



THE BAHAMAS

TECHNICAL ASSISTANCE REPORT— OPERATIONALIZING THE NEW BANK RESOLUTION FRAMEWORK AND AMENDED DEPOSIT INSURANCE LEGISLATION—SECOND MISSION

August 2023

This technical assistance report on The Bahamas was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in August 2023.

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International Monetary Fund
Washington, D.C.



TECHNICAL ASSISTANCE REPORT

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Operationalizing the New Bank Resolution
Framework and Amended Deposit Insurance
Legislation—Second Mission

August 2023

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**Monetary and Capital Markets
Department**

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GLOSSARY

AMC	Asset Management Company
BCCUA	Bahamas Co-operative Credit Unions Act 2015
BCL	The Bahamas Cooperative League Limited
BFSC	The Bahamas Financial Stability Council
BTCRA	Banks and Trust Companies Regulation Act 2020
CBOB	Central Bank of The Bahamas
CMG	Crisis Management Group
DIC	Deposit Insurance Corporation
DIF	Deposit Insurance Fund
DSIB	Domestic Systemically Important Bank
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GFSR	Group of Financial Services Regulators
HR	Human Resource management
IMF	International Monetary Fund
IT	Information Technology
MCM	Monetary and Capital Markets Department
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MPE	Multiple Points of Entry
NPL	Nonperforming Loan
P&A	Purchase and Assumption
PDA	Protection of Depositors Act
ROA	Return on Assets
RU	Resolution Unit
SCB	Securities Commission of The Bahamas
SCV	Single Customer View
SIB	Systemically Important Bank
SPE	Single Point of Entry
TA	Technical Assistance

PREFACE

At the request of the Central Bank of The Bahamas (CBOB), the Monetary and Capital Markets (MCM) Department provided a second Technical Assistance (TA) mission in virtual format during November 7–18, 2022, following from the first virtual mission between October 18 and November 8, 2021, to assist the authorities in operationalizing the new (September 2020) bank recovery, resolution, and amended depositor protection regimes.

The mission engaged with the authorities through virtual meetings and workshops held with officers of the CBOB and the Deposit Insurance Corporation (DIC), which focused mainly on resolution planning and crisis preparation, and resolution and crisis management. Interactions included the CBOB's and DIC's presentation of progress updates and policy proposals, which helped clarify some issues and inform the sequence of priority issues. Each session was followed by questions and answers, and the mission again benefitted from forthright and constructive discussions with the CBOB and DIC management and staff.

The mission met remotely with Mr. John Rolle, Governor; Mrs. Karen Rolle, Inspector of Banks and Trust Companies; and other senior staff of the CBOB and the DIC. The mission also met with executives of the financial safety net agencies, including the CBOB, Ministry of Finance (MOF), DIC, and the Securities Commission of the Bahamas (SCB) on progress of the Bahamas Financial Stability Council (BFSC), which is being established.

The mission wishes to thank the members of the CBOB and the DIC for their cooperation, productive discussions, and hospitality during this virtual TA mission.

EXECUTIVE SUMMARY

The CBOB has made good progress in implementing recovery plans for the domestic systemically important banks (DSIBs). Building on this progress, the mission recommends that the CBOB provide the DSIBs with structured feedback on their initial recovery plans and, based on lessons learned from the pilot, provide to all banks and credit unions updated industry-wide guidance that sets out high-level expectations on the content for recovery plans. Engagement with home supervisory authorities of foreign-owned banks should also be strengthened, with a view to seeking to ensure that parent-bank recovery plans adequately address recovery actions for subsidiaries in the Bahamas.

The CBOB is advised to develop a comprehensive strategy for resolving failed financial institutions. This would require the development of guidance on the selection of resolution options, including special reference to the systemically important banks (SIBs) and the step-by-step procedures for the implementation of the resolution process. These procedures could be laid out in a resolution manual that would identify the key steps in the resolution process, including (i) the activation triggers for resolution; (ii) selection of the resolution strategy; (iii) step-by-step implementation of the resolution process; and (iv) communication protocols.

Once a resolution manual has been developed, the CBOB is advised to prepare a framework for undertaking resolvability assessments and resolution planning for DSIBs. The framework would include a data template for obtaining the information needed to undertake a resolvability assessment and for preparing a resolution plan. The mission recommends starting with a pilot program involving one or two domestically owned DSIBs; then, drawing on lessons learnt, extending the resolution planning process to the remaining DSIBs. The CBOB is encouraged to further strengthen its engagement with the home resolution authorities of foreign-owned DSIBs to support their close cooperation in the CBOB's preparation of resolution plans.

Scaling up of the Deposit Insurance Corporation (DIC) operations to cover banks and credit unions under the amended law needs reforms in a variety of areas. The DIC's governance should be strengthened by proposed increase of the board's size by appointing additional external directors, thereby reducing the dominance of ex officio directors. The relations with other financial safety net members should be strengthened, giving the DIC access to more timely information on impending failures. Design features of the DIC should be strengthened, including (i) extending protection to US dollar-denominated deposits; (ii) increasing the target fund ratio; and (iii) establishing a back-up emergency liquidity facility. Improvements are also needed in the reimbursement process.

The bank resolution law was strengthened in 2020 and provides the CBOB with the key resolution tools needed for an effective resolution regime. However, some aspects of the law would benefit from review to better align with international principles and good practice. In particular, it would be desirable to consider amendments to the law to, among other matters, clarify and place appropriate safeguards on the use of public funding for bank resolution, and

clarify the ownership arrangements in the event that a bridge bank or asset management company (AMC) is established.

The credit union law is currently under review and draft legislation has been prepared to strengthen resolution powers in respect of credit unions. This is important given the current lack of adequate powers to resolve nonviable credit unions. A further review of the draft bill is recommended to tailor it more precisely to the resolution needs applicable to the sector. The CBOB should further develop a sector-specific strategy to address financial stress in credit unions, including establishing a contingency plan for early intervention; a framework for implementing credit union mergers, where feasible; initiatives to help build financial viability and resilience in the sector; and strengthening preparedness for resolving nonviable credit unions.

The domestic coordination on financial stability and crisis management matters would benefit from strengthening. The Bahamas Financial Stability Council (BFSC), which is under development, will be a non-statutory, inter-agency body established to monitor and coordinate policy for emerging risks to financial stability. All financial safety net players should be represented in the BFSC, including the MOF and the DIC, and it should have a broad-based overview of the financial system, including banks, credit unions, insurers, securities firms and markets, wealth management firms, and payment and settlement systems. The BFSC should establish sub-groups that can focus on special issues that affect financial stability.

The mission recommends that the CBOB, in liaison with the other relevant agencies, develop a program of regular training and crisis management testing. This will be an important means of building capacity within the CBOB and across the agencies, and for evaluating the adequacy of resolution guidance and crisis management preparedness. The CBOB and the DIC should undertake annual “desk-top” testing to assess various aspects of their respective resolution functions, including coordination required for the resolution process. In addition to annual training workshops, more comprehensive live crisis-simulation exercises should be held every three to four years, involving the chief executives and relevant senior management of all the member agencies of the BFSC.

Table 1. The Bahamas: Key Recommendations

Recommendations and Authority Responsible for Implementation	Paragraph Reference	Priority	Timeframe^{1/}
<i>Recovery Planning, Resolution Planning, and Crisis Preparation</i>			
Provide the pilot banks that have prepared recovery plans further guidance including an identification of the main deficiencies and highlighting areas for improvement.	4	H	NT
Establish CBOB teams to build recovery and resolution planning expertise and for coordinating related supervisory assessments.	5	H	MT
Require banks to undertake regular testing of their recovery plans.	6	M	MT
Finalize the resolution manual that describes the step-by-step implementation of each resolution tool.	8, 19	H	NT
CBOB should begin resolution planning and resolvability assessment, starting with the largest one or two DSIBs then expanding the coverage to all DSIBs.	20	H	NT-MT
Strengthen the structure and governance of the BFSC, including by establishing a working group to facilitate inter-agency coordination on key aspects of the bank resolution and financial crisis management work programs.	26,29	H	NT
<i>Resolution and Crisis Management</i>			
Strengthen the separation between the supervisory and resolution functions of the CBOB and ensure adequate resources.	35	H	NT
Review the provisions for bank resolution in the BTCRA, including an assessment of the gaps and deficiencies in the resolution powers relative to the Key Attributes and good international practices.	35	H	MT
Revise the proposed draft bill and resolution framework for credit unions to ensure it is proportional to their size and features.	41–43	H	MT
Develop a strategy for resolving stressed or failing credit unions, which could include mechanisms for raising capital and resolution measures.	44, 45	H	NT
CBOB and MOF to develop a contingency plan for public funding that may be required to resolve a SIB, including the purpose, pre-conditions, source and means of recovery of such funding.	48	H	NT
Bring the DIC into line with international standards by reforming its governance structure and powers.	54	H	MT
Strengthen the DIC's reimbursement capacity by improving its ability to obtain deposit data, implement reimbursement plans, and support a purchase and acquisition assumption transaction.	55	H	MT
<i>Capacity Building and Resolution Framework Testing</i>			
Build capacity for dealing with financial distress and failure situations, including developing a program of regular inter-agency training workshops, conducting crisis simulations and testing safety net and resolution frameworks.	59, 60	H	MT

^{1/} Near term: < 12 months; Medium term: 12 to 24 months.

I. INTRODUCTION

A. Overview of the Financial System in The Bahamas

1. **The financial sector in the Bahamas is large and diversified, with total banking system assets amounting to US\$144.9 billion or 1,293.8 percent of GDP at end-June 2022 (Table 2).** The domestic banking sector is composed of 20 institutions that together represent 202.7 percent of GDP, of which a significant majority are foreign owned. Among the nine locally incorporated commercial banks are four foreign-owned subsidiaries, one foreign branch, and four locally owned banks. The seven credit unions are small (4.5 percent of GDP). The international (offshore) banking system represents over 1,000 percent of GDP. However, its impact on the domestic financial system is limited. Bahamian foreign exchange controls limit the ability of international banks to transact in the local market, except for small transactions to cover operational expenses. In the event of financial distress of an international bank, the offshore parent bank is expected to support its subsidiary. In the absence of such support, resolution options would include mergers or closure and liquidation. Given the limited connection with the domestic economy, such a failure would have little impact on the financial system.

Table 2. The Bahamas: Banking System Structure

(As of end-June 2022)

	Number	Assets (B\$ billion)	Assets to GDP ^{4/} (percent of)	Total assets (percent)
Sub-total domestic	20	22.7	202.7	15.7
Total commercial banks	9	17.2	153.6	11.9
Domestic	4	4.1	36.6	2.8
Foreign owned/branch	5	13.1	117.0	8.3
Other LFIs ^{1/}	11	5.5	49.1	3.8
Credit unions	7	0.5	4.5	0.3
Development bank ^{2/}	1	0.1	0.9	0.1
International (offshore) banks ^{3/}	193	121.6	1085.7	83.9
Total system	212	144.9	1293.8	100.0

Source: Central Bank of The Bahamas and IMF staff calculations.

^{1/} Local financial institutions.

^{2/} Data as at end-2021.

^{3/} Includes: 12 branches of foreign banks and 134 restricted, non-active entities that are not required to report assets.

^{4/} Using end-2021 nominal GDP.

2. **The financial position of the banking system appears to remain strong, despite recent market developments that weighed on profitability.** The banking system is highly capitalized and liquid (Table 3). At mid-2022, the average capital ratio for the banking system

was estimated to be 28.2 percent of risk-weighted assets and the liquid assets to total assets ratio was estimated to be 37.6 percent.¹ All banks have significantly more capital than the CBOB's target capital adequacy ratio of 17 percent of risk-weighted assets. Nonperforming loans (NPLs) increased to 8.6 percent of total loans at end 2021 but moderated slightly by mid-2022.

Provisioning remained strong, with specific provisions covering 75.7 percent of NPLs unchanged from the level in 2019. Profitability of the financial system has improved following the losses experienced in 2020, with ROA reaching about 2.0 percent by mid-2022.

Table 3. The Bahamas: Domestic Banking Sector Financial Soundness Indicators

(In percent, unless otherwise indicated)

	2019	2020	2021	June 2022
Capital adequacy				
Regulatory capital to risk-weighted assets	28.1	28.4	26.4	28.2
Regulatory Tier I capital to risk-weighted assets	27.0	27.0	24.5	27.2
Capital to assets	22.4	22.4	21.3	20.0
Asset quality				
NPLs to total gross loans	7.2	7.5	8.6	8.1
NPLs net of provisions to capital	5.4	4.0	6.7	5.8
Specific provisions to NPLs	75.8	84.5	75.4	75.7
Profitability^{1/}				
Return on assets	2.4	-0.1	2.3	1.9
Return on equity	10.7	-0.3	10.9	9.4
Noninterest expenses to gross income	58.3	97.1	61.2	68.2
Personnel expenses to noninterest expenses	39.0	32.8	38.1	28.2
Liquidity				
Liquid assets to total assets	30.1	32.4	33.8	37.6
Liquid assets to short-term liabilities ^{2/}	41.6	45.7	46.7	50.0

Sources: Central Bank of The Bahamas and IMF staff calculations.

^{1/} June 2022 figures are annualized.

^{2/} Short-term liabilities are defined as resident deposits.

¹ Capital and liquidity buffers have remained stable at these levels since the 2019 FSAP, which assessed the banking system as resilient to a range of adverse scenarios, although some individual banks' high NPLs warrant caution.

II. RECOVERY AND RESOLUTION PLANNING AND CRISIS PREPARATION

A. Recovery Planning

Findings

3. **The Banks Trust Companies Regulation Act 2020 (BTCRA) requires banks in the Bahamas to have a recovery plan that accords with requirements specified by the CBOB.** The recovery planning provisions in the Act came into force in 2020. The CBOB initiated bank recovery planning in 2021, initially requiring just the banks classified as DSIBs to prepare a recovery plan. To assist in this process, the CBOB provided the banks with guidance setting out expectations for the structure and content of recovery plans. The draft recovery plans were received by the CBOB around mid- 2022 for review. The CBOB identified a number of deficiencies in the recovery plans. It intends to provide feedback to the banks later this year, with a view to requesting revisions to the recovery plans.² The intention is to extend recovery planning to all supervised financial institutions once the initial pilot program has been completed. All supervised financial institutions will then be required to update their recovery plans on a regular basis.

Recommendations

4. **The CBOB has made good progress in implementing recovery planning requirements for banks.** The mission recommends that the CBOB build on this by providing the banks that have prepared initial recovery plans with further guidance on expectations for recovery plans, including on identification of the main deficiencies arising from the review of the initial draft recovery plans, and highlighting areas for improvement. In that context, the mission suggests that the CBOB feedback be provided on a system-level basis to all of the banks in question, with specific feedback also being provided to individual banks on their own recovery plans, and an indication of how their plan compares with all of the plans reviewed (while preserving banks' confidentiality). Based on the mission team's review of recovery plans, the key issues that the CBOB might wish to emphasize in providing feedback to banks include the need for ensuring that:

- there is clarity on the ownership of the recovery plan and the responsibilities of the CEO, senior management team, and the board in approving the plan;
- there is clarity on “who does what” with regard to invoking the recovery plan and approving particular recovery actions, including the allocation of responsibility between the board and management;

² The CBOB has since provided feedback and further guidance to the pilot banks on their respective recovery plans, including on areas for improvement.

- the recovery plan triggers and restoration points are aligned to relevant metrics in a bank's risk appetite statement (such as minimum risk tolerances in the case of triggers, and target risk operating levels in the case of restoration points);
- the triggers apply well before breaches of regulatory requirements;
- the recovery plan includes early warning indicators of emerging stress in relation to each of the triggers in the plan;
- the recovery actions are appropriately sequenced, quantified, contain realistic timeframes for implementation, are sufficiently timely, and are accompanied by implementation guidance for each recovery action;
- the scenarios selected for the recovery plan are sufficiently severe but plausible, so as to result in a bank breaching its capital and liquidity regulatory requirements;
- the recovery plan sets out the communications strategy for recovery actions, including who says what to whom, when, and how;
- the recovery plan contains preparatory measures, such as terms sheets for capital issuance, securitization documentation, repo pre-positioning for liquidity, and the identification of possible merger partners where relevant; and
- the testing and review arrangements in the recovery plan are well documented.

5. **The mission also recommends that the CBOB establish a small team with responsibility for coordinating the ongoing supervisory assessment of recovery plans.** This would assist in promoting a consistent approach to the review and assessment of recovery plans and peer reviews. It would also enable a pool of expertise to be developed in the CBOB to assist each bank's supervisors in the review of their bank's recovery plan. The establishment of a specialist team on recovery planning would also assist in the work to be done by the Resolution Unit (RU) in undertaking resolvability assessments and preparing resolution plans for DSIBs, given the interconnections between recovery plans and resolutions (e.g., as regards critical functions and services).

6. **Once recovery plans have become well established in banks, it is recommended that the CBOB require the banks (particularly the DSIBs) to undertake regular testing of their plans.** This will help strengthen the quality of the recovery plans and equip the banks with greater preparedness to deal effectively with stress events.

7. **The CBOB should ensure that its early intervention framework incorporates appropriate linkages to bank recovery plans.** This will include the need for a structured preventative and corrective action framework to include triggers that cause the CBOB to require a bank to activate its recovery plan, as well as supervisory response actions that link to, and help facilitate, bank recovery actions. Similarly, the mission recommends that the CBOB refine its early warning system to incorporate early warning indicators (EWIs) that align to the EWIs in banks' recovery plans. The CBOB also needs to ensure that it develops contingency plans for how it would use its early intervention framework for dealing with bank stress events. These plans would be scenario-based and would appropriately include reference to the actions the CBOB would take to require banks to activate their recovery plans and the initiatives the CBOB could take to assist in bank recovery processes, such as through fast-tracking of supervisory approvals of capital issuance and other recovery actions. The CBOB should undertake regular testing of its early intervention arrangements and contingency plans for dealing with bank stress events, such as through the use of desk-top testing and simulation exercises. These exercises should become a regular tool for strengthening the CBOB's capacity for responding to bank stress and for testing the adequacy of early intervention arrangements and contingency plans.

B. The Resolution Process

Recommendations

8. **The CBOB should develop a comprehensive strategy for resolving failed financial institutions.** These procedures should be laid out in a resolution manual, completion of which should be targeted for mid-2023. Such a manual would provide step-by-step guidance for the resolution authority on implementing each of the resolution tools and resolution powers. Although the CBOB has made progress in preparing an initial draft resolution manual, further progress is needed. It should be a key priority for 2023.

9. **A resolution manual would identify the key steps in the resolution process.** It would include the activation triggers for resolution, selection of the resolution strategy, implementation of the resolution, and communication. It would also provide guidance on the coordination of resolution actions among domestic agencies and, in the case of foreign-owned banks or domestic banks with foreign operations, cross-border coordination. The manual should be the first document to consult when faced with a failed or failing financial institution and it provides guidance on the decision-making required by the resolution authorities.

10. **Guidance on the content for a resolution manual is included in Appendix I.** The key elements include:

- Crisis diagnostics—solvency assessment and systemic impact assessment;
- Resolution strategies, including the criteria to assist in selecting which strategy might be appropriate in particular circumstances;

- Cross-border crisis resolution; and
- Step-by-step implementation plans for resolution tools.

C. Resolution Planning and Resolvability Assessment

Findings

11. **The CBOB views resolvability assessments and resolution planning for the DSIBs as essential elements in the resolution framework.** Preparation of bank-specific resolvability assessments and resolution plans will commence once resolution guidance via the resolution manual has first been developed.

12. **Resolution plans provide detailed guidance on the means by which a particular bank can be resolved.** Drawing on generic guidance in a resolution manual, the resolution plan should set out in detail the bank-specific nature of the resolution arrangements for the selected resolution options, and should be prepared for each DSIB, both in respect of the bank itself and any other legal entities that form part of the regulated banking group. In addition, it is generally desirable to prepare a resolution plan for other large banks to the extent that they might be assessed as systemically important in a financial system crisis.

13. **The resolution options would need to be assessed with regard for the particular features of the DSIB and the group of which it is part.** The typical resolution options for a DSIB tend to be: (a) the bank's recapitalization (possibly slimmed down to focus solely on critical functions and services), funded through loss absorption by shareholders, capital instrument holders, and then the bail-in of subordinated and senior unsecured liabilities to the extent feasible; or (b) business transfer of critical functions and systems, and associated assets and liabilities, to either another bank or to a bridge bank established for the purpose. The resolution options are selected with regard for which option(s) meet the resolution objectives, particularly in terms of maintaining continuity of critical functions and services, minimizing disruption to the financial system and economy, and minimizing the need for public funding of resolution. If any public funding is required, this should be addressed in a separate contingency plan developed jointly by the resolution authority and Ministry of Finance (MOF).

