



PARAGUAY

TECHNICAL ASSISTANCE REPORT—BANK RESOLUTION FRAMEWORK AND THE DEPOSIT GUARANTEE FUND

July 2022

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TECHNICAL REPORT

PARAGUAY

Bank Resolution Framework and the Deposit Guarantee Fund

June 2022

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GLOSSARY

BB	Bridge Bank
BCP	Central Bank of Paraguay (for its acronym in Spanish)
CB	Central Bank
CNV	Securities Exchange Commission (for its acronym in Spanish)
CP	Core Principles for Effective Deposit Insurance Systems
DGF	Deposit Guarantee Fund
ELA	Emergency Liquidity Assistance
FAQ	Frequently Asked Questions
FSB	Financial Stability Board
FSC	Financial Stability Committee
FSSR	Financial Sector Stability Review
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund
INCOOP	National Institution of Credit cooperatives (for its acronym in Spanish)
IT	Information Technology
KA	Key Attributes of Effective Resolution Regimes for Financial Institutions
LEG	Legal Department of the IMF
LOLR	Lender of Last Resort
MCM	Monetary and Capital Markets Department of the IMF
MoF	Ministry of Finance
MOU	Memorandum of Understanding
NBFI	Non-Bank Financial Institution
NCWO	No Creditor Worse Off
NPL	Nonperforming Loan
P&A	Purchase and Assumption
Q&A	Questions and Answers
RRPs	Recovery and Resolution Plans
RA	Resolution Authority
SB	Banking Superintendence (for its acronym in Spanish)
TA	Technical Assistance
UAFGD	Administration Unit of the Deposit Guarantee Fund (for its acronym in Spanish)

PREFACE

At the request of the Central Bank of Paraguay (BCP), a joint technical assistance (TA) mission from the IMF's Monetary and Capital Markets Department (MCM) and the Legal Department (LEG), provided offsite TA between June 15 and July 8, 2021 on options to enhance the existing resolution framework and the Deposit Guarantee Fund (DGF). The mission comprised Miguel Otero (MCM), Luis Cortavarría-Checkley (MCM Expert), Mario Tamez (LEG), and Ignacio Caparoso (LEG Expert).

The mission conducted several participatory workshops on the topics related to the resolution framework and the DGF, each followed by Q&A sessions, and benefitted from constructive discussions with BCP management and staff.

The mission met remotely with Liana Caballero, Diego Duarte Schussmuller, and Fernando Filártiga, all Board members of the BCP; Hernán Colmán, Superintendent of Banks (SB); Edgar Paredes, Director of the Administration Unit of the Deposit Guarantee Fund (UAFGD); Aldo Rodriguez, Director of the Legal Department for Financial Institutions; Antonella Torio, Supervision Manager in the SB; María Elena Acevedo, Intendent of Regulations in the SB; Carlos Ayala, Head of Division in the Department of Supervision; Natalia Valinotti, Head of Division in the Intendency of Regulations; Maria Stael Herrera, Head of Accounting at the UAFGD; Ana Franco, Head of Investments at the UAFGD; Ana Vazquez, Senior Analyst in the Legal Department; and Griselda Figueredo, Senior Analyst in the Legal Department.

The mission would like to express its gratitude to the BCP's Board for its kind invitation and support to our mission, and to the management and staff of the BCP for their cooperation and productive engagement during this virtual TA mission.

EXECUTIVE SUMMARY

A joint MCM-LEG mission provided Technical Assistance (TA) to the Paraguayan authorities on their bank resolution framework and the DGF. The mission was carried out remotely and engaged in policy discussions with the authorities, with the view to adopt modern international practices on crisis preparedness and crisis management. It built on the recommendations of the Financial System Stability Review (FSSR), completed by MCM staff in October 2017.

The mission identified several areas where the existing DGF and bank resolution framework could be enhanced. It also provided input on crisis preparedness.

On crisis preparedness and coordination, the mission made recommendations in four areas:

- **The institutional arrangements could be usefully enhanced.** While a Financial Stability Committee (FSC) and a “Crisis Committee” have been established, the authorities should evaluate the benefits of providing a sound legal regime that includes a clear mandate and better delineation of roles and responsibilities.
- **The BCP should consider developing an ongoing process of recovery and resolution planning and underpin it in its regulatory framework, in line with international modern practices.** Recovery and resolution plans are a key element of a modern crisis preparedness framework. These plans are living documents that should be regularly updated with robust, credible, and actionable steps. All banks under SB supervision should develop recovery plans, proportional to their size and complexity, which will be assessed by the SB. Once established, the resolution authority (RA) should develop resolution plans for all the systemic banks.
- **Cross-border coordination is paramount for Paraguay, given the significant presence of international banking groups in the Paraguayan financial system.** Coordination with members of the financial safety net of other jurisdictions is key to ensuring adequate crisis preparedness during normal times and enabling adequate coordination of crisis management measures if there are concerns about the viability of a foreign-owned bank with operations in Paraguay.
- **Effective communications are a key element that requires close coordination.** A one-voice method of communication with the public should be considered, and advance preparation is paramount to ensure a smooth process for communications in the event of a crisis situation.

On the bank resolution framework, the mission offered recommendations in five areas:

- **The current resolution legal framework presents several gaps, including a lack of objectives for the RA.** The statutory objectives of the RA should be clearly codified to guide its actions, provide a benchmark for its activities, and ensure predictability.
- **The RA should be operationally independent from the supervisory functions of the SB.** In line with modern international practices, the operational separation of resolution and supervisory functions would facilitate a more effective implementation of the supervisory and resolution powers by the BCP. Furthermore, the BCP should have governance arrangements to ensure adequate decision making and preparation in relation to its resolution functions, independently from decisions taken in relation to supervisory issues, while maintaining independent reporting lines for both functions.
- **The resolution toolkit should be strengthened.** In particular, the mission recommends further enhancing the effectiveness of purchase and assumption (P&A) transactions and granting explicit powers to the authorities to create temporary banks (bridge banks). This should allow certain assets (often, performing loans) and eligible liabilities to be transferred with public support, if appropriate, and subject to safeguards, to a temporary “good bank” (to be subsequently divested, as a whole or in parts, to one or more private sector acquirers). Remaining assets and non-eligible liabilities would be left in the failing institution and placed in liquidation. The RA should be granted the power to require banks to hold a certain amount of liabilities that would absorb losses in resolution.
- **The resolution regime could be complemented by additional legal safeguards.** While several safeguards geared to facilitate the RA’s actions and to protect the rights of shareholders and creditors are already in place, the legal framework should provide for legal protection for the RA and its staff against liability for actions taken and omissions made in good faith while discharging their duties. Indemnities for costs incurred as a result of litigation could also be considered.
- **Enhancements to the resolution funding arrangements also need to be considered.** The resolution framework should stipulate clear and expeditious access to temporary funding, based on financial stability considerations, in situations where private sector funding has been exhausted or cannot achieve resolution objectives. Losses should be allocated to equity holders and, as appropriate, to unsecured and uninsured creditors, in accordance with the creditor hierarchy and with ex post recovery from the industry of any residual costs. In addition, as part of the contingency planning, the authorities should introduce a framework to guide the use of any public resources, in order to minimize losses and future risks, and ensure that transparent accountability on their use is achieved within a reasonable time.

On the Deposit Insurance Legal Framework, the mission made the following recommendations:

- **The DGF’s legal mandate should clearly establish in law a set of powers and objectives.** The revised law should specify the DGF’s legal mandate as “pay box plus” and ensure consistency with the powers provided by law to the DGF as a financial contributor to P&A transactions, subject to the least-cost criteria. In addition, the DGF’s legal framework should specify that its two main public policy objectives are protecting depositors and contributing to financial stability.
- **The framework for DGF operations (contributions and coverage) should be enhanced.** The introduction in the legislation of back-up sources of alternative liquidity funding could be considered. To foster market discipline, it is also recommended to exclude specific types of deposits from DGF coverage (e.g., interbank deposits, deposits of government ministries and departments, and deposits of regional, provincial, and municipal governments, and other public bodies). In addition, the maximum reimbursement period should be shortened to seven working days. Finally, the authorities should consider the removal of the set-off mechanism before payouts (if kept, it should be limited only to past-due claims and matured loans).
- **The DGF’s institutional arrangements should be overhauled.** The DGF should be operationally independent and protected against external interference, with safeguards in place to avoid and mitigate potential conflicts of interest. In addition, the DGF framework should clarify its role in the preparatory stages of resolution (including contingency planning) and the decision-making process for the resolution of troubled banks.

Table 1 summarizes the mission’s key recommendations.

Table 1. Paraguay: Key Recommendations

Topic/Recommendation	Priority	Timeframe ¹	Area
1. Consider establishing legal provisions to ground the Financial Stability Committee and ‘Crisis Committee’ mandate.	High	Medium term	All
2. Implement a “one-voice” method of communication with the public, whereby all the authorities would use the same set of agreed upon facts and assumptions.	Medium	Short term	All
3. Require all banks to develop recovery plans, focusing first on the largest.	Medium	Short term	Supervision and resolution
4. Elaborate resolution plans for all systemic banks.	Medium	Medium term	Resolution
5. Consider codifying statutory objectives for the RA.	High	Medium term	Resolution
6. Establish an operationally separate unit within the BCP to fulfill the RA functions, with adequate resources to fulfill its mandate and scope to manage any conflict of interests.	High	Medium term	Resolution
7. Revise legal provisions and statutory powers to enhance further the effectiveness of the use of P&A as a resolution tool.	High	Medium term	Resolution
8. Adopt legal provisions and statutory powers for the effective application of new resolution tools, notably, bridge banks.	High	Medium term	Resolution
9. Introduce legal protection for the RA and its staff, supported by indemnifications for litigation costs.	High	Medium term	Resolution
10. Include safeguards in the regime for access to public funding in systemic cases and prepare contingency planning, along with a framework to guide the use of such resources while minimizing moral hazard.	High	Medium term	Resolution
11. Assess the possibility of setting up an ex post resolution funding scheme, comprised of temporary public funding and a recovery mechanism.	High	Medium term	Resolution
12. Establish a “paybox plus” mandate for the DGF in the law, and fully align the powers that the DGF currently has to contribute to a resolution process, subject to the least cost criteria.	High	Medium term	Deposit Insurance
13. Enhance the DGF’s independence and increase its capacity to address potential conflicts of interest.	High	Medium term	Deposit Insurance
14. Remove the automatic setting-off mechanism for debts owed by insured depositors with a failing bank.	High	Medium term	Deposit Insurance
15. Shorten the reimbursement period for insured deposits to seven working days.	Medium	Medium term	Deposit Insurance
16. Exclude specific types of government deposits from DGF coverage.	Medium	Medium term	Deposit Insurance

¹ Short term = less than one year; Medium term = 1–2 years; Long term = More than two years.

