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FINANCE, COMPETITIVENESS & INNOVATION INSIGHT | FINANCIAL STABILITY & INTEGRITY

Financial Safety Nets and Bank Resolution Frameworks in Southern Africa: Key Issues and Challenges

WORLD BANK GROUP

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ABBREVIATIONS AND ACRONYMS

AMC	asset management company
BCBS	Basel Committee on Banking Supervision
BOM	Bank of Mozambique
BOB	Bank of Botswana
BON	Bank of Namibia
BOZ	Bank of Zambia
CBL	Central Bank of Lesotho
CBS	Central Bank of Swaziland
CMA	Common Monetary Area for South African Rand
CMG	crisis management group
DGS	deposit guarantee scheme
DIF	deposit insurance fund
D-SIB	domestic systemically important bank
ELA	emergency liquidity assistance
EWI	early warning indicators
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSC	financial stability committee
FSSA	Financial System Stability Assessment
G-SIB	global systemically important bank
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund
KA	Key Attributes of Effective Resolution Regimes for Financial Institutions
MOU	Memorandum of Understanding
MPE	multiple points of entry
NPL	nonperforming loans
P&A	purchase and assumption
PCA	prompt corrective action
RBZ	Reserve Bank of Zimbabwe
SANT	South African National Treasury
SARB	South African Reserve Bank

SCV	single customer view
SG	supervisory group
SPE	single point of entry
SRR	special resolution regime
TA	technical assistance
WB	World Bank

ACKNOWLEDGMENTS

This report provides an assessment of the current state of development of financial safety nets and bank resolution frameworks in eight countries in southern Africa (Botswana, Eswatini [formerly Swaziland], Lesotho, Mozambique, Namibia, South Africa, Zambia, and Zimbabwe). It has been prepared to inform ongoing and planned technical assistance projects in the southern Africa region and to provide a basis for engagement with the authorities in each of the countries covered by the study. This summary draws from more detailed material contained in a comprehensive study.[1]

The report was prepared by Geof Mortlock (consultant) and Julian Casal and Gunhild Berg (both World Bank staff) with guidance from Douglas Pearce (practice manager), Paul Noumba Um (country director, AFCS1), Mark R. Lundell (country director, AFCS2), Sebastien Dessus (program leader), and Carolin Geginat (program leader).

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[1] Cross-country study for financial safety nets and bank resolution frameworks for Southern Africa, May 2018.

EXECUTIVE SUMMARY

Macrofinancial developments in some southern African countries[2] have exacerbated economic and financial sector risks and can undermine economic growth and development. Macroeconomic risks include currency volatility, commodity prices fluctuation, relatively high fiscal deficits, elevated interest rates (associated in some cases with high inflation rates), and the potential for capital flow reversals, among others. Sovereign debt is emerging as a key vulnerability in the subregion, particularly as the composition of that debt has shifted from concessional financing to market-based financing, often denominated in foreign currency. Higher debt burdens and the increasing exposure to interest rate and foreign currency risks raise concerns about debt sustainability. As a result, more countries in the region have been classified as being at high risk of debt distress. Sudden reversals in capital flows could add pressure to the currencies of many countries in the subregion and widen current account deficits. Recent developments have increased investor risk aversion and the potential for greater volatility in cross-border capital flows.

Financial stability risks have increased in many countries in southern Africa. These risks include a rise in nonperforming loans (NPLs), a larger share of bank lending in foreign currency (which is not always hedged against currency risk), and increased sovereign exposures (direct and indirect, including to state-owned enterprises, some of which are in arrears). Increases in NPLs reduce liquidity, tie bank capital, and undermine credit growth as lenders tighten conditions. Higher levels of NPLs also reduce bank profitability, even once credit losses have been recognized, because of the potentially long overhang of loans that do not provide a yield, placing further pressure on banks' capital. Ultimately, high NPLs lead to bank stress that can undermine the stability of a country's financial system.

Shocks have the potential to exacerbate financial stability risk by increasing the number of firms and individuals that struggle to pay back their loans amid slower economic growth. During times of crisis, banks tend to face tighter application of prudential rules on loan classification and provisioning, which can exacerbate a credit crunch and affect mainly riskier borrowers such as small and medium enterprises. For countries with a floating exchange rate, capital outflows increase pressure on policy makers to raise interest rates to support currencies (unless a currency depreciation is desired as part of the macroeconomic adjustment process). This dynamic increases the cost of financing, can put pressure on already over-indebted individuals and firms, and can potentially exacerbate banks' credit risks.

Financial crises can have severe and lasting effects on economic activity and on the welfare of firms and individuals. Bank failures can result in large fiscal costs, have contagion effects on other banks, and can undermine the stability and health of the financial system in general. Financial crises are typically associated with a severe erosion of real economic activity and—as the government intervenes to stave off a collapse of the financial system—a significant increase in public indebtedness occurs, which undermines growth and the government's ability to adequately attend to social and equity objectives. For countries that have experienced bank failures on a systemic scale, the disruption to economic activity, the loss of savings, and the interruption to credit creation have had long-lasting adverse effects on economic growth, employment, and poverty. Those adverse effects have been evidenced in many regions, including in East Asia and Pacific, Europe and Central Asia, Latin America and the Caribbean, South Asia, and Sub-Saharan Africa.

[2] For the purposes of this report, this statement refers to Botswana, Eswatini (formerly Swaziland), Lesotho, Mozambique, Namibia, South Africa, Zambia, and Zimbabwe.

Strong systems for the early detection of bank risks, corrective action, and resolution, along with financial safety nets, can help countries identify and manage financial risks and resolve bank distress quickly and with minimal disruption to the economy and wider financial system. Countries with poorly developed systems for detecting and responding to bank stress in a timely manner and with inadequately designed and implemented resolution frameworks and financial safety nets, have generally experienced deeper and longer-lasting economic effects than countries with robust frameworks in these areas.

Given the increase in risks in the southern Africa subregion and the need for a comprehensive stocktaking there, the World Bank undertook a detailed analysis of corrective action and resolution frameworks and financial safety nets. The analysis was based on relevant laws, regulations, and policies on early intervention, banking resolution, deposit insurance, and emergency liquidity assistance (ELA) in southern Africa. The report places existing work and reform efforts in the context of broader regional and international efforts. This report includes an assessment of bank resolution and financial safety net arrangements in the subregion by reference to international best practice and standards, particularly those issued by the Financial Stability Board (FSB) on bank recovery and resolution, and by the International Association of Deposit Insurers (IADI) on deposit insurance arrangements. Whereas it is important to recognize that these international standards need to be applied proportionally, depending on the development of a country's financial system and institutional arrangements, many of the principles they cover are applicable to less developed countries. In addition to this report, an important part of the study is a series of tables that identify the main weaknesses and areas needing additional work for each country in the subregion, thus covering a wide range of aspects of bank recovery, corrective action, resolution, and financial safety nets.

Whereas the modernization of financial safety nets and bank resolution frameworks is a priority for many countries in the region, recent reform efforts have yet to show concrete results. Significant reforms are under way in Mozambique, Namibia, and South Africa and smaller changes in existing frameworks are being considered or have recently been implemented in Lesotho and Zimbabwe. Recent experience with bank failures in the region has also highlighted the need to update existing frameworks, and several countries in the subregion are considering reforms. Reforms are also being—or have been—implemented in banking supervision, which provides a critical underpinning of financial stability and the frameworks needed for the early detection of bank stress and early intervention arrangements.

The lack of adequate financial safety nets and crisis preparedness in the region is worrisome given the increase in macrofinancial risks in southern Africa. In most respects, the supervisory authorities have broadly satisfactory legal powers for undertaking corrective actions. However, there are some gaps and deficiencies in powers, such as poorly defined triggers for corrective action, the inability to replace directors and senior management, and the inability to extend corrective action requirements to a regulated group. The most significant gap is the general lack in most of the countries of (a) policies for adequate supervisory corrective action and (b) contingency plans for dealing with bank stress.

The bank recovery planning arrangements across the subregion are underdeveloped. The activation of a bank's recovery plan needs to be integrated into supervisory corrective action frameworks, which is not currently the case in most countries in the region because of the lack of implementation of recovery planning requirements. It is therefore suggested that the supervisory authorities develop contingency plans for dealing with a range of bank stress and noncompliance scenarios, and that the authorities undertake regular internal testing of those plans to build preparedness capacity. The supervisory authorities that have not yet established recovery planning requirements for banks should do so within the limits of their legal powers, focusing initially on domestic systemically important banks (D-SIBs) and then progressively extending recovery planning requirements to smaller banks.

Where reform efforts are under way, the framework for resolution of weak banks is largely inadequate, apart from Namibia and South Africa. In most countries, the law does not specify a resolution authority with explicit responsibility and accountability for bank resolution, and there is an inadequate specification of resolution objectives. Laws relating to bank resolution in southern Africa lack clearly defined statutory triggers for entry into resolution (for example, based on the concept of nonviability). The triggers for resolution must occur well before insolvency to avoid excessive disruption to the financial system, to maximize the potential returns for creditors, and to limit the costs associated with resolution. In most cases, the laws apply resolution powers to licensed banks and do not explicitly enable resolution powers to be exercised in relation to holding companies or subsidiaries, which limit effective group resolution. Resolution powers are also broadly inadequate and need to be brought more in line with the Key Attributes (KA).[3]

The inadequacies are even more acute for cross-border resolution frameworks, which do not exist beyond some incipient initiatives in South Africa. This is a significant issue—given that banks in South Africa have a systemic presence in various countries in the region, as do some foreign banks domiciled outside the region—that increases the risk of contagion. There is no established platform for the exchange of information and monitoring of risks of cross-border groups, and many large banking groups continue to be inadequately supervised. Supervisory authorities have established memoranda of understanding (MOUs) with their counterparts in other countries to facilitate information exchange and cooperation; but such MOUs mainly relate to supervision issues and do not specifically provide for the coordination of cross-border bank recovery or resolution. This report suggests that the authorities in the region, led by the South African Reserve Bank (SARB), undertake further initiatives to promote (a) dialogue on cross-border cooperation and (b) coordination on resolution and crisis preparedness.

The lack of deposit insurance in most southern African countries presents a significant gap in the financial safety net. Two countries, Mozambique and Zimbabwe, have a de jure deposit insurance scheme, but a de facto scheme is nonexistent, given that Zimbabwe is currently experiencing a liquidity crisis and Mozambique's deposit guarantee fund lacks operational capacity and funding to provide substantive protection to depositors. Moreover, these deposit insurance arrangements also currently lack the technical capacity to be effective in a banking crisis, given the inability to make prompt payouts or facilitate purchase and assumption (P&A) transactions.

The absence of deposit insurance increases the risk of retail deposit runs in periods of banking system stress. Without deposit insurance, the probability of fiscal authorities coming under political pressure to bail out failing banks or introduce ad hoc protection of deposits in cases of bank stress increases. The relatively high level of interconnectedness between banking systems in southern African countries results in a significant risk of contagion should the parent banks fail or become acutely distressed. Depositor preference (that is, a law under which depositors meeting eligibility criteria rank ahead of other senior unsecured creditors in the liquidation of a bank) is another related issue that warrants careful consideration. The absence of depositor preference, which is the case in most countries covered in this study, creates a heightened risk of depositor runs in periods of instability and can make it more difficult to apply certain forms of resolution, such as bail-in. Resolution funding arrangements (beyond deposit insurance), for use in a systemic crisis, are nonexistent in the countries studied.

Existing laws across the region generally provide adequate powers for central banks to provide ELA to banks. However, in most of the countries the laws lack clear objectives for ELA. They also lack clarity on the preconditions for providing ELA and on the obligation of central banks to develop clearly specified policies and procedures for ELA.

[3] Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions," (Basel, Switzerland, 2014).

This lack of clear objectives limits transparency and accountability. ELA policies and preparedness would appear to be underdeveloped in most countries in the subregion, including in respect of indicative terms and conditions and collateral arrangements.