14. **The content of a resolution plan will vary depending on the bank concerned, other entities in the banking group, and the selected resolution options.** A typical resolution plan would generally comprise the following elements:

- Identification of the critical functions of the bank and banking group, including deposit-taking; the provision of credit and management of loans; provision of payments and settlement functions; and the ability to meet obligations under derivatives contracts;
- Identification of critical services of the bank and banking group, including for: IT and other services required to maintain critical functions; the management of the bank's risks

for continuing business operations post-resolution; the maintenance of customer accounts; and regulatory compliance;

- Identification of the legal entities that perform critical functions and services for the bank and banking group, and the nature of financial and operational interdependencies between these entities;
- In the case of critical services performed by parties external to the banking group (e.g., outsourced to third parties), identification of the contractual arrangements involved and the means by which the services can be maintained with minimal interruption;
- In the case of critical services provided to the bank by a shared services entity or entities within a financial conglomerate, identification of the means by which such services can be maintained with minimal interruption, including through robust contractual arrangements or possibly relocation of some or all such services to the bank;
- Identification of functions and services that are noncritical, and which could be discontinued without material adverse impact on the financial system, and the means by which that discontinuance could be achieved at least cost;
- The means by which losses can be absorbed in a manner consistent with the ranking of claims in a winding up, including loss absorption by shareholders, additional tier 1 capital instrument holders, tier 2 capital instrument holders, and other subordinated debt holders;
- The means by which contractual bail-in liabilities (if any) would be either converted to equity or written down, and other unsecured liabilities would be converted to equity or written down to the extent practicable;
- In the case of a recapitalization, the resolution plan would identify the source for capitalization, including through bail-in, and the intended capital structure of the bank post-resolution (including whether creditors whose claims were bailed in would be issued equity in the recapitalized bank or potentially issued equity in a special-purpose vehicle that becomes an owner of the recapitalized bank);
- In the case of a business transfer resolution option, the plan would identify the business (including critical functions and services, assets and liabilities, and contractual rights and obligations) to be transferred to another bank, or to a bridge bank, following loss absorption;
- In the case of a bridge bank, the resolution plan would identify the steps involved in establishing and capitalizing the bridge bank, and the ownership structure; and

- For business that is to be discontinued and for impaired assets, the resolution plan would identify the means by which these would be handled, including potentially through liquidation in the remnants of the failed bank (if a business transfer option is applied).

15. **In some situations, bail-in and other sources of internal funding might not be sufficient to facilitate the resolution of a bank.** In that case, some form of public funding or other publicly funded support (e.g., guarantees and indemnities) might be required. In such cases, a separate contingency plan should be prepared to identify the external sources of funding available, including from a systemic resolution fund (if available), deposit insurance (on a least-cost basis), and government funding. The contingency plan should be developed jointly by the resolution authority, deposit insurance agency (if deposit insurance funding is intended to be used as part of the funding of a systemic bank resolution), and the MOF.

16. **Similarly, in some situations, the resolution plan might indicate the possible need for external liquidity assistance in resolution.** If the resolution plan indicates that temporary external liquidity support might be required for a recapitalized bank or bridge bank, this should be addressed in a separate contingency plan prepared by the central bank. The plan would identify the potential need for temporary emergency liquidity assistance (ELA) from the central bank, the collateral available, and the intended terms and conditions on which any such funding would be provided by the central bank, including potentially with an indemnity from the government.

17. **Cross-border resolution plans are the primary responsibility of the home resolution authority.** These plans set out how the parent bank and global group would be resolved. This should be done in coordination with host authorities, desirably through a crisis management group. As part of this cross-border cooperation process, the host resolution authorities identify the means by which they would recognize and support resolution actions taken by the home resolution authority to the extent that the home authority resolution actions meet host country resolution objectives. Although a global whole-of-group resolution strategy should be sought where feasible, there are situations where home and host authorities may have resolution objectives and priorities that are not fully aligned. In such cases, it is common practice for host authorities, in liaison with home authorities, to establish a “fallback” resolution plan for scenarios in which the home-country resolution proposals do not adequately meet host-country resolution objectives. The fallback option would likely take the form of either winding down the subsidiary or branch (if it is not systemically important) or transferring the critical functions and systems, and associated assets and liabilities, of the subsidiary or branch to a bridge bank or another bank. These are matters that should be discussed between home and host authorities as part of a cooperative framework for cross-border resolution planning.

18. **Resolution plans are informed by resolvability assessments.** A resolvability assessment involves assessing the feasibility of selected resolution options for each DSIB by identifying the obstacles to resolution implementation and setting out how the obstacles could be overcome. This typically comprises three stages, being assessment of: (a) the feasibility of

different resolution options for the bank in question; (b) the systemic impact of each resolution option; and (c) the actions needed to improve the bank's resolvability under the preferred resolution options. The resolvability assessment needs to be done on a consistent basis across all DSIBs using a framework developed by the resolution authority in close consultation with the other relevant agencies, such as the deposit insurance agency and the MOF. It should involve an assessment of the resolvability of each DSIB and its relevant banking group based on the most practicable resolution options. This is done by requiring the banks in question to provide comprehensive data to the resolution authority, generally using a data template developed by the authority for the purpose.

Recommendations

19. **The mission recommends that the CBOB commence resolution planning and resolvability assessments once it has completed its resolution manual.** On the basis that the resolution manual will be completed by June 2023, as recommended in this report, the mission suggests that the CBOB begin the resolution planning process shortly thereafter. It is suggested that the CBOB commence this process by preparing a paper for consultation with DSIBs, which would explain the purpose of resolution planning and resolvability assessments, the intended process to be followed, and the division of responsibility between the CBOB and the DSIBs, with the latter being responsible for submitting comprehensive data to the CBOB to facilitate resolvability assessments. The consultation paper would appropriately contain a draft of the data template that the CBOB would use to obtain data from the DSIBs to facilitate the resolution planning and resolvability assessment processes. The CBOB could also hold a workshop with the DSIBs to respond to any questions or comments they may have, following which, the data template could be finalized and released to the DSIBs.

20. **Given the complexity of the resolution planning process, the mission suggests that the CBOB start with one or two domestically owned DSIBs as a pilot program.** This will avoid the inherent complexities with cross-border resolution planning. The learnings from the pilot program will inform refinement of the process and resolution planning could then be extended to the remaining DSIBs. It is recommended that the CBOB aim to start the pilot program by end-2023, and to complete the resolution plans for the pilot banks by end-2024, if possible. Resolution planning for the remaining DSIBs could possibly be completed by end-2025. Guidance on resolution planning and resolvability assessment is provided in Appendix II.

21. **In the case of foreign-owned DSIBs, the mission recommends that the CBOB work closely with the home resolution authorities to deepen the CBOB's understanding of the home authorities' resolution plans.** Where possible, the CBOB's resolution plans for these banks should be informed by and complement the resolution plans of the home authorities. Resolution plans for foreign-owned banks should identify the matters on which, and the means by which, the CBOB would give legal recognition to and support the resolution actions in the Bahamas by the home resolution authority, where this is consistent with the financial stability and depositor interests in the Bahamas. However, in recognition that home resolution authority

resolution plans might not necessarily align fully with the CBOB's resolution objectives and meet financial stability needs for the Bahamas, the CBOB is advised to develop fallback resolution plans that cater for situations where parent resolution actions do not adequately address the needs of the Bahamas. This should be done in cooperation with the respective home authorities.

D. Inter-Agency/Inter-Authority Coordination

22. **Effective coordination among the key government agencies is crucial.** Coordination is needed for information sharing; the development of crisis management policies and procedures; regular training and crisis management exercises; and the development of policy responses to financial crisis. Coordination is also needed for the development of strategies for dealing with a wider systemic crisis.

Findings

23. **The domestic coordination on financial stability and crisis management matters would benefit from strengthening.** The existing domestic coordination body is the Group of Financial Services Regulators (GFSR), which comprises the heads of the CBOB, Securities Commission, Insurance Commission, Compliance Commission, Gaming Board, and Financial Intelligence Unit. The GFSR meets quarterly and focuses mainly on information exchange on financial regulatory issues. It does not specifically deal with financial crisis management matters and does not include the MOF or the DIC. The first TA mission, held in October/November 2021, recommended that the authorities establish a Financial Stability Council to oversee the coordination of financial stability and crisis management initiatives, and that this should include the relevant agencies that have a role in financial stability and crisis management, including the MOF and the DIC.

24. **A draft terms of reference for the Bahamas Financial Stability Council (BFSC) has been prepared by the authorities.** The BFSC is a non-statutory inter-agency body established to monitor and review emerging risks to financial stability and to facilitate regular discussions and system-wide analysis of the financial strength of systemically important financial institutions. The membership includes the Financial Secretary of the MOF, heads of the relevant financial services regulators, and the DIC.

Recommendations

25. **The BFSC has an important role to play in promoting financial stability.** It provides a forum for the regular exchange of information concerning financial sector stability and for the effective coordination on financial stability and financial crisis management issues. It should have a broad-based overview of all the financial system sectors³ and the capacity to establish a

³ These sectors include banks, credit unions, insurers, securities firms, wealth management firms, payment and settlement systems, money market, bond market, and equities market.

program of regular staff training and senior management workshops within an inter-agency basis. Given this broad mandate, it is appropriate that all financial safety net players be represented on the BFSC, including the MOF and the DIC.

26. **While the BFSC is a high-level policy coordinating body, it is helpful to establish sub-committees or sub-groups.** A core working group should be established to facilitate the coordination of the inter-agency aspects of the bank resolution and financial crisis management work program.⁴

27. **In crisis times, the BFSC's role becomes one of crisis response coordination.** It will be the forum where the causes of the crisis are diagnosed and a broad strategy for responding to the crisis is developed. The BFSC's purpose is not to set a policy response but to coordinate the development of a comprehensive response and ensure consistency among all financial safety net players. The BFSC will also be the forum for coordination of communication with the public to ensure that a consistent message is conveyed on the circumstances and the policies being implemented, and thereby limit the potential risk of different agencies announcing partial or limited announcements in the midst of a crisis.

28. **The administrative arrangements for the proposed BFSC are critical for its effectiveness.** All member agencies are equal participants in the coordination body whose role is to facilitate information exchange, cooperation, and coordination among the agencies. The BFSC should not have the authority to require policy changes by member entities. In addition, a suitable chairing arrangement must be agreed by the member agencies. In some jurisdictions, the coordination body is chaired by the central bank in recognition of its financial stability mandate. In some other jurisdictions, it is chaired by the MOF, given its potential importance in a financial crisis. Other examples of domestic coordination bodies involve a rotating chair arrangement under which each member agency chairs the body on a rotating basis. Working groups formed by the domestic body are usually chaired by the agency with the most responsibility for the matters addressed by the working group in question.

29. **Given its broad scope, the BFSC should make public the results of its deliberations.** Information and special reports can be placed in a dedicated website or on the websites of each member agency. The BFSC should also publish an annual report on its activities.

⁴ Other sub-groups could be considered to focus on special issues that affect financial stability in the Bahamas, including such concerns as financial sector efficiency, financial inclusion, competitiveness, costs of financial services, cyber risks, and the impact of climate change on the financial sector.

III. RESOLUTION AND CRISIS MANAGEMENT

A. The Bank Resolution Law

Findings

30. **In many respects, the bank resolution law in the Bahamas is satisfactory and aligns in key areas to the principles set out in the Financial Stability Board’s (FSB) Key**

Attributes. Bank resolution law is set out in the Banks Trust Companies Regulation Act 2020 (BTCRA). The BTCRA was drafted with a view to establishing a robust legal framework for the resolution of banks, modelled closely on the Key Attributes. In that regard, it contains a number of elements which provide a sound framework for bank resolution, including:

- a. clearly specified resolution objectives which align well to international principles;
- b. powers to enable the CBOB to require banks to have resolution plans, and to enable the CBOB to require a bank to make changes to its functions, systems, and structure, which may be needed to facilitate resolution;
- c. powers to enable the CBOB to appoint a statutory administrator (who can be an employee of the CBOB) to assume control of a bank in a range of situations, including where a bank’s financial condition poses a threat to the bank’s soundness, the stability of the financial system, and the interests of depositors;
- d. the powers needed for a statutory administrator to take control of a bank under the direction of the CBOB;
- e. moratorium and stay-of-action provisions;
- f. prevention of contract termination by counterparties to the bank in resolution merely because of entry into resolution;
- g. powers to enable a range of resolutions to be implemented, including recapitalization through bail-in of unsecured liabilities, issuance of shares to external parties, establishment and capitalization of a bridge bank (through powers set out in section 28(4) of the CBOB Act), and transfer of business to a bridge bank or an existing bank;
- h. the power to transfer assets to an AMC; and
- i. resolution safeguards, including a “no creditor worse off” compensation framework.

31. **However, there are some significant deficiencies in the BTCRA that need to be addressed.** It is noted that the BTCRA does not enable a statutory administrator to be appointed to a holding company or to a bank’s subsidiaries. The lack of this power would impede the ability to implement a group resolution where, for example, a bank is owned by a holding

company, or is otherwise part of a group of companies, and where critical functions or services are performed by one or more of these entities.⁵ Given the increasing tendency for banks, especially large banks, to operate via group structures, often of a complex nature, the existing law is an impediment to effectively resolving a bank on a group basis.

32. A further difficulty in the resolution law relates to the statutory manager process once resolution has commenced. Under the law, a statutory administrator is required to prepare a report for the CBOB on the bank to which the administrator has been appointed to determine appropriate remedial or resolution actions. The BTCRA does not allow for a situation in which, before the CBOB appoints a statutory administrator, it has identified the intended resolution strategy, and would therefore want the statutory administrator to take immediate action to implement the selected strategy. In the case of most bank resolutions, especially for DSIBs, it is likely that the CBOB would have identified the resolution strategy before, or at the time of statutory management being commenced. Absent the power for immediate implementation of the CBOB's resolution strategy, there is the risk of adverse market reaction and further losses being incurred as a result of a significant interval between the appointment of a statutory administrator and the announcement of the resolution option to be implemented.

33. The BTCRA and CBOB Act are also problematic in the statutory provisions relating to bridge banks and AMCs. The CBOB Act empowers the CBOB to establish and own a bridge bank, while the BTCRA refers to the ability of the CBOB to license a bridge bank. Standard international practice is for a bridge bank to be established by the resolution authority and licensed by the supervisory authority (CBOB in both cases). The law in the Bahamas is consistent with these practices. However, standard international practice is for a bridge bank to be owned by the government or by bailed-in creditors. It is inappropriate for a supervisory or resolution authority (CBOB in this case) to be the owner of a bridge bank given that this creates conflicts between its supervisory and resolution functions, and the ownership function. It also exacerbates moral hazard risk and poses a risk of a competitively non-neutral regulatory framework applying to the bridge bank, to the potential disadvantage of peer banks. Similar arguments apply in the case of an AMC. It is reasonable that the CBOB has the power, as resolution authority, to establish an AMC if that is assessed as being justified on cost/benefit terms. However, the AMC should not be owned by the CBOB but rather by those whose funds are used to capitalize it—again, either bailed-in creditors or the government.⁶

⁵ Critical functions are activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for financial stability due to the banking group's size or market share, external and internal interconnectedness, complexity and cross-border activities. Critical services (including services shared between or among entities within a group) are activities performed within the firm or outsourced to third parties where failure would lead to the inability to perform critical functions and, therefore, to the disruption of functions vital for the functioning of the real economy or for financial stability.

⁶ Appendix I sets out the principles to govern operations of and prudential requirements applicable to a bridge bank and AMC.

34. **A further issue in the BTCRA that warrants review is the resolution funding structure set out in the Act.** In various sections, the BTCRA refers to resolution funding, including in connection with funds needed (beyond those available via bail-in) to facilitate recapitalization of a bank in resolution or capitalization of a bridge bank, the funding of guarantees and indemnities, and lending to a bank in resolution or to a bridge bank. It is not clear from the Act what the source of the funding is for these purposes; i.e., whether it is sourced from the government (and if so, the procedures for accessing it) or from the CBOB. As a matter of principle, and in keeping with international standards and practice, if public funding is to be provided for bank resolution purposes, it should not come from the central bank; rather, it should be sourced from the government. Moreover, the BTCRA is not sufficiently clear on the preconditions that must be met before accessing public funding. In that regard, section 56(3) of the BTCRA merely requires the CBOB to consider the extent to which a bank's own resources can be used (including through bail-in of liabilities or the sale of assets) before determining whether to use public funding. Moreover, the BTCRA is silent on the important matter of how public funding outlays are to be recovered if there is a shortfall in recoveries from the assets of the resolved bank or liquidation estate of the failed bank; there is no statutory mechanism by which levies could be applied to banks to repay any net public funding outlays.

Recommendations

35. **The mission recommends that the authorities undertake a review of the resolution provisions in the BTCRA and CBOB Act.** The review should include an assessment of the gaps and deficiencies in the resolution powers relative to the Key Attributes and good international practices, taking into account the observations made in this report. Specifically, the mission recommends that the authorities consider developing proposed amendments to the BTCRA (and CBOB Act where appropriate) to:

- a. enable a statutory administrator to be appointed to a bank's holding company (if applicable and where the holding company is licensed and supervised by the CBOB) and any subsidiaries of the applicable holding company and bank that perform critical functions or services for the bank;
- b. make a clear distinction between the operations of the supervisory authorities and the resolution authorities within the CBOB, such that the two functions should be operationally separate, with their own staffing and budget, and with separate reporting to the board, with the RU being able to draw on other staffing resources when needed (e.g., in the context of a pending crisis);⁷

⁷ The structure, staffing and resourcing of the RU were also addressed in section III A of the first mission report

- c. define the role of the resolution authority to include identification of the appropriate resolution strategy, and in that regard, enable flexibility by empowering the CBOB to direct the statutory administrator to implement the resolution it has identified;
- d. make provision for a bridge bank and/or AMC to be owned by either a government entity nominated by the Minister of Finance, if the capital of the bridge bank or AMC is partly or fully funded by public money, or by an entity licensed by the CBOB, which is owned by bailed-in creditors where the capital is funded by bail-in;
- e. remove provisions in the BTCRA that enable the CBOB to provide funding to a bank in resolution, other than via ELA on a collateralized basis or with an indemnity from the government;
- f. clarify the means by which public funding may be provided in a bank resolution, making it clear that such funding may only be sourced from the government, and setting out the procedures required to access this funding;
- g. include provisions in the BTCRA that specify the preconditions on which any public funding (including via guarantees and indemnities) may be provided for a bank resolution, such that public funding may only be provided if the Minister of Finance is satisfied that shareholders, capital instrument holders, subordinated debt holders, and any contractual bail-in debt holders have been required to absorb losses to the full extent of their legal liability, and that senior unsecured liabilities have either been bailed-in to the extent feasible or that bail-in of such liabilities would pose an unacceptably high risk to the stability of the financial system, and that the provision of public funding, guarantees, or indemnities is necessary for the resolution of the bank in a manner consistent with resolution objectives;
- h. include provisions in the BTCRA that empower the Minister of Finance to set a levy on SIBs to recover any public funding outlays not fully recovered from the assets and cash flows of the resolved bank or liquidation estate of the bank, where the basis on which such levies are set is specified in regulations; and
- i. empower the CBOB to give legal recognition to resolution actions taken by a home resolution authority in relation to the operations of a foreign bank operating in the Bahamas, subject to the CBOB being satisfied that the resolution actions are consistent with the interests of financial stability and depositor protection in the Bahamas.

B. The Credit Union Sector Recovery Planning and Resolution Frameworks⁸

Findings

Structure of the credit union sector

36. **The cooperative sector comprises seven credit unions that are small and pose little systemic threat to the financial sector.** The CBOB supervises the credit unions on a similar basis as for the banks, albeit tailored to their small size and relatively simple business models.⁹ Where supervisory requirements are not fulfilled and growing distress or insolvency is being faced, the CBOB may place the credit union into resolution.

Distress management and resolution regime

37. **The options available to the CBOB to deal with a credit union that is in financial distress or failing are limited.** The current law under which distress management and resolution can be undertaken is the Bahamas Co-operative Credit Unions Act 2015 (BCCUA). Under the BCCUA, the CBOB has the capacity to take supervisory and resolution interventions for dealing with a credit union that is financially unsound or nonviable. Principally, the powers available to the CBOB are to give directions to a credit union to require it to take remedial actions, to facilitate a merger with a financially sound credit union, to facilitate the transfer of assets and liabilities of one credit union to another, or in the case of insolvency or capital deficiency, to initiate liquidation. The CBOB does not have the authority to force a merger or business transfer, but can call a credit union board meeting that requires three-fourths of all the members of each credit union to approve an amalgamation or business transfer.

38. **The CBOB has the authority to place a credit union into liquidation.** Such closure can be triggered when a credit union is insolvent or capital deficient and cannot meet the demands of depositors or the credit union's continuation in business would result in a loss to the members of the credit union. The CBOB itself can conduct the liquidation process or it can appoint a person as liquidator, where such person is subject to the directions of the CBOB. Once appointed, the liquidator has the authority to merge the credit union in question with another credit union and to sell assets. The CBOB has no other powers to resolve a credit union.

⁸ The Bahamian authorities make no distinction between credit unions and cooperatives. Credit unions are owned by their members and resemble cooperative institutions in other jurisdictions.

⁹ At mid-2022, total assets of the seven credit unions amount to 0.3 percent of total banking system assets, being equivalent to 4.5 percent of GDP (see Table 2). Total deposits are 4.8 percent of total deposits in the system, of which over 80 percent are fully insured by the deposit insurance corporation (see Table 5).

Proposed Amendments to the Resolution Regime

39. **The authorities have developed draft amendments to the BCCUA to strengthen the powers available to the CBOB.** The proposed amendments are closely modeled on the existing provisions of the BTCRA. The draft bill would empower the CBOB to:

- require credit unions to prepare recovery plans that comply with requirements specified by the CBOB;
- require a credit union to cooperate with the CBOB to enable it to undertake resolvability assessments and prepare resolution plans for credit unions;
- require a credit union to make changes to its structure or operations to facilitate the implementation of a resolution plan;
- issue binding directions to a credit union, covering a wide range of matters;
- appoint a statutory administrator to assume control of a credit union for remedial or resolution purposes; and
- under statutory administration, implement various forms of resolution, potentially including bail-in to facilitate loss absorption; recapitalization; business transfer to another credit union or a bridge institution; establishment of a bridge institution; establishment of an AMC and the transfer of impaired assets to it.

Assessment and recommendations

Resolution powers

40. **As is recognized by the CBOB, the legal framework for resolving failing credit unions is weak and needs to be strengthened.** The necessary amendments include the need for: well-defined resolution objectives anchored to depositor protection and financial stability; clear triggers for entry into resolution before the point of insolvency; powers for the CBOB to (either itself or via a statutory administrator) assume control of a credit union; powers to apply resolution actions, principally focused on business transfer/purchase and assumption (including potentially to transfer business to another credit union or to a bank, or to a bridge institution established by the CBOB) or closure and payout of insured depositors, funded by the DIC, followed by liquidation of the credit union ; and resolution safeguards, particularly the “no creditor worse off” safeguard. The law also needs to enable the CBOB to initiate and complete resolution without court approval and without the need for a mandate from a credit union’s members.

