates on the schemes' structure and functioning: see new Articles 9 and 10.

GOLDEN POWER BETWEEN THE EXERCISE OF ECONOMIC FREEDOMS AND PROTECTION OF ECONOMIC-FINANCIAL SECURITY

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ABSTRACT: *This paper analyses, from a comparative perspective, the extension of the regulation on the control of foreign investments also to banks, insurance companies and other financial intermediaries, focusing on the Italian system and the critical issues that it may present in a global market.*

SUMMARY: 1. From Golden Share to Golden Power. – 2. Comparative law profiles in relation to Golden Power: the main Western models. – 3. The Italian model of Golden Power in the European system. Rules and Principles – 4 Conclusions.

1. The complex and multifaceted issue of special powers in the case of acquisitions of national strategic enterprises has been at the centre of discussion within institutions and among scholars in many areas: not only jurists, economists, and political commentators, but also scholars of the hard sciences (we need only think of the issues tied to the classification of various defence assets considered to belong to strategic or sensitive sectors).

We know the important system-related considerations underlying the effort to analyse existing legislation concerning special powers of the State. Such legislation was conceived for an economic and geopolitical context differing completely from the present one, set in the contemporary world, in which we are aware of the impossibility of predicting the future on a global level.

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It is difficult to provide an effective overview of the issue; we will limit ourselves to illustrating some evolutionary developments that may also be understood through a comparative law perspective:

- transition from the Golden Share to the Golden Power, which signals the State's intent to monitor and not manage private property of strategic interest;

- in recent years we have seen an attitude throughout the West that we might define as a retreat from globalisation. Golden power is a manifestation of this retreat, and Europe has fully embraced this attitude. The extent of the retreat may be deduced from the type of model adopted by each individual State: the minimal model or expanded model. If the model becomes broader in scope, we will have to talk about a general change in strategy, or a genuine industrial policy. In fact, national protection and safeguards are easily understood in such sectors as defence or artificial intelligence, but when they are extended to other areas such as the biomedical sector, their strategic nature becomes less clear;

- there has been a constant expansion of the boundaries of strategic security, from defence and industry to healthcare, services and the financial sector, but here we encounter a definitional problem of absolute relevance: the generic nature of the locutions, and the indeterminacy of what is meant by strategic interest;

- this indeterminacy gives rise to a factual consequence, i.e. the fact that in over seventy percent of the cases of notifications received—at a European level—the competent national authorities have not undertaken any formal inquiry;

- there is a strong sensitivity demonstrated by operators and we see an intervention of States that is wholly modelled after the United States approach.

We shall start off by saying that the analyses we have conducted in this area show a decided divergence, especially in Italy, between law in books—i.e. the written law giving rise to national control mechanisms and the rules regarding their operation, regulations of a unionist but also national derivation—and law in

action—i.e. what then actually happens in the individual systems.

In the majority of Western systems, law in books in effect provides composite legal instruments for controlling foreign investments; an apparatus made up of statutes, institutions and bodies created to direct State interventions in the economy and effectively organise the exercise of these powers by the individual governments. In Europe we may recall the Commission's commitment towards the establishment of national mechanisms for controlling foreign direct investments into the Union which are aligned and cooperate with each other; but if we look at the so-called law in action, i.e. what has actually happened to date from an operational standpoint, we see that some systems, including Italy in the case of Europe, but also common law systems like those in the United States, Canada, and Australia, have made moderate and intelligent use of the available legal instruments.

Moreover, this conclusion is clearly highlighted in the Report from the Commission to the European Parliament and the Council of 19/10/23, and this empirical observation should be duly taken account of in our role as jurists.[1]

In the present stage of evolution, we see that the State is called on to defend the nationality of domestic enterprises in sectors deemed essential irrespective of whether it has an equity stake in the companies concerned. We have witnessed a change of paradigm: the State must be able to intervene in the decisions of enterprises operating in certain essential sectors, even if it does not hold any shares. "What is special is no longer the share held (golden share) but the power of intervention exercised by the State (golden power)" [2].

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[1] www.governo.it

[2] F. BASSAN, *Dalla golden share al golden power il cambio di paradigma dell'intervento dello Stato nell'economia, in Studi sull'integrazione europea*, 2014, p.58. See also, on the interpretation of Art. 63 TFEU: S. GOBBATO, *Golden shares e approccio uniforme in materia di capitali nella recente giurisprudenza comunitaria*, in *Il Diritto dell'Unione Europea*, 2004, p. 427; ff.; T. AJELLO, *Le* golden shares *nell'ordinamento comunitario: certezza del diritto, tutela dell'affidamento degli investitori e 'pregiudiziale' nei confronti dei soggetti pubblici*, *ivi*, 2007, p. 811 ff.; S. DE VIDO, *La recente giurisprudenza comunitaria in materia di* golden share*: violazione delle norme sulla libera circolazione dei capitali o sul diritto di stabilimento?*, in *Diritto del commercio internazionale*, 2007, p. 861 ff.; F. SANTONASTASO, *La 'saga' della* 'golden share' *tra libertà di movimento dei capitali e libertà di stabilimento*, in *Giurisprudenza*

2. Going back to the legislative trends and thus to the evolution of legal systems we observe that:

1) In the case of Europe, it is interesting to note the transition from Golden Share—or *action specifique* in so-called Frenchified systems—to Golden Power, which has served to affirm the total independence between special powers and public ownership of shares. It is a sign of the need for the State, at the instigation of Europe and the European Court of Justice, to act by monitoring private property of strategic interest. This has involved both common law and civil law systems in Europe. Here we should indeed refer to the Western legal tradition as interpreted by Merryman, not the two sub-traditions of common law and civil law.[3]

The United States has followed a different path in the sense that the mechanisms of control over investments do not derive from private-law concepts such as the golden share or *action specifique* but largely take the form of filters to foreign investments. Since the middle of the last century, in the face of risks for national security, the Congress has passed legislation attributing a specific power to the President of the United States, starting from the Defense Production Act of 1950, later amended by Congress in 1988 with the Exon-Florio Amendment, which authorises the President to suspend or prohibit any "merger, acquisition or takeover" that could result in foreign control over any American company, obviously subject to precise conditions. Then in 2007 there was the Bush law, or so-called FINSA (Foreign Investment and National Security Act), which was

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commerciale, 2007, p. 302 ff.; D. GALLO, *Le* golden shares *e la trasformazione del* public/private divide*: criticità, sviluppi e prospettive del diritto dell'Unione europea tra mercato interno e investimenti extra-UE*, in S. M. Carbone (ed.), *L'Unione europea a vent'anni da Maastricht – verso nuove regole*, Napoli, 2012, p. 177 ff. Art. 63 TFEU (ex Article 56 TEC) says: "1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. 2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited".

[3] J.H. MERRYMAN, *The Civil Law Tradition: An Introduction to the Legal Systems of Europe and Latin America*, Stanford, Stanford University Press, 1969.

founded on the increasing awareness of the need to ensure national security and control foreign investments. As is well known, a specific federal agency was established in 1975 (Committee on Foreign Investment in the United States-CFIUS); it is an inter-agency committee tasked with analysing the implications of foreign investments for national security. Companies that are the target of an acquisition by a foreign entity voluntarily provide notification to the CFIUS, but the committee can also analyse transactions that have not been voluntarily reported. Therefore, the aim from the start has been to protect national security, with less of a focus on protecting domestic economic operators.

That being said, as mentioned earlier, in recent years we have seen an attitude on the part of lawmakers and regulators throughout the West that appears to reflect a retreat from globalisation, as is manifested in the golden power regime.

2) This indeterminacy has given rise to two consequences: the first is that the number of notifications is constantly on the rise due precisely to the desire to avoid the risk of sanctions; the other, as already noted, is that in over seventy percent of the cases of notifications received the competent national authorities in Europe have not conducted any formal assessment (outside the golden power regulatory framework). Here we go back to our initial consideration, namely that irrespective of the presence of more or less comprehensive legislation in the various systems and despite a strong awareness demonstrated by operators (maybe not in all sectors: there were only “42” notifications in 2021 for the financial sector in the EU), we have seen an intervention of EU Member States wholly modelled after the United States approach.

It seems to us that the French model, as it has most recently evolved, is a very interesting example of the dichotomy between existing law and applied law. The latest trend emerging in France, as reflected in both legislative and regulatory production, is emblematic: a robustly autonomous regulatory power entrusted to

the government, which is authorised to adopt decisive policies aimed at reinforcing control over foreign investments. The tendency towards a strengthening of control over foreign investments can be clearly seen in France, for example, with the recent amendments to the Monetary and Financial Code (*Code monétaire et financier*) introduced by Decree No 2023-1293 of 1 January 2024, and Decree No 1293 of 28 December 2023, which contains a series of provisions relating to the procedure for foreign investments in France. Let us look at the most significant ones: firstly, under the Decree the measure to control the crossing, by non-European investors, of the 10% threshold of voting rights in companies listed in a regulated market, originally introduced in 2020, was made permanent.

Decree No 2020-892 of 22 July 2020 had been introduced in the context of the COVID-19 health crisis and had in fact provided for a *temporary* lowering, from 25% to 10%, of the threshold for the acquisition of voting rights apt to trigger control over French companies engaged in sensitive activities and whose shares were admitted to trading on a regulated market.

This emergency measure, extended three times up to 31 December 2023 (Decree No 2022-1622, 23 December 2022; Decree No 2021-1758, 22 December 2021; and Decree No 2020-1729, 28 December 2020), changed face.

Under Decree 1293, it was chosen to perpetuate this measure aimed at monitoring the crossing, by non-European investors, of the 10% threshold in listed companies (Monetary and Financial Code, Article R. 151-2, 4, amended by Decree No 2023-1293, 28 December 2023 - Article 1).

And another choice was also made in this area, namely that of further extending the scope of application of foreign investment control in France. Now it also applies to the acquisition of control over branches in France of entities governed by foreign law, where they engage in a sensitive activity or the processing and extraction of critical raw materials (Monetary and Financial Code, Article R. 151-2, 1° amended by Article 1, and Monetary and Financial Code, Article

R. 151-3 amended by Article 2).

Again in relation to so-called sensitive sectors, we see an increase in strategic activities or so-called strategic assets: as has occurred in Germany and Italy.

We already know that the famous *Loi PACTE*, or Law No 2019-486 of 22 May 2019, had broadened the scope of strategic sectors to include activities tied to agriculture, the production, processing and distribution of agricultural products and journalistic activities, but the new decree extends the French FDI control regime to investments in sectors qualified as "sensitive sectors", with a certain terminological confusion between the adjectives strategic and sensitive.

The provision amends Article R151-3 of the Monetary and Financial Code and identifies the sensitive sectors. The list of activities related to infrastructure, goods and services essential to safeguarding public order and public security also includes activities related to the integrity, security or continuity of the extraction, processing and recycling of critical raw materials (e.g. in the framework of lithium mining projects in France).

The definition of the public security sector has been amended to cover prison safety services.

The controlled research and development activities now include those ones related to photonics and low-carbon energy production technologies, where intended to be implemented in the sectors listed in Article R151-3.

However, it is interesting to note that, in parallel, the French government has announced that it is committed to making it less difficult to invest in France.

3. Taking into account the Italian situation, let us remember that the so-called golden share—i.e. the power to introduce, into the articles of association of newly privatised companies, special powers that the government, through the Ministry of Economy and Finance, could exercise also after the transfer of

control—was provided for as part of the general rules on privatisation laid down in Decree-Law No 332 of 13 May 1994. The golden share applied to companies operating in sectors related to public services, expressly indicated by Decree-Law No 332/1994 as defence, transportation, telecommunications and energy sources. The fundamental difference from the model of the countries mentioned above, and the reason why the initial Italian designation was not used in a technical sense, was that the Italian instrument did not necessarily entail any actual possession of equity shares by the State, even only symbolic ones, in order to be able to exercise special powers[4].

The Court of Justice intervened in relation to this legislation, declaring it to be in conflict with the provisions of the EC Treaty regarding the freedom of establishment (Article 43 EC Treaty), the freedom to provide services (Article 49) and the free movement of capital (Article 56) in a judgment delivered on 23 May 2000 (Judgment of the Court of Justice of 23 May 2000 in case C-58/99, Commission vs Italy).[5]

The provisions of the abovementioned Decree-Law were revised accordingly by Article 4, paragraphs 227-231 of the Finance Law for 2004 (Law No 350/2003), which met with the opposition, however, of the ECJ in 2009.

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[4] In Italy the Golden Power regulation found a strengthening during covid time. See F.ANNUNZIATA-A.SACCO GINEVRI-C. SAN MAURO, *I golden powers fra Stato e mercato, e coronavirus: regole per l'emergenza o per il futuro*, in U. Malvagna-A.Sciarrone Alibrandi (a cura di), *Sistema produttivo e finanziario post Covid-19: dall'efficienza alla sostenibilità*, Pacini, Pisa, 2020, p. 34 ss.; M. RESCIGNO-E. RIMINI, *Golden power e coronavirus: regole per l'emergenza o per il futuro*, in AGE, 2020, p. 517 ss.; nonché, sia consentito il rinvio a A. SACCO GINEVRI, *The Italian Foreign Direct Investments Screening in times of COVID-19: trends and perspectives*, in *Law and Economic Yearly Review, 2020, p. 122 ss.; ID., I golden powers fra Stato e mercato ai tempi del Covid-19,* in D. Rossano (a cura di), *Covid*-19 emergenza sanitaria ed economica, Cacucci, Bari, 2020, p. 159 ss.

[5] Case C- 58/99 23 May 2000, Commission v. Italy, Case C-367/98 4 June 2002, Commission v. Portugal , Case C-483/99 4 June 2002, Commission v. France, Case C-503/99 4 June 2002, Commission v. Belgium, Case C-463/00 13 May 2003, Commission v. Spain, Case C-98/01 13 May 2003, Commission v. United Kingdom, Case C-282/04 and C-283/04 28 September 2006, Commission v. The Netherlands, C-174/04 02 June 2005, Commission v. Italy, Case C-112/05 of 23 October 2007, Commission v. Germany, C-463/04 and C-464/04 6th December 2007, Commission v. Italy, C-274/06 14 February 2008, Commission v. Spain, C-207/07 17 July 2008, Commission v. Spain.

In Decree-Law No 21 of 15 March 2012, the legislator redrafted the provisions regarding the special powers exercisable by the government, also in order to comply with the guidelines and respond to the criticisms put forward at the European level. We shall mention the Court of Justice judgment of 2009 according to which[6]: by adopting the provisions contained in Article 1(2) of the Decree of the President of the Council of Ministers of 10 June 2004 defining the criteria for the exercise of the special powers [attributed by virtue of the possession of the so-called golden share] referred to in Article 2 of Decree-Law No 332 of 31 May 1994, converted into law with amendments by Law No 474 of 30 July 1994, the Italian Republic has failed to fulfil its obligations:

— under Articles 43 EC and 56 EC, in so far as those provisions apply to the special powers provided by Article 2(1)(a) and (b) of the Decree-Law, as amended by Law No 350 of 24 December 2003 relating to the provisions for drawing up the annual and pluriannual budget of the State (Finance Law for 2004), and

— under Article 43 EC, in so far as those provisions apply to the special power provided by Article 2(1)(c) of the Decree-Law.

Decree-Law No 21 of 2012 redefined, also by reference to secondary legislation (Decrees of the President of the Council of Ministers), the objective and subjective scope, type, conditions and procedures for the exercise of the aforesaid special powers by the State (in particular by the government). It specifically addressed the powers exercisable in the defence and national security sectors, as well as in some areas of activity in the energy, transportation and communications sectors defined as being of strategic relevance.

Special powers ("golden power") are understood to include, among other things, the authority to establish specific conditions for the acquisition of equity

[6] ECJ 26 March 2009, Case C-326/07.
C-106/22 of 13 July 2023. The Court adopts a restrictive interpretation of the concept of foreign direct investment and narrows the Regulation's scope of application, in fact going so far as to confine applicability to investments made directly by undertakings incorporated in non-European countries.

shares, to veto the adoption of certain company resolutions and to oppose the acquisition of equity shares. The objective of the measure was to ensure that national rules regarding the government's special powers, which could be likened to those of the "golden share" and "action spécifique"—envisaged in the British and French systems, respectively—and had in the past led to the objections raised by the European Commission and the aforementioned judgment of the EU Court of Justice, were compatible with European law.

The legislation in question should be assessed in the light of the guidelines laid down by the European Commission. For the purpose of defining the criteria of compatibility of the special powers legislation, the European Commission issued a specific Communication,[7] whereby it affirmed that the exercise of such powers must in any way take place without discrimination and is admitted if founded on "objective, stable and public criteria" and if justified by "reasons of general interest". Regarding the specific areas of intervention, the Commission admitted a particular regime for investors of another Member State where this was justified by reasons of public order, public security and public health provided that, in accordance with the case law of the Court of Justice, any interpretation resting on considerations of an economic nature was excluded.[8]

In relation to the financial sector and the prudential supervision of financial institutions, or with regard to capital movements, the exceptions allowed must not be a means of arbitrary discrimination or a disguised restriction on the free movement of capital. In any case, according to what was specified by the Commission, the definition of special powers must be consistent with the principle of proportionality, meaning that the State must only be granted the powers strictly necessary to achieve the objective pursued. The guidelines contained in the

[7] On 8 April 2020, in response to the COVID-19 emergency and following EU Commission guidelines issued on 25 March 2020 on the protection of European strategic assets and technologies. See G.LUCHENA, *Il c.d. decreto liquidità è una minaccia per il liberismo? Brevi note sul "nuovo" golden power,* in *www.dirittifondamentali.it*, 2020, 1

[8] The European Commission recently presented a proposal for a regulation to revise and strengthen the EU's FDI rules in light of the critical issues associated with the current Regulation (EU) 2019/452.

aforesaid Communication served as a basis for the Commission's launching of infringement procedures against the provisions of Decree-Law No 332/1994 laying down the general rules regarding special powers.

The so-called Omnibus Decree (Decree-Law No 104 of 10 August 2023. Urgent provisions to protect users in respect of economic and financial activities and strategic investments) was converted into law No 87 on 9 October 2023. It reinforced the government's special powers under the "golden power" regime, extending them to include the authority to intervene within a same group.

Taking into consideration other special powers as well, it should generally be noted that, in addition to the "golden share" rules, other legislative initiatives have pursued—albeit by different means—similar policies to protect companies operating in sectors judged to be strategic for the national economy.

In particular, further special rights were attributed to the public shareholder under the provisions of the Civil Code relating to companies, as well as, subsequently, under Law No 266 of 23 December 2005 (Finance Law for 2006), which introduced the so-called poison pill into the Italian legal system. In the event of a hostile takeover bid regarding companies in which the State had a shareholding, this instrument allowed the government to resolve on a capital increase, by virtue of which the public shareholder could increase its stake, thereby defeating the takeover attempt.

The instrument of the poison pill, also existing in foreign legal systems, can be used to oppose company acquisition transactions based on bids to purchase shares that are not approved by the controlling entities (hostile takeovers, precisely).

In particular, paragraphs 381 to 384 of Article 1 of Law No 266 of 23 December 2005 (Finance Law for 2006) authorised companies in which the State had substantial stake to issue shares and equity-based financial instruments attributing the right to request the issue of new shares or equity instruments with

voting rights.

Essentially, the poison pill represents a different means to achieve purposes similar to those of the golden share, namely to protect the public shareholder in companies operating in sectors considered strategic for the national economy (see section on the "golden share"). In particular, in the event of a hostile takeover bid regarding State-invested companies, the poison pill would allow the government to resolve on a capital increase, by virtue of which the public shareholder could increase its shareholding, thereby defeating the takeover attempt.

Let us also consider Article 7 of Decree-Law No 34 of 2011, which authorised the Cassa Depositi e Prestiti—the Italian National Promotion Institution— to acquire stakes in companies that are of major national interest in terms of the strategic importance of the sector of operations, employment levels, or amount of turnover, that is, in terms of impacts on the country's economy and production. More specifically, the companies defined as being "of major national interest" include those operating in the following sectors: defence, security, infrastructure, transportation, communications, energy, insurance and financial intermediation, research and high-tech innovation and public services.

4. What several critics have objected to is the level of discretion allowed in the exercise of the specified powers. They usually highlight a risk for markets,[9] and one might also point to the lack of an effective exercise of such powers for the purpose of preventing business concentrations from occurring in some countries as a result of law shopping, a practice going against the trend towards the harmonisation of law in Europe, intended to make the EU effectively a single market.

In regulated markets, such as the banking and insurance market, there is a risk of concentration in countries that have "more indulgent" authorities, again in

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[9] "It is necessary, in short, to avoid discretion and the abuse of an instrument that is necessary, but which to some extent distorts the market and is potentially dangerous": R. ARCANO, G. GALLI, I. MAROCCIA, G. TURATI, *Il golden power e i rischi per il funzionamento dei mercati*, 2022, https:/ /osservatoriocpi.unicatt.it/

contrast with the harmonisation of regulations and supervision. However, this should not necessarily lead to intervention under the golden power rules; rather, steps should be taken to develop a uniform system of regulation and supervision, at least at a European level, which takes into consideration the national or international dimension of supervision in the application of the law.

It is argued that, in order not to be in breach of the free movement of capital in the European space, the golden share powers must be "non-discriminatory", "non-discretionary" and "proportionate".[10]

"Non-discriminatory" in the sense that they must not discriminate based on nationality. The term "non-discretionary" should be understood as meaning that the powers must be exercised on the basis of publicly known criteria.

"Proportionate" means that the golden shares must be consistent with the proportionality principle. We have to design a system of "golden share" powers founded on prior authorisation, economic justifications and the safeguarding of the supply of essential services.

Considering the fact that the requirement of prior authorisation is seen as a restriction on the principle of the free movement of capital, the Court uses the proportionality principle to determine the legitimacy of this type of regime.[11] It has been clearly established that any prior authorisation must be proportional to the objective pursued and the objective cannot be reached with less restrictive measures.

Economic justifications are not accepted as legitimate grounds based on existing case law regarding the free movement of goods and services.[12]

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[10] E. SZYSZCZAK, *Golden shares and Market Governance, Legal Issues of Economic Integration*, Kluwer Law International, Netherlands 2002, volume 29 (3), pp.255-284.

[11] Case C- 265/95 Commission v France [1997] ECR I-6959, Case C- 398/95 SETTG [1997] ECR I – 3091, Case C- 120/95 Decker [1998] ECR I -1831.
See also B. RUSSO – *La tutela dell'integrità dei mercati e ruolo proattivo dello Stato nell'evoluzione della disciplina golden power: le possibili criticità applicative dei nuovi profili operativi*, in *Riv. trim. dir. eco.,* supl. 1 2024, p. 49 ss.

[12] E.SZYSZCZAK, *Golden shares and Market Governance, Legal Issues of Economic Integration*, Kluwer Law International, Netherlands 2002, volume 29 (3), pp.255-284.

Other scholars have concluded that the non-discretionary nature is a necessary (albeit not sufficient) condition to ensure proportionality. This explains why discretionary restrictions on the principle of the free movement of capital are never proportional and why it is appropriate to characterise the criteria accepted by the Court of Justice as reflecting a reinforced notion of proportionality.[13]

Regulation of the economy must be predictable and discretion in its application introduces elements of insecurity that preclude reliable forecasts about the costs and revenues arising from a given commercial undertaking. This has negative effects not only for private actors but also for the general interest, and entails, at the very least, a pointless waste of resources and in some cases also costs to undo what has been done.[14]

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[13] P. CAMARA, "*The end of the "Golden" Age of Privatisations? The recent ECJ Decisions on Golden Shares*", *European Business Organization Law Review*,3,(2002), p.506,pp.503-513. See also A. SACCO GINEVRI, *Golden powers, banche e assicurazioni: le ragioni di un difficile incontro,* in *Dir. Bancario*, novembre 2020, p. 1 ss. The author stresses also on the necessity to balance protectionism and technological development in the international market. A. SACCO GINEVRI, *Golden powers e banche nella prospettiva del diritto dell'economia*, in *Riv. Reg. Merc*., 2021, p.67 and the peculiarities of the financial sector A. SACCO GINEVRI, *Golden powers e infrastrutture finanziarie dopo il Decreto Liquidità,* in *Dir. Bancario*, aprile 2020, p. 1

[14] J. S. MASUR & J. R. NASH, *Promoting Regulatory Prediction*, in *Public Law and Legal Theory Working Paper Series*, No.780 (2021), pp. 205: "the costs of an incorrect prediction could be substantial, both to the firm and to society at large. If the firm constructs a nuclear plant and the government later lifts all greenhouse gas regulations—as the Trump Administration did—the nuclear plant could turn out to be much more expensive than coal-fired plants and be forced out of business. If the firm constructs a nuclear plant and the government tightens regulations on nuclear power, the nuclear plant might be prevented from ever operating. The success of the plant—and potentially the fate of the firm—relies on the accuracy of the firm's prediction."

CRYPTO-ASSETS AND WEALTH CIRCULATION: THE ROLE OF SUPERVISORS AFTER MiCAR.

Valerio Lemma[*]

ABSTRACT: *This article examines the regulatory landscape for cryptocurrencies in the EU following the Markets in Crypto-Assets Regulation (MiCAR). It argues that the focus of financial supervisors has extendet from traditional prudential oversight only to managing the wealth circulation facilitated by crypto-assets. The article outlines MiCAR's provisions that empower European authorities to monitor illicit activities within the crypto market and impose sanctions, creating a centralized oversight system. It also emphasizes the need for coordination among institutions like ESMA and EBA to ensure regulatory uniformity, particularly as member states may impose differing restrictions. Moreover, the ECB's role is highlighted, as MiCAR makes its opinions on crypto operations binding, reinforcing the link between monetary stability and digital currencies. The responsibilities of national authorities, such as the Bank of Italy and Consob, are discussed regarding risk management and compliance with anti-money laundering regulations.*

SUMMARY: 1. Foreword. - 2. European authorities and the cryptocurrency market. - 3. The Sevif between micro and macro prudential supervision of crypto-assets. - 4. The ECB in controlling the monetary effects of crypto assets. - 5. The Role of National Competent Authorities.

1. In recent times, supervisors seem to be turning their attention beyond the realms of prudential supervision, toward controlling the expansive trend of the economy and financial formulas that postulate infinite growth. This is an attention that focuses, in particular, on activities and products that seem designed to

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promote the circulation of wealth beyond the speed and extent set by the relevant authorities.

The control of the issuance of crypto-assets, which - in representing a value or a right that can be transferred and stored electronically, using distributed ledger technology or a similar one (as indicated by Article 3, paragraph 1, point 5, of Regulation (EU) 2023/1114, so-called MICAR)[1] - appears to be intended to produce expansive effects with respect to the availability of money, understood as an instrument capable of supporting the circulation of wealth. [2]

In this regard, it seems useful to recall the analyses that have pointed out a political attitude of '*benign neglect*' towards all crypto-assets, whereby the control of their circulation should be considered as one of the possible actions that must coordinate with the indications of policy makers in order to give way to a normalization of monetary policy (and which, in the opinion of the first commentators, represents a more extensive and complex problem, which cannot be solved without a specific and clear position on the decentralized accounting technologies used[3]). [4]

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[1] V. Recitals 1 and 2, Regulation (EU) 2023/1114 on cryptocurrency asset markets (MiCAR). Please consider that this research follows the conclusions of the following articles LEMMA, *Quali Controlli Per Le Valute Virtuali?*, in *Rivista Trimestrale di Diritto dell'Economia*, 2022, and ID., *DLT pilot: verso il mercato degli strumenti finanziari digitali*, in *Diritto Bancario*, May 2023

[2] See P. SAVONA, *Purpose of the Initiative,* in AA.VV., *Monetary Policy Normalization. One Hundred Years After Keynes' Tract on Monetary Reform*, Switzerland, 2023, p. 1 ff.

On closer consideration, albeit within the limits that will be said, perhaps it also represented an alternative solution for the circulation of wealth after the regulatory squeeze operated in the market for financial derivatives, the use of which for monetary purposes was made more onerous following the disciplinary intervention brought about by EMIR; see V. LEMMA - S. CLEMENTS, *Financial information regulation and Emir principles, with Susan Clements, in Open Review of Management, Banking and Finance, 2015, p. 1 ff.*

[3] See R. MASERA, *Economics and Money. Political and Epistemological Perspectives of Connecting and Fault Lines: A Fil Rouge from Keynes to Digitization,* in AA.VV., *Monetary Policy Normalization. One Hundred Years After Keynes' Tract on Monetary Reform*, Switzerland, 2023, p. 13 ff.

[4] See J. MARTINEZ - T. PHILIPPON - M. SIHVONEN, *Does a Currency Union Need a Capital Market Union? Risk Sharing via Banks and Markets,* in CEPR Discussion Paper No. DP14220, 2019 who compare the dynamics of risk sharing in response to demand shocks. Useful, for our purposes, to recall the conclusion reached by AA. in that - in their view - a banking union is

It goes without saying that the monetary policy objective outlined above and those of regulatory policy (designed to ensure investor protection and capital market stability) should soon converge toward a point of equilibrium involving the supervision of all forms of digital circulation of wealth (and their instrumental supports: from automatisms in the structuring of markets to the use of artificial intelligence-and in particular *machine* learning-in the formulation of supply and demand). [5]

It appears, therefore, possible to undertake an analysis of the role of supervisors by highlighting the implications of *infotechnologies* with respect to the circulation of wealth, whether mediated by crypto-assets or other goods or services.[6] Certainly, new kinds of problems and risks are on the horizon; however - as will be seen in the following paragraphs - MiCAR appears to be anchored in a paradigm that, through sanctions on cryptocurrency operations, forces operators to make behavioral adaptations (with respect to possible opportunistic alternatives), even if the relevant disciplinary framework does not address the change that might be induced by the virtuality of the infosphere, *chatbots* and other forms of action based on data processing (generally referred to in the reference to the 'artificial intelligence' pair). [7]

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efficient in sharing all domestic demand shocks (deleveraging, fiscal consolidation), while a capital market union is needed to share supply shocks (productivity and quality shocks). Hence, a useful reference to support the intervention brought by MiCAR, which appears inclined toward broadening the forms in which wealth exchanges and their locations can be organized.

[5] It is useful to recall that case law has tried in various ways to recognize an adequate form of protection for customers who, upon going to a bank, acquired diamonds or other assets that seemed likely to ferry their savings to a future period with adequate levels of security; see Judgment of the Court of Appeals of Milan, Sec. I, Oct. 24, 2023, no. 3015.

[6] In connecting to the broad debate on the coexistence of a natural and an artificial intelligence in a market where capital and risks are changing, the European regulator has not yet intervened to draw a contrast between the human brain and artificial computers, but is proceeding on a disciplinary line that considers the full responsibility of the entities that adopt the technological solutions for the market approach, has it regarding the demand, the supply or the products to which they refer; see Lemma, *Intelligenza artificiale e sistemi di controllo: quali prospettive regolamentari?, in Rivista Trimestrale di Diritto dell'Economia*, Supplement No. 3, 2021

[7] See ONZA - SALAMONE, , Prodotti strumenti finanziari, valori mobiliari, in Banca borsa titoli di credito, 2009, I, 575 ff.

2. MiCAR recognizes a central role for financial market authorities, assigning them the task of presiding over conduct to be considered illicit, for this purpose configuring supervisory and investigative powers (and, therefore, allowing the authorities themselves to proceed to the concrete identifiability of the sanctioning case), so it can be said that the European regulator has chosen the path of administrative governance of the crypto-assets market .[8] Indeed, a course of supervisory action is being taken that, in a decentralized market, does not prudently address only issues referable to the risk-absorbing capacity of intermediaries' assets, but extends as far as verifying the safety and reliability of products circulating in the capital market.[9]

In fact, one is in the presence of a set of powers (declined in the first and third paragraphs of Article 95, MiCAR) that can be exercised directly or in collaboration with other authorities, under one's own responsibility or by delegation, as well as by turning to the competent judicial authorities (Article 96, paragraph 5, MiCAR). However, at the same time, it should be borne in mind that the European regulator did not exclude the possibility of constraints on the part of the member states, which are required to take appropriate measures to enable the competent authorities to exercise the supervisory and investigative powers necessary for the performance of their duties (Art. 96(5), MiCAR). [10]

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[8] See L. TORCHIA, I poteri di regolazione e di controllo delle autorità di vigilanza sui mercati finanziari nella nuova disciplina europea, in AA.VV., Regole del mercato e mercato delle regole. Il diritto societario e il ruolo del legislatore, Milan, 2016, p. 378 ff.

[9] In the aftermath of the triggering of the financial crisis, there had been calls for the adoption of regulatory paradigms that would introduce the goal of product quality and safety among the tasks of supervisors; see Lemma, Financial Crisis and Stability of Real Estate Funds, in AA.VV., Scritti in onore di Francesco Capriglione, Padua, 2010, p. 1242

[10] Useful to mention and, in this regard, the Communication of the Bank of Italy having as its subject "Regulation (EU) 2023/1114 on crypto-asset markets ("MiCAR")" dated July 22, 2024, in which it is clarified that "In order to facilitate an orderly start of the new regime, pending the completion of the national legislation, with the Communication the Bank of Italy makes itself available for informal interlocutions to guide those interested in starting initiatives in this area."

In any case, the centrality of administrative authorities in the system recited by MiCAR appears clear, in that member states must provide - in accordance with national law - for the attribution to the competent authorities of the sanctioning powers referable to the violation of the rules analytically indicated by the European regulator.[11] Moreover, further confirmation of the centrality of the European authoritative system is seen in the provision of precautionary measures and temporary intervention powers in the hands of ESMA and EBA (Articles 102, 103 and 104, MiCAR).[12] We are, therefore, in the presence of a regulatory option that innovates the repressive system, which - while remaining of traditional matrix - takes a step forward with respect to the construction of a common sanctioning system as a result of the aforementioned centrality of the European authorities. [13]

It is in this context, therefore, that the choice of the European regulatory forum to indicate the levels within which to contain sanctioning intervention seems appropriate,[14] hence the possibility of assuming that the disciplinary option

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[11] Equally understandable is the reference to the possible presence of criminal sanctions in the respective national law as of June 30, 2024, to which the option of exempting themselves from providing the aforementioned sanctions is linked (without prejudice to the duty of member states to notify the Commission, ESMA and EBA in detail of the relevant criminal law provisions).

[12] Over time, in fact, the exercise of such powers have been deemed symptomatic of the "shift from a supervision of intermediaries' behavior, centered on rules of conduct such as appropriateness and appropriateness, to a dirigiste supervision of product distribution that avocates to the ESA the power of authoritative selection of financial instruments from the perspective of retail investor protection"; cf. LENER - LUCANTONI, *Product intervention dell'ESMA su opzioni binarie e CFDs collocati presso investitori retail*, in dirittobancario.it, 9 April 2018

[13] See V. TROIANO, *Interactions Between EU and National Authorities in the New Structure of EU Financial System Supervision,* in *Law and Economics Yearly Review,* no. 1/2012, p. 104 ff.

[14] Useful to have in mind that the above levels have regard to the following sanctions and other administrative measures: (a) a public statement indicating the natural or legal person responsible and the nature of the violation; (b) a direct order to the natural or legal person responsible to cease the conduct constituting the violation and to refrain from repeating it; (c) maximum administrative pecuniary sanctions of an amount equal to at least twice the amount of the profits made or losses avoided as a result of the violation, if these can be determined; (d) in the case of natural persons, maximum administrative pecuniary sanctions of at least EUR 700,000 or, in member states whose official currency is not the euro, the corresponding value in the official currency as of June 29, 2023 (Art. 111, para. 2, MiCAR). The same is to be said for the obligation to ensure that the competent authorities have the power to impose, in the case of violations committed by legal

responds to the *commitment* taken by political authorities to initiate action to counter the competition between systems that still undermines the common construction.[15]

In order to have greater insight into the role of the European authorities, it also seems useful to consider that a type of sanction intervention (for violation of any of Articles 59, 60, 64 and Articles 65 to 83) has been envisaged, which provides suitable means for the execution of a prohibitory protection, of a temporary nature, referable to any member of the governing body of the service provider for crypto-activities or any other natural person held responsible for the violation.[16]

For our purposes, it seems possible to find further confirmation of the centrality (of the European authorities) by having regard to the set of additional measures provided for violations of Articles 88 to 92 of MiCAR (Art. 111(5), MiCAR). This is a disciplinary compendium referable to insider information, market manipulation, and related abuses. That is a compendium justifiable in relation to the relevance of the violations with respect to the regular and orderly functioning of the market. [17] And indeed, the European regulator has provided, among others, the special measure of the "public statement indicating the natural or legal person responsible and the nature of the violation"; a statement that appears intended to inform the reference market and, therefore, to restore the levels of knowledge

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persons, maximum administrative sanctions to the extent indicated in the third paragraph of Article 111, MiCAR.

[15] As will be seen, the punctuation of violations recited in Art. 111 of MiCAR follows the disciplinary partitioning used to organize the rules referring, respectively, to generic crypto-assets in Title II, asset-linked tokens in Title III and e-money tokens in Title IV, as well as those relating to authorization for service providers for crypto-assets and market abuse relating to crypto-assets, as well as violations consisting of failure to cooperate or follow up (as part of an investigation, inspection or request by the competent authorities).

[16] It goes without saying that the rule refers the measure to the prohibition of the exercise of management functions in a service provider for crypto-assets; however, it does not clarify the ways in which such a measure may interact with the fit and proper requirements of the relevant recipient; see G. ALFANO, *Fit* e *proper* nel governo delle banche, Bari, 2023, p. 57 ff.

[17] See M. MAUGERI, *Cripto-attività e abusi di mercato*, in *Rivista del diritto commerciale e del diritto generale delle obbligazioni*, 2023, 1, p. 33 ff.

necessary for operators to act in a rational, informed and, therefore, knowledgeable manner. [18]

On closer consideration, such a statement also appears suitable to activate soft-remedies that, at least on the reputational level, could negatively affect the perpetrator of the aforementioned violation.[19] Hence, an importance of the authorities' externals also with respect to the market course, with obvious enhancement of their role with respect to the economic-financial profiles of the exchanges.

Concluding on this point, it seems useful to point out that Article 111 of MiCAR provides that member states may also increase the commitment of the competent authorities, by providing for the attribution of additional powers over and above those indicated in said disciplinary framework, together with the power to introduce sanctions of a higher amount than that established in the relevant paragraphs (both against natural and legal persons responsible for the violation). Such an approach, while at first glance it might appear precautionary (and, therefore, reactionary with respect to the objective of a uniformity of the rules put in place to safeguard the smooth functioning of the European crypto-asset market), on closer examination appears to be a harbinger of an incentive for *the migration of* the most unscrupulous operators (from a strictly strict system adopted by one member state to a more permissive one)· [20]

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[18] See ANNUNZIATA, *An Overview of the Markets in Crypto-Assets Regulation (MiCAR*), in *European Banking Institute Working Paper Series no. 158*, 2023; F. CAPRIGLIONE, *Le cripto attività tra innovazione tecnologica ed esigenze regolamentari*, in *Rivista Trimestrale di Diritto dell'Economia*, 3/2022, 1, p. 225 ff.

[19] Cf. F. CIRAOLO*, L'ecosistema digitale e l'evoluzione dei mercati, in Rivista Trimestrale di Diritto dell'Economia*, 4s/2022, 2, p. 342 ff. where the basic problems of the regulation of digital financial ecosystems are addressed, having regard to the difficulties of legal framing of new digital financial services, as well as the fragmented and contradictory nature of the overall legal framework.

[20] See ZATTI, Verso la regolamentazione europea delle criptoattività, in Diritto del mercato assicurativo e finanziario, 2/2022, p. 28 ff.; N. CIOCCA, Servizi di custodia, negoziazione e regolamento di cripto-attività, in Osservatorio del diritto civile e commerciale, X/2022, p. 79 ff.

Significant, for the purpose of delving into the role of the authorities with respect to the users of crypto-assets, is the construction arranged by the European regulator with reference to the right to challenge sanctioning measures before a court (Article 113, MiCAR). [21] And indeed, it seems possible to consider that this construction has an inclusive character, since it is provided that, in the interest of consumers and in accordance with national law, the competent bodies may also be brought before public bodies or their representatives, consumer organizations (having a legitimate interest in protecting crypto-asset holders) and professional organizations (having a legitimate interest in protecting their members).