Countries in southern Africa need to undertake significant reforms to strengthen financial safety nets and crisis preparedness. Reforms should focus on establishing robust frameworks for the early detection of bank stress, recovery planning, corrective action, ELA, resolution planning, resolution measures, deposit insurance, and resolution funding. Strengthening is also needed for domestic and cross-border coordination frameworks across these areas. Capacity building is another pressing area, particularly in the form of regular domestic crisis simulation exercises and occasional cross-border exercises. To various degrees, technical assistance is likely to be needed to support countries in these efforts.

The sequencing of reforms is important. The nature of sequencing will vary depending on the country in question and the stage of development with a country's economic policies, risk management arrangements for banks, banking supervision, insolvency laws, and many other considerations. An example of the importance of sequencing is found in deposit insurance. It is essential that before deposit insurance is established a country first establishes the prerequisites for deposit insurance. Those prerequisites include a robust banking regulatory and supervisory framework, sound insolvency law, and high-quality governance and risk management practices in banks, together with robust financial reporting and auditing standards. Another example of sequencing is found in ELA. Before ELA policies are formalized and announced, it is important to establish comprehensive liquidity prudential requirements for banks, including minimum liquidity buffers, stress testing, and risk management requirements. Likewise, the introduction of resolution laws needs to precede the development of detailed resolution policies and practices, which in turn need to precede the development of bank-specific resolvability assessments and resolution plans.

The main recommendations resulting from the study are set out in table 1. These are general recommendations for the entire southern African region, and the recommendations vary in relevance depending on the country in question. More specific recommendations by individual country are included in annex I.

Table 1: Summary of Recommendations

No.	Recommendations	Responsible Authority	Time Frame	Priority
1.	Strengthen the capacity of supervisory authorities to detect emerging stress in banks and banking systems, including through greater use of Early Warning Indicators (EWIs) and stress testing.	Supervisory authorities	ST	High
2.	Strengthen the frameworks in supervisory authorities for early intervention and corrective action and develop contingency plans for dealing with likely scenarios of bank distress.	Supervisory authorities	MT	High
3.	For systemic banks with systemically significant operations in host countries, home authorities should develop contingency plans for dealing with the global operations of the bank and should share this with the host authorities, with the host authorities developing contingency plans for their own jurisdiction and with the home authority.	Supervisory authorities	MT	Medium
4.	Develop recovery planning requirements for banks, starting with the systemic banks and extending progressively to medium-size banks and smaller banks, and develop the framework for supervisory review and regular testing of recovery plans.	Supervisory authorities	ST	High
5.	Integrate the activation of recovery plans into supervisory corrective action frameworks.	Supervisory authorities	MT	Medium
6.	Strengthen bank resolution laws in broad alignment with the FSB Key Attributes, but with modifications to suit the institutional arrangements and banking system characteristics of each county. The amendments to the law should include the following: • Clearly stated resolution objectives • Clearly specified entry into resolution (well before bank insolvency occurs) • A resolution authority with robust governance, accountability and transparency arrangements • A comprehensive set of resolution powers to implement a range of resolution options • Clearly specified triggers for resolution powers • Resolution powers that extend to banks, holding companies and subsidiaries • Powers to obtain data from banks for resolution planning purposes • •owers to require banks to make changes to their structure and for operations (including at group level) to facilitate specified forms of resolution in accordance with resolution plans • Powers to exchange information between authorities at domestic and cross-border levels • Strong legal protections for the relevant authorities, their senior management, staff, and agents	Resolution authorities, finance ministries	MT	High
7.	Develop robust safeguards in the resolution laws, including in relation to the “no creditor worse off” principle (with associated compensation and funding arrangements).	Resolution authorities, finance ministries	MT	High

8.	Through amendments to the law, remove the ability of the courts to suspend, modify or terminate resolution decisions and transactions, and instead rely on a safeguard of compensation for creditors (and shareholders) found to be worse off under the resolution than in a conventional winding up under standard insolvency law.	Resolution authorities, finance ministries, justice ministries	MT	High
9.	Develop methodologies and bank data templates for assessing bank solvency, determining bank nonviability and entry into resolution.	Supervisory authorities, in consultation with resolution authorities	ST	High
10.	Develop or strengthen (as the case may be) resolution strategies, crisis management protocols, and guidance on resolution implementation.	Resolution authorities	MT	High
11.	Develop the methodologies for undertaking resolvability assessments and preparing resolution plans for systemic and medium-size banks.	Resolution authorities, in consultation with supervisory authorities	MT	Medium
12.	Undertake resolvability assessments and develop resolution plans, starting with the systemic banks and progressively extending to medium-size banks with the potential to be systemic.	Resolution authorities, in consultation with supervisory authorities	MT	Medium
13.	Strengthen domestic coordination frameworks on financial stability assessment and crisis resolution, including (as appropriate) through a financial stability committee or council of financial regulators.	All financial regulatory agencies and finance ministries	MT	High
14.	Further develop cross-border coordination frameworks for bank recovery and resolution, particularly for South African banks in the region, including through crisis management MOUs between home and host authorities and crisis management groups in individual systemic cross-border banks.	All financial regulatory agencies and finance ministries, led by the home authorities	MT	Medium
15.	Develop or refine (as the case may be) deposit insurance schemes with broad alignment to the IADI Core Principles once the essential prerequisites for deposit insurance have been established.	Deposit insurance agencies	MT	High
16.	Consider the benefits and costs of establishing depositor preference as a framework to support deposit insurance.	Deposit insurance agencies, finance ministries and central banks	MT	Medium
17.	Strengthen the policies, procedures, and practices in central banks with respect to Emergency Liquidity Assistance (Lender of Last Resort).	Central banks, in consultation with supervisory authorities and finance ministries	ST	High
18.	Strengthen the home/host coordination frameworks between central banks on ELA for cross-border banks	Central banks, in consultation with supervisory authorities and finance ministries	LT	Medium

19.	For countries in the Common Monetary Area (CMA) for the South African rand, consideration should be given to the funding mechanisms and currency swap arrangements needed to facilitate ELA in a manner that does not undermine the parity of exchange rates.	Central banks in the CMA, led by the SARB	MT	Medium
20.	Develop resolution funding arrangements for systemic bank resolution situations where funding beyond that available via deposit insurance might be needed, with the primary focus being on post-funded arrangements.	Finance ministries, resolution authorities	MT	Medium
21.	Establish and maintain a program of capacity building at a domestic level through a combination of regular staff training, senior management workshops and simulation exercises to test solvency assessment, collateral valuation, recovery and resolution arrangements, ELA, interagency coordination and communications.	All financial regulatory agencies and finance ministries	MT	High
22.	Undertake occasional cross-border exercises to test bank solvency assessment, collateral assessment, and recovery and resolution frameworks between home and host countries in the region.	All financial regulatory agencies and finance ministries, led by the home jurisdiction authorities	LT	• Medium

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5,000
1,000

1. INTRODUCTION

This report discusses the financial safety net and bank resolution frameworks for eight countries in southern Africa: Botswana, Eswatini (formerly Swaziland), Lesotho, Mozambique, Namibia, South Africa, Zambia, and Zimbabwe.[4] It provides a cross-country comparison of the state of development of financial safety nets and bank resolution frameworks in the region and identifies areas where technical assistance may be better targeted to address gaps and deficiencies in the countries' bank crisis management arrangements. As most financial sector assets are held by deposit-taking banks, the analysis focuses mainly on them. However, many of the points made in the report are also applicable to other banks and some nonbank financial institutions. The report is based on a study undertaken by the World Bank (WB), which provides a detailed cross-country assessment of financial safety net and bank resolution arrangements.

Effective bank resolution frameworks and financial safety nets are important to preserve financial stability, which is a prerequisite for economic growth and sustainable poverty reduction. Financial crises can have severe and lasting effects on economic activity and on the welfare of firms and individuals, especially depositors. Bank failures can result in large fiscal costs, can have contagion effects on other financial institutions (banks and nonbank financial institutions), and can undermine the stability of the financial system. Financial crises tend to result in lower financial intermediation at higher costs, often for some years following a crisis. They also generally take longer to recover from than do other types of economic shocks. Financial crises and the long process of recovery following a crisis reduce the ability of the financial sector to perform its primary role, which is to transform savings into productive investments and provide an efficient framework for payments and settlements. For countries that have experienced bank failures on a systemic scale, the disruption to economic activity, the loss of savings, and the interruption to credit creation have had long-lasting adverse effects on economic growth, employment, and poverty. Those effects have been evidenced in many regions, including in East Asia and Pacific, Europe and Central Asia, Latin America and the Caribbean, South Asia, and Sub-Saharan Africa.

The extent of damage that bank failures impose on the economy and the resultant implications for poverty depend on a country's ability to identify and resolve bank distress quickly and with minimal disruption to the economy and wider financial system. Countries with poorly developed systems for detecting and responding to bank stress in a timely manner, and with inadequately designed and implemented resolution frameworks and financial safety nets, have generally experienced deeper and longer lasting economic effects than countries with robust frameworks in these areas.

This report assesses the financial safety nets and bank resolution framework arrangements in the eight countries on a range of topics. These include:

- Early detection of emerging stress in banks and corrective action frameworks
- Contingency planning by supervision authorities for dealing with weak banks
- Recovery planning requirements for banks
- Resolvability assessments
- Resolution planning

[4] Resolution is the restructuring of a bank using tools that safeguard public interests, including the continuity of the bank's critical functions, financial stability, and minimal costs to taxpayers.

- Legal framework for bank resolution, including objectives, resolution authority, triggers for resolution, legal powers for resolution, and safeguards
- Resolution strategies and crisis management preparedness
- Domestic coordination for financial crisis management
- Cross-border cooperation and coordination for financial crisis management
- Deposit insurance schemes
- Systemic bank resolution funding
- Emergency liquidity assistance

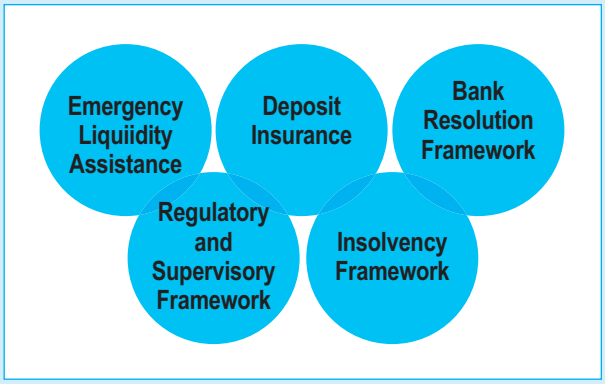
The structure of the report is as follows. Section 2 defines key concepts and terms, including financial safety nets, bank resolution framework, the Financial Stability Board (FSB) Key Attributes, and deposit insurance. Section 3 focuses on the state of financial safety nets and bank resolution frameworks in southern Africa. It provides an overview of the subregion's banking sectors, a summary of recent reform efforts, and an update on international cooperation efforts for cross-border issues. Section 4 summarizes the key resolution and funding issues and challenges identified in the comprehensive country-by-country study. This section includes the frameworks for corrective actions, recovery planning, and resolution. It also looks at the arrangements for domestic and international cooperation and coordination, deposit insurance, and liquidity support. Section 5 concludes with policy recommendations and suggestions of areas for additional work, including technical assistance.

2. TERMINOLOGY

2.1. Financial Safety Nets

Financial safety nets are the set of arrangements to reduce the effects of the failure of one or multiple financial institutions on depositors, the financial system, and the economy. Financial institutions, particularly banks, have a unique function in the economy as they take deposits from the public and play a critical role in payments and transactions between economic agents.[5] Because of this, banks are subject to prudential requirements and close supervision. Financial safety nets fall into two categories: (a) those that apply to adequately capitalized and viable but illiquid banks and (b) those that apply to inadequately capitalized and nonviable banks, which need to be resolved. They serve different purposes—the first for liquidity support and the second as a means of providing support to protected depositors in an insolvency situation—but both aim to minimize adverse effects arising from bank distress or failure. Figure 1 represents the main elements of a financial safety net, which need to work in concert with each other and can involve harmonization of various regulatory frameworks.