41. **The draft bill includes many of these features.** However, a number of the provisions uplifted from the BTCRA are not likely to be suitable for application to credit unions. The provisions in the draft bill that the mission suggests could either be deleted or modified are discussed below:

- The proposed power to require credit unions to have resolution plans is not likely to be used. Bank-specific resolution plans are needed only in the case of DSIBs and other systemically significant financial institutions. In the case of small banks and credit unions, generic resolution guidance is all that is likely to be required, drawing on the CBOB's resolution manual and the DIC's intended plans for depositor payout and P&A. It is suggested that the draft law be amended such that resolution plans would only be required for credit unions if they are assessed by the CBOB to be systemically important.
- The draft clauses relating to bail-in are unlikely to be used in the case of credit unions. The more relevant powers are those enabling the transfer of business from a nonviable credit union to a financially sound credit union or bank.
- The provision for the establishment of a bridge institution is unlikely to be needed for credit union resolution, given that this mechanism is generally applicable to larger and more complex financial institutions. However, if a bridge institution power is to be included in the bill, it is suggested that the law be drafted to limit the use of the power to circumstances where the CBOB is satisfied that this would provide the most cost-effective means of resolution, such as, where several credit unions are nonviable and where it might be cost-effective to establish a bridge institution to acquire viable assets and assume, at least, insured deposits from the failing credit unions.
- The AMC power is unlikely to be necessary and could be deleted.

42. **Consistent with the points made in relation to statutory administration of banks, the mission suggests a modification of the statutory administration arrangements for credit unions.** As drafted in the bill, statutory administration can be used for remediation and resolution purposes. In either situation, the draft bill makes provision for a statutory administrator to review the state of affairs of a credit union and prepare a report of its findings and recommendations to the CBOB. This may be an appropriate process for remediation in a situation where a credit union remains viable, plays a significant role in the sector, and/or an independent assessment is required to inform the best course of action. However, it is not a suitable process for resolution. It creates a risk of significant delay between the appointment of a statutory administrator and the commencement of resolution, and is predicated on an assumption that the CBOB would not have already determined a resolution strategy in the case of a nonviable credit union. In all probability, if the CBOB has determined that a credit union is nonviable, it would have identified the resolution strategy before or at the same time as the appointment of a statutory administrator. Accordingly, the mission suggests that the BCCUA be drafted to enable the CBOB to implement the resolution immediately upon a credit union being put into statutory administration.

43. **The public funding mechanisms in the draft bill amending the BCCUA need to be revised.** The draft bill includes substantially the same public funding clauses as in the BTCRA that need to be revisited and clarified, as noted earlier in this report. Moreover, in the case of credit unions, their small size is very unlikely to pose a threat to the stability of the financial system. Accordingly, it is recommended that the public funding mechanism of the BTCRA not be included in the BCCUA. The resolution of a credit union should rely only on funding from within the credit union or funding from the DIC in the case of a payout of insured deposits or a P&A transaction.

Strategies for dealing with the credit union sector

44. **In addition to strengthening the resolution regime for credit unions, the CBOB should establish a sector-wide strategy for addressing stresses facing the sector.** With few exceptions, credit unions appear to be unprofitable due to lack of economies of scale and scope, and associated high operating costs. Some of the credit unions are operating below minimum liquidity requirements, and asset quality problems are significant, with NPLs exceeding 10 percent of total loans outstanding. The CBOB has noted an intention to wind down the three smallest credit unions due to very low capital positions and an apparent lack of merger opportunities. In the case of at least two other credit unions, the CBOB has noted concern over their longer-term viability.

45. **The IMF team suggests that, building on the analysis already undertaken by the CBOB, the CBOB strengthen its strategy for addressing the problems in the credit union sector.** Appendix III sets out recommendations on some of the elements needed to respond to concerns regarding credit unions.

C. Contingency Plan for Systemic Banks, Public Funding

Findings

46. **As with the resolution of any bank, the resolution of a SIB should be achieved without reliance on public funding to the extent practicable.** In that regard, resolution plans for DSIBs and other potentially systemic banks should be prepared on the basis that funding for loss absorption and capitalization will be sourced from within the failing bank (e.g., through the capacity to bail-in capital instruments and liabilities). However, there may be circumstances in which public funding is required, such as in the case of banks with limited scope for bail-in due to most liabilities being in the form of deposits or where bail-in could potentially destabilize the financial system. In recognition of this, the authorities need to establish plans for how any public funding, if required, would be applied in the case of SIBs.

47. **The resolution law in the Bahamas provides scope for public funding of SIBs.** However, as noted in the discussion on resolution law in this report, the public funding provisions in the law are in need of review and reform. In particular, there is a need to clarify the purposes for which public funds may be used, the preconditions for the use of public funds, the

source of public funding (with any funding being sourced from the government and not the central bank), and the means by which funding outlays net of recoveries from the assets of the resolved bank can be repaid via ex post levies on banks.

Recommendations

48. **Aside from the law reform issues, there is a need for the authorities to develop a contingency plan for public funding, if it is required.** The authorities have not as yet prepared a contingency plan of this nature. It is recommended that the CBOB and MOF jointly develop a contingency plan to provide guidance on when and how any public funding might be applied to resolve a DSIB or other potentially SIB. The contingency plan should at the least address the following matters:

- The purposes for which any public funding, including government guarantees and indemnities, may be used in the resolution of a SIB, with the purposes anchored to the continuity of systemically important banking functions and associated systems, and the maintenance of financial system stability.
- The preconditions that must be met before any public funding may be applied, including that, at the least, shareholders and other capital instrument holders, and any holders of subordinated liabilities, have absorbed losses to the maximum extent of their legal liability, and that other unsecured liabilities have been bailed in to the extent that is not inconsistent with the maintenance of financial system stability.
- The procedures by which public funding can be obtained from the government, including any approvals required by the Minister of Finance and the cabinet, and the passing of public funding law by parliament (if a pre-appropriated funding structure does not exist).
- The indicative terms and conditions that would apply to the provision of public funding for capital injection, including the nature of the equity instruments, voting rights attaching to the instruments, and other mechanisms by which the government may exercise control over a bank that is fully or partially owned by the government.
- The government agency that would hold the equity instruments in the bank and the associated governance arrangements.
- The terms and conditions applicable to any guarantees or indemnities provided by the government, including the types of guarantees and indemnities that may be issued, the duration of the instruments, pricing, and termination arrangements.
- The means by which government guarantees and indemnities may be procured, such as via authorization from the Minister of Finance or the cabinet, and the financial disclosures associated with the granting of guarantees and indemnities.

- The means by which partial or full government ownership of a bank/bridge bank can be terminated, including through the sale of the shares to a suitable investor or group of investors, or a public float of the shares, and the preconditions for any sale.
- The means by which any public funding outlays associated with shares, guarantees or indemnities that are not fully recovered from the sale of the bank/bridge bank or through cash flows from the resolved bank and liquidation estate of the bank can be recovered through levies on banks, and the procedures to implement this recovery process.
- The means by which liquidity support may be provided to a bank in resolution or a bridge bank, including loans provided by the CBOB secured against collateral of the bank/bridge bank, indemnified by the government, and the indicative terms and conditions applicable to such loans.

49. **It is suggested that the CBOB and the MOF develop a public funding contingency plan in parallel with the CBOB's development of the bank resolution manual.** The contingency plan should be informed by the resolution guidance in the manual pertinent to the resolution of SIBs. On this basis, the mission recommends that the CBOB and the MOF aim to complete the public funding contingency plan by about mid-2023, if possible.

D. Deposit Insurance

Findings

50. **The DIC is structured as an independent authority within the CBOB.** It has its own Board of Directors, composed of six members: four ex officio members and two external directors. The DIC has no formal employees but is staffed by employees of the Bank Supervision Department. The DIC is responsible for the payout of depositors in a liquidation and may finance resolution measures proposed by the resolution authorities in the CBOB.

51. **The DIC insures for its member institutions¹⁰ all deposits denominated in Bahamian dollars of both residents and nonresidents.** Deposits denominated in foreign exchange are not protected. Membership in the DIC is compulsory for every licensed bank with Bahamian dollar deposits. Recent modifications to the Protection of Depositors Act (PDA) expanded membership to include both commercial banks and credit unions. Currently there are 11 commercial banks and other DIC deposit-taking member institutions, and 7 credit unions. The DIC is financed by annual premiums levied on member institutions.

¹⁰ DIC members comprise locally incorporated commercial banks, other local deposit-taking member institutions and credit unions.

52. **The DIC aims to pay out deposits within 20 days.** This compares adversely to the international target of seven days. However, achievement of even this 20-day goal is hampered by a lack of deposit data in the appropriate single customer view (SCV) format, and by access limitations in some of the smaller banks and the credit unions.

53. **Funding of the deposit insurance fund (DIF) is provided through premiums paid by members and interest earned from investments.** Member banks, including credit unions, pay premiums on a biannual basis (at end-March and end-September) into a single fund. The fund level is low and would cover the failure of only the three smallest credit unions and the four smallest banks. It would not be able to cover the failure of the largest credit union or any of the medium-sized banks in the Bahamian financial system.

Recommendations

54. **Despite the current financial system soundness, strengthening the deposit insurance system is a high priority task.** First, unexpected shocks are always possible and the DIC needs to be prepared for such unexpected eventualities. Second, some smaller financial institutions are reporting weaker financial conditions and some distress. The cooperative sector, for example, has a relatively high level of NPLs, is subject to lighter supervision and regulation than for banks, and the applicable resolution regime is very limited in scope and is undergoing reform. Full implementation of the DIC system (together with strengthening supervision and resolution arrangements) will enhance financial stability and limit the risks of destabilizing depositor expectations.

55. **Reforms are needed in a variety of areas.** The governance of the DIC should be strengthened under current proposals to appoint additional external directors, and thereby increase the size of the board and reduce the dominance of ex officio officers. Procedures for implementing a sound deposit insurance scheme are also needed. The DIC needs to obtain depositor data in a timely manner and in the appropriate format. Information arrangements should be strengthened to ensure that the DIC is informed well in advance about institutions that are likely to fail. The DIC should then use that information to ensure they can respond promptly and accurately to the requirements of a failure. While coverage levels are broadly appropriate, deposit protection should be extended to US dollar-denominated deposits as a policy objective as the resolution law is revised. There is also scope for strengthening the funding arrangements, including the increasing the target fund ratio and establishing a back-up emergency liquidity facility. Procedures are also needed to guide the reimbursement process, starting from collection of deposit data, to identifying amounts to be paid out, and to transferring needed funds to the payout agent. The operational details needed in implementing these reforms are described in Appendix IV.

IV. FRAMEWORK FOR TESTING RESOLUTION PROCESSES AND THE RESOLUTION PLAN

Findings

56. **An essential element in building capacity and maintaining preparedness for bank resolution is a program of regular testing.** This recognizes that bank failures will, desirably, be few and far between. The desired infrequency of actual bank failures creates a risk that CBOB staff, and the relevant staff of other agencies in the FSC, might lack the necessary skills and knowledge to implement a bank resolution, notwithstanding the development of a resolution manual and the preparation of resolution plans for the DSIBs. In order to build and maintain capacity and preparedness, it is important for the CBOB to undertake regular testing of its resolution framework, and for the DIC to regularly test its systems for obtaining deposit data from banks, determining the amount of payout per depositor on an SCV basis, and having the capacity to implement a payout or P&A transaction. It is also desirable that the other agencies in the FSC participate in cross-agency testing.

57. **Walk-through testing can be used to assess a wide range of elements in the resolution process.** These include: (a) the ability to assess a bank's capital position, solvency, liquidity, and overall viability; (b) the ability to assess a bank's potential systemic importance in the prevailing circumstances; (c) the selection of resolution options for particular types of banks; (d) the implementation of particular resolution options; (e) domestic inter-agency coordination; (f) cross-border cooperation; (g) procurement of public funding, if required (based on the public funding contingency plan); and (h) public communications. A typical walk-through test generally takes place with a relatively small number of senior staff who are pertinent to the selected scope of the test and held over a three- to four-hour period. Such testing can be undertaken on a rotating basis, with particular themes being selected for testing each year. The results of the tests should then be documented, and any recommendations for changes to the resolution manual should be identified and implemented as appropriate.

58. **Live simulation testing provides a more comprehensive form of testing resolution capacity.** This form of testing requires a significant level of planning well ahead of the exercise and will typically include: (a) identification of the objectives and scope of the exercise; (b) nature of participation in the exercise, where it is recognized that the greatest benefits from live simulation exercises are able to be derived by having top management in the resolution authority participating in the exercise; (c) development of the scenario for the exercise; (d) establishment of a planning team; (e) preparation of the detailed events schedule and associated role-play scripts for the exercise; (f) undertaking a rehearsal of the exercise (without actual participants being involved) to assess the adequacy of the exercise arrangements. Live simulation exercises can be used to test for a wide range of resolution elements, but are especially useful for testing the participants' ability to select and implement a resolution option, to facilitate effective inter-agency coordination, and to manage the process for communications with stakeholders. Exercises of this nature are generally held over a 1- to 1.5-day period and are usually followed by a debrief to assess participant feedback. A post-exercise report is then

prepared to document the findings from the exercise, and any recommendations for changes to the resolution manual or resolution plans.

Recommendations

59. **It is recommended that the CBOB, in liaison with the other FSC member agencies, develop a program for the regular training of its staff and testing of its resolution capacity.** This should include the CBOB holding an annual half-day to one-day workshop for senior management, and to extend invitations to senior management from the other FSC agencies to build greater understanding of financial crisis management and bank resolution. Annual desk-top walk-through exercises involving senior staff designed to evaluate various aspects of resolution, as well as live simulation exercises every three to four years, involving top management and other relevant staff, to test resolution capacity more fully are also recommended.

60. **The mission recommends that the CBOB, in liaison with the other FSC agencies, develop a program for resolution testing in the latter half of 2023.** It is suggested that the program include a series of annual desk-top walk-through exercises that test for various elements of resolution. Some of these exercises could involve only CBOB elements of resolution and would only involve CBOB staff. Other exercises might involve testing for inter-agency coordination on specific issues, and would involve staff from the relevant exercises. The program would also include occasional live simulation exercises based on a selected scenario and designed to test a number of elements more comprehensively in the resolution process. It is suggested that the CBOB and other members of the FSC aim to hold a live simulation exercise in 2024 (or earlier, if possible), with a view to testing at least the selection and initial steps in implementing a resolution based on the given scenario, and the coordination required between the FSC agencies for this purpose. Following completion of a few of these simulation exercises, the authorities could seek to be involved in a cross-border simulation exercise hosted by a home resolution authority, if such an opportunity arises. In the absence of such an opportunity, it is recommended that the authorities occasionally design live simulation exercises to involve the resolution of a foreign DSIB and test for the cross-border aspects of this through role-playing the home resolution authority.

V. NEXT STEPS

61. **The mission recommends actions related to key activities and developments within suggested timelines to strengthen the bank resolution framework and related matters.**

These include the following:

- a. ***Complete development and implementation of the Resolution Framework***, including:
 - (i) completing the resolution manual and the public funding contingency plan by mid-2023; (ii) preparing a resolution planning and resolvability assessment framework paper for consultation in 2023H2; and (iii) commencing implementation of resolution planning via an initial pilot in 2023Q4 and completing for all DSIBs by end-2025.

- b. ***Strengthen the structure and governance of the BFSC, once established***, including by:
 - (i) publishing a charter on its objectives and modus operandi; (ii) reporting periodically on its activities; and (iii) establishing a working group to facilitate coordinating the inter-agency aspects of the bank resolution and financial crisis management work program.
 - c. ***Review and strengthen the resolution legislation and frameworks for banks and credit unions to*** (i) address key weaknesses identified and better align with the FSB's Key Attributes and sound international practices; (ii) ensure that the proposed draft law and resolution framework for credit unions are proportional to their size, nature, and features; and (iii) consider mechanisms for credit unions to issue capital instruments to broaden their recovery options.
 - d. ***Strengthen the framework and operational capacity of the DIC and the RU, including by:*** (i) establishing and implementing a DIC fund target size within five years; (ii) formalizing DIC supplementary funding arrangements; (iii) building capacity for prompt payout and supporting a P&A transaction; (iv) establishing a public awareness program; and (v) ensuring appropriate structure and resources for the DIC and the RU.
 - e. ***Build capacity for dealing with financial distress and failure situations, including through:*** (i) the CBOB holding an annual training workshop for its senior management (and inviting senior management from the other FSC agencies); (ii) regularly testing the safety net and resolution framework; and (iii) holding a live crisis simulation exercise every three to four years (starting in 2024).
62. Pursuant to the authorities' request, feedback may be provided by the IMF on related framework documents drafted by the CBOB.

Table 4. The Bahamas: Financial System Structure

(At end 2021)

Type	Financial Institutions		Total Assets	
	Number	(B\$ millions)	(B\$ millions)	(% GDP)
Domestic Financial Market				
Total	21	21,127.5		188.5
Commercial banks:	9	16,175.3		144.3
Foreign owned/branch	5	12,171.6		108.6
Domestic owned	4	4,033.7		36.0
Other Local Financial Institutions	12	4,952.2		44.2
Cooperatives:				
Credit unions	7	474.6		4.2
Development bank/ foundation	1	35.3		0.3
Insurance companies ^{1/}	127	2,152.9		19.1
Money Service Companies:				
Remittance/ money transfer providers	5	25.2		0.2
Payment institutions:				
Nonbank e-money issuers	3	14.1		0.1
Total (A)	164	23,829.6		212.4
International Financial Sector				
Banks, Banks & Trust	59	129,037.3		1,151.2
Other nonbank financial institutions—Pure				
Trusts	45	500.0		4.5
Total International (B)	104	129,537.3		1,155.7
Total Financial Sector (A+B)	268	153,366.9		1368.1

Source: Central Bank of The Bahamas

^{1/} Includes a number of restricted, non-active entities that are not required to report on assets.

Table 5. The Bahamas: Insured and Insurable Deposits of DIC Members

(As at end-June 2022)

Member Institutions Resident Deposits Only	Insured Deposits (B\$ millions)	Insurable Deposits (B\$ millions)	Covered Deposits % of Insured to Insurable Deposits
Banks and other deposit-taking DIC member institutions			
Bank 2	531.2	1,980.4	26.8
Bank 1	447.0	1,704.6	26.2
Bank 5	463.7	1,475.0	31.4
Bank 3	422.6	1,247.0	33.9
Bank 6	190.3	726.4	26.2
Bank 9	178.1	563.2	31.6
Bank 7	78.7	283.4	27.8
Bank 11	16.9	223.3	7.6
Bank 4	1.8	100.2	1.8
Bank 10	0.5	7.6	6.6
Bank 8	0.2	1.5	13.3
Total	2,331.0	8,312.7	28.1
Credit Unions			
Credit Union 1	156.1	188.9	82.6
Credit Union 2	50.8	63.0	80.6
Credit Union 3	48.1	59.5	80.8
Credit Union 4	36.2	48.4	74.8
Credit Union 5	31.1	35.3	88.1
Credit Union 6	12.6	19.7	64.0
Credit Union 7	1.5	1.5	100.0
Total	336.5	416.2	80.9
Total domestic deposit-taking sector	2,667.5	8,728.9	30.6

Source: Central Bank of The Bahamas and Fund staff calculations.

APPENDIX I. GUIDANCE ON THE DEVELOPMENT OF A BANK RESOLUTION MANUAL

1. This appendix provides guidance on the development of a bank resolution manual, resolvability assessments and resolution planning.

Bank resolution manual

Introductory comments

2. The purpose of a bank resolution manual is to provide guidance to a resolution authority on the means by which a bank may be resolved. It should be designed to be accessible and user-friendly. This appendix provides guidance for the CBOB on the main issues that would need to be covered in the manual, including nonviability assessment; entry into resolution; selection of the resolution strategy by category of bank and other considerations; implementation of the resolution; and communication. It also provides guidance on the coordination of resolution actions among domestic agencies and, in the case of foreign-owned banks or domestic banks with foreign operations, cross-border coordination.

3. Although the resolution manual would be developed by the resolution staff in CBOB, there will be a need for input from the other relevant agencies on particular matters. For example, the CBOB and MOF will need to work closely together on elements involving public funding and the provision of government guarantees, as well as on the ownership of a special purpose bank. The MOF will also need to be closely involved in the content relating to the exit from any public support and ownership arrangements. DIC will need to be involved in matters relating to the procedures for handling a failed non-systemic bank from CBOB to DIC. The securities regulator will need to be closely involved in any matters relating to the temporary suspension of disclosures to the stock exchange and on arrangements for public listing of shares in a restructured bank that emerges from resolution. The communications elements of the manual will require input from all four agencies, given that each agency has a role to play in bank resolution (especially as between CBOB and MOF), and there is a need for coordination of crisis management communications. It is suggested that a working group of all four agencies be established by CBOB, led by CBOB, to coordinate the development of the resolution manual and related matters.

4. Separate from resolution manual is the need for CBOB to develop resolution plans for each DSIB, drawing on guidance in the resolution manual. The resolution plans would be informed by resolvability assessments that draw on comprehensive data obtained from each DSIB. Guidance on resolution planning and resolvability assessments is set out later in the appendix.

5. The key elements of a bank resolution manual are set out below, including:
- Crisis diagnostics—viability assessment and systemic impact assessment.
 - Resolution strategies, including the criteria to assist in selecting which strategy might be appropriate in particular circumstances by category of bank.
 - Step-by-step implementation plans for resolution tools.
 - Cross-border cooperation and coordination.