Such an interventionist formula appears aimed at achieving objectives beyond the protection of individual rights, targeting the financial stability of the industry, to be achieved through repressive interventions urged by bodies representing diffuse interests, but consistent with the advanced nature of the crypto-asset trading industry. [22] Confirming this assumption is the provision for the publication of decisions, appeals (which may intervene against a sanction) and information regarding the outcome of such appeals (under Article 114, MiCAR).[23]

3. It is useful to consider that the homogeneous functioning of the internal market is undermined by the *usual* limitation that, in the exercise of sanctioning powers, the competent authorities will have to have regard to the applicable national law; and this cannot be mitigated by the MiCAR requirement to consider

[21] See R. LENER, Criptoattività e cripto valute alla luce degli ultimi orientamenti comunitari, in Giurisprudenza commerciale, p. 376

[22] Cf. M. CIAN, La nozione di criptoattività nella prospettiva del MiCAR. Dallo strumento finanziario al "token", e ritorno, in Osservatorio del diritto civile e commerciale, X/2022, p. 59

See, also, D. ZETZSCHE - F. ANNUNZIATA - D. ARNER - D. BUCKLEY, The Markets in Crypto-Assets Regulation (MICA) and the EU Digital Finance Strategy, in European Banking Institute Working Paper Series No. 2020/77 in that AA. believed that the EU Commission was proposing tailor-made regulation for such activities, subject to supervision by national authorities and the European Banking Authority

[23] See V. LEMMA, Solidarietà e regolazione dell'innovazione finanziaria, in Rivista Trimestrale di Diritto dell'Economia, 1s/2023, p. 83 ff.

the circumstances indicated in order to determine the type and level of sanction or administrative measure, if any, chosen. [24]

It goes without saying that the European determinant may nevertheless unfold significant implications on the decision-making dynamics of the authorities, as the regulation explicitly provides for the elements that will have to be taken into consideration by the body responsible for determining the sanction. [25]

However, the *mere* provision of a rule for the exercise of sanctioning powers that envisages the obligation for the competent authorities to cooperate *closely* and coordinate their actions (Article 112, paragraph 2, MiCAR) does not seem sufficient for this purpose. [26] And indeed, such a rule seems to correspond to the need for integration of the architecture of the European financial order and, therefore, to the articulation of the latter into two pillars, referable respectively to the whole territory of the Union (through the construction of the ESFS) and to the Euro-zone alone (in the constet of the EMU and the UBE); therefore, there is the possibility that the authorities will simply manage the role given to them by MiCAR in the reference to the presence of a committee (the Cers) and other authorities (EBA, ESMA and EIOPA), as well as the ECB (in the performance of the *various* tasks of monetary policy and prudential supervision) and a network of national authorities.[27]

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[24] See, in general, the survey made by G. GASPARRI, I nuovi assetti istituzionali della vigilanza europea sul mercato finanziario e sul sistema bancario, Quaderni Giuridici Consob, 2017, p. 56 ff.

[25] Indeed, the presence of qualitative (i.e., severity) and quantitative (i.e., duration) elements, as well as references to the behavioral profiles of the violation (i.e., intent or negligence) are staples. Other elements referred to by the regulator have regard to the financial capacity, profits made or losses avoided, the conduct of the person (having regard to his or her cooperation, previous violations, measures taken to prevent their recurrence), as well as the consequences of the violation on the interests of crypto-asset holders and customers of crypto-asset service providers, particularly retail holders; see Article 112(1), MiCAR

[26] And indeed, such an approach might appear ephemeral when assessed in view of the EU structural innovation process initiated following the crises of the 2000s; see F. GUARRACINO, Supervisione bancaria europea. Sistema delle fonti e modelli teorici, Padua, 2012, *passim*

[27] See F. CAPRIGLIONE, Nuova finanza e sistema italiano, Turin, 2016, 130 ff., as well as Id., Comment sub art. 6bis, in AA.VV., Commentary on the Consolidated Law on Banking and Credit, Padua, 2018, I, p. 74 ff.

Thus, an authoritative context is outlined in which public intervention in the crypto-asset market corresponds to a supervisory network, the effectiveness of which will depend on the degree of collaboration (and, therefore, on the achievement of a homogeneous and integrated model of control over the activities put in place by sector operators). In the outlined context will have to be framed the discipline of reporting, to ESMA and EBA, of sanctions taken by the competent authorities (Art. 115, MiCAR). This is, in fact, an information link functional to the construction of the supervisory mechanism envisaged by the regulation in question.

We are, therefore, in the presence of a model that will have to respond to the guidelines taken at the European level in order to allow the exercise of discretionary powers typically belonging to supervisory authorities not to prejudice the implementation of a uniform system of controls.[28] It seems, therefore, possible to consider that the decisions taken by the competent authorities in application of MiCAR will have to be justified having regard to the essential elements of the case, as they will be taken through the cooperation of an institutional network that - as anticipated - is articulated along Euro-Union guidelines (within the SEVIF and the UBE) that should mark a significant step forward towards disciplinary uniformity (placed at the foundation of the construction of a single market in the sector in question).[29]

4. It should be considered that MiCAR takes as its basis the assumption that crypto-assets interact with the smooth functioning of payment systems, which is the subject of one of the core tasks of the European System of Central Banks

[28] See A. PREDIERI - S. AMOROSINO, Comment sub art. 6, in AA.VV., Commento sub art. 6bis, in AA.VV., Commentario al Testo Unico delle Leggi in materia bancaria e creditizia, Padua, 2018, I, p. 55 ff.; GUARINO, Pubblico e privato nell'economia, la sovranità tra costituzione ed istituzioni comunitarie, in Quad. cost., 1992, p. 21 ff.

[29] Cf. PREDIERI, *Non di solo euro. Appunti sul trasferimento di poteri al Sistema Europeo delle Banche Centrali ed alla Banca Centrale Europea*, in *Dir. Un. Eur*., 1998, p. 7 ff.

(ESCB), established by Article 127(2), fourth indent, of the Treaty on the Functioning of the European Union (TFEU). This results in an additional link between ESMA, EBA, the ECB and the National Central Banks concerning information useful for the effective performance of their tasks related to the oversight of payment systems and, in particular, the dynamics of payment clearing.[30]

It goes without saying that the aforementioned assumption also influenced the decision to provide for the consultation of the ECB during the authorization process required to initiate operations in this market. Hence, it seems possible to conclude that the centrality of monetary policies in the common construction has led the regulator to attribute a binding character to the ECB's opinions on crypto-assets, with the obvious consequence that these opinions may be subject to a review of legitimacy by the Court of Justice of the European Union, in view of the possibility of interpreting Article 263, first paragraph, TFEU in a sense that ascribes primary importance to the substance and effects of the opinions considered herein.[31]

In light of the above, it seems necessary to question the nature and scope of the ECB's supervisory power over the interaction between cryptocurrency circulation and monetary policy. There is no doubt that the most recent interventionist options - marked by the experience of the crises of the 2000s, Mario Draghi's 'whatever it takes', and Christine Lagarde's more recent policies[32] - may condition the interpreter and lead him toward the temptation to address numerous interconnected issues, traceable to unity in the reference to the wish for

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[30] See M. PELLEGRINI, *L'architettura di vertice dell'ordinamento finanziario europeo: funzioni e limiti della supervisione,* in *Riv. trim. dir. dell'economia*, 2012, I, p. 54 ff.

[31] See M. CLARICH *I poteri di vigilanza della Banca centrale europea,* in *Dir. pubbl.,* 2013, p. 975 ff;

[32] See M. DRAGHI, Speech at the Global Investment Conference, London, July 26, 2012, as well as C. Lagarde, Welcome address at the fifth ECB Forum on Banking Supervision, Speech by Christine Lagarde, President of the ECB, at 5th ECB Forum on Banking Supervision "Europe: banking on resilience" in Frankfurt, Germany, November 30, 2023

normalization of ECB policy. However, it appears necessary to remain anchored in the legal issues pertaining to the effects of the new forms of digital circulation of wealth with respect to the protection of the individual rights of citizens and the control of the stability of the system; issues with respect to which the technical contents of the innovations in question appear marginal, but the perceptions held by the public regarding the possibility that certain crypto-assets may be surrogates for sovereign currency with respect to the functions of circulation of wealth, preservation of value and measurement of consideration appear significant. [33]

Hence the belief that the sanctions framework introduced by MiCAR is also placed to guard against the money market and, in particular, against the critical issues arising from the circulation of the aforementioned surrogates (and their potential impact on the effectiveness of monetary policy and, by that means, on the functioning of the economy).

5. In assessing the contribution of crypto-assets to the circulation of wealth, it is necessary to consider that, as part of a broad oversight strategy on digital finance (outlined by the European Commission in 2020), the entire European system is coordinating to capitalize on the opportunities while managing the risks emanating from the latest technological innovations. [34]

Hence, to this end, the role of the competent national authorities is essential, as they cooperate in the realization of an integrated system of controls extended as far as considering the regular functioning of the payments system and hindering the illegal economy, money laundering and the financing of terrorism. This is a role that in our country should follow a distribution of competencies for

[33] See P. SAVONA, Hearing of President Paolo Savona at the Parliamentary Commission of Inquiry on Consumer and User Protection, March 9, 2022, where he concludes that the risks for investors in the digital world of crypto-assets have new characteristics.
[34] See Bellofiore, Hearing of CONSOB, Head of the Regulatory Office, Regulatory Strategies Division, SENATE OF THE REPUBLIC, Sixth Permanent Commission (Finance and Treasury), Government Act No. 172 Adaptation of National Legislation to the Provisions of Regulation (EU) 2023/1114, on Cryptocurrency Markets Rome, July 24, 2024

purposes and functions similar to that envisaged in the sector regulations,[35] involving the Bank of Italy for the profiles of risk containment, capital stability and sound and prudent management, as well as Consob in matters of transparency, correct behavior, market integrity and investor protection. It goes without saying that the Bank of Italy will also be the competent authority for supervising compliance with anti-money laundering obligations by service providers in crypto-assets, hopefully through the intervention of the FIU,[36] firm the launch of future European Anti-Money Laundering and Anti-Terrorist Financing Authority (AMLA) .[37]

It is useful to start from the Bank of Italy's task of overseeing the smooth functioning of the payments system, as the properties of crypto-assets can interact in the choice of payment settlement instruments and, therefore, the quality of the latter can influence the reliability and efficiency of the former. We are, therefore, in the presence of a surveillance profile that transcends the protection of the users of payment services, as it does not end in the bilateral sphere of investor-issuer relations (of the crypto-assets), but takes as its reference the multilateral sphere of the relevant exchanges and, for the effect, takes as its objective the stability of the financial system, together with its contribution to the sustainability of the real reference economies.

However, in a system in which monetary profiles are the responsibility of the European Central Bank and regulatory declinations are attributed to the European Supervisory Authorities, the Bank of Italy does not appear destined to take on - directly and autonomously - the controls related to the incidence of the

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[35] Obviously, in accordance with Article 93 MiCAR, where Member States designate more than one competent authority pursuant to paragraph 1, they shall determine their respective tasks and designate one competent authority as the single point of contact for cross-border administrative cooperation between competent authorities as well as with EBA and ESMA. Member States may designate a different single point of contact for each of those types of administrative cooperation.

[36] See Bank of Italy Communication on Regulation (EU) 2023/1114 on cryptocurrency asset markets ("MiCAR") dated July 22, 2024,

[37] See, in general, the reconnaissance summary published by the Council of the European Union, Press release, Feb. 22, 2024, *Frankfurt will host the new EU Anti-Money Laundering Authority (AMLA)*

use of crypto-assets (by credit institutions and other financial intermediaries) with respect to prudential, first, and monetary dynamics, then. The same is to be said for any crypto-asset borrowing and lending activities (even if carried out through repurchasing agreements).

Confirming this is the redefinition of the regulatory framework governing the Eurosystem (so-called Eurosystem oversight framework for electronic payment instruments, schemes and arrangements, PISA framework), which now has regard to any form of "transfer of value" (instead of the previous reference to the traditional concept of "transfer of funds").[38]

However, it should not be omitted to consider the Bank of Italy's high technical qualification and sensitivity of monetary issues, as they should underlie the warning to "all entities operating in the crypto-asset markets - including crypto-asset providers and issuers and service providers, as well as supervised entities under Art. 146 of the Consolidated Banking Act," according to which "the addressees ... should pay special attention if ARTs are offered to customers for payment purposes";[39] this, "also because of the safeguards and restrictions that

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[38] See ECB, Electronic payment instruments, schemes and arrangements, PISA framework package, Oversight applicable from November 15, 2022, available at https://www.ecb.europa.eu/

[39] It is useful to recall the approach taken initially to express general appreciation with regard to the proposed regulation of a market of a new kind, configured through safeguards to address potential risks to financial stability and orderly monetary policy that could arise from improper application of financial innovation; Cf, for a first reading, V. LEMMA, “Banking” e “shadow banking” al tempo del Covid-19: riflessioni nella prospettiva del “Market” in “Crypto-Assets (MICA)”, in Rivista di diritto bancario 4/2020, 1, p. 851 ff.

See, also, F. CAPRIGLIONE, *Le cripto attività tra innovazione tecnologica ed esigenze regolamentari*, in *Rivista Trimestrale di Diritto dell’Economia*, 3/2022, 1, p. 225 ff. where he examines, from a critical perspective, crypto assets and contributes with an insight into the controversial issues that cryptocurrencies present to the legal scholar. The A.'s main objective is to redefine the contractual relationships between cryptocurrency market players, illustrating the essential elements of financial contracts and the operational procedures that determine the economics of product supply and demand. Significant, in fact, appears to be the central argument identifies a possible legal qualification of "cryptographic activities," although criticism has been raised among commentators about the regulatory framework of cryptography, which seems to cover, on the one hand, financial instruments and, on the other, intangible assets. Recent developments within the EU have not addressed the issues, hence the lack of consistency on the

MiCAR places to limit their use as means of exchange in order to safeguard the smooth functioning of payment systems, the transmission of monetary policy and monetary sovereignty." [40]

As for the information profiles, it seems intuitive to perceive that Consob's intervention may have regard to issues regarding the completeness, comprehensibility and consistency of the *white paper* (i.e., the document outlining the essential information for the purpose of knowing the contents of the crypto-activity under consideration), along with controls concerning marketing communications and transparency.

On closer consideration, need for procedural expeditiousness may suggest that the authority in question should also be given the task of proceeding with the examination of the legal opinion that excludes the classification of the token as a financial instrument, also because of the commonality of this concept with MiFID regulations and, therefore, the division of competencies made by the same (using, first, the reference to financial instruments to define its scope).

Also deserving of independent consideration appear to be the rules on conflicts of interest and rules of conduct. It goes without saying that the application of the principle of 'same business, same risk, same rules' easily leads to an allocation of such competences in favor of Consob; therefore, it is expected that service providers intervening in the crypto-asset market will be required to extend the model developed in deference to the obligations under MiFID. After all,

part of regulators to establish parity of rules in this area. According to the A., it is clear that contractual expectations in crypto assets are often driven by speculative intentions and a desire to experience gambling. In this context, the sense of responsibility of supervisors, in the absence of "ad hoc" regulation, is the only safeguard against the risks that the rapid expansion of "crypto assets" may create to the financial system.

See, also, D. ZETZSCHE - F. ANNUNZIATA - D. ARNER - D. BUCKLEY, The Markets in Crypto-Assets Regulation (MICA) and the EU Digital Finance Strategy, in European Banking Institute Working Paper Series No. 2020/77 in that the AA. believed that the EU Commission was proposing tailor-made regulation for such activities, subject to supervision by national authorities and the European Banking Authority.

[40] See Bank of Italy, Regulation (EU) 2023/1114 on crypto asset markets ("MiCAR") Bank of Italy Communication Rome, July 2024, pp. 3 - 4

intermediaries have long been overseeing 'business conflicts' (other than those covered by the aforementioned directive) in similar ways and, that is, through processes and procedures that have regard to the client's interest.[41]

That being said, special consideration must be given to the profiles pertaining to market integrity, in that the operators of a cryptocurrency trading platform are required to inform the respective competent authority when they detect cases of market abuse or attempted market abuse committed in or through their trading systems. And indeed, the provision of a duty to report and, at the same time, such authoritative intervention entails a duty to provide for the monitoring of transactions having regard to conduct that, on the one hand, indicates insider trading and, on the other, perpetrates forms of market manipulation itself. Significant, in this regard, is the level of pervasiveness of the control, as IT systems allow platform operators to access the contents of the *devices* used by the relevant users and, therefore, to acquire information in relation to their information background.

This is not the place to delve into the IT dynamics underlying such access; however, the question must be asked whether supervisory authorities should require that the operator of regulated platforms must acquire the information available from the aforementioned systems and, then, transmit it to the authority in order to verify whether, in any way, the user has violated the integrity of the markets. In the affirmative, it would mark a decisive step forward in the pervasiveness of controls, with obvious impact on the supervisory policies underlying public intervention in capital markets. Hence, a clarifying intervention appears necessary that would indicate to platform operators what behavior they should engage in if their users have given their consent to such profiling.

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[41] Finally, Consob's jurisdiction over the safeguards provided by MiCAR that are aimed at countering market abuse related to cryptocurrencies traded on trading platforms (proper disclosure of insider information, prohibition of insider trading, prohibition of unlawful disclosure of insider information, and prohibition of market manipulation) remains firm.

In conclusion, the assumption should be shared that the markets for financial instruments (albeit digital) and crypto-assets are contiguous, even if they are placed - as indicated in the introduction - in a relationship of objective alternativity, insofar as there are common purposes to those underlying investment transactions and collection activities that are carried out in traditional markets (with regard to the instrumentality of crypto-assets with respect to the functions of investment, collection and payment).[42] Therefore - while it is equally clear that, with reference to the object of the exchanges, different goods are involved - it is necessary for the authorities to have regard to the interests of the operators who formulate the demand and supply of crypto-activities, also with a view to introducing incentives and disincentives that guide operators toward sustainable behavior with respect to the goal of preserving the ordering function of the state with respect to the orientation of economic activities toward the maximization of social welfare.

[42] See, also, LEMMA, Asset digitali nei contratti e nelle imprese: quali controlli dopo il Micar?", in press for Contratto e Impresa.Europa at the time of handing in drafts of this paper.

DIGITAL FINANCE REGULATION AND THE MARKET FOR DLT FINANCIAL INSTRUMENTS

Mads Andenas[*] - Carlotta Giustiniani[**]

ABSTRACT: *This article explores the regulatory challenges raised by distributed ledger technology (DLT) and blockchain in the context of financial regulation. While these technologies offer numerous opportunities, they also require a proactive regulatory approach to maintain financial stability, investor protection and market integrity. The increasing interconnectedness of financial institutions presents emerging risks that could lead to systemic problems, requiring regulatory changes. Supervisors need to pay particular attention to the digitization of finance, as it introduces new types of risk that need to be managed effectively. It is crucial to find a balance between technological innovation and supervision that does not prevent the development of the sector but ensures security and stability. Systemic risk management, investor protection and international cooperation are key aspects of this regulation, which promotes a resilient and sustainable digital finance ecosystem. A rapidly evolving regulatory framework that can adapt to technological innovation without compromising protection and stability is essential. Cooperation between international authorities will be crucial to address common challenges and ensure adequate supervision in an increasingly globalized and digitized financial landscape.*

SUMMARY: 1. Introduction - 2. Foundations of digital finance regulation. - 3. From high-tech services to digital financial instruments. – 4. Digital financial instruments and the market. - 5. The regulatory framework. - 6. Conclusion.

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Although this paper is the result of a joint reflection of the authors, which wrote together the introduction and the conclusions, Mads Andenas wrote the paragraphs 2 – 3 and Carlotta Giustiniani wrote the paragraphs 4 – 5.

1. Several factors reinforce the economic rationale of the regulation of digital finance and frame the 'public good' of financial stability in a narrow and technically limited sense. Financial markets are highly regulated and new products should not create ways of circumventing public regulation that threaten systemic stability, investor protection or the efficient functioning of the market. But only a fair balance between regulation and innovation will prevent public intervention from stifling innovation or acting as a disincentive against innovation.

First, the haste of post-crisis reforms may have been necessary to bring the crisis under control. The adoption of rapid reforms may mean that such reforms are not necessarily the product of fundamental changes in normative thinking. They are more readjusted measures based on the same economic rationale for regulation. Post-crisis regulatory reforms are overly focused on the technical rather than the substantive aspects with a modern emphasis on 'governance, responsibility, integrity and accountability'.[1]

The rise of digital finance marks a pivotal shift in the global financial landscape. Digital finance requires a comprehensive and nuanced regulatory framework. The Letta Report and Draghi Report[2] argue for moving regulatory power to the European Union level. The review of the Italian regulation below in this article illustrates that the role of Member State regulators and legislators remains important in the rule making, and this gives rise to some fragmentation.

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[1] Capriglione, Francesco *La supervisione finanziaria dopo due crisi. Quali prospettive (Financial Supervision after two Crisis. What perspectives)*, in *Rivista Trimestrale di Diritto dell'Economia*, Sup. n. 1/22. See also Andenas, Mads and Chiu, Iris H-Y, *The Foundations and Future of Financial Regulation. Governance for Responsibility*, Routledge 2014, p. 33.

[2] Enrico Letta, *Much more than a market* (April 2024) sets a strategy for Europe to become a 'creator and a maker of new technologies' with focus on 'a clean and digital transition'. Mario Draghi, *The future of European competitiveness – A competitiveness strategy for Europe* (September 2024). The two reports warn against the fragmentation of European markets. Absence of European regulation leaves the field to Member State regulation, and the main remedy against the fragmentation this leads to is to move more regulatory powers to an overarching European authority.

Digital finance encompasses a wide range of financial services and products that use digital technologies, including distributed ledger technology (DLT), to improve efficiency, transparency and accessibility.[3] As the financial sector undergoes rapid transformation, regulators around the world are challenged to develop policies that balance innovation with the need to maintain financial stability, protect investors, and ensure market integrity. Innovation should not bar required regulation, which in the medium and long term may be necessary for innovation or promote it.

One of the most transformative aspects of digital finance is the development and proliferation of DLT financial instruments. DLT, often referred to as blockchain technology, underpins a wide range of digital assets, including cryptocurrencies, security tokens and smart contracts.[4] These instruments promise to revolutionize the way in which financial transactions are conducted, offering potential benefits such as reduced transaction costs, increased speed of settlement, and enhanced security through decentralization. The novel characteristics of DLT also pose unique regulatory challenges, as traditional

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[3] Bank of Italy, *Communication on decentralized technologies in finance and crypto assets* (Comunicazione della Banca d'Italia in materia di tecnologie decentralizzate nella finanza e cripto-attività), 15 June 2022. The Italian Supervisory Authority has pointed out that the financial sector, like others, is making increasingly extensive and significant use of the potential offered by digitization. Prominent among the new solutions has been the application of decentralized, so-called distributed ledger technologies (DLT). These are technologies of potentially very wide application, even in areas unrelated to finance. A rapid and wide diffusion of these tools could jeopardize the stability of the financial system because of the interdependence of regulated and unregulated participants, as well as the lack of controls and tools that can limit the effects of unfavourable events. Indeed, the world of crypto assets is still largely deregulated. Work is underway at the international and European level to design a new set of rules and controls for these products and related "ecosystems," but they will still take time to become fully operational. At the same time, the developments experienced by the sector-the high growth in the number and value of crypto-assets; the extreme volatility of quotations; the recurrent episodes of crises of operators and schemes of the kind, due to fraud, computer crashes or underlying flaws, which have also recently led to large losses for those involved; the strong opacity of the exchanges and ownership structures of most of these schemes; and in many cases, the very high volatility of their prices-raise concerns about issues that fall within the mandate of the authorities.

[4] Kakavand et all., *The Blockchain Revolution: An Analysis of Regulation and Technology Related to Distributed Ledger Technologies* (January 1, 2017).

financial regulations may not adequately address the complexities of these new instruments.[5]

A critical aspect of financial regulation is investor protection,[6] which has become increasingly important in the context of digital finance. Investor protection aims to protect investors from unfair practices, fraud and financial loss, thereby fostering confidence in financial markets.[7] The need to introduce regulations based on varied levels of investor protection, including in relation to the qualities and professional characteristics of investors is due to the fact that the channeling of savings toward productive investments (implemented through the issuance of financial instruments, which are aimed at stimulating individual propensity to invest, reducing transactional costs and lowering barriers to entry) has led intermediaries to have relationships with non-homogeneous categories of clients, endowed with differentiated degrees of awareness.

The global financial crisis of 2008 underlined the importance of robust investor protection mechanisms, as the crisis demonstrated how systemic failures and inadequate regulation can lead to widespread financial instability and economic downturns.[8] The need to introduce regulations based on varied levels of investor protection, including in relation to the qualities and professional characteristics of investors the channelling of savings toward productive investments, is implemented through the issuance of financial instruments, which are aimed at stimulating individual propensity to invest, reducing transactional costs and lowering barriers to entry, has led to the fact that intermediaries have relationships with non-homogeneous categories of clients, endowed with

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[5]Lemma, Valerio 'DLT *pilot: verso il mercato degli strumenti finanziari digitali'*, Diritto Bancario, https://www.dirittobancario.it/art/dlt-pilot-verso-il-mercato-degli-strumenti-finanziari-digitali/.

[6] See Andenas, Mads and Chiu, Iris H-Y *The Foundations and Future of Financial Regulation. Governance for Responsibility*, Routledge 2014, p. 33-72 and 133-274.

[7]Hileman, Garrick and Rauchs, Michel, *2017 Global Blockchain Benchmarking Study (September 22, 2017)* (https://ssrn.com/abstract=3040224 or http://dx.doi.org/10.2139/ssrn.3040224).

[8] Lemma,Lemma *Fintech Regulation, Exploring New Challenges of the Capital Markets Union*, p. 1 and ff., 2020. The A. point out how the market failure (due to the combination of globalization, financialization and digitalization) has led to a "new needs for regulating finance".

differentiated degrees of awareness.[9] Post-crisis regulatory reforms have emphasised the need for enhanced investor protection in both wholesale and retail markets. The minimalist regulatory approach that previously characterised the wholesale sector has evolved to reflect policymakers' concerns about financial stability and the impact of wholesale behaviour on systemic risk. For example, the sale of unaffordable mortgages to subprime borrowers and the subsequent securitisation of these mortgages led to significant asset losses and systemic risk, demonstrating the link between market failures in investor protection and financial stability.[10]

For example, in Europe MIFID", Directive 2014/65/EU, highlights a clear distinction between nonqualified investors (retail customers) and qualified counterparties (i.e. banks, investment firms, asset management companies etc). The intermediaries' duties in the profiling of clients in the different categories are listed,[11] having regard to the ability to adequately assess the content of contractual proposals and the risks of the investment and the economic availability. In the case of the non-professional investor, there is a discipline geared toward providing significant safeguards for the investor's protection, such as, *inter alia*, operation in situations of conflict of interest, disclosure requirements, and assessment of the appropriateness of the transactions entered into. However, it should not be limited only to a contraposition between professional and retail clients, but, with a view to maximum client protection, it was deemed appropriate to extend certain information and reporting requirements to non-retail clients as

[9] Pellegrini, *Le regole di condotta degli intermediari finanziari nelle prestazioni dei servizi di investimento*, in Capriglione, *Manuale di diritto Bancario e finanziario*, Milan, 2024, p. 655 and ff.
[10]Bank of Italy, *Communication on decentralized technologies in finance and crypto assets* (Comunicazione della Banca d'Italia in materia di tecnologie decentralizzate nella finanza e cripto-attività), 15 June 2022.
[11] Under Article 24(1) of Directive 2014/65/EU, intermediaries must conduct their business in an honest, fair and professional manner to serve the best interests of their clients.

well, moving from a classification system focused on the possibility of upgrading and downgrading clients.[12]

In Italy, these principles have been developed in Consob Intermediaries Regulation No. 2037 of 2018 and subsequent amendments, introducing the discipline of adequacy,[13] appropriateness[14] and mere execution or receipt of orders (execution only). [15] The tripartition of investors is into professional clients, eligible counterparties and retail clients.[16] The proper mapping of financial products is a necessary condition for improving the adequacy assessment to which it is responsible, fostering greater retail investor confidence and greater participation in capital markets.[17]

Investor protection is now infused with broader financial stability concerns, leading to greater regulatory paternalism in both sectors. This shift is based not only on addressing information asymmetries and market failures, but also on the overarching objective of mitigating systemic risk. Reforms in the wholesale sector

[12] Recital 104 of Directive 2014/65/UE.
[13] See Article 40 of the Intermediary Regulations, pursuant to which in order to make the adequacy assessment, intermediaries must obtain from the client all information regarding the client's experience or knowledge, their financial situation, including ability to sustain losses, their investment objectives, including risk tolerance with regard to the specific type of instrument or service, and, lastly, their ESG preferences pursuant to ESMA Guidelines 03/04/2023. An intermediary who has not acquired such information should refrain from providing the requested services.
[14] According to art. 42 of the Intermediary Regulations, appropriateness is measured with regard to the client's level of knowledge and experience (and not also as appropriateness based on the assessment of the client's financial capacity or on his or her investment objectives). If the intermediary believes that the financial instrument or service is not appropriate for the client, it shall warn the trading counterparty of this situation also using a standardized form.
[15] Ref. to art. 43 of the Intermediary Regulations, which details some exceptions, whereas intermediaries can provide services of order execution on behalf of clients or the reception and transmission of orders, with or without ancillary accessories without it being necessary to obtain the information or perform the assessment
[16] See art. 35 and Annex 3 of the Intermediaries' Regulation.
[17] Annunziata, Lupoi et al., *La mappatura dei prodotti finanziari nella prospettiva della tutela del risparmiatore*, Quaderno giuridico Consob n. 28, aprile 2023. Available in https://www.consob.it/web/area-pubblica/abs-qg/-/asset_publisher/pWAo8NyvjOZ1/content/qg28/11973. The allocation is made on the basis of objective data (i.e., amount of an adequate amount of own funds to the satisfaction of quantitative requirements in terms of balance sheet or net sales), defined at the regulatory level and not on the basis of the client's mere attestation of the knowledge of financial matters. It starts with "preliminary" profiling, which does not preclude a possible corrective assessment, aimed at screening the client's knowledge, capital base and risk appetite. Clients must be made aware of their classification and, if necessary, request a variation.

in the aftermath of the crisis, while incremental, highlight a trend towards increased regulatory oversight and the mobilization of market discipline to ensure financial stability.[18]

In the retail sector, regulatory governance has moved towards greater paternalism, reflecting a shift from efficiency-based narratives to safeguards that emphasise social utility and equity. The regulatory stance in the UK and EU is increasingly paternalistic and protective, aiming to ensure that consumers are treated fairly and purchase appropriate products. This approach not only protects consumers but also supports wider social and economic stability.[19]

The regulatory framework for digital finance needs to address the unique characteristics of DLT financial instruments.[20] These instruments challenge traditional regulatory paradigms due to their decentralised nature, pseudonymity and potential for cross-border transactions. Effective regulation in this area requires a deep understanding of the technological underpinnings of DLT and the associated risks and opportunities.[21]

Regulators need to strike a balance between encouraging innovation and ensuring robust investor protection. This means crafting regulations that provide

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[18] Capriglione and Lemma, *The Adoption of Digital Euro: Problems and Perspectives*, on AA.VV., *Monetary Policy Normalization,* editors Savona and Masera, Springer, 2023, p. 123.

[19] Blemus, *Law and Blockchain: A Legal Perspective on Current Regulatory Trends Worldwide (January 17, 2018).* Revue Trimestrielle de Droit Financier (Corporate Finance and Capital Markets Law Review) RTDF N°4-2017 - December 2017, Available at SSRN: https://ssrn.com/abstract=3080639 or http://dx.doi.org/10.2139/ssrn.3080639

[20] Zetzsche and Buckley and Arner, *The Distributed Liability of Distributed Ledgers: Legal Risks of Blockchain* (August 13, 2017). University of Illinois Law Review, 2017-2018, Forthcoming, University of Luxembourg Law Working Paper No. 007/2017, Center for Business & Corporate Law (CBC) Working Paper 002/2017, University of Hong Kong Faculty of Law Research Paper No. 2017/020, UNSW Law Research Paper No. 17-52, European Banking Institute Working Paper Series (https://ssrn.com/abstract=3018214 or http://dx.doi.org/10.2139/ssrn.3018214). The AA. In the paper that DLT has an important impact on the construction of the wy the financial markets work, even though "*DLT commonly gives rise to at least three major types of potential liability risk: ledger transparency risks, cyber risks and operational risks*".

[21] Capriglione and Lemma, *The Adoption of Digital Euro: Problems and Perspectives*, on AA.VV., *Monetary Policy Normalization,* editors Savona and Masera, Springer, 2023, p. 123; Blemus, *Law and Blockchain: A Legal Perspective on Current Regulatory Trends Worldwide* (January 17, 2018). Revue Trimestrielle de Droit Financier (Corporate Finance and Capital Markets Law Review) RTDF N°4-2017 - December 2017.

clarity and certainty for market participants, while addressing risks such as fraud, market manipulation and cybersecurity threats. In addition, the global nature of digital finance requires international cooperation and harmonization of regulatory standards to prevent regulatory arbitrage and ensure a level playing field.

One approach to regulating digital finance is to apply existing financial regulations to DLT financial instruments, where applicable. This includes enforcing anti-money laundering (AML) and counter-terrorist financing (CTF) measures, ensuring transparency and disclosure requirements, and protecting consumer rights. However, given the novel features of DLT, there is also a need for tailored regulatory frameworks that address specific risks and promote the safe and sustainable growth of digital finance.[22]

As digital finance continues to evolve, the regulatory landscape must adapt to address the unique challenges and opportunities presented by DLT financial instruments.[23] Robust investor protection mechanisms are critical to maintaining confidence and stability in financial markets, particularly in light of the lessons learned from the global financial crisis. By balancing innovation with the need for oversight and protection, regulators can foster a thriving digital finance ecosystem that benefits investors and the broader economy.[24]

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[22] Rauchs and Glidden and Gordon et all., *Distributed Ledger Technology Systems: A Conceptual Framework* (August 13, 2018) (https://ssrn.com/abstract=3230013 or http://dx.doi.org/10.2139/ssrn.3230013). The AA. in the text point out how terms such as cryptocurrency, blockchain and distributed ledger technology (DLT) are present in our vocabulary today and have played an increasingly important role in news and media. However, there is no strictly defined set of terminologies or a commonly accepted taxonomy. So, what happens is that terms are often used incorrectly. What is emphasized is the need to provide a common terminology and framework, designed as a multidimensional tool for policymakers, practitioners, researchers and investors, in order to better understand the characteristics and inner workings of a DLT system and the roles that various actors play in the system.

[23] Lemma, ‘*DLT pilot: verso il mercato degli strumenti finanziari digitali*’, Notes in the margin of Decree Law No. 25 of March 17, 2023, and Regulation (EU) 2022/858, in *Diritto Bancario,* 2 May 2023.

[24] Rauchs and Glidden et al., *Distributed Ledger Technology Systems: A Conceptual Framework* (August 13, 2018). Available at SSRN: https://ssrn.com/abstract=3230013 or http://dx.doi.org/10.2139/ssrn.3230013

The tentative conclusions of this article shall identify pertain, first, to the prospect of significant Distributed Ledger Technology (DLT) and blockchain development, which brings unique regulatory challenges due to the peculiar operability brought about by the evolution of financial regulation in the digital age, where the integration of DLT and other digital financial instruments requires a proactive approach that facilitates significant regulatory changes aimed at maintaining financial stability, protecting investors and ensuring market integrity. Forward-looking assumptions that are reinforced where consideration is given to the fact that the interconnectedness of financial institutions could result in systemic risks, requiring regulation that addresses collective behaviours while ensuring investor protection from unfair practices, fraud and financial losses.

Add to this the new risks brought about by the evolution enabled by the digitization of finance; this while holding firm to the need to pay special attention to the scrutiny that supervision is called upon to prevent, given the need to balance innovation with oversight and protection, focusing on systemic risk management, investor protection and international cooperation to promote a resilient digital finance ecosystem in support of sustainable economic development, which is essential for the continued growth and stability of the sector.

2. The foundations of digital finance regulation lie at the intersection of technological innovation and financial market integrity. As financial markets evolve through the integration of digital technologies, regulatory frameworks must adapt to ensure stability, safety and fairness. Digital finance encompasses a range of activities and instruments, including automated decision-making processes, digital financial instruments and peer-to-peer transaction platforms, all of which require a nuanced regulatory approach.

One of the main drivers for the regulation of digital finance is the need to address the significant changes brought about by technological advances in the

way financial intermediaries operate. The empirical studies on the use of new digital technologies in the credit market highlight the importance of establishing technical-legal frameworks for digital financial instruments. These frameworks aim to assess and mitigate risks, such as credit risk, arising from the use of digital financial instruments. The processes and intervention methods that asset management companies should adopt revolve around investments in digital financial instruments based on distributed ledger technologies (DLT) and decentralised finance (DeFi) principles.[25]

Digital financial instruments represent a new asset class that enables networked transactions distributed among multiple parties without the need for a central administrator. This decentralisation enhances the ability of intermediaries to assess the risk of investments using digital data and new methodologies. However, it also requires rigorous oversight to prevent abuse and ensure that those accessing credit are properly assessed. The development of digital financial instruments through automated operations predicts integration between financial and non-financial industries, with platforms offering financial services directly to users through authorised parties.[26]

An important aspect of the regulation of digital finance is the control and prevention of conflicts of interest among the authorised parties, who must meet specific suitability requirements. The Italian regulatory system, in line with advanced European countries such as France, has implemented rules to facilitate digital securities trading. For example, Italy's Fintech Decree includes anti-money

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[25] IOSCO Final Report of 19 December - Policy Recommendations for Decentralized Finance (DeFi), 19 December 2023; Treleaven and Greenwood et all., Web 3.0 *Tokenization and Decentralized Finance (DeFi)* (February 17, 2022) (SSRN: https://ssrn.com /abstract=4037471 or http://dx.doi.org/10.2139/ssrn.4037471).

[26] Lemma, *Fintech Regulation, Exploring New Challenges of the Capital Markets Union*, 2020.

laundering provisions that classify registry managers as "other non-financial operators", ensuring that they comply with strict regulatory standards.[27]

Investor protection is a fundamental principle underpinning financial regulation, particularly in the context of digital finance. The global financial crisis underscored the need for robust investor protection mechanisms to safeguard financial stability. In the wholesale sector, minimal regulation has historically been justified by the presumed sophistication of market participants. However, the crisis revealed that flaws in both wholesale and retail sectors could cumulatively provoke systemic risks. As such, post-crisis regulatory reforms have enhanced investor protection in both sectors, emphasizing financial stability and public interest objectives.[28]

Considering digitalization, it is worth noticing that the notion of investor protection has evolved to include wider financial stability concerns, linking market failures in investor protection to systemic risk mitigation. The reforms have introduced a more protective regulatory approach, especially in the retail sector, which is increasingly framed around social utility and justice. This shift reflects a move away from purely transactional regulation towards a framework that considers the broader impact of financial stability on the economy and society.[29]

The implementation of regulatory standards for digital financial instruments also involves significant public controls, especially when the trading parties are intermediaries subject to public supervision. These intermediaries have to comply with reporting obligations and specific rules in addition to those set out in the Fintech Decree. This comprehensive regulatory framework aims to ensure transparency, prevent fraud and maintain the integrity of digital financial markets.

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[27] Those in charge of digital circulation registries are obligated to the anti-money laundering provisions, falling into the category of “other non-financial operators” within the meaning of Article 3, paragraph 5, of Legislative Decree No. 231 of 2007 (Anti-Money Laundering Decree).

[28] Lemma, *Fintech Regulation, Exploring New Challenges of the Capital Markets Union*, p. 1 and ff., 2020.

[29] Capriglione – Lemma, *The Adoption of Digital Euro: Problems and Perspectives*, on AA.VV., *Monetary Policy Normalization,* editors Savona and Masera, Springer, 2023, p. 123.

A key challenge in regulating digital finance is the cross-border nature of digital financial services.

DLT and other digital technologies allow financial transactions to take place seamlessly across national borders, complicating the regulatory landscape. Regulatory arbitrage, where firms choose to operate in jurisdictions with more lenient regulations, can undermine the effectiveness of national regulatory frameworks. International cooperation and harmonisation of regulatory standards are therefore essential to address the challenges posed by the global nature of digital finance.

