



# BOTSWANA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### TECHNICAL NOTE ON FINANCIAL SECTOR SAFETY NETS, CRISIS MANAGEMENT, AND BANK RESOLUTION FRAMEWORK

March 2024

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# TECHNICAL NOTE

## FINANCIAL SECTOR SAFETY NETS, CRISIS MANAGEMENT, AND BANK RESOLUTION FRAMEWORK

Prepared By  
**Monetary and Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Botswana. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

# CONTENTS

Glossary	3
<b>EXECUTIVE SUMMARY</b>	<b>4</b>
<b>INTRODUCTION</b>	<b>9</b>
<b>FINANCIAL SAFETY NET</b>	<b>11</b>
A. Early Intervention and Recovery Planning	11
B. Resolution Framework	12
C. Emergency Liquidity Assistance	14
D. Deposit Insurance	17
<b>CRISIS PREPAREDNESS</b>	<b>19</b>
A. Effective Coordination through the FSC	19
B. Cross-Border Issues	22
C. Simulations	23
<b>CRISIS MANAGEMENT</b>	<b>24</b>
<b>BOXES</b>	
1. Bank Resolution Sequencing	11
2. ELA for Non-Bank Financial Institutions	16
3. Communications in Bank Resolution, Crisis Preparedness and Management	19
4. Central Bank and MoF Roles in the FSC	21
<b>TABLES</b>	
1. Key Recommendations	7
2. Deposit Distribution Survey	18
<b>APPENDICES</b>	
I. Status of 2017 TA Report (as of January 2023)	26
II. Some Observations on the Draft Revised Banking Act—Selected Issues	28
III. Some Observations on the Deposit Insurance Scheme of Botswana Regulation—Selected Issues	31
IV. Example of a Country Contingency Plan Outline	33
V. Example of a Bank Recovery Plan Outline	35

## Glossary

BA	Banking Act 1995
BoB	Bank of Botswana
BoBA	Bank of Botswana Act
BoBAA	Bank of Botswana Amendment Act, 2022
BSD	Bank Supervision Department
DRBA	Draft Revised Banking Act
DICP	Deposit Insurance Core Principles
DISB	Deposit Insurance Scheme of Botswana
DISR	Deposit Insurance Scheme Regulation
D-SIBs	Domestic Systemically Important Banks
ELA	Emergency Liquidity Assistance
FIA	Financial Intelligence Agency
FSB	Financial Stability Board
FSC	Financial Stability Council
FSN	Financial Safety Net
IADI	International Association for Deposit Insurers
IDT	Insured Deposit Transfer
KA	FSB Key Attributes of Effective Resolution Regimes for Financial Institutions
MCM	Monetary and Capital Markets Department
MOU	Memorandum of Understanding
NBFI	Non-bank Financial Institution
NBFIRA	Non-bank Financial Regulatory Authority
NB-SIFI	Non-Bank Systemically Important Financial Institutions
NPL	Nonperforming Loan
OA	Official Administration (or Administrator)
PCA	Prompt Corrective Action
P&A	Purchase and Assumption Transaction
RA	Resolution Authority
RU	Resolutions Unit
RRP	Recovery and Resolution Plans
SIFIs	Systemically Important Financial Institutions
TA	Technical Assistance
TM	Temporary Management

## EXECUTIVE SUMMARY<sup>1</sup>

**The financial safety net framework in Botswana is incomplete, while crisis preparedness and management structures must be expanded.**<sup>2</sup> The Bank of Botswana (BoB) lacks an emergency liquidity support mechanism for commercial banks, bank resolution and liquidation remain under the Companies Act, and there is no deposit insurance system. A 2016 TA mission<sup>3</sup> on “Banking Sector Safety Net and Crisis Management” identified many deficiencies. To date, there has been limited progress in achieving the recommendations.

**The authorities are, however, poised to significantly improve the Financial Safety Net (FSN) and Crisis Management framework.** Specific legal reforms include: (1) the implementation of the Bank of Botswana Amendment Act, 2022 (BoBAA) will give the BoB power to provide liquidity assistance to banks and set up a deposit insurance scheme; (2) the Draft *Revised* Banking Act (DRBA), which will, *inter alia*, establish a special bank resolution regime including expanded resolution powers is at an advanced stage; and (3) the draft Deposit Insurance Scheme of Botswana Regulation (DISBR)<sup>4</sup> is almost complete, and aims to establish a narrow mandate “paybox plus” the Deposit Insurance Scheme of Botswana (DISB).<sup>5</sup> At the same time, further improvements appear warranted in each of these legal instruments as described subsequently in this FSAP TN.

**Advancing the reforms for operationalizing safety nets and implementing an effective crisis management and resolution framework are achievable in case the BoBAA, the DRBA, and the DISB are aligned with good practices.** The BoB should seek to address relevant deficiencies in relation to the preemption in bankruptcy matters in the DRBA. In tandem, the new bank Resolution Unit (RU), working with the bank supervisors should develop policies, procedures and manuals for bank intervention and resolution. Additionally, implementing an effective DISB should be created by law in order to ensure stability and legal certainty.

**The authorities should prioritize operationalization of the “sale of assets and transfer of liabilities,” better known as a Purchase and Assumption (P&A) transaction.** A P&A transaction should be considered the preferred resolution tool for non-systemic banks. A P&A transaction entails insured deposits and certain good assets being transferred to a healthy bank. When there are

<sup>1</sup> This Technical Note (TN) was prepared by David Parker (MCM, External Expert). The FSAP mission would like to thank the authorities for their full cooperation towards the completion on this assessment.

<sup>2</sup> The FSAP review commenced in May 2022 and referenced the laws and regulations, namely, the Banking Act (BA), 1995, and the Bank of Botswana Act (BoBA), 1996 which were in force in January 2023 at the time of the assessment. The Bank of Botswana Amendment Act (BoBAA), 2022, was passed by the Parliament in August 2022 and its effective date is February 2023. The Banking Act, 2023 was published via the Botswana Government Gazette on January 13, 2023.

<sup>3</sup> “Banking Sector Safety Net and Crisis Management”, IMF TA Report, February 2017.

<sup>4</sup> The mission has recommended that the Deposit Insurance Scheme of Botswana be created via law in order to enhance stability and legal certainty.

<sup>5</sup> Additional observations on the DRBA and DISBR, specifically related to financial safety nets, crisis preparedness and management are outlined in appendices.

insufficient good assets to cover insured deposits, the contemplated DISB would advance funds to balance the transaction. The other assets and liabilities remain in the liquidation estate of the failed bank. The P&A is typically less costly than direct payout in a liquidation and causes much less disruption to depositor services. BoB should prepare operational manuals and procedures to timely enact such resolution measures. Recovery plan requirements for all banks and resolution plans for, at least, systemic banks should be implemented. Importantly, expanding supervisory MOUs with all home countries that include alternative options of bank resolution would be appropriate given the dominance of foreign-owned banks in Botswana.

**Implementing a suitable law for the DISB and preparing the action plan for its operationalization, including clear funding arrangements through bank contributions and a public backstop, are needed.** Importantly, the operational independence of the DISB should be assured by establishing a separate and independent unit that reports directly to the BoB Board, with the Board overseeing the fund's activities and ensuring that resources are used as prescribed in a future DISB law.

**Once the BoBAA is effective the BoB needs to develop the policies and procedures for the ELA framework.** ELA should be reserved as a funding source of last resort for solvent but temporarily illiquid banks that are adequately regulated by the BoB. Solvency assessments should be forward-looking accompanied by anticipated funding plan; with the BoB having a sufficiently wide range of eligible collateral with a suitable risk management framework. The framework could benefit from clarifying that ELA should be subject to a penalty interest—i.e., higher than the policy rate or the prevailing market interest rate. Additional recommendations from the 2007 FSAP and past IMF technical assistance remain relevant.

**Developing these safety nets that characterize good international practices in the financial regulatory architecture will require the Financial Stability Council (FSC) to prioritize work over the near- to medium-term.** The FSC is uniquely positioned to engage in crisis preparedness and management activities and should develop an effective and comprehensive implementation framework, including for communicating on these activities. The responsibilities of the FSC will likely cascade to the technical working groups, comprising the supervisors, financial stability staff and for the deposit insurance.

**The FSC should be expanded to include a crisis preparedness and management mandate which is in line with its statutory responsibilities outlined in the BoBAA.** The FSC would oversee high-level monitoring of the financial system, analyzing the risks affecting the system, and discussing the appropriate policies to mitigate those risks. The FSC is not a decision-making body but builds on each authority's statutory duties. FSC's current MOU calls for semi-annual meetings; however, it would be more effective with regular quarterly meetings, while technical level working groups would meet more frequently. Crisis simulations should be conducted regularly, and an *ex-ante* communications framework established.

**The FSC should also formally introduce system-wide crisis management protocols to plan and implement solutions in the event of a crisis.** No effective underlying framework currently exists. However, the DRBA, after further amendment to align with good practices, will help improve the bank resolution framework, by providing a broad menu of resolution measures. The authorities should stand ready to provide financial assistance in a crisis situation subject to robust safeguards and conditions, including, *inter alia*, that shareholders take the first loss, management is changed, compensation limits, no dividends and an exit strategy. The Ministry of Finance should also be enabled to exercise extraordinary powers in a crisis situation, including guaranteeing uninsured depositors.