Figure 1: Financial Safety Nets and Regulatory and Resolution Frameworks



For banks that are assessed by the authorities as viable and with sufficient collateral but in liquidity stress, financial safety nets refer to emergency liquidity assistance (ELA) provided by central banks (also known as "lender of last resort" facilities). ELA is generally provided when a bank is assessed as being adequately capitalized (or in the process of being restored to capital adequacy) and when the bank has suitable collateral available to cover the central bank's credit risk and market risk associated with ELA funding. The ELA funds are generally extended for a short period (often less than one month) with a capacity for rollover and are subject to conditionality, including measures the bank in question must take to restore itself to a sound financial position. ELA is typically provided at interest rates above prevailing market rates in recognition of the higher risk involved and to discourage banks from accessing ELA facilities other than as a last resort.

For a financial institution assessed as nonviable (that is, substantially undercapitalized and unable to conduct its business in a prudent manner) and unable to restore itself to viability, financial safety nets are designed to minimize effects on depositors and the wider financial system on the closure of the bank or other form of resolution. The main financial safety net for a failed bank is deposit insurance. Deposit insurance schemes provide a mechanism to

[5] Banks are the primary financial institution in southern Africa, thus this report refers mainly to them.

insulate small depositors from loss and to give them prompt access to their deposits, up to a defined level, on the failure of a bank. Deposit insurance schemes are generally funded through regular levies on banks covered by the scheme and supplemented with a funding line from the government (known broadly as a pre-funded deposit insurance scheme). However, in some cases, deposit insurance schemes are funded initially through government funding, with ex post levies being imposed on banks if the government cannot recover its funding outlays from the assets of the failed bank (known as post-funded deposit insurance schemes).

Deposit insurance schemes fall into different categories depending on their range of functions. The simplest deposit insurance schemes are referred to as "paybox" schemes. These are used to reimburse insured depositors upon the closure of a bank by payout to insured depositors and the funds cannot be used for wider resolution purposes.[6] An alternative scheme known as "paybox plus" enables a deposit insurer to make a financial contribution to a wider range of bank resolutions, including purchase and assumption (P&A). The financial contribution to a resolution made by a deposit insurance scheme is normally subject to a least-cost test that limits the amount of funds provided to the minimum amount that would have been paid through payout. A deposit insurance scheme with an explicit mandate to seek the lowest-cost form of resolution to meet the objective of providing insured depositors with access to their funds is known as a "loss minimizer" scheme. A smaller number of deposit insurance schemes are referred to as "risk minimizer" schemes. These are schemes in which a deposit insurer has comprehensive risk minimization functions, including risk assessment and management, a full suite of early intervention and resolution powers, and, in some cases, prudential oversight responsibilities.

Another form of financial safety net in bank failure is the availability of systemic resolution funding.[7] Such funding may be needed for a range of purposes when resolving a systemic bank, potentially including the need (a) to finance the transfer of deposit liabilities (beyond insured deposits) to another bank, (b) to fund the transfer of impaired assets to asset management companies (AMCs), (c) to fund the capitalization of a bridge bank, and (d) to finance guarantees and indemnities. Its purpose is to reduce the adverse impact of bank resolution on creditors, the financial system, and economy. Systemic resolution funding can be sourced from regular levies on banks or, more commonly, through government funding that is repaid by the assets of the resolved bank, with any residual being repaid by ex post levies on banks. Under an appropriately structured systemic resolution scheme, any resolution funding needs to be provided subject to robust safeguards, such as (a) clearly specified statutory objectives, (b) specified purposes for which the funding may be used, (c) preconditions that must be met to access resolution funding (including that shareholders and other capital providers, at a minimum, must absorb losses to the full extent of their legal liability before any resolution funding is provided), (d) powers to apply terms and conditions to such funding, and (e) a process for recovering the full net present value of funding outlays (for example, through levies on systemic banks) over time.

2.2. Bank Resolution Framework

A bank resolution framework refers to the set of tools and arrangements available to resolve a nonviable bank. There are several tools by which a nonviable bank can be resolved. For nonsystemic small- and medium-size banks where a commercial (privately funded) sale to another bank is not feasible, the standard options are to either implement a P&A

[6] Barend Jansen, "Challenges for Resolution of Banks in Africa" (World Bank Group, Washington, DC, forthcoming).

[7] A systemic bank is a bank or banking group whose size, complexity, and other features have the potential to cause significant disruption to the financial system and economy in during failure or distress. Under Financial Stability Board and Basel Committee on Banking Supervision guidelines, a bank assessed as being systemically important at a global level (that is, across multiple countries and international financial markets) is categorized as a global systemically important bank (G-SIB). A bank that is not systemically important globally but is systemic at a domestic level is categorized as a domestic systemically important bank (D-SIB).

transaction (involving the transfer of insured deposits and viable assets to another bank) or to implement a payout of insured deposits. In either case, the failed bank's license is revoked, and nonviable assets are auctioned or otherwise liquidated. P&A and deposit payout options are only viable if an established deposit insurance scheme) or some other form of resolution funding is available.

In the case of systemically important banks, the authorities would likely determine that closing a failing bank would adversely affect the stability of the financial system, impede the continuity of critical functions, and cause significant damage to the economy. In those cases, resolution is likely to involve restructuring the bank to maintain critical functions and services (that is, banking functions and services that are essential to protect bank customers and maintain the stability of the financial system). This restructuring would generally be done either through recapitalizing the bank, for example, through a conversion of certain liabilities into equity or a write-down in the value of those liabilities (that is, a bail-in), or through an injection of capital from an external source, or through a transfer of the critical functions and services of the failed bank to a new entity, such as a "bridge bank." A bridge bank would be capitalized either through the bail-in of liabilities or through external capital injection. A variant of the bridge bank option is the so-called "good bank/bad bank" form of resolution, in which critical functions and services plus viable assets are transferred to the bridge bank (the good bank) and impaired assets and nonsenior liabilities are either retained in the failed bank (bad bank) or liquidated via asset management companies (AMCs). A further option for resolving a bank is to merge it into an existing bank by issuing new equity to the acquiring bank, generally with the shareholders' existing equity being written off or severely diluted.

Bank resolution frameworks typically consist of the following:[8]

- There is a government agency with statutory responsibility for resolving a bank. This agency, known as a resolution authority (RA), has the legal powers to intervene in a nonviable bank.
- There are statutory safeguards to protect against abuse of resolution powers, including the so-called "no creditor worse off" principle, under which creditors rendered worse off in a resolution than they would have been under a conventional winding up are compensated through a resolution funding mechanism.
- The legal framework provides tools for resolving failing banks such as (a) closure and payout, (b) P&A transactions, (c) mergers, (d) recapitalization through bail-in of creditors, (e) bridge banks, and (f) nationalization. See box 1 for a set of definitions of different forms of bank resolution.

The selection of resolution options will depend on several factors.[9] These include the systemic importance of the bank (having regard to its size and complexity and its market share in financial systems and markets) and the risk of contagion (that is, the potential for the distress or failure of one bank to spread to other financial institutions). Subject to these considerations, the selection of resolution will also depend on the costs of the resolution. The resolution option selected will be the one that achieves the desired resolution objectives (of maintaining financial stability, maintaining critical functions, protecting insured depositors, avoiding damage to the economy, and minimizing taxpayer risk) at the least cost. In the case of a nonsystemic bank, the most effective and least-cost resolution options tend to be those that favor P&A, with the residual (impaired) assets and uninsured deposits and other liabilities being retained in the failed bank and liquidated. For systemically important banks, the most effective and least-cost resolution options tend to be those that maintain continuity of critical functions and systems, either within the bank in restructured form or in another bank.[10]

[8] Javier Bolzico, Yira Mascaró, and Paola Granata, "Practical Guidelines for Effective Bank Resolution" (policy research working paper, World Bank, Washington, DC, 2007).
[9] David C. Parker, Closing a Failed Bank: Resolution Practices and Procedures (Washington, DC: International Monetary Fund, 2011).
[10] Claire L. McGuire, Simple Tools to Assist in the Resolution of Troubled Banks (Washington, DC: World Bank, 2012).

Box 1: Principal Resolution Options

Asset management company (AMC)	AMCs can be used in a range of bank resolutions. They involve the resolution authority establishing a company or other legal entity and funding it to acquire impaired assets at market prices or estimated recoverable values. In some cases, existing AMCs that are commercially owned may be used to acquire impaired assets from a failing bank, where in this case the AMC purchases the impaired assets at assessed recoverable value through a competitive bidding process. In either case, an AMC can be a useful way of separating impaired assets from a recapitalized bank or a bridge bank, thereby enabling management to focus on the resumption of normal banking business.
Bail-in	There are two forms of bail-in, each of which can be used to assist in recapitalizing a failing bank or capitalizing a bridge bank. The first type of bail-in is the contractual bail-in of liabilities, such as convertible bonds issued by a bank. Where bonds or other debt instruments have been issued with the legal capacity for conversion to equity or write-down upon defined triggers being breached (e.g., capital or nonviability triggers), these instruments would be bailed-in using the legal mechanism provided. The second type of bail-in is "statutory" bail-in, under which statutory powers are used by the resolution authority to convert debt to equity or to write down the value of debt upon a defined statutory trigger. Typically, this second type of bail-in occurs when the resolution authority deems a bank to be nonviable. Depending on the legal powers available, statutory bail-in could be applied to any subordinated and senior unsecured liabilities, excluding insured deposits. Bail-in would be applied in the inverse order of the ranking of liabilities in a winding up—that is, the lowest ranked liabilities in a liquidation would be bailed-in first, followed by the next lowest ranking, and so forth. Statutory bail-in is generally only a viable option if a bank has a reasonably significant tranche of subordinated debt or nondeposit unsecured senior liabilities (e.g., bonds); it is unlikely to be an attractive option if a bank is funded only by deposits.
Bridge bank (BB)	A bridge bank is a new bank, publicly owned and established by the resolution authority or another relevant agency, that acquires the critical business functions and services of a failing bank. It is capitalized through the transfer of assets (in an amount exceeding any liabilities transferred), to the bridge bank and by the bail-in of liabilities. Capitalization can also be achieved by the injection of funds through a resolution fund or the government. The noncritical functions and impaired assets of the failed bank are then wound up through liquidation processes.
Closure and payout (C&P)	C&P involves withdrawing the operating license of a nonviable bank and payout of insured depositors by the deposit insurance agency. The bank's assets are typically auctioned in tenders or similar processes and, after the deposit insurer has been reimbursed for all expenses, noninsured creditors are paid based on the realized value of the assets. This option is only used for small- or medium-size banks of no material systemic importance.

Good bank/bad bank (GB/BB)	GB/BB is a form of resolution in which the commercially viable business, insured deposits, and critical functions and services of the failed bank are moved to a bridge bank (or retained in the failed bank if that bank is recapitalized) and the impaired assets, subordinated liabilities, and noncritical functions and services are either retained in the failed bank to be liquidated or transferred to asset management vehicles for progressive winding up. The good bank is either a bridge bank with viable assets and critical functions and services, appropriately capitalized, or the original bank recapitalized and stripped of impaired assets. The bad bank is either the original bank in liquidation, containing impaired assets and nonsenior liabilities or an asset management company holding impaired assets.
Merger and acquisition (M&A)	Under a merger, most or all of the failed bank is sold to another bank by either diluting existing equity in the failed bank and issuing shares to the acquiring bank or by canceling existing equity and issuing new shares to the acquiring bank. This option is generally only used (a) where the failing bank has positive equity or where liabilities can be written down to eliminate losses and (b) where it is not so large as to result in excessive market concentration upon merger or acquisition. If implemented, a merger would need to be structured to ensure that only viable assets are included in the merger transaction or at least that impaired assets are fully written down to recoverable values.
Nationalization	As a last resort, a bank can be resolved by a transfer of its ownership to the state, followed by being recapitalized through government injection of equity. This option should be avoided where possible but is sometimes used in the case of systemic banks if the other resolution options are not feasible or would have adverse effects on the financial system or economy.
Purchase and assumption (P&A)	This is the most commonly used means of resolving a small- to medium-size bank. It involves transferring the insured deposits (and sometimes other liabilities) and viable assets to another bank willing and able to acquire them. Deposits and other liabilities are "assumed" by the acquiring bank in exchange for purchasing assets of the failed bank or by being provided with cash or securities by the deposit insurance agency or the resolution authority or via an alternative resolution funding arrangement. The residual assets of the failed bank are then sold off to repay remaining liabilities, often through a tender process where banks can bid competitively for the assets. This option can be used for banks of any size but is less likely to be used for systemic banks because issues over excessive market dominance of the acquiring bank can result from this. Moreover, in the case of large banks it may be impractical to implement a P&A transaction because other banks might not necessarily have the ability to absorb the business of the failing bank on such a large scale.
Temporary administration	The supervisory or resolution authority takes over the management of the troubled bank and runs it for a determined period, generally leading to either a restructuring of the bank and its restoration to viability, its sale, or resolution. Temporary administration is often used in situations where a supervisory authority lacks confidence in the ability of a bank's board and management to resolve a bank in distress and therefore appoints an administrator to assume temporary control to manage the bank into a recovery situation or to initiate resolution. Administration is not a permanent mechanism or a form of resolution in itself; it is a process by which recovery and resolution options can be assessed and implemented. It should be terminated as soon as the recovery has been completed or resolution has been initiated (if resolution then occurs under the direct control of the resolution authority) or completed (if resolution occurs via an administrator).