The Financial Stability Board (FSB)[30] and the International Organisation of Securities Commissions (IOSCO)[31] play a crucial role in promoting international cooperation in financial regulation. These organisations are working to develop global standards and guidelines to ensure that digital financial services are effectively regulated across jurisdictions. Their efforts are aimed at preventing regulatory arbitrage and ensuring a level playing field for all market participants.

The integration of financial and non-financial industries through digital platforms further complicates the regulatory environment. Digital platforms often offer a range of services that blur the lines between traditional financial services and other commercial activities. For example, technology companies that provide payment services or facilitate peer-to-peer lending may not fit neatly into existing regulatory categories. Regulators need to adapt their frameworks to take account

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[30] *Inter alia*, Report FSB 16 February 2022 - Assessment of Risks to Financial Stability from Crypto-assets, 16 February 2022; Report FSB – Crypto-asset markets - Potential channels for future financial stability implications, 10 October 2018.

[31] *Inter alia*, IOSCO Final Report of 19 December - Policy Recommendations for Decentralized Finance (DeFi), 19 December 2023; IOSCO Public Report of 16 November 2023 - Policy Recommendations for Crypto and Digital Asset Markets, 16 November 2023; IOSCO Public Report - Global Stablecoin Initiatives, 1 March 2020; IOSCO Final Report - Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms - Fintech - Final Report, 29 February 2020.

of these hybrid business models and ensure that all relevant activities are subject to appropriate supervision.[32]

Indeed, the use of digital data and advanced analytics for risk assessment represents a significant advance in financial regulation. These technologies enable financial institutions to analyse vast amounts of data quickly and accurately, improving their ability to assess and manage risk. However, this increased reliance on data also raises privacy and security concerns. Regulators need to ensure that financial institutions implement robust data protection measures and comply with relevant data privacy regulations, such as the GDPR in the European Union.[33]

Moreover, the rise of digital finance also requires a re-evaluation of traditional regulatory approaches to consumer protection. The principles of fairness, transparency and accountability must be upheld in the digital finance ecosystem to protect consumers from unfair practices and ensure that they are fully informed about the risks associated with digital financial services. Regulators must develop guidelines and standards that address the unique challenges posed by digital technologies, such as the use of complex algorithms and the potential for biased or discriminatory decision-making.

In addition, the increasing role of digital finance in delivering financial inclusion highlights the importance of regulatory frameworks that promote access to financial services while protecting vulnerable populations. Digital financial services have the potential to reach underserved and unbanked populations, providing them with access to banking, credit and investment opportunities.

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[32] Lemma, *Fintech Regulation, Exploring New Challenges of the Capital Markets Union*, p. 1 and ff., 2020.

[33] Consob, FinTech and the data-driven economy - Some civil and criminal law issues, December 2018. Consob highlights that the availability of both generic and specific information-about assets, investors' risk appetite, consumption habits, and past financial history-is a crucial element in the development of many FinTech sector applications. The conditions that have fostered the development of the FinTech sector are in fact constituted not only by the well-known economic contingencies related to the financial crisis and the contraction of profit margins in lending and investment activities, but also by a particular technological context, in which the increase in computing power, the great accessibility and availability of data at the macro and individual level, and the multiplication of platforms in which the collection and exchange of information take place, intersect.

However, regulators must ensure that these services are designed and delivered in a way that protects consumers and promotes financial literacy and education.

The regulation of digital finance also involves addressing systemic risks associated with the widespread adoption of digital technologies. Automated decision-making processes, while enhancing efficiency, can lead to increased market volatility if not properly managed. The potential for algorithmic trading to exacerbate market fluctuations and the reliance on complex financial models that may fail under stress conditions are significant concerns for regulators.[34]

The integration of artificial intelligence and machine learning in financial services adds another layer of complexity. While these technologies can improve risk assessment and decision-making, they also introduce new risks related to their opacity and the difficulty of understanding their decision-making processes. Regulators need to develop strategies to effectively supervise these technologies and ensure that they do not pose undue risks to financial stability.[35]

The implementation of regulatory standards for digital financial instruments also involves significant public oversight, especially when the trading parties are intermediaries subject to public supervision. These intermediaries have to comply with reporting obligations and specific rules, in addition to those set out in the Fintech Decree. This comprehensive regulatory framework aims to ensure transparency, prevent fraud and maintain the integrity of digital financial markets.

Effective regulation of digital finance requires robust supervision and compliance frameworks. Regulators must have the tools and capabilities to monitor digital financial activity in real time and ensure compliance with regulatory

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[34] Bank of Italy, *Communication on decentralized technologies in finance and crypto assets* (Comunicazione della Banca d'Italia in materia di tecnologie decentralizzate nella finanza e cripto-attività), 15 June 2022.

[35] Lemma, *Fintech Regulation, Exploring New Challenges of the Capital Markets Union*, p. 1 and ff., 2020; Baskerville, Capriglione et all., Impacts, Challenges and trends of Digital Transformation in the Banking Sector, in Law and Economics Yearly Review, 2020, p. 341 ff.; Pollari, *The Rise of Fintech: Opportunities and Challenges*, in *the Australasian Journal of Applied Finance*, 2016, p. 16.

standards. This includes developing advanced monitoring systems that can detect irregularities and potential breaches in a timely manner. In addition, regulators must foster a culture of compliance within financial institutions, encouraging them to adopt best practices and adhere to regulatory requirements.

As digital finance continues to evolve, regulators must remain vigilant and proactive in addressing emerging risks and challenges. The regulatory landscape must be flexible enough to accommodate rapid technological change, while ensuring that the core principles of financial regulation - such as investor protection, market integrity and financial stability - are upheld. This requires continuous engagement with industry stakeholders, academia and international regulators to keep abreast of technological developments.

The regulatory frameworks developed in response to these challenges must balance the benefits of digital finance with the risks it poses to market integrity and economic stability. By addressing these foundational issues, regulators can foster a secure and equitable financial ecosystem that leverages the potential of digital technologies. Regulators must also consider the broader implications of digital finance for the global financial system. This includes promoting financial inclusion, ensuring equitable access to financial services, and supporting sustainable economic development.

Furthermore, by adopting a holistic approach to digital finance regulation, policymakers can create an environment that encourages innovation while protecting the interests of all stakeholders.

In conclusion, the regulation of digital finance requires a dynamic and adaptive framework that can respond to the evolving landscape of financial technologies. By focusing on investor protection, international cooperation, data privacy, and systemic risk management, regulators can build a resilient financial system that harnesses the benefits of digital innovation while mitigating its risks.

3. The digitalization is changing the current provision of services in the financial markets, and this has raised significant concerns in the law and economics debate.[36]

A wide range of application concerns the use of automated decision-making processes, the issuance of new products and the setting up of platforms that promotes peer to peer transactions for capital and risks. All the above calls for a focus on the notable changes induced by technological innovation in the operational methods of intermediaries.[37]

As a result, the use of new digital technologies in the credit market relates to the bonds issued in digital form which indicates investments to assess the effects of credit risk. Specifically, the processes and methods of intervention that an Asset Management Company should adopt find its main rationale into an investment in a digital financial instrument. It refers to a new asset class of bonds that is based on distributed ledger technologies,[38] or rather on 'distributed ledger' technologies that are framed in 'decentralized finance'[39] as they allow for networked transactions spread among several parties without the intervention of a central administrator.[40]

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[36] See ALPA, *L'intelligenza artificiale. Il contesto giuridico*, Modena, 2021, 115 ff.; ID., *Fintech: un laboratorio per i giuristi*, *Prefazione* a AA.VV., *Fintech: diritti concorrenza, regole*, Bologna, 2019, p. XIII.

[37] David McNulty, Andrea Miglionico, Alistair Milne, *'Data Access Technologies and the 'New Governance' Techniques of Financial Regulation*', *Journal of Financial Regulation* (2023) 9(2), 225. The Authors observe how information technologies are changing the financial services, opening new frontiers in regulation, enhancing of prudential and conduct risks as well as substantially lowering compliance costs.

[38] LA SALA E*., L'applicazione della Distribuited Ledger Technology all'emissione di strumenti finanziari*, Societa., 2019, 6, 715.

[39] DE FILIPPI and WRIGHT A., Decentralised Blockchain Technology and the Rise of Lex Cryptographia, in Working paper, 2015; EULER V.T., The token classification framework; a multi-dimensional tool for understanding and classifying crypto tokens; Leocani, Malvagna, Sciarrone Alibrandi and Tranquillini*, Tecnologie di registro distribuito (distributed ledger technologies – blockchain) per la rappresentazione digitale di strumenti finanziari (security token): tra diritto cartolare e disciplina delle infrastrutture di mercato*, in *Rivista di diritto bancario*, 2/2022, 2, p. 73.

[40] SCARDOVI, *Restructuring and Innovation in Banking*, Springer, 2016, p. 16.

The significant development of 'digital bonds' due to the new automated operations represents the "integration between the financial and non-financial industries," which experiences "an increasing number of platforms ... non-financial ... that make directly available to users even typically financial services, through authorised parties ... signalling... directly on their site the possibility of financing, under certain conditions, for the payment of a given asset".[41] There is an inherent improvement in the ability of intermediaries to assess the riskiness of investments enabled by the use of digital data and new methodologies while maintaining the requirement to focus on the monitoring of those who access credit.

4. Turning to an analysis of the structure of transactions involving the issuance and trading of digital bonds, the first point to highlight concerns the difference from the dematerialized financial instruments.[42] These structures are implemented by an accounting record that is allocated to a custodian bank, which is required to carry out a series of activities that must guarantee the existence of the security and the lack of liens on it, as well as prevent any form of 'appropriation' by third parties and allow for possible 'recalls' by investors. Through the use of blockchain, the need to rely on the custodian bank is eliminated. The digital nature of the instrument simplifies the proof of ownership. This proof is represented by its inclusion on a 'distributed digital ledger' accessible by all[43] (where the bank makes accounts accessible only to customers who are the holders of them).

It is evident how this operation allows for the bypassing of the former system in its entirety since, given the inclusion of the transaction in a distributed

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[41] Annunziata, *Fintech: tra infrastrutture tecnologiche e intelligenza artificiale,* on *Quaderni di ricerca giuridica della Consulenza legale della Banca d'Italia*, 2024, n. 100, p. 273.
[42] Lener, *La regolamentazione del settore DeFi*, in AA.VV., *La finanza decentralizzata*, a cura di Furnari, Rome, 2023, p. IX ff, where the operational techniques of Decentralized Finance are outlined by connecting its essence to blockchain technology.
[43] Annunziata, *Distributed Ledger Technology e mercato finanziario: dalle prime posizioni ESMA alle ultime proposte, on PARACAMPO M.T. (a cura di), FinTech, Introduzione ai profili giuridici di un mercato unico tecnologico dei servizi finanziari*, Vol. II, Turin, 2019, 329 ss.

digital register, the non-changeability of the same over time is achieved; hence, the intervention of a custodian bank is not necessarily required. The Legislative Decree No. 25 of 17 March 2023 (the so-called Fintech Decree) clarified that while banks are ‘centralized depositories’ by election, technological entities that meet certain requirements can also be qualified to perform this function.[44]

It should be noted that the traditional back office process involves the buyer passing the order on a trading platform where it crosses with the counterparty's sales order. Subsequently, a flow of information takes place between the buyer's back office and the seller's back office, thus implementing the confirmation of the contract, hence the proof that the transaction has been validly carried out, given that the information in question is sent to the custodian bank by implementing the settlement process. Hence the successful registration of securities in the accounts of the custodian bank which certifies the existence of financial instruments having certain characteristics.[45]

It is evident that through blockchain the trading parties have the advantage of sending directly to the registry, which takes into account all the characteristics of the transaction.[46] The lack of digital currency makes it more difficult to verify the validity of such transactions, and it becomes necessary to rely on the

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[44] Emiliano La Sala and Francesco Guelfi, *Emissione e circolazione di strumenti finanziari in forma digitale: profili legali e fiscali*, on Le Società, n. 11, 1 November 2023, p. 1235. The Authors outline that the D.L. Digital Instruments introduces a third regime of the form and circulation of financial instruments, as the digital form. The D.L. allows for the issuance and circulation of digital financial instruments, aiming to ensure that the distributed ledgers guarantee the non-reproducibility of financial instruments and the exclusivity of ownership.

[45] Onnig Dombalagian, *Trading Debt at the Digital Frontier (2023). 49 Journal of Corporation Law (Forthcoming)*, Tulane Public Law Research Paper No. 22-6, https://ssrn.com/ abstract=4247 300.

[46] Banca d’Italia, *La tecnologia blockchain: nuove prospettive per i mercati finanziari,* Rome, June 2016, in which the elements that characterize blockchain technology are clarified, specifying that it represents a process in which a set of entities share computing resources (memory, CPU, bandwidth) to build and update a virtual database (the blockchain) that is public (everyone can see it) and decentralized (each participant has a copy of the data); the information thus collected is considered certain by the community sharing the process. See also TAPSCOTT, *The Blockchain Revolution: How the Technology Behind Bitcoin is Changing Money, Business, and the World.*, May, 2016; MARVIN, *Blockchain: The Invisible Technology That's Changing the World,* August, 2017; DI PAOLA*, Blockchain supply management. Teoria e pratica manageriale in evoluzione nell’era digitale*, Padova, 2018.

intermediation of banks to carry out the exchange of money.[47] Only upon receipt of the payment is the relationship crystallized; the 'block' becomes, in fact, unalterable the moment the register receives confirmation (by e-mail) that there has been payment.

Therefore, a simplification of the investment procedure is achieved, the economic advantage of which is identified in a reduction of the costs linked to the issuance of the bonds, which is accompanied (for the buyer) by back-office costs, transaction management costs and the costs of maintaining the account in which the instruments in question are allocated. A reduction in costs will be greater when it becomes possible to use digital currency in payments, a solution which, however, will require a technical and organizational adjustment of the authorized parties involved in the investment operations.[48] This is the difficulty represented in doctrine about the necessary acceptance of the digital euro by the political authorities,[49] since it is not configurable the possibility of this currency being imposed directly by the ECB.[50]

From another point of view, digital bond issues are reserved for qualified investors (large financial institutions) and not accessible to the retail public, as can be seen from the offering documents (private risk memorandum). This significantly limits the scope of parties who can benefit from the simplification of processes by accessing the blockchain which allows them to gain awareness of the counterparty's actual financial instruments. It also follows that, in such an operational context, the possibility of reducing counterparty risk, the assessment of which for an investor (an Asset Management Company) is particularly

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[47] Troiano, '*Electronic money and payment tokens between MICAR and PSD 3 proposal*' (2023), in *Open Review of Management, Banking and Finance*.

[48] Sepe, *Italian Banking and Financial Law*, *Regulated Markets*, p. 117, who provides, *inter alia*, an overview on the issue of financial instruments considered ad merely nominalistic value that go beyond the concept of "Stock Exchange" as a system of public exchanges operating under monopoly, introducing the concept of regulated markets.

[49] Bocchini., *Lo sviluppo della moneta virtuale: primi tentativi di inquadramento e disciplina tra prospettive economiche e giuridiche*, Dir. inf., n. 1, 2017, 27 ss.

[50] Capriglione – Lemma, *The Adoption of Digital Euro: Problems and Perspectives*, on AA.VV., *Monetary Policy Normalization,* editors Savona and Masera, Springer, 2023, p. 123.

challenging because of the analyses that should support the decisions that support its action.[51]

The complexity of the operational framework outlined so far appears in its entirety where one has regard to the orientation of market players toward increased investment in digital financial instruments such as, for example, shares in some real estate funds. The difficulties encountered in the acquisition of listed real estate funds are well known, since this is an asset class, reserved for institutional investors, characterised by a limited transparency as far as the income profile is concerned (because it is necessary to wait until the end of the fund's life cycle to realise investment income). These difficulties become particularly relevant where one intends to proceed with the sale of such funds using blockchain technology. The Fintech Decree envisages the possibility of activating digital trading for such financial instruments upon the creation of an exchange platform that allows for the sale of a share of them on the market, increasing the amount of the relevant transactions due to the greater liquidity they present. The digitization of bonds opens up an expectation in which a not-too-distant future will be qualified by the extension of such operational form to all financial instruments (equities, bonds, fund shares) that exist on the market.

5. The regulatory framework gained momentum with the Fintech Decree in which the Italian legislator, implementing the EU Regulation No. 858 of 2022 (so-called 'DLT Pilot Regime'),[52] recognised that financial instruments could be issued

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[51] In particular, the structures (i.e., risk management) of these operators that owe the necessary assessments that precede the investment. Thus, we are dealing with an activity that impacts all internal processes upstream and downstream of an investment that a management company or other licensed entity intends to make.

[52] Starting from the clarification contained in the Press Release of the Council of Ministers No. 25 of March 16, 2023, where it is meant that the disciplinary measure was intended to promote an innovative solution, on the operational level, regarding the use of digital technology for the circulation of digital financial instruments.

in digital form.[53] This regulatory measure made it possible to "adapt our legal system to the DLT pilot regime and digital financial instruments", outlining the disciplinary features of the new activity reserved for those responsible for the distributed register.[54]

This Decree marks an important step forward in the evolution of the financial sector in Italy as it aims to promote innovation and digitization of financial markets, facilitating access to credit for businesses and investors.

With this it came the first opening of the financial sector to the offering and trading of tokens representing traditional and alternative asset classes, such as stocks, bonds, investment fund shares and certificates of deposit EU Regulation No 858 of 2022, which provides the possibility for regulated market operators, investment firms and central depositories to establish trading platforms for digital financial instruments (with financial instruments issued, registered, transferred and stored using TLDs) issued in the European context.[55]

The European regulator aimed to prepare a pilot project with a view to a wider diffusion of market infrastructures based on the use of DLT. This includes an adjustment of the regulations concerning the financial sector protecting market participants who proceed, among other things, to the trading of bonds in the cryptographic modes that have long been experimented with the cryptocurrency

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[53] Annunziata, Chisari and Amendola, 'DLT-Based Trading Venues and EU Capital Markets Legislation: State of the Art and Perspectives under the DLT Pilot Regime' (1 February 2023). Bocconi Legal Studies Research Paper No. 4344803, https://ssrn.com/abstract=4344803, who highlight that the DLT Regulation aims at establishing operating conditions in order to allow crypto-assets to be traded and settled using DLT and enabling regulators to remove regulatory constraints capable of inhibiting the development of DLT-based solutions in the Union.

[54] Lemma, '*DLT pilot: verso il mercato degli strumenti finanziari digitali'*, Notes in the margin of Decree Law No. 25 of March 17, 2023, and Regulation (EU) 2022/858, in *Diritto Bancario,* 2 May 2023. The Author highlights that we are dealing with a new reserved activity (i.e., the maintenance of the distributed registry) and a new asset (i.e., the digital financial instrument), operators who traditionally operated in the field of issuance and market management will have to observe the reference market, in order to assess the adoption of the innovations regulated by the aforementioned European regulation (and, as a result of this choice, activate the relevant licensing procedure).

[55] See the editorial entitled Decreto Fintech: novità e semplificazioni per gli strumenti finanziari digitali, May 2023, www.agendadigitale.eu/mercati-digitali/decreto-fintech-novita-e-semplificazio ni- per -gli-strumenti- finanziari-digitali.

formula.[56] The regulator intended to go beyond the 2019 Italian regulations, which introduced a simplified and transitional regime (regulatory sandbox) for testing digital technology innovation activities.[57]

It should be considered particularly significant the definition contained in the provisions of Article 1, paragraph 1, letter c, of “digital financial instruments”, by which means those outlined in Article 2 of the decree under consideration (i.e., shares, bonds, debt securities issued by limited liability companies, etc.) issued on a registry for digital circulation.[58] This definition includes all those asset classes that are represented in the form of digital tokens which can be traded and transferred through a distributed ledger.[59] This activity should be carried out by testing innovative solutions from a digital point of view and with constant dialogue with supervisory authorities. A representative of the Bank of Italy, stressing the importance of the Fintech Decree, pointed out that “our country is now able to bridge the gap with other European legal systems and keep up with the digital transformation that is affecting financial infrastructures and markets”.[60]

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[56] Masera, *Nuovi rischi e regolazione delle cryptovalute*, *Bancaria*, 2022, n. 3, p. 5.; CAPRIGLIONE, *Le cripto attività tra innovazione tecnologica ed esigenze regolamentari*, *Riv. trim. dir. econ.*, 2022, I, 225.

[57] Nicotra, *Fintech, l’Italia sposa l’idea sandbox: ecco gli impatti,* on *https://www.age ndadigitale. eu/cittadinanza-digitale/fintech-litalia-sposa-lidea-sandbox-ecco-gli-impatti,* July 2019, where reference is made to Law No. 58 of June 28, 2019, which introduced the possibility of creating regulatory sandboxes in the fintech sector, so that the creation and promotion of entrepreneurial activities and technological solutions in this sector can be incentivised.

[58] This definition has now been incorporated into Article 1(2) and Annex I of the Consolidated Law on Finance (Legislative Decree No. 58 of February 24, 1998), following the amendments introduced by the Fintech Decree.

[59] MILLS D. et al., *Distributed 141 Tokenizzazione di azioni e azioni tokens ledger technology in payments*, clearing, and Settlement, in Finance and Economics Discussion Serie Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board, Washington, D.C., 2016, 25 ss; Maestretti M.– Ferro L., *La tokenizzazione di azioni, tra sviluppi dottrinari e novità normative*, in *Novità fiscali*, n. 5, 2020, 286 ss; Maas T., *Initial coin offerings: when are tokens securities in the EU and US?*, February 2019, https://ssrn.com/abstract=3337514); Lucantoni P., *Distributed Ledger Technology e infrastrutture di negoziazione e post-trading*, in FCHUB, 2018; Pinna a.– Ruttenberg w., *Distributed ledger technologies in securities post-trading. Revolution or evolution?*, in *European Central Bank Occasional Paper Series*, n. 172, 2016, 1 ss; WALPORT M., *Distributed Ledger Technology. Beyond Block Chain, A report by the UK Government Chief Scientific Adviser*.

[60] Cipollone, *Audizione sul disegno di legge n. 605 di conversione in legge del decreto-legge 17 marzo 2023, n. 25, recante disposizioni urgenti in materia di emissioni e circolazione di determinati strumenti finanziari in forma digitale e di semplificazione della sperimentazione*

The need to provide for exemptions from the requirements set by the MiFID II Directive, the Consolidated Law on Finance (TUF), and the European Regulation on Central Securities Depositories which aimed at the efficiency of distributed ledgers, are repositories of information in which transactions involving digital financial instruments are recorded, shared by networked computing devices or applications and synchronized with each other.[61]

The provision in the new legislation for a special list of entities that can maintain blockchain registries introduces an element of significant transparency into the operational processes.[62] This is subject to the involvement of the Supervisory Authorities (in particular Consob, which is responsible for verifying the suitability of the registry holders), to identify suitable technological solutions to be able to mitigate the risks in which they may incur (including loss of data or possibility of being the recipients of fraud). Significant in this regard is the application to registry officers of the rules of governance and prevention of conflicts of interest, as well as the requirement for them to meet special suitability requirements.

The Italian regulatory system aligned with the most advanced European countries (in particular France).[63] It should also be noted that, when the Fintech Decree was converted, a new article was introduced regarding anti-money

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FinTech, Republic Senate 6th Standing Committee (Finance and Treasury), April 4, 2023. Specifically, the Author highlight that the regulation has introduced the possibility that multiple (equally necessary for the performance of financial activities) are provided by a single market infrastructure; an innovation that allows "to concentrate on a single platform different phase of operations on financial instruments without the need to separate them.... in different technological, administrative and regulatory environments".

[61] Yermack D., 'Corporate Governance and Blockchains' (2017) 21 *Review of Finance* 7.

[62] A party responsible for the registry is identified, giving security to the mode of issuing and circulating financial instruments such as tokens, which is entirely new to the Italian legal system. Consob, in agreement with the Bank of Italy, may identify by regulation the criteria of significance for the identification of "significant" registrars and dictate the cases of application of the rules provided for in Articles 14 to 16 of the Consolidated Law on Finance to holdings in such entities (Article 28(4) of the Fintech Decree).

[63] it has thus become possible to overcome the difficulties of Italian companies which, they have been able, until recently, to hypothesize only by way of interpretation (the dematerialization regime that has been in place for financial instruments for several years) the construction of digital securities trading operations.

laundering regulations. It stipulated that those in charge of digital circulation registries are obligated under the anti-money laundering provisions, falling into the category of “other non-financial operators” within the meaning of Article 3, paragraph 5, of Legislative Decree No. 231 of 2007 (Anti-Money Laundering Decree).

It is worth mentioning the regulatory powers granted by the Fintech Decree to Consob, which intervenes, in some cases, in agreement with the Bank of Italy. These are powers concerning in the first place the principles and criteria relating to the establishment and maintenance of the list of registry managers and the related forms of publicity and, therefore, functional to the concrete activation of the operational forms that concern it here (Article 28, paragraph 1 Fintech Decree). Hence the necessary exercise of these regulatory powers, which are not referred to a discretionary evaluation of the Authority.

A second group of regulatory powers is non-binding, the concrete implementation of which is left to the autonomous determinations of the Authority (Article 28, paragraph 2, Fintech Decree). Therefore, it is in the presence of a broad framework of power that, among other things, includes the provision of further limits and conditions, compared to those indicated by the decree in question, for the issuance and circulation of digital financial instruments; of a broadening of the scope of practicable digital instruments (including in it also “derivative instruments” and shares in an limited liability company); of the identification of the operating procedures for the change of the regime of form and circulation of digital financial instruments, as well as for the conversion into digital financial instruments of instruments originally subject to a different circulation regime.

The range of public controls should be considered more relevant if the parties responsible for trading in digital instruments are intermediaries subject to

public supervision[64]; in this case, they will be subject to all the reporting obligations to the authority to which members of the financial sector are subject, as well as to compliance with the rules imposed on them by the special regulations in addition to those provided for in the Fintech Decree.[65]

6. Post-crisis regulatory reforms represent a general shift towards a more integrated and proactive approach to financial regulation, and this is also true for the regulation of digital financial instruments. The review of the Italian regulation in this article has shown that the role of Member State regulators and legislators remains important in the rule making, and this gives rise to some fragmentation. Viewing financial stability as a public good requires a continued collaborative effort between regulators, financial institutions and other stakeholders to safeguard the integrity of the financial system and the quality of the instruments that are willing to circulate.

The concept of financial stability has evolved significantly in the post-crisis period, as this century highlighted the interconnectedness of financial institutions and the systemic risks that can arise from their collective behaviour. The digitalization of finance represents uncertainties and new risks. As a result, as we approach the digitalization of finance, supervision is called upon to prevent the systemic risks and contagion risks associated with digital financial instruments.

The evolution of financial regulation in the digital age necessitates a comprehensive and proactive approach as the integration of Distributed Ledger Technology (DLT) and other digital financial instruments prompts significant regulatory changes aimed at maintaining financial stability protecting investors and ensuring market integrity. Indeed, it needs a nuanced framework that balances innovation with risk management the interconnectedness of financial

[64] La Sala and Guelfi (n 24) 1235.

[65] Piattelli, *La regolamentazione del Fintech, Dai nuovi sistemi di pagamento all'intelligenza artificiale. Aggiornato al D.L. 17 marzo 2023 c.d. "Decreto Fintech"*, II Ed., June 2023.

institutions heightens systemic risks requiring regulations to address collective behaviour while ensuring investor protection from unfair practices fraud and financial losses.

The rapid adoption of DLT and blockchain revolutionizes transactions offering reduced costs and enhanced security yet presenting unique regulatory challenges that traditional frameworks may not address fully the shift towards greater regulatory paternalism in both wholesale and retail sectors emphasizes social utility and equity ensuring fair treatment of consumers adopting an activity-based rather than entity-based regulatory approach ensures neutrality and equal protections.[66]

International cooperation is essential to prevent regulatory arbitrage and ensure consistent standards across borders. Furthermore, traditional financial institutions must adapt by revising business models to leverage technological innovations diversifying services and improving efficiencies maintaining customer trust. Moreover, FinTech companies must prioritize transparency and fairness particularly with retail clients.

Further research is needed to explore the implications of digital finance on intermediation theory and regulatory adequacy. Among the implications could be new collaborative models between regulatory authorities to effectively oversee the ecosystem into which the regulatory landscape must evolve rapidly. This is necessary to balance innovation with oversight and protection, focusing on systemic risk management, investor protection and international cooperation to foster a resilient digital finance ecosystem supporting sustainable economic development essential for the continued growth and stability of the sector.

[66] Quattrocchio, *Fintech: il quadro di riferimento normativo, in Diritto ed economia dell'impresa*, n. 1/20.

RUSSIAN EXPERIENCE OF TAX INCENTIVES FOR SMES AS A FACTOR OF SUSTAINABLE DEVELOPMENT

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ABSTRACT: *This article analyses sustainable development through Russian SMEs as a concept based on an approach that aims to achieve balanced economic, social and environmental objectives. This concept places special emphasis on long-term business sustainability, minimizing negative environmental impacts and ensuring a long-term well-being of the entity itself and society as a whole. The aim of this article is to examine a state role in managing sustainable development of SMEs. Since tax incentives are the government's best instrument to encourage SMEs' contribution to economic growth, the article focuses on relevant tax measures to support small and medium-sized businesses in Russia. National project "Small and medium-sized entrepreneurship and support for individual entrepreneurial initiative" is discussed in light of recent developments. Benefits of special tax regimes are revealed as one of the priority directions for national economic policy. The role of tax measures as one of the means of SME support is reflected.*

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This article is a result of joint research. Sections 1, 2 and 3 have been written by K. Novikova; sections 4, 5 and 6 have been written by I. Goncharenko.

SUMMARY: 1. Introduction. – 2. Regulatory framework for tax incentives for Russian SMEs. – 3. SME definition. – 4. Summary of special tax regimes. – 5. Tax incentives under a general tax regime. – 6. Additional tax incentives for SMEs. – 7. Conclusion.

1. Promoting the Sustainable Development Goals (SDGs) is a priority for governments around the world seeking to raise living standards of their citizens. Small and medium-sized enterprises (SMEs) are an important tool for achieving the SDGs. SMEs are seen as economic drivers and are used as an important instrument to reduce poverty by promoting SDGs. SMEs help reducing unemployment and promote economic development besides paying taxes. SMEs must always be sustainable in order to continue their contribution to economic growth[67].

Tax incentives are the best tools for governments to encourage SMEs to maintain their sustainable capacity and contribute to economic development. Tax relieves are a way to reduce tax burden on business and encourage it to fulfill their social responsibilities and engage in behaviors that benefit society. Therefore, appropriately designed tax incentives will have a positive and statistically significant impact on the growth and sustainability of SMEs.

Tax benefits for SMEs that develop innovative solutions to environmental or social challenges will contribute to SDG 8 and SDG 9. Tax incentives for SMEs aimed at poverty eradication will promote SDG 1.

Today SMEs are becoming a priority area for the development of Russia's long term financial policy. Both federal and regional strategic documents without exception include measures to stimulate SMEs.

Thus, a Decree of the Russian Federation President dated 13.05.2017 N 208 “On a Strategy for Economic Security of the Russian Federation in the period up to 2030” states “support for high-tech small and medium-sized businesses” among

[67] Tekola, H., & Gidey, Y. Contributions of micro, small and medium enterprises (MSMEs) to income generation, employment, and GDP: Case study Ethiopia. Journal of Sustainable Development, 12(3), 46–81. [2019].

the main tasks of ensuring sustainable growth for the real sector of economy[68]. Target indicators are defined in the national project “Small and medium-sized entrepreneurship and support for individual entrepreneurial initiative” (national SME project) in accordance with a Decree of the Russian Federation President dated 07.05.2018 N 204 “On national goals and strategic tasks for the development of the Russian Federation in the period up to 2024”[69].

The national SME project envisages a growth in the number of economically active population in this sector of the economy up to 25 million people by the end of 2024. By contrast, in 2018 a number of those employed in the SMEs sector according to the Federal Tax Service of Russia[70] was only 15.9 million people, which is 1.6 times less than the mentioned target indicator. As of 10.03.2024, the number of people employed in the SME sector already reached 25 million people[71]. Thus, formally, the target indicators of the national SME project have already been met.

New goal of the national SME project was announced on February 29, 2024 by the President of the Russian Federation in his annual speech to the Federal Assembly: to increase the income of companies per employee by 2030, which should exceed a GDP growth[72]. Key task for the next few years is qualitative rather than quantitative growth of this sector, which will eventually increase the share of SME contribution to the country's GDP, the number of SMEs, the share of SMEs operating in priority industries along with other economic indicators.

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[68] Decree of the Russian Federation President dated 13.05.2017 N 208 “On a Strategy for Economic Security of the Russian Federation in the period up to 2030” available at <http://www.consultant .ru> (accessed 25 July 2024).

[69] Decree of the Russian Federation President dated 07.05.2018 N 204 “On national goals and strategic tasks for the development of the Russian Federation in the period up to 2024” available at <http://www.consultant.ru> (accessed 25 July 2024).

[70] The Unified Register of small and medium-sized businesses, ‘Official website of the Federal Tax Service’, available at < https://rmsp.nalog.ru/index.html> (accessed 25 July 2024).

[71] Ibid.

[72] Speech of the Russian Federation President to the Federal Assembly dated 02.29.2024, available at <http://www.consultant.ru> (accessed 25 July 2024).

2. The following legal acts serve as a regulatory basis for tax incentives for the small and medium-sized enterprises in Russia:

- Tax Code of the Russian Federation, Part 1 dated 31.07.1998 and Part 2 dated 05.08.2000[73];
- Federal Law dated 24.07.2007 N 209-FZ “On Development of Small and Medium-Sized Entrepreneurship in the Russian Federation”[74];
- Federal Law dated 26.12.2008 N 294-FZ “On Protection of the Rights of Legal Entities and Individual Entrepreneurs while Implementing State Control (Supervision) and Municipal Control” (latest version)[75];
- Decree of the Russian Federation President dated 07.05.2018 N 204 “On national goals and strategic objectives for the development of the Russian Federation in the period up to 2024”[76];
- Order of the Russian Federation Government dated 02.06.2016 N 1083-r “On a Strategy for the Development of Small and Medium-sized Businesses in the Russian Federation in the period up to 2030 and an action plan (”road map“) for its implementation”[77];
- Regulatory acts of the Russian Federation’s subjects (e.g., Moscow city Law dated 31.10.2012 N 53 “On a patent system of taxation”[78].

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[73] Tax Code of the Russian Federation, Part 1 dated 31.07.1998 and Part 2 dated 05.08.2000 available at <http://www.consultant.ru> (accessed 25 July 2024).

[74] Federal Law dated 24.07.2007 N 209-FZ “On Development of Small and Medium-Sized Entrepreneurship in the Russian Federation” available at <http://www.consultant.ru> (accessed 25 July 2024).

[75] Federal Law dated 26.12.2008 N 294-FZ “On Protection of the Rights of Legal Entities and Individual Entrepreneurs while Implementing State Control (Supervision) and Municipal Control” (latest version) available at <http://www.consultant.ru> (accessed 25 July 2024).

[76] Decree of the Russian Federation President dated 07.05.2018 N 204 “On national goals and strategic objectives for the development of the Russian Federation in the period up to 2024” available at <http://www.consultant.ru> (accessed 25 July 2024).

[77] Order of the Russian Federation Government dated 02.06.2016 N 1083-r “On a Strategy for the Development of Small and Medium-sized Businesses in the Russian Federation in the period up to 2030 and an action plan (”road map“) for its implementation” available at <http://www.consultant.ru> (accessed 25 July 2024).

[78] Moscow city Law dated 31.10.2012 N 53 “On a patent system of taxation” available at <http://www.consultant.ru> (accessed 25 July 2024).

3. Despite the fact that an SMEs definition varies from country to country, SMEs are widely recognized for the important contribution they make to sustainable development by promoting scientific and technological progress and innovation, accelerated GDP growth, job creation and consequent employment, provision of public goods and services, reduction of poverty and inequality.

According to the Federal Law dated 24.07.2007 N 209-FZ[79], SMEs refer to the organizations and sole proprietors, who meet a number of criteria and are included in the relevant register on the website of the Federal Tax Service.[80] At the same time, in accordance with the above-mentioned law, individuals using a professional income tax (PIT) regime have the same status as SMEs[81], i.e. the self-employed using PIT have the same benefits and privileges as sole proprietors considered small and medium-sized businesses.

Today, SMEs in Russia include medium, small and so-called "micro enterprises". However, Russian Government plans to introduce a new category - "small and medium-sized business plus" ("SME+") in 2025[82]. This category should become an intermediate stage between medium and large companies, which would allow to retain benefits for a gradual growth of business and help solving a problem of illegal business fragmentation.

Yet in accordance with current legislation, small and medium-sized businesses in terms of business structure include the following:

- organizations,

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[79] Federal Law dated 24.07.2007 N 209-FZ "On a Development of Small and Medium-Sized Entrepreneurship in the Russian Federation" available at <http://www.consultant.ru> (accessed 25 July 2024).

[80] The Unified Register of small and medium-sized businesses, 'Official website of the Federal Tax Service', available at < https://rmsp.nalog.ru/index.html> (accessed 25 July 2024).

[81] Federal Law dated 24.07.2007 N 209-FZ "On Development of Small and Medium-Sized Entrepreneurship in the Russian Federation" available at <http://www.consultant.ru> (accessed 25 July 2024).

[82] Article "So and so will take away: business named the risks of granting benefits to growing companies", Official site of Izvestia newspaper, available at <https://iz.ru/1668699/mariia-stroitele va/tak-i-ubudet-biznes-nazval-riski-predostavleniia-lgot-rastushchim-kompaniiam> (accessed 25 July 2024). Federal Law dated 24.07.2007 N 209-FZ "On Development of Small and Medium-Sized Entrepreneurship in the Russian Federation" available at <http://www.consultant.ru> (acc essed 25 July 2024).

- sole proprietors,

- individuals paying a professional income tax.

The main criteria to classify legal entities and sole proprietors as SMEs are the average number of employees and income (turnover) from business activities.

Currently *medium-sized business* in Russia refers to an enterprise with 101 to 250 employees and a turnover from 800 million to 2 billion rubles.

Small business refers to an enterprise with 16 to 100 employees and a turnover from 120 million to 800 million rubles.

Microbusiness – an enterprise with up to 15 employees and a turnover of up to 120 million rubles, including all sole proprietors working on a patent tax regime.

Some types of business activities are subject to significant exceptions: the number of employees of an average light industry enterprise (clothing, leather, fabric) may reach 1,000 people and the number of employees of a catering company may be as many as 1,500 people.

Another criterion to classify organizations as SMEs is a structure of authorized or equity capital. Share of a foreign entity in the authorized capital shall not exceed 49%, share of a Russian company that is not an SME shall not exceed 49% either. Share of the state, subjects of Federation or non-profit organizations – not more than 25%.

Thus, in order to be considered SME in Russia, one shall fall within the limits of three key parameters: the amount of income (turnover), the number of employees, as well as the participation share of other companies in the authorized capital.

4. Small and medium-sized enterprises represent 99% of all businesses in the EU[83]. In Russia SMEs account for the major share of businesses and

[83] Information from the official European Commission site, available at <https://single-market-economy.ec.europa.eu/smes/sme-fundamentals/sme-definition_en> (accessed August, 19, 2024)

employment as well. According to the Federal Tax Service of Russia, in the beginning of 2024 small and medium-sized enterprises accounted for 81,2% of businesses[84]. Based on RIA Rating data, in 2023 SMEs accounted for 40,7% of employment[85]. Therefore, small and medium-sized businesses are one of the most powerful driving forces of economic development. SMEs sustainable development is largely facilitated by reducing their tax burden. The effect of such tax measures includes both motivations to increase production volumes due to tax liability savings and incentives to come out of grey economy by reducing their costs.

In Russia tax incentives for SMEs are largely established in a form of special tax regimes providing relevant tax benefits.

A special tax regime (STR) is “a special procedure to calculate and pay taxes and fees for a certain period of time, applied in cases and in accordance with the procedure established by federal laws”[86].

Special tax regimes may provide for the federal and reginal taxes not listed in Article 13 and 14 of the Tax Code of the Russian Federation. STR application as a rule exempt taxpayers from paying several federal, regional and local taxes and fees, replacing them with one tax.

STR taxpayers are organizations, sole proprietors and individuals paying a professional income tax.

Depending on the nature of their activities, small and medium-sized businesses may choose the most appropriate special tax regime[87] from the following options:

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[84] The Unified Register of small and medium-sized businesses, ‘Official website of the Federal Tax Service’, available at < https://rmsp.nalog.ru/index.html> (accessed 25 July 2024).