I. INTRODUCTION

1. **In October 2017, at the BCP’s request, MCM staff conducted a Financial System Stability Review Mission (FSSR) in Paraguay.** The mission identified several capacity development needs, which included the review of the bank resolution framework and the DGF. A joint MCM-LEG mission in June 2021 conducted that review.
2. **Paraguay’s regulatory framework for bank resolution and the DGF has not been substantially revised since 2003.** According to this regulatory framework, which is developed in Law No. 2334/03, the SB hosts the resolution functions, and the only resolution tool available is the P&A. Recent efforts to update and modernize the law have not been finalized.
3. **Paraguay has not experienced episodes of acute financial stress in the last two decades.** Since 2004, the Paraguayan financial system has exhibited remarkable financial stability; only three small, non-systemic banks failed during this period.¹ During the mission, the BCP stressed that the banking system is well capitalized and situations that could trigger resolution measures, or the need to use the DGF, are not expected.
4. **Nonetheless, Paraguay would benefit from aligning its regulatory framework to the international modern practices.**² This should be done to the extent possible and in a proportionate manner, taking into consideration the special features of Paraguay’s financial system.
5. **This report is structured as follows.** Section II provides a brief overview of Paraguay’s financial system. Section III focuses on Crisis Preparedness and Coordination, offering views on institutional arrangements in crisis situations, recovery and resolution planning, cross-border coordination, and communications. Section IV elaborates on the bank resolution framework, including on the scope and objectives of the resolution framework; the RA and its key features; resolution tools; legal safeguards and judicial review; and resolution funding arrangements. Finally, Section V focuses on the deposit insurance legal framework, going through the legal mandate, objectives, powers, coverage, funding, and recoveries, as well as the DGF’s role in crisis management.

II. PARAGUAY’S FINANCIAL SYSTEM—AN OVERVIEW

6. **Paraguay’s financial system comprised 390 financial institutions that, as of end-2020, held assets equivalent to 91 percent of GDP (70 percent for the banking sector).** Five out of the 17 licensed banks (3 foreign and 2 domestically owned) account for almost two-thirds of the banking sector assets and are classified as systemically important. Notably,

¹ The term “bank” throughout this report will refer to licensed banks, finance companies, and other deposit-taking institutions that fall under the supervision of the SB and the BCP. Credit cooperatives and other NBFIs that are not subject to the SB’s supervision are therefore not covered in this report.

² [FSB Key Attributes of Effective Resolution Regimes for Financial Institutions](#), revised in October 2014, and the [IADI Revised Core Principles for Effective Deposit Insurance Systems](#), issued in November 2014.

the cooperative sector represents the second largest group of financial institutions (8 percent of financial system assets), of which the three largest entities (accounting for about 40 percent of the cooperative sector assets) show similar asset size than some small banks. However, credit cooperatives are subject to less rigorous regulatory and supervisory framework than banks and are not covered by a sound resolution framework, nor are their deposits insured by the DGF. While out of scope for this TA mission, the authorities should seek to strengthen the regulatory and supervisory framework for credit cooperatives, while further analyzing their ability to effect orderly exits of credit cooperatives.

7. **The COVID-19 pandemic does not appear to have affected banks' performance, as the standard indicators suggest that they remain well capitalized and profitable (Table 2).** Nonetheless, while NPL indicators do not show deterioration in comparison with pre-pandemic levels, the stock of “watch out” loans (including nonperforming, rescheduled, refinanced, and restructured loans, net of provisions) has increased significantly, driven mainly by special repayment facilities granted to borrowers in response to the COVID-19 pandemic. As a result, as of end-May 2021, these “watch out” loans accounted for more than one-third of the total stock of loans or 1.3 times banks' equity (from one-fifth of the total stock of loans or 0.7 times banks' equity as of March 2020), which suggests that further provisioning needs cannot be ruled out going forward.

8. **While the banking system is largely funded by deposits (almost 90 percent of funding), only 15 percent of the system deposits are protected by the DGF.** Household and corporate deposits are insured up to about five times income per capita,³ which is broadly in line with the average coverage of other upper middle countries. However, the coverage of total deposits is very low, which may be explained in part by regulations that require banks to set-off all loans that are owed by its depositors before the DGF reimburses their deposits. This practice is uncommon and risks undermining the purpose of the DGF. That said, the steady rise in the ratio of bank deposits to GDP in recent years (from 40 percent at end- 2017 to 51 percent at end-2020) suggests that the low coverage has not hindered financial deepening.

III. CRISIS PREPAREDNESS AND COORDINATION

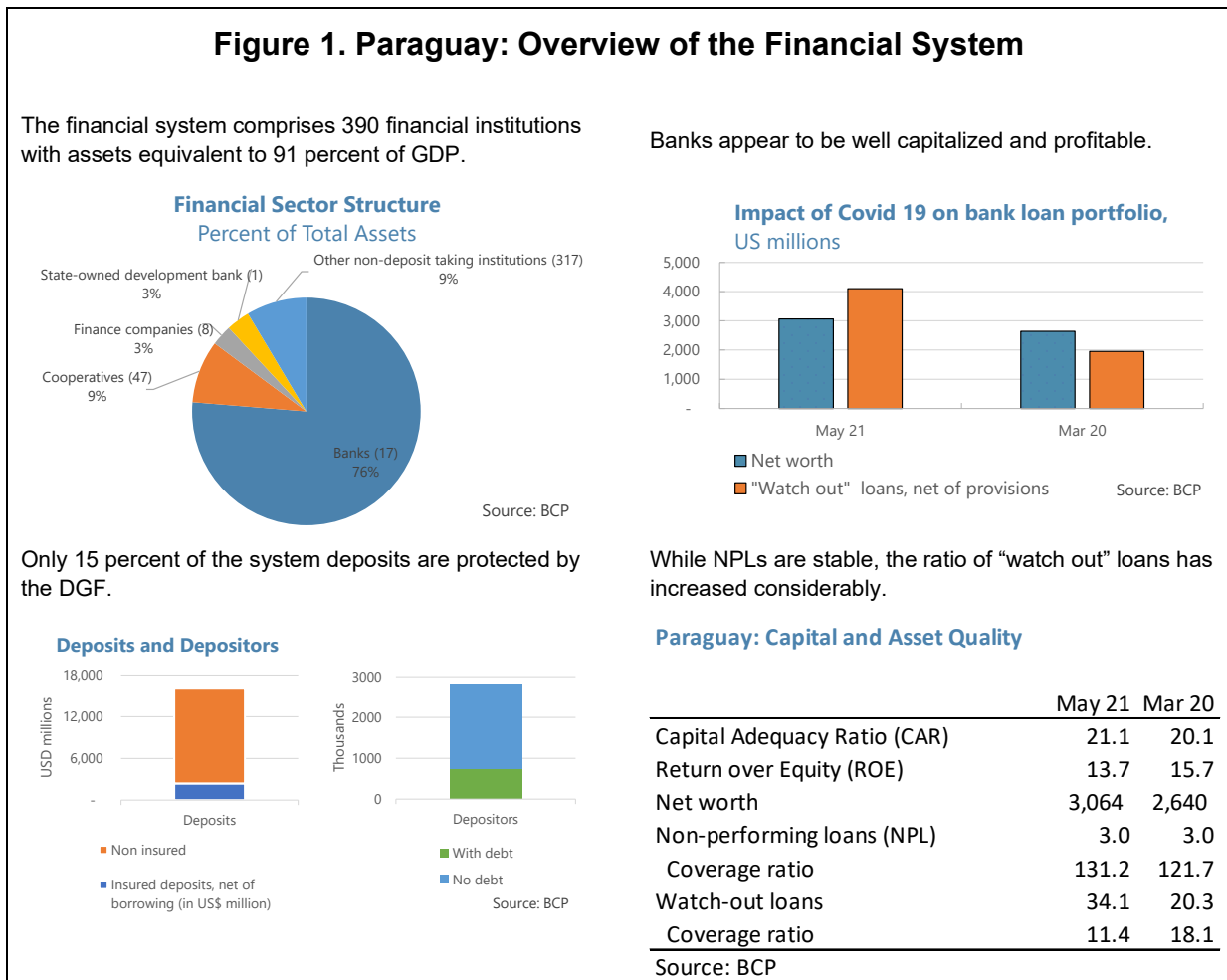
9. **On crisis preparedness and coordination, three areas need improvement.**

A. Institutional Arrangements in Crisis Situations

10. **Multiple functions are housed in the BCP.** The BCP has been assigned, on top of its core central bank responsibilities, the supervision, resolution, and deposit guarantee functions, effectively concentrating all the functions of the financial safety net. While this is not uncommon, the authorities should recognize that placing most of the financial safety net functions in the same institution could pose conflicts of interest (e.g., between supervision,

³ In accordance with Article 1(c) of Law No. 2334/03, the deposits insured amount to 75 times the minimum monthly salaries, which is equivalent to about US\$24,000 per insured deposit in each financial institution.

resolution, and deposit guarantee), which should be carefully addressed to safeguard that each function will perform adequately. At the same time, a clear legal framework that allocates roles and tasks is essential for enhancing effectiveness and accountability.