2.3. "Key Attributes of Effective Resolution Regimes for Financial Institutions"

In undertaking this study, the authors referred to the elements of bank resolution set out in the "Key Attributes of Effective Resolution Regimes for Financial Institutions" (Key Attributes) established by the FSB.[11] The Key Attributes (KA) are the principal international guidance on bank recovery and resolution issues and an important reference point for assessing the resolution frameworks of the countries covered in this study. A summary of the KA is set out in the box 2.

Box 2: Summary of Key Attributes

The "Key Attributes of Effective Resolution Regimes for Financial Institutions" set out 12 essential features that should be part of the resolution regimes of all jurisdictions. They are briefly summarized here.

- Scope. The resolution framework should at least apply to all systemically important financial institutions (banks, FMIs, insurance companies), including holding companies, subsidiaries, and foreign branches.
- Resolution authority. There should be a dedicated authority responsible for the resolution of financial institutions, with appropriate governance, operational independence, legal powers, accountability, and transparency.
- Resolution powers. There should be a comprehensive range of legal powers to enable a financial institution and members of the relevant regulatory group to be resolved in a manner consistent with resolution objectives. The powers should include the ability to assume control of a nonviable financial institution and relevant members of its group, replace senior management, implement a business transfer, recapitalize the financial institution, establish a bridge bank and implement a bail-in of liabilities.
- Resolution powers. There should be a comprehensive range of legal powers to enable a financial institution and members of the relevant regulatory group to be resolved in a manner consistent with resolution objectives. The powers should include the ability to assume control of a nonviable financial institution and relevant members of its group, replace senior management, implement a business transfer, recapitalize the financial institution, establish a bridge bank and implement a bail-in of liabilities.
- Set-off, netting, collateralization, segregation of client assets. The legal framework governing set-off rights, contractual netting, collateralization agreements, and the segregation of client assets should be clear, transparent, and enforceable and should not hamper the effective implementation of resolution measures.
- Safeguards. Resolution powers should be exercised in a way that respect the hierarchy of claims while providing flexibility to depart from the general principle of equal treatment of creditors of the same class. Creditors should be compensated to the extent they are rendered worse off than under a conventional liquidation of the resolved financial institution.
- Funding of firms in resolution. Jurisdictions should have statutory funding mechanisms or other arrangements in place so that authorities do not rely on public ownership or bailout funds as a means of resolving firms. Jurisdictions should have in place privately financed deposit insurance or resolution funds or a government-based funding mechanism with ex post recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the firm. Any funding arrangements should be subject to robust safeguards to minimize taxpayer liability and moral hazard.
- Legal framework conditions for cross-border cooperation. The statutory mandate of a resolution authority should empower and strongly encourage the authority wherever possible to achieve a cooperative solution with foreign

[11] The FSB's "Key Attributes of Effective Resolution Regimes for Financial Institution" was first released in October 2011 and revised in October 2014. See http://www.fsb.org/wp-content/uploads/r_111104cc.pdf?utm_content=VKD.

resolution authorities. Among other matters, the resolution framework should facilitate mutual recognition and enforcement in a host jurisdiction of a home authority's resolution actions while enabling the host authority to separately resolve a branch operation, if necessary.

- Crisis management groups (CMGs). Home and key host authorities should maintain CMGs with the objective of enhancing preparedness for, and facilitating the management and resolution of, a cross-border financial crisis affecting the firm.
- Institution-specific cross-border cooperation agreements. For financial institutions of systemic importance and with significant cross-border operations, there should be institution-specific cooperation agreements between the home and host authorities that set out the framework and processes for achieving a coordinated cross-border resolution.
- Resolvability assessments. Resolution authorities should regularly undertake resolvability assessments that evaluate the feasibility of resolution strategies and their credibility considering the likely effect of the firm's failure on the financial system and the overall economy. To improve a firm's resolvability, supervisory authorities or resolution authorities should have powers to require, where necessary, the adoption of appropriate measures to reduce the complexity and costliness of resolution.
- Recovery and resolution planning. Jurisdictions should put in place an ongoing process for recovery planning and resolution planning, covering at minimum domestically incorporated firms that could be systemically significant or critical if they fail. The recovery plan and resolution plan should be informed by resolvability assessments and take account of the specific circumstances of the firm and reflect its nature, complexity, interconnectedness, level of substitutability, and size.
- Access to information and information sharing. Jurisdictions should ensure that no legal, regulatory, or policy impediments exist that hinder the appropriate exchange of information.

The KA were drafted mainly to apply to global systemically important financial institutions (principally banks) and in the context of the lessons learned from the global financial crisis of 2009. However, many of the KA are equally relevant for domestic systemically important financial institutions and, to varying degrees, small- to medium-size financial institutions. Although the KA are not binding on countries, they have become increasingly influential and have been adopted as one of the international standards for the financial sector used by the WB and the International Monetary Fund (IMF) in providing Financial Sector Assessment Programs (FSAPs) and technical assistance (TA).

Proportionality is an important principle in assessing a country against the KA and in making recommendations for changes to resolution arrangements based on the KA. This principle recognizes that not all attributes are applicable to all countries. They need to be applied in a manner that considers the institutional arrangements, structure of the financial system, bank funding arrangements, and complexity of banking operations. Whereas some countries in the region, such as South Africa, may decide that a full application of the KA is appropriate in their specific cases, the other countries in the region would benefit from a proportional application of the standards that considers the structural and institutional characteristics of their respective financial systems.

A recent paper suggested that 7 of the 12 KAs are applicable to all countries, irrespective of the size and systemic importance of their financial system and banking institutions.[12] Those seven include (a) scope for the resolution regime (KA 1), (b) resolution authority (KA 2), (c) set-off/netting (KA 4), (d) safeguards (KA 5), (e) cross-border cooperation (KA 7), (f) resolvability assessment (KA 10), and (g) access to information and information sharing

[12] World Bank Group, "Using the FSB Key Attributes of Effective Resolution Regimes to Design Resolution Frameworks for Non-FSB Members" (policy note, World Bank Group, Washington, DC, forthcoming).

(KA 12). Several other KAs should be implemented proportionally, such as KA 11 on recovery and resolution planning, by focusing a risk-based approach on the largest and most complex institutions, as well as the KA related to funding (KA 6). The KAs related to crisis management groups (KA 8) and cross-border cooperation agreements (KA 9) are primarily relevant for global systemically important banks (G-SIBs) and other systemic cross-border banks. However, even smaller financial institutions need some degree of cross-border coordination where those financial institutions have cross-border operations that are systemically significant in home or host jurisdictions. This is the case with some South African banks, given their dominance in several host countries in the southern African region.

The KA related to resolution powers (KA 3) is important and complex, and the application of the different criteria depends on the complexity and systemic nature of the institution under resolution. The powers that are likely to be relevant in all jurisdictions are the powers to (a) remove management, (b) appoint an administrator, (c) operate and resolve a firm, (d) override shareholder rights, (e) transfer and assume assets and liabilities, and (f) liquidate an institution. Jurisdictions may want to include in their legal framework some of the powers that are more appropriate for the resolution of systemic institutions. Examples include the power to (a) ensure continuity of essential services, (b) carry out a bail-in, (c) impose a temporary stay on early termination rights, (d) impose a moratorium with suspension of payments, (e) establish a bridge bank, and (f) establish an asset management vehicle.

Not all resolution tools may be needed for all financial systems. For instance, a banking sector that is entirely or predominantly funded by deposits (especially retail deposits) does not lend itself well to bail-in. Bail-in also requires a comprehensive legal framework to ensure that legal challenges cannot result in the resolution being suspended or terminated through the courts. As part of the legal framework, bail-in requires a comprehensive framework and funding arrangements for compensating creditors who are rendered worse off because of a bail-in, as compared with the outcome that would have prevailed in a conventional winding up.

Some countries have resolution laws that apply differently to systemic banks than to smaller banks, with a wider range of resolution powers being available for systemic banks than for other banks or nonbank financial institutions. However, it is generally more common for countries to have a standard set of resolution laws applicable to all banks regardless of systemic importance. In that way, the resolution authority has the flexibility to select the appropriate resolution option for any given bank, depending on the circumstances. This recognizes that in some situations, such as in periods of acute financial system fragility, banks that would not ordinarily be regarded as systemic may have systemic effects on failure. Therefore, jurisdictions should design their resolution laws so that the resolution authority can flexibly determine which resolution tools to apply in the prevailing circumstances.

2.4. Deposit Insurance

Deposit insurance is a core element in the bank resolution framework. It provides a source of funding and associated processes to enable insured depositors to be fully protected from loss and to be given prompt access to their deposits up to a defined deposit limit (per depositor per bank) in a bank failure. Deposit insurance helps reduce the risk of depositor runs when the banking system is fragile. Deposit insurance also helps reduce the risk of government bailouts of banks, given that it provides a formal and capped protection of the most vulnerable parties in a bank failure, that is, the small depositors.

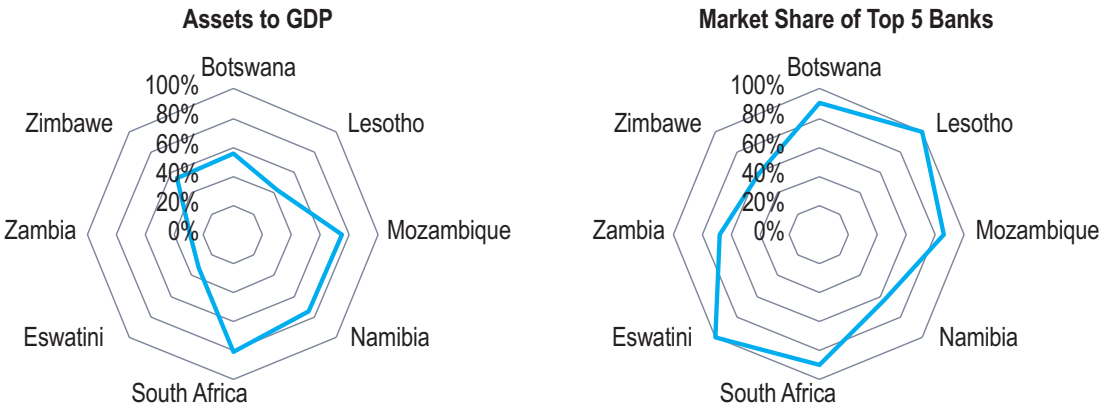
In some deposit insurance schemes, the funds available in the scheme can be used for a wider range of bank resolutions than just depositor payout. For example, the funds can be used to fund the transfer of insured deposit liabilities to another bank through a P&A transaction and can sometimes be applied to other forms of resolution, such as options with a bridge bank. The international standard for assessing countries' resolution arrangements is the International Association of Deposit Insurers' (IADI) "Core Principles for Effective Deposit Insurance Systems" (Core Principles), published in 2014 and summarized in annex II.