[85] Rating of regions by employment in small and medium-sized businesses in Russia - 2023, ‘Official website of the universal rating agency RIA Rating of the media group MIA "Russia Today"’, available at <https://riarating.ru/infografika/20230912/630248863.html> (accessed July, 25, 2024).

[86] Tax Law: Textbook for universities / Edited by S. G. Pepelyaev. - Moscow: Alpina Publishers, P. 796. [2017].

[87] Tax Code of the Russian Federation, Part 1 dated 31.07.1998 available at <http://www.consultant.ru> (accessed 25 July 2024).

1) taxation system for agricultural producers (the unified agricultural tax/UAT).

A unified agricultural tax is an STR developed with due regard to the specifics of agricultural production.

Taxpayers are organizations or sole proprietors recognized as agricultural producers.

For tax purposes, agricultural producers are those engaged in production, processing and sale of agricultural products, provision of livestock or crop production services to other agricultural enterprises, fishing or extraction of other bioresources.

Organizations and sole proprietors which carry out primary or subsequent (industrial) processing of agricultural products do not fall under this tax regime.

UAT organizations are exempt from paying:

- corporate income tax (except for tax paid on income from dividends and certain types of debt obligations),
- property tax on organizations (on property used in agricultural activities).

UAT sole proprietors are exempt from paying:

- personal income tax (on income from entrepreneurship),
- personal property tax (used in agricultural activities).

As a rule, UAT SMEs are subject to VAT, but they may be exempt.

Switching to UAT is voluntary and by a notification.

The main condition for the application of this tax regime is complying with the share of income requirement. Share of income from the sale of agricultural products shall be at least 70% of all taxpayer’s income.

The base UAT rate is 6%. The taxable base is calculated as income minus expenses.

Taxpayers may not combine UAT with any other tax regime. However, a sole proprietor may combine UAT with a patent tax regime (when combining regimes, the share of income from agricultural activities shall be at least 70% of income from all types of business).

Obvious advantages of UAT include replacing a set of taxes by only one, a possibility for a sole proprietor to combine UAT with a patent tax regime, simplified tax administration, a right to choose whether to pay VAT or not, as well as voluntary and notification way to switch to it.

Nevertheless, this regime has some disadvantages, such as requirements on certain share of income derived from the sales of agricultural products, as well as limited application: this regime is designed exclusively for certain business activities.

2) simplified tax system (STS).

The STS is a STR, which implies a special tax payment procedure and is aimed to support SMEs as part of promoting SDG. STS is one of the most popular tax regimes used by SMEs in Russa.

In order to use this tax regime, it is necessary to comply with the following criteria:

- number of employees - not more than 130 people (however, if the number of employees exceeds 100, the STS rates go up),
- annual revenue - not more than 200 million rubles,
- residual value of fixed assets - not more than 150 million rubles (although this restriction formally applies to the organizations only, the Ministry of Finance of the Russian Federation insists that sole proprietors shall also comply with this restriction),
- other legal entities' participation in the company - not more than 25%,

- no branches (however, other separate subdivisions with no branch status are allowed),
- the company is not engaged in activities listed in the Tax Code of the Russian Federation (e.g. gambling),
- the company is not a party to any product sharing agreements.

Application of STS exempts organizations from paying:

- corporate income tax (except for tax paid on dividends and certain types of debt obligations),
- property tax on organizations (however, since 2015 organizations have been required to pay property tax in respect of real estate, a tax base for which is determined as its tax assessed value),
- VAT (however, organizations are required to pay VAT when importing goods and when executing a simple partnership agreement or property trust management agreement).

Sole proprietors are exempt from paying:

- personal income tax (on income from entrepreneurship),
- personal property tax (used in business) (however, since 2015 sole proprietors are required to pay property tax in respect of real estate that is included in a list determined in accordance with Clause 7, Article 378.2 of the Tax Code of the Russian Federation),
- VAT (however, required to pay VAT when importing goods and when executing a simple partnership agreement or property trust management agreement).

The application of this tax regime does not exempt from calculating and withholding personal income tax from employees' salaries.

There are two types of STS (depending on the object of taxation or the amount the tax is paid on):

- STS "Income" – all business income is taxed,

- STS "Income minus expenses" – the amount of income reduced by the amount of expenses is taxed.

The tax rate of STS depends on the chosen object of taxation. The base rates of STS are 6% for STS "Income" and 15% for STS "Income minus expenses" respectively.

Taxpayers are not entitled to combine STS with other tax regimes. However, a sole proprietor has a right to combine STS with a patent tax system.

STS is the most common special tax regime among Russian SMEs. STR is suitable for almost any small and medium-sized business and significantly simplifies their operations.

STS benefits include exemption from a number of taxes, simplified accounting, as well as an ability to choose the object of tax calculation as well as tax rate.

Among the drawbacks it is necessary to highlight a limitation in terms of types of business activities, lack of a possibility to open branches, which hinders business development, limited choice of counterparties (since it is not favorable for organizations to buy/sell with no VAT).

3) patent tax system (PTS).

The essence of the patent tax system is in sole proprietors acquiring patents for certain types of activity provided by law, like repair and washing of motor vehicles, tutoring, renting out apartments, etc.

This special tax regime may only be applied by sole proprietors employing not more than 15 people with a total income of not more than 60 million rubles (i.e. microbusinesses).

PTS Sole proprietors are exempt from paying:

- personal income tax (only in respect of entrepreneurial income from activities for which the patent is granted),

- personal property tax (only in respect of property used in carrying out business for which the patent is granted),
- VAT (however, sole proprietors are required to pay VAT when importing goods into Russia and other territories under its jurisdiction; when carrying out operations taxable in accordance with Articles 161 and 174.1 of the Tax Code of the Russian Federation, as well as when carrying out business activities for which no patent is issued).

A patent is purchased for any period from 1 month up to a year and is valid only on the territory of the subject of Federation, which issued the patent for this type of activity.

The rate is 6%. When calculating the cost of a patent, potential income is taken into account, and 6% of this amount constitutes the size of the patent.

PTS may be combined with other special tax regimes: for example, STS or UAT.

Obvious advantages of PTS are the simplicity of this STR, its transparency and a possibility to apply PTS to different types of activities. Also, the advantage is in paying only one tax - for the issued patent, and the amount of this tax does not depend on the actual income. Moreover, simplified accounting, no tax returns, a possibility for the entrepreneur to independently determine the patent's term.

At the same time, PTS has a number of disadvantages, the main of which is that the patent will have to be paid for, even if an entrepreneur does not receive any income. In addition, organizations are not allowed to use this regime. Entrepreneurs also consider the limited types of activities covered by a patent as a disadvantage.

4) professional income tax (PIT) (by way of an experiment)[88].

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[88] Federal Law dated 27.11.2018 N 422-FZ “"About carrying out experiment on establishing special tax regime "Professional income tax" (latest version) available at <http://www.consultant.ru> (accessed 25 July 2024).

PIT is a STR for self-employed citizens. It is currently realized as an experiment carried out in all subjects of Federation.

PIT will be in force until December 31, 2028. During this period, PIT tax rates will not change.

Taxpayers are individuals, including sole proprietorships, who do not have an employer and do not hire employees (i.e. microbusinesses).

Switching to this regime is voluntary.

Applying PIT exempts individuals from paying:

- personal income tax (only in respect of business income that is subject to PIT).

PIT sole proprietors are exempt from paying:

- personal income tax (only in respect of business income that is subject to PIT),
- VAT (however, sole proprietors are required to pay VAT when importing goods into Russia),
- fixed insurance contributions (type of social security contributions).

Tax rates: 4% on individuals' income and 6% on income of organizations and sole proprietorships.

It is not allowed to combine PIT with other special tax regimes.

Among the advantages of using PIT are: no reports and tax returns, no online cash registers, an ability to conduct business legally without registering as a sole proprietor, simple registration via Internet, combining it with the main job, tax deductions, low rates, no obligation to pay insurance premiums, etc.

Disadvantages include a number of restrictions on income and types of activities, as well as inability to combine PIT with other STR.

5) automated simplified tax system (ASTS) (by way of an experiment)[89].

[89] Federal Law dated 25.02.2022 N 17-FZ "About carrying out experiment on establishing special tax regime "The automated simplified tax system" (latest version) available at <http://www.consultant.ru> (accessed 25 July 2024).

ASTS is a STR, which as an experiment operates in Moscow, Tatarstan, Moscow and Kaluga regions from July 1, 2022 to December 31, 2027, in which the tax is calculated automatically.

Taxpayers – organizations and sole proprietorships that meet the following criteria:

- employing not more than 5 people,
- income – not more than 60 million rubles per year (i.e. microbusiness),
- residual value of fixed assets (organizations) – not more than 150 million rubles,
- current accounts are opened only in the authorized banks,
- salaries are paid only by wire transfer,
- no branches,
- taxpayer is not engaged in the types of activities listed in the law (e.g., lawyers, notaries or insurance business),
- no other STR is used.

ASTS provides for the same tax exemptions as regular STS.

The tax rate for "income", as a taxation object, is 8%, for the taxation object "income minus expenses" – 20%.

The pros of ASTS are that there is no need to calculate taxes, submit reports and pay insurance contributions on your own.

The cons are that ASTS is not suitable for all organizations and sole proprietorships, and the tax rates are higher than for STS. In addition, it is prohibited to combine ASTS with other STR.

Special tax regimes are in high demand among Russian SMEs. Thus, out of almost 6 million SMEs in 2022, 81% used STR. And the number of taxpayers using PIT, i.e. self-employed, reached 10 million people in 2024[90].

Nevertheless, not all SMEs are able to take advantages of these benefits, as most of the STR, namely, PTS, PIT and ASTS are applied only to microenterprises. As for the STS, only small enterprises can benefit from this special tax regime in terms of income limits.

There are positive and negative aspects of STR.

Firstly, the use of STR allows to reduce tax burden, reduce the time required to draw up documents, facilitate record keeping and tax payment, which is very important for most entrepreneurs.

Secondly, STR is an instrument of tax regulation in those areas that, due to their peculiarities, require additional regulation, which, in turn, cannot be carried out within the framework of a general tax regime.

Third, the use of STR is appropriate to support specific industries, e.g. agriculture.

Fourth, the use of STR causes problems in co-operation between businesses, as not all counterparties are satisfied with no VAT on the purchase of goods, works and services.

Fifth, large businesses are often divided to apply STR, which is an abuse of tax advantages.

5. SMEs have a right to use a general tax system, paying all legally established taxes and levies, taking into account certain peculiarities:

1) VAT exemption.

SMEs, provided that their turnover does not exceed 2 million rubles in 3 months, may be exempt from paying VAT.

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[90] The Unified Register of small and medium-sized businesses, ‘Official website of the Federal Tax Service’, available at < https://rmsp.nalog.ru/index.html> (accessed 25 July 2024).

2) application of a so-called "cash method" in determining income and expenses for the purposes of calculating corporate income tax.

SMEs, whose turnover in the preceding 4 quarters did not exceed 1 million rubles per each quarter, may apply the cash method in calculating corporate income tax (only the actually received or paid out amounts are accounted for).

3) peculiarities of corporate income tax payment for SMEs.

SMEs, whose turnover in the previous 4 quarters did not exceed on average 15 million rubles per each quarter, are allowed to pay only quarterly advance corporate income tax payments.

4) professional personal income tax deductions for sole proprietors.

Sole proprietors have a right to use professional personal income tax deductions.

6. Specific tax incentives[91] for SMEs include the following preferences:

1) "tax holiday" regime.

The term "tax holidays" is not used in Russian legislation. It came to use after the amendments introduced by Federal Law dated 29.12.2014 N 477-FZ to the Tax Code of the Russian Federation came into force, providing for a 0% tax rate for up to two tax periods (two calendar years).

From 2015 to 2024, certain categories of entrepreneurs were granted special tax benefits – tax holidays. Today, regional authorities may introduce tax holidays only until December 31, 2024, so starting January 1, 2025 tax holidays for sole proprietors using STS and PTS shall not apply.

The mentioned above certain categories of entrepreneurs include citizens registered as sole proprietors for the first time or those who have restored the status of a sole entrepreneur after a suspension of activities. Moreover, those

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[91] Tax incentives – advantages granted to certain categories of taxpayers in comparison with other taxpayers, including a possibility not to pay taxes or to pay them in smaller amount. Tax Code of the Russian Federation, Part 1 dated 31.07.1998 available at <http://www.consultant.ru> (accessed 25 July 2024).

applying for tax holidays shall use STS or PTS. Entrepreneurs must carry out their activities in production, social, scientific or service spheres. Revenue from activities that qualify for tax holidays shall constitute at least 70% of the total revenues. Entrepreneurs must also be registered in the subject of Federation, where a regional law on “tax holidays” is in force on the date of such registration.

2) holidays from inspections.

“Holidays from inspections” for SMEs is a moratorium on scheduled and unscheduled inspections by control and supervisory authorities. Suspension of planned inspections was first introduced in 2016[92]. This measure in respect of some organizations and sole proprietors was repeatedly extended, last time until the end of 2024. However, the moratorium does not apply to prosecutor's supervision and desk tax audits in 2024.

3) regional tax incentives.

Local authorities have a right to introduce tax incentives for taxpayers working in certain areas (scientific, social, production). Reliefs, as a rule, are granted in a form of reduced tax rate, possibility to receive a tax deduction, exemption from a particular tax and other forms.

4) reduced rates of insurance contributions.

Starting 2021, reduced insurance contribution rates apply for SMEs regarding monthly payments to individuals, which exceed a minimum wage established in regulations at the beginning of the year:

- 10% - pension contributions,
- 0% - temporary disability and maternity contributions,
- 5% - mandatory medical insurance contributions.

5) sectoral tax incentives.

VAT exemption for catering.

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[92] Federal Law dated 24.07.2007 N 209-FZ “On Development of Small and Medium-Sized Entrepreneurship in the Russian Federation” available at <http://www.consultant.ru> (accessed 25 July 2024).

Cafes, restaurants and other public catering enterprises using STS shall not pay VAT if they meet the following criteria:

- total income in the previous year – not more than 2 billion rubles (i.e. SMEs),
- income from the sale of catering services – not less than 70% of the total income,
- average monthly payments to personnel must be higher than an average monthly salary in the subject of Federation for this type of activity.

However, not all catering activities fall under the VAT exemption[93].

7. Russian system of tax incentives for SMEs is quite diverse. It is presented in special tax regimes and various additional tax incentives.

Using special tax regimes is among peculiarities of the Russian system of tax incentives for SMEs, which allow SMEs to pay a single tax instead of a number of taxes, thus significantly reducing their tax burden, as well as simplifying procedures to calculate and pay tax. Moreover, under a general tax regime for SMEs there is also a number of benefits, such as a VAT exemption or professional personal income tax deductions for sole proprietors.

Introduction of such mechanisms as tax holidays and holidays from inspections serve as important steps on the side of the state to support sustainable development of small and medium-sized entrepreneurship in Russia. It triggered the development of entrepreneurial initiative, growth of labor productivity, as well as intensification of the use of the latest technologies by SMEs in order to increase competitiveness.

Another positive aspect is decentralizing state support for SMEs, with responsibility being shifted to the regional level. Regional incentives allow the

[93] Federal Law dated 02.07.2021 N 305-FZ “On Amending Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation” (latest version) available at <> (acessed 25 July 2024).

subjects of Federation's authorities to independently reduce tax rates, provide tax deductions, exemptions and other incentives, taking into account the level of wages in their region, the number of SMEs and other factors.

At the same time, the domestic system has a number of drawbacks, the main of which is its fragmentation, which is caused by the implementation of tax incentives through special tax regimes, along with the application of other tax benefits. Another significant problem of applying special tax regimes is a limitation in the choice of counterparties, as not every taxpayer agrees to no VAT on the purchase of goods, works and services. To apply preferential tax regimes, large businesses are often artificially divided into several smaller ones for the sole purpose of obtaining unjustified tax advantages and abusing an SMEs support system.

To conclude, it goes without saying that tax incentive practices promote the development of SMEs. Thus, in order to stimulate SMEs to expand sustainably, the government should set a goal to improve business climate through additional tax incentive measures. Tax incentive policies, including tax holidays, tax credits, tax rate reduction, tax exemption, should be further shaped to support sustainability and growth of SMEs. In addition, SME owners should fully realize and work towards proper utilization of tax incentives provided to them in order to maintain their high business performance and contribution to economic development.

BEHAVIOUR OF CREDITORS AND INVOLVED STAKEHOLDERS IN CORPORATE INSOLVENCY RESOLUTION PROCESS (CIRP) IN INDIA: AN ECONOMIC PERSPECTIVE

Hiteshkumar Thakkar[*] - Pranay Agarwal[**] - Randall K. Johnson[***]

ABSTRACT: *IBC has long clarified its purpose of achieving efficiency in the resolution procedure along with the welfare of the stakeholders. In order to achieve it, the code introduced Corporate Insolvency Resolution Process (CIRP) as a group solution mechanism in insolvency cases. While there is a plethora of studies focusing on the procedural and substantive working of the process, its influence over the behaviour and conduct of the stakeholders and its impact on its success has been ignored. Through this study, the author aims to develop a comprehensive economic model to explain the impact of CIRP on the creditor's behaviour and the consequential conduct which can be seen in the practical world. The model will utilize various economic tools and theories in order to answer the complex phenomena during the conducting of the CIRP process. Moreover, the suggestions given in the article can help mitigate the inefficient outcomes due to the existing laws and behaviour of creditors.*

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This paper is the result of a unitary approach and a common reflection by the three authors. However, section 1 to 5 and section 6 (first to third paragraphs) can be attributed, in particular, to Dr. Hiteshkumar Thakkar and Mr. Pranay Agarwal; section 6 (fourth to sixth paragraphs) can be attributed, in particular, to Professor Randall K. Johnson.

This paper is the outcome of the conceptual framework of research project titled, 'Impact Assessment of Corporate Insolvency Resolution Process (CIRP) in the State of Gujarat', Faculty Seed Grant Project (2022–2023), Gujarat National Law University, GNLU Centre for Law & Economics, Gandhinagar, Gujarat, India.

SUMMARY: 1. Introduction. – 2. Legislative framework of CIRP. – 3. Deterrence Effect Of CIRP. – 3.1. Cost-Benefit Analysis of CIRP and OCS. – 3.2. Hindrances in adopting a rational choice. - 3.3. Deterrence factor of CIRP. – 4. Mutual interaction of Creditors during Voting. – 4.1. Efficiency from the exclusion of operational creditors in the decision-making process. – 4.2. Interaction between big and small creditors during voting. – 4.3. Efficient outcome of the interaction. – 4.4. Comparison with other jurisdictions. – 5. CIRP and Behavioural Economics. – 5.1. Nudge Theory. – 5.2. Default effect. – 5.3. Behaviour influenced by other stakeholders. – 5.4. Prospect theory and loss aversion bias. – 6. Conclusion and Policy Recommendations.

1. Law is often termed as a 'social engineering' tool to balance the interests of various stakeholders in society, thus creating an economical solution to the conflicts among various stakeholders through efficient management of limited resources (Pound, 1902).[1] The sociologist perspective of the law brings out this distinct feature of the law and policies in detail which considers that the design of law can be determined only upon the collective thinking of the interest groups in terms of incentives (what is desirable) and disincentives or deterrence (what is not desirable or what causes an individual prevents from doing an act like punishment).[2]

CIRP is often called as a group solution, which resolves insolvency cases not through litigation or any other forceful manner but by giving an opportunity to the creditors and the Corporate Debtor (CD) to come up with an equitable resolution plan themselves. In such group solutions, therefore, the role of creditors becomes important to consider while analyzing and forecasting the outcome of CIRP proceedings. IBC, the central legislation for the insolvency legislative framework in India, also highlights the importance of creditors in deciding the company's fate as

[1] Pound, Roscoe (1902). Social Control through Law. Journal of Philosophy, 39 (20), pp. 559-560.
[2] The idea is based on the Marxist theory according to which the legal system of the society is one of the components of the 'superstructure' which exerts influence over the base or 'substructure' comprising of the forces governing the production of the necessities of the life.

a going concern. Therefore, it becomes crucial to study the behaviour and the conduct of the creditors before, during and after the proceedings.

The efficiency of any insolvency proceedings greatly depends on the behaviour of the stakeholders and the way they perceive the proceedings and their nuances. In this respect, to draw guiding insights, it is pertinent to comparatively analyze the insolvency regimes in other jurisdictions and the behaviour of the stakeholders in foreign jurisdictions like the United States (US), Australia and New Zealand. Although the socio-economic conditions will also influence the stakeholders' behaviour in the nation, the general interest of the majority of stakeholders remains the same irrespective of the jurisdiction (Hussain & Wihlborg, 1999).[3]

The proceedings of CIRP and the laws related with it are wide enough to decisively influence the creditors who might then behave in predicted manner which can be forecasted to increase both welfare and efficiency. In this regard, this paper aims to analyze the behaviour of the creditors from an economic perspective and predict the result of the proceedings and the conduct of the creditors after interacting with the legal provisions which decisively shape their behaviour. For that purpose, the paper is divided into five sections.

The first section deals with the relevant legislative framework which helps in influencing the behaviour of creditors. The second section deals with the deterrent factor of IBC and its impact on creditors and CDs while filing the application for initiation of CIRP. In the third section, the paper analyzes the behaviour and conduct of the creditors while voting in CoC based on their nature or the size of the debts they owe. The fourth section gives an application of Behavioural economics to the present problem in order to explain the actions of creditors. In the final section, the paper summarises its findings and observations and provides

[3] Hussain, Q., Wihlborg, C. (1999). Corporate Insolvency Procedures and Bank Behavior: A Study of Selected Asian Economies. United States: INTERNATIONAL MONETARY FUND.

with the relevant policy recommendations to address the inefficient behaviour and practices from creditors.

2. The CIRP as a process or its objective is neither defined under the IBC nor have the courts made any attempt in this respect. However, the objective of the CIRP as a process can be understood by the broad intention behind the enactment of IBC, which is to balance the rights of the creditors with the debtor company.[4] CIRP therefore unlike different from winding up and liquidation, where the sole focus is on the recovery of debt, provides a mechanism to both the creditors and the debtor to resolve the insolvency by a group solution, proposing a creditor-in-control model and also simultaneously providing for the debtor company to re-establish itself.

The process which IBC has evolved is complex on one hand, but it is also a scientific and systematic one. The process of CIRP begins with its initiation by filing the application under IBC either by the creditors (financial or operational) under Sections 7 and 9 of IBC, respectively or by the CD itself under Section 10 IBC. After it, the Adjudicatory Authority, i.e. the National Company Law Tribunal (NCLT) admits the application, and the process is commenced. After the admission of the application, the NCLT imposes a moratorium on any other proceedings against the CD and appoints Interim Resolution Professional (IRP) to manage the affairs of the company as a going concern. The IRP gives a public announcement and constitutes the CoC which then appoints Resolution Professional (RP).[5]

It is also important to note that the creditors are given an option to withdraw their application before the commencement of CIRP proceedings and

[4] As per the preamble of the IBC, the objectives of the law are to maximise the value of assets of the debtor, promote entrepreneurship, promote the availability of credit and balance the interests of all stakeholders in a time bound manner.

[5] An IRP is appointed under Section 16 of IBC by the NCLT on the date of commencement of CIRP whose main function is to constitute a Committee of Creditors (CoC) which consists of the financial creditors of the company and perform various management duties of the CD till the first meeting of CoC. The RP is appointed by the CoC, under Section 22 of IBC, to overtake the functions and duties of the IRP. It is interesting to mention that the IRP can be reappointed as the RP by the CoC which is generally the case.

before the constitution of CoC under Rule 8 of the IBC Rules and Rule 11 of the NCLT Rules respectively. But after the invitation of the Expression of Interest (EoI),[6] the withdrawal can only be allowed subject to the discretion of the court under Regulation 30A of IBBI Regulations 2016.[7]

The RP prepares the information memorandum and invites EoI from the Resolution Applicants. Based on the resolution plans prepared the CoC votes on the plan and the plan which gets the approval of 66% of the members gets approved and is then sent to NCLT for final approval. It is only after the approval of the Adjudicatory Authority (NCLT) that the resolution plan is binding and can be enforced upon the creditors. However, if the same is not approved by the CoC within the given time frame or is rejected by the NCLT, liquidation proceedings are initiated against the CD.

3. The provisions of the IBC and the introduction of CIRP to create incentives and disincentives in order to change the actions and behaviour of the stakeholders are in conformity to the purpose of bringing efficiency to the debt recovery process. While there are many facets of the CIRP which make it a more attractive option than the earlier debt recovery processes, creating an incentive towards faster insolvency resolution, the CIRP also indirectly creates a fear (deterrence factor) in the minds of the CDs (IBBI Report, 2021).[8] The process of CIRP as a way to resolve insolvency related conflicts and bring outcomes for the benefit of every stakeholder was introduced for the first time in the corporate debt market in India. The procedure ensures speedy recovery of corporate debts and adopts a "creditor-

[6] An Expression of Interest is invited by the RP under Section 25(2)(h) of IBC, to invite bids and resolution plans from the resolution applicants i.e. bidders for the debtor company.

[7] The insolvency regime in India is prominently governed by the IBC and other debt restructuring laws like SARFAESI Act which looks into the secured debt of the Banks and their recovery. However, the tribunals have been giving IBC prevalence over other laws making them inefficient solutions to the insolvency resolution problems. Further, the regulations formed by the Insolvency and Bankruptcy Board of India (IBBI), the regulator in the insolvency regime governs the procedural aspects subject to the scope provided under IBC.

[8] IBBI, Report of the working group on tracking outcomes under the Insolvency and Bankruptcy Code, 2016, Nov. 2021

centric" approach to give creditors to initiate the CIRP proceedings and take major decisions during the process (Kumar and Kavitha, 2021).[9]

In adopting this approach, the CDs are divested from their powers to control, manage and take the financial decisions of the enterprise and the powers are rather transferred to the appointed Interim Resolution Professionals (IRPs) and Committee of Creditors (CoC).[10] Though the intention behind adopting such an approach was to give creditors enough say in the financial decisions of the insolvent companies to help them recover their dues, the purpose of divesting the powers of the promoters and Board of Directors (BoD) of the CDs is the practical assumption that the interests of debtors and creditors are not in concurrence to make the debtors sole decision-makers in the matters where the interests of huge number of creditors is involved, thus implying injustice to several investors in the process (Mehta, 2018).[11]

However, the provision to divest the promoters from their management and control the enterprise the financial position of the enterprise, apart from giving more powers to the creditors to ensure speedy and efficient recovery, also instils fear in the minds of the promoters and directors of losing their powers in the enterprise and disruption in the business activities of the company (Tiwari, 2021).[12] If seen from the economic point of view, the CDs and their promoters are faced with the dilemma of choosing from the two options in order to achieve the

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[9] Kumar, S. Kiran and Kavitha, D. (2021) Bankruptcy Reforms in India – Progress and Challenges Ahead. ICCAP 2021, 7-8 December 2021, https://eudl.eu/doi/10.4108/eai.7-12-2021.2314625

[10] According to section 17 of IBC 2016, the management of the affairs of the CD is vested to the IRPs from the date of his appointment while such powers are then transferred to the RP under section 23 and CoC under section 28 after their appointment and formation respectively.

[11] The creditor centric approach of the IBC and CIRP proceedings was highlighted in the recent case of insolvency proceedings of Dewan Housing Finance Ltd. (DHFL) where the Mumbai NCLT opined that the promoters of CDs cannot impose any settlement on the CoC and the application can only be withdrawn by the creditors through mutual and real consensus. See Mehta, Sangita. Jul. 5, 2018. Conflict of interest in resolution plans may erode IBC credibility, The Economic Times. https://economictimes.indiatimes.com/industry/banking/finance/banking/conflict-of-interest-in-resolution-plans-may-erode-ibc-credibility/articleshow/64849092.cms?from=mdr.

[12] Tiwari, Dheeraj. Jul. 4, 2021. IBC review likely to keep promoters out, The Economic Times. https://economictimes.indiatimes.com/news/economy/finance/ibc-review-likely-to-keep-promoters-out/articleshow/83223260.cms?from=mdr.

maximum utility, thus making a rational choice in order to attain the maximum level of welfare.

The first option is filing an application before the NCLT for the initiation of the CIRP or tacitly accepting the approval given by the NCLT to initiate the CIRP proceedings in case the creditors file the application. In this case, the CIRP proceedings will be initiated against the CD and the promoters and BoD will be divested of their management powers and will be transferred to the newly appointed RP. The second option with the CDs is that they may choose to avoid the CIRP proceedings by filing an application of withdrawal under Section 12A of IBC, 2016 through the consent of the creditor applicants and settle the dues through an Out-of-Court Settlement (OCS).[13]

3.1. As rational individuals, the promoters and BoD of the CDs will make a rational decision to promote their and their enterprise's welfare in choosing between the two choices and in furtherance to that, will make a Cost-Benefit Analysis (CBA) to determine the market efficiency of both the choices and preference of the CDs. For a proper CBA, both the explicit and implicit costs and the benefits related to the choices have to be analyzed to reach to an efficient outcome and therefore the costs and benefits indirectly resulting in the change in the welfare of the CDs have to be taken into account (Kornhauser, 2000).[14]

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[13] Regulation 30A of the CIRP regulations requires reasons to be provided for an application to withdraw under s. 12A of IBC, 2016 if it is filed after the EoI (Expression of Interest) has been issued, thus providing for a safeguard to the creditors in unethical and manipulative withdrawing of CIRP applications by the promoters and BoDs.

[14] Kornhauser, Lewis A. (2000), On Justifying Cost-Benefit Analysis, The Journal of Legal Studies, 29(2), 1037-57

CIRP	OCS
RPs and CoC take control – no control of promoters	Creditors may recover more – loss to the assets of CDs
Disruption in the business	Judicial proceedings may be initiated in between the settlement
Danger of liquidation in case of failure of resolution Plan	
Pecuniary costs of CIRP	

Table 3.1: Costs of CIRP and OCS

The costs of both choices, as has been reflected in Table 3.1, include both the direct and indirect consequences of choosing those options which will negatively affecting the welfare of the CDs and their promoters, thereby giving the disincentive to choose that option. However, to properly analyze the impact of the costs on the decision-making of the CDs depends on the magnitude of the change they affect the welfare of the CDs. In this respect, it has been observed that the loss of control over the business and its financial operations, thus severely hurting the revenue of the enterprise has more affect on the utility value of the promoters and directors than the adverse effects leading to only pecuniary loss in short run (IBBI Report, 2021).[15]

CIRP	OCS
Moratorium from judicial proceedings	Faster resolution
No loss to assets – creditors have to adjust	No disruption in business
Faster resolution – no legal costs	No danger of liquidation
RP and CoC can raise interim finance to make CD remain operational till the CIRP process is completed	Less/no legal or other pecuniary costs
	No loss of control

Table 3.2: Benefits from CIRP and OCS

[15] IBBI, Report of the working group on tracking outcomes under the Insolvency and Bankruptcy Code, 2016, Nov. 2021.

In terms of benefits derived, if seen from the degree of the utility which will be maximised subjected to the benefits derived, the CDs and their promoters will feel more inclined towards safeguarding the business and its prestige at all costs to keep it running and thus would avoid such measures which will tarnish the image of the business (Sircar, 2022).[16] In this regard, the CDs will instead opt for the OCS than to go for CIRP where the enterprise will be declared insolvent publicly by the NCLT. Though there is a risk of litigation through which the public reputation of the enterprise will be even in a more daunting situation, the CDs and their promoters will be willing to take such a risk where there are chances that they may lose nothing (this behaviour on the part of the CDs will be explained in the later section of this chapter).

Moreover, it is clear from the above CBA that the Costs of CIRP (Cc) ≥ Costs of OCS (Co) and even if considering that the benefits are equal (in case promoters are not willing to make the risky decision and will rather choose CIRP where a moratorium is provided), the relationship between the costs and the benefits of both the choices as it stands **[Bc – Cc < Bo – Co]** explains that CDs, being rational beings, will make a choice to ensure their greater interest and therefore will go for the OCS instead of CIRP. The promoters therefore, will try to avoid the initiation of the CIRP and will rather withdraw from the proceedings and settle the dues of the creditors through an informal procedure.

Like IBC, the American laws for restructuring also do not provide for any legal incentive towards the settlement of debts. However, from the angle of CBA, the debtors have more benefits (Debtor in possession) than the costs of restructuring, thereby rendering the analysis in favour of the restructuring. If seen from the perspective of Oceanic nations like Australia and New Zealand, the

[16] There have been several instances where the promoters have tried to avoid the CIRP proceedings through an out-of-court settlement with the creditors so as to regain control over the business and its financial operations. However, as has been in the cases of Binani Cement, Gujarat NRE Coke and Essar Steel, the NCLT tries to safeguard the interest of the creditors by protecting from the manipulative resolution plans of the promoters. Sircar, S. and Roy, S., Withdrawal of CIRP may save corporate debtor. Mar. 4, 2022, https://law.asia/withdrawal-cirp-may-save-corporate-debtor/

settlement is given more importance than in the US law, thus promoting settlement (Chamorro-Courtland, 2021).[17] From a CBA as well, the costs of the settlement is minimized by the states to incentivize the stakeholders to settle their claims, which is evident by the favourable treatment the provisions of a Deed of Company Agreement get in the court of law [Part 5.3A Corporations Act (Aus)].

3.2. From a CBA, the CDs are more likely to take a rational decision in favour of OCS than the CIRP proceedings where there is an absolute risk of losing the control over the business and its management. However, according to the IBC, the withdrawing of the CIRP application pending before the NCLT can only be done by the applicant of such an application. As per the rational approach of the CDs and the supporting statistics, the CDs or their promoters rarely file such applications and most of them are rather filed by the (financial) creditors who seek the maximum welfare from their own perspective, which lies in the 'creditor-centric' CIRP proceedings (Annual Report, 2021).[18] This means that the application can only be pragmatically withdrawn through mutual consensus between the creditors and CDs.[19] The approach of creditors in this regard has been conditional with different outcomes seen in different cases.

While the creditors, in general, are not interested in withdrawing or getting benefits from a legal procedure instead of an informal procedure, the CDs in many instances have no choice but to cooperate in the smooth proceedings of CIRP, which they tried to avoid. If seen from an economic perspective, the CIRP in this case is diminishing the welfare of the CDs by placing restrictions on their free choice. Though the CDs may offer a better settlement plan to the creditors, which

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[17] Chamorro-Courtland, Christian, The Future of Clearing and Settlement in Australia: Part I - The Current System (July 12, 2021). Company & Securities Law Journals (Forthcoming in Vol 38 No 6, 2021), Available at SSRN: https://ssrn.com/abstract=3884972 or http://dx.doi.org /10.2139/ssrn. 3884972

[18] IBBI, Report of the working group on tracking outcomes under the Insolvency and Bankruptcy Code, 2016, Nov. 2021

[19] According to s. 29A of IBC, 2016, the promoters are not allowed to propose resolution plans before the CoC.

may lead to withdrawal of the CIRP application, the pecuniary loss to CDs (difference in the recovery given in CIRP and OCS) will be much higher to provide for the benefits accrued by adopting an informal procedure, thus leading to an inefficient outcome.

3.3. Given there is no real option available to the CDs in case of initiation of CIRP proceedings, the behaviour of the CDs will be influenced to avoid the very cause which leads to such filing of the application in the first place i.e. 'default' in repayment of debts, thus acting as a deterrent factor in the credit market of India. However, such deterrence will be conditional and subjective to the financial position and the reputation of the enterprise it enjoys in the market. This can be explained by the fact that opting for the first option will lead to a drastic change in the balance of costs and benefits of OCS (the extra amount given to the creditors to make them accept OCS and not go for CIRP will add to the costs of OCS), making the costs probably higher than that of CIRP. In this respect, the CDs enjoying high prestige in the market (having high business transactions), where the promoters and BoD of the CDs do not want to lose control of the business, would be deterred by the CIRP process whereas the smaller enterprises will instead prefer CIRP due to high claims of creditors in OCS (Annual Report, 2021).[20] Therefore, it is the behaviour of various interest groups on which the deterrence of the CIRP process can be inferred and not on the law itself, making the law less deterrent and effective.

In this respect, the deterrence factor can be enhanced to an optimum level through different set of laws for different types of CDs (large and small), which will establish different insolvency procedures and institutions for different CDs,

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[20] In Pankaj Agarwal v. Union of India, W.P. (C) 3685/2020 & C.M. APPLS. 13194/2020, 13195/2020, 13196/2020, the major contention was highlighted before the NCLT of the more benefits of CIRP to the MSMEs and their creditors than the enterprises with high market capital. IBBI, Report of the working group on tracking outcomes under the Insolvency and Bankruptcy Code, 2016, Nov. 2021

thereby increasing the efficiency in the insolvency process. In this regard, however, the rise in the case filing threshold from Rs. 1 lakh (INR 100 thousands) to Rs. 1 crore (INR 10 million) has made an adversarial effect by leaving out the debt of smaller CDs which is instead recovered efficiently through CIRP and not giving any incentive to the creditors of the larger and renowned CDs to opt for the OCS, thereby reducing the relative deterrence factor for the bigger CDs.

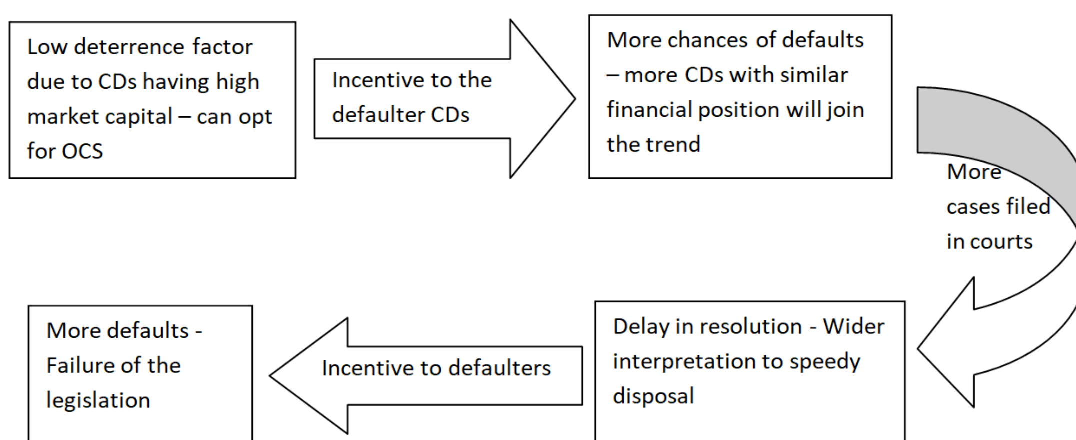

Fig. 3.1: Repeated Game theory of low deterrence

Such reduction in the deterrence factor has a multi-fold detrimental effect on the efficiency of the IBC and the provisions of CIRP. This can be explained through the repeated game theory model, which tries to analyze that the effect of an action or phenomenon leads to the cause of the same phenomenon, giving a multi-fold effect of the phenomenon. In a simple game theory model, there are two strategies available to the debtor - (a) cooperation which includes honouring debts on prior notice or entering into an informal agreement (OCS) with the creditors, or (b) non-cooperation, which includes defaulting loans and appropriation. In the case of the latter strategy, the IBC provides for the CIRP mechanism. However, the debtor in the process, incurs several costs in the form of time costs, loss of bargaining power, and loss of control over the company, thus raising the deterrence factor against defaulting or going for CIRP.

In this case, the reduction of the deterrence factor or the fear due to the increase in the threshold to file a CIRP application reduces the disincentive that was given to the prospective defaulters with huge market capital through CIRP. In simple terms, the debtors with high debts and huge bargaining power who can easily opt for OCS are instead given the option of CIRP and not the smaller debtors who will instead prefer CIRP due to less bargaining power. This means a reduction in the costs to the debtors which will lead them to make defaults in the initial stage. In a repeated game theory setup, such behaviour on the part of such CDs will incentivize other prospective defaulters (CDs) with similar market capital structures to default (Singh & Thakkar, 2021).[21] The huge number of defaults will in turn not only lead to increased litigations and resulting delays but also a broader interpretation of the laws for their fast disposal, giving CDs the upper hand over the creditors contrary to the intent of the legislation. By repeating the same thing over and over, the CDs will change their strategy from cooperative to non-cooperative, thereby ultimately increasing the defaults in future (See Fig. 3.1).