11. **Several committees have been put in place to support the BCP Board.** The board has been given a wide range of responsibilities. In response, the board has established several ad hoc committees that are tailored to perform specific tasks, without ensuring a homogeneous framework. In that context, it might be useful to further explore the possibility of a comprehensive approach to the institutional set-up of such committees, ensuring that they all have a clear definition of tasks and homogeneous rules governing their functioning.

12. **Establishing a sound legal foundation for the recently established FSC would be advisable.**⁴ The Paraguayan authorities have set up a committee composed of members of the BCP (including the Superintendent of Banks, the Director of the UAFGD, and the Superintendent of Insurance Entities), the Ministry of Finance (MoF), the Securities Exchange Commission (CNV), and the Supervisor of Credit Cooperatives (INCOOP). According to its governing rules, the FSC is chaired by the President of the BCP in normal

⁴ It was created by Decree No. 2114/2019.

times. When the FSC declares a systemic crisis, the “Crisis Committee,” chaired by the Minister of Finance, will replace the FSC. The BCP staff indicated that periodic meetings take place to identify potential systemic risks in normal times and, in the case of a crisis, the “Crisis Committee” will play a key coordinating role among the different entities that integrate the financial safety net. However, the lack of sound legal grounds could hinder the effective operation of the FSC. In particular, a clear set of legal objectives, functions, and powers of the FSC, coherent with its advisory role, is essential for (i) determining the contours of responsibilities; (ii) preventing overlaps with the functions assigned to the member institutions; and (iii) specifying the measures that such a collegial body could adopt. Furthermore, a sound legal framework could serve to better support several operational issues, for instance, the adequate exchange of information among its participants.

B. Recovery and Resolution Planning

13. **The BCP is yet to introduce a framework for recovery and resolution planning (RRPs).** RRP frameworks are a key component of a modern crisis preparedness framework. The BCP should evaluate the implementation of banks’ own preparedness for responding to distress and establishing clear roles and responsibilities for each bank, the SB, and the RA. Furthermore, resolution planning would help the BCP be better prepared to deal with crisis situations, preserve financial stability, and minimize potentially adverse impacts on the financial system if a systemic institution were to become unviable. These plans are “living” documents that should be revised at least annually, and whenever deemed necessary by the BCP; their contents are robust, credible, and actionable. To be in line with modern international practices, the revised resolution regime should include an RRP framework and provide sufficient legal underpinnings.

14. **All financial institutions under the SB’s supervision should be required to develop a recovery plan.** Each bank should be responsible for developing its own recovery plan, with the aim of being able to recover on its own from a situation of significant financial deterioration in a going-concern situation. The contents of each recovery plan should be assessed by the SB, which should incorporate the assessment as one of its supervisory tasks. The comprehensiveness and level of detail of each recovery plan will have to be commensurate to the size and complexity of each bank. The SB should have the power to require changes to the recovery plans, and to make use of a bank’s recovery plan during early intervention. It is advisable that the SB prioritizes its efforts by starting with the assessment of the largest systemic institutions and then continues with the rest of the banks as it gains more experience in the assessment of recovery plans.

15. **Once it is established, the RA should develop resolution plans for Paraguay’s systemic banks.** Those resolution plans should enable the RA to address the failure of a systemic financial institution without severe disruption to the financial system, while minimizing the potential use of taxpayers’ money. The resolution plan should include a resolution strategy to facilitate the implementation of resolution measures and enable the preservation of systemically important functions carried out by the failing financial institution. The RA should also conduct resolvability assessments to identify potential

impediments to the resolvability of systemic financial institutions, and the BCP should have powers to request the adoption of measures necessary for the removal of such impediments. It is advisable that the RA takes a gradual approach in the development of the resolution plans, focusing its efforts first on the largest systemic banks and then taking into account proportionality considerations and capacity constraints, developing resolution plans for the other systemic banks.

16. **The SB, as well as the RA, should have enough human and technology resources to build the necessary expertise to successfully implement an RRP framework.** The authorities should take this into consideration when considering budgetary allocations. Sufficient allocation of human resources, with specific training as well as adequate technical means, are key to achieving this aim. The BCP could also consider a gradual approach, focusing first on the resources needed to cover the largest financial institutions.

C. Cross-Border Coordination

17. **Paraguay is a host jurisdiction for several international banking groups, mostly through subsidiaries but also directly with branches.** Three of the systemic banks in Paraguay are foreign owned. Cross-border coordination is paramount to ensuring adequate crisis preparedness, as well as for crisis management in cases involving cross-border banking groups. When there is a risk of failure, either at the parent undertaking or at the local subsidiary, a coordinated approach should be promoted. To this end, transparent and clear processes and protocols should be in place to provide for adequate cooperation.

18. **Cross-border coordination should be expanded to recovery and resolution planning, and to resolution activities, as efforts advance domestically.** Both the SB and the UAFGD have already signed several Memoranda of Understanding (MoUs) with relevant home authorities of banking groups present in their jurisdictions. The RA should also strive to ensure adequate cooperation with resolution authorities and other members of the financial safety net in other jurisdictions. In this regard, the revised law should provide the RA with the legal capacity to have formal exchanges of information and to sign cross-border cooperation agreements with foreign authorities, both for planning purposes as well as for the implementation of coordinated resolution measures related to cross-border banking groups.

19. **Cross-border coordination should continue to be promoted at both regional and bilateral levels.** The SB is currently a member of two supervisory colleges. However, the SB is not a member of the supervisory colleges for other cross-border banking groups with significant presence in Paraguay; the SB should continue to maintain a continuous dialogue with the relevant home authorities of those countries and seek to discuss recovery planning issues. In parallel, the RA should also seek to engage with the RAs of the parent countries of cross-border banking groups present in Paraguay to discuss resolution planning. At the regional level, Paraguay recently participated in a regional crisis-simulation exercise—which is useful in order to promote timely information sharing and coordination among jurisdictions—and participation in future exercises is encouraged.

D. Communications

20. **Effective communications are a key element of crisis management.** The authorities should consider developing a communications strategy for adequate coordination among key public sector bodies involved (especially the BCP and the MoF) in case of need to inform the public about the situation in some/many banks. All communications to the public should be conveyed with simple and consistent language, explaining the problems found and the solutions identified.

21. **It is advisable to adopt or ensure a “one-voice” approach of communication with the public.** This approach facilitates ensuring consistency of the messages and enhances transparency. When there are several spokespersons involved (e.g., BCP and MoF), they should coordinate closely in their communications methods. Public statements should emphasize the actions taken by the authorities in the best interests of depositors and with the aim to restore banking system stability.

22. **Advance preparation is paramount in order to ensure smooth communications.** To this end, draft press releases and Frequently Asked Questions (FAQs) may be prepared in advance, considering different types of problems and solutions. It would also be important to build trust and relationships with the media representatives that cover financial sector issues during normal times, in order to ensure fluid channels of communications in the event of bank problems. Also, the authorities should plan to use various media channels as well as their web-based platforms in those communications.

IV. BANK RESOLUTION FRAMEWORK

23. **On the bank resolution framework, the mission has provided recommendations in five areas.**

A. Scope and the Objectives of the Bank Resolution Framework

24. **In general, the mission recommends that resolution regimes include all banks, with the systemic nature of concerned institutions being a key factor when considering the use of specific powers and tools.** Current international standards (KA 1.1) recommend that any financial institution that could be systemically significant or critical if it fails be made subject to a resolution regime.⁵ To prevent systemic disruptions, Paraguay’s SB has developed guidelines that consider the size, interconnectedness, substitutability, and complexity of the bank. Under such guidelines, banks are assessed periodically to determine which ones could be considered systemic. However, no comparable framework has been developed for nonbanks (e.g., cooperatives). To support the resolution of an affiliated

⁵ Defined as any institution whose failure could lead to a disruption of services critical for the functioning of the financial system or the real economy. While *ex ante* designations of “systemicness” can provide important guidance, it should be noted that the failure of non-designated (i.e., non-systemic) institutions can also satisfy this criterion, e.g., due to elevated contagion risks.

banking institution, relevant features of the resolution regime should be extended to nonregulated operational entities within a financial group or conglomerate.

25. **The legal resolution framework in Paraguay does not include clear statutory objectives for the RA.** The objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss. International standards (KA 2.2) explicitly advocate for the inclusion of statutory objectives and functions of the RA in legislation. Concretely, the law should make clear that the functions of the RA include:

- (i) pursuing financial stability and ensuring the continuity of systemically important financial services and payment, clearing, and settlement functions;
- (ii) protecting, where applicable and in coordination with the relevant insurance schemes and arrangements, depositors as covered by such schemes and arrangements;
- (iii) avoiding unnecessary destruction of value and seeking to minimize the overall costs of resolution and losses to creditors; and
- (iv) duly considering the potential impact of its resolution actions on financial stability in other jurisdictions.

26. **Clear objectives are essential to determine the contours of the responsibilities and for guiding the authorities' actions while implementing resolution.** Clear objectives also serve to provide legal certainty, not only for the authorities but also for the shareholders, depositors, other creditors, and counterparties of the nonviable bank, and the financial system as a whole.

B. The Resolution Authority and Its Key Features

27. **The RA should have a clear legal mandate to preserve financial stability.** The resolution objectives and resolution powers should enable the RA to achieve this mandate. The RA should have a broad range of resolution powers that allows it to achieve these objectives.

28. **The RA should be operationally separated from supervisory functions.** This operational separation will enable the RA to focus on the planning and application of resolution powers, while the SB continues to focus on the supervision of all going-concern financial institutions under its remit.⁶ This operational separation does not preclude that both the SB and the RA remain beneath the BCP's umbrella, but it will facilitate more effective implementation of its supervisory and resolution powers. Such separation would facilitate reducing and resolving conflicts of interest between both functions, preventing undue delays

⁶ The current legislation indicates that the SB is a technical body of the BCP with functional, administrative, and financial autonomy to fulfill its legally assigned mandate.

when resolution actions are needed, and having specialized staff dedicated to resolution planning and the implementation of resolution tools when necessary. At the same time, while operationally separated, the RA and the SB should develop internal mechanisms and protocols to ensure close coordination and information sharing between the functions. The mission defers to the authorities for the specific configuration of the institutional arrangements.