3. FINANCIAL SAFETY NETS AND BANK RESOLUTION IN SOUTHERN AFRICA

3.1. Overview of Banking Sectors in Southern Africa

The banking sectors in southern Africa vary greatly in size and sophistication from some of the largest in the continent to some of the smallest. In South Africa, the banking sector is large and sophisticated, having the attributes of an advanced country banking sector. In Eswatini and Lesotho, the banking sectors are small, and at an early stage in their development, and provide only a relatively limited range of banking services. The banking sectors of Botswana, Mozambique, Namibia, Zambia, and Zimbabwe fall in between the two extremes, albeit at varying stages of development, but they are still significantly underdeveloped relatives to South Africa. Large parts of the population in all countries have limited access to financial services, and financial inclusion is particularly limited in rural areas.

Figure 2: Bank Assets to GDP and Market Share of Top 5 Banks



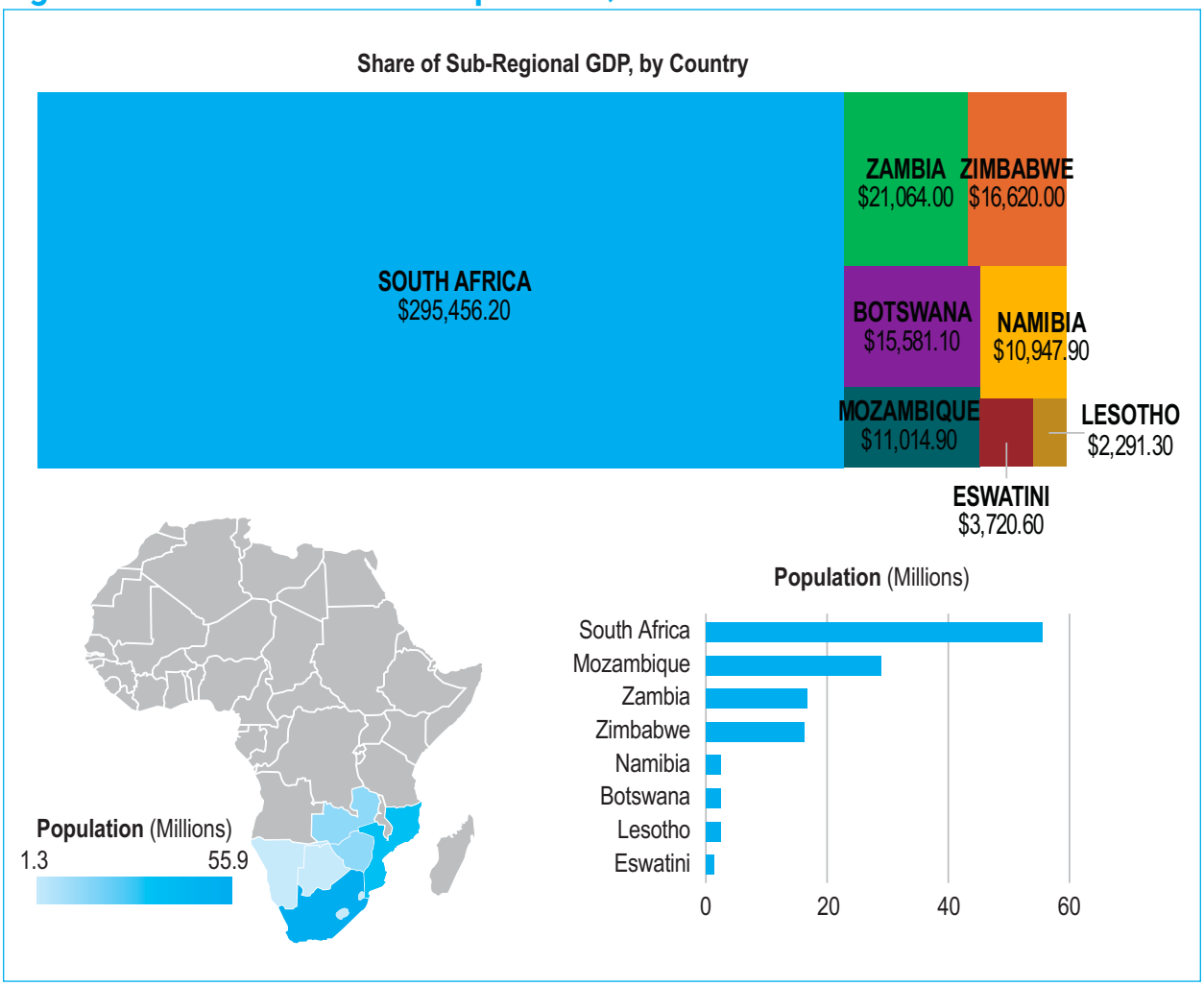
Source: World Bank FinStats 2018 (database).
Note: GDP = gross domestic product.

Most of the countries in southern Africa, except South Africa, have banking sectors dominated by foreign banks. The major banks domiciled in South Africa (especially Standard Bank and Nedbank) have a strong and systemically important presence in most of the countries in the region, especially in Botswana, Lesotho, Namibia, and Eswatini. Foreign banks from outside Africa, particularly the United Kingdom (in the case of South Africa, Zambia, and Zimbabwe) and Portugal (in the case of Mozambique) also have a significant presence. Although foreign banks provide undoubted benefits to the host countries, such as financial sector development and deeper capacity for the provision of credit and risk diversification, they also present a challenge to the host countries. The dominance of foreign banks creates a significant risk of cross-country contagion through various channels, including credit exposures, funding, functionality dependency, and financial market participation. These risks suggest the importance of the countries

across the region developing robust cross-border cooperation and coordination arrangements in supervision, corrective action, recovery, ELA, and bank resolution. This risk is one of the critical themes of this report.

Recent experience with systemic banking crises in Sub-Saharan Africa is relatively limited. Except for Nigeria in 2009, the last major banking crisis was in the 1980s and 1990s when large parts of banking systems had to be restructured or resolved.[13] Although financial depth was limited, the consequences of the financial crisis were significant and long lasting. Financial institutions became reluctant to lend, especially over the medium term. Customers became reluctant to open accounts, slowing down financial inclusion. Fiscal costs of resolving these crises were high.[14] Many businesses and households could not withstand the losses.

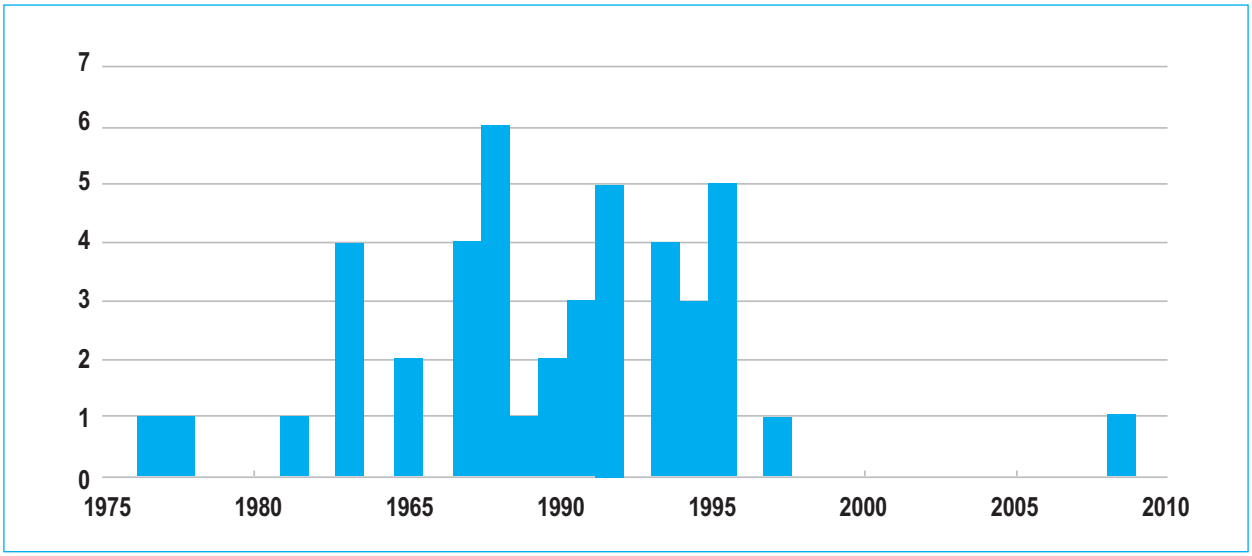
Figure 3: Nominal GDP and Population, Selected Countries



Source: World Bank. World Development Indicators database, 2019.
Note: GDP = gross domestic product.

[13] During that period, nonperforming loans reached 45 percent of loans in Nigeria, 70 percent in Cameroon in 1989, 60 percent to 80 percent in Tanzania, 50 percent in Senegal, and 40 percent in Ghana.
[14] Fiscal costs were 25 percent of GDP in Côte d'Ivoire and 10 percent of GDP in Tanzania.

Figure 4: Systemic Banking Crises in Sub-Saharan Africa, 1975–2011



Source: Reinhart and Rogoff, 2010; Laeven and Valencia, 2013.

Financial systems in southern Africa do not currently exhibit features commonly observed as contributory factors in past financial crises in other countries. There has been no significant increase in credit in recent years, external financing for banks is limited with domestic deposits remaining the principal source of funding, and there are few complex financial products in the markets. Nevertheless, there have been many recent bank failures on the continent. The most prominent failures include Crane in Uganda (9 percent of banking system assets), BIAC in Democratic Republic of Congo (10 percent), Moza Banco in Mozambique (9 percent), and three banks in Kenya (5 percent). Those banks failed for various and differing reasons; economic stresses triggered the crisis in most cases, and they were compounded typically by poor governance and risk management in the banks in question. Transmission channels also take a long time to materialize, as exposures are rolled over and liquidity support is provided, which can increase the magnitude of the resulting crisis.

3.2. Summary of Recent Reform Efforts

While the modernization of financial safety nets and bank resolution frameworks is a priority for many countries in the region, recent reform efforts have yet to show concrete results. Significant reforms are under way in Mozambique, Namibia, and South Africa, and smaller changes in existing frameworks are being considered or have recently been implemented in Lesotho and Zimbabwe. Recent experience with bank failures in the region has also highlighted the need to update existing frameworks, and several other countries are considering changes. Reforms on resolution and financial safety net arrangements are under way in some of the countries in the region, as discussed in this section. Reforms are also being or have been implemented for banking supervision, which provides a critical underpinning of financial stability and the frameworks needed for the early detection of bank stress and early intervention arrangements. Box 3 provides a brief discussion of banking supervision frameworks and reforms in two countries in the region: Namibia and South Africa.

South Africa is in the process of significantly modernizing its resolution framework through a new resolution bill, which will also introduce deposit insurance. The resolution bill, which will be introduced through an amendment to the 2015 Financial Sector Regulation Act,[15] is planned to be

[15] Parliament of South Africa, Financial Sector Regulation (FSR) Act, 2017.

Box 3: Supervisory Capacity in Namibia and South Africa

Namibia

Namibia improved its level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) between the 2006 and 2017, based on findings of the Detailed Assessment of Compliance conducted in 2017. Comprehensive regulatory regimes were introduced for market risk, country risk, consolidated supervision, and AML/CFT (Anti-Money Laundering and Countering Financing of Terrorism Act of 2009), and effective information-sharing arrangements have been put in place with the South African Reserve Bank (SARB), among others.

The Bank of Namibia employs separate on-site and off-site teams to assess the risks that banking groups are facing, the combination of which provides supervisory senior management with a good sense of the overall risk profile of each bank or banking group. Risk-based supervision was introduced in 2008. The assessment undertaken recommended to further strengthen the supervisory regime by consolidating risk methodologies and focusing more on forward-looking analyses. It also recommended to increase resources in the banking supervision department, particularly given additional responsibilities the department is scheduled to assume.

The regulatory framework for consolidated supervision was assessed as comprehensive. However, it relies on data being provided by the nonbank financial institution supervisor, which has room for improvement given that risk-based supervision has not been fully embedded for nonbank financial institutions. Because nonbank financial institutions are critical in Namibia because of their size, the interconnected financial system, and the prevalence of financial groups, making this data reliable will be an important area of future work. The assessment also recommended improvements in the approach toward dealing with problem assets, provisioning, and reserves as well as the liquidity risk framework applicable to banks.