**Table 1. Botswana: Key Recommendations**

	<b>Recommendations</b>	<b>Timeline<sup>1/</sup></b>	<b>Initiative or Responsible Party</b>
<b>Enhancing Financial Safety Nets</b>			
1.	Implement remaining recommendations from the February 2017 Technical Assistance Report on Banking Sector Safety Net and Crisis Management (see Appendix I); including making further amendments to align the DRBA with good international practices and establishing the DISB by standalone legislation [¶15, ¶25]	I	FSC: (BoB, MoF, NBFIRA, FIA and DISB)
2.	Ensure that DRBA supersedes other laws, particularly the Companies Act and Insolvency Act. [¶17]	ST	BoB
3.	Prepare early intervention, resolution and liquidation plans for any CAMELS 4- and 5-rated banks, as well as banks, that show no improvement in their situation (CAMELS 3-rated banks). [¶11]	ST	BoB
4.	Develop comprehensive (i) bank intervention manuals; (ii) bank resolution manuals; (iii) detailed instructions including conservative operating procedures for bridge bank managers; and (iv) wide-ranging and thorough directions for liquidators. [¶18]	MT	BoB
5.	Develop Resolution Plans for systemic banks and foreign bank subsidiaries in Botswana. [¶19]	ST	BoB
6.	Develop an ELA framework for an expansion of acceptable collateral (with appropriate haircuts), other appropriate safeguards, and guarantees from the government if needed in systemic circumstances (once the BoBAA comes into force). [¶20-24]	ST	BoB
7.	Ensure that DRBA and DISR are harmonized to establish license revocation as the trigger for insured deposit repayment, in accordance with the DISB law. [¶26]	ST	BoB
8.	Ensure that DRBA and DISR stipulate that insured depositor repayments be automatic, based on the failed bank's records and in accordance with the DISB law. [¶26]	ST	BoB
9.	Develop a simulation program for non-systemic bank resolutions. [¶29]	MT	BoB, DISB
<b>Crisis Preparedness</b>			
10.	Prepare ex ante, a "one-voice" method of effective communication with the public, whereby all spokespersons would use the same set of agreed upon facts and assumptions. [¶29]	ST	FSC: (BoB, MoF, NBFIRA, FIA and DISB)

**Table 1. Botswana: Key Recommendations (concluded)**

	<b>Recommendations</b>	<b>Timeline<sup>1/</sup></b>	<b>Initiative or Responsible Party</b>
11.	Enhance crisis preparedness and management regime by enabling the FSC to engage in simulations that inform crisis management procedures, and develop manuals and checklists for crisis management. [¶32, ¶34]	MT	FSC: (BoB, MoF, NBFIRA, FIA and DISB)
12.	Expand extant supervisory MOUs or develop resolution MOUs to include cooperation regarding recovery and resolution issues and ask home authorities for foreign banks' recovery and resolution plans to determine if they are acceptable for treatment of the local subsidiaries. [¶36]	MT	BoB
13.	Seek letters from parent banks committing to provide sufficient liquidity and capital to the local subsidiaries to meet potential risks. [¶37]	ST	BoB
14.	Conduct periodic and comprehensive simulations to ensure that liquidity assistance can be mobilized in a timely manner. [¶39]	MT	BoB
<b>Crisis Management</b>			
15.	Consider the use of supervisors onsite at problem banks, with clear terms of reference, to prevent asset-stripping, document destruction and to gather information for the RA. [¶11]	ST	BoB
16.	Require all banks to prepare comprehensive Recovery Plans, updated annually, respecting proportionality. [¶13]	MT	BoB
17.	Plan for the possible need of extraordinary resolution and guarantee powers with strong safeguards for a systemic risk. [¶43]	MT	FSC: (BoB, MoF, NBFIRA, FIA, and DISB)
<sup>1/</sup> I: Immediately=within 6 months; ST: short term= less than 1 year; MT: medium term= 1–5 years			

## INTRODUCTION

1. **The banking sector of Botswana is concentrated, and relatively small.** It consists of nine commercial banks and two state-owned “statutory banks” (specially chartered banks), and one building society. Two commercial banks account for 46 percent of the banking sector assets and have been designated Domestic Systemically Important Banks (D-SIB). The eight commercial banks are foreign owned as direct subsidiaries of United Kingdom, South Africa, Namibia, Malawi, and India. Nonperforming loans (NPL) are relatively low and stable in comparison to pre-pandemic levels. NPLs to total loans were 3.7 percent as of June 2022 compared with 4.3 percent in 2020.
2. **The NBFi sector (including insurance companies, and retirement funds) is growing fast and raises financial stability concerns.** The NBFi sector reflects an assets concentration in retirement funds at 43 percent of the sector. Interconnectedness between banks and NBFIs can pose a contagion risk. NBFIs hold nearly 20 percent of the deposits funding the banking system and also have other investments in bank bonds and equities.
3. **An efficient financial safety net (FSN) can help mitigate the risk of severe financial crises by preventing smaller financial sector problems (e.g., failure of a non-systemic bank) from snowballing into a crisis situation.** Effective crisis management preparation, including through the establishment of procedures and policies can help mitigate the consequences of financial crises when they occur. The FSN covers emergency liquidity assistance<sup>6</sup> (ELA), early intervention, bank resolution, deposit insurance systems (DIS), and liquidation. Crisis preparedness and management involves planning and preparation activities for facing system-wide financial crisis, including preparing effective communication strategies *ex ante* (Box 3), cooperation and coordination arrangements, both among domestic authorities and with foreign authorities, when cross-border activities are significant.
4. **The BoB plays a key role in the contingency framework for crisis preparedness and management as the prudential supervisor and future resolution authority.** The FSC provides a forum for the involvement of the Ministry of Finance (MOF) with BoB<sup>7</sup> regarding information sharing and cooperation for crisis preparedness and management. Deposit protection will be provided once the draft DISBR comes into effect.
5. **Botswana needs to improve its financial safety net to provide an effective lender of last resort process, introduce a deposit insurance system, develop effective operational policies and procedures to accompany the legislative framework for bank resolution, and establish crisis preparedness and management protocols.** These improvements should be underpinned by a sound legal framework for bank resolution that is aligned with good practices and

<sup>6</sup> Also referred to as Lender of Last Resort facilities (LOLR).

<sup>7</sup> Other agencies including NBFIRA, FIA and the soon to be created DISB are FSC members; however, experience has shown that the central bank and ministry of finance are the major players in resolving a systemic crisis.

the FSAP's recommendations. In addition, effective bank supervision needs to include progressive enforcement measures and allowances for early intervention before a bank's capital is depleted.

**6. An IMF Technical Assistance (TA) report<sup>8</sup> on Banking Sector Safety Net and Crisis Management identified many deficiencies in the FSN and Crisis Management areas.** Relatively few of the recommendations have been fulfilled and remain valid (Appendix I). The pending Bank of Botswana Amendment Act 2022 (BoBAA)<sup>9</sup> and Draft *Revised* Banking Act (DRBA) will fulfill many of the previous IMF TA recommendations. However, there are remaining deficiencies in the DRBA that do not represent good international practices as noted throughout the text of this Technical Note (TN) and summarized in Appendix II. This TN will not repeat the analysis, discussion, and recommendations of the 2017 IMF TA report, but rather builds on those recommendations in order to improve the FSN and Crisis Preparedness and Management practices.

**7. The bank resolution and crisis management framework has seen some improvements, including creation of the FSC, and will be furthered with passage of the BoBAA and the DRBA.** For example, bank resolution under the current 1995 Banking Act (BA), is court based, which is slow, unwieldy and risks financial instability when prompt resolution actions cannot be taken. The DRBA, will establish bank resolution as an administrative function under the BoB, providing for irreversible resolution actions, enabling swift and irreversible resolution actions.<sup>10</sup> With the creation of the contemplated DISBR, and along with DRBA, the authorities would be poised to be able to conduct a swift non-systemic bank resolution action (license revocation and closing) and promptly repay insured depositors, mitigating potential contagion and deposit runs. The DRBA should supersede all other legislation in relation to bank intervention and resolution, particularly the Companies Act and Insolvency Act. Nevertheless, the latter instruments may be supplementary to the DRBA to ensure there are no gaps in the legal framework, provided that there are sound provisions on resolving conflicts among these laws.

**8. Despite progress to date, the authorities need to ensure that the draft BoBAA and DRBA and DISBR are revised for greater alignment with good international standards and practices.** Accordingly, the resolution regime and the deposit insurance scheme were evaluated against the standards of the Financial Stability Board's (FSB), viz, Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs), and the International Association of Deposit Insurers' (IADI), Revised Core Principles for Effective Deposit Insurance Systems (DICPs), respectively.

**9. The rest of this TN is organized as follows:** Section II discusses the FSN including Early Intervention, Recovery and Resolution, Emergency Liquidity Assistance and Deposit Insurance. Section III covers Crisis Preparedness and Management.