Supervision to resolution

6. The management of weak and failed banks is a continuum, ranging from early supervisory actions, including preventative actions to address early-stage stress or compliance issues, to more intensive corrective actions to address more advanced stress or noncompliance matters, through to the placing of a bank into resolution if it becomes nonviable and is not recoverable. In that process, a clear distinction should be maintained between activities for supervision and for resolution. Increasingly, experience has suggested that there are significant benefits when supervision and resolution are managed as separate processes. Supervision and resolution are very different activities that require different skill sets and different analytical tools. Supervision policies are about keeping the institution functioning in a safe and sound manner. Resolution policies are about resolving the failed institution as quickly as possible.

7. This separation of supervision and resolution is outlined in Figure 1. The first stages of managing a weak bank involve the identification of financial distress and the use of informal, and then formal preventative and correction measures. The institution would be required to take appropriate remedial measures to restore itself to financial and operational soundness and to full compliance with regulatory requirements. This might involve invoking its recovery plan to take initiatives within the plan to restore the bank to acceptable financial and risk positions. If unsuccessful, a private-sector solution is sought, involving the continuity of critical functions with a private sector solution (e.g., merger with a larger, financially sound bank) This part of the process is managed by the supervisors with the institution treated as a going concern.

8. The process of managing early-stage and more serious bank stress and compliance issues should desirably involve a structured framework of preventative and corrective actions, based on an escalating set of quantitative and qualitative triggers and supervisory response actions. The preventative and corrective action framework should include triggers for requiring a bank to invoke its various contingency plans, including its recovery plan. In addition, the supervisory authority should maintain contingency plans for how it would apply its preventative and corrective action framework in a range of scenarios.

9. If these measures are unsuccessful, the supervisory authority would trigger resolution and the resolution staff take over responsibility for the institution. The decision to initiate resolution should be based on an analysis of the bank's viability, such that if the bank is assessed as being nonviable and unable to restore itself to viability, the bank would be placed into resolution. Accordingly, there is a need for a clear definition of nonviability and a framework for assessing it. The principal element of viability assessment is solvency assessment to determine the capital ratio and leverage ratio of the bank/group on the basis of an asset quality review that involves estimating the probable recoverable value of assets of the bank. It will also involve assessment of the liquidity position of the bank on a projected basis, using a stress testing framework. This indicator-based analysis should be complemented with a qualitative assessment of the institution's medium-term prospects. Such an assessment will be based on an evaluation of the medium-term business model, the growth and resilience of the institution's principal markets, and the quality of management.

10. Irrespective of an institution's perceived medium-term prospects, it is desirable to have a hard trigger for entry into resolution as a fallback if there is uncertainty over viability assessment outcomes. For example, a hard trigger could be where the bank's capital ratio, calculated using the asset quality review, is estimated to be below a defined threshold (e.g., 3 percent of risk-weighted exposures).

11. If the bank is assessed as being nonviable or otherwise where the capital threshold has been reached, the institution passes into the control of the resolution authority. At this point, the resolution authority evaluates the bank's condition and explores various resolution options. These options will depend on the systemic importance of the bank and other considerations—see later in this appendix.

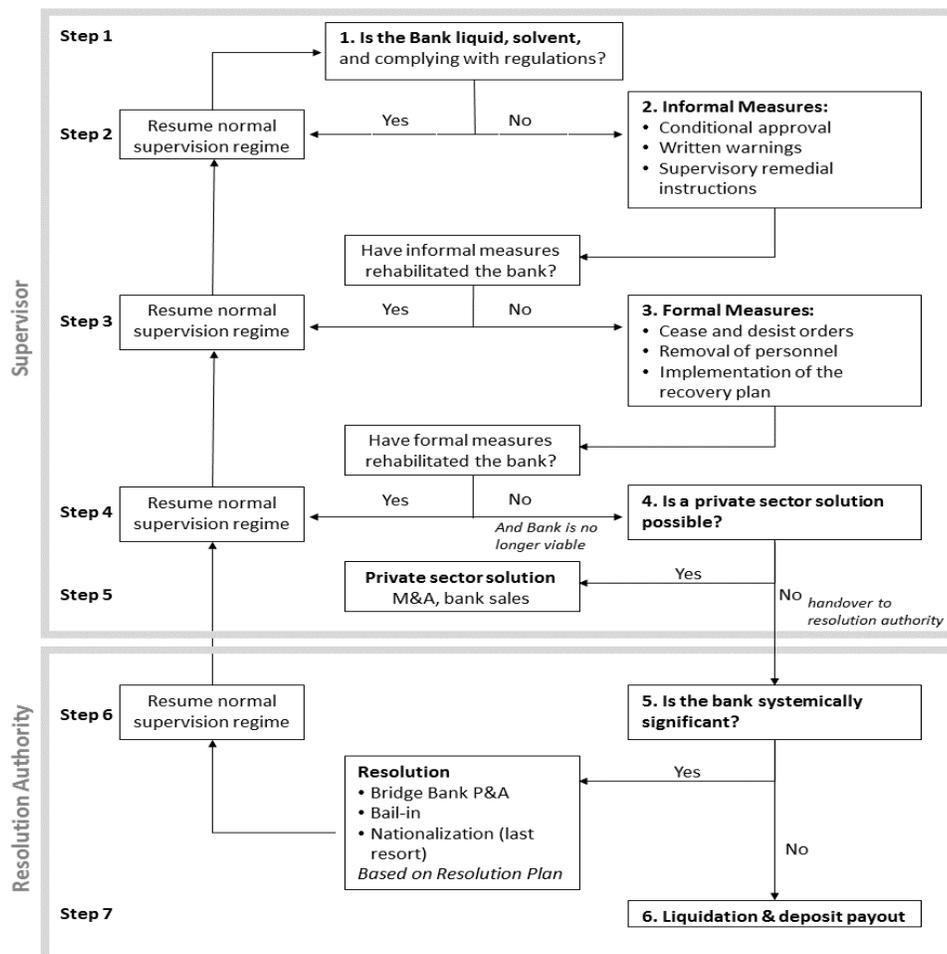
12. The steps set out in the diagram of the Intervention and Resolution Process are explained below.

Steps 1—4: Supervisory Assessment: crisis diagnostics

13. In a period of emerging stress, any bank considered to be potentially vulnerable should be assessed by the supervisory authority to determine the bank's:

- Solvency (i.e., surplus of assets over liabilities);
- Common equity tier 1 capital position;
- Total tier 1 capital position;
- Total capital position;
- Exposure to shareholders and other related parties;
- Level of NPLs;
- Level of specific provisions in relation to NPLs;
- Expected loss on NPLs; and
- Liquidity position

Overview: Intervention and Resolution Process



14. The analysis would include an estimation of a range of capital values for the bank, from best case to worst case, with assets estimated at expected recoverable values net of realization expenses. Valuations of assets should be undertaken on a “going concern” basis unless there is an expectation that the bank will be closed, in which case valuations would be on a “gone concern” basis. The supervisory authority should develop a methodology for asset quality review, including the methodology for valuing individual loans and other assets above a given amount and the methodology for valuing a portfolio of smaller loans. If a bank’s financial condition is deteriorating relatively slowly and there is time for a thorough due diligence of the bank, this could be achieved through a combination of onsite assessment by the supervisors and engaging specialist asset valuation experts from an external party (such as one of the major accounting firms, other than the bank’s external auditor) to assist in the review. If the bank’s condition is deteriorating rapidly, then the supervisors may need to undertake a fast-tracked solvency and capital asset review based on relatively conservative estimations of asset valuation.

15. The analysis would also include an assessment of the bank's liquidity position and a stress-tested assessment of how vulnerable the bank is to wholesale and retail liquidity withdrawals. Liquidity assessment would include analysis of, among other matters:

- the amount and quality of liquid assets;
- access to parent or other shareholder liquidity (where applicable);
- access to committed standby facilities with other banks;
- amount and nature of assets capable of being used for collateral to obtain liquidity from the CBOB or other sources;
- maturity profile of liabilities, both using contractual and behavioral maturities, under assumed stress conditions;
- schedule of projected payment and settlement obligations for a defined period (e.g., next one, two weeks, month, etc.); and
- stress testing of liquidity by estimating the capacity of the bank to meet payment and settlement obligations, including deposit withdrawals, under a range of plausible stress scenarios.

16. Where a bank has subsidiaries that perform essential functions for the bank, there should also be a solvency and liquidity assessment of the relevant subsidiaries.

17. The supervisory authority should have the capacity to undertake solvency assessments, capital adequacy assessments and liquidity assessments under acute time pressure (e.g., within 24 hours). Mechanisms and processes for such analysis should be developed and tested on a regular basis. In this regard, it is useful for the supervisory authority to develop a data template that sets out in detail the information needed to undertake an asset quality review/solvency assessment, and a liquidity assessment. Banks should be required to have the ability to provide data to the supervisors upon request, within a tight timeframe (e.g., 24 hours) using the data template. This should be tested periodically.

18. An important supervisory tool is peer review of selected institutions. The supervisors identify financial institutions similar to the institution under examination. The financial statistics, described above, are then compared across institutions. The supervisors will come to a judgment whether the bank under examination is broadly in line with peer institution or, if an outlier, what remediate actions are needed to strengthen the institution.

19. If the supervisors determines that the institution is failing and supervisory actions cannot reverse the financial distress, or that the institution is nonviable, responsibility for the oversight and management of the institution passes to the responsibility of the resolution authority.

Step 5: Supervisory Triggers for Determining Nonviability

20. The legal framework should establish a clear dividing line between supervisory intervention and resolution by the resolution authorities. Early intervention, which is a supervisory tool, intends to reduce the likelihood of a bank's failure, whereas resolution aims to minimize the impact of a failure. It is important for legal frameworks to clearly demarcate early intervention and resolution by establishing well-designed triggers.

21. Resolution triggers should include both qualitative and quantitative indicators, which should not be unduly prescriptive.

22. Quantitative triggers can include capital and liquidity indicators. A possible discretionary ground could be the decrease of a bank's regulatory capital levels to below a predefined threshold (e.g., CAR or leverage ratio below 50 percent of the minimum required). In doing so, this resolution trigger need not necessarily specify the reference minimum CAR or leverage ratio in law, as these may change under the supervisory framework. However, some authorities specify a minimum level or hard trigger for entry into resolution (in addition to any other triggers that might also apply), such as the CAR below 3 percent of risk-weighted assets or CET1 ratio falling below 3 percent of risk-weighted credit exposures. This has the advantage of lowering the risk of regulatory forbearance leading to a delayed entry into resolution and the associated risk of greater losses for creditors.

23. Quantitative triggers should be based on a forward-looking evaluation that supplements the conventional insolvency test. The following conditions can be made resolution grounds where the bank: (i) has become or is likely to become insolvent; (ii) has suspended or is likely to suspend payments as they fall due; (iii) has defaulted or is likely to default in making payments to depositors and other creditors; (iv) is otherwise in a situation or circumstance that may materially impair the ability of the financial institution to make payments or otherwise continue its operations; (v) the commencement of an insolvency or reorganization proceeding (other than on a solvent basis) over a group entity (including holding company); or (vi) is a branch or subsidiary of a bank that has had its license in the country of its origin cancelled or been subjected to a resolution action or insolvency process. The CBOB may also add other indicators corresponding to above circumstances, such as the bank's inability to access financial markets or reliance by the bank on extraordinary public financial support.

Steps 5–6: The Resolution Assessment and Process

24. Once the supervisory authorities trigger resolution (passing responsibility for the institution to the resolution authorities), several steps are immediately taken.

25. The immediate task of the resolution authority is to review the diagnosis of the failed institution, determine the range of possible resolution options, and select the least cost option. Typically, this process of diagnosis and review of resolution options will have begun before the supervisors activate resolution (the resolution trigger). Thus, once the trigger is pulled, the resolution authority is able to move quickly. If required, the resolution authority would immediately appoint a statutory manager or administrator to a bank. The statutory manager's responsibility is to implement the resolution strategy developed by the resolution authorities. Another option is for the appointed administrator to analyze the conditions of the failed institution, identify the range of available options, determine the least cost resolution option, and then begin implementation.

26. The selection of the resolution option will depend on a variety of factors:

- If the supervisors determine that the bank is capable of recovery but they do not have confidence in the management, the statutory manager takes control of a bank and the recovery strategy.
- If the institution is nonviable, the resolution authorities will assess resolution options and recommend a resolution option to the Board of the CBOB. In the case of a small bank with little or no systemic impact, and where recovery is not possible, closure and prompt pay-out of insured depositors or deposit account transfer to another bank via a P&A transaction would be the likely resolution option
- In the case of an institution whose failure would have a systemic impact, a form of "open resolution," where the bank's core banking functions are kept open, would be the likely resolution option.

27. The statutory manager/administrator will need to have different skills, depending on the resolution strategy. For that reason, the resolution authority should develop a list of available candidates, including their backgrounds and experience. Such a list will allow the authority to respond quickly in the face of a failing institution.

Step 5a: Systemic impact assessment

28. The determination of the systemic impact of a failure should be taken by the supervisory/resolution authority, in liaison with other relevant agencies. This assessment would be based on CBOB's framework for determining DSIBs, but the assessment would need to take into account the particular circumstances of the bank and financial system at the time of the distress event. In that regard, it is important to remember that the potential systemic impact of a bank varies over time and on the fragility of the financial system. In a period of financial system stability, small to medium-sized banks might be assessed as having a low systemic impact, whereas in periods of financial system instability the failure of the same banks might have a significant impact on the financial system, given the potential for contagion and confidence effects. Accordingly, it is essential that the systemic impact assessment is made at the time of

distress and that it factors in the then prevailing circumstances affecting financial system stability.

29. Systemic impact assessments would appropriately draw on the criteria applied in the DSIB framework developed by the BCBS. The analysis would therefore take into account:

- the market share of each bank in each of the key lending sectors;
- the market share of each bank in the deposit market (differentiating between retail and wholesale deposits);
- the bank's share of payments services, differentiated by payment system and payments product;
- the bank's share of lending to economic and social infrastructure providers;
- inter-connectedness (including intra-group and between banks);
- potential for the bank to cause contagion (drawing on the contagion criteria referred to below);
- substitutability of systemically important financial functions (including considerations related to the concentrated nature of the banking sector); and
- complexity (including any complexities arising from group structures and the location of essential banking functions in subsidiaries, and cross-border activity).

30. The systemic impact assessment should be undertaken not just for the bank on a solo entity basis, but also on a banking group basis (i.e., taking into account the systemic impact of the failure of subsidiaries of the bank), where banks have significant business in subsidiaries.

31. As part of the systemic impact assessment, contagion risk should be assessed. The analysis would appropriately include an assessment of:

- contagion via inter-bank exposures;
- contagion arising from related party exposures, such as credit exposures to parent banks and other substantial shareholders;
- credit rating downgrade risks associated with parent bank stress;
- reputation impacts associated with parent bank or other major shareholder distress;
- contagion risks associated with functional dependencies between banks with common shareholdings;

- contagion via banks having common credit exposures (e.g., syndicated lending, where the failure of one bank to meet commitments under a syndicated loan could impact the other banks in the syndicate);
- the contagion impact of bank defaults on interest rate and foreign currency derivatives (i.e., requiring other banks to replace interest rate and currency contracts they had with the failed bank, and the potential difficulty in doing so under stressed conditions, possibly leaving them with unhedged exposures); and
- confidence-linked contagion risks and the potential for a generalized depositor run on banks.

32. Special considerations are needed if the institution is deemed to be systemic. Systemic institutions contain functions that need to be continued. Options may include the recapitalization of the bank or transferring critical functions and services and relevant assets and liabilities to a bridge bank or an existing bank. The manual should set out the generic functions that would normally be regarded as critical functions required for systemic stability. It would also include guidance on what quantitative thresholds might appropriately be applied by CBOB in determining, as part of bank-specific resolution plans, whether particular banks have sufficient critical functionality as to warrant a form of resolution that maintains the continuity of these functions (i.e., an “open resolution,” in essence). See later in this appendix.

Step 5b: Resolution strategies and implementation of resolution

33. The resolution authority is responsible for determining the appropriate resolution strategy for both systemic and non-systemic financial institutions. The standard resolution options that would normally be considered are set out below, including the circumstances in which each resolution option may be appropriate.

34. ***Option 1: Closure of a bank and pay-out of insured deposits, followed by liquidation of the bank.*** This would involve appointment of an administrator to the bank and withdrawal of the bank from all payment channels. Eligible deposit balances would be calculated on the basis of end-of-day positions. DIC would confirm the amount to be paid to each depositor, capped at the level of the deposit insurance cover per depositor/deposit category. Payments would then be made to depositors, generally via a bank appointed as the paying agent, funded by the deposit insurance fund. Payments should be made as soon as practicable following the closure of the bank, and desirably within seven days.

35. Option 1 might be appropriate if:

- a. the bank is insolvent or otherwise very substantially below minimum capital requirements;

- b. the bank cannot recover—i.e., there is no prospect of shareholder support or external financial private sector support in the required timeframe;
- c. no other bank is prepared to acquire equity in the failing bank or to assume deposit liabilities (either total or solely insured deposits) and acquire assets from the failing bank;
- d. closure of the bank would not have a significant adverse impact on the stability of the financial system or economy; and
- e. closure and pay-out is a lower cost option than the alternative closed resolution options (such as P&A).

36. ***Option 2: Closure of a bank and transfer of insured deposit accounts and performing assets to a receiving bank (either an existing bank or a bridge bank)—referred to as a P&A form of resolution.*** This would involve appointment of an administrator to the bank and withdrawal of the bank from all payment channels. Eligible deposit balances would be calculated on the basis of end-of-day positions. DIC would confirm the amount to which each depositor is entitled, capped at the level of the deposit insurance cover per depositor. The deposit accounts (together with the legal right to operate associated IT systems) would be transferred to an acquiring bank willing to assume the deposit liabilities or to a bridge bank established for the purpose. The acquiring bank/bridge bank would administer the failed bank's IT systems required to operate the deposit accounts. The deposit accounts would operate as usual, with no change of account numbers, once transferred to the receiving bank. The receiving bank would purchase assets from the failed bank at market value. If only insured deposits are transferred, the DIC will fund any shortfall in assets over deposit liabilities. If there are sufficient performing assets to fund the transfer of some or even all uninsured deposits (in addition to funding the transfer of insured deposits), then this resolution option could include the transfer of the appropriate amount of uninsured deposits to a bank willing to accept them or to a bridge bank established for the purpose. If uninsured deposits are also transferred, the DIC will provide funds up to the amount of insured deposits and the resolution authorities will fund the remaining gap. The failed bank would then be wound up through the insolvency law arrangements, and the deposit insurance agency would have a subrogated claim of the insured depositors on the assets of the bank in liquidation.

37. For a P&A transaction to be effective, it requires the deposit insurance agency to pre-identify banks with the prudential and operational capacity to assume at least the insured deposits and acquire performing assets, and associated critical functions and systems, of the failing bank. This should be done through regular assessments of suitable candidate banks. If there is sufficient time leading up to the invoking of resolution, the deposit insurance agency would require the candidate banks to submit bids for the eligible business of the failing bank, and would select the bank on the basis of least cost to the deposit insurer and suitability of the candidate bank. (See section on P&A.)

38. Option 2 might be appropriate if:
- a. the bank is insolvent or otherwise very substantially below minimum capital requirements;
 - b. the bank cannot recover; i.e., there is no prospect of shareholder support or external financial private sector support in the required timeframe;
 - c. no other bank is prepared to acquire equity in the failing bank;
 - d. one or more banks are willing to assume the deposits (either all deposits or at least insured deposits), funded either fully by the deposit insurance agency or funded through a combination of deposit insurance funding and assets transferred to the acquiring bank.;
 - e. closure of the bank would not have a significant adverse impact on the stability of the financial system or economy; and
 - f. closure and transfer of insured deposits is assessed as being a lower cost option than the alternative closed resolution options (such as payout).

39. ***Option 3: Transfer of most or all of the failed bank's assets, liabilities and business functions to another existing bank or a bridge bank.*** This would be a more comprehensive business transfer than the standard P&A transaction, as it would involve the acquiring bank or a bridge bank purchasing a broader range of the failed bank's business, e.g., it might involve the transfer of derivatives contracts, insurance business, ownership of key subsidiaries, etc.). It would involve appointment of an administrator to the bank and withdrawal of the failed bank from the payment systems. An assessment would be of the systemically important and otherwise viable business that is to be transferred to either an existing bank willing to acquire this business and associated functionality or to a bridge bank established for the purpose. The business to be transferred (most likely including all critical functions and performing assets) would be valued and transferred at assessed market value.

40. If the assets (including estimated franchise value) to be transferred at least equal the liabilities to be assumed by the acquiring bank, then no resolution funding would be required. A surplus of assets relative to liabilities transferred would entail payment of the net amount to the account of the bankruptcy estate of the failed bank. A deficiency in assets relative to liabilities transferred would require funding from either the bail-in of uninsured and unsecured liabilities (where feasible), the deposit insurance agency or the government (as a last resort only). DIC's funding would be capped at the amount it would have paid (net of recoveries) under a least-cost deposit insurance pay-out or insured deposit account transfer.