South Africa

South Africa has a high level of compliance with the BCPs based on the 2015 Detailed Assessment of Compliance.[a] The supervisory regime is based on strong relationships between the supervisory authority and bank boards and senior management, as well as with banks' internal and external auditors. The Assessment also states that the registrar of banks (the head of banking supervision) and staff in the Bank Supervision Department (BSD) of the SARB are working under appropriate responsibilities and with adequate powers, holding banks to a high standard of corporate governance and risk management. South Africa has implemented Basel III requirements (a set of international banking regulations developed by the Basel Committee on Banking Supervision to promote stability in the international financial system).

The BSD was assessed as having an appropriate level of resources with highly qualified staff, substantial specialist skills, improved supervisory techniques and tools and as having more frequent on-site assessments, including for in-depth reviews. BSD uses the SREP (supervisory review and evaluation process) cycle and risk rating system as a general framework, together with sector-wide approaches and thematic on-site reviews. In addition, the BSD conducts detailed and intensive off-site analysis, equipping the analysis with wide-ranging techniques and tools appropriate for oversight of risk profiles and operations of banks and banking groups in South Africa.

One area noted for further work was the tools and techniques to assess and monitor spill-over risks to the banks from nonbanking activities in their financial groups. This area is especially important given the prevalence of conglomerate financial groups in South Africa. Another noted shortcoming was the lack of a resolution framework and, correspondingly, the incipient recovery and resolution planning of large banking groups.

The assessment also recommended reviewing the supervisory approach after the organizational changes resulting from the Twin Peaks reform[b] are completed. The review will be necessary to ensure that prudential risks of the entire financial system are monitored and that conglomerate supervision is being appropriately undertaken. Also needed may be a more formal framework to detect and assess systemwide and cross-sectoral risks and its integration to supervision of individual financial groups and regulated financial institutions.

[a] International Monetary Fund. 2015. South Africa: Financial Sector Assessment Program—Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision.

[b] Twin Peaks is model of financial regulation that splits regulation into two broad functions: market conduct regulation and prudential regulation.

introduced in the South African Parliament in 2019.[16] Reform efforts have been ongoing since 2013. As part of the new bill, the South African Reserve Bank (SARB) will be appointed as the resolution authority for banks and for systemic nonbank financial institutions and their holding companies.

It is proposed that the resolution authority in South Africa will have comprehensive powers. These powers will include (a) write down shareholders and unsecured and uninsured creditors to absorb losses, (b) require the issuance of new shares, (c) transfer assets and liabilities as part of a P&A transaction, (d) require a merger or amalgamation, (e) establish a bridge bank, and (f) convert unsecured and uninsured creditors' claims into equity (bail-in). Given that South Africa is a member of the G20, the aim is to bring the resolution framework fully into line with the KA.

South Africa is the only G20 country without explicit deposit insurance. The scheme proposed as part of the bill will be a prefunded paybox plus deposit insurance scheme, operated by a deposit insurance corporation to be established within, but operationally independent from, the SARB. All banks would be required to be members. The scheme is intended to be fully aligned with the IADI Core Principles.

Mozambique lacks the legal instruments to resolve failed banks, particularly the ability to write down existing shareholders.[17] Mozambique passed a law establishing a deposit insurance scheme in 2010, but it lacks operational capacity and is critically underfunded.[18] As a result, Mozambique is reviewing its existing legal and regulatory framework for bank resolution and deposit insurance. This includes amendments to the laws governing financial institutions, the central bank, the special insolvency regime for financial institutions, and the deposit insurance fund. Draft amendments propose to make the central bank the statutory resolution authority and provide for the introduction of new resolution powers in line with the KA.

The absence of resolution funding is a critical weakness in Mozambique, particularly as the existing deposit insurance scheme cannot be used to facilitate resolution. This situation limits the options for the authorities and increases the reliance on public funds to finance the cost of winding up distressed financial institutions. As a result, the authorities are also considering reforms to the deposit guarantee fund and an expansion of its mandate to paybox plus.

Namibia has drafted amendments to the Banking Institutions Act 1998 that will establish a Special Resolution Regime (SRR) for banks and bank holding companies. The amendments are meant to be adopted in 2018/19. The SRR would provide the Bank of Namibia (BON) with a wide range of powers for resolving the failure of a systemically important bank or bank holding company. Those powers would allow the BON to (a) write down shareholders and unsecured and uninsured creditors, (b) require the issuance of new shares, (c) carry out a P&A transaction, (d) establish a bridge bank, (e) establish an asset management vehicle, and (f) bail in unsecured and uninsured creditors. The provisions aim to bring the SRR in line with the KA.

Namibia has also drafted a deposit guarantee scheme (DGS) bill. The DGS will be a paybox scheme within the BON. All banks would be required to be members. Under the legislative calendar, the DGS bill would become effective after the SRR is in place.

[16] At the time of writing, South Africa's resolution bill was being reviewed by cabinet with the expectation that it would be passed into law by parliament in 2019. A consultation paper on the bill has been released. National Treasury, South African Reserve Bank, and Financial Services Board, "Strengthening South Africa's Resolution Framework for Financial Institutions" (consultation paper, National Treasury and Financial Services Board, 2015).

[17] When Mozambique's fourth largest bank by assets (Moza Banco) failed in late 2016, the central bank placed it under temporary administration. It was eventually recapitalized by the central bank employee's pension fund, which became the majority shareholder while existing shareholders retained a minority ownership.

[18] The deposit insurance fund struggled to pay out depositors of a small bank (less than 1 percent of system assets) that was closed in November 2016. After almost a year of effort, it had only managed to reimburse half of depositors and eventually ceased reimbursements.

Zimbabwe is one of the few countries in the region with an established deposit insurance scheme. Resolution functions were recently transferred from the deposit insurer to the central bank, and updates to the framework are envisaged with a view to adding capacity to develop a single customer view (SCV), least-cost testing, and P&A at the deposit insurance agency. The effectiveness of the deposit insurance scheme is limited, however, by the shortage of hard currency in a U.S. dollarized economy. As a result, any type of payout would likely need to be electronic and at a significant discount to the U.S. dollar nominal value of the deposit.

Lesotho is at a relatively advanced stage of assessing the parameters of a deposit insurance scheme and has developed a policy paper that sets out proposals for a scheme. Lesotho has received TA for its design, but considerable work remains to be done. Enactment of legislation appears to be many months or even years in the future.

Botswana has not yet established a deposit insurance scheme. However, preliminary assessment of the case for deposit insurance has been undertaken by the Bank of Botswana (BOB). A TA mission conducted by the IMF in 2017 recommended that Botswana establish a deposit insurance scheme.

Similarly, there is no deposit insurance in Zambia. The 2017 FSAP noted that a draft deposit protection law has been under preparation since the late 1990s but has made no substantive progress. The report noted that the draft is under review at the Bank of Zambia (BOZ). Likewise, there is no deposit insurance scheme in Eswatini and no progress has yet been made to establish one.

3.3. International Cooperation on Cross-Border Issues

As noted elsewhere in this paper, the banking systems in the southern Africa region are characterized by significant dominance of foreign banks, whether in the form of banks from South Africa having a major presence in other countries in the region or Europeans banks having a major presence in some of the countries (including Mozambique and South Africa). Foreign banks bring substantial benefits, including risk diversification, deeper capacity for lending and financial market development. However, they also bring risks, including the risk of contagion from parent bank distress to the subsidiaries or branches in host countries. It is therefore essential that there are robust frameworks in place for cross-border cooperation and coordination between the home and host countries for early intervention, ELA, recovery and resolution.

Ongoing efforts to promote regional cooperation on cross-border bank supervision and resolution have gained momentum in recent years. The FSB Regional Consultative Group for Sub-Saharan Africa regularly convenes policy makers to discuss financial vulnerabilities and the effects of financial regulatory reforms. The Association of African Central Banks (AACB) brings together governors of central banks and has established the Community of African Banking Supervisors (CABS), to convene all supervisory authorities in Africa. CABS has two established working groups: (a) one on cross-border banking supervision, chaired by the SARB, and (b) another on cross–border resolution and crisis management, which is chaired by the Central Bank of Nigeria. The work plan for the latter calls for the formation of crisis management groups to exchange information and develop joint crisis management plans. In addition, representatives of various central banks have identified the need for regional crisis simulation exercises to improve cooperation.

There is no established platform for exchanging information and monitoring risks of cross-border groups. Many large banking groups continue to be inadequately supervised, which potentially exposes the region to the risk of large cross-border contagion. The absence of proper cross-border supervision and information on cross-border activity and exposures impedes effective group oversight of cross-border banks, which features prominently in southern Africa. This absence also creates risks of a build-up of intragroup exposures and the potential bypassing of regulatory requirements (for example, with respect to related party and concentration limits). Recognizing

this, the AACB/CABS cross-border supervision working group has prioritized developing comparable financial and prudential data on pan-African banks. Such development aims to improve risk monitoring, decision making, and international cooperation. AACB is receiving support from FIRST (Financial Sector Reform and Strengthening Initiative) and the WB to improve the availability and regular exchange of supervisory information, to increase supervisory capacity, and to enhance the effectiveness of cross-border supervisory cooperation. The proposed project builds on work with the Partnership Making Finance Work for Africa and GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH).

In response to increased demand for guidance and technical assistance, the FSB, supported by the WB and the IMF, has developed extensive guidance on bank recovery and resolution. FSAPs and TA programs led by the WB and IMF have also provided mechanisms by which countries' financial safety nets and bank resolution frameworks can be assessed and recommendations can be made to strengthen them.

CAPITAL
BANKS
RISK

4. KEY ISSUES AND CHALLENGES

This section sets out the main issues and challenges in the eight countries covered in the study. It draws on the main report, which describes the issues in detail.

4.1. Preventive and Corrective Action Frameworks

Preventive and corrective action frameworks that trigger supervisory action to deal with noncompliance or emerging stress in banks are a crucial element of the banking supervision framework. Here, a distinction needs to be made between (a) preventive and corrective action frameworks that allow for supervisory discretion but provide for a structured approach to assessing response options based on triggers and (b) more rigid and prompt corrective action frameworks that have mandatory actions linked to statutory-based triggers. In this report, the term "preventive and corrective action" refers to the former, in which a supervisory authority has a framework in place that sets out triggers and corresponding indicative responses, but that provides the supervisory authority with considerable flexibility in its responses.

In most respects, the supervisory authorities in the countries included in this study have generally satisfactory legal powers for undertaking preventive and corrective actions. However, there are some gaps and deficiencies in the powers, such as (a) poorly defined triggers for preventive and corrective action powers, (b) the inability to replace directors and officers of a bank, and (c) the inability to extend preventive and corrective actions to a regulated group (as opposed to a licensed bank on a solo entity basis). Examples of poorly defined triggers for preventive and corrective action include broadly expressed statutory phrases, such as a bank that is "conducting its affairs in an unsound manner," a bank that is in "an unsound condition," or a bank that is "in violation of the [relevant] Act." In some countries, such as Mozambique, the supervisory authorities lack sufficient powers to remove shareholders from a bank, even in a situation where the bank's capital is negative. These gaps and deficiencies should be addressed as part of a broader strengthening of recovery and resolution powers.

The supervisory authorities' most significant gap is the general lack of adequate preventive and corrective action policies and of contingency plans for dealing with weak or noncompliant banks. Although the information is difficult to find from public sources, TA reports (for example, for Botswana and Lesotho) and FSAP reports (for example, for Namibia and South Africa) highlight the need to develop preventive and corrective action policy frameworks and contingency plans that have better definitions of the triggers and associated actions for each trigger (see table 2 for an example of a preventive and corrective action framework).