29. The BCP should develop special governance arrangements, structures, and processes to ensure adequate decision making in relation to its resolution functions.

Decisions taken in relation to resolution matters should be taken independently from decisions related to supervisory issues, and both functions should have independent reporting lines to the BCP Board and/or the BCP president. The BCP should ascertain the best set-up to achieve this objective, taking into consideration its existing statutory provisions and idiosyncrasies, as well as its governance culture (See Appendix II for examples of governance arrangements in central banks that host the RA).

30. The RA will have to undertake multiple tasks. In “normal” times, the RA will have to develop and maintain resolution plans for systemic banks and conduct resolvability assessments of those plans. In addition, the RA will have to ensure that adequate information-sharing and cooperation arrangements are in place with RAs in other jurisdictions, especially for those that are the home authorities of banking groups with systemically important operations in Paraguay. Other tasks in normal times will include participation in domestic and regional crisis-simulation exercises. In times of financial distress, the RA will be in charge of implementing the resolution strategy for resolving one (or more) financial systemic institution(s) deemed as nonviable, while safeguarding financial stability.

31. The RA will require adequate resourcing and autonomy. The RA will need an adequate number of staff with the necessary skills and technical equipment. It will also need autonomy on three fronts: (i) institutional autonomy (arrangements, procedures, and safeguards to avoid undue political or industry influence); (ii) personal autonomy (independent appointment procedures, conflict of interest rules, the establishment of adequate qualifications and incompatibilities, proper dismissal criteria and procedures, and remuneration protection); and (iii) financial autonomy (a separate budget with sufficient financial resources). If the RA is to remain under the BCP’s umbrella, the BCP should develop arrangements to resolve potential conflicts of interest. Consideration could also be given to a “pop-up” design, comprised of a relatively small core team that would prepare resolution plans and otherwise seek to build operational capacity. With careful planning, additional resources could be mobilized from other BCP functions, as well as external service providers, if banking sector stress were to materialize.

C. Resolution Tools

32. In the upcoming legal review, efforts should be made to enhance further the effectiveness of P&A transactions. The current legal framework provides for transfers of

assets and liabilities, implemented directly or via a securitization, to solvent institutions through a competitive process. In practice, however, this may not provide the RA with sufficient flexibility to act swiftly to ensure that critical functions are not disrupted, and to minimize the potential destruction of value. The securitization option, in particular, may introduce additional risks to the DGF (in comparison with a traditional P&A), because new losses may arise during the lifetime of the instrument used in the securitization. Any potential dispute between the acquiring institution and the DGF at a later stage would affect the credibility of the original transaction.⁷ In this context, the resolution framework should adhere as close as possible to the following principles:

- The least-cost approach should be conducted using the most recent market data on recovery rates for distressed assets that are available, instead of outdated information provided by lengthy judicial liquidation processes.
- Preparatory resolution work should be initiated when a bank is subject to early intervention measures by the SB, and in close coordination with that office. That work should prioritize: (i) ensuring that loan and collateral documentation is well organized and updated; and (ii) identifying potential IT risks, such as program documentation, backup controls, and ownership of IT services.
- Independent firms should be allowed to assist the RA in finding a good range of references about the market value of assets to be transferred. This will not only protect the authorities that are responsible for bank resolution, but also introduce additional incentives for the participation of interested parties in the bidding process and speed it up; and
- Ensuring that banks participating in P&A transactions hold sufficient capital and liquidity to absorb the operation being acquired. In this regard, the legislation could, for instance, introduce provisions to incentivize the participation in P&A transactions of banks that hold the highest credit rating categories and have ample capital and liquidity. Requirements to quickly ensure the viability of the entity resulting from the potential merger should also be included.

33. **Consideration should also be given to explicitly granting powers to the BCP to create temporary banks (bridge banks).** This would enable the transfer of high-quality assets and eligible liabilities (deposits) from the failing bank in the absence of a private sector acquirer, while remaining assets and non-eligible liabilities are liquidated as part of the failing institution. Importantly, while in principle a bridge bank is intended to exist for a relatively short period of time (between 1–3 years), it may remain under public ownership for longer periods. In view of this, an effective resolution framework should ensure that bridge

⁷ Experience in several countries has shown that banks that participate in P&A transactions are looking for high-quality bank assets instead of instruments that are difficult to evaluate based on market prices.

banks are well capitalized, based on a sound viability plan, and managed professionally from the outset (see Appendix III). In summary, making a bridge bank operational requires:

- **Advanced preparation.** The authorities should be able to license a new bank on short notice and transfer assets and liabilities to it quickly. To be ready for this, the RA should draft in advance a bridge bank charter and identify a list of potential managers that would meet fit-and-proper criteria;
- **Prudential requirements.** The supervisors should be able to expedite the process to grant a banking license to the bridge bank, which should comply with prudential requirements from the start;
- **Ownership and governance.** The bridge bank should be owned by the government, who should put in place adequate governance arrangements. For example, the MoF could consider transferring the representation of such investments to a holding company, which should be run professionally and according to a transparent relationship agreement with the government;
- **Valuation and transfer of assets and liabilities.** The RA should undertake a prudent valuation of all assets and liabilities of the failed bank before transferring part of the assets and liabilities to the bridge bank; and
- **Reverse transfer powers (put-back option).** Powers to transfer assets and liabilities back to the entity in liquidation should be subject to a time limitation and restricted to exceptional cases.

Finally, as the creation and operation of bridge banks can prove challenging, their use should be restricted to systemic banks only as a matter of practice (Box 1).

34. **The authorities could explore the possibility of introducing the bail-in resolution tool.** Such decision should be taken only after a careful assessment of the feasibility of establishing the necessary loss-absorbing capacity in banks and addressing the operational challenges that would arise. In particular, due consideration should be given to the legal framework, as well as to the degree of development of capital markets in Paraguay. If considered suitable, the following aspects should be considered:

- **Bail-in could facilitate an effective resolution of banks.** The introduction of bail-in powers can minimize the risk of a bank bail-out with taxpayers' money by seeking private creditors' involvement in loss absorption and recapitalization of failing banks. By establishing a robust framework for bail-in, supported by the build-up of loss-absorbing capacity (see below), Paraguay could seek to overcome the limited availability of government resources to finance resolution measures. These benefits, however, would need to be carefully weighed against a potential increase of funding costs (as creditors start pricing in the prospect of loss allocation) and/or contagion risks.

Box 1. Bridge Banks

International experience shows that, although bridge banks (BBs) can be helpful in resolving systemic banks, their actual implementation carries both advantages and disadvantages.

Advantages. The BBs may help to:

- Preserve critical systemic banking activities and keep them functioning while potential investors undertake proper due diligence of the bank business that is being transferred;
- Protect asset value by keeping financial assets within the banking system; and
- Limit fiscal resolution costs, as hidden contingencies may be left in the bank under liquidation.

Disadvantages. The use of BBs may risk:

- Delaying the recognition of losses, and of capital and liquidity needs, if expectations from national authorities regarding the time of the sale are too optimistic;
- Facing high funding costs, as retaining large depositors and creditors may be difficult;
- Requiring continuous liquidity support from the central bank;
- Possible deposit losses, which in turn may reduce their franchise value; and
- Increasing workload for the authorities, as divesting the bridge bank and liquidating the failed bank is a complex and time-consuming task.

- **The design of the bail-in tool should be aligned with modern international practices.** Concretely, the resolution framework should introduce administrative powers to write down and convert into equity of the bank under resolution creditors' claims to the extent necessary to absorb losses.
- **The RA should be allowed the power to require banks to hold a certain amount of liabilities that are eligible for bail-in.** However, the exercise of this power should consider: (i) the amount of debt liabilities that are currently issued by banks (some banks in Paraguay have issued contractual convertible bonds, but the volume is still small); and (ii) the type of holders of the debt (retail, institutional, or other financial institutions), as such aspects could make the bail-in tool ineffective or pose contagion effects.
- **The bail-in tool should be usable with other resolution tools and other powers.** In particular, for this tool to be more effective, the resolution framework should make it possible to apply bail-in powers in conjunction with other resolution powers (e.g., replacement of senior management, temporary stays on early termination rights, or adoption of a new business plan) to ensure the bank's viability.
- **The sequence of the write-down and conversion powers should be clear and transparent.** The exercise of bail-in powers should respect the hierarchy of claims and the general principle of equal (pari passu) treatment of creditors of the same class. However, the framework should also provide flexibility to depart from the pari passu principle and explain clearly the reasons for such departures (e.g., financial

stability considerations or to maximize the franchise value for the benefit of all creditors). Importantly, the resolution framework should stipulate clearly that equity would absorb losses first, and that no loss would be imposed on senior creditors until subordinated debt (including all regulatory capital instruments) has been written off entirely.

- **There should be clear safeguards to protect the rights of shareholders and creditors.** To this end, clear obligations should be laid down in the resolution framework concerning the valuation of the assets and liabilities of the bank under resolution (due to the urgency of the resolution process, provisional valuation could be foreseen). Valuation of the treatment that shareholders and creditors would have received, if the institution had been liquidated under normal insolvency proceedings, should be also envisaged to respect the NCWO safeguard. These considerations also apply with respect to other tools available under the resolution framework.

D. Legal Safeguards and Judicial Review

35. **Resolution regimes should include adequate legal safeguards.** Modern international practices advocate for an adequate balance among the intrusive measures that resolution authorities could implement to safeguard financial stability and the protection of the legitimate rights of shareholders and creditors. In that context, resolution regimes should establish:

- a transparent creditor hierarchy;
- the right to receive compensation when it is determined that a creditor has been treated worse off than in liquidation (NCWO safeguard);
- adherence to and respect of legal remedies; and
- legal protection of the resolution measures and restrictions to the courts' powers to reverse resolution measures.