41. The failed bank would be closed, and its residual business wound up under insolvency law. Ex post compensation would be paid to creditors, respectively, to the extent they were rendered worse off than under a conventional winding up had the bank been retained whole and wound up, applying the statutory ranking of claims in winding up.
42. NPLs could either be retained in the failed bank or transferred to an existing private sector entity in the business of acquiring and working out impaired assets.
43. Option 3 might be appropriate if:
- a. the bank is still solvent (i.e., has positive equity), at least with respect to deposit liabilities and possibly other senior unsecured debt, but can be used if the bank is insolvent if resolution funding is applied to make up for any deficiency in assets relative to liabilities being transferred;
 - b. the bank cannot recover; i.e., there is no prospect of shareholder support in the required timeframe;
 - c. the closure of the bank would have a significant adverse impact on the stability of the financial system; and
 - d. at least one suitably capitalized bank is able and willing to acquire the systemically important business of the bank, or a bridge bank could be established to acquire the relevant business. (The latter would be an option where no existing bank is willing or able to acquire the systemic business of the failed bank or where market concentration factors would make it undesirable for the business to be transferred to an existing bank).
44. **Option 4: Sale of the bank to another bank.** This would involve placing the bank into administration and selling a majority shareholding position to an acquiring bank. This could be done by cancelling existing shares (assuming the powers were in place to do this), with compensation to shareholders for the assessed value of the shares (if any) and issuing new shares to the acquiring bank. Alternatively, it could be achieved by issuing new shares to an acquiring bank and diluting existing shares to their assessed market value, resulting in the acquiring bank assuming a controlling shareholding. In either case, the distressed bank would be recapitalized to the appropriate target level (i.e., sufficient to comfortably exceed the regulatory requirements and to maintain an acceptable credit rating and maintain depositor and investor confidence).
45. Option 4 might be appropriate if:
- a. the bank is still solvent (i.e., has positive equity);
 - b. the bank cannot recover; i.e., there is no prospect of shareholder support in the required timeframe;

- c. the closure of the bank would have a significant adverse impact on the stability of the financial system;
- d. at least one suitably capitalized bank is able and willing to acquire either 100 percent or a majority shareholding in the bank, sufficient to recapitalize the bank to the required target level; and
- e. the acquisition of the failed bank by the acquiring bank would not lead to excessive market concentration or systemic risk.

46. ***Option 5: Recapitalization of the bank through bail-in.*** This option would involve appointing an administrator to the bank, assessing the worst-case capital position of the bank (taking into account the need for any capital support to essential subsidiaries) and determining the amount of capital required to meet a target capital ratio sufficient to comply with capital requirements and maintain market confidence and credit ratings. Bail-in could be implemented via a number of routes, including by write-down or conversion of applicable liabilities (being either contractual loss-absorbing debt issued as an additional tier 1 or tier 2 capital instrument or otherwise unsecured and uninsured liabilities) to an equity instrument that ranks equal to the diluted equity of existing shareholders or converted to preference shares that rank above existing equity and that would qualify for inclusion in CET1. Liabilities would be bailed-in in the inverse order of their ranking in a winding-up; i.e., the lowest ranking liabilities (such as loss-absorbing capital-eligible debt instruments or subordinated debt) would be bailed-in first, followed by senior unsecured bonds, followed by uninsured deposits, etc. Insured deposits would be exempted from bail-in but the deposit insurance agency would bear the bail-in cost if it had subjugated their claims. Some other liabilities might also be exempted from bail-in, potentially including liabilities payable to suppliers of essential services and liabilities in relation to derivatives required to maintain balance sheet hedges.

47. Bail-in can be achieved through different mechanisms, as discussed later in this note.

48. Option 5 might be appropriate if:

- a. the bank cannot recover; i.e., there is no prospect of shareholder support in the required timeframe;
- b. the bank has sufficient loss-absorbing debt, subordinated debt and senior unsecured debt (excluding insured deposits) to be a source for recapitalization, either through conversion to equity or other eligible capital instrument or write-down, after first writing down existing equity;
- c. the closure of the bank would have a significant adverse impact on the stability of the financial system; and

- d. bail-in would not trigger contagion or other systemic disruption on a significant scale. Bail-in is more likely to be a viable solution for an idiosyncratic bank failure, where the other banks in the financial system are in a prudentially sound condition and market confidence in the banking system as a whole is reasonably strong. Bail-in is generally dependent on banks having a tranche of loss-absorbing capital in the form of senior or subordinated debt that can be contractually converted to equity or written down upon specified nonviability triggers but can also be applied using statutory bail-in powers (if they exist) to other forms of junior unsecured debt. Bail-in is less likely to be an attractive option in the case of multiple bank distress and where the bail-in of one bank could trigger a contagious run on other banks.

49. **Use of public support as a last option:** Under some extreme conditions, these restructuring options may not be possible and some temporary public financial support may be the only way to avoid widespread financial contagion and collapse. In times of significant contagion risks, when markets are dislocated or frozen, failure of a financial institution could exacerbate contagion and undermine confidence. At the same time, resolution options described above may be unavailable. The market may be unwilling or unable to absorb failing institution and large firms may not have adequate loss-absorbing liabilities to allow for recapitalization through bail-in. Under these conditions, the temporary use of public funds may be the only viable alternative. Central banks and deposit insurers should not contribute to recapitalizations to avoid potential conflicts of interest.

50. This option would involve appointing an administrator to the bank, assessing the worst-case capital position of the bank (taking into account the need for any capital support to essential subsidiaries) and determining the amount of capital required to meet a target capital ratio sufficient to comply with capital requirements and maintaining market confidence and credit ratings. Recapitalization would be implemented by the issuance of shares to the government (either directly or via a government-owned entity) sufficient to achieve the target capital ratio. This would be a last resort option where all other options (including bail-in) have been assessed and found to be nonviable or systemically destabilizing. Government-funded recapitalization should occur only after existing shareholders have been fully bailed-in, such that their shares are either cancelled (if of no value or very little value) or diluted to the assessed market value. Subordinated debt should also be bailed in.

51. The government's shareholding could either take the form of ordinary shares with full voting rights or preference shares with full or limited voting rights (where existing shareholders and bailed-in creditors hold a substantial proportion of total equity). In either case, the government should ensure that it prices the shares it holds, and any other support it provides (e.g., guarantees or indemnities), at appropriate commercial pricing to ensure that taxpayers are compensated for the risks involved. It should also ensure that it has sufficient control of the bank to manage all risks arising from its equity stake and other forms of support it provides.

52. The power to use public resources should be set out in law or regulation to limit excessive reliance on public money. The regulations should identify the safeguards that are needed. Specifically:

- Systemic stability: Use of public resources should be a last resort, limited to cases that threaten the financial system or jeopardizing the continuity of essential payment, clearing, and settlement functions.
- Loss recognition: All unrecognized losses must be recognized and the bank's equity and other capital instruments written down for the losses.
- Restructuring: Solvency support needs to be combined with a comprehensive restructuring plan that restores long-term viability. That plan should include time-bound, monitorable targets and recipients must be subjected to strict supervision and enhanced reporting requirements.
- Recovery: Use of public resources should be repaid within a reasonable timeframe, either through participating in asset recoveries of the failed institution or through special levies on the industry.

53. Option 6 might be appropriate if:

- a. the bank cannot recover; i.e., there is no prospect of shareholder support in the required timeframe;
- b. the bank does not have sufficient subordinated debt and senior unsecured debt (excluding insured deposits) to be a source for full recapitalization, either through conversion to equity or other eligible capital instrument or write-down, after first writing down existing equity;
- c. the closure of the bank would have a significant adverse impact on the stability of the financial system;
- d. bail-in would likely trigger contagion or other systemic disruption on a significant scale; and
- e. the government ensures that existing shareholders and subordinated creditors are required to absorb all losses to the extent of their holdings before any government-funded support is provided.

Criteria for selecting resolution options

54. **The selection of the resolution option will depend on many considerations.** The relevant factors will typically include the following:

- a. ***The impact of the potential closure of the bank (especially its critical functions and services) on the stability of the financial system and economy.*** In general, a bank whose closure would have little impact on the stability of the financial system and real economy could be subject to a closed resolution, whereas a bank whose closure would have significant adverse impact on the financial system or economy would generally be subject to an open resolution (at least in respect of its critical functions and services). For banks with significant potential adverse impact on the stability of the financial system and real economy, the key focus should be to ensure that the form of resolution adopted maintains continuity of critical functions and services with minimum interruption and disruption. It should also seek to avoid or at least minimize contagion risk and adverse impacts on confidence in the financial system and economy. See the next section for a brief discussion on the factors relevant for assessing systemic impact.
- b. ***The cost of resolution.*** Subject to meeting financial stability and real economy impact considerations, the resolution option selected should generally be the one which involves the lowest cost of implementation, including the costs (measured in terms of Net Present Value (NPV)) of:
- loss of value from assets upon disposal;
 - cost of recapitalization (if applicable);
 - costs associated with guarantees and indemnities (if applicable);
 - legal, accounting and other professional fees;
 - tender costs (where applicable); and
 - administration costs.
- c. ***Protection of insured depositors.*** Whichever form of resolution is selected, it should ensure that insured depositors (if a deposit insurance scheme exists) are provided with prompt access to 100 percent of their insured deposits at minimum inconvenience. Any closed resolution option should be designed to achieve this, either via prompt payout to insured depositors (e.g., via an agency bank selected by the deposit insurance agency or the payment infrastructure of the failed bank) or transfer of insured deposit accounts to another bank via a P&A process. Under an open resolution, insured deposits, as with most other deposits, would be preserved with minimal interruption to access through either a recapitalization of the bank, or a bridge bank or transfer of deposit accounts (insured and uninsured) to another bank. In any of these options, the deposit insurance agency's contribution to the resolution should be on a 'least cost' basis—i.e., the least amount required to be disbursed from the deposit insurance fund to ensure prompt access to insured deposits (including accrued interest thereon), net of recoveries from the balance sheet of the bank.
- d. ***Impact on public funding.*** The resolution option selected should, in principle, involve zero public funding (including the costs and risks associated with guarantees and indemnities). For closed resolutions, this would generally be achieved by ensuring that

the deposit insurance fund is sufficient to meet expected claims under a plausible range of bank failure situations and that any supplemental funding required is fully reimbursed (in NPV terms) from the banking industry. For open resolutions, the least impact on public funding is generally achieved by ensuring that shareholders and other capital providers absorb losses to the maximum extent of their legal liability and that, where practicable, other liabilities are bailed-in to absorb remaining losses if necessary. However, in some situations, public funding might be unavoidable—e.g., in an open resolution in which losses exceed shareholders' funds and other capital, and where bail-in is considered to be destabilizing for the financial system. In that situation, if public funding is provided, then it should be on the basis of commercial pricing (e.g., for capital funded by the taxpayer and for guarantees and indemnities) and with any amounts in NPV terms being recovered from levies on the banking industry to the extent that the assets of the resolved bank are insufficient to meet these amounts.

- e. ***Impact on moral hazard and market discipline.*** The resolution option selected should seek to minimize moral hazard risks and preserve or enhance market discipline on the financial system. This is best achieved by ensuring that losses are borne by shareholders, other capital instrument holders and then creditors in the order of their claims in a winding up, with zero or minimal contribution from the taxpayer.
- f. ***Impact on competition and financial system efficiency.*** The resolution option selected should be designed to minimize adverse impacts on competition and financial system efficiency. Resolution options that lead to significantly reduced competition tend to have adverse impacts on financial system efficiency—e.g., via higher margins, reduced range of financial services, greater market concentration. The closure of many small banks create this risk. Likewise, the merger of large or medium-sized banks can result in excessive market concentration and reduced competition and efficiency in the financial system.

Aspects of resolution implementation

A. Legal framework

55. The resolution manual should include the relevant documents that provide the legal foundation for resolution¹. Typically, implementing the resolution of a failed institution involves affecting shareholder and creditor rights. Accordingly, the resolution authorities need to have easy access to the legal basis and legal documents supporting their activities. While admittedly, the resolution staff will be fully aware of their legal rights, having access to the specific documentation in the midst of an emerging crisis may save time and make the process more effective.

¹ In this regard, e-copies of the resolution manual should include links to the relevant documents

B. No creditor worse off

56. In any form of resolution, the principle of ‘no creditor (or shareholder) left worse off’ than under liquidation should be applied, such that creditors and shareholders are compensated to the extent that the resolution option chosen left them worse off than had the bank been retained whole and liquidated under conventional insolvency law. The manual should set out the procedures to be followed for assessing what the outcome (in net present value terms) would have been for shareholders and each category of creditor under a conventional winding up so as to determine whether any compensation is payable to the affected parties. This would involve undertaking a “counterfactual” valuation of the estimated recoverable value of assets of the failed bank in a winding up through an independent valuation process. The assessed valuation, and any compensation, should be subject to robust transparency and accountability arrangements, with scope for the affected parties to challenge the valuation through court processes, and where the courts have the capacity to impose alternative valuations if reasonable cause is found for doing so.

C. Communications and coordination

57. Communications and coordination are essential in a crisis. For each resolution strategy, the manual needs to identify what communications need to be made to each category of stakeholder (including depositors, the wider public, banks, other financial institutions, foreign counterparties, foreign regulators, rating agencies, news media and social media). The manual should identify the key information to be conveyed to each category of stakeholder and which agency has responsibility for each element of this. It should also include the development of checklists for the issues to be considered by each agency in preparing media statements and other forms of communication.

58. There must be clear and concise guidance on public and other stakeholder communications. For example, if, in an open resolution, most or all of the business of the bank is to be maintained, the resolution authority needs to be ready to publicly announce at the time an administrator is appointed the intended scope of business of the bank under administration, which obligations will be continued, and which will be suspended. Clarity and certainty are crucial for counterparties, depositors, and other stakeholders. The communications strategy should include an identification of the information to be conveyed by each agency, to each category of stakeholder, the timing of each communication in the resolution process and the channels used for communications. Key stakeholders will include:

- depositors of the bank being resolved;
- depositors in other banks;
- other creditors of the bank being resolved;

- borrowers of the bank being resolved, especially those with overdraft and other committed credit facilities;
- the management of other banks;
- the financial institutions which meet their payment obligations through the bank being resolved;
- foreign regulators (e.g., of the foreign banks operating in the country); and
- the financial news media and general news media;
- social media; and
- the general public.

D. Cross-border coordination and cooperation

59. The manual needs to include guidance on cross-border coordination and cooperation. Matters that should be covered in this area include the following:

- a. A clear delineation of resolution responsibilities between the parent authorities (the prudential supervisor/resolution authority and ministry of finance in the home and host countries. These should be documented in either a multilateral MOU (for all agencies) or bilateral MOUs.
- b. Identification of information exchange arrangements between the respective agencies, based on the above-mentioned MOU(s).
- c. Coordination of the development and enforcement of recovery plans, resolvability assessments and resolution plans, such that the recovery plans and resolution plans for the subsidiary banks in the host country are informed by, and not materially inconsistent with, the parent bank recovery and resolution plans.
- d. Processes for coordinating the solvency/capital assessment and liquidity assessment for the parent banking group and subsidiaries in the host country.

60. Process for coordinating the identification and assessment of resolution options. This is especially important for recapitalization options for the subsidiary, drawing on the two generic models for group-based recapitalization: Single Point of Entry (SPE) and Multiple Points of Entry (MPE).

61. Under an SPE model, the recapitalization of the subsidiary in a host country would be performed at the parent level, either via bail-in of liabilities in the parent bank, bail-in of liabilities in the subsidiary (in exchange for shares in the parent bank) or external injection of capital into the parent bank, with the capital being cascaded to the subsidiary in the host country.

62. Under an MPE model, the recapitalization of the subsidiary in the host country would be performed at the level of the subsidiary, either by bail-in of liabilities of the subsidiary or injection of capital into the subsidiary by the government or another party approved by the CBOB. Under an SPE approach, the parent bank remains the shareholder of the subsidiary. However, under the MPE approach, the subsidiary might cease to be a member of the parent banking group, reflecting its new shareholding arrangements. In that event, it would be necessary to ensure that contractual arrangements are entered into between the subsidiary and parent bank for all essential functional support provided by the parent bank to be continued (on commercial terms).

Procedure for conducting a P&A) transaction

63. The process for implementing a P&A must be clearly laid out in decrees and resolution manuals. The P&A process involves valuing a bank, marketing it, soliciting and accepting bids for its sale, and working with an acquirer through the closing process. These tasks include:

- a. Resolution preparation;
- b. Marketing strategy;
- c. Legal documents;
- d. Potential acquirers;
- e. Marketing presentation;
- f. Due diligence;
- g. Bid acceptance;
- h. Contract signing;
- i. Closing the transaction; and
- j. Public awareness.

Resolution preparation

When a problem bank is dealt with swiftly, asset and franchise values are preserved, generating maximum return. This makes the failing bank more desirable to potential acquirers and lowers the ultimate cost of resolution. Resolution preparation involves four steps:

- Compiling Initial Information
- Asset Valuation
- Completion of a financial information package (Bid Package)
- Marketing Meeting Logistics

64. In preparing for the P&A, specialized staff may be needed including an asset valuation specialist and a marketing specialist.

Initial information

65. The resolution authority must gather preliminary information regarding the bank. Such information includes:

- Bank premises and owned property:
 - Location and number of main offices and branches;
 - Number of employees at each location;
 - Records maintained on site (at each location);
 - Banking premises owned or leased;
 - Recorded value;
 - Other tenants; and
 - Information system—computerized or manual.
- Loans including:
 - Name and amount of major debtors;
 - Insider lines (directors, officers, shareholders, affiliates); and
 - Loan classifications.
- Deposits
 - Number and value of deposits at each location;
 - Name and amount of major depositors;
 - Insider depositors (directors, officers, shareholders);
 - Distribution of depositors; and
 - Debtor/depositor relationships (for potential offsets²).
- Borrowings—secured and unsecured;
- Subsidiaries;
- Contingent liabilities;
- Trust Department activities;
- Ownership structure;
- Enforcement actions pending;
- Litigation; and
- Other—leases, contracts, etc.

66. This preliminary information will give the marketing specialist an idea of the condition of the bank and will likely affect the decision as to what type of transaction to offer. A more

² Depending on local law.

comprehensive information package (discussed below) will be prepared for potential acquirers' review.

Asset valuation

67. The supervisory authority staff or other experts must estimate the worth of a bank's assets. Because time is of the essence, there is not enough time to appraise every asset, so models may be used to provide statistical sampling. They can divide the assets into categories, identify a sample, and carefully review the assets to establish a liquidation value for each asset.

68. The liquidation value is derived from the future cash flows and the expenses likely to be incurred during the collection of the asset. Adjustments can be made to discount future cash flows and to account for liquidation expenses. The loss factor that results from that estimate is then applied to the category from which the sample was taken.

69. When all categories are sampled and evaluated, the loss factors are aggregated and extrapolated to the bank as a whole. This computation will produce a loss factor, or cost of liquidation, which will be used in assessing bids from potential acquirers.

Bid package

70. The bid package should build on the initial information include detailed data on the amounts and types of assets and liabilities that the failing bank holds. The information may vary from bank to bank, depending on business strategy as reflected in the asset and liability structure. Some of the more important information contained in the bid package includes:

- Demographic information, including market area, population, history of bank, customer type, competition;
- Schedules that represent the book value of items that comprise bank's balance sheet:
 - Cash and equivalents—due from banks spread by Bank name, term and interest rates;
 - Investment securities—separated by marketability, and listed by name, term and interest rates;
 - Loans—summary reports by type (commercial, real estate, installment, credit cards, etc.), concentrations of credits, maturity, interest rate, etc., including accrued interest receivable. Provide separate reports for local currency and each foreign exchange currency used;
 - Fixed assets—location of bank premises, including branches, appraisals (if available), terms of leases and leasehold improvements (as applicable), computer and other equipment, furniture and fixtures, applicable insurance coverage. Distribution of

- ATM machines, itemizing the number of operations per day, per location, and the mean volume per transaction;
- Other real estate—individually listed by name, location, book value, and appraised value (if available);
 - Subsidiaries—name, type, purpose and status (active or dormant);
 - Other assets—detailed listing;
 - Deposit base—summary reports reflecting cost of deposits, by type (demand, savings, time) and maturity, including accrued interest payable. Detailed listing of individual deposits, concentrations, and number of debit cards. Provide separate reports for local currency and each foreign exchange currency used;
 - Borrowings—identified by name, term and interest rates;
 - Guarantees—identified by name and other details (including obligations regarding term, interest rates, etc.);
 - Other liabilities—detailed listing;
 - Contingent liabilities; and
 - Capital accounts—include recent income and expense statement.
- Detailed description of the data processing facilities:
 - Description of the communications map;
 - Description of the security modules (redundant files, back-ups, etc.); and
 - If the data processing is outsourced, it will be necessary to include the contract, with any negotiations underway, as well as the terms and scope of the service so acquired.
 - Employees—short biographies of key management personnel, unusual situations (golden parachutes, onerous employment contract obligations), chart of ALL employees: titles, number, capabilities, training and salaries if possible;
 - Contracts—detailed listing of all contracts, whether the bank is party as provider or receiver of goods or services; and
 - Litigation—Detail of pending court cases, including a legal opinion estimating the outcome and foreseeable consequences for the bank.

71. Both the asset valuation and the bid package are proprietary and strictly confidential. Although the bid package will be provided to potential acquirers, the asset valuation will not.

Marketing presentation logistics

72. The marketing specialist should estimate the necessary time for completion of the asset valuation and the bid package, so that a presentation can be scheduled for potential acquirers. Confidentiality Agreements will need to be prepared for all potential acquirers who will be invited.

73. Once the information mentioned above has been compiled, the marketing specialist can begin determination of the best transaction form to offer potential acquirers. Some factors that affect the marketing strategy are:

- Asset and liability composition of the failing bank;
- Competitive and economic conditions of the bank's market area;
- Prior resolution experience in the same market; and
- Other relevant information (such as potential fraud at the bank).

74. Some of the questions that must be answered to determine the appropriate form of the transaction are:

- What types or categories of assets will be offered?
- How should the assets be packaged?
- How should the assets be priced?

75. P&As with put options on assets allow acquirer to perform due diligence after transaction (although this "cherry-picking" often leads an acquirer to neglect servicing questionable assets).

Under the P&A concept, assets and insured deposits of the failed bank are transferred to bank at market value. If there are not enough "good" assets to balance the amount of insured deposits, the deposit insurance scheme must advance the cash to balance the transaction--assets must equal liabilities.

76. This resolution technique will try to include as many assets as possible in the transaction while being sure that they are of adequate quality so as to not jeopardize the financial position of the acquirer.