The deterrence factor is one of the important functions of insolvency regimes all over the world. In this regard, the laws of other nations differ in their approach and quantum of deterrence (fear/disincentive) depending on their socioeconomic conditions. The US Bankruptcy Act is often considered to be less deterrent in comparison to laws of other common law nations because of its debtor-in-possession principle and voluntary nature (Coleman, 1999).[22] However, if seen from the other perspective, the deterrence factor is maintained through other provisions like winding up and liquidation, which is applicable in case of failure of restructuring, thus making the voluntary administration and restructuring seem more viable for the debtor company.

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[21] Singh, R. and Thakkar, H. (2021). Settlements and Resolutions under the Insolvency and Bankruptcy Code: Assessing the Impact of Covid-19. Indian Economic Journal. 69(3): 568-583. doi: 10.1177/00194662211013218

[22] Coleman, P. J. (1999). Debtors and Creditors in America: Insolvency, Imprisonment for Debt, and Bankruptcy, 1607-1900. United States: Beard Books.

In the same manner, the Australian and New Zealand's insolvency laws provide deterrence through an alternate measure of liquidation, which the debtor avoids in normal circumstances (Morrison & Anderson, 2006).[23] Nevertheless, the deterrence factor given by these nations is different from that given by the CIRP which instead has its deterrence factor, thus incentivizing debtors to settle the dispute beforehand. In this respect, the Oceanic nations also provide for the settlement through a Deed of Company Agreement which also incentivizes the debtors to instead settle the claims than to go for the long-drawn process of administration.

4. As has been highlighted in the EU Insolvency Regulation, cooperation in the context of enterprise insolvency should be aimed at finding a solution so as to take care of the different interests of the stakeholders (Garcimartin, 2016).[24] In this aspect, the enactment of IBC and the resulting introduction of CIRP establish a cooperative process for resolutions leveraging various synergies across different interest groups and stakeholders.[25] While such a group solution (CIRP) entails deep concerns for the CDs, thus requiring greater attention towards prevention of their integrity upon the insolvency proceedings, the stakeholders like creditors of the entities also seek to ensure their welfare in this "game". With asymmetrical information in the credit market and different stakeholders present to ensure their maximum welfare, it is of specific concern to analyze as to which player (the

[23] Morrison, D., & Anderson, C. (2006). The Australian insolvency regime revisited: Précis of the next leap forward. *International Insolvency Review, 15(3),* 129-146.
[24] Garcimartin, Francisco, The EU Insolvency Regulation Recast: Scope and Rules on Jurisdiction (March 21, 2016). Available at SSRN: https://ssrn.com/abstract=2752412 or http://dx.doi.org/10.2139/ssrn.2752412
[25] A group insolvency solution is defined as "A proposal or set of proposals developed […] for the reorganization, sale or liquidation of some or all of the assets and operations of one or more enterprise group members, with the goal of protecting, preserving, realizing or enhancing the overall combined value of those enterprise group members." In this regard, see Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner's Report (Valukas Report) (2010), p 1550, describing Lehman's centralized intra-group cash pooling system.

creditor) will act in consonance with the actions of other players (Bernanke & Gertler, 1995; Meza & Webb, 1987).[26]

From a macroeconomic perspective, the card that a player (stakeholder) will play in this regard will decide the actions and behaviour of other stakeholders, thereby causing a chain of actions and events leading to an efficient or inefficient outcome. In the CIRP proceedings, where the creditors hold the key and the CDs are devoid of their powers and control of the financial operations of the business, their actions hold little relevance in the current analysis. Furthermore, the same can also hold true for the operational creditors who though given participatory rights to some extent, are rendered powerless when it comes to decision-making and voting.

4.1. Exclusion of the operational creditors from the decision-making procedure and CoC has been a point of debate since the enactment of the code and has been termed as contrary to the objective of the code to "balance the interests of all the stakeholders."[27] However, economic thought has to be given to the problem before reaching a final conclusion and deciding on the issue of affecting the efficiency of the resolution process by giving more voting rights to the operational creditors in the CoC. At present, the operational creditors can find their place in CoC only if their debt is more than 10% of the total debts or in case, the CoC lacks any financial creditors. In both situations, it is indicated that the operational creditors are given a lesser role in the insolvency process as compared to the financial creditors. But for an unbiased economic analysis of the outcome of the equitable treatment between the creditors, it is necessary to presume the non-existence of these discriminatory provisions.

[26] Bernanke, Ben S. and Mark Gertler. "Inside the Black Box: The Credit Channel of Monetary Policy Transmission." Journal of Economic Perspectives 9 (1995), 27-48; Meza, David de & Webb, David. "Too much Investment: A Problem of Asymmetric Information." Quarterly Journal of Economics 102 (1987), 281-292.

[27] Swiss Ribbons Pvt. Ltd. v. Union of India, Writ. petition (Civil) No. 99/2018.

In this regard, the mutual interaction between the behaviour, stipulations and actions of both creditors become necessary factors in reaching an efficient outcome. [28] Therefore, while making the decision on the particular issue, the creditors have the option of either rejecting or accepting the resolution plan which is presented before the CoC by RP. Presuming that the status of both the creditors is equal with voting share proportionate to their strength, rejection of the plan by any creditor will lead to rejection and thus liquidation, which is an inefficient outcome of the "game" as compared to the resolution. In this sense, even if the liquidation may recover the same amount of dues, the costs incurred in the process (C) make it a worse-off situation for both stakeholders.

OC

FC	ACCEPT	NOT ACCEPT
ACCEPT	R, R	R-C, R-C
NOT ACCEPT	R-C, R-C	R-C, R-C

OC

FC	ACCEPT	NOT ACCEPT
ACCEPT	R^R_F, R^R_O	$R^L_F - C$, $R^L_O - C$
NOT ACCEPT	$R^L_F - C$, $R^L_O - C$	$R^L_F - C$, $R^L_O - C$

Fig. 4.1: Game theory: Strategy of creditors while approving the resolution plan

If seen from a theoretically ideal view, both the players in order to maximise their own welfare will accept the resolution plan as the liquidation is a worse off condition for both the players. However, from a practical application, the recovery of the financial creditors is much more than that of operational creditors ($R_F > R_O$). The same holds true for the recovery amount which will be different from what is recovered from resolution (R^R) and liquidation (R^L). Though, the dominant strategy of the financial creditors will remain same in this context, the operational creditors

[28] IBC essentially differentiates the operational creditors i.e. creditors involved in day-to-day trade, and financial creditors i.e. actual lenders who provided loans and credit facilities to CD to raise money. While the financial creditors are given superior rights to not only represent their interest in CoC but also vote on the resolution plans, the operational creditors can be represented in CoC only if they constitute 10 percent or more of the aggregate debt with no right to vote.

may rather opt for liquidation, leading to an inefficient outcome (A rational choice given utility derived from $R^L_F - C$ by FCs < utility derived from $R^L_O - C$ by OCs).

While it may be counter-argued that the operational creditors will also stick to their dominant strategy due to more recovery in resolution ($R^L_O - C < R^R_O$) and will thus make a sacrifice in long run to reach a Pareto efficient solution, it is pertinent to consider that the operational creditors are more vulnerable to the asymmetrical information in the credit market than the financial creditors and are more likely to ignore the costs which will be incurred in initiating liquidation process, thus making an irrational choice. Therefore, while the financial creditors will always stick to their dominant strategy i.e. accepting resolution plans, knowing the adverse consequences of the rejection, this may not hold good in the case of operational creditors, hence making the operational creditors left out of the decision-making process of CoC an economically efficient solution, ensuring the welfare of both the creditors.

4.2. Though the lawmakers have ensured some level of efficiency in the CIRP proceedings and its outcomes by rejecting the rights of the operational creditors, the voting procedure in the CoC and the division of the voting share between the financial creditors (FCs) presents another facet of the interaction of the creditors among themselves. As per the IBC, the voting share of the creditors is proportionate to the financial debts the CD owed to them. In simple terms, the voting share of each creditor will be the proportion of the financial debts owed to the FC in relation to the total debt owed by CD towards all members of CoC, thus giving more rights to the creditors with more debt owed. Such division of the voting share gives rise to new players in the CIRP process – Creditors with bigger debts owed (bigger creditors) and Creditors with smaller debts owed (smaller creditors).

Though both the creditors are financial creditors sharing the same level of knowledge and nature of interest during the voting, both the creditors differ

significantly in terms of their nature and size and mode of the debt they owe. In the “game” which is then set up during the voting procedure, the influence of the interest of bigger creditors will be much larger to the interests of smaller creditors due to the bigger voting share to the former, thus leading to a danger of sacrificing of the interests of the smaller creditors during the voting. In this respect, the interests of the bigger creditors are given preference over that of the smaller creditors and the resolution plans approved to lead to greater welfare maximization for bigger creditors than that for the smaller creditors. If seen from an economic point of view, the Pareto efficiency has been reached in this sense, irrespective of the difference in the rise in welfare. However, less attention has been given to the number of creditors each category holds and the aggregate welfare which is accrued due to the approval of the resolution plan for both types of creditors.

SC

BC	ACCEPT	NOT ACCEPT
ACCEPT	R, R	L, l
NOT ACCEPT	L, l	L, l

SC

	ACCEPT	NOT ACCEPT
ACCEPT	R, R	R, r
NOT ACCEPT	L, l	L, l

Fig. 4.2: Game theory: Mutual interaction between big and small creditors during voting

Before the amendment of 2020, the voting threshold to approve a resolution plan was kept higher (75%). In this situation the smaller creditors had a larger say in the voting process and were able to influence decisions in a major way so as to promote their interests and welfare and thus the plans were required to be approved by both the creditors to get accepted by the CoC. However, the chances of resolution from such mutual interaction were far lower than that of liquidation. Also due to such low probability of getting the plan approved and accumulation of the interests of more creditors, the speediness of the process was declining.

Thus, with the intent to increase the probability of the resolution plans getting approved and reducing delays in getting the CoC approval, the amendment of 2020 reduced the voting threshold to approve the plan to 66%. While the move was able to increase the chances of resolution plans of getting approved by CoC, it indirectly led to the infringement of the powers of the smaller creditors during the voting.

Here, as can be seen, due to the reduced voting threshold for the approval, the bigger creditors will have bigger say (due to the higher voting share allotted to them) which makes their dominant strategy more significant than the dominant strategy of the smaller creditors (R > r; L > l). Therefore, in case of weakling dominant strategy of the smaller creditors i.e. rejecting the plan, the outcome will depend upon the decision of the strategy of the bigger creditors. In case, the plan is favourable to the bigger creditors, the decision of the smaller creditors thus, is of little relevance.

Though the action successfully leads to the more resolutions and less liquidations as the outcomes of the CIRP (goal of the government), the aim of efficiency is instead remained unachieved. As can be seen in the figure, the acceptance of the resolution plan by both the parties remains the Pareto efficient solution. But as the smaller creditors are larger in number than the bigger creditors, the utility attached to the resolution plan and the recovery is greater in case of smaller creditors. Therefore, although the chances of resolution have been increased, the utility derived is lesser than the Pareto efficient solution (R > r).

4.3. In every case, the recovery rates from the liquidation has been lower than from that of CIRP, thereby indicating the importance of the CIRP and the preferred choice of the creditors towards the resolution (R/r > L/l). Therefore while deciding on the approval of the resolution plan, both big and small creditors will instead try to reach to a resolution plan and due to the lower voting share, the smaller creditors will remain intact to their strategy i.e. voting for the resolution

plan (Nash Equilibrium) thereby playing the sacrifice game. However, this sacrifice will only be relevant if it is long run and not in short run which will instead reduce the welfare of the sacrificing party in the benefit of the gaining party.[29] Thus, efficiency can only be reached if the resolution plan satisfies both the parties in complete and equal terms.

For that due recognition has to be given to the votes and decisions of the smaller creditors by the RP. The voting procedure can be changed in this regard to classify the smaller and bigger creditors in different categories and the threshold of approval required through voting from each category separately. Furthermore, a specific voting threshold can be fixed which is required from the smaller creditors to approve the resolution plan (E.g. 67 % of total creditors should vote for the resolution which shall include 60% of all smaller creditors) which will lead to shift in the approach of the bigger creditors and in moving the resolution plan from being centred around interests of a specific group of creditors to a cooperative solution signifying the protection of the interest of every creditor.

4.4. While in the Indian scenario, such analysis is suitable due to the differentiated treatment by the IBC, the situation in the other jurisdictions is quite different due to the different classification adopted by the law. In US like most of the foreign jurisdictions, secured creditors are given preference over the unsecured creditors (Deakin et al, 2017).[30] However, an equitable measure has also been provided where all creditors are given the right to vote with the democratic principle of "one vote one value" (Frost, 2013).[31]

In Australia and New Zealand too, the US model of classification and voting has been adopted thus giving preference to the secured creditors while

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[29] In long run, the sacrifice made by a party for the benefit of the other party will be made by the beneficiary party while also undertaking to make the similar sacrifice in the next game to benefit the present sacrificing party.

[30] Simon Deakin, Viviana Mollica, Prabirjit Sarkar, Varieties of creditor protection: insolvency law reform and credit expansion in developed market economies, *Socio-Economic Review*, Volume 15, Issue 2, April 2017, Pages 359–384, https://doi.org/10.1093/ser/mww005

[31] Christopher W. Frost, Bankruptcy Voting and the Designation Power, 87 Am. Bankr. L.J. 155 (2013).

maintaining equity in the voting. Although it can be contended that the Indian law is better which instead makes no distinction between secured and unsecured creditors, the differential treatment given to the operational creditors as well as creditors with smaller claims in the voting procedure makes it less efficient.

5. While laws seek to enforce a certain kind of behaviour in the society, the mechanism through which it directly or indirectly influences the behaviour and psychology of the agents to do the certain actions or act in a certain behaviour as required to achieve the intent of the legislation is an interesting area of study (Shefrin, 2000).[32] In this aspect, it was Friedman (2001), who recognised the importance of behavioural economics in giving practical repercussions of the law through which the economic agent's choice behaviour from the list of choices presented before him can be analyzed and explained.[33] In analyzing such aspects of law, it is pertinent to see that in economic terms, the human behaviour is centred on itself which aims at maximizing the utility from a "stable set of preferences and accumulate an optimal amount of information of information and other inputs in a variety of markets" (Becker, 1976).[34]

The IBC, 2016 was too introduced to alter the behaviour of the stakeholders and agents in the Indian credit market towards a more cooperative, efficient and speedy resolution of the insolvency cases to ensure maximum welfare to every stakeholder instead of opting for the litigation and other measures under debt recovery laws. Nevertheless, the economic analysis of the code and the CIRP procedure will be incomplete without looking at the behavioural side of the law

[32] Shefrin H., 2000. Beyond Greed and Fear: Understanding Behavioural Finance and the Psychology of Investing.

[33] According to Friedman, "legal rules are to be judged by the structure of incentives they establish and the consequences of people altering their behavior in response to those incentives." Friedman D. David (2000). Law's Order: What Economics Has to Do with Law and Why It Matters. Princeton University Press, 2000.

[34] Becker S. Gary (1976). The Economic Approach to Human Behavior. University of Chicago Press Books.

and the incentives and disincentives it has created to ensure the accomplishment of its intended objectives.

5.1. Nudge theory, a relatively newer concept in the discipline of behavioural sciences, is mainly concerned with the designing of choices and has based its argument on the presumption that people act and behave in an uncertain or instinctive and yet predictable manner (Thaler & Sunstein, 2008).[35] The theory therefore is the direct counterpart of the major assumption behind the economic decisions of the agents (rational choice) and instead proposes that the people make decision with an irrational mind which can be estimated in long run. If seen from an economic perspective, it is important to clarify that "Nudges" are not per se mandates or actions of the government to control the market behaviour of the people but are instead is a choice architecture that alters people's behaviour in a predictable manner without disrupting the free market and free choices (Saghai, 2013; Parkinson et. al., 2014).[36]

Therefore, the characteristics of a free market remain intact allowing people to choose without any incentive or disincentive from the government. However, the move of the government will indirectly affect the behaviour of the people who will choose the desired option.[37] For instance, keeping fruits near the cash counter will gather more attention of the consumers leading them to buy them than banning junk food or changing prices of fruits or junk food to alter the behaviour of

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[35] Thaler, Richard; Sunstein, Cass (2008). Nudge: Improving Decisions about Health, Wealth, and Happiness. New Haven, CT: Yale University Press.

[36] Saghai, Yashar (2013). "Salvaging the concept of nudge". Journal of Medical Ethics. 39 (8): 487–93. doi:10.1136/medethics-2012-100727; Parkinson, J.A.; Eccles, K.E.; Goodman, A. (2014). "Positive impact by design: the Wales centre for behaviour change". The Journal of Positive Psychology. 9 (6): 517–522. doi: 10.1080/17439760.2014.936965.

[37] The British government led by PM Boris Johnson relied on the nudge theory to fight the coronavirus pandemic and encourage "herd immunity" with the strategy. Anthony Costello, "The UK's Covid-19 strategy dangerously leaves too many questions unanswered". *www.theguardian. com. 15 March 2020.*

the consumers (Arvai et. al., 2014; Gestel, 2018).[38] In this case, the nudge was created by analyzing the consumer behaviour in the groceries while shopping and the instinctive decisions they make not even knowing it (consumer bias).

The IBC, 2016 too in this sense have attempted to create both positive and negative nudges in order to alter the behaviour of the stakeholder towards the debt recovery and insolvency processes by using the common biases which lead even the rational stakeholders to take instinctive decisions attributed to their behaviour towards the acts and behaviour of other agents as well as the resulting events.

Like the IBC, the insolvency regimes of US, Australia and New Zealand also provides for a positive nudge towards restructuring and amicable settlement of the claims. If seen from the American perspective, the debtor in possession principle attached with the restructuring coupled with the deterrence of liquidation provides a positive nudge towards the restructuring to the Corporate Debtors. The laws of Australia and New Zealand also provide a positive nudge by giving the alternatives like Liquidation and Deed of Company Agreement which generally has higher costs compared to the voluntary administration.

5.2. IBC, 2016 provides for various types of insolvency process including Liquidation and OCS (withdrawing of CIRP allowed under s. 12A is indirectly providing for it) in cases of corporate insolvency. But at the same time, the code, in order to give preference, makes the CIRP as the first or default choice under s. 6 and liquidation only ensures in cases where the CIRP i.e. the default option fails to provide for an effective resolution (s. 33 of IBC, 2016). In this respect, OCS too is although not mentioned anywhere in the code but is considered as a procedure

[38] Campbell-Arvai, V; Arvai, J.; Kalof, L. (2014). "Motivating sustainable food choices: the role of nudges, value orientation, and information provision". Environment and Behavior. 46 (4): 453–475. doi: 10.1177/0013916512469099; Van Gestel, LC (2018). "Nudging at the checkout counter - A longitudinal study of the effect of a food repositioning nudge on healthy food choice". Psychol Health. 6 (33): 800–809. doi: 10.1080/08870446.2017.1416116.

which needs to be deliberated and pre-mediated before its initiation (withdrawing of CIRP application needs consensus of creditors). Thus, the code allowing various methods to the creditors and CDs to initiate proceedings, the first option (default option) which has to be exercised is to initiate the CIRP proceedings by filing an application to NCLT.

In this sense, by giving CIRP as the default option to the stakeholders, the code seeks to create a positive nudge towards a group solution in coordination with all the stakeholders than to promote bidding and liquidation where some parties may win and some may lose. In this aspect, the code has made use of the behaviour of the people to choose the first option or the default option given to them and not look for any other alternatives, popularly known as "Anchoring Bias" (Cen et. al., 2013).[39] However, the code has ignored an important aspect of the bias that the behaviour of the people was attributed to their ignorance of the other options and the utility they may derive from them.

The stakeholders in the credit market, particularly financial creditors and CDs, are already aware of the law and the legal consequences of their actions, thereby making them behave in accordance to the utility maximization than to the default choice (Prasad, 2019).[40] Though the CDs and financial creditors may behave in an unintended manner contrary to the anchoring bias, nevertheless, the CIRP being a more efficient measure to the majority of the stakeholders, will provide incentive to the stakeholders to stick to the default option than to going for other options.

However, unlike IBC which provides CIRP as a default option, the insolvency regimes in US, Australia and New Zealand do not give such an option and instead

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[39] Cen, L., Hilary, G., & Wei, J. (2013). The Role of Anchoring Bias in the Equity Market: Evidence from Analysts' Earnings Forecasts and Stock Returns. The Journal of Financial and Quantitative Analysis, 48(1), 47–76. http://www.jstor.org/stable/43303792.

[40] Prasad, Vipul. Anchoring bias in investments: Awareness and assessment can act as first line of defence. *Financial Express*. May 9, 2019. https://www.financialexpress.com/opinion/anchoring-bias-in-investments-awareness-and-assessment-can-act-as-first-line-of-defence/1572769/

provides it as one of the options on the discretion of the creditors and the court (adjudicatory authority) (Hannan, 2018).[41]

5.3. Various psychological studies have shown that the behaviour of the people in a group is greatly influenced by the conducts and behaviour of the other members of that group (Janis, 1972).[42] The major reason for the same can be attributed to two individual biases. As per studies, people with a little or incomplete knowledge and experience consider people around them to have superior knowledge and experience regardless of their actual competence. This bias is known as social proof heuristics or commonly called as 'herd behaviour' (Kroese & de Ridder, 2017).[43] In this sense, the code through the introduction of CIRP has tried to incentivize the financial creditors (investors and financial institutions) who considerably have superior knowledge and experience in the credit market. With bigger players (bigger financial creditors) going for the initiation of CIRP due to the preference given to them in the process, the "less experienced" smaller players will follow their lead, thereby inducing their behaviour towards the CIRP.

However, it may be then pointed out that the OCS is equally viable option for the big creditors who may refuse to initiate such proceedings against the CDs in favour of the informal settlement and clearance of their dues (Singh & Thakkar, 2021).[44] In such case, the smaller creditors will suffer where the CDs have more bargaining power than the creditors. But for the OCS to happen, the majority of

[41] Hannan N. (2018). A case for insolvency law reform in Australia. *Australian Restructuring Insolvency & Turnaround Association Journal*, 30(1), 30-34. https://search.informit.org/doi/abs/10.3316/ielapa.509194596579552

[42] Irving Janis, Victims of Groupthink: A Psychological study of foreign –policy decisions and Fiascoes 78-169 (Houghton, Mifflin 1972).

[43] Heung, T.; Kroese, F.; Fennis, B.; de Ridder, D. (2017). "The hunger games: using hunger to promote healthy choices in self-control conflicts" (PDF). Appetite. 116: 401–409. doi: 10.1016/j.appet.2017.05.020

[44] Singh, R. and Thakkar, H. (2021). Settlements and Resolutions under the Insolvency and Bankruptcy Code: Assessing the Impact of Covid-19. Indian Economic Journal. 69(3): 568-583. doi: 10.1177/00194662211013218

the creditors should agree with the withdrawing of CIRP application and with larger number of creditors being small with lower debts owed, the OCS, if it happens, will be in benefit to the smaller creditors as well, thus ensuring an efficient outcome.

The second bias relates to the negative nudge created by the society or the group against some non-preferable actions or choices (Bicchieri and Dimant, 2019).[45] In this instance, the people are informed of their deviant behaviour and the ill consequences of the same, thus inducing the person to alter his behaviour in line with the described social norm. The IBC in this regard has tried to deter the CDs from defaulting through various disincentives and has created a positive trend towards lesser defaults in the Indian credit market. Moreover, by incentivizing the creditors for opting CIRP, the code has promoted a coordinated solution in the minds of the stakeholders.[46]

Unlike Indian insolvency regime which provides variety of options with different framework, approach and procedure, the laws in US, Australia and New Zealand majorly provides for winding up, liquidation, settlement and restructuring (Administration). In this regard, it is also important to highlight that while such categorization is narrow in comparison to that of India, the big and influential stakeholders like corporate debtors, secured creditors and big financial institutions influence the procedure as well as the approach of the non-influential stakeholders (Routledge & Morrison, 2012).[47]

Such influential stakeholders will therefore try to adopt such procedure to promote their interest. Nevertheless, the impact of such stakeholders will be much lesser than that in India due to the democratic value of 'one vote one value' and

[45] Bicchieri, C. and Dimant, E., Nudging with Care: The Risks and Benefits of Social Information (April 19, 2019). Public Choice (2019). doi: 10.1007/s11127-019-00684-6

[46] Incentives are provided in the form of higher preference given to the financial creditors during the voting process along with greater allotment of the management powers of the promoters and BoD of the enterprise to the CoC to safeguard the interests of the creditors.

[47] Routledge, J., & Morrison, D. (2012). Insolvency administration as a strategic response to financial distress. *Australian Journal of Management*, *37*(3), 441–459. https://doi.org/10.1177/0312896211428494

equitable treatment given to every class of creditor, thereby making them only socially and politically influential.

5.4. It is always said that *"the losses loom more to a man than the happiness he receives from the similar gains"* (Kahneman & Tversky, 1979).[48] The statement here highlights the loss aversion bias of an individual on which the prospect theory is based. The theory is the standpoint on the behaviour of the investors while making investment in the market, propounding the behavioural outcomes of the investors while making investing decisions and taking risky choices (Waweru et. al., 2008).[49] In simple terms, according to it, when faced with a risky choice, the decision of the person will depend on the result of such choice and the alternative non-risky choice (Barberis et. al., 2006).[50] For instance, if the investors faces a risky choices leading to gains (100% chance to gain 450$ or 50% chance of winning 1000$), the behaviour of the investor will be risk averse due to the instinct that he may not get anything in the riskier choice. Quite contrary to it, in cases of risky decisions leading to losses, the behaviour will be risk taking due to the instinct of losing nothing in the later case (Kahneman & Tversky, 1986).[51]

If seen from micro-economic terms, the situation is opposite to the rational decision of the investors who should have acted in a rational manner so as to maximise their utility instead of saving their existing utility. IBC, 2016 on the same lines, divests the promoters of CDs of their powers to manage financial operations of the enterprise and instead gives it to the CoC and RPs. In this respect, the promoters are in a similar situation where they are offered two choices. If CIRP is

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[48] Kahneman, D., & Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica, 47*, 263-291.
[49] Waweru N.M., Munyoki E. and Uliana E., 2008. The effects of behavioural factors in investment decision-making: a survey of institutional investors operating at the Nairobi Stock Exchange International Journal of Business and Emerging Markets, 1(1): 24-41.
[50] Barberis, Nicholas; Heung, Ming; Thaler, Richard H. (2006). "Individual preferences, monetary gambles, and stock market participation: A case for narrow framing". American Economic Review. 96 (4): 1069–1090, doi: 10.1257/aer.96.4.1069.
[51] Tversky, Amos; Kahneman, Daniel (1986). "Rational Choice and the Framing of Decisions". The Journal of Business. 59 (4): 251–278. doi: 10.1007/978-3-642-74919-3_4.

initiated they will be surely be divested from their powers to control the enterprise but if they prefer to settle the dues beforehand, there is a chance that a settlement is made between them and the creditors which is less damaging to the enterprise than what had been the outcome of the resolution process but at the same time it might get more damaging than what would be after resolution.

In this case, the promoters of the CDs will instead try to avoid defaults and rather will try to settle the dues of the creditors before the initiation of the CIRP proceedings. Although it might happen that the settlement cost more to the CDs than the CIRP would have, it is instinctive risk taken by the CDs in order to prevent disruption in the business activities and ensure survival of the enterprise.[52] Such an alteration of the behaviour on the part of the CDs and their promoters constitute an effective deterrent factor of the code and the CIRP proceedings, thereby leading to less defaults and increased investing sentiments in the credit market.

In the US insolvency regime also, the debtor is given two choices in case of inability to pay debts. Either the debtor will prefer voluntary initiation of administration or will rather file voluntary winding up or liquidation petition (Chapter 11, Bankruptcy Code). In this situation, due to high benefits accrued with the administration, the loss aversion is towards the administration and restructuring. Similarly, the laws in Australia and New Zealand give the two choices of restructuring and settlement to the debtor. However, in this context, due to the incentives given to the settlement, the loss aversion is instead towards the settlement. Moreover, in all three jurisdictions, the laws provide a deterrence factor to the debtor for the timely payment of dues.

6. IBC has attempted to introduce a group solution in the form of CIRP. The mechanism not only provides for more efficient resolution plans but is also able to

[52] According to the Economic Survey 2021-22, as many as 18,629 applications for initiation of CIRP (Corporate Insolvency Resolution Process) of CDs having underlying default of Rs 5,89,516 crore were resolved before their admission till September 2021.

influence the behaviour and the subsequent conduct of the creditors as well as the CDs. Considering that the stakeholders are rational beings, they would prefer the OCS instead of the CIRP or litigation. It cannot be denied that OCS are more efficient than CIRP in the current times where a huge time costs have to be incurred by both CDs and creditors. However, a CIRP application will be filed by the creditors in the first instance, considering the individual welfare in group solutions. Therefore, in this case, CIRP will instead serve the purpose of deterrence, which will increase the probability of successful OCSs which will not only the serve the purpose of debtors but also ensure the welfare of creditors.

However, the reduction of the threshold for filing the application to initiate CIRP has greatly hindered the deterrence function of CIRP. While it is accepted that the move was to reduce the cases to trivial cases and the cases guided with wrong motivations, a separate mechanism can be adopted which can serve as an effective deterrent mechanism for the CDs. In this respect, it is important to highlight that the government introduced the pre-packaged insolvency resolution process (PPIRP) for Small and Medium enterprises, its efficiency with respect to deterrence is lesser in comparison to CIRP due to non-availability of the option of withdrawal and OCS. Therefore, it is recommended that the option of withdrawing PPIRP application at various stages should be clearly defined in IBC and its related regulations and a clear mechanism should be provided for the insolvency cases with claims ranging from INR 100 Thousands to INR 10 million for which CIRP application cannot be filed.

Moreover, the behaviour of the creditors during the voting process is more or less influenced not only by the CIRP proceedings but also by the nature and the quantum of the debts the CD owes them. In this regard, a differentiation can be made between the small creditors and big creditors who have relatively more voting shares. To make use of such behaviour, the government came up with a reduction of the voting threshold required for approving the plan. However, though such a move was successful in achieving its objective of increasing

successful resolutions, it indirectly affected the welfare of the small creditors who have lesser say in the resolution procedure. Therefore, instead of reducing the voting threshold, a specific threshold should be fixed which is mandatorily required from the smaller creditors to approve the plan along with the general approval threshold. This system will be similar to an effective majority vote system followed in Parliaments of India and UK to ensure a balance between welfare and efficiency.

If viewed from the perspective of behavioural economics, IBC has achieved its objectives by creating various incentives that alter the behaviour of creditors and CDs towards the CIRP. In this regard, making the mechanism a default option and creating herd behaviour is largely successful in channelizing the behaviour of the stakeholders, thus giving them an indirect incentive to opt for the CIRP for the resolution of insolvency matters as well as for recovering dues.

It is well established, in a variety of other contexts, that administrative agencies who create incentives for regulated parties to makes better use of their scarce resources also tend to be viewed more favourably.[53] These introspective institutions, which may include the District of Columbia Recorder of Deeds in the United States, also benefit from the trust they engender in others.[54] One such benefit could include increasing the standards that regulated parties impose on themselves.[55]

Therefore, when viewed in light of previous administrative agency experiences within country and abroad, it can be safely concluded that the CIRP is a useful debt recovery mechanism which also provides an efficient solution to a seemingly intractable problem. However, as illustrated in this paper, this resounding success is not due solely to the increased procedural efficiency of the

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[53] *See* Randall K. Johnson, How The United States Postal Service Could Encourage More Local Economic Development, 92 CHI. KENT L. REV. 593, 597 (2017) ("explaining that "least cost avoiders tend to be more introspective than otherwise similarly-situated parties.").

[54] *See* Randall K. Johnson, Frederick Douglass And The Hidden Power Of Recording Deeds, 95 S. CALIF. L. REV. POSTSCRIPT 54, 68 (2022) (explaining that "the D.C. Recorder came to be viewed as a means of ascent for ambitious … politicians across the country.").

[55] *Id*.

insolvency process but also to the influence that IBC has on the behaviour of the parties. This fact is evidenced in a number of ways, which include the impact that reforms have upon even the withdrawals of the applications and OCSs. Nevertheless, the behaviour it induces at times also has led to the sacrifice of one of the major goals of this process i.e. welfare of the stakeholders. While the damage can be said to have been compensated through the benefit it provides to other stakeholders, to ensure that the spirit of the group solution remains in the proceedings, the same has to be rectified through appropriate legislation or policy. Thus, it is a clear position that though CIRP has been successful to a much extent, more steps have to be taken to make it a complete success in the coming years.

PRUDENTIAL REQUIREMENTS FOR PAYMENT INSTITUTIONS: A EUROPEAN UNION PERSPECTIVE IN VIEW OF PSD3

Ciro G. Corvese*

ABSTRACT: *This paper focuses the attention on a particular topic not much discuss in doctrine: the prudential requirements for payment institutions. Like all other intermediaries operating in the financial market, payment institutions are subject to strict prudential regulations concerning the request for a specific authorization. For supervisory authorities to release that authorization, payment institutions must comply with some requirements that primarily concern legal form, ownership of shares, capital and other funds. The existence of these requirements is a necessary condition for obtaining authorization, which is subject to stringent rules that concern not only the issue of said authorization but also its maintenance and possible revocation. The principal aim of this paper is to focus the attention on the rules providing important prudential requirements like ownership, own funds, the identity of directors and persons responsible for the management, internal control system, seeking to grasp differences and/or similarities with financial market regulations on other intermediaries (banks and insurance companies) considering, inter alia, the possible effect of the new proposal of PSD3.*

SUMMARY: 1. Premises: object and limits of the research. - 2. The Authorization and Its Requirements: The Importance of Prudential Requirements. – 2.1. The Prudential Requirements: some Preliminary Notes. – 3. The Ownership Rules: two Different Profiles. – 3.1. The Requirements of Qualifying Shareholders. – 3.1.1. Reputation requirement if the applicant is a natural person. – 3.1.2. Reputation requirement if the applicant is a legal person or an entity. – 3.1.3. Common rules for the reputation requirement required both for natural persons and for legal person or entity. – 3.2. Disclosure of Relevant Shareholdings. – 4. The Integrity of Own

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Funds: Initial Capital and Safeguarding Requirements. – 4.1. Supervisory Capital: Amounts And Three Methods for Calculation. – 4.2. Safeguarding Requirements. – 5. Specific Provisions for PI Corporate Governance. – 5.1. Introduction – 5.2. The Identity of Directors and Persons Responsible for The Management. – 5.3. Internal Control Mechanism and its Importance for Anti-Money Laundering and Counter Terrorist Financing. – 6. The Authorization Procedure. **–** 7. *De Iure Condendo*: towards PSD3.

1. This paper focuses the attention on a particular topic not much discuss in doctrine: the prudential requirements of payment institutions (hereinafter PIs for the plural and PI for the singular). Like all other intermediaries operating in the financial market, PIs are subject to strict prudential regulations concerning the request for a specific authorization. For supervisory authorities to release that authorization, PIs must comply with some requirements that primarily concern legal form, ownership of shares, capital and other funds. The existence of these requirements is a necessary condition for obtaining authorization, which is subject to stringent rules that concern not only the issue of said authorization but also its maintenance and possible revocation.

The principal aim of this paper is to comment the articles of PSD2[1] regarding ownership, own funds, the identity of directors and persons responsible for the

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[1] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, OJ L 337, 23.12.2015, p. 35–127.
For a systematic comment of PSD2 see GIMIGLIANO and BOŽINA BEROŠ (eds), *The Payment Services Directive II. A Commentary*, (Elgar 2021). Regarding the implementation of PSD2 in the Italian legal system see, *ex* multis¸ RISPOLI, SANTORO, SCIARRONE ALIBRANDI, TROIANO (eds), *Armonizzazione europea dei servizi di pagamento e attuazione della direttiva 2007/64/CE*, Milano, 2009; CAPRIGLIONE (eds), Commentario al Testo unico delle leggi in materia bancaria e creditizia, T. 3, Padova, 2018, specially comments to Articles 126 bis-novies, p. 2243 ss.
In this research we do not consider other aspects of PSD2 like, open banking, consumer protection and so on. Regarding these aspects see CAPRIGLIONE, *Law and economics. The challenge of artificial intelligence*, Law and Economics Yearly Review, 10(2), 2021, p 189; RABITTI and SCIARRONE ALIBRANDI, *I servizi di pagamento tra PSD2 e GDPR: Open Banking e conseguenze per la clientela*, in CAPRIGLIONE, (ed.), *Liber Amicorum Guido Alpa*, CEDAM, Padova 2019, p. 711- 735. About the relation between PSD2 and GDPR see FERRETTI and PETKOFF, *Open finance and consumer protection: uneasy bedfellows*, Law and Economics Yearly Review, 11(2), 2022, p 261.

management, internal control system[2], seeking to grasp differences and/or similarities with financial market regulations on other intermediaries (banks and insurance companies) considering, inter alia, the possible effect of the new proposal of PSD3.[3]

This work establishes licensing requirements and prudential rules for PIs, i.e., financial institutions other than credit institutions authorised to professionally operate as payment service providers, according to Article 1 PSD2[4]. Detailing the PSD2 licensing rules, the EBA has issued guidelines (EBA/GL/2017/09, hereinafter EBA Guidelines) on the information to be provided for authorisation/registration of any type of PIs.[5]

It is made up of a further eight paragraphs: paragraph 2 focuses on the rationale for the authorization process and what appears new, drawing a comparison between PSD1[6] and PSD2; paragraphs 3 and 4 examine prudential

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[2] There are no specific references concerning the profiles that will be dealt with in this research work. For all of them, refer to JANCZUK-GORYWODA, *Public-Private Hybrid Governance for Electronic Payments in the European Union*, German Law Journal, (2012) 13, pp. 1435-1455; JANCZUK-GORYWODA, *Evolution of EU Retail Payments Law*, European Law Review, (2015) 40, p. 858, p. 862 and JANCZUK-GORYWODA, *Enforcing Smart: Exploiting Complementarity of Public and Private Enforcement in the Payment Services Directive 2 (PSD2)*, in CHEREDNYCHENKO and ANDENAS (eds), *Financial Regulation and Civil Liability in European Law* (Elgar 2020).
Most important about the effectiveness of PSD2 is EUROPEAN COMMISSION, A *study on the application and impact of Directive (EU) 2015/2366 on Payment Services (PSD2) FISMA/2021/ OP/0002*, available at link https://www.ecri.eu/sites/default/files/a-study-on-the-application-and-impact-of-directive-ev0423061enn.pdf.

[3] We wish to refer to Proposal for a Directive on payment services and electronic money services in the Internal Market amending Directive 98/26/EC and repealing Directives 2015/2366/EU and 2009/110/EC, Brussels, 28.6.2023. COM (2023) 366 final, 2023/0209 (COD). At the same time European Commission presented a Proposal for a Regulation on payment services in the internal market and amending Regulation (EU) No 1093/2010. At the end of this work, we will focus the attention only on the first proposal because the second one does not affect the profiles that we will examine.

[4] From the outset, it is necessary to underline that the licensing requirements are to be met not only when the authorisation is released, but throughout the life of PIs.

[5] According to Articles 5 (4), 5 (5) and 6 of PSD2, EBA issued "*Final Report on Guidelines under Directive (EU) 2015/2366 (PSD2) on the information to be provided for the authorisation of PIs and e-money institutions and for the registration of account information service providers*" (see the link:https://extranet.eba.europa.eu/sites/default/documents/files/documents/10180/1904583/f0e944 33-f59b-4c24-9cec-2d6a2277b62c/Final%20Guidelines%20on%20Authorisations%20of%20paym ent%20Institutions%20%28EBA-GL-2017-09%29.pdf?retry=1 accessed 20 January 2024).

[6] The PSD1 («Payment Services Directive») is «Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007, relating to payment services in the internal market, amending directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC, which repeals Directive

requirements, namely, rules concerning ownership structure, initial capital, own funds and, in general, risk management, which are largely the same as under PSD1; paragraph 5 looks into PIs corporate governance; paragraph 6 deals with the authorization procedure; concluding, paragraph 7 draws both a comparison between prudential requirements for PIs and for credit institutions, traditionally performing the monetary function and an analysis of possible effects deriving from the PSD3 proposal.