The activation of banks' recovery plans should be integrated into supervisory preventive and corrective action frameworks as one of the key early-stage actions in addressing bank stress. Given the absence of recovery planning requirements in most countries in the region, supervisory preventive and corrective action frameworks generally lack this element. In addition, supervisory authorities need to further develop contingency planning to identify the responses they would take during situations of bank distress. Except for South Africa, contingency planning to deal with bank stress is significantly underdeveloped in the region. Supervisory authorities need to develop and keep under review contingency plans for dealing with a range of bank stress and noncompliance scenarios, and the authorities need to regularly test those plans so that they build their capacity for preparedness.

Table 2: Indicative Triggers and Responses for a Supervisory Preventive and Corrective Action Framework

Stage	Risk	Indicative Triggers	Typical Actions
Normal	Low	• Capital ratio is above minimum tolerance level (where the tolerance level is a specified margin above the minimum regulatory capital ratio). • Liquidity ratio is above minimum tolerance level (where the tolerance is above the minimum regulatory liquidity requirement.) • Impaired loans are below a defined level (e.g., 1.0% of total loans). • Exposure concentration is below maximum tolerance level (a specified percentage below the maximum prudential limits). • Early warning indicators (EWIs) are all in the low risk (green) zone.	• Conducting normal supervisory risk assessment process • Conducting regular reviews of the institution • Conducting review and analysis of prudential data • Providing the assigned risk rating to the institution
Early warning	Moderate	• Capital ratio is below minimum tolerance (but still above minimum regulatory ratio requirement). • Liquidity ratio is below minimum tolerance (but still above minimum regulatory ratio requirement). • Impaired loans are between 1.0% and 2.0% of total loans. • Exposure concentration above maximum tolerance level (but below the maximum prudential limits). • Some EWIs are in low to moderate risk (yellow) zone.	• Conducting more frequent and targeted reviews by specialist risk teams • Imposing more frequent and additional reporting requirements • Having direct interaction and meetings with senior management and board • Providing written communication that requires the institution to present a plan and time frame to restore compliance with identified deficiencies • Conducting more frequent monitoring and communication of measures taken by the institution
Intensive oversight	Moderately high	• Capital ratio is below minimum regulatory ratio requirement but not less than 90% of the regulatory minimum. • Liquidity ratio is below minimum regulatory ratio requirement but not less than 90% of the regulatory minimum. • Impaired loans are between 2.0% and 4.0% of total loans. • Exposure concentration is above the maximum prudential limits (but not more than 20% above). • Some EWIs are in high risk (red) zone and others are in moderate to high zone (amber).	• Using formal powers to issue directions • Conducting more frequent on-site visits, meetings with board • Requiring revisions to business plans or governance arrangements • Requiring recovery plans to be activated • Requiring immediate steps to increase capital and liquidity • Placing restrictions on existing or planned business activities, limiting balance sheet growth • Increasing capital and liquidity requirements, limiting capital distribution, and having stricter leverage limits • Engaging external specialists to assess certain areas, such as asset quality

Mandated action	High	• Capital ratio is below minimum ratio requirement (e.g., between 50% and 90% of the minimum). • Liquidity ratio is below minimum ratio requirement (e.g., between 50% and 90% of the minimum). • Impaired loans are between 4.0% and 6.0% of total loans. • Exposure concentration is above the maximum prudential limits by more than 20%. • Most EWIs are in high risk (red) zone.	• Using formal powers to issue directions • Requiring institution to present and execute a remediation plan in short time frame and full recovery plan activation • Removing directors and management as necessary • Having institution demonstrate recovery actions or take formal enforcement actions taken • Preventing new lending and requiring reduction in operation expenses • Appointing a statutory manager or administrator if the supervisor has low confidence in the ability or willingness of management to restore the bank to financial soundness
Nonviable		• Capital is below 50% of minimum ratio requirement. • Liquidity is below 50% of minimum required level. • Recovery actions are assessed by supervisor as unlikely to restore the bank to viability.	• Resolution regime triggered

A further deficiency is the underdevelopment of EWIs and stress testing across most of the supervisory regimes (except, possibly, South Africa). Although most supervisory agencies do undertake some form of stress testing of banks and have some EWIs in place, these systems tend not to be well developed or integrated into the preventive and corrective action frameworks. This matter warrants further attention. Monitoring a range of EWIs can help to identify emerging stress in bank capital, liquidity, asset quality, market risks, and profitability at an early stage. This monitoring should be done in respect of the banking system as a whole and for individual banks. Annex III provides an example of EWIs.

For stress testing, supervisory authorities could be expected to conduct both top-down and bottom-up stress tests of the banking system and individual banks. Stress tests typically take several forms, including (a) macrofinancial stress tests (assessing overall effects on the banking system and individual banks), (b) single factor stress tests (assessing the effect of movements in interest rates and exchange rates), and (c) liquidity stress tests. In addition, reverse stress tests are becoming more commonly used, particularly for bank recovery planning. In all of the countries in the region more progress is needed in developing bank stress testing, both at systemwide level and individual bank level. These tests need to become a core element in the banking supervision framework for assessing bank vulnerability to economic and financial shocks. Annex IV provides information on stress tests.

The preventive and corrective action arrangements lack regular testing by the supervisory authorities in southern Africa. Some authorities have conducted simulation exercises to test for responses to bank stress and failure, but most have not done so yet.[19] Few, if any, have undertaken regular testing of their corrective action capacity. A further gap is the absence of cross-border testing of preventive and corrective action arrangements, which is an important matter, given the dominant presence of South African banks in the region.

[19] Crisis simulation exercises facilitated by the World Bank were undertaken in Mozambique in July 2016, in South Africa (albeit on cybersecurity) in June 2017, and in Zimbabwe in February 2018.

Mechanisms for cross-border cooperation and coordination in the preventive and corrective action processes, particularly memoranda of understanding (MOUs) between supervisory agencies, appear only to deal with information exchange. At a minimum, jurisdictions that prepare contingency plans, resolvability assessments, and resolution plans for parent banks (as in the case of South Africa) should share them with the authorities in host jurisdictions to clarify the intended approach for the parent bank's subsidiaries in the host jurisdictions.

Supervisory agencies need to develop their capacity to assess solvency, viability, and liquidity for preventive and corrective action, for ELA, and for resolution purposes. The South African supervisory authorities have greater capacity in this regard than do the supervisory authorities in the other countries of the region. However, even South Africa has scope to further strengthen the frameworks needed to assess solvency, liquidity, and viability, especially under acute time pressure.

Strengthening the supervisory capacity to undertake assessments of bank solvency, liquidity, and viability requires developing data templates that banks can complete at short notice when the supervisory authority requests information. The data templates need to contain enough data so that meaningful assessments of solvency and viability can be made. Strengthening capacity will also require methodologies for asset valuation, including (a) conducting valuation under acute time pressure (as is often the case in a financial crisis), (b) training supervision staff to undertake these valuations, and (c) exercising the authority to outsource valuation to external firms. Solvency and viability assessment will also need to be tested regularly to build and maintain capacity among the supervisory authorities.

4.2. Recovery Planning

The bank recovery planning arrangements across the region are underdeveloped. South Africa appears to be the only supervisory authority that has established recovery planning requirements for banks, although Namibia is expected to require recovery plans in the next 12 months or so. The absence of effective recovery planning requirements is a significant deficiency in the region and should be a matter of high priority. The supervisory authorities that have not yet established recovery planning requirements should do so within the limits of their legal powers, focusing initially on D-SIBs and then extending progressively to other banks.

Recovery planning should be closely integrated into bank risk management frameworks, ICAAP (internal capital adequacy assessment process) requirements, bank liquidity planning arrangements, and business continuity planning requirements. Laws need to be upgraded to specifically establish recovery planning requirements for banks, including the ability of the supervisor to specify the minimum requirements, to require board sign-off, to require external audit or review, and to require banks to undertake periodic testing of recovery plans. As has been done in many advanced and emerging economies, the supervisory authorities in southern Africa need to develop guidance for banks to help them prepare recovery plans. This guidance would usually cover the following: governance arrangements for recovery plans (business-as-usual governance and crisis response governance); triggers for invoking recovery plans and recovery actions; restoration points for postrecovery capital and liquidity; preparatory measures to implement recovery actions; recovery options; steps to implement recovery action; scenario requirements; and recovery plan review and testing arrangements. Supervisory authorities will also need to build capacity among their staff to review and provide feedback to banks on recovery plans and to integrate the supervision of recovery plans into the broader on-site and off-site supervisory arrangements.

Supervision authorities need to integrate the activation of recovery planning into the authorities' preventive and corrective action frameworks. Specifically, supervisory authorities should identify the triggers for a bank to activate its recovery plan and the specific recovery actions within the plans and should integrate these into supervisory early

intervention arrangements. Supervision authorities should develop a program of regularly testing their preventive and corrective action frameworks, including activation of bank recovery plans, so that they can build and maintain the capacity to respond to bank stress and distress situations.

4.3. Bank Resolution

Resolution Authority, Objectives, Operational and Institutional Independence, Access to Information

In most countries the law does not explicitly specify a resolution authority. South Africa's Parliament will be enacting a new resolution bill that will appoint the SARB as the resolution authority for systemic banks and will formalize resolution powers and responsibilities. Mozambique is also undertaking similar reforms to designate the Bank of Mozambique as the resolution authority. In Zimbabwe, the resolution functions were recently transferred from the deposit insurer to the central bank. In other countries, the law does not formally designate a resolution authority, although it is generally clear which agency performs the resolution function in each case (that is, the central bank or supervisory authority). Laws need to be strengthened along the lines specified in the KA, with clearly defined resolution authorities, with well-specified functions, and with robust accountability and transparency arrangements.

The specification of resolution objectives is generally inadequate in most countries' laws. The laws generally contain a broad set of purposes, but they are typically confined to financial stability or the protection of depositors. They rarely include reference to other considerations, such as maintaining the continuity of critical functions and services, seeking to minimize adverse impacts on the real economy, or seeking to avoid, where practicable, fiscal costs or risks. Similarly, the resolution legislation in the countries studied does not generally include reference to avoiding adverse effects on the financial systems of other countries, which is a significant omission given the degree of cross-border banking activity in the region.

The countries in question should review their resolution laws and incorporate more precisely defined objectives, broadly aligned to those set out in the KA. A hierarchy of objectives could be considered to manage potential conflicts between objectives (such as promoting stability in the financial system while seeking to avoid fiscal costs and risks). A ranking of objectives could involve the following:

Maintaining continuity of critical functions and services, maintaining the stability of the financial system, and protecting insured depositors.

- Subject to the above, avoiding adverse effects on the economy and uninsured creditors.
- Subject to the above, minimizing fiscal risks and costs and associated moral hazard.
- Subject to the above, avoiding adverse effects on the financial systems and economies of the home or host countries affected.

Powers and Tools

Laws relating to bank resolution in southern Africa generally lack clearly defined triggers for entering a bank into resolution (for example, on the basis of nonviability). Triggers often relate to different types of situations or events including "insolvency," generally not defined; breach of prudential requirements; imprudent conduct; and capital deficiency. Laws need greater clarity, including clear triggers to enter a bank into resolution on the basis of nonviability, with statutory criteria to enable nonviability to be clearly understood. Supervisory and resolution authorities need to develop in a transparent manner more detailed administrative guidance for the factors to be considered when assessing bank solvency, liquidity, and viability.

Triggers for resolution must occur well before insolvency to avoid excessive disruption to the financial system and thus maximize the potential returns for creditors and limit the costs associated with resolution. The inclusion of subtriggers should also be considered for categories of resolution powers once entry into resolution has occurred. For example, the use of statutory bail-in (if adopted) could be subject

to a trigger that involves both the systemic effect of the bank's failure and the need to first have required shareholders and subordinated creditors to absorb losses to the full extent of their potential liability before bailing in senior unsecured debt.[20]

In most cases, the laws limit resolution powers to licensed banks. The laws do not explicitly enable resolution powers to be exercised for holding companies or subsidiaries, which impedes effective group resolution. Moreover, the laws in most countries in the study do not explicitly apply resolution powers to host jurisdiction branches of foreign banks. Because of those omissions, many of the authorities in the region would be unable to implement group resolution comprehensively. The authorities in host countries would also be impeded in exercising resolution of foreign branches in their jurisdiction where the home resolution authorities have not implemented a group-based resolution to satisfactorily minimize adverse effects on the host country's financial system and bank customers. Most of the countries in the region lack statutory powers to enable a host authority to legally recognize and enforce actions of a home resolution authority. Having a power of this nature is important, particularly in situations where the host authority is satisfied that the home authority's resolution actions would meet the systemic stability and customer protection objectives of the host authority. The absence of cross-border legal recognition and enforcement powers should be remedied as part of a major upgrade to resolution laws across the region.