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<sup>8</sup> IMF Technical Assistance Report, February 2017

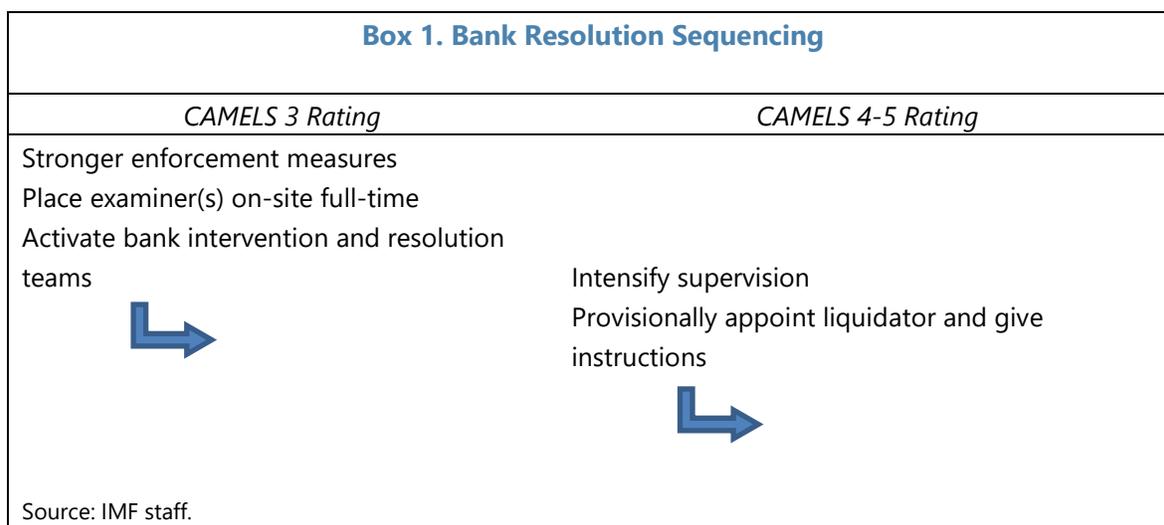
<sup>9</sup> While the BoBAA was passed by the National Assembly in November 2022, its effective date is February 2023.

<sup>10</sup> Aggrieved parties still have due process; however, any successful challenge would be subject to monetary compensation and not reversal of the resolution action.

## FINANCIAL SAFETY NET

### A. Early Intervention and Recovery Planning

**10. BoB currently lacks an effective early intervention regime, but its powers will be significantly improved with passage of DRBA once it is further aligned with good practices.** An effective program of corrective measures should include early intervention ability based on quantitative (mandatory) triggers with qualitative (and inherently more judgmental) elements to guide early intervention measures for problem financial institutions, which would enable BoB to take over a bank before balance sheet capital falls to zero. The best corrective action is the measure that accomplishes the bank's improvement with the least intrusion. BoB should closely monitor Capital adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity to market risk (CAMELS or BoB equivalent) particularly for banks rated 4 and 5, as well as banks that show no improvement in their situation. Such intense scrutiny would be expected to result in imposing credible, time-bound plans to correct outstanding deficiencies, along with a clear message citing the BoB enforcement actions that will be taken if problem banks do not improve their condition and operations.



**11. Should a bank linger in problem status, BoB should intensify its monitoring and supervision, including placing examiner(s) onsite full time with appropriate terms of references within the ambit of supervision and oversight.** The onsite examiner(s) ought not to assume management responsibilities, as this could create moral hazard risks. But they can help in fulfilling key roles, such as: (i) limiting asset stripping by monitoring insider and related parties, and other large transactions; (ii) preventing document destruction; and (iii) gathering and providing information for the RU (e.g., about questionable transactions) which should be making advance preparations (including setting out intervention and resolution plans for any CAMELS 4- and 5-rated banks, as well as banks, that show no improvement in their situation viz, CAMELS 3-rated banks). Such mitigation measures will have a direct impact on reducing resolution costs, coupled with advanced preparation to effectively conduct bank intervention and resolution.

**12. BoB should undertake resolvability assessments of all D-SIBs and NBFIRA should do the same for D-SIFIs.** These assessments are intended to identify how BoB would resolve a particular financial institution cost-effectively. Resolvability assessments should be reviewed regularly and updated to ensure that they remain current. The resolvability assessment should identify the resolution options for each of the financial institutions on the basis of achieving a least-cost resolution that meets the objective of maintaining financial system stability and protecting depositors. The framework for undertaking resolvability assessments should have close regard to the guidance provided in the KAs and published by the FSB.

**13. BoB should require recovery plans for all banks, based on proportionality.** The KA recommend that banks prepare recovery plans and for resolution authorities to prepare resolution plans. Recovery plans are essentially contingency plans, prepared by banks, that demonstrate their ability to maintain and continue profitable operations during stressful times or sudden shocks BoB should require all financial institutions to prepare recovery plans, based on proportionality, detailing their responses to recover from financial stocks, such as illiquidity and asset quality deterioration. The BoB could prescribe the main scenarios on which the plans are to be based, such as the assumed level of capital depletion, liquidity stress, and extent of parent support (if any). BoB should assess what actions they may need to take to assist the banks in their recovery actions and consider the nature of coordination required between BoB and the home supervisory authorities for the foreign banks, particularly as with regards to parent bank support. Recovery plans should be approved by the board of directors of the bank, to ensure ownership. The Recovery Plans should be reviewed by the Prudential Authority and Payments Oversight Department, BoB, for efficacy and approval, and updated annually (see Appendix V for an example outline of a Bank Recovery Plan).

**14. The current Banking Act (BA) provides for Temporary Management (TM) by an appointee of BoB and appears to be a mandatory step towards resolution (Article 33).** As the BA requires publication of this action (Article 33(2)), placing a bank under TM can threaten financial stability and increase the risk of deposit runs, not only at the bank put into TM, but also at any or all banks in the sector. Clearly, this tool should be used very judiciously and not in every resolution scenario. The DRBA has a similar, but greatly expanded tool of Official Administration (OA). Given adequate advance preparation, it would be preferable to resolve a bank without putting it into TM. TM is a valuable tool and can be useful delaying tactic. However, in cases where it may be necessary to take over a bank immediately, e.g., when fraudulent or other criminal activities are discovered, it would be prudent to have a list of possible managers ready for probable future assignments on short notice (with contacts and resumes on hand).<sup>11</sup>

## B. Resolution Framework

**15. The DRBA designates the BoB as Resolution Authority (RA) and establishes a special resolution regime enabling irreversible resolution actions without court involvement; however, there remain deficiencies in meeting good international standards and practices.** The

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<sup>11</sup> This list can be essentially the same as required for potential bank managers for government-owned bridge or nationalized banks.

DRBA also expands the resolution tools available to BoB to use in situations involving failing banks, including, including, Official administration, sale of assets and liabilities—also known as a Purchase and Assumption (P&A) transaction—bridge banks, bail-in and asset management companies (which have a mixed track record in other countries). The BoB should consider that most of the expanded tools are relevant only to systemic banks, with the P&A or liquidation being the appropriate tools for non-systemic banks. In addition, the DBRA should be further strengthened to align it with good international practice including to:

- Allow for the implementation of resolution measures without shareholders' consent and without requiring the prior appointment of an official administrator.
- Ensure that a bridge bank is wholly or partially owned by one or more government institution, without any residual ownership by the original shareholders, and establish clear rules for its prudential treatment.
- Strengthen the provisions governing resolution triggers (including to define non viability) and amend the resolution objectives (including to drop the protection of shareholders and uninsured creditors).
- Allow flexibility to depart from pari-passu treatment of creditors of the same class when applying resolution powers and strengthen the provisions pertaining to early termination rights.

**16. An ex-post funding mechanism could be introduced to cover for resolution costs outside of DISB's paybox plus mandate and to ensure that taxpayers do not have to pay for the costs of a bank resolution.** Such mechanism would be consistent with the Key Attributes. An ex-post resolution fund would enable the authorities to allocate public funds to resolution and trigger a mechanism to recover those funds from the banks at a later stage. For this approach to work, a few conditions must be met. First, a procedure to determine that failing financial institutions are systemic, and that temporary public funds are needed to preserve financial stability, would have to be established in advance. Second, the mechanism to ensure that public funding becomes available at short notice also would have to be established. And third, there would have to be a legal mechanism linking the temporary support from the authorities to the recoveries from the firms' stakeholders and creditors and, if necessary, from the wider banking complete industry via levies (KA 6.2), phased in as appropriate to mitigate procyclicality. In all cases, the appropriate authority to provide the temporary public funding would be the government, not BOB.

**17. As RA, the BoB should establish a Resolutions Unit (RU) that is outside of the Bank Supervision Department (BSD), and which will also draft resolution plans for individual banks.** This unit should develop intervention and resolution manuals to guide the process of resolving a failing bank.<sup>12</sup> BoB should prepare resolution plans for all D-SIBs and request information about group resolution plans from home regulators pertaining the subsidiaries in Botswana. Once

<sup>12</sup> In the case of non-systemic banks, intervention is the act of physically taking over a bank, while resolution represents the decisive action to resolve a problem bank situation.

established, during normal times, the RU would have very few staff. In the case of a deteriorating weak bank, however, the RU should be authorized to activate resolution staff from various other BoB departments (especially from BSD), in order to efficiently accomplish the goals of a prompt and efficient resolution. In cases where a bank appears likely to fail, BoB should formally appoint a Resolution Manager to advance preparations as soon as there is the expectation that a bank may fail.<sup>13</sup> The BoB should also provisionally appoint a liquidator, preferably from its staff.<sup>14</sup>

**18. Moreover, the Resolution Unit (with input from the Supervision Department) to develop operational intervention and resolution manuals, as well as instructions for official administrators or bridge-bank managers, and directions for liquidators.**<sup>15</sup> The operational intervention and resolution manuals, checklists, policies, and procedures can be bifurcated between systemic and non-systemic banks. For non-systemic banks, BoB, as RA, should focus on the P&A as the most effective resolution tool. Less preferable is an Insured Deposit Transfer (IDT) to an acquiring bank, with a fallback to straight liquidation and direct payment of insured depositors should a P&A or IDT prove impossible. The authorities should commit to engaging in intervention and resolution simulations (including the DISB, once established) to ensure adequate preparation for their mandate in resolution.