36. **The current resolution regime of Paraguay includes provisions to suspend legal action during resolution and constrains the reversal of resolution measures.** However, further consideration could be given to the possibility of including in the resolution regime the possibility of departing from the hierarchy of claims in cases of public interest (e.g., for financial stability reasons). In that case, the statutory provisions should include adequate safeguards to prevent any undue use of the departure from the pari passu principle.

37. **Legal protection is a key element that could enhance the effectiveness of Paraguay's resolution regime.** The Paraguayan authorities should consider including in the legal regime protections for the authority and its staff against liability for actions taken and omissions made in good faith while discharging their duties, including actions in support of decisions by foreign authorities (KA 2.6). The scope of legal protection for directors, officers, and staff of the bank in resolution should extend to civil litigations relating to all actions taken

in good faith when acting in accordance with, or giving effect to, decisions and instructions of the domestic resolution authorities, and of foreign resolution authorities where such decisions and instructions have effects in the jurisdiction under review. The authorities should also consider operational arrangements to make legal protection effective, including to cover legal costs.

38. The legal framework should allow the postponement of public disclosure requirements. In the context of a resolution, with the aim of safeguarding financial stability and avoiding undue destruction of value, the resolution authorities should have the power to temporarily waive or suspend the regulatory disclosure requirements (e.g., regular and ad hoc disclosures under market reporting and listing rules) of the nonviable financial institution. In that context, the authorities could evaluate the need for introducing legal provisions that would clearly grant these powers, and for appropriate coordination among the different regulators (RA, securities regulator).

E. Resolution Funding

39. Funding is required in different phases of a banking crisis. Financial resources are needed to facilitate liquidity to solvent financial entities, support the P&A transactions, and recapitalize systemically important institutions.

40. A sound bank resolution framework should thus contain provisions that give the authorities clear and expeditious access to funding. There is consensus that a primary source of funding for bank resolution should be the private sector, and that central banks' balance sheets be protected all the time against bank resolution losses. However, there is also common understanding that in systemic crises, private participation and funding tends to be elusive. In those cases, the use of public funds may become unavoidable to preserve the critical functions of the banking system.⁸

41. Although adequate ex ante funding of a deposit insurance scheme is advisable, the establishment of a separate resolution fund, financed by ex ante contributions from banks, entails large opportunity costs (Box 2). The ultimate purpose of a resolution fund should be to cover potential financing gaps that may arise in the resolution of a systemic banking crisis after contribution by the DGF has been made.⁹ A less costly alternative would be to set up an ex post scheme that is comprised of temporary public funding and a recovery mechanism, especially when scarce national savings would be better deployed elsewhere.¹⁰

⁸ So far, there is no relevant international experience where a large portion of resolution costs, funded with fiscal resources, has been recovered through contributions from the private sector.

⁹ See discussion on deposit insurance and its role on idiosyncratic and systemic bank resolution events in section C. Role on crisis management of V. Deposit Insurance Legal Framework.

¹⁰ See [Resolution Funding: Who Pays When Financial Institutions Fail?](#), IMF Technical Notes and Manuals No. 2018/01.

42. **More broadly, the authorities should develop a framework to guide the use of public resources to minimize losses and moral hazard.** This framework should seek to:

- **Establish a high-level group to deal with the crisis.** As discussed earlier,¹¹ the current framework in Paraguay provides for an FSC, which in systemic crisis situations will be replaced by a “Crisis Committee” chaired by the Minister of Finance. A sound legal framework that delineates roles and responsibilities and provides a clear and coherent set of objectives, functions, and powers, would be key to ensuring the predictability and effectiveness of its operation. Ideally, the participation of political bodies (e.g., the president of the country) should be avoided or restricted, given the technical nature of the decisions during a crisis. At the same time, mechanisms to ensure political support, such as giving a non-objection to the high-level group’s plan, could be considered.
- **Write down the bank’s equity before releasing any public funds, allocate losses to unsecured, uninsured creditors, and hold the bank’s directors and senior management accountable.** In addition to writing down equity and other capital instruments and allocating losses to unsecured and uninsured creditors, as appropriate, options to recover funds from senior management and directors—to the extent that their action or inaction contributed to the bank’s failure—should also be carefully considered. The power to (i) recover variable remuneration that has already been paid; or (ii) reduce or prevent the payment of deferred elements that have been awarded but not yet paid out (through the use of claw-back powers) could be an option to consider for this purpose, together with the pursuit of claims for damages in judicial proceedings.
- **Identify bank losses and capital needs of the failing institution as early as possible, based on an independent asset valuation with a market forward-looking approach.** This exercise would help to identify hidden losses that are likely to appear at later stages, especially if initial bank losses were determined by accounting firms or bank supervisors based on ongoing-concern criteria.
- **Select the most suitable resolution or restructuring option after assessing viability and business projections based on different proposals.** While restoring bank solvency is key, the injection of resolution fund resources should only be made after the authorities have assessed financial projections for 2–3 years and restructuring plans that show the (new) institution will, at least, reach break-even point and/or remain fully capitalized within such time horizon. These projections should be prepared on the basis of macroeconomic assumptions provided by the authorities.
- **Timely identify and address the main sources of the bank’s failure.** The resolution framework should aim to achieve these goals within a reasonable timeframe.

¹¹ See Paragraph 11.

Furthermore, the framework should trigger the legal prosecution of those responsible for wrongdoing

- **To the extent possible, rely on cash rather than government bonds to recapitalize troubled banks.** Banks must price government bonds at market value at their inception, which in turn may nominally increase resolution costs. Additionally, large holdings of government bonds by the restructured banks may expose them to excessive sovereign risk going forward, as well as large currency and interest rate mismatches.
- **Allow public funds to be injected into banks, not only under the form of common shares but also in exchange for a variety of financial instruments.** Where consistent with capital requirements, instruments such as preferred shares, convertible debt instruments, and subordinated debt could be considered to the extent that doing so is compatible with prudential requirements, and long-term viability considerations.
- **Facilitate private participation in bank restructuring processes.** To this end, the revised legislation should consider conditioning the government’s participation in the recapitalization of an insolvent or undercapitalized bank to situations in which: (i) financial stability is at risk; (ii) all private recapitalization options have been explored; and (iii) bank losses have been allocated to equity and subordinated debt holders. In the same vein, the legislation should require arm’s-length participation by the MoF on its equity participations, with sound commercial principles in the ownership and running of the troubled bank. In addition, revisions of the legal regime should also ensure that the injection of public funds is allowed and would not create problems.

43. **The BCP should develop mechanisms to ensure that a transparent accountability process on the use of the resolution fund resources is achieved within a reasonable time period (e.g., 30–90 days after a bank recapitalization has been completed).** Including such mechanisms in the revised resolution framework will also help to deal with moral hazard issues and to limit the activation of the systemic risk chapter of the legislation to well-defined circumstances.

V. DEPOSIT INSURANCE LEGAL FRAMEWORK

44. **In relation to the DGF, the mission focused on the following areas.**

A. Legal Mandate, Objectives, and Powers

45. **The DGF’s objectives should be clearly established by law.** According to best international practices (CP 1), a deposit insurance system should have, at least, two main public policy objectives: (i) protecting depositors; and (ii) contributing to financial stability. Currently, Law No. 2334/03 does not establish any public policy objectives. These two objectives should be included in the revised law, so that the DGF is guided by them when exercising its powers, including through contributing to P&A transactions and to the

implementation of bridge banks. This will, in turn, provide transparency and clarity to the public.

Box 2. Some Features of Resolution Funds¹

In contrast with deposit guarantee funds, the resolution funds are yet to become of general use by countries. Only a few countries have adopted separate resolution funds, and those that have done so have followed different approaches regarding their funding (i.e., ex ante or ex post), governance, and safeguards.

Ex ante and ex post resolution funds have advantages and disadvantages that need to be fully understood to make informed policy decisions: :

- **Ex ante, pros:** Allow to gradually build resolution funds through periodical contributions from the private industry that would be always available to deal with a systemic situation.
- **Ex ante, cons:** Over the years, it may imply the allocation of a large amount of resources that are extracted from the financial sector and kept “frozen”. It may also become subject to political interference in the administration of its resources. As gross funding needs may well be large, industry contributions should be backstopped by a government credit line.
- **Ex post, pros:** Aim to recover from the private sector, as much as feasible, the resolution costs covered by the state, so there is not immobilization of a significant amount of resources.
- **Ex post, cons:** It may require a sudden and large call on public resources, which, in some circumstances, may have adverse effect on the sovereign’s debt position and the cost of sovereign borrowing. Recovery mechanisms may also be more procyclical, especially if applied shortly after a period of stress.

^{1/} For further reference see discussion on [Resolution Funding: Who Pays When Financial Institutions Fail? \(imf.org\)](http://imf.org).

46. **The DGF should be operationally independent without external interference to fulfill its mandate, and its potential conflicts of interest should be addressed, in line with international practices.** The UAFGD is hosted within the BCP, which has also been assigned supervision and resolution functions. Where an authority combines all these functions, specific institutional arrangements should be in place with the aim of preventing conflicts of interest that may arise. In this regard, the BCP should evaluate assigning clear and explicit responsibilities to the UAFGD in the legal or regulatory framework (e.g., internal resolutions). Arrangements that adequately separate the relevant functions, with staff dedicated to each task and different reporting lines (e.g., UAFGD staff would report directly to the Director of UAFGD, who in turn would report to the BCP Board) will also support the decisions related to the DGF. In addition, governance arrangements (such as internal rules, policies, and codes of practice) and decision-making procedures within the BCP can assist in managing conflicts by ensuring that the different perspectives of supervision, resolution, and deposit guarantee functions are heard and considered before adopting decisions. The UAFGD should also have the capacity and resources (e.g., human resources, operating budget, and an adequate salary system) to support its operational independence and the fulfillment of its mandate.