2. The provision of payment services, as listed in the PSD2 Annex I, is a regulated activity. Therefore, it may be carried out professionally if the business entities concerned are authorised as credit institutions, electronic money institutions, post office giro institutions, or PIs, in compliance with Article 1, paragraph 1, PSD2[7]. Indeed, Article 37 PSD2[8], on the "Prohibition of persons other than payment service providers from providing payment services and duty of notification", provides, at paragraph 1, that "*Member States shall prohibit natural or legal persons that are neither payment service providers nor explicitly excluded from the scope of this Directive from providing payment services*".

This is relevant for the PIs authorization process from two different points of view:

on one hand, only authorized PIs may carry out payment services as listed in Annex I of PSD2; payment services, covered by the authorisation released, may be carried out either by establishing a branch in another Member State (freedom of

97/5/EC". In doctrine, among the comments on PSD1, see CHEREDNYCHENKO, *Public and Private Enforcement of European Private Law in the Financial Services Sector* (2015) (23) ERPL p. 621, p. 628-629.

[7] For more details see GEVA, *Title I 'Subject matter, scope and definition' (Arts.1-4)*, in GIMIGLIANO and BOŽINA BEROŠ (eds), cit., p. 8 f.

[8] For more details see DIVISSENKO and GIMIGLIANO, '*Title II – Payment service providers, Chapter 2 Common provisions*, in GIMIGLIANO and BOŽINA BEROŠ (eds), cit., p. 99.

establishment) or on a cross-border services basis without using an establishment in the host state (freedom of providing services)[9];

on the other hand, natural or legal persons may carry out payment services without authorization if they are included in the list of exemptions provided by Article 3 of PSD2. This means that if natural or legal persons wish to have exemptions in order to carry out certain payment services – precisely, services referred to in points (i) and (ii) of point (k) of Article 3, point (k) and in the same Article, point (l) – they must send a *notification* to competent authorities[10].

The competent authorities shall inform the EBA of the services notified pursuant to paragraphs 2 and 3, stating under which exclusion the activity is carried out. When the notification requirement is not complied with or, despite compliance, the competent authority considers that the conditions for exemption are not met, the entity is obliged to apply for authorisation.

However, neither PIs authorisation nor cases of exemption are completely new to PSD2. Indeed, Article 109 PSD2 is committed to dealing with those PIs authorised or exempted within the framework of PSD1 and still operating when PSD2 came into effect[11].

Drawing a comparison between PSD1 and PSD2, the main changes in Title II, Chapter 1, concern, firstly, enhanced levels of payment security: in fact, business entities that wish to be authorized as PIs must provide a security policy document together with their application, as well as a description of their security incident management procedure, contingency procedures and so on[12]. In addition, there are new elements concerning new payment services (n. 7 and 8, PSD2 Annex I), the

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[9] "*Passporting is the exercise by a business of its right to carry on activities and services regulated under EU legislation in another EEA State on the basis of authorisation or registration in its home EEA State*"

[10] As regards competent authorities in Member States see Chapter 4. <https://ec.europa.eu/info/sites/info/files/authorisation-supervision-08082013_en.pdf>.

[11] Guidance PSD2 establishes transitional provisions for PIs already authorised to provide services under PSD1 (See European Banking Federation, 'Guidance for implementation of the revised Payment Services Directive' - PSD2 guidance – (2019) <www.ebf.eu/wp-content/uploads/2020/01/EBF-PSD2-Guidance-Final-v.120.pdf p. 80>). Concerning Article 109 of PSD2.

[12] See European Banking Federation, 'Guidance for implementation of the revised Payment Services Directive' - PSD2 guidance – (2019), footnote (10).

Payment Initiation Service (hereinafter PIS)[13] and the Account Information Service (hereinafter AIS)[14]:

(a) PIS works as an alternative to paying online using a credit card or debit card. The new rules bring PIS within the scope of regulation, which will ensure that payment initiation service providers (hereinafter PISPs) receive access to payment accounts, whilst also placing requirements on them to ensure security for users.

(b) AIS provides the payment service user with consolidated information on payment accounts held by a payment service user with different payment service providers. PSD2 brings them within the scope of regulation, and this will ensure that account information service providers (hereinafter AISPs[15]) can have access to payment accounts, whilst also placing requirements on them to ensure security for users.

PISPs must be authorized by the competent authority in their home Member State, setting out their business plan and operating model, demonstrating appropriate levels of initial and working capital, and specifying their risk management, financial controls, fraud and security monitoring, and business continuity arrangements[16]; in addition, they must hold a professional indemnity insurance or comparable guarantee to cover their liabilities in this respect.

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[13] The definition of PIs covers services to initiate a payment order at the request of the payer with regard to a payment account held at another PSP located in one of the EEA States. More precisely, the payer 'has the right to make use of a PISP to obtain the service referred to in point (7) of Annex I of PSD2" if the payment service is provided within the EEA according to Article 2 of PSD2'.

[14] As regards the role of these two services within the internal market for payments, see: Gabriella Gimigliano, 'The Lights and the Shadows of the EU Law on Payment Transactions', in Gabriella Gimigliano (ed.), *Money, Payment Systems and the European Union* (Cambridge Scholars Publishing 2016) p. 32.

[15] For a detailed analysis of the legal profiles of the new account information services see BURCHI, MEZZACAPO, MUSILE TANZI, TROIANO, *Financial Data Aggregation e Account Information Services, Questioni regolamentari e profili di business*, Quaderni FinTech, 4, marzo 2019, http://www.consob.it/documents/46180/46181/FinTech_4.pdf/2adb8707-41bf-48a4-ad4e-ce8ecce0ab13, p. 23.; CATENACCI and FORNASARO, *PSD2: i prestatori di servizi di informazione sui conti (AISPS),* April 2018, 3-4, available on *www.diritto bancario.it*.

[16] All authorised credit institutions are entitled to provide the whole range of payment services, including AIS and PIS, and to do so without any need for additional authorisation, pursuant to Articles 33 and 34 of Directive (EU) 2013/36 on capital requirements, known as CRD IV, which sets forth that financial institutions and credit institutions can provide all payment services. Indeed, EBA confirmed that: 'all authorised credit institutions are entitled to provide the whole range of payment services, including AIS and PIS, and to do so without any need for additional

In this study we presume that applicants intend:

a) to provide only payment services referred to in points 1-7 of Annex I to PSD2 or service 8 referred to in the Annex I of PSD2 in combination with other service or services referred to in points 1-7 without providing e-money services. In this case, applicants should refer to the specific set of guidelines on the information required from them for authorisation as PIs set out in Section 4.1.

b) to provide only the payment service referred to in point 8 of Annex I to PSD2 without providing e-money services. In this case, applicants should refer to the guidelines on the information required from them for registration for the provision of only service 8 of Annex I PSD2 set out in Section 4.2.

Article 5 of PSD2 provides a number of items required of businesses requesting authorization by the competent authorities of their home Member State. The list of requirements is as follows (Article 5.1.):

(a) a programme of operations;

(b) a business plan;

(c) initial capital;

(d) a description of measures taken to safeguard payment service users' funds;

(e) a description of the applicant's governance arrangements and internal control mechanisms;

(f) a description of the procedure in place to monitor, handle and follow up on a security incident and security related customer complaints;

(g) a description of the process in place to file, monitor, track and restrict access to sensitive payment data;

(h) a description of business continuity arrangements;

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authorization'. See para. 26 of the *Final Report on Draft Regulatory Technical Standards setting technical requirements on development, operation and maintenance of the electronic central register and on access to the information contained therein, under Article 15(4) of Directive (EU) 2015/2366 (PSD2),and Draft Implementing Technical Standards on the details and structure of the information entered by competent authorities in their public registers and notified to the EBA under Article 15(5) of Directive (EU) 2015/2366 (PSD2) (EBA/RTS/2017/10 and EBA/ITS/2017/07).*

(i) a description of the principles and definitions applied for the collection of statistical data on performance, transactions and fraud;

(j) a security policy document;

(k) for PIs subject to obligations regarding money laundering and the financing of terrorists, a description of the internal control mechanisms which the applicant has established in order to comply with those obligations;

(l) a description of the applicant's structural organisation, including, where applicable, a description of the intended use of agents and branches;

(m) the identity of persons holding within the applicant company, directly or indirectly, qualifying holdings;

(n) the identity of directors and persons responsible for the management of the PIs and, where relevant, persons responsible for the management of the PI's payment services activities;

(o) the identity of statutory auditors and audit firms as defined in Directive 2006/43/EC of the European Parliament and of the Council;

(p) the applicant's legal status and Articles of association;

(q) the address of the applicant's head office.

Like other financial intermediaries set up in the EU, PIs are also required to fulfil a variety of qualitative and quantitative prudential requirements:

1) principal qualitative requirements include sound administrative, risk management and accounting procedures, proper internal control mechanisms, directors and managers who are of good repute and possess appropriate knowledge and experience, as well as suitable shareholders, taking into account the need to ensure the sound and prudent management of a PI;

2) quantitative capital requirements intended to ensure financial stability include initial and ongoing capital requirements appropriate to the low level of risk of PIs, own funds and safeguarding requirements.

In the following paragraphs, we shall focus attention on these prudential requirements regarding, in particular:

(a) the ownership structure and disclosure rules;[17]

(b) initial capital, own funds and separation of funds;[18]

(c) the identity of persons holding within the applicant company, directly or indirectly, qualifying holdings;

(d) the identity of directors and persons responsible for the management of the PIs and, where relevant, persons responsible for the management of the PI's payment services activities;

(e) internal control system; [19]

(f) registration.

Given this specific purpose, for all other requirements we shall limit the discussion to some profiles considered by the EBA in its Guidelines[20]. In particular, we wish to shed light on the main differences between:

(a) Section 4.1 of EBA Guidelines on information required from applicants for authorisation as PIs for the provision of *services 1-8 of Annex I to PSD2* and

(b) the Section 4.2 of EBA Guidelines on information required from applicants for registration for the provision of *only service 8 of Annex I to PSD2*

This second set of guidelines applies to applicants for registration as AISPs. This refers to applicants that intend to provide *only* AIS. Should the applicant intend to provide other services in addition to AIS, they should apply for authorisation and refer to the guidelines set out in Section 4.1 for PIs.

2.1. Before going into details, we should underline that Article 33 of PSD2, dedicated to AISPs, provides that natural or legal persons, providing only payment services as referred to in point (8) of Annex I, shall be exempt from application of

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[17] See below in this paper, paragraph 3.
[18] See below in this paper, paragraph 4.
[19] See below in this paper, paragraph 5.3.
[20] See above in this paper, footnote 5.

the procedures set out, for the purposes of our research, in Section 2 with the exemption of point (a), (b), (e), (f), (g), (h), (j), (l), (n), (p) and (q) of Article 5.1., Article 5.3. and Articles 14 and 15. This rule confirms that there are no capital and safeguarding requirements for AISPs; indeed, it provides an exemption for the application of Article 5.1, points (c) and (d).

The first requirement provided by point (a) of Article 5.1. concerns "a programme of operations setting out in particular the type of payment services envisaged" [(Article 5.1, point (a)]. The programme of operations is nothing more than a letter of intent in which the applicant promises to respect certain obligations linked to PIs activities. EBA Guidelines provide different information for applicants asking to operate carrying out all payment services[21] as opposed to those limited to AIS only[22]. The main differences between the two guidelines regard: 1) the requirement of funds and 2) the restricted aim for AIS.

The second requirement is "a business plan including a forecast budget calculation for the first 3 financial years which demonstrates that the applicant is able to employ the appropriate and proportionate systems, resources and procedures to operate soundly" [(Article 5.1, point (b)]. For this requirement as well, rules provided by the EBA differ depending on the payment services that the applicant declares it intends to carry out[23].; for instance:

(a) information on own funds, including the amount and detailed breakdown of the composition of initial capital as set out in Article 7 of PSD2,[24] is not required for AIS;

(b) information on, and calculation of, minimum own funds requirements in accordance with the method(s) referred to in Article 9 of PSD2[25] as determined by the competent authority, unless the applicant intends to provide PIS or AIS only.

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[21] See EBA Guidelines, Section 4 (1), point (3).
[22] See EBA Guidelines, Section 4 (2), point (3).
[23] See EBA Guidelines, Section 4 (1), point (4) and Section 4 (2), point (4).
[24] See below in this paper, paragraph 4 (1).
[25] See below in this paper, paragraph 4 (2).

The third requirement is "*a description of the procedure in place to monitor, handle and follow up a security incident and security related customer complaints, including an incident reporting mechanism which takes account of the notification obligations of the PI laid down in Article 96"* [(Article 5.1, point (f)]. For this requirement, the EBA provides similar rules for all payment services[26].

The fourth requirement is "a description of the process in place to file, monitor, track and restrict access to sensitive payment data" [(Article 5.1, point (g)]. As regards this requirement, the EBA[27] has provided a uniform set of guidelines for PIs and AISPs, while if the applicant intends to provide PIS only, certain information is not required, e.g. a description of how the collected data are filed: f) unless the applicant intends to provide PIS only, the expected internal and/or external use of the collected data, including by counterparties.

The fifth requirement is "a description of business continuity arrangements including a clear identification of the critical operations, effective contingency plans and a procedure to regularly test and review the adequacy and efficiency of such plans" [(Article 5.1, let. h)]. For this requirement as well, the EBA[28] has issued almost the same rules for PIs, PISs and AISPs; for the latter it has not required a description of the mitigation measures to be adopted by the applicant, in cases of the termination of its payment services, ensuring the execution of pending payment transactions and the termination of existing contracts.

The sixth requirement is "a description of the principles and definitions applied for the collection of statistical data on performance, transactions and fraud" [(Article 5.1, point (i)] and for this requirement the EBA has issued guidelines applicable only if the applicant wishes to exercise all payment services[29], Section 4.1., point 12.

The seventh requirement is "a security policy document, including a detailed risk assessment in relation to its payment services and a description of

[26] See EBA Guidelines Section 4 (1), point (9) and Section 4 (2), point (7).
[27] See EBA Guidelines, Section 4 (1), point (10) and Section 4 (2) point (8).
[28] See EBA Guidelines, Section 4 (1), point (11) and Section 4 (2), point (9).
[29] See EBA Guidelines, Section 4 (1), point (12).

security control and mitigation measures taken to adequately protect payment service users against the risks identified, including fraud and illegal use of sensitive and personal data" [(Article 5.1, point (j)].

Regarding this requirement, the EBA[30] requires more detailed information from solely-AIS businesses concerning:1) a description of IT systems; c) the type of authorised external connections, such as with partners, service providers, entities of the group and employees working remotely, including the rationale for such connections; 2) the logical security measures and mechanisms that govern internal access to IT systems; 3) the security of payment processes.

Another requirement for authorisation is established by Articles 5.2 and 5.3 of PSD2, which states that applicants intending to provide PIS or AIS payment services as referred to in point (7) of Annex I[31] and in point (8) of Annex I[32] must hold professional indemnity insurance.

The EBA[33] has provided guidance on how to stipulate the minimum amount of professional indemnity insurance or other comparable guarantee. As evidence of a professional indemnity insurance or comparable guarantee that is compliant with EBA Guidelines on criteria for stipulating the minimum monetary amount of professional insurance or other comparable guarantee (EBA/GL/2017/08) and Article 5(2) and 5(3) of PSD2, the applicant intending to offer PIS or AIS should provide the following information: a) an insurance contract or other equivalent document confirming the existence of professional indemnity insurance or a comparable guarantee, with a cover amount that is compliant with the above-

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[30] See EBA Guidelines, Section 4 (1), point (13) and Section 4 (2), point (10).

[31] "Member States shall require undertakings that apply for authorisation to provide payment services as referred to in point (7) of Annex I, as a condition of their authorisation, to hold a professional indemnity insurance, covering the territories in which they offer services, or some other comparable guarantee against liability to ensure that they can cover their liabilities as specified in Articles 73, 89, 90 and 92" (Article 5 (2) of PSD2).

[32] 'Member States shall require undertakings that apply for registration to provide payment services as referred to in point (8) of Annex I, as a condition of their registration, to hold a professional indemnity insurance covering the territories in which they offer services, or some other comparable guarantee against their liability vis-à-vis the account servicing payment service provider or the payment service user resulting from non-authorised or fraudulent access to or non-authorised or fraudulent use of payment account information' (Article 5 (3) of PSD2).

[33] See EBA Guidelines, Section 4 (1), point (12) and Section 4 (2), point (18).

mentioned EBA Guidelines, showing the coverage of relevant liabilities; b) documentation of how the applicant has calculated the minimum amount in a way that is compliant with the above-mentioned EBA Guidelines, including all applicable components of the formula specified therein.

3. As regards rules concerning ownership of PIs, following the same method used for other financial intermediaries, the European legislation considers two different profiles:

(a) first, PSD2 imposes specific requirements for natural or legal persons holding, directly or indirectly, qualifying participations in the PI's capital [Article 5.1., point (m)];

(b) second, Article 6 imposes control of shareholdings, and it is important to note that this article is new relative to PSD1.

3.1. Since, as regards the attainment and maintenance of healthy and prudent management, it is necessary that those in important positions in the organizational structure respect determined requirements of good repute and professional competence[34], holders of a qualifying holding in a PI must meet the transparency principle and the suitability rule.

The Article deals with the qualitative aspect of capital, which assumes particular relevance in the financial market due to the fiduciary nature of the activity of financial intermediaries and the importance of guaranteeing efficient allocation of resources in the economic system.

From one perspective, the suitability requirements for qualifying shareholders are intended to keep dangerous persons from gaining entry into PIs (sadly, the phenomenon of financial intermediaries being set up by criminal

[34] See below in this paper, paragraph 5.

organizations for money-laundering purposes must be acknowledged) that do not provide appropriate guarantees of correctness; while from another point of view, the obligation to communicate shareholder information not only provides a picture of the order and distribution of the stock capital or significant quotas of a given PI at a given moment, but also generates a record of all upward or downward variations and oscillations that occur thereafter.

Operating in this way, it would be difficult for qualifying shareholders holding a portion of capital considered significant enough to allow them to influence decisions concerning the PI to remain anonymous, and this is important to safeguard the existing fiduciary relationship between the public/savers and management.

Given that, as provided by Article 5 (1), point (m) of PSD2, information that must be provided with requests for authorization includes the identity of persons holding in the applicant, directly or indirectly, qualifying holdings within the meaning of point (36) of Article 4.1 of Regulation (EU) No 575/2013.

The quoted point (36) provides that 'qualifying holding' means a direct or indirect holding in an enterprise which represents 10 % or more of its capital or voting rights or which makes it possible to exercise a significant influence over the management of that enterprise; of such holdings, businesses must submit information on the size of their holdings and evidence of their suitability taking into account the need to ensure the sound and prudent management of a PI.

For the purposes of the identity and evidence of the suitability of persons with qualifying holdings in the applicant PI, without prejudice to the assessment in accordance with the criteria, as relevant, introduced with Directive 2007/44/EC and specified in the joint guidelines for the prudential assessment of acquisitions of qualifying holdings (JC/GL/2016/01), EBA Guidelines[35] provides that

the applicant should submit the following information: a) a description of the group to which the applicant belongs and an indication of the

[35] See EBA Guidelines, Section 4 (1), point (15).

parent undertaking, where applicable; b) a chart setting out the shareholder structure of the applicant[36]; c) a list of the names of all persons and other entities that have or, in the case of authorisation, will have qualifying holdings in the applicant's capital[37].

Following these general requirements, the EBA provides different instructions depending on whether the applicant is a natural person[38] or a legal person or entity[39].

3.1.1. In the first case, the principal requirement regards the reputation of the qualifying shareholder. The EBA states that "Where a person who has or, in the case of authorisation, will have a qualifying holding in the applicant's capital is a natural person, the application should set out all of the following information relating to the identity and suitability of that person:

a) the person's name and name at birth, date and place of birth, citizenship (current and previous), identification number (where available) or passport number, address and a copy of an official identity document;

b) a detailed curriculum vitae stating the education and training, previous professional experience and any professional activities or other functions currently performed;

c) a statement, accompanied by supporting some documents;

d) a list of undertakings that the person directs or controls and of which the applicant is aware of after due and careful enquiry; the percentage of control either direct or indirect in these companies; their status (whether or not they are active, dissolved, etc.); and a description of insolvency or similar procedures;

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[36] Structure means: 'i) the name and the percentage holding (capital/voting right) of each person that has or will have a direct holding in the share capital of the applicant, identifying those that are considered as qualifying holders and the reason for such qualifications; ii) the name and the percentage holding (capital/voting rights) of each person that has or will have an indirect holding in the share capital of the applicant, identifying those that are considered as indirect qualifying holders and the reason for such qualification'.

[37] It is necessary to indicate for each such person or entity 'i. the number and type of shares or other holdings subscribed or to be subscribed; ii. the nominal value of such shares or other holdings'.

[38] See EBA Guidelines, Section 4 (1), point (15)(2).

[39] See EBA Guidelines, Section 4 (1), point (15)(3).

e) where an assessment of reputation of the person has already been conducted by a competent authority in the financial services sector, the identity of that authority and the outcome of the assessment;

f) the current financial position of the person, including details concerning sources of revenues, assets and liabilities, security interests and guarantees, whether granted or received;

g) a description of any links to politically exposed persons, as defined in Article 3(9) of Directive (EU) 2015/849[40]”.

3.1.2. Where a person or entity who has or, in the case of authorisation, will have a qualifying holding in the applicant’s capital (including entities that are not a legal person and which hold or should hold the participation in their own name), the application should contain the following information relating to the identity and suitability of that legal person or entity:

(a) name;

(b) where the legal person or entity is registered in a central register, commercial register, companies register or similar register that has the same purposes of those aforementioned, a copy of the good standing, if possible, or otherwise a registration certificate;

(c) the addresses of its registered office and, where different, of its head office, and principal place of business;

(d) contact details;

(e) corporate documents or, where the person or entity is registered in another Member State, a summary explaining the main legal features of the legal form or the entity;

(f) whether or not the legal person or entity has ever been or is regulated by a competent authority in the financial services sector or other government body;

[40] Council Directive 2015/849/EU of 20 May 2015 laying down the prevention of the use of the financial system for the purposes of money laundering or terrorist financing [2015] OJ L141/73.

(g) where such documents can be obtained, an official certificate or any other equivalent document evidencing the information set out in paragraphs (a) to (e) issued by the relevant competent authority;

(h) the information referred to in EBA Guidelines 15(2)(c), 15(2)(d), 15(2)(e), 15(2)(f), and 15(2)(g) in relation to the legal person or entity;

(i) a list containing details of each person who effectively directs the business of the legal person or entity, including their name, date and place of birth, address, their national identification number, where available, and a detailed curriculum vitae (stating relevant education and training, previous professional experience, any professional activities or other relevant functions currently performed), together with the information referred to in Guideline 15(2)(c) and 15(2)(d) in respect of each such person;

(j) the shareholding structure of the legal person, including at least their name, date and place of birth, address and, where available, personal identification number or registration number, and the respective share of capital and voting rights of direct or indirect shareholders or members and beneficial owners, as defined in Article 3 (6) of Directive (EU) 2015/849;

(k) a description of the regulated financial group of which the applicant is a part, or may become a part, indicating the parent undertaking and the credit, insurance and security entities within the group; the name of their competent authorities (on an individual or consolidated basis);

and (l) annual financial statements, at the individual and, where applicable, the consolidated and sub-consolidated group levels, for the last three financial years, where the legal person or entity has been in operation for that period (or, if less than three years, the period for which the legal person or entity has been in operation and for which financial statements have been prepared), approved by the statutory auditor or audit firm within the meaning of Directive 2006/43/EC4 , where applicable, including each of the following items: i. the balance sheet; ii. the profit-and-loss accounts or income statement; iii. the annual reports and financial

annexes and any other documents registered with the relevant registry or competent authority of the legal person;

(m) where the legal person has not been operating for a sufficient period to be required to prepare financial statements for the three financial years immediately prior to the date of the application, the application shall set out the existing financial statements (if any);

(n) where the legal person or entity has its head office in a third country, general information on the regulatory regime of that third country as applicable to the legal person or entity, including information on the extent to which the third country's anti-money laundering and counter-terrorist financing regime is consistent with the Financial Action Task Force Recommendations;

(o) for entities that do not have legal personality such as a collective investment undertaking, a sovereign wealth fund or a trust, the application shall set out some information[41].

3.1.3. In addition, the EBA also sets forth common rules regarding the reputation requirement[42]. The principal aim of said requirement is the stability of PIs, not only financial but corporate as well.

As regards corporate stability, the application shall set out all of the following information for each natural or legal person or entity who has or, in the case of authorisation, will have a qualifying holding in the capital of the applicant:

(a) details of that person's or entity's financial or business reasons for owning that holding and the person's or the entity's strategy regarding the holding, including the period for which the person or the entity intends to hold the

[41] Specifically: the identity of the persons who manage assets and of the persons who are beneficiaries or subscribers; ii. a copy of the document establishing and governing the entity including the investment policy and any restrictions on investment applicable to the entity. 4 Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

[42] See EBA Guidelines, Section 4 (1), points (15)(4) and (15)(5).

holding and any intention to increase, reduce or maintain the level of the holding in the foreseeable future;

(b) details of the person's or the entity's intentions with respect to the applicant and the influence the person or the entity intends to exercise over the applicant, including with respect to the dividend policy, the strategic development and the allocation of resources of the applicant, whether or not it intends to act as an active minority shareholder, and the rationale for such intention;

(c) information on the person's or the entity's willingness to support the applicant with additional own funds if needed for the development of its activities or in the case of financial difficulties;

(d) the content of any intended shareholder's or member's agreements with other shareholders or members in relation to the applicant;

(e) an analysis as to whether or not the qualifying holding will impact in any way, including as a result of the person's close links to the applicant, on the ability of the applicant to provide timely and accurate information to the competent authorities;

(f) the identity of each member of the management body or of senior management who will direct the business of the applicant and will have been appointed by, or following a nomination from, such shareholders or members, together with, to the extent not already provided, the information set out in EBA Guidelines point (16).

As concerns financial stability, the application should set out a detailed explanation of the specific sources of funding for the participation of each person or entity having a qualifying holding in the applicant's capital, which should include:

(a) details on the use of private financial resources, including their availability and (so as to ensure that the competent authority is satisfied that the activity that generated the funds is legitimate) source;

(b) details on access to financial markets, including details of financial instruments to be issued;

(c) information on the use of borrowed funds, including the name of the lenders and details of the facilities granted, such as maturities, terms, security interests and guarantees, as well as information on the source of revenue to be used to repay such borrowings; where the lender is not a credit institution or a financial institution authorised to grant credit, the applicant should provide to the competent authorities information on the origin of the borrowed funds;

(d) information on any financial arrangement with other persons who are shareholders or members of the applicant.

3.2. In addition to the reputation requirement, Article 6 of PSD2 provides for a specific discipline for the control of qualifying shareholdings. This rule is not present in PSD1 and it can be supposed that this rule has been introduced in the interest of homogeneity with rules regarding other financial intermediaries. In fact, the rule substantially reproduces the same rule found in European directives regarding banks, insurance undertakings and investment firms.

According to Article 6 (1) of PSD2, "*Any natural or legal person who has taken a decision to acquire or to further increase, directly or indirectly, a qualifying holding within the meaning of point (36) of Article 4(1)of Regulation (EU) No 575/2013 in a PI, as a result of which the proportion of the capital or of the voting rights held would reach or exceed 20 %, 30 % or 50 %, or so that the PI would become its subsidiary, shall inform the competent authorities of that PI in writing of their intention in advance*".

First, we must consider the use of the generic term "any natural or legal person". It is intended to mean that the precept applies to any subject able to acquire shares in the capital of PIs, therefore both natural persons and legal persons.

Second, regarding the moment at which the obligation arises, the rule focusing on the intention to acquire or surrender shares prescribes that the obligation must be fulfilled before the passage of ownership has happened and that, in any case, the intention has gone beyond the phase of simple negotiations and has irreversibly acquired juridical consequence binding one or both parties. For the purposes of the regulation, the effectiveness of the contracts for the acquisition of qualifying holdings is subordinate to the condition that the competent authority does not forbid the operation.

It should be noted that the transfer or acquisition of qualifying holdings may be subject to obligatory communication regardless of the underlying instrument and whatever the circumstance may be (acquisition, signature, etc).

From an objective point of view, the disclosure obligation is required when any natural or legal person who has taken a decision to acquire or to further increase, directly or indirectly, a qualifying holding, that is to say 10 % or more of the capital or of the voting rights or one that allows the holder to exercise a significant influence over the management of the enterprise [See point (36) of Article 4 (1) of Regulation (EU) No 575/2013] in a PI, as a result of which the proportion of the capital or of the voting rights held would reach or exceed 20 %, 30 % or 50 %, or the PI would become its subsidiary.

The proposed acquirer of a qualifying holding shall supply to the competent authority information indicating the size of the intended holding and relevant information referred to in Article 23.4 of Directive 2013/36/EU [Article 6 (2) of PSD2].

It is also important to consider the powers of Member States.

Member States shall require that where the influence exercised by a proposed acquirer, as referred to in paragraph 2 is likely to operate to the detriment of the prudent and sound management of the PI, the competent authorities shall express their opposition or take other appropriate measures to bring that situation to an end. Such measures may include injunctions, penalties

against directors or the persons responsible for the management, or the suspension of the exercise of the voting rights attached to the shares held by the shareholders or members of the PI in question. Similar measures shall apply to natural or legal persons who fail to comply with the obligation to provide prior information, as laid down in this article [Article 6 (3) of PSD2].

If a holding is acquired despite the opposition of the competent authorities, Member States shall, regardless of any other penalty to be adopted, provide for the exercise of the corresponding voting rights to be suspended, the nullity of votes cast or the possibility of annulling those votes [Article 6 (4) of PSD2].

For this second power, we may suppose that the Italian legislature will not provide a different solution than that envisaged for the other financial intermediaries.

Even if the requirements of reputation of the qualified shareholders are one of the conditions for the issuance of authorization, the sanction should they fail to respect the requirement consists exclusively of the suspension of the voting right. The qualifying shareholder, therefore, is not deprived of any faculty to hold a juridical position, but only the possibility to exercise some rights inherent to it, and this is more consistent with the aim of the rules, which is to keep disreputable persons from influencing management.

It might be possible to distinguish between constitutive quorums and deliberative quorums, provided that the actions for which the voting right is suspended are for the purpose of the regular constitution of the meeting. It is up to the president of the shareholder meeting, in relation to his tasks of verifying of the regular constitution of the meeting and the legitimation of shareholders, to admit or not to admit the shareholders to the vote for which, on the base of the available information, they are required to prove they meet the suitability requirements.

If shareholders exercise the voting right despite the prohibition, the decision may be annulled, in accordance with the general rules provided by company law,

by the directors, by control bodies and by absent, dissentient and abstaining shareholders within a determined period from the date of the resolution or of registration in the register of companies, presuming that the resolution was adopted with the controlling vote of the shareholder who should have abstained (i.e., the resolution does not pass the test of resistance).

4. The PSD2 imposes several requirements on PIs which aim to make these institutions safe.

These requirements relate to:

(a) *initial capital* required at the time authorisation is issued by the competent authority (Article 7 of PSD2);

(b) *own funds* to be held at all times by PIs (Article 8 of PSD2). Under Article 9 of PSD2, PIs must hold at all times own funds that can be calculated in accordance with one of three methods (A, B or C), as determined by national legislation;

(c) *safeguarding requirements* that require funds (which have been received from payment service users or through another payment service provider for the execution of payment transactions) to be safeguarded by either: a) holding such funds in an account separate from the operational account(s) of the payment service provider and insulating such funds from claims of the other creditors in case of bankruptcy, or b) having an insurance policy or a guarantee in place (Article 10 of PSD2).

The rules concerning initial capital and other own funds have the direct aim of ensuring the stability of PIs, and only indirectly serve to protect payment service users, who are mainly protected by safeguarding requirements.

4.1. According to Article 5.1, point (c) of PSD2, the applicant shall demonstrate evidence that the PI holds initial capital as provided for in Article 7 of PSD2.

The latter article provides different minimum levels of initial capital to be held at the time of authorisation depending on the payment services the PI wishes to offer.

Article 7 of PSD2 provides that Member States shall require PIs to hold, at the time of authorisation, initial capital, comprised of one or more of the items referred to in Article 26(1)(a) to (e) of Regulation (EU) No 575/2013[43] as follows:

(a) where the PI provides only the payment service as referred to in point (6) of Annex I, its capital shall at no time be less than EUR 20,000;

(b) where the PI provides the payment service as referred to in point (7) of Annex I, its capital shall at no time be less than EUR 50,000;

(c) where the PI provides any of the payment services as referred to in points (1) to (5) of Annex I, its capital shall at no time be less than EUR 125,000.

As noted in the introduction, there is no minimum capital requirement for AISPs (service as referred to in point 8 of Annex I).

According to EBA Guidelines point (6), the applicant should submit the following documents:

(a) for existing enterprises, an audited account statement or public register certifying the amount of capital of the applicant;

(b) for enterprises in the process of being incorporated, a bank statement issued by a bank certifying that the funds are deposited in the applicant's bank account.

(c) for the PIs referred to in Article 10.1, a description of the measures taken for safeguarding payment service users' funds in accordance with Article 10[44].

[43] Council Regulation (EU) 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 648/2012 [2013] OJ L176/1.

[44] See below in this paper, paragraph 4 (2).

For own funds, the definition and calculation is provided in Articles 8 and 9 of PSD2.

In addition to the initial capital requirement, Article 8 of PSD2 provides for some specific rules regarding own funds. The PI's own funds shall not fall below the amount of initial capital as referred to in Article 7 or the amount of own funds as calculated in accordance with Article 9 of PSD2, whichever is the higher.

Member States shall take the necessary measures to prevent the multiple use of elements eligible for own funds (so-called double gearing) where the PI belongs to the same group as another PI, credit institution, investment firm, asset management company or insurance undertaking. This paragraph shall also apply where a PI has a hybrid character and carries out activities other than providing payment services [Article 8 (2) of PSD2].

The PSD2 sets out some exemptions. If the conditions laid down in Article 7 of Regulation (EU) No 575/2013 are met, Member States or their competent authorities may choose not to apply Article 9 of PSD2 to PIs which are included in the consolidated supervision of the parent credit institution pursuant to Directive 2013/36/EU [Article 8 (3) of PSD2].

Concerning the calculation of own funds, article 9 provides that, notwithstanding the initial capital requirements set out in Article 7, Member States shall require PIs, except those offering only services as referred to in point (7) or (8), or both, of Annex I, to hold, at all times, own funds calculated in accordance with one of the following three methods, as determined by the competent authorities in accordance with national legislation:

In method A, the PI's own funds shall amount to at least 10 % of its fixed overheads of the preceding year. The competent authorities may adjust that requirement in the event of a material change in a PI's business since the preceding year. Where a PI has not completed a full year's business at the date of the calculation, the requirement shall be that its own funds amount to at least 10

% of the corresponding fixed overheads as projected in its business plan, unless an adjustment to that plan is required by the competent authorities.

Turning to method B, the PI's own funds shall amount to at least the sum of the following elements multiplied by the scaling factor k defined in paragraph 2, where payment volume (PV) represents one twelfth of the total amount of payment transactions executed by the PI in the preceding year:

(a) 4.0 % of the slice of PV up to EUR 5 million;

plus (b) 2.5 % of the slice of PV above EUR 5 million up to EUR 10 million;

plus (c) 1 % of the slice of PV above EUR 10 million up to EUR 100 million;

plus (d) 0.5 % of the slice of PV above EUR 100 million up to EUR 250 million;

plus (e) 0.25 % of the slice of PV above EUR 250 million.

Finally, method C, where the PI's own funds shall amount to at least the relevant indicator defined in point (a), multiplied by the multiplication factor defined in point (b)[45] and by the scaling factor k defined in paragraph 2. 1.068. (a) The relevant indicator is the sum of the following: (i) interest income; (ii) interest expenses; (iii) commissions and fees received; and (iv) other operating income. Each element shall be included in the sum with its positive or negative sign. Income from extraordinary or irregular items shall not be used in the calculation of the relevant indicator. Expenditure on the outsourcing of services rendered by third parties may reduce the relevant indicator if the expenditure is incurred from an undertaking subject to supervision under PSD2. The relevant indicator is calculated on the basis of the 12-monthly observation at the end of the previous financial year. The relevant indicator shall be calculated over the previous financial year. Nevertheless, own funds calculated according to Method C shall not fall

[45] The multiplication factor shall be:
(i) 10 % of the slice of the relevant indicator up to EUR 2.5 million;
(ii) 8 % of the slice of the relevant indicator from EUR 2.5 million up to EUR 5 million;
(iii) 6 % of the slice of the relevant indicator from EUR 5 million up to EUR 25 million;
(iv) 3 % of the slice of the relevant indicator from EUR 25 million up to 50 million;
(v) 1.5 % above EUR 50 million.

below 80 % of the average of the previous 3 financial years for the relevant indicator. When audited figures are not available, business estimates may be used.

Article 9 (2) provides that the scaling factor k to be used in Methods B and C shall be:

(a) 0.5 where the PI provides only the payment service as referred to in point (6) of Annex I;

(b) 1 where the PI provides any of the payment services as referred to in any of points (1) to (5) of Annex I.

The competent authorities may - based on an evaluation of the risk-management processes, risk loss data base and internal control mechanisms of the PI- require the PI to hold an amount of own funds which is up to 20 % higher than the amount which would result from the application of the method chosen in accordance with paragraph 1, or permit the PI to hold an amount of own funds which is up to 20 % lower than the amount which would result from the application of the method chosen in accordance with paragraph 1.

4.2. The segregation of funds or, if it prefers, the safeguarding requirements, has the main object to protect payment services users' and specifically costumers' funds. According to Article 10 (1) of PSD2, the Member States or competent authorities shall require a PI which provides payment services as referred to in points (1) to (6) of Annex I[46] to safeguard all funds which have been received from the payment service users or through another payment service provider for the execution of payment transactions. In this case there is no rule concerning safeguarding requirements not only for AISPs but also for PIS.

The Article provides two ways to safeguard funds.

According to Article 10 (1), lett (a), where the abovementioned funds are still held by the PI and not yet delivered to the payee or transferred to another

[46] Points 1-6 of Annex I, and not points (7) and (8) of the same Annex.

payment service provider by the end of the business day following the day when the funds have been received, they shall be deposited in a separate account in a credit institution *or* invested in secure, liquid low-risk assets as defined by the competent authorities of the home Member State.

In these cases, the rule provides for two important effect related to safeguarding: (a) funds shall not be commingled at any time with the funds of any natural or legal person other than payment service users on whose behalf the funds are held and (b) they shall be insulated in accordance with national law in the interest of the payment service users against the claims of other creditors of the PI, in particular in the event of insolvency [Article 10 (1), point (a)].

For this profile, EBA[47] provides that where the applicant safeguards the payment service users' funds through depositing funds in a separate account in a credit institution or through an investment in secure, liquid, low risk assets, the description of the safeguarding measures should contain:

(a) a description of the investment policy to ensure the assets chosen are liquid, secure and low risk, if applicable;

(b) the number of persons that have access to the safeguarding account and their functions;

(c) a description of the administration and reconciliation process to ensure that payment service users' funds are insulated in the interest of payment service users against the claims of other creditors of the PI, in particular in the event of insolvency;

(d) a copy of the draft contract with the credit institution;

(e) an explicit declaration by the PI of compliance with Article 10 of PSD2[48].

Neither the law nor EBA Guidelines solve some questions arising from the obligation to deposit funds which have been received from the payment service users or through another payment service provider for the execution of payment transactions in a separate account in a credit institution.

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[47] See EBA Guidelines, Section 4 (1), point (17)(1).

[48] See also Article 36 of PSD2 and DIVISSENKO and GIMIGLIANO, *op. cit.*, p. 97 f.

The questions are: first, what is the legal nature of this deposit? Second, is it possible to receive interests? Third, are these deposits subject to the rules for deposits' protection? In this place it is not possible to solve this question but just to put in light them.

In addition, Article 10 (1), lett (b) provides that such funds may be covered by an insurance policy or some other comparable guarantee from an insurance company or a credit institution as far as the following requirements are met: (a) the insurance company or the credit institutions do not belong to the same group as the PI itself and (b) the insurance policy is made for an amount equivalent to that which would have been segregated in the absence of the insurance policy or other comparable guarantee, payable in the event that the PI is unable to meet its financial obligations [(Article 10 (1), point (b)].