77. Some examples of the forms a P&A can take are:

- **Whole Bank**—where a resolution authority pays an acquirer to take virtually all assets and liabilities of a failed bank).

- **Clean Bank**—some good assets are sold to an acquirer who also assumes insured deposit liabilities. There are many variations of the asset sale. It can include:
 - Put back rights;
 - Exclusive asset purchase options; and
 - Representations and warranties.

78. Of these, the exclusive asset purchase option is the simplest. The liquidator, or receiver, may lack funds to pay for assets put back, and asset quality is usually insufficient to justify representations and warranties.

79. The basic P&A Agreement is adaptable to change. The provisions of the P&A should be accommodating enough to return the greatest value for the failed bank. When liquid assets are sufficient to cover payment of insured deposits, a good strategy may be to offer a P&A with exclusive option to purchase certain assets. This will give an acquirer enough time for asset review to determine which ones meet their criteria. Purchase of additional assets may fund payment of all or part of uninsured deposits and other creditors, and will quickly return assets to the private sector.

80. Another alternative is to pass assets at book value initially and then provide for third-party valuation after the fact. The government and the Assuming Bank can each hire an independent auditing firm to value the assets and negotiate from the two results. If there is more than a ten percent variation between the two reports, a third can be ordered.

Legal documents

81. There are several standardized documents for a P&A transaction which the legal staff will need to review to ensure compliance with applicable legislation. Briefly, the documents include:

- **Confidentiality Agreement**—this agreement must be signed by any bank or investor group who is interested in receiving any information regarding the pending transaction. Confidentiality is paramount in order to maintain public confidence and limit competitive abuse
- **Deposit Transfer Agreement**—the Deposit Transfer Agreement identifies the deposits, terms and conditions under which they are to be assumed.
- **Asset Sales Agreement**—this document comprises the terms and conditions of any assets to be sold as part of a problem bank resolution.
 - These two documents can be combined to create various P&A Agreements as discussed above.

- In all these agreements, the acquirer is indemnified for any actions of the failing bank prior to failure, unless expressly assumed. (This is not a monetary indemnification, but a legal re-direction of claims to the receiver.)
- **Interim Asset Servicing Agreement**—this agreement requires an acquirer to responsibly service specific assets for a certain period. This can apply in cases where the acquirer has an exclusive purchase option on assets, or when the liquidating Supervisory Authority lacks personnel to service their assets
- **Escrow Agreement**—this provides an opportunity to consummate a P&A in advance of the scheduled bank closing. It assures both parties that commitments will be honored
- **Bid Agreement Form**—a legal document and form that commits the potential acquirer to abide by the restrictions of the resolutions process and pay the amount specified

Potential acquirers

82. A P&A transaction provides an acquiring bank to either increase market share or to expand into areas where the acquirer does not have a presence. Paying a premium for deposits and options on banking premises is much more cost-effective than obtaining premises and soliciting deposits on a *de novo* basis. (In the U.S., estimates are that the acquirers in these types of transactions retain approximately 70 percent of deposits.)³

83. In many cases, it may be prudent to maintain a database of approved banks and investors that are interested in establishing bank operations in the country. When evaluating investor groups for approval, the resolution authority must consider, among other factors:

- The length of time required for licensing a new bank;
- Whether the investor group can raise sufficient capital; and
- Whether the investor group can provide competent management.

84. The supervisory authorities and the resolution authority must be confident that those parties on the list are strong enough to acquire a failed bank and sustain profitable operations. The supervisory authority should keep track of any seriously interested bank or investor group and provide that information to the Marketing specialist.

Marketing presentation

85. After potential acquirers have been identified they should be contacted and invited to a marketing presentation. Registration forms and Confidentiality Agreements should be mailed or faxed to the potential acquirer. Neither of these forms should identify the failing bank under

³ In many countries, banks do not seem to recognize this opportunity; occasionally it is necessary to pay a fee to an agent bank to make repayment of deposits on behalf of the Deposit Insurance Agency or Supervisory Authority.

consideration. Potential acquirers should return a copy of each of the forms. This will guide the marketing specialist in preparing the appropriate number of information packages. The potential acquirers should retain the original forms and present them as their admission tickets to the marketing presentation.⁴

86. Before the meeting, the marketing specialist should ensure that logistical requirements of the meeting are met. There should be adequate amounts of chairs and tables. Any audio-visual equipment (e.g., microphones, overhead or slide projectors, personal computers for PowerPoint presentation, etc.) should be tested.

87. At registration, an information package consisting of financial data, legal documents, transaction description, and other material should be provided to each potential acquirer. (More than one representative from a potential acquirer may attend the presentation, but only one package should be provided.)

88. The marketing specialist should cover the following topics:

- **Financial data on the bank**—this should consist of applicable portions of the Bid Package discussed above redacted of any confidential information.
- **P&A transaction summary**—provide a sample pro forma balance sheet, clearly marked “For Reference Purposes Only,” that demonstrates the financial effects of the transaction. It should show the effect of the required assets to be purchased and deposits to be assumed. Optional asset purchase opportunities can be on other schedules.
- **Legal summary**—a resolution authority attorney should make a short presentation describing the nature of the transactional documents and be available to address legal issues.
- **Regulatory requirements**—briefly describe the capital and other requirements of a new or enlarged bank.
- **Due diligence scheduling**—potential acquirers should have the opportunity to go onsite and examine the relevant records of the failing bank. Depending on the nature of the proposed transaction and the size of the failing bank, this could range from 1 day to 1 week or more. The marketing specialist should provide contact information for due diligence scheduling.
- **Bid process**—the Bid Agreement Form, provided in the package of materials, spells out the legally binding process for bid acceptance. The marketing specialist should estimate

⁴ Where there is expected to be a limited amount of interest in acquisition of a problem bank, this process can be conducted in a more informal manner.

the time needed for due diligence and establish tentative dates for bid acceptance and closing of the transaction.

89. The marketing specialist should clearly advise potential acquirers that they are not to discuss the bank failure or the impending transaction with any failed bank employee, bank's vendors, lessors, attorneys, or accountants prior to the actual closing of the transaction. Any such communication is a violation of the Confidentiality Agreement. The marketing specialist should stress that potential acquirers are strictly prohibited from contacting other potential acquirers regarding any aspect of the process.

Due diligence

90. Due diligence is the potential acquirers' onsite inspection of the premises, records, and operations of the failing bank. Due diligence allows the potential acquirers to assess the franchise value and calculate a knowledgeable bid amount.

91. Approved potential acquirers will have the opportunity to go onsite and examine the relevant records of the failing bank. The potential acquirer must have completed a Confidentiality Agreement and should be reminded of the need for confidentiality regarding the transaction. The confidentiality agreement is a legally binding document and violations are subject to criminal penalties.

92. Potential acquirers should be granted adequate review time, keeping in mind the urgency of the resolution process. If the failing bank is relatively small and/or the contemplated transaction is a deposit transfer with no asset sales, due diligence may be accomplished in a day or less. On the other hand, a larger bank in a transaction with possible asset sales may require a week or more. In cases of lengthy due diligence, appropriate financial information may be updated and provided to all potential acquirers.

93. Policies regarding record review access must be developed. For example, to prevent customer raiding, due diligence policy may dictate providing depositor information represented only by account numbers, with no names and addresses (if possible). More access should be allowed in asset review, because it is in the best interest of the Supervisory Authority to divest as many assets as possible.

94. Copying of the failing bank's records should be prohibited, although handwritten notes or personal computer-generated information may be permitted. Additionally, the potential acquirers conducting due diligence should not have access to:

- Board minutes;
- Supervisory examinations; and
- Personnel or other sensitive records.

Bid acceptance

95. After all potential acquirers have finished due diligence, they will submit their bids to the resolution authority. The bid amount (or premium) is the price a potential acquirer puts on the value of the transaction (asset purchase options, deposit base, branch network, etc.).

96. The resolution authority reserves the right to accept or reject any bid for any reason. After bids are received, the winner is selected. Because the P&A transaction is so simple, usually this is a matter of selecting the highest bid. When priced pools of assets have been offered as an option, however, more complex analysis may be necessary.

97. The winning bidder should be notified and a meeting to sign contracts should be scheduled. A reminder of the confidentiality of the process is appropriate at this point. Losing bidders should also be notified; however, again because of confidentiality concerns, the identity of the winning bidder should not be disclosed. The winning bidder is referred to as the “Agent Bank” in the P&A because they are assuming deposits as an agent of the Supervisory Authority.

Contract signing

98. To provide a comfort level to both parties to the transaction, the P&A contracts are signed several days prior to the actual closing of the bank. This eliminates last minute conditions or demands by either party. Authorized representatives from the resolution authority and the Agent Bank will sign the Deposit Transfer and Asset Sales Agreements, and, if applicable, the Interim Servicing Agreement. Both parties will also sign the Escrow Agreement. The Escrow Agreement merely states that the aforementioned documents were signed and put into escrow until the stipulated date. The Agent Bank receives only a copy of the Escrow Agreement. The other signed Agreements will be delivered to the Agent Bank at the time of the bank closing.

Closing the transaction

99. Bank failures can disrupt a community and undermine confidence in a banking system. Because it is critical to provide prompt access of customers to their deposits, a quick resolution to the event is required. The final step in the resolution process is actually closing the bank and transferring the assets purchased and deposits assumed to the Agent Bank.

100. If the bank has been operating under conservatorship, much of the preparation for the final resolution can be done in advance. The final resolution will occur in a similar fashion to the initial intervention and appointment of a Conservator.

101. The resolution authority is responsible for settling the affairs of the closed bank. At the closing, the accounting team will prepare Pro Forma financial statements. According to the terms of the P&A Agreement, the team will:

- Balance the accounts of the bank;

- Transfer certain assets and insured deposits to the acquirer;
- Prepare a pro forma balance sheet demonstrating the division of assets and deposit liabilities that pass to an acquirer and those that remain with the liquidation; and
- Calculate any amount necessary to balance the transaction (assets purchased compared to deposits assumed, minus bid amount).

102. An efficient use of time is to close a bank at the usual time on a Friday, work through the weekend to prepare the Pro Forma, and allow the Agent Bank to re-open the bank as a branch the following Monday morning. The Agent Bank will sign Official Receipts documenting the assets and liabilities transferred to it.

103. On Monday, the Agent Bank will have access to the liquid assets purchased in an amount necessary to fund the transferred deposits. This will be based on the Pro Forma created over the weekend. If the Pro Forma is not completed, an estimate will be produced, subject to adjustment for errors and omissions.

Public awareness

104. When the bank is closed and the resolution authority appoints an administrator, the CBOB issues a press release to inform the public. The press release should stress that the action is being taken to minimize the impact of a bank failure on the local economy, by finding an Agent Bank to handle deposits, and transferring assets into the private sector. The Agent Bank may also issue a press release; however, the P&A requires that the resolution authority approve it in advance.

Bail-in

105. Bail-in is the means by which subordinated and senior liabilities can be converted to equity or another form of eligible capital, or written down, to absorb losses and to facilitate either the recapitalization of a bank in resolution or a bridge bank. The guidance below is drawn from the FSB and guidance prepared by IMF consultants.

106. In order to minimize the need for government funding and risks to the taxpayer, consideration should be given to the possibility of achieving some form of bail-in of existing bank debt, e.g., subordinated debt and possibly senior unsecured bonds. Bail-in could potentially be achieved by any of the following mechanisms:

- Requiring banks, as part of recovery planning requirements, to have a tranche of debt capable of being contractually converted to eligible capital instruments or written down upon defined triggers (such as the capital ratio falling below a trigger level).

- Using statutory powers to bail-in any unsecured debt instrument by converting it to an eligible capital instrument or write it down. The bail-in would apply to debt in a manner consistent with the ranking of claims in a winding up—i.e., lower-ranked debt in a winding up would be bailed-in before higher-ranked debt.
- Implementing a bail-in using business transfer powers, whereby a tranche of debt is retained in the failed bank, such that the reduced level of debt transferred to a bridge bank provides the funding for capital in a bridge bank. A similar option would be to assess whether tranches of debt could be transferred out of the failed bank to a special entity established for the purpose if the decision were made to recapitalize the failed bank rather than establish a bridge bank. The creditors of the debt retained in the failed bank or transferred to the special entity, as the case may be, would be compensated ex post to the extent that they are left worse off than if the bank had been liquidated in its entirety (on the basis of the ranking of claims in winding up).

107. In the case of complex and systemically important institutions or their groups, bail-in is one resolution tool for addressing their potential failure.

108. Using the bail-in tool as such consists in the write-down and conversion of capital and liabilities (that are not compulsorily excluded from bail-in treatment) to the extent sufficient to restore regulatory capital to the level necessary for continuation of the activities for which the institution is authorized (in particular identified critical functions) and to maintain sufficient market confidence. The bail-in tool as such is implementable on the basis of a decision by the resolution authority.

109. If resolution proceedings using the bail-in tool are to achieve their objectives, the tool must be implemented in a credible and transparent manner. This requires both sufficient preparation on the part of active participants in the process (i.e., the failing institution, the resolution authority, securities depositories, or other persons keeping records of affected instruments, and organizers of regulated markets) and the ability of market participants to anticipate each step taken throughout the resolution process.

110. This simplified bail-in process outlines the steps to be followed. When preparing this simplified process, the resolution authority relies on the applicable legal framework and the Principles on Bail-in Execution^[1] issued by the FSB, and worked in a close cooperation with the Central Securities Depository, the Stock Exchange and the supervisors overseeing these financial market infrastructures (“FMIs”). The proposed process uses the existing procedures, technologies and conventions of the above-mentioned FMIs to the maximum extent possible and takes into account the possible involvement of international central securities depositories (“ICSDs”).

111. The process deals with the implementation of the bail-in tool, that recapitalized the undercapitalized institution, The resolution authority must combine bail-in measures with broader restructuring policies to ensure the resulting institution is viable.

Step/Action	Responsibility	Description of Step/Action
1	Central Bank	<p>Before taking resolution action, the supervisors ensure that a fair, prudent and realistic valuation of the assets and liabilities of the institution is carried out, to provide information necessary to:</p> <ul style="list-style-type: none"> a. decide whether the conditions for resolution are met (“Valuation 1”) b. determine the appropriate type and extent of resolution action to be taken in respect of the institution (“Valuation 2”) <p>The valuation must be carried out by a person who has sufficient experience and knowledge in valuing institutions and who is independent of the resolution authority, any other relevant public authority and the failing institution (“the independent valuation”). Where, due to urgency or other serious circumstances, it is not possible to conduct an independent valuation, the resolution authority will ensure that a provisional valuation of the institution’s assets and liabilities is carried out, with the independent valuation to be conducted as soon as possible.</p> <p>In relation to the central guiding principle of the resolution framework that no creditor shall incur greater losses than would have been incurred if the institution had been wound up under normal insolvency proceedings, the resolution authority will ensure that an independent valuation providing information on compliance with that principle (“Valuation 3”) is carried out. On the basis of Valuation 3, the resolution authority, no later than 1 year after the application of the resolution measure, will decide on any potential compensation in order to comply with the above principle. Creditors who registered^[3] their claims with the resolution authority within 6 months after the bail-in decision became enforceable are the only creditors entitled to compensation.</p>
A	Central Bank/Resolution authority	<p>Based on the information from Valuation 1, the central bank will decide whether the institution is failing or likely to fail (“FLTF”). Subsequently, the resolution authority will assess whether the conditions for the use of the bail in tool have been met.</p>
2	Resolution authority	<p>The resolution authority may introduce resolution administration. In line with the requirements, the resolution administration may be performed either by the resolution authority directly or by a special administrator.</p> <p>By virtue of the imposition of resolution administration, the exercise of the powers of the management body and of the</p>

Step/Action	Responsibility	Description of Step/Action
		<p>supreme body of the liable entity is suspended and their responsibilities are exercised by the administrator.</p>
3	Resolution authority	<p>In the event of the failure of an institution whose instruments subject to bail-in (“the instruments concerned”) are admitted to trading on a regulated market, the resolution authority will inform the relevant regulated market operator without delay.</p> <p>Depending on the situation, the resolution authority will require the regulated market operator to suspend, delist or remove the instruments concerned from trading on the relevant regulated market.</p> <p>In order to enable the settlement of unsettled transactions in the instruments concerned that were traded before their suspension, delisting or removal from trading (“in-flight transactions”), the transferability of the instruments concerned will not be limited in any way (i.e., settlement, including suspended settlement, will be governed by the rules and procedures of the relevant settlement system operator).</p>
B	Regulated market operator	<p>Based on the obligation imposed by the resolution authority, the regulated market operator will suspend, delist or remove the instruments concerned from trading on the relevant regulated market for the time necessary for the implementation of the bail-in tool.</p>
4	Resolution authority	<p>The resolution authority will select an institution with adequate technical, procedural and governance capabilities and entrust it with administering the implementation of the bail-in tool (“the bail-in agent”).</p> <p>Depending on the scope of the bail-in implementation and on practical experience, in particular in the field of securities processing, settlement and custody services, the role of bail-in agent may also be entrusted to the institution subject to the bail-in implementation, i.e., the institution determined as being FLTF, meaning that the bail-in agent and the FLTF bank are one and the same institution.</p>
C	Resolution authority	<p>Based on the information from Valuation 2, the resolution authority will issue a decision, or a measure of a general nature, implementing the bail-in tool (“the bail-in decision”). The bail-in decision contains in particular the identification of instruments against which the bail-in tool is to be applied and conversion rates determined. When setting the conversion rates, the resolution authority will make sure that no creditor will receive treatment which is worse than the treatment they would have received if the institution had entered national insolvency proceedings, and that all creditors within the same insolvency class are treated equally.</p> <p>The implementation of the bail-in tool may lead to a situation where creditors of a particular insolvency class contribute to</p>

Step/Action	Responsibility	Description of Step/Action
		<p>the institution's loss absorption and recapitalization at the same time, i.e., the market value of shares received in conversion is lower than the receivable from the instruments concerned. Therefore, if the bail-in tool is to be implemented on the basis of a provisional Valuation 2, the resolution authority may deem it appropriate to distribute to such creditors, along with shares, also securities that can be converted into shares or debt instruments issued by the institution ("certificates of entitlement"), so that the losses to be borne by these creditors correspond to the outcomes of the independent Valuation 2.</p>
5	Resolution authority	<p>Straight after the bail-in decision is issued, the resolution authority will inform the failing institution, the central securities depository ("CSD") and other (I)CSDs where applicable about its relevant attributes. The resolution authority's communication will contain, but is not limited to, information on:</p> <ul style="list-style-type: none"> • the instruments subject to the bail-in tool implementation, including the treatment each instrument is to receive; • the parameters of the instruments to be issued in the process of bail-in implementation (e.g., type, quantity and face value); • the conversion rates per instrument and insolvency class, i.e., the rate to be used for conversion into shares of the institution. <p>Where the bail-in implementation process requires new shares to be issued by the institution, these will be issued and registered at the CSD.</p> <p>If the resolution authority requires the institution to issue certificates of entitlement, these will be issued and registered primarily at the CSD, and their transferability will not be limited.</p>
6	Failing institution	<p>Based on the information on the scope and process of the bail-in implementation, the failing institution will prepare all the necessary information and documents, which will then be made available to the bail-in agent.</p>
7	Bail-in agent	<p>The bail-in agent will process the information and documents prepared by the failing institution into electronic instructions, which will be transmitted to the CSD and, where relevant, to other persons maintaining registers of the instruments concerned.</p>
D	CSD	<p>The CSD, on the basis of instructions received, will process the write-down and conversion of the instruments concerned, as a result of which:</p>

Step/Action	Responsibility	Description of Step/Action
		<ul style="list-style-type: none"> • the original instruments (whether shares or instruments representing institution's debt): <ol style="list-style-type: none"> a. will be cancelled: where these instruments are no longer needed for the successful completion of the bail-in process; or b. their face value will be reduced accordingly: where part of the instruments are to remain issued either at the time of the bail-in implementation or as a result of compensation according to the independent Valuation 2 • shares and, where applicable, certificates of entitlement will be distributed to the creditors affected by the implementation of the bail-in tool. <p>For instruments registered in the CSD, the CSD will, in accordance with the instructions received, exchange these instruments for an appropriate number of shares and, where relevant, also certificates of entitlement directly on the owners' accounts where the original instruments are registered at the time just before the bail-in execution.</p> <p>For instruments registered in other records or registers, the CSD will, in accordance with the instructions received, credit the corresponding number of shares and, where relevant, also certificates of entitlement to the designated owner's account of the bail-in agent.</p> <p>Where certificates of entitlement have been used, these will be converted into shares or instruments representing the debt of the institution using the conversion rates corresponding to the outcomes of the independent Valuation 2. The conversion will be performed by the CSD, in accordance with the instructions received, directly on the owners' accounts where the certificates of entitlement were registered just before the exchange.</p>
E	ICSD	<p>ICSD, on the basis of the electronic instructions received, will process the write-down of the instruments concerned, as a result of which:</p> <ul style="list-style-type: none"> • the original instruments: <ol style="list-style-type: none"> a. will be cancelled: where these instruments are no longer needed for the successful completion of the bail-in process; or b. their face value will be reduced accordingly: where parts of the instruments are to remain issued at the time of the bail-in implementation; • the corresponding number of shares and, where relevant, the certificates of entitlement will be credited to the owners' accounts in the follow-up records maintained by the ICSD

Step/Action	Responsibility	Description of Step/Action
8	CSD /ICSD/ Custodian	The CSD, using the standard means of communication, will inform the owners' accounts' beneficiaries about all the transactions that took place on all the relevant owner's accounts with the CSD. The owners' accounts' beneficiaries will inform their clients where applicable.
F	Bail-in agent	The bail-in agent, based on information and documents from the failing institution, will maintain a list of real owners of the shares and, where applicable, the certificates of entitlement that have been credited to the dedicated bail-in agent's owner's account with the CSD. The bail-in agent will inform the real owners from the list above and invite them to provide instructions according to which these securities can be transferred to the corresponding owners' accounts (held either directly with the CSD or in the follow-up records maintained by a CSD's participant).
9	Shareholders	Beneficiaries of securities that are held on a bail-in agent's owner's account will instruct the bail-in agent to transfer the corresponding amounts of securities to the owners' accounts of their choice.