47. **The DGF’s framework should be clarified.** The current legal framework explicitly states that the DGF will be managed by the BCP. In addition, it indicates that the DGF’s funds should only be used for the purposes established in law and should not be considered as BCP’s assets. In that context, to enhance the operational soundness of the DGF, the BCP could consider clarifying several of its key features and evaluate the need for amendments to primary

legislation in order to hire independent advisors (valuation experts, financial, or legal firms). It should also develop a framework to enable entering into agreements quickly and effectively in situations of a bank's potential failure.

48. **The DGF should have access to information necessary to fulfill its tasks.** The DGF should be enabled to obtain information from banks (based on public law powers). The law should also grant the DGF explicit powers to request information directly from banks. Also, given its potential participation in P&A transactions, consideration should be given in the law to the DGF's role in the preparatory and decision-making processes. In particular, it should be informed about proposals to use its funds and should be able to voice its views thereon in deliberations (also see para. 58).

B. Coverage and Funding

49. **The scope of deposit coverage should be narrowed.** The current scope of deposit coverage does not exclude many types of deposits, which are typically considered ineligible for protection (in addition to the deposits held by employees, related persons, or derived from fraud or illegal actions). For example, the BCP could consider excluding from deposit insurance: interbank deposits; deposits of government departments, and of regional, provincial, and municipal governments and other public bodies; and deposits of individuals who are regarded as responsible for the deterioration of an institution.

50. **The authorities should consider eliminating the set-off mechanism before payout.** In the case of a failing bank, Law No. 2334/03 currently enables the DGF to set-off all reciprocal debts (due and current) of each insured depositor with the failing bank, before effecting the payout. This set-off mechanism risks undermining one of the main DGF's objectives, namely, to minimize the risk of deposit runs (as depositors with loans in the same bank would be incentivized to withdraw their deposits in case of bank distress). It would thus be advisable that the authorities consider removing such mechanism in the revised law. If maintained, the mechanism should be restricted only to past-due claims and matured loans. Having such a mechanism in place may also give rise to delays in the eventual payout of insured depositors.

51. **The size of the ex-ante DGF currently reaches almost half of the target level.** As of end-May 2021, the DGF amounts to the equivalent of US\$790 million, which represents 4.7 percent of total deposits against a target level of 10 percent of total deposits. Whereas the size of the DGF seems adequate, more than one-third of the DGF's resources are invested in long-term debt securities. This implies that, if the DGF were to need quick access to such resources and liquidating such securities on short notice is not possible, albeit not without incurring additional costs, it would have to use discount lines with the BCP (which are already agreed) against these debt securities as collateral. The DGF should continue its strategy of increasing the amount of short-term investments in its portfolio to avoid excessive dependence on the discount lines of the BCP and to minimize potential conflicts of interest.

52. **The BCP could consider the introduction of a risk-based component.** Law No. 2334/03 establishes ex ante contributions of a quarterly flat rate of 0.12 percent, based on

the average of the deposits held by the institution during the previous quarter. A variable component based on the assessed risk of each bank into the premium structure could be considered. Given the significant presence of international banks in Paraguay, however, this measure could result in higher premia for domestic banks. Also, the risk-based component is complex to design, and a phased-in implementation schedule would be needed to adopt this approach.

53. **Alternative funding sources should be considered.** The revised law could enable the DGF to:

- require extraordinary contributions or increase premiums to recover losses in cases where the events deplete its resources; and
- enter into emergency funding arrangements to which it can resort in a timely manner when its resources are exhausted or insufficient. This would typically consist of government-backed sources of liquidity, as private sector borrowing (even with a government guarantee) tends to be unavailable in times of stress.

54. **The period of eventual reimbursement of insured deposits should be shortened.** According to Law No. 2334/03, deposit payouts must be made within a maximum of 15 natural days. According to the revised Core Principles (CP 15), the deposit insurer should be able to reimburse most of the insured depositors within seven working days. If the DGF cannot currently meet this target, it should develop a plan to do so. This plan should have a relatively short timeframe for implementation (e.g., within two years) and be supported by relevant laws.

C. Role in Crisis Management

55. **The DGF’s mandate needs to be fully aligned (CP 2).** Concretely, the revised law should stipulate that the legal mandate of the DGF is a “pay box plus,” and it should ensure full consistency with the powers provided by law to the DGF as a financial contributor to P&A transactions and the implementation of bridge banks. Currently, Law No. 2334/03 establishes in Article 1 a paybox mandate for the DGF, which conflicts with the powers that the DGF has been attributed, according to Article 2(2), to provide funds to contribute to a P&A transaction.

56. **The UAFGD should be aligned with international best practices when determining the least-cost threshold to contribute to a P&A.** In accordance with paragraph 50, if the set-off mechanism is removed, this should also be done for the calculation of the least-cost threshold to contribute to a P&A. If kept, the UAFGD should only take into consideration the netting of past-due loans of the depositors being transferred to the acquiring entity, instead of netting the total amounts owed by such depositors to the bank being resolved.

57. **The UAFGD, as part of the financial safety net, should coordinate closely with the SB and the future RA, both in “normal times” and in times of financial distress (CP 4).** To this end, it is important that internal arrangements are in place to ensure a fluent and timely

flow of information between all the components of the financial safety net.¹² Currently, the SB, the UAFGD, and the BCP's Operations Department have MoUs in place, and these should be extended to include the future RA when it is created as a separate unit within the BCP. A high level of cooperation and information sharing would be facilitated by the fact that all of the financial safety net functions are housed in the BCP, and the confidentiality of information collected by the BCP when exercising its functions is already enshrined in the Organic Law of the BCP.¹³

58. **A high level of cooperation between the UAFGD and the RA will be particularly important in cases where the P&A is used as a resolution tool (CP 9).** In this regard, the cooperation arrangements should ensure that the following conditions are met: (i) the UAFGD is informed and involved in the resolution decision-making process; (ii) the use of the DGF's resources is transparent and documented, and is clearly and formally specified following the least-cost criteria; (iii) the acquiring entity is solvent and viable, thus limiting the exposure of the DGF with respect to the transferred deposits; and (iv) the use of the DGF's funds is subject to an independent audit and all related resolution actions and decisions are subject to ex post review.

¹² The SB, the DGF, the RA, and the BCP as lender of last resort.

¹³ Article 6 of Law No. 489/95.

**APPENDIX I. SUMMARIES OF SELECTED RECOVERY AND RESOLUTION PLANS
(EUROPEAN UNION AND UNITED KINGDOM)**

European Union

EU Bank Recovery and Resolution Directive (BRRD)

The EU BRRD is designed to provide “adequate tools at European Union level to effectively deal with unsound or failing credit institutions.” It aims to make sure a bank or an institution can be resolved speedily and with minimal risk to financial stability. The directive preserves systemically important functions when a bank fails, so that, upon failure, shareholders and creditors, rather than taxpayers, bear the losses.

Recovery plans

Member states shall ensure that each institution draws up and maintains a recovery plan providing, through measures taken by the management of the institution or by a group entity, for the restoration of its financial situation following significant deterioration.

The annex to the Directive contains information requirements for the recovery plan, including:

- (1) A summary of the key elements of the plan, strategic analysis, and summary of overall recovery capacity;
- (2) A summary of the material changes to the institution since the most recently filed recovery plan;
- (3) A communication and disclosure plan outlining how the firm intends to manage any potentially negative market reactions;
- (4) A range of capital and liquidity actions required to maintain operations of, and funding for, the institution's critical functions and business lines;
- (5) An estimation of the timeframe for executing each material aspect of the plan;
- (6) A detailed description of any material impediment to the effective and timely execution of the plan, including consideration of impact on the rest of the group, customers, and counterparties;
- (7) Identification of critical functions;
- (8) A detailed description of the processes for determining the value and marketability of the institution’s core business lines, operations, and assets;

- (9) A detailed description of how recovery planning is integrated into the institution's corporate governance structure, as well as the policies and procedures governing the approval of the recovery plan, and identification of the persons in the organization responsible for preparing and implementing the plan;
- (10) Arrangements and measures to conserve or restore the institution's own funds;
- (11) Arrangements and measures to ensure the institution has adequate access to contingency funding sources, including potential liquidity sources, an assessment of available collateral, and an assessment of the possibility to transfer liquidity across group entities and business lines, to ensure that it can carry on its operations and meet its obligations as they fall due;
- (12) Arrangements and measures to reduce risk and leverage;
- (13) Arrangements and measures to restructure liabilities;
- (14) Arrangements and measures to restructure business lines;
- (15) Arrangements and measures necessary to maintain continuous access to financial markets infrastructures;
- (16) Arrangements and measures necessary to maintain the continuous functioning of the institution's operational processes, including infrastructure and IT services;
- (17) Preparatory arrangements to facilitate the sale of assets or business lines in a timeframe appropriate for the restoration of financial soundness;
- (18) Other management actions or strategies to restore financial soundness and the anticipated financial effect of those actions or strategies; and
- (19) Preparatory measures that the institution has taken or plans to take in order to facilitate the implementation of the recovery plan, including those necessary to enable the timely recapitalization of the institution.

This gives the RA information to help plan how the essential functions of the institution or the group may be isolated and continued.

Resolution authorities will also have powers to require an organization to take steps to restore financial soundness or to reorganize its business.

Resolution plans

The RA will prepare a resolution plan for an institution (at both entity and group levels) setting out options for resolving the institution in different scenarios, including systemic instability.

The resolution plan will include details of how to apply the resolution tools and how to make sure the institution continues to provide critical functions. Resolution tools include, inter alia:

- Early intervention powers if the financial situation or solvency of an institution is deteriorating.
- Implementation of recovery plan measures or requirement to remove or replace management.
- Appointment of a special manager to replace the institution's management or EU holding company. (A special manager has all the powers given to management by the company's constitutional documents and by national law. The manager's actions may include an increase of capital, a corporate reorganization, or a takeover of the institution by another viable institution.)
- A sale of business tool: this enables authorities to sell part of the business without shareholders' consent;
- A bridge institution tool: this allows authorities to transfer all or part of the business to an entity owed by the authorities, which continues to provide essential financial services pending onward sale or entity wind down;
- An asset separation tool: this enables the transfer of "bad" assets to a separate vehicle or "bad bank"; and
- A bail-in tool: this allows equity and debt to be written down and is intended to ensure that most unsecured creditors of an institution bear appropriate losses.