**19. BoB should develop resolution plans for all systemic banks.** Resolution plans should be based on the resolvability assessments undertaken by BoB and provide a roadmap for the orderly wind-down of weak systemic banks based on the main resolution strategies and options identified by BoB. Resolution plans should include, *inter alia*: (i) detailed information of the institution's business lines and information on its corporate organization; (ii) information regarding its ownership structure; (iii) comprehensive accounting of the assets, liabilities, and contractual obligations of the institution; (iv) indication of where critical functions—such as information technology or treasury functions—are conducted, and so forth. BoB should identify potential resolution strategies and assess the necessary preconditions, funding needs and operational requirements for their implementation in the case of each SIB, including with regard to arrangements for cross-border coordination. Again, the Key Attributes provide helpful guidance in this area. Resolution plans should be revised and updated at least annually, and more often if there are significant changes in the institution.

## C. Emergency Liquidity Assistance

**20. The pending Bank of Botswana Amendment Act 2022 (BoBAA) provides a general framework for extension of ELA, overcoming the significant gap that existed under the**

<sup>13</sup> Based on the size and complexity of the bank under consideration for resolution, one person may fill both positions.

<sup>14</sup> Using BoB staff as liquidators, and guaranteeing their jobs back once liquidation is completed, will prove to be a strong mitigant to the perverse incentive that liquidators face—that of working themselves out of a job.

<sup>15</sup> Chapters 3, 5, 4, 6, and 7, respectively, of Parker, David C., 2010, "Closing a Failed Bank: Resolution Practices and Procedures," (International Monetary Fund, Washington, DC), provide examples of templates for creating these manuals.

**current Bank of Botswana Act (BoBA).** The power to administer ELA support to banks in need of liquidity can help mitigate the risk that temporary liquidity pressures in one or more institutions spreads across the banking sector, threatening financial instability. Article 38A(1)(i) BoBAA states that BoB can provide liquidity assistance to banks that BoB determines are solvent and secured by adequate collateral. Banks must prepare a business plan specifying the measures that it will take to resolve liquidity problems. The BoBAA also provides for government guarantees<sup>16</sup> for liquidity assistance provided that this is determined as necessary to preserve financial stability.

**21. The ELA provisions are discretionary and should be reinforced by an implementing regulation which provides for policies and procedures to enable prompt access to ELA.** A well-functioning framework should enable the central bank to assess the forward-looking solvency and viability of a bank applying for ELA. Further, the implementing regulation should specify a maximum time limit; slightly punitive interest rate (e.g., above the standing facility rate); and an itemized list of acceptable collateral, along with conservative haircuts based on asset risk. For example, if the applicant bank lacks high quality collateral such as government securities or corporate bonds, the BoB may want to consider accepting a pool of low risk performing loans (e.g., mortgage or consumer loans). Such an expanded collateral pool must carry extremely conservative haircuts to fully protect BoB's financial outlay. Banks should be able to pre-position loan pools to offer such as collateral for ELA (e.g., segregated promissory notes that can be secured under BoB's control or some other transfer of the eligible collateral that is legally and operationally feasible). BoB should ensure risk equivalence when determining the haircuts for riskier assets, including having adequate and up-to-date market-, credit- and liquidity risk information on the additional collateral to be able determine the haircuts that ensure risk equivalence).

**22. Any liquidity provision should be accompanied by intensified supervision and corrective measures, especially including high frequency liquidity flow reporting.** The BoB must be prepared to discharge more intrusive supervision and regulation of ELA recipients, as failure to abide by their restorative business plan or becoming insolvent would be grounds for actions to resolve the institution. Moreover, BoB should conduct periodic and comprehensive simulations also under the involvement of banks to ensure that liquidity assistance can be mobilized in a timely manner.

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<sup>16</sup> The government guarantee as presented, suggests a general guarantee that is not specific to the institution's status.

### Box 2. ELA for Non-Bank Financial Institutions

The Non-bank Financial Regulatory Authority (NBFIRA) is the regulator of NBFIs, including insurance companies, retirement funds, capital markets and non-bank lending (micro lenders, finance companies, leasing companies and pawnshops). NBFIRA has designated three entities under their supervision as Non-Bank Systemically Important Financial Institutions (NB-SIFI). Because distress in one or more of these NB-SIFIs could pose threats to financial stability due to liquidity needs, the newly formed Financial Stability Council (FSC) Secretariat has developed a policy paper regarding ELA for NBFIs.

Legally, there are no provisions for liquidity assistance under the current BoBA and the BoBAA contemplates ELA only for banks. In general, central banks should not provide ELA to NBFIs, but only to the financial institutions under their regulation. Moreover, there is currently no legal basis for the BoB to provide ELA to NBFIs.

As a member of the nascent FSC, the NBFIRA should provide information regarding the entities under their remit, especially including SIFIs and any problem institutions. ELA for NBFIs would not be considered part of the FSN; but could pose a significant challenge from a crisis perspective. If problems occur at one or more of the NB-SIFIs, the NBFIRA would be expected to call an emergency meeting of the FSC, with the intent to mobilize whatever, presumably *ad hoc*, measure had previously been decided. Importantly, the authorities should ensure that robust regulation and supervision exist as these are the first line of defense to address and mitigate the systemic risks from NBFIs.<sup>1</sup>

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Sources: IMF staff, NBFIRA and BoB.

<sup>1</sup> See 'Nonbank Financial Intermediaries: Vulnerabilities Amid Tighter Financial Conditions', IMF, 2023, *Global Financial Stability Report: Safeguarding Financial Stability amid High Inflation and Geopolitical Risks*. Washington, DC, April.

**23. Arrangements for provision of ELA must address transparency and governance.** The governance framework of the ELA should safeguard the central bank's institutional independence and accountability. The transparency policy should be designed so that ex-ante communication of the ELA conditions facilitates eligible institutions preparedness and prevents stigma to the extent possible. Ex-post transparency should be arranged with adequate delay and appropriate granularity so that neither the central bank's credibility nor the ELA recipient's stability is jeopardized. Moreover, a well-functioning ELA framework should enable the central bank to assess the forward-looking solvency and viability of an institution applying for ELA.

**24. The issue of ELA for a bank in resolution needs to be addressed.** A central bank should be able to provide liquidity, subject to safeguards, to an institution, which is considered systemic and viable and whose solvency concerns will be resolved with certainty in the context of a realistic, time-bound resolution plan. The resolution and/or supervisory authority should make a positive determination of viability. It should then be up to the central bank to decide on liquidity provision, which should be backed by an indemnity from the government. In a resolution, it cannot be ruled out—and should be reflected in the resolution scheme as necessary—that, notably, bailed-in entities may need significant liquidity to preserve confidence in the immediate aftermath of a crisis.

## D. Deposit Insurance

**25. There is currently no deposit insurance system in Botswana, but its inception is imminent.** BoB plans to issue a DISBR, but in the interests of stability and legal certainty, the DISB should be established by a standalone law to set strong legal basis for: its mandate; governance; membership; resources and the use of funds; accountability; and transparency; among other things. At the moment, the BoBAA only includes a broad enabling clause for the establishment of the DISB, instead of defining its key aspects in the law.

**26. Although the DISBR may contain elements in line with international best practices, the DISBR should be harmonized with the DRBA and key deficiencies in the DISBR addressed prior to introduction of deposit insurance.** The deficiencies include: (i) lack of specific designation of license revocation as trigger for insured depositor repayment; (ii) a provision for the DISB to backstop a voluntary liquidation; (iii) the lack of a specific target reserve fund ratio, specific designation of periodic premium amount; and (iv) the explicit allowance that the DISB can support the transfer of deposits, as agreed with the resolution authority, to a stronger bank via a P&A or IDT which will represent fulfilment of the DISB's duty to reimburse depositors by making them available at a stronger bank. Moreover, Article 7 of the DISBR provides for borrowing from BoB, which may be appropriate assistance to the DISB (at set-up) as it becomes established. However, any emergency funding, to finance the repayment of insured deposits, should come from the MOF (via a pre-approved line of credit) since that represents a fiscal responsibility and not a monetary policy function.

**27. The contemplated DISB calls for a narrow mandate (“paybox plus”), ex ante funded DISB, contained within BoB, but with separate operations, funding, and accounting.** The size and composition of Botswana's banking sector support this institutional set up. The DISR contemplates a separate Deposit Insurance Committee to oversee the DISB. While the DISB could, in principle, report to the BoB Board, it is important that its operational independence be maintained. This independence should be assured by establishing direct reporting to the BoB Board, with the Board overseeing the fund's activities and ensuring that resources are used as prescribed in a DISB law. In accordance with the IADI Core Principles for Effective Deposit Insurance Systems, the pending regulation provides for compulsory membership for all banks; limited coverage to protect small, financially unsophisticated depositors; and periodic premiums to build a target reserve fund<sup>17</sup> determined by, *inter alia*, coverage levels, impact on the banking sector, and other transparent criteria.