As regards this second way, EBA[49] provides that where the applicant safeguards the funds of the payment service user through an insurance policy or comparable guarantee from an insurance company or a credit institution, the description of the safeguarding measures should contain the following:

(a) a confirmation that the insurance policy or comparable guarantee from an insurance company or a credit institution is from an entity that is not part of the same group of firms as the applicant;

(b) details of the reconciliation process in place to ensure that the insurance policy or comparable guarantee is sufficient to meet the applicant's safeguarding obligations at all times;

(c) duration and renewal of the coverage;

(d) a copy of the (draft) insurance agreement or the (draft) comparable guarantee.

Where a PI is required to safeguard funds under the above commented rules and a portion of those funds is to be used for future payment transactions with the remaining amount to be used for non-payment services, that portion of

[49] See EBA Guidelines, Section 4 (1), point (17)(2).

the funds to be used for future payment transactions shall also be subject to the quoted requirements [Article 10 (2) of PSD2].

Where that portion is variable or not known in advance, Member States shall allow PIs to apply this paragraph on the basis of a representative portion assumed to be used for payment services provided such a representative portion can be reasonably estimated on the basis of historical data to the satisfaction of the competent authorities [Article 10 (2) of PSD2].

5.

5.1. In terms of prudential rules, it is important to consider that the applicant must also respect some requirements regarding corporate governance, which generally means the system by which companies are directed and controlled. This is not the place to discuss the corporate governance of PIs in depth, but simply to mention some Articles of PSD2 regarding corporate governance among the authorization requirements. We wish to refer to the identity of directors and persons responsible for the management of the PI [(Article 5 (1), point (n)], and to the internal control mechanism [Article 5 (1), points (e) and (k)].

5.2. According to Article 5 (1), point (n) of PSD2, applicants must provide the identity of directors and persons responsible for the management of the PIs and, where relevant, persons responsible for the management of the payment services activities of the PIs, as well as evidence that they are of good repute and possess appropriate knowledge and experience to perform payment services as determined by the home Member State of the PI.

This rule introduces one new principle: directors and persons responsible for the management of the PI and persons responsible for the management of the payment services activities of the PIs must meet two different requirements: a) good reputation and b) possession of appropriate knowledge and experience.

To specify the content of these requirements, the EBA issued the same rules for PIs and AISPs[50]. For the purposes of the identity and suitability assessment of directors and persons responsible for the management of the PI, the applicant should provide information regarding possession of knowledge and experience and good reputation.

As regards the possession of appropriate knowledge and experience, the specific information requested is as follows:

(a) personal details;

(b) where applicable, information on the suitability assessment carried out by the applicant, which should include details of the result of any assessment of the suitability of the individual performed by the institution, such as relevant board minutes or suitability assessment reports or other documents;

(c) evidence of knowledge, skills and experience, which should include a curriculum vitae containing details of education and professional experience, including academic qualifications, other relevant training, the name and nature of all organisations for which the individual works or has worked, and the nature and duration of the functions performed, in particular highlighting any activities within the scope of the position sought.

The suitability assessment is based on a broad range of information sources.

Indeed, EBA rules and regulations consider among the others,

(a) criminal records and relevant information on criminal investigations and proceedings, relevant civil and administrative cases, and disciplinary actions, including disqualification as a company director, bankruptcy, insolvency and similar procedures, notably through an official certificate or any objectively reliable

[50] See EBA Guidelines, Section 4 (1), point (16) and Section 4 (2), point (11).

source of information concerning the absence of criminal conviction, investigations and proceedings, such as third-party investigations and testimonies made by a lawyer or a notary established in the European Union;

(b) a statement as to whether criminal proceedings are pending or the person or any organisation managed by him or her has been involved as a debtor in insolvency proceedings or comparable proceedings;

(c) investigations, enforcement proceedings or sanctions by a supervisory authority that the individual has been directly or indirectly involved in;

(d) refusal of registration, authorisation, membership or licence to carry out a trade, business or profession; the withdrawal, revocation or termination of registration, authorisation, membership or licence; or expulsion by a regulatory or government body or by a professional body or association;

(e) dismissal from employment or a position of trust, fiduciary relationship or similar situation, or having been asked to resign from employment in such a position, excluding redundancies;

(f) previous inquiries carried on by other authorities, not necessarily financial authorities. To this end, the exchange of information among competent national authorities seems extremely important.

Both PSD2 and EBA Guidelines avoid addressing some important questions, leaving this task to Member States.

For instance, we know that the original lack of the above-cited requirements is a cause of ineligibility, in addition to other requirements provided by Member States legal systems regarding management. But what if the requirements are breached after authorisation has been issued?

To answer to this question, we need to take a step-by-step approach, keeping in mind, first of all, that the possession of appropriate knowledge and experience and good repute represent among the conditions on the basis of which authorization shall be granted by the competent Authorities. As such, we would

expect the lack of those requirements to produce effects on the PIs (for instance, the revocation of authorization).

However, we may presume that answer to this question will be the same as for other financial intermediaries, i.e., the removal of the persons responsible for management from their positions[51].

5.3. Another profile of corporate governance relevant for granting authorization concerns the internal control system of PIs.

The internal control system or mechanism means a set of rules, policies, and procedures an organization implements to provide direction, increase efficiency and strengthen adherence to policies. These are important for achieving the business objective. The components of an internal control system are closely linked to the company organization. Regarding PIs, the PSD2 provides for two different structures.

First, according to Article 5 (1), point (e) of PSD2, the applicant must present "a description of the applicant's governance arrangements and internal control mechanisms, including administrative, risk management and accounting procedures, which demonstrates that those governance arrangements, control mechanisms and procedures are proportionate, appropriate, sound and adequate". As regards this profile, the EBA issued the same rules for PIs[52] and for AISPs[53].

First, the applicant should provide a description of the governance arrangement and the internal control mechanisms consisting of:

a) a mapping of the risks identified by the applicant, including the type of risks and the procedures the applicant will put in place to assess and prevent such risks;

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[51] See below the comment to Article 13 of PSD2 at paragraph 6.
[52] See EBA Guidelines, Section 4 (1), point (8).
[53] See EBA Guidelines, Section 4 (2), point (6).

b) the different procedures to carry out periodical and permanent controls including the frequency and the human resources allocated;

c) the accounting procedures by which the applicant will record and report its financial information;

d) the identity of the person(s) responsible for the internal control functions, including for periodic, permanent and compliance control, as well as an up-to-date curriculum vitae;

e) the identity of any auditor that is not a statutory auditor pursuant to Directive 2006/43/EC;

f) the composition of the management body and, if applicable, of any other oversight body or committee;

g) a description of the way outsourced functions are monitored and controlled so as to avoid an impairment in the quality of the PI's internal controls;

h) a description of the way any agents and branches are monitored and controlled within the framework of the applicant's internal controls;

i) where the applicant is the subsidiary of a regulated entity in another EU Member State, a description of the group governance.

Second, regarding solely PIs, according to Article 5 (1), point (k) of PSD2, for PIs subject to the obligations in relation to money laundering and terrorist financing under Directive (EU) 2015/849 of the European Parliament and of the Council (1) and Regulation (EU) 2015/847 of the European Parliament and of the Council (2), the applicant must present a description of the internal control mechanisms which the applicant has established in order to comply with those obligations".

The EBA[54] states that the description of the internal control mechanisms that the applicant has established to comply, where applicable, with those obligations should contain the following information:

[54] See EBA Guidelines, Section 4 (1), point (14): Internal control mechanisms to comply with obligations in relation to money laundering and terrorist financing (AML/CFT obligations).

(a) the applicant’s assessment of the money laundering and terrorist financing risks associated with its business, including the risks associated with the applicant’s customer base, the products and services provided, the distribution channels used and the geographical areas of operation;

(b) the measures the applicant has or will put in place to mitigate the risks and comply with applicable anti-money laundering and counter terrorist financing obligations, including the applicant’s risk assessment process, the policies and procedures to comply with customer due diligence requirements, and the policies and procedures to detect and report suspicious transactions or activities;

(c) the systems and controls the applicant has or will put in place to ensure that its branches and agents comply with applicable anti-money laundering and counter terrorist financing requirements, including in cases where the agent or branch is located in another Member State;

(d) arrangements the applicant has or will put in place to ensure that staff and agents are appropriately trained in anti-money laundering and counter terrorist financing matters;

(e) the identity of the person in charge of ensuring the applicant’s compliance with anti-money laundering and counter-terrorism obligations, and evidence that their anti-money laundering and counter-terrorism expertise is sufficient to enable them to fulfil this role effectively;

(f) the systems and controls the applicant has or will put in place to ensure that its anti-money laundering and counter terrorist financing policies and procedures remain up to date, effective and relevant;

(g) the systems and controls the applicant has or will put in place to ensure that the agents do not expose the applicant to increased money laundering and terrorist financing risk;

(h) the anti-money laundering and counter terrorism manual for the staff of the applicant.

6. Prudential requirements are relevant for all parts of the authorization procedure that it is regulated by Articles 11, 12, 13 and 16 of PSD2 and it is divided into four different legal parts:

(a) granting of authorisation,

(b) communication of the decision,

(c) withdrawal of authorization and

(d) maintenance of authorization.

The authorisation process is regulated by Article 11 of PSD2. According to Article 11 (1), Member States shall require undertakings other than those referred to in points (a), (b), (c), (e) and (f) of Article 1 (1) and other than natural or legal persons benefiting from an exemption pursuant to Article 32 or 33[55], who intend to provide payment services, to obtain authorisation as a PI before commencing the provision of payment services. An authorisation shall only be granted to a legal person established in a Member State.

According to Article 11 (2), competent authorities shall grant an authorisation if the information and evidence accompanying the application complies with all of the requirements laid down in Article 5 of PSD2, already analysed in this chapter, and if the competent authorities' overall assessment, having scrutinised the application, is favourable. Before granting an authorisation, the competent authorities may, where relevant, consult the national central bank or other relevant public authorities. However, the Article 11 introduces other two requirements; one shall be applied to all PIs, the other one to apply only to PI provides any of the payment services as referred to in points (1) to (7) of Annex I and, at the same time, is engaged in other business activities.

Article 11 (3) introduces an important requirement for authorization: a PI which, under the national law of its home Member State, is required to have a

[55] For a comment of these two articles see and BOŽINA BEROŠ, *Chapter 4: Title II 'payment service providers', Chapter 1 'Payment Institutions', Section 4 'Exemptions' (arts 32-34)*, in GIMIGLIANO and BOŽINA BEROŠ (eds), p. 82.

registered office, shall have its head office in the same Member State as its registered office and shall carry out at least part of its payment service business there. This requirement, provided for all financial intermediaries, was introduced by Article 3 of Directive 95/26/EC of 29 June 1995 to preclude financial intermediaries from benefiting from regulatory arbitrage. It is particularly strange that this requirement is indicated in the rule regarding the granting of authorization and not in Article 5 which contains all the other requirements; but it can be readily supposed that the Italian legislature will adopt the same solution used for all other financial intermediaries and will maintain the cited requirement among the other requirements.

Article 11 (5) states that where a PI provides any of the payment services as referred to in points (1) to (7) of Annex I and, at the same time, is engaged in other business activities, the competent authorities may require the establishment of a separate entity for the payment services business, where the non-payment services activities of the PI impair or are likely to impair either the financial soundness of the PI or the ability of the competent authorities to monitor the PI's compliance with all obligations laid down by PSD2.

Despite the objective authorisation requirements, the competent authorities still enjoy some degree of leeway. Indeed, the competent authorities shall grant an authorisation only if, taking into account the need to ensure the sound and prudent management of a PI[56],

(a) the PI has robust governance arrangements for its payment services business, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective procedures to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate internal control mechanisms, including sound administrative and accounting procedures [Article 11 (4)];

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[56] For example, *sub* point (a) and the rule of Article 11 (6), it is not possible to find an objective definition of "sound and prudent management".

(b) where close links[57]exist between the PI and other natural or legal persons, those links do not prevent the effective exercise of their supervisory functions [Article 11 (7)];

(c) the laws, regulations or administrative provisions of a third country governing one or more natural or legal persons with which the PI has close links, or difficulties involved in the enforcement of those laws, regulations or administrative provisions, do not prevent the effective exercise of their supervisory functions [Article 11 (8)].

Moreover, the competent authorities shall refuse to grant an authorisation if, taking into account the need to ensure the sound and prudent management of a PI, they are not satisfied as to the suitability of the shareholders or members that have qualifying holdings [Article 11 (6)].

Concluding, Article 11 (9) provides the principle of passporting; indeed, an authorisation shall be valid in all Member States and shall allow the PI concerned to provide the payment services that are covered by the authorisation throughout the Union, pursuant to the freedom to provide services or the freedom of establishment.

About the communication of the decision, withdrawal and maintenance of authorisation, Article 12 states that within 3 months of receipt of an application or, if the application is incomplete, of all those information required for the decision, the competent authorities shall inform the applicant whether the authorisation is granted or refused. The competent authority shall give reasons where it refuses an authorisation.

Conversely, according to Article 13, the competent authorities may withdraw an authorisation issued to a PI only if the institution:

[57] "Close links" are defined in Article 4 (1), point (38) of Council Regulation (EU) 575/2013, cit., 'close links' means a situation in which two or more natural or legal persons are linked in any of the following ways: (a) participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of an undertaking; (b) control; (c) a permanent link of both or all of them to the same third person by a control relationship.

(a) does not make use of the authorisation within 12 months, expressly renounces the authorisation or has ceased to engage in business for more than 6 months, if the Member State concerned has made no provision for the authorisation to lapse in such cases;

(b) has obtained the authorisation through false statements or any other irregular means;

(c) no longer meets the conditions for granting the authorisation or fails to inform the competent authority on major developments in this respect;

(d) would constitute a threat to the stability of or the trust in the payment system by continuing its payment services business; or

(e) falls within one of the other cases where national law provides for withdrawal of an authorisation.

The competent authority shall give reasons for any withdrawal of an authorisation and shall inform those concerned accordingly, and make public the withdrawal of an authorisation, including in the registers referred to in Articles 14 and 15.

Finally, according to Article 16, where any change affects the accuracy of information and evidence provided in accordance with Article 5, the PI shall, without undue delay, inform the competent authorities of its home Member State accordingly.

7. The Commission's 2020 Communication on a Retail Payments Strategy (RPS) for the EU[58] laid down the Commission's priorities regarding the retail payments sector for the term of office of the current College of Commissioners (2019-2024). It was accompanied by a Digital Finance Strategy, which set out priorities for the digital agenda in the finance sector other than payments. The RPS

[58] COM (2020) 592 final, of 24 September 2020.

announced that "*at the end of 2021, the Commission will launch a comprehensive review of the application and impact of PSD2*".

This review was duly undertaken, essentially in 2022, and led to a decision by the Commission to propose legislative amendments to PSD2, to improve its functioning. These amendments are set out in two proposals:

a) the proposal for a Directive on payment services and electronic money services, focussing on licensing and supervision of PIs and amending certain other Directives (hereinafter PSD3[59]) and

b) a proposal for a Regulation on payment services in the EU[60].

The proposal for a Directive on licensing and supervision of PIs is largely based on Title II of PSD2, regarding "Payment Service Providers", which only applies to PIs. It updates and clarifies the provisions relating to PIs and integrates former EMIs as a sub-category of PIs (and consequently repeals the second Electronic Money Directive, 2009/110/EC)[61]. Furthermore, it includes provisions

[59] COM (2023) 366 final, of 28 June 2023. The second Electronic Money Directive (Directive 2009/110/EC) and the second Payment Services Directive (Directive 2015/2366/EC) will be repealed with effect from the date of application of PSD3.

[60] COM (2023) 367 final, of 28 June 2023.

[61] See also EBA, *Opinion of the European Banking Authority on its technical advice on the review of Directive (EU) 2015/2366 on payment services in the internal market (PSD2)* EBA/Op/2022/06 of 23 June 2022 at the link https://www.eba.europa.eu/sites/default/files/document_library/Publications/Opinions/2022/Opinion%20od%20PSD2%20review%20%28EBA-Op-2022-06%29/1036016/EBA%27s%20response%20to%20the%20Call%20for%20advice%20on%20the%20review%20of%20PSD2.pdf.
In particular it is important to indicate the point 19 (p. 15) where EBA proposes for the Directive to: a) align the initial capital requirements for all PIs with the exception of payment initiation service providers (PISPs) and account information service providers (AISPs), with CAs having discretion to decide, depending on the business model of money remitters whether to apply the threshold for initial capital or the one for own funds; b) apply Method B under Article 9 of PSD2 as a default method for the calculation of own funds requirements since it reflects in the best way the applicable risks arising from the activities. However, to address specific cases, the EBA also proposes CAs to have discretion to decide whether another method should be used based on uniform conditions and criteria, which should be set out in the Directive or by the EBA in a mandate; c) introduce additional own funds requirements for granting of credit related to the provision of payment services; and d) clarify the application of the professional indemnity insurance (PII), including its characteristics, risks to be covered, possibility of use of excess, deductibles and thresholds, and what could be considered as a comparable guarantee. The EBA also proposes to introduce initial capital requirements for AISPs as an alternative to PII during the process of authorisation. See also Section 2 of the EBA, *Opinion - Licensing of PIs and supervision of PSPs under PSD2 - Question 6 - Does the EBA see a need to change the prudential requirements under PSD2, such as the calculation of own funds for particular types of payment services or the application of the requirements on professional indemnity insurance?* (p. 34-44)

concerning cash withdrawal services provided by retailers (without a purchase) or independent ATM deployers and amends the Settlement Finality Directive (Directive 98/26/EC)[62].

As regards the main object of this research, licensing and supervision of PIs, we may resume that the procedures for application for authorisation and control of shareholding are mostly unchanged from PSD2, with the exception of a new requirement for a winding-up plan to be submitted with an application but made fully consistent for institutions providing payment services and electronic money services[63].

Amongst other changes, it is acknowledged that PISPs and AISPs may hold initial capital instead of a professional indemnity insurance, considering that the requirement to hold a professional indemnity insurance at the licensing stage may be difficult to fulfil, considering previous experience. Requirements for initial capital are updated for inflation since the adoption of PSD2, except for PISPs as this is considered not appropriate given the relatively short time, they have been in operation[64].

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[62] To understand better the reasons of changes we can put the attention to Recital (18) of PSD3 where the Commission underlines the results of The EBA Peer Review on authorisation under Directive (EU) 2015/2366 published in January 2023 (European Banking Authority, EBA/REP/2023/01, Peer Review Report on authorisation under PSD2). In this Report EBA *"concluded that deficiencies in the authorisation process have led to a situation where applicants are subject to different supervisory expectations as regards the requirements for authorisation as a payment institution or electronic money institution across the Union, and that sometimes the process of granting an authorisation may take an exceedingly long time. To ensure a level playing field and a harmonised process for the granting of an authorisation to undertakings applying for a payment institution license, it is appropriate to impose to competent authorities a time limit of 3 months for the authorisation process to be concluded, after the receipt of all the information required for the decision"*.

[63] See Article 3, paragraph 3, lett. s), PSD3.

[64] The new Article 5, *Initial capital*, of PSD3 states that "*Member States shall require payment institutions to hold, at the time of authorisation, initial capital, comprised of one or more of the items referred to in Article 26, points (1)(a) to (e), of Regulation (EU) No 575/2013 as follows:* ***(a)*** *where the payment institution provides only the payment service referred to in Annex I, point (5), its capital shall at no time be less than EUR* **25 000;** ***(b)*** *where the payment institution provides the payment service referred to in Annex I, point (6), its capital shall at no time be less than EUR 50 000;* ***(c)*** *where the payment institution provides any of the payment services referred to in Annex I, points (1) to (4), its capital shall at no time be less than EUR 150 000; (d) where the payment institution provides electronic money services, its capital shall at no time be less than EUR 400 000*".

If we focus attention on capital requirements, we may note the substantial difference between the minimum initial capital required for PIs and for banks: for PIs, at this moment the amount varies from EUR 20,000 to 125,000[65] whereas banks are required to have EUR 10,000,000[66]. We may presume that this sizeable difference is owing to the different activities carried out by banks. The latter hold deposits, which they use for a variety of risk-taking activities, including providing credit, and can pose a systemic risk to the wider financial system. On the other hand, PIs cannot take deposits and cannot use monies in a payment account to finance their own payment activities, including possible credit granting. PIs are therefore subject to an extremely low level of risk that does not pose a systemic risk to the financial system.

The possibility given to PIs to grant credit would not have justified the extension to them of the same minimum capital requirements provided for banks because, unlike the credit granting exercised by banks, that carried out by PIs is not connected to the business of taking deposits or repayable funds.

As regards this topic it is important to remember the recital 20 of the PSD3 proposal where it is stated that "*the prudential framework applicable to payment institutions should continue to rest on the premise that those institutions are prohibited from accepting deposits from payment service users and are only permitted to use funds received from payment service users for rendering payment services. Consequently, it is appropriate that prudential requirements applicable to payment institutions reflect the fact that payment institutions engage in more specialised and limited activities than credit institutions, thus generating risks that are narrower and easier to monitor and control than those that arise across the broader spectrum of activities of credit institutions*".

Continuing the brief considerations of PSD3, we may note that the possible methods for calculation of own funds are not changed, either for PIs covered by

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[65] Specifically, EUR 20,000 money remitters; EUR 50,000 mobile payments and EUR 125,000 full-range payment service providers including any credit.

[66] See also, European Commission, 'Payment Services Directive: Frequently Asked Questions' <https://ec.europa.eu/commission/presscorner/detail/en/memo_15_5793> accessed 15 February 2024.

PSD2 or for former electronic money institutions; it is provided that one of the three possible methods of calculation of own funds should be considered the default option to enhance the level playing field – but exceptions are allowed for particular business models[67].

Safeguarding rules for PIs are unchanged except that the possibility of safeguarding in an account of a Central Bank (at the discretion of the latter) is introduced in order to extend the options for PSPs in this regard and that PIs must endeavour to avoid concentration risk in safeguarded funds; EBA regulatory technical standards on risk management of safeguarded funds are to be adopted in this respect. For PIs providing electronic money services, the safeguarding rules are fully aligned with those applying to PIs only providing payment services. More detailed provisions on internal governance of PIs, including EBA guidelines, are introduced.

Member States and the European Banking Authority shall continue to maintain a register of authorised PIs and in addition develop a list of machine-readable payment initiation services providers and account information service providers.

As in PSD2 and the Electronic Money Directive, competent authorities, with adequate powers, must be designated by Member States for licensing and supervision. Provisions for cooperation between national competent authorities are laid down, clarifying the rules in this regard, and adding the possibility for NCAs

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[67] The new Article 7 of PSD3, named "Calculation of own funds for payment institutions not offering electronic money services", will replace the Article 5 of PSD2 and states that "*1. Notwithstanding the initial capital requirements set out in Article 5, Member States shall require payment institutions, other than payment institutions that either only offer payment initiation services as referred to in Annex I, point (6), or only offer account information services as referred to in Annex I, point (7), or both, and other than payment institutions offering electronic money services, to hold own funds calculated in accordance with paragraph 2 at all times. 2. Competent authorities shall require payment institutions to apply, by default, method B as laid down in point b) below. Competent authorities may however decide that, in light of their specific business model, in particular where they only execute a small number of transactions but of a high individual value, payment institutions shall rather apply method A or C. For the purposes of methods A, B and C, the preceding year is to be understood as the full 12-month period prior to the moment of calculation*". See also the Article 8 of PSD3 that introduces a new rule regarding the *Calculation of own funds for payment institutions offering electronic money services*.

to request assistance of the EBA in solving possible disagreements between other NCAs.

As in PSD2, PIs which only carry out account information services are subjected to a requirement of registration not authorisation. The proposal specifies the documentation that must accompany the registration application. Account information service providers remain supervised by competent authorities. The optional exemptions from certain provisions which Member States may grant to small PIs are unchanged.

PRIVATE ECONOMIC INITIATIVE AND BANK CORPORATE GOVERNANCE AT THE TIME OF SUSTAINABILITY: REFLECTIONS ON CURRENT TRENDS

Giovanni Capo* - Edoardo De Chiara**

ABSTRACT: *This research aims to analyse the significant effects arising from the impact of sustainability issues on private economic initiative, and to assess how these are affecting bank corporate governance.*

SUMMARY: 1. Foreword. 2. The "new paradigms" of enterprise. 3. The "new paradigms" in the European framework. 4. The "new paradigms" in the Italian legal system. 4.1. Regulatory interventions in ordinary law. 4.2. Self-regulation. 4.3. The constitutional legislature. 5. Common company law and evolutionary processes. 6. The goals of sustainable finance. 7. Effects on bank corporate governance. 8. Summary considerations.

1. This paper explores crucial aspects of the much-debated issue of sustainability, assessing how the "new paradigms" impact enterprise and banking. It will thus seek to determine whether sustainability and its consequences are affecting bank corporate governance in different ways compared to common law enterprises, at least in terms of how typical functional goals are impacted.

2. Alongside the traditional view of the enterprise as a productive concern aiming to achieve shareholders' interests (i.e. maximizing the value of their investment and the returns on them), there is also a tendency to focus on interests

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The entire work has been thought and discussed by both authors; however, paragraphs 2, 3 and 4. 4.1, 4.2, 4.3, 5 are attributable to Giovanni Capo, while paragraphs 1, and 6, 7, 8 are attributable to Edoardo De Chiara.

outside the corporate structure. This is especially true of large corporations and constitutes the core of corporate social responsibility (CSR) theory [1].

In essence, the management policies of large companies must be geared towards responding to petitions beyond the maximization of shareholder profit, i.e. those from the various centres of interest impacted more or less directly and to a greater or a lesser extent by their economic activity. These might, for instance, include the interests of workers, operators in the supply chain, consumers and users as well as, more generally, the now increasingly extended communities where productive activity takes place[2].

This vision of the more recent expressions of society tasks governance with seeking the point of equilibrium (or, rather, of synthesis) between a) the remunerative (selfish) nature of the traditional aims of a business model, and b) the adoption of Environmental, Social and Governance (ESG)-oriented strategies characterised by social and environmental sustainability criteria[3].

In this approach, and regardless of the achievement of profit maximization goals, the economic initiative must be carried out consistently with procedures that make it possible to contain, or indeed neutralize, its long-term impact on the social fabric, on the environment and, ultimately, on collective well-being, thus making it sustainable. This presupposes that sustainability, as defined above, is a

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[1] See C. ANGELICI, *Divagazioni sulla "responsabilità sociale" d'impresa*, in *Riv. soc*., 2018, 3 et seq.; H. FLEISCHER, *La definizione normativa dello scopo dell'impresa azionaria: un inventario comparato*, ivi, 803 et seq.; M. STELLA RICHTER JR., *Long-Termism*, in *Riv. soc*., 2021, 16 et seq.; U. TOMBARI, *La proposta di direttiva sulla Corporate Due Diligence e sulla Corporate Accountability: prove (incerte) di un capitalismo sostenibile*, ivi, 375; ID., *Corporate social responsibility (CSR), environmental social governance (ESG) e "scopo della società"*, in *Riv. dir. comm*., 2021, 225 et seq.; F. CAPRIGLIONE, *Responsabilità sociale d'impresa e sviluppo sostenibile*, in *Riv. trim. dir. econ*., Suppl. n. 4/2022, 1 et seq; G.B. PORTALE, *La Corporate Social Responsibility alla prova dell'effettività*, in *Banca borsa tit. cred*., 2022, 947 et seq.; A. SACCO GINEVRI – L. LOCCI, *All stakeholders are equal, but shareholders are more equal than others*, in this *Journal*, 20.02.2023;F. FIMMANÒ, *Art. 41 della Costituzione e valori ESG: esiste davvero una responsabilità sociale dell'impresa ?*, in *orizzonitideldirittocommerciale.it*; A. GENOVESE, *La gestione ecosostenibile dell'impresa azionaria. Fra regole e contesto*, Bologna, 2023.

[2] See S. ROSSI, *Il diritto della Corporate Social Responsibility, in Riv. ODC*, 2021, 99 et seq.

[3] See S.A. CERRATO, *Appunti per una «via italiana» all'ESG: l'impresa «costituzionalmente solidale» (anche alla luce dei «nuovi» artt. 9 e 41, comma 3, Cost.*, in *AEG*, 2022, 1 et seq., and in *Governance e mercati. Studi in onore di Paolo Montalenti*, I, Turin, 2022, 227 et seq. For a different *thesis* see U. TOMBARI, loc. ult. cit.

determining factor in ensuring the economic sustainability of the enterprise, thereby fostering its financial equilibrium and continuity over time[4].

Apart from the actual feasibility of governance policies aiming to combine financial and non-financial sustainability[5], it remains to be seen whether and to what extent the current regulatory framework reflects the corporate enterprise as a productive body aiming not only to make a profit but also to pursue interests beyond those of the shareholders and, potentially, to make these a priority [6].

3. These new business paradigms stem from the underlying trend in the evolving European scenario. In many countries, such as France and the UK, there are interventions that, despite following profoundly different systematic approaches, seem to reframe the classic paradigm of corporate goals by enhancing interests not directly related to the corporate structure and, indeed, "external" to it[7].

Unsurprisingly, European Union legislation appears to be giving ever greater prominence to the enhancement of social and environmental sustainability issues in the planning, organization and management of economic activities[8], albeit from different perspectives and on different levels.

Recent years have seen a marked shift in the European Commission's position. It has moved away from a position based on the optional choice of

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[4] See M. STELLA RICHTER JR., *op. cit*., 30.

[5] See M. STELLA RICHTER JR., *op. cit*., 48; F. DENOZZA, *Lo scopo della società tra short-termism e stakeholder empowerment*, in Riv. *ODC*, 2021, 37 et seq.; S.A. CERRATO, *op. cit*., 232.

[6] See for further information G.D. MOSCO - R. FELICETTI, *Orizzonte temporale e corporate governance sostenibile tra iniziative europee e autodisciplina interna*, in Aa.Vv., *Governance e mercati*, cit., I, 267 et seq., ivi, 273 et seq.; F. DENOZZA, *Due concetti di stakeholderism*, ivi, 768 et seq.; P.M. SANFILIPPO, *Tutela dell'ambiente e "assetti adeguati" dell'impresa: compliance, autonomia ed enforcement*, in *Riv. dir. civ*., 2022, I, 993 et seq.

[7] See G.B. PORTALE, *op. cit*., 949; P.M. SANFILIPPO, *op. cit*., 993 s.; C. AMATUCCI, *Responsabilità sociale dell'impresa e obblighi degli amministratori. La giusta via di alcuni legislatori*, in *Giur. comm.,* 2022, 632 et seq.; C. ANGELICI, *A proposito di shareholders, stakeholders e statuti*, in *Riv. dir. comm*., 2021, 213 et seq.; G.D. MOSCO-R. FELICETTI, *op. cit*., 267 et seq.

[8] See M. LIBERTINI, *Economia sociale di mercato e responsabilità sociale dell'impresa, in, La responsabilità sociale dell'impresa. In ricordo di Giuseppe Auletta*, *edited by* V. Di Cataldo - P.M. Sanfilipppo, Turin, 2015, 34. For the A., in the past, it cannot be considered that a real legal duty.

companies in the adoption of CSR-inspired and ESG-oriented management policies towards a new perspective in which social responsibility and sustainability are promoted and incentivized or even imposed on companies[9], at least in certain respects and in certain contexts.

Indeed, the upshot of this shift in perspective can already be seen in the Non-Financial Reporting Directive (2014/95/EU), as amended by Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022, issued following the proposed amendment of 21 April 2021 (COM (2021) 189 final). The latter required large companies that constitute public interest concerns and employ an average of five hundred people over the financial year to disclose information on the policies that they have freely adopted for the management of environmental and social risks (Art. 1)[10].

Similar signs can be seen in the Shareholders' Rights Directive (2017/828/EU). This stipulates that companies whose registered office is in a member state and whose shares are traded on a regulated market located or operating within a member state must establish policies for the remuneration of management contributing to the definition of corporate strategies, the achievement of long-term goals and the sustainability of those companies (Recital 29)[11].

Also in this vein are the Commission's Action Plan on Sustainable Finance, presented on 8 March 2018, and Regulation (EU) 2020/852 of 18 June 2020, on Taxonomy Regulation, aiming to establish uniform criteria for determining the "eco-sustainability" of economic activities[12].

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[9] Cf. M. LIBERTINI, *Sulla proposta di direttiva UE*, cit., 329.

[10] On non-financial information see M. MAUGERI, *Informazione non finanziaria e interesse sociale*, in *Riv. soc.*, 2019, 992 et seq.; G. STRAMPELLI, *L'informazione non finanziaria tra narrazione e misurazione delle politiche di sostenibilità*, in *La nuova società quotata: tutela degli stakeholders, sostenibilità e nuova governance*, edited by P. Montalenti-M. Notari, Milan, 2022, 209 et seq.; M. RESCIGNO, *Note sulle «regole» dell'impresa «sostenibile». Dall'informazione non finanziaria all'informativa sulla sostenibilità*, in *An. giur. econ.*, 2022, 165 et seq.

[11] Cf. ASSONIME, *Doveri degli amministratori e sostenibilità. Note e Studi*, 6/2021, I.

[12] P.M. SANFILIPPO, *op. cit.*, 995; A. GENOVESE, *La gestione ecosostenibile*, cit.

The terms of the new approach are explicitly defined in the Inception Impact Assessment for Sustainable Corporate Governance Initiative of 30 July 2020. This stems from an analysis highlighting the limitations of business policies characterised by shareholder primacy and short termism and lays out a number of interventions to foster the adoption of long-term scheduled management choices with a view to protecting stakeholders' interests. These will be achieved both through the reformulation of the concept of social interest and management's fiduciary duties and through the provision of investor incentives [13].

More recently, on 23 February 2022, the European Commission followed up on the European Parliament's resolution of 10 March 2021 by adhering to the contents of the Sustainable Corporate Governance Initiative document of July 2020 and formulating the proposal for a directive of the European Parliament and of the Council on the need for oversight of companies with regard to sustainability, thereby amending Directive (EU) 2019/1937[14]. Following the agreement reached by the European Parliament and the Council on 14 December 2023, this proposal was approved, although greatly reduced in content and scope, by the Council of the European Union on 15 March 2024 and by Parliament on 24 April.

This is a directive that will impact the general framework of company law by requiring corporations, especially those larger than the specified parameters, to respect human rights, the natural environment, the climate and the rules of good governance along the value chain, through the introduction of more specific obligations to ensure their protection and a system of sanctions to be applied in the event of non-compliance[15].

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[13] See M. LIBERTINI, *op. ult. cit*., 329 s.

[14] On proposal see M. LIBERTINI, *op. ult. cit*., 325 et seq.; P. MARCHETTI, *Il bicchiere mezzo pieno*, in *Riv. soc*., 2021, 336 et seq.; E. BARCELLONA, *La sustainable corporate governance nelle proposte di riforma del diritto europeo: a proposito dei limiti strutturali del c.d. stakeholderism*, in *Riv. soc*., 2022, 1 et seq.; G.D. MOSCO-R. FELICETTI, *Prime riflessioni sulla proposta di direttiva UE in materia di Corporate Sustainability Due Diligence*, in *An. giur. econ*., 2022, 201 et seq.; G. BALLERINI, *Spunti problematici su sostenibilità, modifiche alla Costituzione italiana e Proposta di Direttiva europea sulla dovuta diligenza*, in *Studium iuris*, 2022, 999 et seq.

[15] See M. LIBERTINI, op. ult. cit., 331; S.A. CERRATO, *op. cit*., 234 et seq.

The aim is not simply to reduce corporate profitability so as to achieve social and environmental objectives, but to nurture the profit motive through policies consistent with the changing context in which economic activity must take place in order to achieve the objectives of European institutions [16].

Against this backdrop, the directive is authoritatively believed to be a key waystage along the path toward regulating economic activities in terms of sustainability.

4. Awareness of the values of social and environmental sustainability has grown considerably in recent years, although it has not resulted in national regulatory interventions to modify the function of business accordingly.

4.1. Many significant measures have been drawn up to urge compliance with social and/or environmental values in the conduct of economic activities, including:

i) Article 1 (5), (d) of law No. 180 of 11 November 2011, (Rules for the Protection of Freedom of Enterprise. Business Statute);

ii) Law No. 208 of 28 December 2015, Article 1 (376-383), regulating benefit companies[17];

[16] P. MARCHETTI, *op. cit.,* 337 et seq.

[17] See S. CORSO, *Le società benefit nell'ordinamento italiano: una nuova "qualifica" tra profit e non-profit (Art. 1 commi 376-384, L. 28 dicembre 2015, n. 208 e Allegati 4 e 5 in G.U. n. 302 del 30 dicembre 2015, S.O. n. 70)*, in *Nuove leggi civ. comm*., 2016, 995; D. SICLARI, *Le società benefit nell'ordinamento italiano*, in *Riv. trim. dir. econ*., 2016, 36; A. FRIGNANI-P. VIRANO*, Le società benefit davvero cambieranno l'economia?*, in *Contr. impr*., 2017, 503 et seq.; A. GALLARATI, *Incentivi e controllo del mercato nella società benefit. Un'analisi economica e comparata*, ivi, 2018, 806 et seq.; D. STANZIONE, *Profili ricostruttivi della gestione di società benefit*, in *Riv. dir. comm*., I, 2018, 487 et seq.; .

iii) the regulation of social enterprises, introduced by Legislative Decree No. 155 of 24 March 2006, which was subsequently repealed by Legislative Decree No. 112 of 3 July 2017 – enacted in implementation of the delegation conferred on the government by Law No. 106 of 6 June 2016 – which now regulates such an institution[18];

iv) Article 6 (3), (c) and (d) of Legislative Decree No. 175 of 19 August 2016, on the Consolidated Law on Publicly Owned Companies;

v) The legislation implementing the European directive on non-financial reporting, enacted by Legislative Decree No. 254 of 30 December 2016[19];

vi) Article 57 (2) of the new Public Contracts Code, enacted by Legislative Decree No. 36 of 31 March 2023 [20].

4.2. The 'private' sources, so to speak, include the 2020 edition of the Self-Regulatory Code of Listed Companies drawn up by the Italian Stock Exchange. Also known as the Corporate Governance Code and in force since 2021, it embraces the above view and sets management the objective of "sustainable success," i.e. the realization of shareholders' interests while also taking interests outside the corporate structure into account. This principle has since been incorporated by several listed companies into their articles of association [21].

[18] Cf. art. 1, comma 1, d.lgs. n. 112/2017.
[19] We can consider as well the art. 21 et seq. Codice del consumo, d.lgs. 6 settembre 2005, n. 206, cf. P.M. SANFILIPPO, *op. cit*., 996.
[20] See l. 21 giugno 2022, n. 78, art. 1, comma 2, lett. f).
[21] See N. ABRIANI, *Successo sostenibile e regole statutarie: il ruolo del board nel Codice di Corporate Governance*, in *Riv. corporate governance*, 2021, 7 et seq.; O. CAGNASSO, *La dimensione dell'impresa e il Codice di corporate Governance*, ivi, 19 et seq.; P. MONTALENTI, *Il nuovo Codice di corporate Governance*, ivi, 39 et seq.; P. MARCHETTI, *Il nuovo Codice di Autodisciplina della società quotate*, in *Riv. soc*., 2020, 268 et seq.; M. VENTORUZZO, *Il nuovo Codice di Corporate Governance 2020: le principali novità*, in *Dir. merc. fin*., 2020, 439 et seq.; C. ANGELICI, *A proposito di shareholders, stakeholders e statuti*, in *Riv. dir. comm*., 2021, 213 et seq.; M. STELLA RICHTER JR., *Profili attuali dell'amministrazione delle società quotate*, in *Giur. comm*., 2021, I, 420 et seq.; A. CETRA-P. CUOMO, *"Responsabilità sociale" e gestione*

More specifically, Article 1 of the Code defines "sustainable success" as the "objective that guides management in the creation of long-term value for shareholders while taking the interests of other company stakeholders into account"[22]. This clearly points out that companies intent on complying with the self-regulatory provisions must commit to the implicit long-term pursuit of their shareholders' interests, while also pursuing stakeholders' interests relevant to the business scope of the company [23]. Management must therefore weigh up, gauge and adopt interests that are "external" to the corporate structure but also "relevant to the company". "Taking these interests into account" is no simple task and they must also find the point of equilibrium between the natural – and necessary – entrepreneurial objective of realizing shareholders' interests and the duty to foster the "external" interests adopted [24].