If the resolution authorities identify a significant impediment to a resolution, they will have the power to request the institution (or group for the group RA) to address or remove this impediment.

Further details can be found at:

[EUR-Lex - 02014L0059-20210626 - EN - EUR-Lex \(europa.eu\)](#)

United Kingdom

Recovery plans

A recovery plan should have the following features:

- A sufficient number of credible options to cope with a range of scenarios, including particular and market-wide stress.
- Options to return the firm to a stable and sustainable position following capital shortfalls and/or liquidity pressures.
- Appropriate governance processes, including intervention conditions and procedures, to ensure timely implementation of recovery options in a range of stress situations.

Key elements

- A detailed exposition of how the implementation of the recovery plan fits within the firm's existing risk management framework.
- An explanation of the triggers that would indicate when the plan should be invoked.
- A comparative summary of the firm's complete list of recovery options.
- A description of each option, using a consistent framework.
- A list of key executives/managers who will be involved in each recovery action and the roles they would play, as well as key staff at group level.
- A communication plan (internal and external) to accompany the recovery options, which outlines the issues to be considered when implementing the options to prevent doubts of the firm's viability, and to preserve the confidence of markets and other stakeholders.

Resolution plans

1. The information and analysis provided to the authorities will help the authorities prepare a resolution plan, with the aim to:

- Ensure that resolution can be carried out without public financial support;
- Minimize the impact on financial stability;
- Minimize the effect on depositors and consumers;

- Allow decisions and actions to be taken and executed in a short space of time (for example, over a “resolution weekend”); identify those economic functions for which continuity is critical to the economy or financial system; identify those economic functions that would need to be wound up in an orderly fashion; and identify and consider ways of removing barriers that may prevent critical functions being resolved successfully;
 - Allow a resolution that separates the identified critical economic functions from noncritical activities that could be allowed to fail; and
 - Enhance international cooperation and crisis management planning between international regulators for global SIBs.
2. Ultimately, resolution information and analysis will allow the authorities to commit more credibly to putting firms that fail to meet threshold conditions into resolution in an orderly manner, with minimal impact on the financial system, regardless of the firm’s size or complexity.

Key elements

- Overall group structure diagram.
- A high-level understanding of the economic functions performed within, or in some way dependent on, each significant legal entity.
- A breakdown of group balance sheet by significant legal entity.
- An understanding of major financial dependencies between legal entities.
- An understanding of the firm’s interconnectedness with other banks.
- Operational dependencies.
- Other dependencies.

Further details can be found at:

[Recovery planning | Bank of England](#)

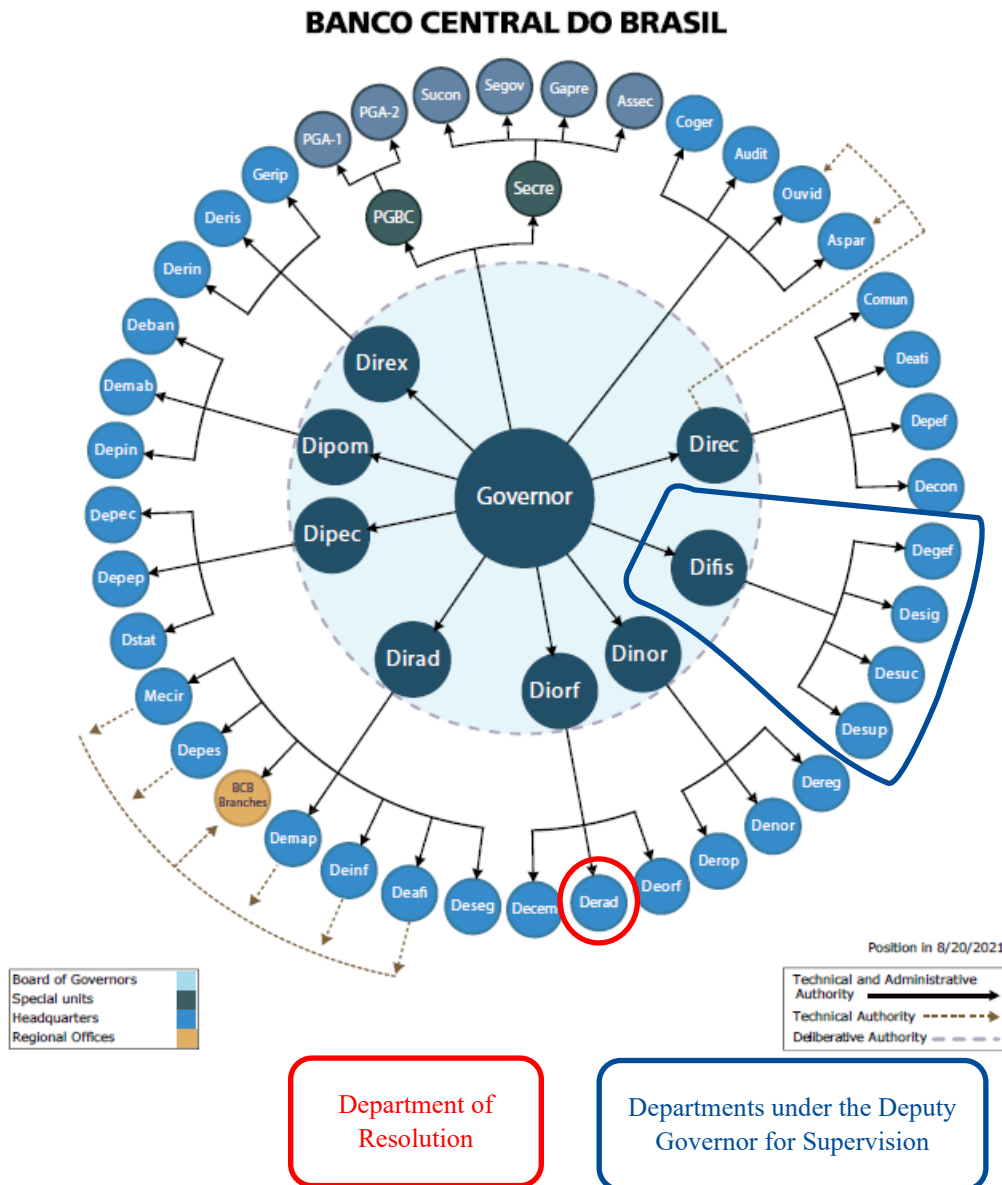
[Resolution planning | Bank of England](#)

APPENDIX II. GOVERNANCE ARRANGEMENTS IN OTHER JURISDICTIONS TO HOST THE RESOLUTION AUTHORITY WITHIN THE CENTRAL BANK

Four cases are listed below for illustrative purposes: Brazil, Cyprus, Italy, and the United Kingdom. In all these cases, the CB is both the supervisory authority and the RA, and two main approaches prevail:

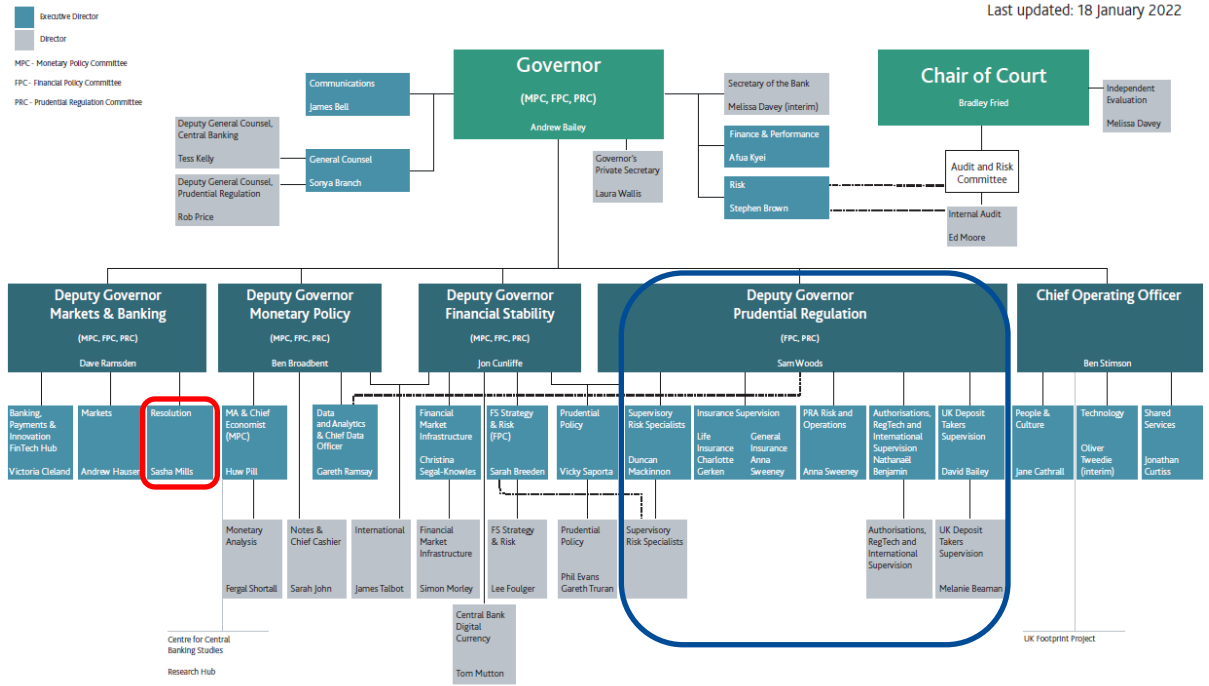
- Differentiated reporting lines to different Deputy Governors (Central Bank of Brazil and Bank of England); or
- A direct reporting line of the Resolution Unit/Department to the Governing Board/Governor of the CB (Banca d'Italia and Central Bank of Cyprus).

Central Bank of Brazil



Source: Organizational chart from the Central Bank of Brazil.