**28. The regulation contemplates a coverage level of P250,000 per depositor per bank.** Calculation of this coverage level was based on per capita income which does not always provide a consistent basis for determining coverage level. An analysis of deposit distribution supports this coverage level as it fully covers roughly 84 percent of depositors but only around 14 percent of the

<sup>17</sup> The regulation also contemplates “seed” funding from the government of BoB.

value of system-wide deposits (Table 2). At this level, DISB meets the primary objective to fully cover a great number of depositors at a relatively small value of deposits amount.

**Table 2. Botswana: Deposit Distribution Survey**

What if Deposit Insurance Coverage was (amounts in Pula)?	CUMULATIVE Report the total amount of deposits up to and including this level (Pula)	Report the total number of depositors fully covered at this level	CUMULATIVE Report the total number of depositors fully covered at this level	Report the percentage of fully covered depositors (USING CUMULATIVE) (Column D as a percentage of total number of depositors in the bank)	Report the number of depositors whose total deposits exceed this level (total depositors less column D)	Report the percentage of the amount of deposits covered at this level to total deposits at the bank (column C as a percentage of the total amount of deposits in the bank)
100,000	6,941,611,371.00	1,887,650	1,887,650	83%	376,187	8%
150,000	8,629,200,854.80	16,354	1,904,004	84%	359,833	2%
200,000	10,074,645,673.28	10,841	1,914,845	85%	348,992	2%
250,000	11,418,734,210.15	8,731	1,923,576	85%	340,261	2%
300,000	12,636,903,703.47	7,443	1,931,019	85%	332,818	1%
350,000	13,931,032,328.51	7,064	1,938,083	86%	325,754	2%
400,000	15,144,671,467.72	6,503	1,944,586	86%	319,251	1%
500,000	17,568,714,636.07	8,111	1,952,697	86%	311,140	3%
>500,000	50,533,301,899.43	311,140	1,626,124	100%	-	79%
<b>Total and &gt; 500,000</b>		<b>2,263,837</b>				<b>100%</b>

Source: IMF analysis of BoB data.

**29. Once established, BoB and DISB staff should conduct non-systemic bank resolution simulations.** Simulations should include BoB's bank supervision departments and include training on bank intervention and resolution. Such training and simulations on best practices for intervention and resolution, including the use of the Purchase and Assumption (P&A) methodology, will better prepare staff to implement operating policies and procedures to avoid suspending bank operations and ensure continued access to deposits. DISB will also need to prepare for a payout as a backup option if a P&A is not feasible. A communications program should be developed to address proper communication methods and tools in the event of a bank failure (Box 3), as well as a public awareness policy for DISB covering basic information about deposit insurance (e.g., *inter alia*, level of coverage, which instruments are covered, and which are not, etc.).

### Box 3. Communications in Bank Resolution, Crisis Preparedness and Management

Advance preparation for effective communications during bank resolution, crisis preparedness, and management is paramount. Whenever a non-systemic bank is subject to resolution or a crisis appears imminent, they should plan to deliver statements to the media, providing information in a constructive manner to reassure the public. The authorities should plan on a “one-voice” method of communication with the public, whereby all political leaders and government officials are using the same facts and assumptions.<sup>1/</sup> The authorities should be ready to deliver statements that seek to reassure the public. All media channels to be utilized (e.g., press releases, television and radio announcements, social media, and web-based platforms), to provide answers to frequently asked questions (FAQs).

For non-systemic bank resolution, basic information to be provided to the public includes: when, where and how insured depositors will be repaid and what information a depositor must provide to claim his/her deposit. In situations of a P&A the communication should stress that depositors’ funds are available via transfer to a stronger bank. Any communications (e.g., press releases, FAQs, etc.) by the acquiring bank must be reviewed and approved by BoB communications department to avoid false or misleading information that may confuse the public.

Talking points, FAQs and other important information or appropriate links should be made available on applicable websites (e.g., BoB, DISB, MOF and the failed bank’s). Draft press releases and FAQs can be prepared well in advance. Public statements should have talking points that describe measures taken with a positive spin and emphasize that the authorities have acted in the best interest of depositors and to restore banking system stability.

To forestall any ambiguity and misunderstanding, all communication should be provided in simple terms, clearly noting the solutions for the problems identified. Building effectual relationships and trust with the media representatives that cover the financial system in normal times can boost the positive treatment in crisis times. The aim is to convey an accurate, honest, and prompt message that the authorities have taken strong action that will fortify the banking sector in due course.

Notwithstanding the complexity a crisis situation poses compared to a non-systemic bank resolution, the authorities should still prepare draft press releases and FAQs in advance, taking into account different types of problems and solutions. As soon as a crisis appears unavoidable, the authorities should plan to deliver a “one voice” media statement providing information in a constructive manner to reassure the public and contain the crisis.

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<sup>1/</sup> Additional principles for effective crisis communication include: (i) do not communicate problems without solutions, (ii) deliver bad news in clear definitive on-alarmist terms, (iii) do not over promise. “Managing Systemic Banking Crisis: New Lessons and Lessons Relearned”, IMF, 2020.

Source: IMF staff.

## CRISIS PREPAREDNESS

### A. Effective Coordination through the FSC

**30. There is no universal blueprint or “one size fits all” approach to crisis preparedness and management.** Strategies need to fit legal and institutional framework and the nature of systemic vulnerabilities. Contingency planning is not primarily a set of documents and instructions

but rather a living, comprehensive framework consisting of up-to-date laws, rules, processes, and organizational structures; and skilled, prepared, and informed people. Effective crisis preparedness begins with establishment of a high-level crisis management committee, to include, inter alia, the Governor and the Minister of Finance.

**31. The FSC—established by a Memorandum of Understanding (MOU) in February 2019 and designated a statutory Committee under BoBAA—should be expanded to include crisis preparedness and management responsibilities.** This can be achieved within the legal responsibilities outlined in BoBAA, which would allow the FSC to oversee high-level monitoring of the financial system, analyze the risks affecting the system relying on the advice of the primary regulators, and discuss the appropriate and coordinated policies to mitigate those risks. This entity is not a decision-making body but facilitates information sharing, and relies on each authority's statutory responsibilities to develop a coordinated response in the event of a crisis. Terms of References should be considered to augment the MOU and elaborate on the role of each entity in crisis management; setting out the scope of work for respective resolution agencies and specific parameters of information sharing. The FSC's existing MOU calls for semi-annual meetings. It would be more effective, however, to hold quarterly meetings with technical level working groups meeting more frequently.

**32. The enabling conditions for the broadened MOUs should define respective responsibilities of FSC members in responding to a banking crisis, particularly in the case of systemic bank crisis situations.** The FSC should start work to develop the key aspects including:

- Institutional arrangements for domestic and international coordination and crisis preparedness and management;
- The crisis management options available to address a range of systemic bank distress situations;
- Discussing methods for resolution and funding;
- Crisis communication during and after a crisis; and
- Crisis simulations that will test the capacity to respond to severe shock and identify gaps in preparedness.

**33. In times of crisis, the FSC would review the system's diagnostics made by the primary technical units, agree on the basic measures to be adopted, and oversee and coordinate the execution of those measures.** The FSC must address the respective agencies' responsibilities for, and cooperation and coordination in relation to:

- The assessment of the systemic and wider economic impact of a bank in distress (BoB);
- The assessment of the bank's financial position, including its capital position, solvency, and liquidity (based on input from the BoB's supervision department);

- The options for resolution, assuming that recovery is not feasible, and the assessment of each option (based on BoB's Resolution Unit);
- The matters on which each agency should coordinate with their respective foreign counterparts, where applicable;
- The possible need for government financial support; and
- The key stakeholders with whom each agency should take responsibility for communicating, and the coordination thereof.

<b>Box 4. Central Bank and MoF Roles in the FSC</b>	
<b>BoB</b>	<b>MoF</b>
<ul style="list-style-type: none"> <li>• Define and execute a policy for financial stability</li> <li>• Ensures access to secure payments, clearing, and securities settlement systems; including ensuring ready availability of cash</li> <li>• Notify the FSC in case a financial institution may need solvency support</li> <li>• Develop frameworks for the early identification of crises</li> <li>• Bank structure (ownership, legal entity form)</li> <li>• Banks' FSIs and CAMELS ratings</li> <li>• Trends and forecasts on banks' loans, liquid assets, deposits, profitability, and capital (in amounts and percent of GDP)</li> <li>• Banks' costs of funding</li> <li>• Banks' stress test results (e.g., potential liquidity and capital needs)</li> <li>• List of Systemically Important Financial Institutions (SIFIs); [NBFIRA, being the non-bank regulator, should provide a list of D-SIFIs]</li> <li>• Problem banks (including level of involvement of the deposit insurance scheme)</li> </ul>	<ul style="list-style-type: none"> <li>• Main fiscal and tax indicators, with trend analysis and forecasts, external and domestic developments that may affect the fiscal situation</li> <li>• Information on outstanding government securities listed by maturity, interest rate forecasts, future expectations on new issues, and opinions on probable implications of a crisis on debt sustainability</li> <li>• Data on public borrowings from foreign financial institutions, listed by maturity</li> <li>• Sources of financial support for exceptional measures (if needed)</li> <li>• Short-term liquidity situation of the general budget, particularly the government's bank balance and forecast</li> <li>• A list of expenditures that cannot be legally blocked</li> </ul>
Source: IMF staff.	