^{1/} Available online at <https://www.fsb.org/2018/06/principles-on-bail-in-execution-2/>

112. In considering bail-in as a loss absorption mechanism, the resolution authority will need to develop guidance in its resolution manual on the following matters:

- a. The methodology to determine the extent to which identified losses can be absorbed by diluting shareholders. In this context, there should be guidance on how a share dilution would be executed, including the company law and stock exchange listing requirements that might apply.
- b. The determination of the extent to which subordinated debt (if any) will be written down or converted to equity (if technically possible) as part of the loss-absorption process. In the case of a business transfer, this might involve determining the treatment of subordinated debt, including whether it is left in the failed bank for liquidation or transferred to a recipient bank (existing bank or bridge bank).
- c. The means by which contractual bail-in debt (if any) would be converted to equity or written down, if that had not already been done under prompt corrective action administered by the CBOB or as part of the bank's recovery plan.
- d. The means by which a forced bail-in would be applied to unsecured liabilities if the CBOB resolution plan contains a proposal for a bail-in using emergency decree provisions, including the liabilities to be subject to bail-in, the methodology to determine the proportion of the selected liabilities to be bailed in, the mode of bail-in (such as

conversion to equity or write-down), the communications with affected creditors, the arrangements for any “no creditor worse off” compensation process, and public communications relating to the bail-in.

- e. The determination of whether existing shareholders are left in the bank as minority shareholders if a recapitalization is to be implemented, or are paid out for any residual value of their shares and the shares cancelled.

Bridge bank

113. In the case of establishing and capitalizing a bridge bank, the following issues would need to be considered:

Rationale for establishing a bridge bank

114. When the resolution authority determines that a bank is nonviable but the authorities determine that the failure of the institution will cause systemic distress in the financial system, the authority may establish a bridge bank for a temporary period. In this case, the resolution authority transfers critical functions and services, insured and possibly uninsured deposits, and viable assets, as well as contractual rights and obligations relating to critical functions and services of the failing institution to the bridge bank. This temporary institution will help preserve financial sector stability. Other assets and liabilities, including “bad” assets that are not critical and certain liabilities such as subordinated debt, can be left behind in the failed institution for liquidation.

115. The resolution authority must decide on the amount of deposits to be transferred. At a minimum, all insured deposits are transferred, with the deposit insurer providing any additional cash necessary to ensure transferred assets equal transferred deposits. If there are sufficient performing assets in the failed institution, all deposits may be transferred, with the deposit insurance contributions limited to what it would payout to insured depositors. Bail-in of contractual bail-in debt and possibly of other unsecured liabilities would occur in the resolution phase immediately preceding the transfer of business to the bridge bank.

116. The key objectives of a bridge bank are to maintain critical services and continuity of operations that are important for financial stability. This would minimize the disruption to the financial system that might otherwise occur if those functions were subject to wind-up and liquidation procedures.

Preconditions for establishing a bridge bank

117. The pre-conditions for the use of bridge bank resolution tool are:

- The supervisory authorities must determine the nonviability of the institution.

- The resolution authorities determine that the bank's failure poses a systemic threat and proposes the establishing of a bridge bank. That proposal will include (i) the future business plan of the bridge bank; (ii) the funding necessary to ensure it has adequate capital and liquidity; and (iii) any requirement for public sector support.
- If the bridge bank requires the use of public resources, the resolution authority reviews options and recommends the resolution approach for the failing bank to the Minister of Finance. The Minister of Finance approves the resolution approach.

118. If a bridge bank is to be used, the contingency plan should identify the steps required for the resolution authority to establish the legal entity. The contingency plan should include pre-prepared documentation for the establishment of a bridge bank, including a company constitution, governance structure, management structure, etc. It will also be necessary to maintain updated lists of potential directors and senior management for a bridge bank. The resolution manual should also include guidance on the steps required for fast-tracking bank licensing and other consent processes, as appropriate

119. A bridge bank resolution would be designed to span the time between when the institution has failed and when a sale of the bridge bank or its assets can be completed. Unlike the conventional forced sale tool, a bridge bank may be used when there are no immediate private sector acquirers.

120. The bridge bank model would be especially suited for member institutions that deteriorate rapidly with little notice and where a potential buyer does not emerge and there are financial stability concerns. This would promote stabilization for depositors and all creditors that are passed to a bridge bank.

Governance of the bridge bank

121. In this process, the resolution authority will need to ensure that there is adequate capital and liquidity in the bank and will need to ensure necessary IT changes to facilitate the transfer of some parts of the undertaking to another entity, etc. There may also need to remove directors and management to the extent they are thought to be obstacles to resolution and not required for the resolution process.

122. If the resolution authority believes new directors and management are needed before the appointment of an administrator or as an alternative to administration, they should pre-identify candidates for the appointments, potentially including senior staff from the resolution authority or from suitable foreign banks. For example, the replacement of directors and senior management might be required ahead of the appointment of an administrator in situations where the resolution authority wants to pre-position the bank for an expected resolution; e.g., to restructure the bank, curtail new lending, etc., and where they do not have confidence in some of the existing directors or management team to undertake pre-positioning for resolution.

123. The bridge bank is not to be viewed as having a competitive advantage over other banks. It should meet the same prudential norms and regulations of other member institutions. The bridge bank should be required to meet all prudential regulations of other member banks and should not have a competitive advantage over other banks in the system. In that sense, the resolution authority would need to determine an appropriate capital ratio, and therefore capital injection, required to restore the distressed bank to financial soundness or to capitalize a bridge bank. The capital ratio would need, at the least, to be around the same level as for other banks in the peer group and sufficient to obtain a credit rating similar to the rating that applied before the bank became distressed. In order to restore market confidence and enable the bank to resume normal funding, the target capital ratio is likely to have been higher than it was pre-distress, based on a target credit rating (e.g., at least investment grade and likely higher for any major bank).

124. The goal would be to return the bridge bank to the private sector through one or more transactions (e.g., a sale of the bridge bank to a third party or an amalgamation with another bank) as soon as possible. It is expected that the pricing of loans and deposits at the bridge bank and various fees would be roughly equivalent to industry norms.

Capital support by the government

125. If the bridge bank is to be recapitalized by the government, it is essential that this is done as a last resort (i.e., failing any other sources of capital) and on commercial terms. It is also essential that the existing shareholders are either removed from the recapitalized bank (e.g., by using a bridge bank and leaving shareholders in the failed bank) or diluted in accordance with the assessed value of shareholders' funds immediately pre-resolution. If the government does need to provide capital support, the MOF will need to develop guidance on the following matters:

- whether capital provided by the government is in the form of preference shares (which would rank ahead of ordinary shares and therefore reduce the risk of the government) or ordinary shares ranking equally with existing ordinary shares;
- the pricing of the shares paid for by the government, based on a conservative valuation of the bank immediately pre-resolution;
- the voting rights on preference shares if that form of capital is used;
- the other forms of control which the government may wish to exercise (either via voting rights on shares or through another means, such as a deed poll entered into by the bank), such as:
 - the right to appoint directors, in proportion to the share of the capital the government holds;

- veto rights over the appointment of directors by other shareholders (if they are minority shareholders);
- the right to appoint (or veto the appointment of) the CEO, CFO and CRO;
- the right to approve (or veto) key transactions, such as lending to related parties, large exposures, disposal of business, acquisition of new business, etc.;
- the right to determine the risk appetite and nature of business strategy adopted by the bank; and
- the nature of the exit arrangements, such as eventual sale of the government's shares to another party (subject to the approval of the RA).

Financial support to a bridge bank

126. The resolution guidance needs to identify the extent and nature of liquidity which may need to be provided by the central bank to a bridge bank. This should be done on the basis of a methodology that involves a stress-tested liquidity projection for the bank at the point of resolution, taking into account the debt funding needs of the bank and its subsidiaries for the continuity of all critical functions and services, the possible withdrawal of some deposit funding, and the possible difficulty that the bank may have in financing from the markets for a period.

127. The guidance should set out indicative terms and conditions for any liquidity support to be provided by to the bridge bank, including maximum funding amount, purposes for which funds may be applied, preconditions for drawdown, term of the funding, interest rate, fees, repayment schedule, terms of rollover (if applicable), financial reporting requirements, restrictions on risk-taking activity, events of default, remedies for events of default, and debt acceleration provisions in a situation of default.

128. Funding should be provided on a collateralized basis, where possible. In that regard, the guidance should identify the types of collateral that could be used, the legal and operational arrangements needed to access the collateral, and the level of haircuts applied to collateral (by category of collateral). Funding should be provided on commercial terms, with pricing that reflects the risk associated with the funding.

129. All other forms of financial support, such as guarantees and indemnities of the bank's counterparties should be identified where feasible. The guidance should set out the terms and conditions of such support, including preconditions, obligations to be covered by the guarantee or indemnity, fees, conditionality, reporting requirements, duration of the support, events of default, and remedies for default. Guarantees and indemnities should be provided on commercial terms, with pricing that reflects the risk associated with the support arrangements.

APPENDIX II. RESOLUTION PLANNING AND RESOLVABILITY ASSESSMENTS

1. This appendix sets out guidance on resolution planning and resolvability assessments.

Resolution plans

2. A resolution plan sets out the means by which a DSIB (or other large bank) would be resolved, taking into account the specific features of that bank and any entities in its financial group (e.g., holding company and subsidiaries) relevant to the performance of a bank's critical functions and services. Resolution plans are prepared by the resolution authority on the basis of selecting one or two resolution strategies suitable for the DSIB, informed by the guidance in the resolution authority's bank resolution manual.

3. A resolution plan is intended to facilitate the effective use of resolution powers to maintain continuity of systemically important functions ('critical functions') and associated services ('critical services'), with the aim of making the resolution of any bank and its associated group feasible without severe disruption to the financial system and economy, and without exposing taxpayers to loss where practicable. It should include a resolution strategy and an operational plan for its implementation and identify, in particular: (i) financial and economic functions, and associated services, for which continuity is critical; (ii) suitable resolution options to preserve those functions or wind them down in an orderly manner; (iii) data requirements on the bank's and associated group's business operations, structures, and systemically important functions; (iv) potential barriers to effective resolution and actions to mitigate those barriers; (v) actions to protect insured depositors and insurance policy holders and ensure the rapid return of segregated client assets; and (vi) clear options or principles for the exit from the resolution process.

Resolvability assessments

4. Resolution plans are informed by resolvability assessments. Resolvability assessments comprise three stages: (a) an assessment of the feasibility of different resolution options for the bank in question; (b) an assessment of the systemic impact of each resolution option; and (c) an assessment of the impediments to resolvability and identification of the actions needed to improve the bank's resolvability under the preferred resolution options. The resolvability assessment needs to be done on a consistent basis across all DSIBs using a framework developed by the resolution authority. It should involve an assessment of the resolvability of each DSIB and its relevant banking group based on the most practicable resolution options. Subject to assessing the particular characteristics of a bank and its relevant group, the most likely resolution options for a DSIB are generally (i) recapitalization of the bank (likely slimmed down to focus on critical functions and services, and associated assets and liabilities); or (ii) transferring critical functions and services and other relevant assets and liabilities from the failing DSIB to a bridge bank.

5. The resolvability assessment framework is necessarily a relatively complex process. It needs to be undertaken thoroughly and on a consistent basis across all systemic banks. The framework for assessment would typically involve assessing such matters as: (a) the existing capital structure of the bank and the availability of any contractual bail-in debt; (b) the estimated maximum losses and capital shortfalls for a range of severe financial shocks; (c) the availability of debt that could potentially be subject to contractual bail-in and to forced bail-in (if the emergency decree option is adopted); (d) the technical issues involved in diluting existing shares and implementing bail-in; (e) the identification of all critical functions and services, and the entities within which these are performed; (f) the ability to separate critical from noncritical functions and services; (g) the extent to which critical functions and services are performed by parties outside the banking group (i.e., outsourced) and the contractual arrangements applicable to them; (h) the payment and settlement systems of which the bank or its subsidiaries are members, and the implications of entry into resolution or change of ownership for each such system; (i) the types of capital instruments that would be used in a recapitalization of the bank or of a bridge bank; (j) the regulatory requirements, including disclosure requirements, associated with each phase of resolution; (k) the fast-track licensing steps needed if a bridge bank solution is used; (l) the rights of termination of counterparties to the bank upon entry into resolution or change of ownership, and the means by which this could be avoided where it is desirable to do so; (m) the arrangements required to ensure continuity of critical functions and services of foreign subsidiaries and branches if applicable, including foreign regulatory requirements; (n) the process for establishing a bridge bank; and (o) the funding requirements for each aspect of resolution for each resolution option.

Critical functions and services

6. A key focus of resolvability assessments is to identify a bank's/group's critical functions and services. These represent the parts of a bank/group that need to be continued in order to minimize adverse impacts on the financial system and economy. Any form of resolution for a bank assessed as being systemically important should ensure that critical functions and services are continued, either in the bank itself or in another entity (i.e., a bridge bank or another bank).

7. The FSB notes that a critical function has the following two elements:
- a. it is provided by a bank/group to third parties not affiliated to the bank/group; and
 - b. the sudden failure to provide that function would be likely to have a material impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to:
 - the systemic relevance of the function for the third parties; and
 - the systemic relevance of the bank/group in providing the function.

8. Critical functions will typically include functions relating to:
 - Deposit-taking, particularly the capacity to receive deposits into transaction accounts.
 - Transactions capacity—the ability to make and receive payments.
 - Clearing and settlement functions.
 - Wholesale funding, particularly the ability to receive funding via on-call wholesale deposits.
 - Correspondent banking functions.
 - Treasury functions.
 - Derivatives servicing—e.g., with respect to interest rate and currency swaps, forwards and options.
 - Provision of credit under committed credit facilities.
 - Loan servicing.
 - Provision of risk hedges to customers.
 - Provision of financial services to markets in which the bank is the sole or predominant provider and where significant disruption to the financial system or economy would result if the services were discontinued.
9. Critical services also need to be identified. Critical services (including services shared between or among entities within a group) are activities performed within the firm or outsourced to third parties where failure would lead to the inability to perform critical functions and, therefore, to the disruption of functions vital for the functioning of the real economy or for financial stability.
10. The critical services will include systems, data and other functionality required to:
 - perform critical functions;
 - maintain customer accounts;
 - maintain financial records;
 - meet financial obligations as they become due and payable;
 - maintain payroll and other employee obligations;

- maintain operational security, including the security of all premises required for critical functions and services;
- maintain all assets required for the performance of critical functions and services;
- identify, measure, monitor and manage all material risks;
- comply with prudential requirements; and
- comply with other legal requirements.

11. As part of the resolvability assessment, there needs to be an identification of the entities that perform critical functions and services, and the country or other jurisdiction in which the entities are located. In many cases, some critical functions will not necessarily be performed by the bank itself; some functions might be performed by other entities in the financial group. In the case of critical services, it is often the case that some of these services are performed by a holding company or parent bank (if applicable) or by subsidiaries of the bank or by other entities in the group (e.g., subsidiaries of a parent bank, if applicable). In addition, it is common for some critical services to be performed by entities outside the group through outsourcing arrangements.

12. The resolvability assessment also needs to identify the contractual arrangements on which critical functions and services are performed, including Service Level Agreements (SLAs) and the contractual implications for each function and services of the bank or any entity in the banking group being placed into resolution. Potential impediments to the continuity of critical functions and services under each resolution option should be assessed, and the means by which these impediments can be avoided or managed should be identified. Drawing on the resolvability assessment, resolution plans pull together the operational details required for continuity of operation of critical functions and services for each resolution option.

Loss absorption

13. The resolvability assessment also needs to assess the potential for loss absorption and funding to facilitate recapitalization of the bank or capitalization of a bridge bank based on the capital and liabilities of the bank. This should be done by assessing possible worst-case losses in a nonviability scenario (drawing on reverse stress tests) and assessing the amount of loss absorption available from: (i) common equity; (ii) additional tier 1 capital; (iii) tier 2 capital; (iv) subordinated liabilities capable of contractual bail-in not included in capital; (v) senior unsecured liabilities capable of contractual bail-in not included in capital; and (vi) other unsecured liabilities capable of statutory bail-in, consistent with the ranking of claims under applicable insolvency law. If there is an insufficient amount of loss absorption available to absorb losses under a plausible worst-case nonviability scenario and to facilitate recapitalization of the bank or capitalization of a bridge bank without causing financial stability risks (e.g., contagion impacts), the resolution authority should assess the feasibility and cost/benefit trade-offs of requiring the bank in question to increase its capital or contractual bail-in liabilities.

Impediments to resolution

14. Other potential impediments to resolution should be assessed and appropriate solutions should be identified. These include: (i) domestic statutory and regulatory impediments to resolution implementation; (ii) foreign statutory or regulatory impediments; and (iii) contractual impediments. In the case of critical services that are provided within a financial group on a shared services basis (e.g., via a holding company, parent bank, regional hub entities, or centralized services provider within the group), the potential impediments to continuity of services under selected resolution options should be assessed and the means by which these can be avoided or managed should be identified. Options that can be considered include: (i) requiring shared services to be contractually documented in ways that prevent suspension or termination of services merely as a result of entry into resolution or the exercise of resolution powers, provided that the bank in resolution or its relevant subsidiaries continue to make payments due under contractual arrangements; (ii) requiring back-up systems for critical services to be located within the bank; or (iii) requiring critical services to be located within the bank. The resolvability assessment should assess the feasibility and costs/benefits of each applicable option.

15. Once a resolvability assessment has been completed for each DSIB, a resolution plan can then be prepared. The resolution plan should set out in detail the specific nature of the resolution arrangements for the selected resolution options. Depending on the resolution options selected, the resolution plan should include: (a) an identification of the amount and nature of capital injection required; (b) the type of capital instruments to be used; (c) the nature of dilution of existing shareholders and write-down or bail-in of subordinated creditors; (d) the critical business to be continued; (e) the business lines to be discontinued; (f) the separation of critical functions and services from noncritical functions and services; (g) the nature of business to be transferred to another bank or to a bridge bank (if that option is applied); (h) the transfer of impaired assets to an AMC (if that option is to be applied); and (i) the nature of cross-border resolution actions required (if applicable).

16. Resolution plans should be reviewed and updated on a regular basis. This is done by the resolution authority on the basis of periodic resolvability assessments that take into account any material changes to the business operations of the bank.

Cross-border cooperation and coordination

17. In the case of cross-border banking groups, the home resolution authority should lead the development of the group resolution plan in coordination with members of the banking group's Crisis Management Group (CMG) or supervisory college. Host authorities that are involved in the CMG or are the authorities of jurisdictions where the banking group has a systemic presence should be given access to resolution plans and the information and measures that would have an impact on their jurisdiction. Host resolution authorities may maintain their own resolution plans for the banking group's operations in their jurisdictions, cooperating with the home authority to ensure that the plan is as consistent as possible with the group plan.

18. The parent entity resolution plan should focus primarily on how a whole-of-group resolution would be implemented. This would generally be done in ways that enable the parent entity to provide the required capital, liquidity funding and operational support to the operations in the host country. This might involve some form of ‘Single Point of Entry’ (SPE) resolution, under which any capital and liquidity injections needed by the bank subsidiary/branch in the host country would be facilitated via the parent entity (either through some form of bail-in at parent level or alternative capital-raising mechanism). Alternatively, the resolution plan might involve a ‘Multiple Points of Entry’ (MPE) form of resolution, under which capital and liquidity would be injected separately into the parent bank/holding company and each relevant subsidiary bank. The costs/benefits of each option should be assessed in the resolvability assessment and resolution planning processes.

19. If the parent resolution involved a sale of the bank to another party or the transfer of some of its business to a bridge bank in the home jurisdiction, the resolution plan would desirably set out the means by which the subsidiary/branch in the host country is integrated into the parent bank resolution strategy, including by way of appropriate recognition or facilitation by the host resolution authority of resolution actions needed in the host country to accommodate the parent resolution strategy.

20. Resolution plans also need to cater for situations where the home authorities do not implement a form of resolution that meets the financial system and depositor protection needs of the host country. In such cases, it will be important to incorporate into resolution plans a host country ‘fallback’ resolution option that enables the subsidiary/branch in the host country to be separated from the parent banking group and resolved in a manner that maintains continuity of critical functions and systems in the host country so as to minimize disruption to the domestic financial system. This is likely to involve consideration of the means by which critical functions and services can either be performed by the subsidiary/branch or performed through a shared services company in the parent group and structured so that there is reasonable certainty of the ability to maintain continuity if the subsidiary/branch is separated from the parent. This resolution option would also likely involve the transfer of the relevant business functions of the subsidiary/branch to either another bank in the host country (if feasible) or to a bridge bank established for the purpose. In such a case, some host resolution authorities require foreign subsidiaries or branches to be pre-positioned to enable them to maintain critical functions and services on a stand-alone basis so that, in a resolution, they could be fully separated from the parent entity, if necessary.

21. These are complex issues and require careful consideration and planning by the home and host authorities. The development of cross-border banking group resolution plans needs to recognize that the home and host countries have overlapping interests, with both seeking to achieve cost-effective financial stability outcomes in the home and host countries. However, there also needs to be a clear recognition of divergent interests between the home and host countries. The home country authority’s primary focus is the financial stability of its own country and the achievement of a least-cost resolution for the home country. In contrast, the host

authority's primary focus is on protecting the financial stability impact in the host country and minimizing resolution costs at a local level. These divergent and competing interests should be dealt with openly, with a view to seeking to strike a workable whole-of-group resolution that meets the needs of home and host countries, but with an understanding of the likely need for the host authority to establish a fallback resolution option that can be implemented by the host resolution authority in the event that the home authority's proposed approach does not adequately meet the needs of the host country.