4.3. Article 41 of the Italian Constitution, which was drafted as a synthesis of diverse and partly opposing ideological, political and cultural positions[25], had already been earmarked for amendment[26] with a view to mitigating its dirigiste inspiration. However, another line of thought that values the elasticity of the littera legis has always denied any need for amendments.

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dell'impresa azionaria nel nuovo codice di corporate governance, in *Studi di diritto commerciale per Vincenzo Di Cataldo*, edited by C. Costa-A. Mirone-R. Pennisi-P.M. Sanfilippo-R. Vigo,Turin, 2021, 165 et seq.

[22] See for more D. STANZIONE, *op. cit*., 1026; F. CUCCU, *La (in)sostenibilità del nuovo codice di corporate governance*, in *Riv. dir. comm*., 2022, I, 250 et seq.

[23] Cf. P. MONTALENTI, *La nuova società quotata: quali prospettive?*, in *La nuova società quotata*, cit., 30 et seq.). On the problem of creditor protection see A. BASSI, *La CSR doctrine di fronte ai creditori, stakeholders di prima istanza*, in *Governance e mercati*, cit., 175 et seq.

[24] See P. MONTALENTI, *loc. ult. cit*.; P.M. SANFILIPPO, *op. cit*., 1023 et seq.

[25] See F. GALGANO, *La libertà di iniziativa economica privata nel sistema delle libertà costituzionali*, in *Trattato di diritto commerciale e di diritto pubblico dell'economia,* edited by F. Galgano, I. *La costituzione economica*, Padova, 1977, 511; V. BUONOCORE, *L'art. 41 della Costituzione: libertà e limiti dell'iniziativa economica privata*, in *Iniziativa economica e impresa nella giurisprudenza costituzionale*, *edited by* V. Buonocore, Naples, 2007, 3 et seq.; ID., *Etica degli affari e impresa etica*, in *Giur. comm*., 2004, I, 196.

[26] See F. ZATTI, *Riflessioni sull'art. 41 Cost.: la libertà di iniziativa economica privata tra progetti di riforma costituzionale, utilità sociale, principio di concorrenza e delegificazione*, in *Studi in onore di Claudio Rossano*, Naples, 2013, 2235 et seq.; N. IRTI, *L'ordine giuridico del mercato*, Rome-Bari, 1998.

Constitutional Law No. 1 of 11 February 2022 nevertheless amended Articles 9 and 41 of the Constitution, not such as to dilute their dirigiste scope but so as to bring the Charter into line with the new supranational trends discussed above. The role of private economic initiative and the limits imposed on it by the legal order were thus impacted[27] although the principle of general freedom remained the same.

The constitutional legislature essentially amended only the second and third paragraphs of Article 41, confirming that private economic initiative cannot be carried out in conflict with social utility, but the limits placed on its application were extended with explicit reference to health and the environment. Likewise, the new wording of the third paragraph supplemented the original text with specific reference to the environment, while deferring to the Law for the determination of suitable programmes and checks in the direction and coordination of public and private economic initiative for social purposes[28].

The reform of Article 41 of the Constitution was impacted by the particular attention then being paid to the relations between business enterprise – the most significant expression of economic initiative[29] – and the multiple interests of the communities involved in production processes[30].

The debate engaging economists, sociologists and jurists on the topic of "social responsibility"[31] and corporate "sustainability"[32] is now wide-ranging. This

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[27] Cf. A.O. COZZI, *La modifica degli artt. 9 e 41 Cost. in tema di ambiente: spunti dal dibattito francese sulla Carta dell'ambiente del 2004 tra diritti e principi*, in *dpceonline.it*, 3391 et seq.

[28] The art. 41 Cost.:«*L'iniziativa economica privata è libera. Non può svolgersi in contrasto con l'utilità sociale o in modo da recare danno alla salute, all'ambiente, alla sicurezza, alla libertà, alla dignità umana.La legge determina i programmi e i controlli opportuni perché l'attività economica pubblica e privata possa essere indirizzata e coordinata a fini sociali e ambientali*». The third paragraph of Article 9 Cost.: «*Tutela l'ambiente, la biodiversità e gli ecosistemi, anche nell'interesse delle future generazioni. La legge dello Stato disciplina i modi e le forme di tutela degli animali*».

[29] See G. OPPO, *Princìpi*, in *Trattato di diritto commerciale* directed by V. Buonocore, 1, Turin, 2001, 10 et seq.; ID., *L'iniziativa economica*, in *Scritti giuridici*, I, Padova, 1992, 16 et seq.; V. BUONOCORE, *L'impresa*, in *Trattato di diritto commerciale*, cit., I, 2.1, Turin, 2002, 8.

[30] See G.B. PORTALE, *op. cit*., 947 et seq.

[31] Cf. P. MARCHETTI, *op. cit*., 342 et seq.; S.A. CERRATO, *op. cit*., 255 et seq.; M. LIBERTINI, *Sulla proposta di Direttiva UE*, cit., 328; G. PALMIERI, *op. cit*., 18 et seq.; U. TOMBARI, *Riflessioni sullo statuto organizzativo dell'impresa sostenibile*, cit., 138 et seq.

has been fuelled to a great extent by the consequences of the covid-19 pandemic[33], which has led to profound reflections on the regulatory level and probably brought about the amendment of the Constitution[34].

From this perspective, the rationale behind the reform of Article 41 cannot be the promotion of an institutionalist view of enterprise, in which the limits placed on the exercise of economic initiative end up informing its function[35]. The limits imposed by the constitutional provisions, especially in the second paragraph, constitute "external" limits on the freedom of economic initiative, and not objectives that must be pursued[36]. Nor can the enterprise per se be identified as an institution devoted to the achievement of social and environmental ends on the basis of Article 41(3) of the Constitution, given that the possibility of preparing programmes aimed at orienting business activity toward such ends remains the express option of the legislature[37].

There is certainly no shortage of authoritative voices stressing the need to "resume reflection on Article 41(2) of the Constitution," precisely because of the profound changes that have impacted the regulatory landscape on an international, European and national scale. They have also raised the issue of whether the time is not now ripe to abandon the view of the legislation as a provision bearing precepts addressed exclusively to the legislature and, therefore,

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[32] See F. D'ALESSANDRO, *Il mantello di San Martino, la benevolenza del birraio e la Ford modello T, senza dimenticare Robin Hood (Divagazioni semi-serie sulla c.d. responsabilità sociale dell'impresa e dintorni)*, in *Riv. dir. civ*., 2022, 409 et seq.

[33] See *incipit* Part I (Obiettivi generali e struttura) PNRR.

[34] See M. LIBERTINI, *Sulla proposta di Direttiva UE su "Dovere di diligenza e responsabilità delle imprese*", in *Riv. soc*., 2021, 325 et seq., spec. 328; G. PALMIERI, *La crisi del diritto societario e la riscoperta del valore della "nuda" impresa nell'economia post Covid-19 (con uno sguardo all'art. 41 della Costituzione)*, in *Banca borsa tit. cred*., 2021, I, 18 et seq.; D. STANZIONE, *Scopo e oggetto dell'impresa societaria sostenibile*, in *Giur. comm*., 2022, I, 1023 et seq. For the consequences of the pandemic see v. N. ABRIANI-G.C. CASELLI-A. CELOTTO-F. DI MARZIO-S. MASINI-G. TREMONTI, *Il diritto e l'eccezione. Stress economico e rispetto delle norme in tempi di emergenza*, Rome, 2020.

[35] G. MINERVINI, *Contro la «funzionalizzazione» dell'impresa privata*, in *Riv. dir. civ*., 1958, I, 618 et seq., e in Scritti giuridici, Naples, 1998, 57 et seq.

[36] See G. OPPO, *L'iniziativa economica*, cit., 35; G. MARASÀ, *L'imprenditore. Artt. 2082-2083*, in *Il codice civile. Commentario*, founded and already directed by P. Schlesinger, continued by F.D. Busnelli-G. Ponzanelli, Milan, 2022, 16 et seq.

[37] Cf. V. BUONOCORE, *L'impresa*, cit., 11, e ID., *L'art. 41*, cit., 10 et seq.

not of immediate application in intersubjective relations, “in sharp contrast to the increasingly marked trend in the direction of the direct applicability of constitutional provisions”[38].

However, it is worth noting that the traditional reading of Article 41, which entrusts the legislature with the task of identifying the boundaries of economic initiative, does not appear inconsistent with the current European and national regulatory framework, as it does not downgrade the relevance of social utility and solidarity. Not surprisingly the fulfilment of these duties constitutes the limit on the exercise of enterprise in favour of social utility[39].

Within this frame of reference, a part of the legal doctrine claims that, in identifying health and environmental protection as additional limits to the freedom of private economic initiative, the 2022 reform merely incorporates principles long expressed by constitutional jurisprudence into Article 41[40].

While it is true that health and the environment were already contemplated by constitutional jurisprudence[41], the legislative emergence of principles already consolidated in institutional practice nevertheless gives them greater strength and content[42]. In this way, the opinion of those who see the amendment of Article 41(3) within the broader horizon of European Union law as the basis for opening up to a green programming of economic activities is also justified[43].

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[38] See P. MARCHETTI, *op. cit*., 342 et seq.

[39] Cf. G. OPPO, *Principi*, cit., 39. See also L. MENGONI, *Fondata sul lavoro: la Repubblica tra diritti inviolabili e doveri inderogabili di solidarietà*, in *Jus*, 1998, 49; A. BARBERA, *Art. 2*, in *Commentario della Costituzione*, *edited by* G. Branca, Bologna, 1975, 99. For the direct application of the art. 2 Cost. see S.A. CERRATO, *op. cit*., 255 et seq.

[40] See G. SEVERINI - P. CARPENTIERI, *Sull'inutile, anzi dannosa modifica dell'articolo 9 della Costituzione*, *in giustiziainsieme.it*. For different thesi, M. CECCHETTI, *Virtù e limiti della modifica degli articoli 9 e 41 della Costituzione*, in *Corti supreme e salute*, 2022, 1 et seq.

[41] See L. CASSETTI, *Riformare l'art. 41 della Costituzione: alla ricerca di “nuovi” equilibri tra iniziative economica privata e ambiente*, in *Il costituzionalismo mulitilivello nel terzo millennio: scritti in onore di Paola Bilancia*, in *federalismi.it*, 4/2022, 188 et seq. e, ivi, 200; I. SPEZIALE, *Il nuovo paradigma dell'impresa sostenibile*, in *Contr. impr*., 2022, 761 et seq.; F. FIMMANÒ, *op. cit*., 13 et seq.

[42] U. TOMBARI, *Riflessioni sullo statuto organizzativo dell'impresa sostenibile*, cit., 138.

[43] See M. CECCHETTI, *Virtù e limiti della modifica degli articoli 9 e 41 della Costituzione*, in *cortisupemeesalute.it*, 1/2022, 147; P. MARCHETTI, *op. cit*., 343.

Article 41 of the Constitution thus represents the foundation of an evolutionary process that, through the mediation of the legislature, aims to orient (not functionalize) businesses toward the goal of sustainability, and the reconciliation of opposing needs[44]. It also acknowledges that protecting the environment in which economic activity takes place while also safeguarding its social components in the medium to long term will result in greater resilience for the enterprise itself, which will directly benefit the subjects involved[45].

5. In this complex scenario, the evolutionary processes sweeping through the legal system are not remodulating the corporate objectives as defined in the general discipline dedicated to it (Article 2247 Civil Code), at least for the time being.

Interests and demands outside the corporate structure being brought into the causal dimension cannot be inferred from the above legislative interventions, with the exception of certain business models (such as social enterprises or benefit companies), in which the pursuit of objectives "other" than profit – to the exclusion of the latter or together with it – constitutes an essential and qualifying factor. However, in such cases the choice to make use of these organizational codes of economic activity[46] remains delegated to negotiating autonomy.

In this sense, the adoption of social and environmental sustainability as the purpose of a corporate enterprise remains substantially left to private autonomy, whereby such values are correlated to the legal configuration of a particular organizational form or model, such as social enterprises or benefit societies. Their adoption is the result of free determination of the subjects involved. It also arises when sustainability finds its raison d'être in the will of the corporate structure, as

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[44] ASSONIME, *Doveri degli amministratori e sostenibilità*, cit., 1.

[45] M. LIBERTINI, *Gestione "sostenibile" delle imprese e limiti alla discrezionalità imprenditoriale*, in *Contr. impr.*, 2023, 63; U. TOMBARI, *Corporate Social Responsibility*, cit., 227 s.; ID., *Corporate purpose e diritto societario: dalla "supremazia dell'interesse dei soci" alla libertà di scelta dello "scopo sociale"?*, in *Riv. soc.*, 2021, 1 et seq., spec. 13.

[46] See G.B. PORTALE, *op. cit.*, 953; S.A. CERRATO, *op. cit.*, 238; G. MARASÀ, *op. cit.*, 35.

expressed in the articles of association, or in management options induced or incentivized by specific regulatory measures[47]. This is without prejudice to the fact that any such choice by shareholders or management cannot result in the company's abdication of its selfish aims[48].

In other words, management policies focusing on sustainability can only be adopted within a causal framework in which pre-eminence is given to the pursuit of the shareholders' primary interest, namely the increase in returns on their investment. It is precisely this interest that management must typically take into account, unless excluded or limited by law[49].

It is quite another thing to say – in relation to the new evidence emerging from the regulatory landscape and the dynamic pervading the social fabric and markets – that it is questionable whether Article 2247 of the Civil Code reflects a functional view of the corporate enterprise – or, rather, of the enterprise per se[50] – that can still be said to be fully consistent with current models of economic development and in line with the evolution that, in other legal experiences mentioned above, seems to be impacting the institution[51].

It has been observed that the indications (and occasionally suggestions) provided by the disciplines to which reference has been made – for instance the legislation on social enterprises and others – could lead to a reading of Article 2247 of the Civil Code that fosters the increasing number of applications of the corporate setup for the pursuit of non-profit objectives, not as "exceptions" to the traditional profit-seeking or selfish configuration of the institution, but as the

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[47] R. COSTI, *Banca etica e responsabilità sociale delle banche, in La responsabilità sociale dell'impresa. In ricordo di Giuseppe Auletta*, cit., 131; M. CIAN, *Clausole statutarie per la sostenibilità dell'impresa: spazi, limiti e implicazioni*, in *Riv. dir. soc.*, 2021, 475 et seq.

[48] See G. BONFANTE-G. COTTINO, *L'imprenditore*, in *Trattato di diritto commerciale* directed by G. Cottino, I, Padova, 2001, 441; V. BUONOCORE, *L'impresa*, cit., 86 and 87.

[49] V. BUONOCORE, *loc. ult. cit*.

[50] See S.A. CERRATO, *op. cit*., 242; U. TOMBARI, *«Potere» e «interessi» nella grande impresa azionaria*, Milan, 2019; ID., *Corporate purpose e diritto societario: dalla «supremazia degli interessi dei soci» alla libertà di scelta dello «scopo sociale»?,* in *Riv. soc*., 2021, 1 et seq.; ID., *Corporate social responsibility*, cit., 225 et seq.

[51] U. TOMBARI, *«Potere» e «interessi» nella grande impresa azionaria*, cit., 102; I. SPEZIALE, *Il nuovo paradigma dell'impresa sostenibile*, cit., 753 et seq., spec. 759.

confirmation of a substantial functional neutrality acquired over time[52]. In line with the times and with the most widely felt demands of the social and economic fabric, this neutrality is legitimized for the pursuit of any lawful purpose[53].

What cannot be doubted is management's obligation – as confirmed by the amendments to the Civil Code (Article 2086, in particular) taken from the Business Crisis and Insolvency Code – to direct their actions on the basis of an appropriate rationale. This will promote the implementation of the corporate goal of realizing its shareholders' interests and ensure business continuity by equipping the enterprise with organizational, administrative and accounting structures able to prevent crisis situations and facilitate their timely detection[54]. This obligation is incumbent on every entrepreneur who, in compliance with regulatory and statutory precepts and the principles of due diligence underpinning their action (Article 2392 of the Civil Code), must define and implement management policies that assess "external" interests and give them prominence when (and provided that) this contributes to the maintenance of the going concern and when this is not incompatible with the preservation of the company's economic-financial equilibrium and its ability to operate on the market, producing value for the benefit of shareholders[55].

6. Even in the absence of a precise definition, "finance" that takes due account of the degree of compliance with ESG principles is commonly regarded as

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[52] See G. SANTINI, *Tramonto dello scopo lucrativo nelle società di capitali*, in *Riv. dir. civ.*, 1973, 133 et seq.

[53] See A. CETRA, *Impresa sociale vs. impresa socialmente responsabile: prove di avvicinamento tra terzo e secondo settore*, in *Oltre la pandemia. Società, salute, economia e regole nell'era post covid-19*, *edited by* G. Palmieri, Naples, 2020, 249 s. But see the thesi of G. BONFANTE-G. COTTINO, *op. cit.*, 440.

[54] Cf. S.A. CERRATO, *op. cit.*, 231.

[55] Cf. S.A. CERRATO, *op. cit.*, 249; See even G. RACUGNO-D. SCANO, *Il dovere di diligenza delle imprese ai fini della sostenibilità: verso un Green Deal europeo*, in *Riv. soc.*, 2022, 726 et seq. L. NAZZICONE, *L'art. 2086 c.c.: uno sguardo d'insieme*, in *Gli assetti organizzativi dell'impresa (Scuola Superiore della Magistratura, Quaderno n. 18)*, Rome, 2022, 44 et seq.; G. SCOGNAMIGLIO, *Genesi e fondamento dell'art. 2086, comma 2, c.c.*, ivi, 63 et seq., spec. 73; P.M. SANFILIPPO, *op. cit.,* 1000.

sustainable[56], not only on the internal organizational level of "intermediaries" but also in the selection of entities to be financed[57], investments to be made and products to be traded[58]. As mentioned above, the tendency to give prominence to sustainability has been gaining momentum in recent years, above all due to multifarious EU-regulatory drives[59] directing capital towards economic activities planned in accordance with ESG principles, in an increasingly transparent[60] and taxonomized[61] context characterized by homogeneous and comparable data[62].

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[56] For an examination of different notions of sustainable finance see M. SIRI, S. ZHU, *L'integrazione della sostenibilità nel sistema europeo di protezione degli investitori*, in *Banca Impr. Soc*., 2020, 12; M. GARGANTINI -M. SIRI, *Information Intermediaries and Sustainability: ESG ratings andd benchmarks in European Union,* in *ECMI working papaer*, no. 15/ november 2022, 3 et seq. On this topic see also F. CAPRIGLIONE, *Responsabilità sociale d'impresa e sviluppo sostenibile*, cit., 5 et seq.; ID., *Evoluzione della disciplina di settore*, in *Manuale di diritto bancario e finanziario* edited by F. Capriglione, Milan, 2024, 103 et seq.; F. RIGANTI - A.M. WEBER, *Market Regulation, Banking Industry and ESG: The Long and Winding Road to Sustainability*, in this *Journal*, 13.12.2021; V. TROIANO, *Regolamentazione finanziaria, finanza sostenibile e obiettivi ESG*, in *Riv. trim. dir. econon*., 2023, 587 et seq.

[57] See M. COSSU, *Sostenibilità e mercati: la sostenibilità ambientale dell'impresa dai mercati reali ai mercati finanziari*, in *Banca, borsa e tit. cred*., 2023, 592 et seq.; G. CAZZETTA, *Impatti della sostenibilità ambientale sulla valutazione del merito creditizio*, in *Riv. dir. banc*., Suppl. 2023, 23 et seq.

[58] See F. RIGANTI, *La gestione "sostenibile" del "risparmio gestito". Divagazioni sull'art. 47 della Costituzione (e non solo)*, in *Contr. Impr. Eur*., 2023, 509 et seq.; A. CARRISI, L*a finanza sostenibile e la ricerca di nuovi parametri di adeguatezza*, in *Riv. dir. banc*., Suppl., 2023, 3 et seq.; A. DAVOLA, *Informativa in materia di prodotti finanziari sostenibili, tutela dell'investitore e contrasto al greenwashing: le criticità dell'assetto europeo tra norme primarie e disciplina di dettaglio*, in *Riv. dir. banc*., 2022, 513 et seq. On the sustainability preferences M. RISPOLI FARINA, *La sostenibilità nei servizi di investimento*, in *orizzontideldirittocommerciale.it.*

[59] See, *inter alia*, F. CAPRIGLIONE, *Clima Energia Finanza. Una difficile convergenza*, Turin, 2023, *passim*.; L. VENTURA, *Corporate Sustainability Due Diligence and the New Boundaries of the Firms in the European Union,* in *European Business Law Review,* 2023, 239 et seq.; M. BODELLINI - D. SINGH, *Sustainability and finance: utopian oxymoron or achievable companionship ?*, in *Law and Economics Yearly Review*, 2021, 163 et seq.

[60] See M. RABITTI, *Due diligence sulla sostenibilità e digitalizzazione della catena del valore: l'apporto di blockchain e smart contracts*, in *Riv. trim. dir. econ*., 2022, 167 et seq.

[61] On the environmental and social taxonomy see T. DI MARCELLO, *Strategia europea sulla finanza sostenibile, informazione societaria e possibili riflessi sulla gestione della società*, in *Giur. comm*., 2023, I, 608 et seq. See also M. COSSU, *Tassonomia finanziaria e normativa dei prodotti finanziari sostenibili e governo societario*, in *Banca Imp. Soc*., 2022, 433 et seq.

[62] See L. AMMANNATI, *Dimensioni "eccentriche" dell'impresa bancaria nell'era della sostenibilità*, in *Riv. reg. merc*., 2023, 264. On the rating ESG, see S. MICHIELIN, *Misurare la sostenibilità : note introduttive e inuadramento del problema: il ruolo del rating ESG*, in *Riv. reg. merc*., 2022, 708 et seq. See also ECB, *Proposal for a Regulation of the European Parliament and of the Council on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities*, 4 October 2023, in https://eur-lex.europa.eu/legal-content/EN/TXT/?uri= CELEX:52023PC0314.

This will favour long-term rather than short-term results[63]. Thus, we are witnessing the integration of ESG factors into financial analyses[64] and the increasing diffusion of financial services and products, as well as funding and bank deposits defined as "sustainable" from an ESG perspective[65]. In spite of the residual and well-known dangers of social washing and greenwashing[66] potentially arising from current transition processes[67], there remains a doubt that this function of capital reorientation may be bringing about a veritable genetic change[68] in the purpose of banking. In order to dispel this doubt, it is worth assessing whether and how these (and other) exogenous drives are cogently impacting[69] bank corporate governance[70].

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[63] See G. FERRARINI - M. SIRI - S. ZHU, *The EU Sustainable Governance Consultation and the Missing Link to Soft Law*, in *ECGI Law working paper* N. 576/2021, April 2021, 26 et seq.; R. CALDERAZZI, *La sostenibilità nell'impresa bancaria*, in *Riv. trim. dir. econ*., Suppl. n. 4/2022, 172 et seq.

[64] See, *inter alia*, L. TRONCI, *Gli obiettivi "ESG" nella governance delle imprese bancarie: KPIe doppia materialità (Impact e Financial materiality)*, in *Riv. dir. banc*., Suppl. 2023, 109 et seq.

[65] See C. MARASCO, *Limiti normativi allo sviluppo del mercato dei green bond: la proposta di riforma dell'art. 2483 c.c*., in *Riv. dir. banc*., Suppl. 2023, 87 et seq.; P. COPPOTELLI, *La strategia europea sullo sviluppo sostenibile. In particolare, la finanza sostenibile e le modifiche al quadro regolamentare europeo*, in *AGE*, 2022, 299; V. BEVIVINO, *Il bank government dopo l'integrazione dei fattori ESG nella regolazione prudenziale europea*, in *Banca Imp. Soc*., 2022, 602.

[66] On this topic see A. BLANDINI - G. ALFANO - P. CAPPABIANCA, *Greenwashing-related risks: analysis and future perspectives to tackle environmentalism as a form of virtue-signalling*, in *Law and Economics Yearly Review*, 2023, 229 et seq.; D. BUSCH, *EU Sustainable Finance Disclosure Regulation*, in *Capital Markets Law journal*, vol. 18, n. 3, 2023, 327; G. SCHNEIDER, *Per un approccio sostanziale alla finanza sostenibile: il greenwashing sotto la lente del rischio di condotta*, in *Riv. trim. dir. econ*., Suppl. n. 4/2022, 223 et seq.; D. ROSSANO, *Il fenomeno del* greenwashing *alla luce delle recenti evidenze empiriche. La proposta di direttiva* green claims, in *Riv. trim. dir. econ*., 2023, 601 et seq.

[67] See F. CAPRIGLIONE, *The financial system towards a sustainable transition,* in *Law and Economics Yearly Review*, 2021, 2 et seq.; E. BANI - E. SIGNORINI, *Come governare la transizione nel e del mercato*, in *Riv. trim. dir. econ*., Suppl. n. 4/2022, 459 et seq.

[68] Raises the question V. FORLENZA, *La conformazione della corporate governance bancaria nel contesto della transizione ecologica*, in *Riv. trim. dir. econ*., 2022, 202 et seq.

[69] A change in approach is recognised by M. RESCIGNO, *L'evoluzione e il ruolo dell'informazione non finanziaria fra doveri informativi ed obblighi gestori*, in *Riv. ODC*, 2023, 641.

[70] On this topic, already, F. CAPRIGLIONE - R. MASERA, *La corporate governance delle banche: per un paradigma diverso,* in *Riv. trim. dir. econ*., 2016, 296 et seq. The Authors argue that: "*Failures of the corporate governance of banking firms were one of the major causes of the 2007-09 Great Financial Crisis. Various reforms have been enacted to ameliorate Governance standards, notably risk management and incentive systems; but the key driver remains the improvement of shareholders rights, with a view to ensuring sustainable value creation.*".

7. With regard to the impact of the sustainability paradigm on bank corporate governance, the ECB and, above all, the Bank of Italy have intervened in essentially similar ways noteworthy because of their relative preceptive scope.

In November 2020, the ECB published the Guide on climate-related and environmental risks. Supervisory expectations relating to risk management and disclosure[71]. Expectation 3 states that "The management body is expected to consider climate-related and environmental risks when developing the institution's overall business strategy, business objectives and risk management framework and to exercise effective oversight of climate-related and environmental risks."

On 30 June 2021, The Bank of Italy published the 35th update to Circular No. 285 of 17 December 2013[72], containing the "Supervisory Provisions for Banks" stipulating that the corporate body with strategic supervisory functions should also take into account: "(iv) the sustainable finance targets, in particular, the integration of environmental, social and governance (ESG) factors into processes related to corporate decisions."

Part of the legal doctrine claims that the latter intervention has broken with the past and brought about a sort of functionalization of banking to the objectives of sustainability through a "genetic mutation" of the institution. This view is supported by several considerations: a) the fact that the many sources of soft law and hard law in Italy and the EU have a strong ideological component (i.e. financing sustainable growth); b) the fact that the Italian legal system does not envisage the clear US distinction between regulatory duties and ordinary duty care.

Although insightful and well-argued, this view is not widely accepted. Firstly, because the reference to an administrative regulatory source, albeit from an independent authority, should not be able to innovate the system by introducing

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[71] See ECB, *Guide on climate-related and environmental risks Supervisory expectations relating to risk management and disclosure*, November 2020.
[72] See *https://www.bancaditalia.it/compiti/vigilanza/normativa/archivio-norme/circolari/c285/*.

such a major genetic mutation not prescribed by superordinate hard-law regulatory sources.

As suggested above, although the main EU and Italian sources stress sustainability and the enhancement of ESG factors, they do not expressly or implicitly imply this quasi-managerial functionalization of the market, which has been overcome once and for all by the introduction of the Consolidated Banking Act.

The Circular update directly impacts supervision, as evidenced by its collocation within the application rules (the so-called application lines) and not among the general provisions or principles, limiting itself to specifying data consistent with tradition. Even if we set store in the absence of an explicit reference to the mere "eventuality" of sustainable finance objectives becoming prominent and, thus, accept the parameter's general cogency – although ESG factors cannot always be taken into account in decision-making processes – there remains the indisputable lack of any hierarchical calibration among the criteria. Hence, ESG factors apply as an operational criterion only where this is compatible with the profit-centred/mutualistic function. The typical social purpose of banking is in no way called into question[73], even though, ontologically speaking, banks were originally companies operating in the market, albeit subject to specific disciplines resulting from a complex regulatory compendium largely "acentric" with respect to common company law because of the interests involved.

The provision is perfectly homogeneous or, in any case, compatible the with the traditional banking system.

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[73] See A. SACCO GINEVRI, *Il problema dell'interesse sociale nelle banche*, in *Nuova giur. civ. comm.*, 2017, 1558 et seq.; ID., *Divagazioni su corporate governance e sostenibilità,* in *Riv. trim. dir. econ.*, Suppl. n.3 al n. 1,/2022, 85 et seq.; C. BRESCIA MORRA, *Chi salverà il pianeta: lo Stato o le grandi Corporation? ESG: una formula ambigua e inutile*, in *Riv. tri. dir. econ.*, Suppl. n. 4/2022, 94; F. RIGANTI, *Sostenibilità non finanziaria, "sana e prudente gestione" e governo societario delle banche. Arlecchino nel C.d.A.? (Note a margine di un convegno sull'isola di Capri)*, in *Riv. trim. dir. econ.*, 2022, 330 et 341; ID. *Regolazione del mercato e "fine di lucro". Spunti per una ricerca attualizzata in tema di sostenibilità*, in *Dialoghi di Diritto dell'Economia*, May 2022, *passim.*; ID., *L'impresa bancaria nella transizione sostenibile: principi e problemi*, in *AGE*, 2022, 325. On this topic see also F. CAPRIGLIONE - A. SACCO GINEVRI, *Metamorfosi della governance bancaria*, Turin, 2019, 183.

To this end, it is worth considering the Supervisory Expectations on Climate and Environmental Risks, dated April 8, 2022[74]. Indeed, the Bank of Italy itself states that: "The management body of intermediaries plays an active role in steering the integration of climate-related and environmental risks into the corporate culture and strategy, into the corporate risk appetite framework (where applicable) and into the risk limits of the portfolios managed, consistently defining the main corporate policies and the adaptation of organisational and management systems. In this regard, the management body approves an appropriate action plan."

It then specifies that in order to effectively fulfil these expectations, the management body should pay particular attention to: 1) expertise (the management body has to fully understand and assess the implications of climate-related and environmental risks)[75]; 2) roles and responsibilities (the management body explicitly assigns roles and responsibilities in relation to climate-related and environmental risks to its members and/or to existing intra-board committees; alternatively, intermediaries may consider establishing a dedicated committee)[76]; 3) adequate information flows.

However, these cannot be regarded as significantly new developments since they are also generally relevant for non-banking companies. Hence, nihil novi sub soli apart from their specific use in the sphere of sustainability.

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[74] See *https://www.bancaditalia.it/media/notizia/aspettative-di-vigilanza-sui-rischi-climatici-e-ambientali/*

[75] See on the general thema G. ALFANO, Fit e proper *nel governo delle banche. Idoneità individuale e adeguatezza collettiva nella prospettiva della* diversity *degli esponenti*, Bari, 2023, 57 et seq.

[76] On this topic see A. M. PANCALLO, *Fattori ESG e governance bancaria*, in *Riv. trim. dir. econ.*, Suppl. n. 4/2022, 217 et seq.

Even in the ESG perspective, the risks of sustainability are stressed more or less directly because of their impact on the traditional risks of banking, such as credit risk, market risk, operational risk and liquidity risk[77].

Thus, some initiatives can be regarded positively, such as those:

a) aiming to encourage the indication of ESG objectives among the variable components[78] making up the remuneration of banking's top management;

b) intended to pay due attention to the profile of expertise on sustainability issues.

The same can be said for the decision to include climate-related and environmental risks in the most important assessments, such as those on adequacy of capital and liquidity[79] due to their effects on so-called traditional prudential risks. Similar basic reasoning also applies to social and governance risks, although these seem to be considered less important[80] by regulatory initiatives[81]. It is an inescapable fact that ESG risks can impact the stability of both individual institutions and the financial system as a whole, thus justifying the proposals[82],

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[77] See EBA, *Report on management and supervision of ESG risks for credit institutions and investment firms,* 2021, *passim;* F. RIGANTI, *Climate change e vigilanza prudenziale: questioni di (semplici) "Aspettative"*, in *Nuove leggi civ. comm*., 2022, 1271 et seq.

[78] On this topic see A. CHILOIRO, *La remunerazione degli esponenti bancari*, Milan, 2023, 39 et seq /144 et seq.

[79] See R. CALDERAZZI, *La sostenibilità nell'impresa bancaria*, cit., 180.

[80] See C. BRESCIA MORRA, *Chi salverà il pianeta*, cit., 83.

[81] On this concept see S. AMOROSINO, *Le regolazioni pubbliche delle attività economiche*, Turin, 2021, 3 et seq.; A. SCIARRONE ALIBRANDI, *Innovazione tecnologica e regolazione dei mercati*, in *Mercati regolati e nove filiere di valore*, edited by R. Lener - G. Luchena - C. Robustella, Turin, 2021, 5 et seq.; M. CLARICH, *Alle radici del paradigma regolatorio dei mercati*, *ivi*, 17 et seq.

[82] See ECB, *Opinion of the European Central Bank of 24 March 2022 on a proposal for amendments to Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CON/2022/11).* See also ECB, *Opinion of the European Central Bank of 27 April 2022 on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, environmental, social and governance risk (CON/2022/16) 2022/C 248/03*.

later accepted with CRR III and CRD VI[83], to giving ESG risks greater prominence in the prudential framework.

On the other hand, the "expectations" aimed at burdening "intermediaries" with the exercise of purely predictive duties appear unacceptable. This is also true, and to a greater extent, for those claiming that the market and its operators can and must be functionalized[84] (and not simply oriented and facilitated) towards remedying the deficiencies of the public system[85]. That is, assuming there is no desire to undermine the social market economy[86] on which the European Union is founded[87]. This view[88] also seems corroborated by the fact that, even assuming the legitimacy of a regulatory intention to functionalize banks to ESG objectives, this

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[83] See *Regulation (EU) 2024/1623 of the european parliament and of the council of 31 May 2024 amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor*. See also Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024 amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks. On this topic see V. LEMMA, *Fintech and the impact on the corporate governance of commercial banks*, in *Law and Economics Yearly Review*, Special issue, 2023, 28; A. VITA, *Regolamentazione dei rischi emergenti e prospettive sul secondo pilastro di Basilea alla luce della CRD VI*, forthcoming in *Riv. dir. banc*.

[84] See, *inter alia*, M. PELLEGRINI - A. DAVOLA - N. CASALINO - P. BEDNAR, *Striking a balance between profit, people welfare, and ecosystem health in the transition towards a sustainable financial system*, in *Law and Economics Yearly Review*, 2021, 318 et seq.

[85] C. BRESCIA MORRA, *op. cit.,* 94 et seq.

[86] For different thesi, if we understand rightly, see P. CORRIAS, *Dignità della persona e mercato*, in *Riv. trim. dir. econ.*, Suppl. n. 4/2022, 435 et seq.

[87] Cf. Art. 3, par. 3, TUE.

[88] See CAPRIGLIONE - R. MASERA, *La corporate governance delle banche: per un paradigma diverso*, cit., 296 et seq. The Authors speculate that: "*Instead, in this paper it is argued that, to strive for a structural advance in the risk appetite framework of the banking firm, the fundamental assumption behind corporate governance – i.e. that the ultimate authority lies in shareholders (the "owners") who detain exclusive voting rights – should be reconsidered. To start with, it is recalled that, according to the options enterprise model, the effective owners of a corporation can be identified with its debt holders. More specifically and more recently, in the case of banking firms, the bailin/resolution mechanisms enacted create new obligations and responsibilities for holders of subordinated debt: accordingly, the traditional corporate governance framework should be modified to allow - in appropriate forms - for their voting rights and presence in the Board of Directors/Supervisory Board*". In the end, the Authors do not support a mere functionalization of the banking company to the public interest. The Authors say that the bank's activity is *oriented* by the public interest. Therefore, the discipline of bank governance is a kind of specification of the discipline of companies *tout court* (313 et seq.).

would expose the financial sustainability of firms to serious risks[89], which would, paradoxically, end up alienating depositors and investors and endangering the stability of the system[90]. If these considerations are framed in the present day with the constant need to address the critical implications[91] of new technologies[92] and, above all the risk of credit and financial disintermediation[93], the view discussed here is unfounded, albeit only logically.

8. Banking is not just another business enterprise but, rather, one of the pillars of contemporary capitalist systems, role it is likely to play for a long time to come. Thus, barring sudden, undesirable developments in technology[94], it will maintain its public relevance[95] and its characteristics different further private undertakings[96], as corroborated by a fragmented and complex sectoral discipline

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[89] See M. DE POLI, *La governance dei mercati finanziari*, in *Riv. trim. dir. econ*., Suppl. n. 4/2022, 134.

[90] R.LENER -P. LUCANTONI, *Sostenibilità ESG e attività bancaria*, in *Banca, borsa e tit. cred*., 2023, 21.

[91] The regulation of crypto-assets (MiCa) gives little importance to ESG factors, see F. RIGANTI, - T. RODRÍGUEZ DE LAS HERAS BALLELL - A.M. WEBER, *The «wild west» of digital finance – do we need an(other) eu «sheriff»?*, in *Law and Economics Yearly Review*, 2022, 102; F. RIGANTI, *Cripto-attività e finanza sostenibile: gli "opposti" (non) si attraggono ?,* in *Riv. dir. banc*., 2024, 16. See also I. ŻUCHOWSKI - F. CAPRIGLIONE- N. CASALINO- I. SKRODZKI, *Crypto assets, decentralized autonomous organizations and uncertainties of distributed ledger technologies*, in *Law and Economics Yearly Review*, 2022, 147. See also, on the risks of technology, L. AMMANNATI - G. L. GRECO, *Il credit scoring "intelligente": esperienze, rischi e nuove regole*, in *Riv dir. banc*., 2023, 461 et seq.; E. MACCHIAVELLO, *PMI sostenibili ed accesso a fonti alternative di finanziamento: green DLT-based finance e recenti normative europee*, in *Banca Imp. Soc*., 2023, 552 et seq.

[92] But see for the Fin Tech and the opportunities offered to sustainable finance, E. MACCHIAVELLO -M. SIRI, *Sustainable Finance and Fintech: Can Technology Contribute to Achieving Environmental Goals? A Preliminary Assessment of 'Green FinTech'*, in *European Banking Institute Working Paper Series*, 2020 – no. 71,16 et seq.

[93] F. CAPRIGLIONE, *Competition and stability in the digital paradigm, in Law and Economics Yearly Review*, 2023, 29; V. LEMMA, *Digital euro: is it a further way to financial disintermediation?*, in *Law and Economics Yearly Review*, 2022, 186 et seq.; See also F. CAPRIGLIONE - A. SACCO GINEVRI, *Metamorfosi della governance bancaria*, cit., 124; A.F. ARCELLI, *Could ESG Regulation Play a Significant Role in New international Financial Architecture ?*, in *Riv. trim. dir. econ*., supp. n. 2 al n. 3/2023, 9 et seq.

[94] See F. CAPRIGLIONE, *Le cripto attività tra innovazione tecnologica ed esigenze regolamentari,* in *Riv. trim. dir. econ.*, 2023, 225 et seq.

[95] See S. AMOROSINO*, Le dinamiche del diritto dell'economia,* Pisa, 2018, 26 et seq.

[96] See F. CAPRIGLIONE - R. MASERA, *Bank Corporate Governance: A New Paradigm*, in this Journal, 23/12/2016. In the second paragraph the authors state: "*Since the Eighties, characterised by banking de-regulation, the axiom that the bank is a firm has gained ground. This approach had*

operating on many levels. However, as argued above, this does not mean a functional alteration of the social purpose of the bodies involved, which will continue to meet the need for sound and prudent management[97]. Hence, despite the well-known warning that "tempus edax legum"[98], there seems to be no differing trend (or, rather, any incompatibility of the decisions taken) with respect to general company law.

some good points; however, it ended up with neglecting that the banking company has nevertheless some features that are special with respect to other corporations".

[97] On this topic see also M. SEPE, *Sviluppo, sostenibilità e sana e prudente gestione in ambito finanziario*, in *Diritti e mercati nella transizione ecologica e digitale*, edited by M. Passalacqua, Studi dedicati a M. Giusti, Milan, 2022, 63 et seq.

[98] S. AMOROSINO*, Le trasformazioni delle banche. Riforme Crisi Tutele*, Pisa, 2018, 9.