**34. The FSC should develop an over-arching national contingency plan framework, underpinned by the contingency plans of each of its members.** The objective is to ensure that contingency plans are well coordinated and no gaps or overlap exist, which can lead to delays or confusion in dealing with a crisis (see Appendix IV for simple outline of a country Contingency Plan). Effective implementation hinges on the ex-ante creation of sub-committees and working groups, a clear designation of responsibilities, timely information collection and analysis, advance preparation of documentation, and periodic training. Such working groups should include all relevant areas of expertise, e.g., market operations, lawyers, supervision, financial stability, communications, and payment systems.

**35. Crisis preparedness entails effective coordination and information sharing among the financial safety net members, particularly BoB and MOF, to prepare for crises.** Assuming passage of DRBA, such operational material for the expanded resolution tools, designed for systemic banks and situations, will be necessarily more complex and involve other departments within BoB and the MOF. Developing capacity and coordination protocols requires disciplined project management and realistic assignment of the staff resources reasonably needed to operate these frameworks effectively.

## B. Cross-Border Issues

**36. Given the substantial presence of foreign banks' subsidiaries, BoB should maintain discussion with foreign authorities and parent banks.** BoB participates in supervisory colleges but no resolution colleges. BoB and the MoF should seek to expand supervisory MOUs (or seek new MOUs with foreign resolution authorities) from all home countries to cover resolution plans and issues. BoB should be proactive in discussing that the Botswanan subsidiary is included and treated equitably in the group resolution plan of the home authority. MOUs would appropriately set out the responsibilities of each agency and the matters on which coordination will be required.<sup>18</sup> These would likely include:

- The assessment of the financial position of the bank in Botswana and, where applicable, the parent bank, including its capital position, solvency, and liquidity;
- Notifying other authorities in home countries of the emergency situations, e.g., firms facing severe distress;
- The approaches and options for group resolution, assuming that recovery is not feasible, and the assessment of each option.
- The implementation of foreign resolution measures in Botswana if they do not have direct effect:

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<sup>18</sup> Some references regarding cross-border MOUs can be found here: <https://www.fsb.org/2014/10/key-attributes-of-effective-resolution-regimes-for-financial-institutions-2/> and here: <https://www.bis.org/fsi/publ/insights22.pdf>

- Ideally, burden-sharing arrangements between the parent authorities and authorities in Botswana. The BoB should request insight into group resolution plans which will allow the BoB to better understand the resolution approaches developed by home supervisors. This is especially important for those banks specifically designated as systemic in Botswana;
- Allowing for sharing firm-specific confidential information, subject to confidentiality; and
- The key stakeholders with whom each agency should take responsibility for communicating, and the coordination thereof.

**37. Ideally, parent-bank support should be a first line of defense for foreign-owned subsidiaries.** The authorities' "Plan A" should be that foreign parent banks bear the responsibility to ensure adequate liquidity and capital support for their subsidiaries. BoB should request support-commitment letters from the parent banks to help strengthen this plan. Home authority's resolution plans should reflect this. BoB should avoid a situation where a local subsidiary's assets are up-streamed to the parent to compensate home-country depositors and creditors to the detriment of domestic depositors and creditors. The "assurances by the home countries may not prove to be sufficient to help address the major challenges for Botswana caused by a largely foreign owned banking sector. While Botswana's contingency planning should be based primarily on the home resolution plan for the group, the authorities in Botswana will need to prepare alternative plans in case the resolution decision deviates from the agreed resolution plan and is endangering financial stability in Botswana.

## C. Simulations

**38. Crisis preparedness requires expertise, resources, and operational capacity.** Objectives, tools, strategies, processes, and procedures need to be fully understood. Simulation exercises can be targeted or comprehensive, and include single agency or multi-agency, domestic or cross-border.<sup>19</sup>

**39. A regular program of crisis exercises should be developed and maintained, covering all elements of crisis resolution.** Simulations can begin with relatively simple "what if?" exercises, perhaps based on extreme stress tests, designed to elicit how the competent authorities (e.g., BoB, MOF) would react to specific situations, such as a liquidity shortfall at a large bank, or the default of several large borrowers. The BoB should conduct periodic and comprehensive simulations to ensure that liquidity assistance can be mobilized in a timely manner. Simulations can be useful to help prepare and improve departmental level checklists and contingency plans and to test these procedures to detect any shortcomings. More comprehensive exercises could be developed later.

<sup>19</sup> BoB staff informed that they will be participating in a crisis simulation exercise with seven other African countries February 15–17, 2023, put on by the Financial Stability Institute of BIS.

## CRISIS MANAGEMENT

**40. Systemic crises are chaotic events.** They may build up gradually, but commonly emerge suddenly. They are interlaced with political and social problems. Crisis management is challenging—there is usually little time to prepare and strategize, as there is a pressing need for prompt and decisive response. There can be many unknowns regarding the condition of banks and without an effective framework, there could be legal and institutional limitations. Therefore, advanced crisis preparedness is key.

**41. To give one example, a systemic bank may experience illiquidity, requiring ELA, perhaps due to massive deposit withdrawals.** As there is no time to determine whether it is a liquidity or solvency problem, the BoB should be able to provide ELA (with a government guarantee), based on expanded collateral for the liquidity support as discussed above. When or if it becomes clear that the systemic bank is not only illiquid, but also insolvent, then BoB liquidity support should shift to the MOF as solvency support and will likely entail expenditures from public funds. The MOF would not be responsible for providing ELA, but could possibly provide capital or necessary funding for a bridge bank in systemic cases.

**42. Extraordinary provisions may be required to maintain financial stability in a crisis.** These can include provisions for the MOF to use public funds to inject capital, make asset purchases, provide loans or guarantees to weak systemic banks, protect uninsured depositors and creditors, and even nationalization. Such tools may be needed to prevent depositor panic or liquidity freezes, depending on the size and significance of the problems, their potential adverse consequences on the banking sector and the economy, and the urgency with which they need to be resolved. Since such guarantees represent a potentially large government liability, along with their impact on moral hazard, these powers should be used only as a last resort—otherwise, market discipline will suffer.<sup>20</sup> Additionally, these extraordinary provisions do not need to be enshrined in law (for moral hazard reasons), but could be prearranged in form of a draft emergency law to be enacted in case of need. Such powers ultimately must be a decision by the responsible entity following consultation in the FSC and the MOF, keeping them only as a last resort.

**43. Botswana’s legal system does not currently foresee extraordinary powers that can be used in situations of systemic risk.** The authorities may want to pass a financial stability law in advance or to have one drafted for emergency passage when needed. The latter may eliminate the temptation to misuse emergency powers, e.g., to provide open bank assistance inappropriately, if an existing law permits it. Specific safeguards for the extraordinary powers can be provided in implementing regulations and/or executory contracts with the recipient banks. For example, capital injections or other financial assistance should carry strict conditions such as, *inter alia*:

- Shareholders take the first loss;

<sup>20</sup> Banks receiving such guarantees should be prohibited from dividend declaration and payment.

- Management changes;
- Restrictions on dividends;
- Limits on executive compensation (including bonuses and severance packages);
- Close monitoring (and blocking, if necessary) of insider and related-party, intra-group and large transactions to mitigate asset stripping; and
- Providing a business reorganization plan detailing the exit strategy, with repayment of the assistance at a reasonable rate of return within a reasonable timeframe. A resolution plan, or living will, could be quite useful in developing the exit strategy.
- Any public funds used in a resolution action should be recouped by levies on the banking industry.

## Appendix I. Status of 2017 TA Report (as of January 2023)

Main Recommendations	Relevant Authority	2023 FSAP Status
<b>Bank Corrective Action</b>		
Amend the legislation (BA and BoBA) to strengthen the legal powers for enabling the BoB to respond quickly, effectively, and decisively to banking problems, as well as to strengthen and clarify the powers and mandate to extend ELA (paragraphs 19 and 59).	BoB, MFDP	In process DRBA
Develop a corrective action framework and contingency plan for responding to banking problems (paragraph 21).	BoB	In process DRBA
Strengthen the early warning system arrangements to enable early detection of bank stress and liquidity vulnerabilities (paragraph 25).	BoB	...
<b>Emergency Liquidity Assistance</b>		
Review the existing liquidity management capabilities of the banking system, including the effectiveness of current BoB liquidity-providing market operations and the functioning of the interbank market (paragraph 79).	BoB	...
The BoB should establish an ELA framework to respond to idiosyncratic liquidity needs of banks and internal ELA governance and authorization procedures should be clearly set out (paragraph 81).	BoB	In progress - once BoBAA is effective.
Clear criteria as to when and why to provide ELA funding to a bank should be set out, including reliable solvency, systemic importance, viability, and capital assessments to enable correct ELA decisions to be made (paragraph 84).	BoB	Not Done
Internally, the BoB should document and duly authorize the ELA principles, guidelines, and criteria to be followed in order to ensure that it is adequately collateralized and not unduly exposed to potential losses (paragraph 92).	BoB	Not Done
Devise a detailed and robust collateral assessment and valuation approach surrounding ELA (paragraph 95).	BoB	Not Done
Develop clear trigger points and metrics against which the provision of funding by the BoB to a counterparty can be assessed on an ongoing basis (paragraph 104).	BoB	Not Done
<b>Bank Recovery and Resolution</b>		
Devise a framework for ongoing ex post monitoring of banks' use of funds, business practices, transactions carried out, and any additional conditionality imposed on ELA borrowers should be devised (paragraph 106).	BoB	In process DRBA