Indicative process for preparing resolution plans and conducting resolvability assessments

22. An indicative process for preparing resolution plans and conducting resolvability assessments is set out below.

Step 1—Identify potential resolution options for the bank and relevant group

23. The resolution authority identifies likely resolution options for the bank and its relevant group, drawing on the resolution manual guidance. In the case of a DSIB, the most likely resolution options are:

- Recapitalization of the bank (slimmed down to exclude noncritical functions and services). This would desirably be done through bail-in of liabilities to the extent feasible, but might require some public funding.
- Business transfer. This would be involve transferring critical functions and systems, and associated assets and liabilities, to a bridge bank established by the resolution authority and capitalized by bail-in and selective liability transfer to the extent possible, supplemented with public funding if necessary.

24. A resolution plan might focus just on one of these resolution options, but will often allow for both options, with the resolution authority then selecting the preferred option on the basis of least-cost resolution based on information at the time of nonviability.

Step 2—Consult DSIBs on resolution planning

25. The resolution authority should prepare a paper that sets out its approach to the resolution of DSIBs, including resolution objectives, nature of resolution powers, the point of entry into resolution, the purpose of resolution plans and resolvability assessments, and the resolution options. It should explain the intended process and timeline for undertaking resolvability assessments and preparing resolution plans, and the inputs required from the DSIBs in that process. The paper would note that DSIBs may be required to make changes to the structure and operations for the purpose of enabling particular resolution options to be capable of implementation. The resolution authority would include as an attachment to the consultation paper a draft data template (see below in Step 3).

26. The resolution authority might usefully hold a workshop with the DSIBs to explain the issues and respond to questions. Banks would be invited to make submissions on the paper and suggested changes. Once this has been completed, the resolution authority would finalize the paper and data template.

Step 3—Obtain comprehensive data from the bank and relevant group

27. The resolution authority should develop a data template to be used to obtain the information it needs in order to assess the feasibility of the resolution options. The same data template should be used for all DSIBs in order to obtain data in a standardized format and to enable peer review by the resolution authority.

28. The data template would typically require data in relation to:

- a. Organization structure of the banking group, including identification of a holding company (if applicable), bank, all subsidiaries of the bank, and any ‘sister’ subsidiaries of the bank (i.e., subsidiaries of the holding company) that provide material functions or services to the bank or any of its subsidiaries. The information should include an identification of country of domicile of each entity.
- b. For each entity in the group, an identification of the functions it performs (i.e., business products and services it provides to persons outside the group) and services it performs (i.e., services it provides to entities within the group).
- c. Nature of the legal form (e.g., company, cooperative) and capital structure of the holding company and the bank.
- d. Detailed balance sheet of the bank and holding company and of any subsidiary that provides critical functions or services on which the bank is dependent, including detailed information on capital, quasi-capital, subordinated debt, and liabilities by category of liability.
- e. Critical functions and services performed by the bank and group, including the entities performing each function and service.
 - o Critical functions are activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for financial stability due to the banking group’s size or market share, external and internal interconnectedness, complexity and cross-border activities. Examples include payments functions, custody, certain lending and deposit-taking activities in the commercial or retail sector, clearing and settling, segments of wholesale markets, market-making in certain securities, provider of swaps, futures and options in the interest rate and foreign exchange market, and highly concentrated specialist lending sectors.

- Critical shared services are activities performed within the firm or outsourced to third parties where failure would lead to the inability to perform critical functions and, therefore, to the disruption of functions vital for the functioning of the real economy or for financial stability. Examples include the provision of information technology given the dependency of core banking processes on IT and other services such as facility management and administrative services.
- Critical functions would be selected by reference to the following criteria:
 - the function is provided by an institution to third parties not affiliated to the institution or group; and
 - a sudden disruption would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function.
- Critical services would be selected by reference to the following criteria:
 - an activity, function or service is performed by either an internal unit, a separate legal entity within the group or an external provider;
 - the activity, function or service is performed for one or more business units or legal entities of the group;
 - the sudden and disorderly failure or malfunction would lead to the collapse of or present a serious impediment to the performance of, critical functions.

See FSB guidance on critical functions and services: Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Identification of Critical Functions and Critical Shared Services: https://www.fsb.org/2013/07/r_130716a/

- f. For critical systems, the identity of any providers of such services under outsourcing arrangements and their country of domicile need to be identified. The bank should provide details of contractual arrangements for each outsourced service provider, with particular focus on the grounds on which the service may be terminated or suspended by the outsourced provider.
- g. For each critical function, the local currency amount of the function performed—e.g., by reference to the total amount of lending or funding as at the most recent date for which data are available or as at a date specified by the resolution authority. This should be done at a granular level by category specified by the resolution authority—e.g., lending by borrower and loan product category, and deposits by customer category. This will enable the resolution

authority to assess the market share of the bank/group in each category and therefore assess the extent of potential impact if there was a discontinuity of those functions and substitutability.

- h. Participation of the bank in each payment and settlement system, including the types of payments/settlements performed by the bank. The bank should provide information on average payment/settlement volumes for a period specified by the resolution authority (e.g., over a given month or quarter or year). This will enable the resolution authority to assess the bank's share of total volume of payment and settlement transactions made in each payment/settlement system in the given period.
- i. Amount of inter-bank funding and credit exposures as at a date specified by the resolution authority. This will enable the resolution authority to assess the potential implications of the bank's failure for inter-bank liquidity and contagion.
- j. For bank and holding company, the amount of loss absorption capacity, including ordinary share capital (and extent to which it is fully paid), preference share capital, Additional Tier 1 capital instruments, Tier 2 capital instruments, other subordinated debt, uninsured deposits (disaggregated between retail and wholesale deposits), and unsecured bonds and paper issued by the bank or holding company. The bank should identify those debt instruments with a contractual capacity for conversion to equity or ability to be written down, and the terms on which this may be done.

Step 4—Initial resolvability assessment

29. Based on the data provided by each DSIB, the resolution authority would undertake a resolvability assessment to evaluate the feasibility of either or both resolution options. This would take into account:

- a. The nature of critical functions and services and the location of them by legal entity in the group.
- b. The nature of critical services performed by outsourced parties and the nature of the contractual arrangements, focusing on the capacity for the providers of outsourced services to suspend or terminate the services.
- c. The noncritical functions and services that could be discontinued.
- d. The market share of the DSIB in each category of critical function, and its share of participation in FMI and key financial markets, and assess the impact of failure of the DSIB on the financial system and economy and on other banks, and the speed with which other banks could replace the functions provided by the DSIB if the functions were to be discontinued.

- e. The amount of loss absorption and the sequencing with which this could be implemented. This should be assessed on a working assumption that the DSIB's capital ratio has fallen to not more than 3 percent of risk-weighted exposures and potentially as low as -20 percent (informed by stress tests based on nonviability scenarios).
- f. An evaluation of whether recapitalization should be undertaken (under option 1) on a SPE or MPE basis.
- g. An evaluation of the business that would be transferred to a bridge bank.
- h. An assessment of the extent to which there is a funding shortfall required to establish the recapitalized bank or bridge bank to a capital rate that is at least 300 bps above the regulatory minimum for DSIBs, taking into account termination of noncritical functions.
- i. An assessment of the external funding sources needed and the process for obtaining the funds.
- j. Obstacles to implementation of either resolution option, including contractual impediments, location of critical functions and services, cross-border complications, and regulatory impediments.

Step 5—Discuss with DSIB

30. Discuss the results of the analysis in step 4 with the DSIB to seek clarification on issues on which there are uncertainties and where further information may be required. Discuss possible changes to the bank and group that may be required to facilitate resolution under either option.

Step 6—Prepare comprehensive resolution plan

31. Based on the analysis in steps 4 and 5, the resolution authority should prepare comprehensive resolution plans that set out the means by which each resolution option would be implemented, including the changes needed to group structure, locations of critical functions and services, contractual arrangements with service providers, and the amount and structure of contractual bail-in liabilities that would be required for a sufficient level of loss absorption to minimize the need for external funding.

32. It would also identify the capital structure that would evolve from bail-in and the form of capital arising from any external capital sources.

33. It would identify the possible need for government guarantees and indemnities by amount and duration.

34. It would identify possible liquidity support from the central bank by amount and duration, and collateral available and possible indemnity requirements.

35. It would identify communications required for each resolution option from the point of entry into resolution through each stage of resolution.

Step 7—Pre-positioning the DSIB

36. The resolution authority would specify the pre-positioning needed for each DSIB to implement the selected resolution options, such as the simplification of a group structure, the movement of some critical functions and services from other legal entities to the bank, establishing specific contractual arrangements for outsourced critical services that do not provide for termination in a resolution situation, and the establishment of a tranche of bail-in debt.

See below for useful reference material.

FSB, *Thematic Review on Bank Resolution Planning Peer Review Report*, April 2019

<https://www.fsb.org/2019/04/thematic-peer-review-on-bank-resolution-planning/>

———, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies*, July 2013

https://www.fsb.org/wp-content/uploads/r_130716b.pdf?page_moved=1

———, *Guidance on Arrangements to Support Operational Continuity in Resolution*, August 2016

<https://www.fsb.org/wp-content/uploads/Guidance-on-Arrangements-to-Support-Operational-Continuity-in-Resolution1.pdf>

EU Single Resolution Board, *Introduction to Resolution Planning*

https://www.srb.europa.eu/system/files/media/document/intro_resplanning.pdf.pdf

———, *Critical Functions: SRB Approach*

https://www.srb.europa.eu/system/files/media/document/critical_functions_final.pdf

Bank of England: *The Bank of England's approach to resolution*, October 2017

<https://www.bankofengland.co.uk/-/media/boe/files/news/2017/october/the-bank-of-england-approach-to-resolution.pdf>

CDIC: *Resolution Plan Guidance for Domestic Systemically Important Banks*, June 2022

<https://www.cdic.ca/wp-content/uploads/CDIC-Resolution-Plan-Guidance-for-DSIBs.pdf>

US FDIC: *Statement on Resolution Plans for Insured Depository Institutions*, June 2021

<https://www.fdic.gov/resources/resolutions/resolution-authority/idi-statement-06-25-2021.pdf>

APPENDIX III. ELEMENTS NEEDED TO RESPOND TO STRESS IN THE CREDIT UNION SECTOR

1. Given the current weaknesses in the credit union sector, the mission recommends that the CBOB develops a comprehensive strategy for addressing the situation. This appendix provides guidance on the key elements of such a strategy.

2. The strategy would appropriately be designed to strengthen the viability of the credit union sector to the extent feasible, and for the credit unions that are unlikely to remain viable to put in place a strategy for either merging them into the larger credit unions if possible or winding them down. In the development of a strategy for the credit union sector, it is suggested that consideration be given to the following issues:

- a. ***Strengthening the early intervention arrangements, including contingency plans, for the credit union sector.*** Building on existing supervisory initiatives, the IMF team suggests that the CBOB review and strengthen as necessary the framework for the management of credit union stress. This would draw on the CBOB's existing early intervention and intensified supervision arrangements and should include:
- intensified monitoring of the credit unions to assess compliance with regulatory requirements and key prudential and financial data (especially in relation to liquidity, asset quality, provisioning, profitability and capital);
 - the setting of triggers for proactive intervention by the CBOB, desirably before any breach of regulatory requirements has occurred, with a view to minimizing the risk of regulatory breaches or significant deteriorations in risk position;
 - the requirement for credit unions in stress to establish remedial action plans to address significant risk issues and regulatory noncompliance, with such plans being signed off by credit union senior management and boards;
 - the establishment by the CBOB of contingency plans for dealing with situations in which a credit union is unable to remedy a stress or noncompliance matter. Contingency plans for the CBOB might appropriately cover the following response options (depending on the nature and severity of the credit union stress or noncompliance event(s) in question):
 - appointment of a suitable expert to advise a credit union on remediation strategy;
 - intensification of offsite monitoring and onsite assessments by the CBOB to deepen its understanding of the situation and to work with the credit union to develop an appropriate remediation plan;

- development of guidance for credit unions on possible elements of a remediation plan, such as for reducing non-essential expenditures, curtailing new lending, strengthening liquidity, and raising capital (if feasible);
 - preparation of directions that the CBOB would give to a credit union, upon specified trigger events, to reduce the risk of further deterioration in the prudential and financial position of the credit union and to facilitate its remediation;
 - development of merger or business transfer plans for weak credit unions, such that viable assets, insured deposits and critical functions and services are transferred to a willing, larger credit union.
- b. **Centralization of core services.** One of the constraints on credit union viability is the high operating costs. One solution might be to centralize the provision of some core services through an entity jointly owned and controlled by credit unions (possibly The Bahamas Cooperative League Limited (BCL)—the apex body already in existence). Such services could include IT services, legal services, HR functions, and even physical infrastructure such as branch networks in an attempt to reduce operating expenses. Similarly, as has been done in some countries with credit unions, a ‘federation model’ could potentially be considered, under which a number of credit unions establish a jointly owned company to perform core IT and other services for the credit unions which form part of the federation structure, while still retaining their individual legal forms and brands.
- c. **Capital-raising capacity.** One of the core difficulties facing credit unions is the inability to raise capital in the form of equity. One option is to incorporate into the BCCUA a capacity for credit unions (either directly or via an apex body) to issue mutual capital instruments up to a limit without causing the risk of demutualization.
- d. **Recovery plans.** Credit unions should be required to prepare recovery plans as part of their risk management framework. The recovery planning guidelines for banks can be applied to credit unions in simplified form, but with particular focus on the realistic means by which a credit union could improve its capital position through balance sheet reduction or issuance of an additional tier 1 or tier 2 capital instrument, and by requiring credit unions to develop merger options where feasible.
- e. **Resolution strategy.** In the case of credit unions that are not able to restore themselves to viability within an acceptable timeframe, it will be necessary for the CBOB to invoke some form of resolution. Resolution should be activated well before the point at which a credit union becomes insolvent; it should commence upon a defined point of nonviability. Once the legal framework has been strengthened, the resolution options most likely to be applicable to credit unions will be either business transfer (where insured deposits and viable assets are transferred to another credit union or a bank) or closure and then payout by the DIC. Preparations for these resolution options should be developed by the CBOB and DIC through a generic resolution plan for the credit union sector. In the meantime, under the

existing BCCUA, the CBOB, and the DIC should strengthen their preparedness to implement available resolution options, including the CBOB facilitating voluntary amalgamation where feasible or initiating liquidation and facilitating prompt payout via the DIC.

APPENDIX IV. OPERATIONALIZING THE DEPOSIT INSURANCE CORPORATION

1. **The DIC should implement a series of reforms aimed at strengthening its operational readiness and effectiveness.** Those reforms include changes in its organizational structure, in some basic design features, in the funding arrangements to support resolution measures and depositor payout, and for strengthening the reimbursement procedures. Finally, a comprehensive and wide-ranging public awareness program should be designed and implemented.

Organization

2. **The legal framework for the DIC can be strengthened in several areas.** The PDA should extend deposit insurance coverage to foreign exchange denominated deposits. While relatively small in the onshore financial system, not covering them creates incentives for transferring deposits in times of instability and may increase volatility. Second, the PDA should be expanded to include basic powers for the DIC, including authority to set and collect premiums, to transfer deposits to another bank, to reimburse insured depositors, and to obtain timely, accurate and comprehensive deposit data information in a format determined by the DIC.

3. **Safeguards are needed on the use of DIC funds.** The Act should limit the use of DIC funds to the amount it would have paid on a least-cost basis to depositors in a liquidation. Consideration could also be given to setting a maximum contribution by the DIC to a resolution e.g., 50 percent of the existing fund that could be used in resolution, thus ensuring that the DIC fund will not be exhausted

4. **The DIC lacks dedicated staff; instead, staff are seconded from the CBOB.** However, managing an effective deposit insurance system requires specialized skills that are learned over time. Having dedicated staff will ensure that techniques and understanding are retained in the institution. The DIC should have a small core of permanent staff and establish arrangements to enable it to quickly ramp up staffing, as needed, e.g., via seconding of additional staff from the CBOB during times of stress. Initially, the DIC will be tasked with a significant amount of work, including developing guidelines for reimbursements and appropriate safeguards for the use of DIC funds. A minimum staff of three to four persons seems reasonable, including a CEO, a staff person for all funding issues, and one to two staff for reimbursement, data preparation, and evaluation.

Deposit data

5. **A medium-term objective for the DIC is to ensure that the financial institutions can produce deposit data in a timely manner using a SCV format.** This effort can begin by establishing working groups with the banks to modify their IT systems as appropriate. The DIC would then need to test on a regular basis the ability of the banks to prepare the appropriate data files and then be able to securely transfer that information electronically to the DIC. Similar efforts are needed with the credit unions. However, some of the credit unions do not have the

necessary IT functions. Accordingly, the CBOB will need to work with them, providing guidance on the strengthening of their data management capabilities.

Funding

6. **The DIC has reviewed the target fund ratio.** Based on the DIC's expected loss calculations, the target fund should be increased from 2.0 percent of insured deposits to 4.7 percent or B\$120 million. This fund will be fully constituted as an ex-ante fund and will fully cover deposits in 13 of the 18 member financial institutions. The fund will be financed through premium assessments on member institutions, with the target fund being reached in five years.

7. **The proposed target fund is appropriate and puts the DIC on a sound financial basis.** The target fund will be reviewed every three years. The DIC could complement this methodology by assessing the amount to be paid out in each institution and applying an estimated default risk for each institution based on historical data, supervisory assessments, and stress tests. This check would ensure that the fund will have the minimum level necessary to cover insured deposits in the bulk of the system.

8. **The DIC should have a dedicated, pre-arranged back-up funding arrangement.** The back-up funding should be sufficient and available to ensure that liquidity requirements are met. Typically, such back-up funding is provided by the MOF. However, the provision of such funding must be extremely fast. In this context, the CBOB might appropriately provide the funding within the context of a formal agreement under which all credits to the DIC are indemnified by the MOF. Any use of this emergency funding facility should be repaid from asset recoveries or levies on members.

Reimbursement framework

9. **The DIC should develop a comprehensive step-by-step procedure guiding the reimbursement process.** That procedure should begin with a definition of the format for deposit records and data transfer. These records typically include a unique depositor identifier, personal data, and account details.

10. **The DIC should engage in on-going preparation for a payout.** The DIC should validate the deposit data format and then test on a regular basis the ability of the institution to generate a timely and accurate list of depositors. The DIC will need to ensure that excluded deposits are identified and that the treatment of trust accounts and accounts with multiple owners are identified and applied.

11. **Critical to the rapid payout is the early identification of the payout process.** Typically, the deposit insurer will have signed agreements with a variety of institutions, able to act as paying agents. Once the liquidator provides the deposit data and the DIC validates the data, the DIC selects the paying agent and transfers deposit data and funding to that agent for payout. Paying agents should be identified in normal times and must meet specific conditions.

For example, the supervisors should confirm that the institution has strong financial indicators and a history of compliance with supervisory regulations. It must also meet technical requirements such as adequate IT systems, capacity to deal with the heightened work associated with a payout, the ability to set up an effective call center and to provide adequate staffing to handle a payout process.

12. **The reimbursement process can be described in three steps.** The first step is the preparation phase and can begin up to a month before payout is triggered by the CBOB. At this stage, the DIC confirms the deposit data base, reviews contacts with paying agents, and ensures adequate staffing and funding are available. The second step is the actual reimbursement and follows the triggering of the payout by the CBOB. The DIC obtains the deposit files from the liquidator, validates the deposit database, and sends it to the paying agent. The DIC will need to make public announcements, which can be prepared in advance. The final step is the ex-post assessment, identifying factors that went well and identifying any implementation problems.

13. **Payout procedures can be complex and infrequently used.** For that reason, the DIC should have a regular schedule of testing procedures. The DIC should plan to conduct a full test of the entire reimbursement process every three years. In other years, segments of the process can be independently tested.

Information exchange and early warning arrangements

14. **Domestic inter-agency cooperation and coordination are essential for an effective response to financial institution distress and failure.** Currently, domestic coordination is achieved through the Group of Financial Services Regulators (GFSR), which comprises the heads of the CBOB, SCB, Insurance Commission, Compliance Commission, Gaming Board, and the Financial Intelligence Unit. The GFSR focuses mainly on information exchange on financial regulatory issues but does not deal with financial crisis management, and it does not include the MOF or the DIC. As recommended in the first mission, in November 2021, the authorities should establish a new inter-agency coordination body—a Financial Stability Council (FSC)—comprising the chiefs of the GFSR member agencies that have a financial stability and crisis management role, plus the MOF and the DIC. Its focus should be to facilitate regular information exchange, advice, and cooperation on financial stability and crisis management issues.

15. **The supervisors and the DIC should hold frequent meetings and exchange critical information.** The DIC needs to be notified whenever a member institution is in stress or in respect of which the CBOB supervisors have material concerns (e.g., where an institution is put on watch list or is facing supervisory actions affecting capital or viability). It should also be notified whenever the supervisors begin planning to put in an administrator or liquidator. This notification will give the DIC time to review existing files, review funding and identify critical staff to implement a payout should one be necessary.

Public awareness

16. **A robust public awareness program is an essential element of a successful deposit insurance system.** The DIC should develop a public awareness policy framework. Such a framework would identify member institutions; stakeholders to whom communications should be directed; what information on deposit insurance information should be distributed; and the communication tools and channels to be applied, including (i) website; (ii) mass media: newspapers, magazines, television, and radio; (iii) online and social media; and (iv) educational activities. This framework would identify mechanisms for enhancing public awareness, such as preparation of information leaflets, a dedicated website, and provision of information sheets for banks to provide to depositors that outline the main elements of the deposit insurance system, and how reimbursement will be provided. An independent evaluation is needed to measure on a regular basis the effectiveness of the public awareness program or activities.