Bank of England



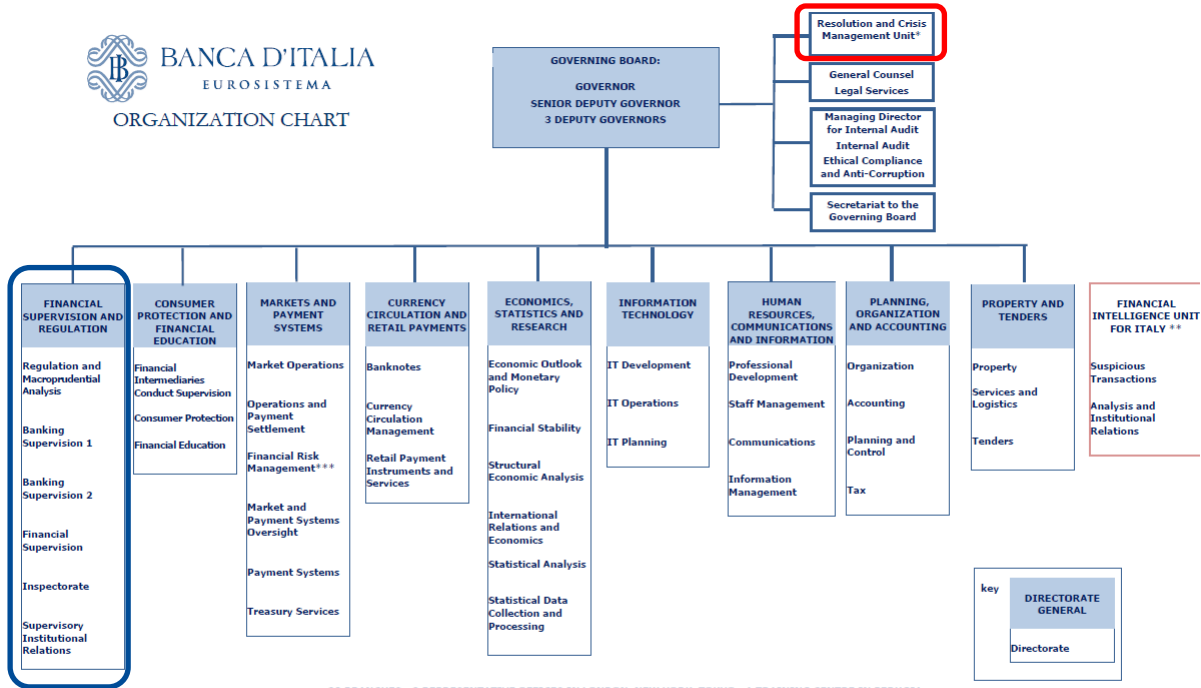
BANK OF ENGLAND

Resolution Directorate

Prudential Supervision

Source: Organizational chart from the Bank of England.

Banca d'Italia



* An Advisory Committee on Resolution and Crisis Management gives opinions on the proposals to be submitted by the Unit to the Governing Board.
 ** The Financial Intelligence Unit (FIU) for Italy, established under the terms of Legislative Decree 231/2007, is an independent body, performing its functions in full autonomy. The Bank of Italy issues the regulations governing its organization and functioning. The FIU's staff, technical and financial resources, and hardware are provided by the Bank of Italy.
 *** The Financial Risk Management refers directly to the Governing Board on matters of financial risk assessment and control.

22 November 2021

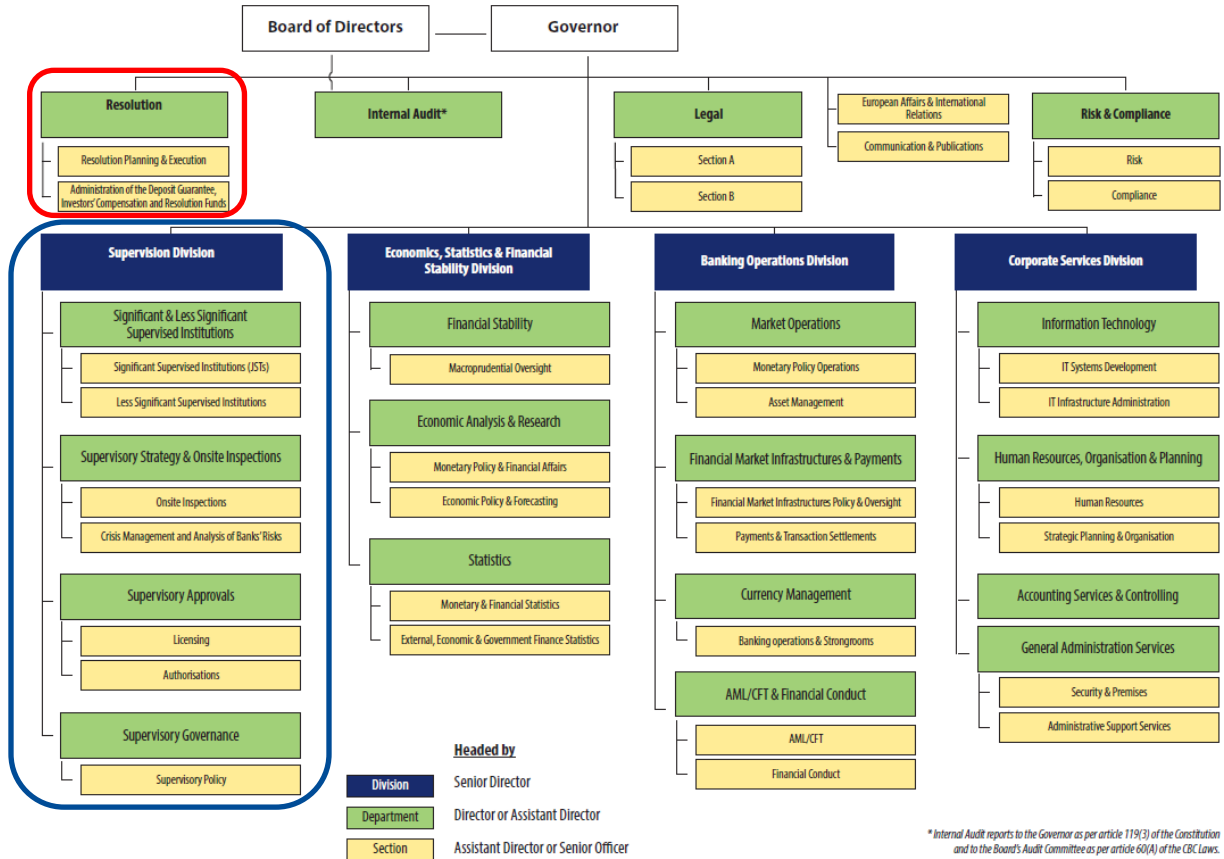
Directorate General of
Financial Supervision

Resolution Unit

Source: Organizational chart from Banca d'Italia.

Central Bank of Cyprus

Central Bank of Cyprus - Organisational Chart



* Internal Audit reports to the Governor as per article 119(3) of the Constitution and to the Board's Audit Committee as per article 60(A) of the CBC Laws.

Division of Supervision

Department of Resolution

Source: Organizational chart from the Central Bank of Cyprus.

APPENDIX III. BRIDGE BANKS IN PRACTICE

The Federal Deposit Insurance Corporation (FDIC) of the U.S. has used bridge banks as temporary solutions to cover the period during which it is evaluating, marketing, and eventually transferring the assets and selected liabilities of a failed institution to a third party. Since 2007, the FDIC has used a bridge bank structure in three instances, including for IndyMac, a US\$30 billion thrift that failed in July 2008, without any loss-absorbing unsecured debt. As the FDIC could not identify a viable private sector acquirer, it had to manage the institution's portfolios over a nine-month period, while imposing losses on US\$2.6 billion of uninsured deposits. Ultimately, IndyMac turned out to be the costliest failure in the FDIC's history, with a loss of US\$12.4 billion to the deposit insurance fund.

Cross-country experiences with bridge banks highlight the challenges associated with operating and divesting bridge banks:

- In Portugal, a bridge bank was used in 2014 to resolve Banco Espírito Santo, which was the third largest bank in the country at that time. The resolution scheme involved the transfer of selected assets and liabilities, together with resources raised by the newly created resolution fund from the government and going-concern banks. After an initial privatization effort collapsed in 2015, a 75 percent stake in the bank was sold to a U.S. private equity firm in March 2017—albeit with additional costs for the resolution fund in the form of a capital infusion and various guarantees.
- The Danish Resolution Authority, Finansielt Stabilitet, utilized a bridge bank structure to resolve Andelskassen J.A.K. Slagelse, a mid-size cooperative bank in 2015. A competitive tender process for its divestiture initially resulted in a sales agreement with a company associated with the Norwegian Netfonds Bank, but this transaction fell apart in October 2016, as the envisaged acquirer failed to obtain supervisory approval, prompting the initiation of an orderly wind-down.
- Banca d'Italia relied on bridge banks in 2015 to resolve four regional banks (Banca Marche, Banca dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, and Cassa di Risparmio della Provincia di Chieti), which had been placed under administration and were struggling to identify effective rehabilitation options. The resolution scheme imposed a substantial cost on the Italian resolution fund (which provided the necessary capital contributions), as senior creditors, including uninsured depositors, were effectively protected. The eventual divestiture of the bridge banks in 2016 generated further outlays for the fund in the form of capital contributions and guarantees.
- The clean-up of the banking system in Ghana also made extensive use of bridge banks, as the assets and liabilities of multiple banks, including UniBank (one of the biggest commercial banks in Ghana at the time) were amalgamated during 2018 and

2019 in the newly created Ghana Consolidated Bank. As assets were insufficient to cover all the assumed liabilities, the bank received contributions of almost 3 percent of GDP in the form of special government securities that were, in part, subsequently monetized via the Bank of Ghana. Aided by cost-cutting and returns on its bond holdings (which comprise 80 percent of its assets), the bank realized modest profits in 2019 and 2020.