Main Recommendations	Relevant Authority	2023 FSAP Status
Revise and strengthen the proposed amendments to the BoBA and the BA to establish a comprehensive set of powers for bank recovery and resolution, benchmarking against the FSB Key Attributes (paragraph 28).	BoB, MFDP	In process DRBA
Establish a Financial Stability Council to facilitate coordination between the BoB, the MFDP, and the NBFIRA on financial stability (including resolution) issues (paragraph 54).	BoB, MFDP, NBFIRA	Done
Establish a Financial Stability Committee within the BoB to oversee and coordinate all aspects of financial stability, comprising representatives of banking supervision, the proposed resolution team, financial markets, financial stability, and Payment Systems Department (paragraph 83).	BoB	Done
Develop and implement the policies and arrangements needed to require all banks to establish recovery plans, and require all banks to develop, maintain, and regularly test those plans (paragraph 28).	BoB	In process DRBA
Develop the policies and arrangements needed for the BoB to undertake resolvability assessments and develop resolution plans for, at least, all systemically important banks, and for other banks, if resources permit (paragraph 39).	BoB	Not Done
Establish a multilateral Memorandum of Understanding (MOU) on financial crisis resolution between the BoB, the MFDP, and the NBFIRA (paragraph 53).	BoB, MFDP, NBFIRA	Done
Establish liquidity management, bank recovery and resolution MOUs between the BoB and its foreign counterparts, and seek to participate in cross-border crisis management groups for systemically important banks (paragraph 56).	BoB	Not Done
Develop a program of workshops, staff training, and regular bank crisis exercises to build capacity in crisis resolution (paragraph 58).	BoB, MFDP, NBFIRA	Not Done
Develop comprehensive policy proposals for a deposit insurance scheme, with a view to establishing the scheme within the next two to three years, if possible (paragraph 46).	BoB, MFDP	In process DISR
Develop comprehensive policy proposals for resolution funding arrangements (beyond deposit insurance), with associated safeguards (paragraph 51).	BoB, MFDP	Not done beyond paybox plus DIS
Review and assess the adequacy of existing resolution arrangements for payment and settlement systems, and develop proposals as appropriate (paragraph 17).	BoB	In process BoBAA

## Appendix II. Some Observations on the Draft Revised Banking Act—Selected Issues<sup>1</sup>

1. As a general statement, many Articles of the DRBA call for input, decisions and/or approval from the Minister of Finance. However, it is inappropriate for the Minister to have power in central bank routine and technical matters, such as the implementation of corrective measures, as it compromises central bank independence. References to Ministerial involvement in operational issues for bank resolution should be removed from the DRBA.
2. Article 18(2) requires that BoB, “before revoking a licence in accordance with this section, serve on the bank or deposit-taking institution in question written notice of its intention to do so, specifying a date, being not less than 30 calendar days after the date of service of the notice, upon which the revocation shall take effect...” This advance notice requirement should be eliminated. Giving a failing bank notice of impending license revocation is a recipe for asset stripping, document destruction and other insider abuse that could greatly increase the resolution cost.
3. Article 56(2)(d) is a “catch-all” corrective measure that BoB can take to “order the bank or deposit-taking institution to cease and desist from particular actions, or require the bank or deposit-taking institution to take affirmative action to correct the violations or unsafe and unsound banking practices.” This article could form the basis for prudent supervisory measures to preserve a foreign subsidiary’s assets by prohibiting transactions with the parent involving “upstreaming” assets from the subsidiary to the parent to the detriment of domestic depositors and creditors, especially if the parent (home) bank is facing difficulties.
4. Article 57, regarding early intervention does not have a clause that would enable BoB to revoke a bank’s license before capital reaches zero. Prompt Corrective Action calls for license revocation when a bank is severely undercapitalized, but still has positive capital.
5. The last sentence of Article 60(1) provides that “resolution plans for other (non-systemic) banks may be prepared on a need basis.” The BoB should prefer the P&A as the most desirable resolution tool for non-systemic banks, followed by an IDT, and, if BoB Resolutions Unit cannot find a suitable healthy bank to execute a P&A or IDT, then liquidation and direct payment to insured depositors. Operational manuals detailing advance preparation for intervention, resolution and liquidation should provide the basis for the resolution plans for non-systemic banks.
6. Article 61(1) permits BoB to “establish a resolution fund, financed through levies on banks, for the purpose of facilitating bank resolutions”. A paid-in resolution fund is not recommended in jurisdictions where the DISB fund has not reached its target funding level, as it would impose additional levies on the banking sector.<sup>2</sup>

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<sup>1</sup> For this assessment, only the parts of the DRBA related to license revocation, early intervention, resolution, Official Administration, and liquidation were reviewed.

<sup>2</sup> See: <https://www.imf.org/-/media/Files/Publications/TNM/2018/tnm1801.ashx>

**7.** Article 64 (1) permits BoB to “appoint an official administrator to conduct resolution functions and apply resolution actions and measures.” The authorities must be judicious and very careful in taking this action because Article 64(4)(a) and (b) require posting of the notice of such action on the doors of all the bank’s offices and publishing it in the *Gazette*, at least two newspapers of general circulation in Botswana and on the Central Bank’s website. Such publication of notices risks deposit runs on the intervened bank and quite possibly contagion to other banks in the system, which will likely have an adverse impact on financial stability and public confidence. It seems that the DRBA contemplates Official Administration (OA) as a necessary step on the road to resolution. If this is to be the case, the authorities must develop positive and effective communication strategies and actions to mitigate possible (probable) deposit runs and contagion. OA should be avoided, except in cases where fraud or other criminal activity is suddenly discovered, necessitating seizing control of the bank immediately. In addition, revisions to the DRBA to align with good international practices should ensure that the RA can implement the resolution powers without first having to appoint an official administrator. If AO is used by the authorities as a mechanism to implement resolution powers, the official administrator would need to be ready to implement a resolution shortly after the appointment becomes public information, which would require considerable advanced preparation by the RA.

**8.** Article 65 (2)(b) permits the OA to “sell, transfer, or dispose of the whole or any part of assets and liabilities of the bank...” This can be done for systemic banks as part of the OA’s (or Resolution Authorities) actions and doesn’t necessarily involve license revocation. It should be made clear that this tool (which is the most effective resolution tool for non-systemic banks) should be permitted to use for non-systemic banks, with the caveat that it occurs simultaneously with license revocation.

**9.** Article 65 (2)(i) permits the OA to “establish a bridge bank to take over and continue operating certain critical functions and viable operations of the bank under resolution.” Creating and running a bridge bank should be a decision reserved for top officials of BoB and MOF, because the BoB is the RA and MOF will be the owners of the bank, having advanced funds to facilitate the action. The bridge bank tool should only be used for systemic banks and decisions should be discussed within the FSC, with BoB and MOF then exercising their statutory powers to create and operate the bridge bank. Such a major resolution decision should not be delegated to the OA.

**10.** Article 65 (2)(j) gives the OA power of “applying bail-in within resolution.” As with all resolution tools there would need to be sufficient liabilities that can absorb losses in resolution. Given that Botswanan banks are largely deposit funded, and may not be able to issue long term debt on a cost-effective basis, the advantages of using bail-in powers should be carefully assessed by the authorities and would most likely apply only in systemic cases. The bail-in tool requires expert valuation capabilities, carries litigation risks (including because contingent liabilities are not left behind in liquidation), and may also require liquidity support to stabilize the balance sheet.

**11.** Article 67 (1)(a), (b), and (d) involve attempts to increase capital by issuing shares, arranging a merger, or transferring shares of the bank. If a bank is in such bad shape to require an OA, then it

is unlikely to be resolved via injections of capital from the private sector. Rarely, if ever, has a bank in OA recovered and gone back into private operations—virtually all require resolution or liquidation.

**12.** Article 67 (5)(a) which states that a bridge bank should be owned by “...shareholders and/or bail-in creditors of the bank...” should be revised. Shareholders should have operated the bank according to prudential standards to prevent the need for OA. Since the bank is in OA, it is likely substantially undercapitalized, so obviously they have failed and should not be rewarded by continued ownership of a bank that has benefited from BoB (and possibly MoF funding). In addition, a bridge bank should exist on a temporary basis until a private sector purchaser is found and, in the interim, should be under the control and the ownership of the authorities. The legal framework also needs to set out clear rules for the prudential treatment of bridge banks including for licensing and governance arrangements.

**13.** Article 71 (4) (a) giving shareholders back voting rights, dividends and other capital distribution should not be permitted unless they have contributed all the funds necessary to recapitalize the bank. If government support has been used, shareholders should have no rights except to file a claim with the liquidator.

**14.** Article 73 references provisions of the Companies Act regarding winding up of a bank and is inappropriate. The Banking Act should supersede all other legislation in relation to bank intervention and resolution, including the Companies Act and Insolvency Act. Nevertheless, the latter instruments may be supplementary to the Banking Act to ensure there are no gaps in the legal framework, provided that there are sound provisions on resolving conflicts among these laws.

**15.** Article 78 (1) states that “the liquidator may... transfer in whole or in part, assets and liabilities of a bank or deposit-taking institution without the consent of any person, including shareholders.” This would be the appropriate place to execute a P&A for a non-systemic bank and would require that the liquidator be provisionally appointed in advance (another reason to use BoB employee as liquidator) to prepare in advance and be given instructions, the first of which is to put the (previously prepared) P&A into effect.

**16.** Article 84 (1) establishes the order of priority in claims payment, which is in line with best practices. The only change that would be recommended is that item (g) “wages and salaries of employees, but not members of the board of directors and principal officer of the bank or deposit-taking institution, provided that such amount in respect of each employee, does not exceed P100 000” could be given a higher claim status (e.g., (b) or (c)), so as to not further exacerbate employees’ financial distress caused by the bank failure and the amounts are unlikely to be so great to adversely affect other claim classes. Also, a class should be added as (k) to represent the shareholders’ claims, which should come absolutely last.

## Appendix III. Some Observations on the Deposit Insurance Scheme of Botswana Regulation—Selected Issues<sup>1</sup>

1. Bank of Botswana plans to issue a Deposit Insurance Scheme of Botswana Regulation (DISBR). However, in the interests of stability and legal certainty, a deposit insurance scheme should be established by a standalone law.
2. Public policy objectives are covered in Article 3(2) (a), (b) and (c), of which the latter 2 are similarly covering the same objective and could usefully be combined to provide for only 2 objectives which represents best practices.
3. Article 4(3) regards publishing a list of member institutions in the Gazette annually. This list should be constantly present and updated as necessary on the DISB' website.
4. Article 4(6) requires that member institutions provide their clients information regarding the extent to which their deposits are protected. It is important that the DISB require banks to use DISB written informative brochures, etc. in order that an institution(s) not misrepresent the benefits and limitations of deposit insurance.
5. Article 5(1)(a) regarding cessation of membership indicates that revocation of the institution's license terminates DISB membership. It should be clearly stated that license revocation is the trigger for insured depositor repayment. Moreover, it should be explicit that membership and a banking license go together—there cannot be a licensed bank that is not a DISB member and there can be no DISB member that is not a licensed bank.
6. Article 5(1)(d) provides for DISB involvement in a voluntary winding up. A DISB should never be involved in voluntary liquidation. Voluntary liquidation should never be allowed unless the financial institution can make immediate payment to depositors and creditors. [Voluntary liquidation must be closely monitored in order to prevent asset stripping by the owners and managers.]
7. Article 6 lists some actions that a financial institution must take upon cessation of membership. This is misguided because upon license revocation, the financial institution no longer exists. These actions, therefore, should be performed by BoB and DISB.
8. Article 7 provides for borrowing from BoB. It is appropriate for BoB to assist the DISB as it becomes established; however, emergency funding to finance the repayment of insured deposits should come from the MOF (via a pre-approved line of credit) since that represents a fiscal rather than monetary policy operation.
9. In Article 8 regarding establishment of the Fund, the authorities may want to consider imposing initial membership fees for existing banks and entry membership fees for *de novo* banks.

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<sup>1</sup> These observations are selected in so far as they are likely to impact on the operationalization of the Deposit Insurance Scheme of Botswana, and do not represent a full review of the legal specifications and requirements of any impending DISB law.

Another source of funds which should be mentioned in this Article is the liquidator's distribution of recoveries on asset liquidation.

- 10.** Article 9(1) provides that there should be a target reserve fund; however, it lacks a specific target range.
- 11.** Article 9(2)(b)(i) provides for suspension of premium payments after the target fund has been reached. Deposit insurance is a good, premium payment of which is a normal operating expense. Deposit insurance will promote confidence in the banking sector from which all member institutions benefit, so they should always be required to pay some amount for this benefit.
- 12.** Article 10 (a) should add "in the event of a bank failure" at the end of the sentence.
- 13.** Article 11, Fund Investment should be more general in the law/regulation, with specific allowable instruments itemized in a formal investment policy. [the "any other security" clause is arbitrary and could be subject to abuse.]
- 14.** Articles 15 and 16 regard creation of a Deposit Insurance Committee to act as de facto board of the DISB. Since the DISB is housed in the central bank, it is more expedient to simply let the CB's board also be the DISB board, reporting via a Deputy Governor.
- 15.** Article 20(3) seems to provide for risk-based premiums. Simpler language could provide for flat-rate premiums initially, with the ability to introduce risk-based premiums after the DISB matures.
- 16.** Article 20(4) contemplates penalties for late payment of premiums. A simpler workaround for such situations is to provide for the DISB to automatically debit the member institutions' account at BoB & late payments would not be an issue.
- 17.** Item (i) of Article 22 regarding excluded deposits should be removed as "any other deposit" is too arbitrary.
- 18.** Article 23(1) should establish license revocation (rather than a determination of non-viability) as the trigger for insured deposit reimbursement. Viability and non-viability issues are applicable to systemic banks while deposit insurance is designed for closure and liquidation for non-systemic banks.
- 19.** Article 23(3) regarding insured depositor payment should specifically permit (and favor) funding insured deposits via a transfer to a stronger bank via P&A or IDT.
- 20.** Article 29(2)(a) should specifically allow DISB staff to go to member institutions on site to analyze and audit deposit related issues. Ideally the DISB staff would join the BoB on-site examination team, but not duplicate BoB's asset quality, risk management, etc. analysis. They would complement BoB examiners, not duplicate their efforts.
- 21.** The Deposit Insurance Regulation/Law must be harmonized with the Banking Act (Article 84) by adding the right of subrogation to the second claim class in the creditor hierarchy.

## Appendix IV. Example of a Country Contingency Plan Outline

### Background

- **Macro conditions and vulnerabilities.** Brief analysis of macro indicators, baseline projections, and risks to baseline.
- **Structure of the banking system.** Brief description regarding the number of banks, type of ownership (public, private, and foreign), size of assets compared to GDP, cross-border activities, external exposures, etc.
- **Condition of the banks.** Include short analysis based on main financial soundness indicators (liquidity, solvency, asset quality, and profitability). Also discuss the potential deterioration in case of domestic and external shocks.

### Crisis Scenario and Policy Response

Based on the background, develop difficult but plausible macro crisis scenarios (e.g., significant commodities price shock, capital outflows, reduction in remittances, etc.). Develop possible policy response to address such scenarios (e.g., changing reserve requirements and/or liquidity ratios, importing more banknotes, etc.).

### Crisis Preparedness

**Implication of crisis scenarios for banks.** Develop at least two possible scenarios—moderate and pessimistic.

- Moderate—based on past crisis experiences (e.g., asset quality, deposit runs, foreign credit lines reduction, etc.). This situation may also assume that tentative policy responses (discussed above) are effective.
- Pessimistic—deterioration of banks' indicators are much more negative (e.g., deposit run of 20–30 percent, asset deterioration twice or three times worse than past crises, etc.).

**Banking legal and regulatory framework.** Describe key legal tools, including liquidity facilities, bank intervention powers, capacity to transfer assets and liabilities from failed to sound institutions, and any other tools to deal with a systemic crisis. Legal and operational weaknesses for proper bank resolution should also be noted.

### Banking Resolution Strategy for the Banking System

Include steps to address both the moderate and the pessimistic scenarios above, and:

- Criteria to provide access to liquidity support (i.e., solvency, collateral, limits, etc.);
- Ensuring adequate supply of bank notes and counting machines;
- Options to protect depositors (partial or full guarantee);
- Triggers for bank resolution and suspension of liquidity facilities; and
- Options for bank recapitalization, including asset purchase and incentives for private capitalization (i.e., together with partial public participation, conversion of liquid into medium-term debt, etc.). These options should also include some estimate of the potential source and cost of funding;
- Procedures to manage and dispose assets from failed banks.

### **“Last Resort” Administrative Measures**

If conditions become too difficult to successfully implement the banking strategy, discussion of extreme measures to contain deposit outflows should be included.

- Support from foreign lenders.
- Full bank nationalization (conditions, use of bridge bank, treatment of subsidiaries, etc.).
- Deposit administrative measures (coverage, type of measure, lifespan, restricted list of exceptions, etc.).

## Appendix V. Example of a Bank Recovery Plan Outline

Banks should be required to prepare Recovery Plans for crisis situations, or other times of financial distress, in order to minimize their risks. A bank's Board of Directors and senior management are in charge of establishing contingency planning policies, procedures, and responsibilities.

A recovery plan should clearly specify the sources of funds and amounts available from these sources, conditions for the funds to be utilized, and how quickly they can be accessed. Management should always keep shareholders informed of liquidity and solvency developments in times of distress; including the likelihood that the bank might need urgent shareholder support. Banks should be required always to maintain specific plans for addressing a possible deterioration in the following areas:

### Capital

Describe how the bank will increase needed capital from existing shareholders, capital markets, new investors, or subordinated loans.

### Liquidity

Considerations include the market liquidity for the bank's assets, the bank's creditworthiness, and effective systems for monitoring payments and receipts. The plan should cover:

- Stand-by agreements with other local and foreign financial institutions;
- Balance-sheet restructuring, sales of assets, and moratoria on new loans;
- Funds management systems to track flows of funds and eligible assets for sale or to use as collateral for liquidity assistance;
- Time required to convert eligible assets into cash at reasonable cost;
- Intra-day credit facilities with the BoB and overnight interbank credit facilities; and
- Maintenance of adequate collateral for intra-day and interbank facilities.
- Another important liquidity concern is that banks not rely heavily on borrowings that contain "material adverse change clauses," which can trigger early payments in case of specific market or credit events.

### Asset Quality

Include action plans to speed up and improve debt recovery, including possible settlements for less than full book value, investigation procedures of credit extensions, dismissal of negligent or dishonest employees, and legal actions to recover losses.

## **Profitability**

Address how to decrease expenses, eliminate excessive overhead, reduce the cost of funding, and increase net interest income, commission, and fee revenue.