Most of the countries have only limited legal powers available for resolution. Most can issue directions to a bank (which can be used to pre-position for resolution and to implement elements of a resolution), and most have some form of business transfer powers and powers to appoint an administrator or statutory manager to assume control of a bank, but with significant gaps or deficiencies in the laws. In most cases, the powers for dealing with bank failure rely on court-based insolvency processes, with only limited scope for the resolution authority to implement resolution options.

In general, the countries in the region lack sufficient powers to do the following:

- Appoint an administrator to replace management and override shareholders' powers.
- Establish and capitalize a bridge bank, and transfer some or all of a failed bank to a bridge bank.
- Establish and fund an asset management company.
- Issue capital instruments in a bank under resolution.
- Remove shareholders from an insolvent or otherwise nonviable bank or dilute shareholders' interests to reflect the assessed market value of their equity.
- Implement a statutory bail-in of liabilities for which there is no contractual basis to convert to equity or write-down.
- Apply a comprehensive moratorium or stay-of-action.

South Africa is implementing a set of comprehensive reforms through a resolution bill that, once enacted, will incorporate those kinds of resolution powers, broadly in alignment with the KA. Namibia is also embarking on legislative reforms to establish a comprehensive set of resolution powers aligned to those in the KA. To varying degrees, the other countries in the region have laws that fall well short of what is needed for effective resolution and would appear to be several years away from being able to implement the needed reforms. A priority for these countries is to quickly develop policies and laws to ensure that, in due course, they align broadly to the KA. However, this action needs to be done in a manner that suits each country's circumstances and institutional arrangements.

Safeguards

The laws in the countries in southern Africa generally make no provision for safeguards in the exercise of resolution powers, such as the "no creditor worse off" safeguard referred to in the KA. Reflecting this, there is no mechanism to compensate creditors

[20] As noted elsewhere in this report, statutory bail-in is a tool that is most likely to be applicable in countries where the systemic banks are funded by substantial tranches of senior and subordinated unsecured nondeposit debt, in addition to deposit liabilities. Bail-in is much less likely to be a viable option in countries where the banks are predominantly funded by deposits.

that are rendered worse off under a bank resolution than in a conventional insolvency liquidation. This omission makes it difficult to implement some forms of resolution without incurring considerable risks of legal challenge, especially in the use of partial transfers of business to a bridge bank (where some of the business is retained in the failed bank) or in a statutory bail-in of creditors.

Sufficient safeguards against court intervention in bank resolutions are lacking. In many countries, judicial challenge to a resolution is a considerable risk, especially if the resolution resulted in an alteration of shareholder or creditor property rights. In such cases, the judicial remedies may take the form of suspending, modifying, or terminating a bank resolution that the resolution authority was implementing or had implemented. Such a situation might create attendant disruption to creditors and other bank customers, interruption of critical functions and services, and financial system instability. In recognition of these adverse effects, international principles such as the KA, advocate a constraint on judicial remedies, such that a court is empowered to award compensation only to creditors and others rendered worse off than under a conventional winding up (that is, the "no creditor worse off" principle). Under such international principles, courts are not empowered to suspend, modify, or terminate a bank resolution. Resolution laws in the region's countries need to be amended in line with such principles.

Reforms are well under way in South Africa, and Namibia is also considering developing new resolution laws that would, if implemented, incorporate safeguard processes. In the other countries, reforms have been undertaken in some areas, but not comprehensively. Much work remains to be done in this area across the region.

Resolvability Assessments and Resolution Planning

The laws in most countries do not explicitly provide for a resolution authority to obtain data from banks to undertake bank-specific resolvability assessments and resolution planning. This ambiguity potentially impedes the ability of resolution authorities to undertake bank-specific resolvability assessments and to develop resolution plans. General supervision powers to obtain data from banks would likely enable much of the data for resolvability assessments and resolution planning to be acquired. Nevertheless, almost of the relevant information and data for resolvability assessments and resolution planning will not be available through the normal information collected by supervisors. Accordingly, as appropriate, the laws in the countries in question should be amended to empower the resolution authorities to obtain information and data from banks, including as a group, for the purposes of resolvability assessments and resolution planning. In addition, the resolution authorities should require banks to obtain external audits or other forms of independent verification of this information and data. In addition, the laws should enable the resolution authorities to require banks (and wider financial conglomerates where applicable) to make specified changes to their organizational structure and operations, consistent with resolution plans, to facilitate cost-effective resolution.

Beyond the need for stronger laws in this area, the authorities need to develop data templates for the granular information needed for resolvability assessment and resolution planning. Much of this data is outside the normal range of information that supervisors routinely collect to assess a bank's financial and prudential condition; it relates more to the operational structure of a bank and banking group, the identification of specific critical functions and services, the extent and nature of the participation of a bank in key financial systems and markets, and the nature of interdependencies between different legal entities in a banking group. Resolution authorities will need to develop data templates to capture information of this nature and work with the banks to build their internal capacity to generate such data. Resolution authorities will also need to build their internal capacity to interpret the information received and integrate it into resolvability assessments and resolution plans.

Information on the extent of progress on resolvability assessments and resolution planning in the region's countries is limited. In Botswana and Lesotho, the authorities have not yet developed the policy frameworks for undertaking resolvability assessments

or developing resolution plans. In South Africa, the SARB has undertaken preliminary thinking on these matters, but to our knowledge has not yet implemented resolvability assessments or resolution planning for systemic banks. Mozambique and Namibia have yet to undertake resolvability assessments or resolution planning. It is unclear what the state of progress is in the other countries, but it seems unlikely that they have made much progress. This is understandable, given that these are highly complex areas; many G20 countries have not yet made substantial progress in resolvability assessments and resolution planning. Nonetheless, over the medium term, the authorities in the region need to develop the frameworks for resolvability assessments and resolution planning and then at least implement resolution plans for the D-SIBs in their jurisdictions.

Resolution Strategies and Toolkits

The respective resolution authorities need to prepare a generic resolution "toolkit" as an important precursor to developing resolution plans for systemically important banks. Such a toolkit is fundamental to building the capacity for bank resolution. It needs to cover several elements, including the following:

- Identification of resolution strategies for a range of bank failure situations, including closure and payout, P&A transactions, recapitalization through bail-in, recapitalization via bailout, and bridge bank solutions
- Criteria for selecting resolution strategies, including systemic impact assessment, contagion risk, and resolution costs
- Preparatory measures for different resolution options, such as the arrangements for creating bridge banks and the indicative terms sheets for capital instruments.
- Guidance on the step-by-step implementation for each resolution option.
- Domestic coordination arrangements
- Cross-border coordination arrangements
- Public communication strategies

In southern Africa, given the dominance of South African banks, cross-border coordination is an important element of resolution toolkits and bank-specific resolution plans. This situation suggests that the SARB, when it undertakes resolvability assessments and resolution plans for D-SIBs domiciled in South Africa, needs to extend those frameworks to the cross-border operations of the banks and closely coordinate with the host country authorities. This coordination should include an assessment of the feasibility and efficacy of resolution options under single point of entry (SPE) and multiple points of entry (MPE) models.[21]

Except for South Africa, resolution authorities have not yet begun to prepare resolution toolkits. This effort should be a key priority in the near term, given that the development of resolution guidance is a foundation for building capacity. Once the resolution toolkits have been developed, ongoing capacity building will require regular testing. This testing should be done in conjunction with the other domestic authorities that have responsibilities for aspects of resolution, such as the finance ministries and securities regulators. In the medium term, and ongoing, the authorities should undertake occasional cross-border crisis resolution exercises to test their capacity to implement a coordinated resolution of banks with significant cross-border operations.

Resolution Funding

Existing arrangements for resolution funding are inadequate in all southern African countries covered in this study. Except for Mozambique and Zimbabwe, no country in the region has established deposit insurance schemes. South Africa is planning to establish a scheme through legislation to be submitted

[21] Under an SPE resolution model, resolution involving recapitalization entails injecting capital at the level of the parent entity at the top of the group. Capital can be introduced either through external capital sources or through bail-in, and it needs to be sufficient to recapitalize the parent entity and all bank entities in the group. Under an MPE model, capital injection (through external capital sources or bail-in) is done individually at each bank entity in the group. The two models have different advantages and disadvantages, which are discussed elsewhere in the report

to parliament in 2019. Namibia is also developing legislation to establish deposit insurance. The other countries in the region have yet to establish deposit insurance schemes, although most intend to do so to help strengthen their resolution arrangements.

Southern African countries lack funding structures for other forms of resolution, such as in systemic crises, and would rely on ad hoc public funding under current arrangements. For example, funding may be needed for recapitalization (especially where statutory bail-in is not applied to some liabilities), liquidity support, guarantees, indemnities and the financing of transfers of assets, and liabilities from a failing bank to another entity (for example, a bridge bank, existing bank, or an AMC).

There are no industry-financed resolution funds or statutory systemic funding through temporary government financing with ex post bank levies in place in any of the countries. Nor are there any proposals to implement such arrangements. TA programs in some countries (for example, Botswana and Lesotho) and FSAP reports (for example, Namibia) have recommended that the countries establish either industry-funded resolution funding schemes (beyond deposit insurance) or a statutory framework enabling the government to provide resolution funding. The statutory framework would be subject to robust safeguards, including defined preconditions and a statutory capacity for the government to recover any public funding outlays (in net present value terms) from the banking industry. Those TA and FSAP reports also recommended that a statutory framework specify the objectives of and preconditions for any use of public funding in bank resolution to minimize moral hazard and excessive risk to the taxpayer.

For most countries with relatively small banking systems, the general view is that a postfunded system—under which the government provides interim funding and then levies banks on an ex post basis to recover any funding outlays not reimbursed from assets of the resolved bank—is a more efficient and less burdensome way to fund systemic resolution than a pre-funded scheme with ex ante levies on banks. This postfunded system recognizes a low probability of systemic bank failures. Building a potentially large pool of funds for such events imposes significant costs on banks and their customers and entails substantial opportunity costs because of the funds being unavailable for other purposes, notably lending to bank customers. Further work in these areas will be necessary across the region as the authorities consider the alternative funding options available.

4.4. Domestic and International Cooperation and Coordination

Domestic and (especially) cross-border information exchange arrangements are limited across the region. Many supervisory authorities have the legal powers to exchange bank-specific information with foreign supervisory authorities. However, domestic and cross-border powers to exchange bank-specific information between supervisory or resolution authorities and other agencies (for example, finance ministries and nonbank financial institution regulators) are limited. This limitation constrains a jurisdiction's ability to coordinate bank recovery and resolution, particularly where the supervisory and resolution roles are conducted by different agencies. Legal powers and associated confidentiality requirements need to be strengthened for bank-specific information exchange and cooperation between supervision and resolution authorities and other relevant domestic agencies, and between countries.

Most countries lack a financial stability committee (FSC) or a similar body to coordinate domestic crisis management. South Africa has a Financial Stability Oversight Committee and a Financial Sector Contingency Forum and is planning to establish a council of financial regulators. In Zimbabwe, an FSC was established in 2012. In other countries, the absence of an FSC is a significant gap in their frameworks for dealing with systemic bank distress situations, given that the capacity to respond effectively to a systemic crisis requires effective coordination between the relevant agencies. More generally, the lack of effective FSC arrangements impedes developing a coordinated approach to promoting financial stability. Accordingly, it is recommended that FSC arrangements should be established in countries that do not currently have them.

Supervisory authorities have established MOUs with their counterparts in other countries to facilitate information exchange and cooperation. However, those memoranda mainly address supervision issues and do not specifically provide a basis for information exchange for cross-border recovery or resolution. Similarly, comprehensive MOUs have not been developed at a domestic level between the relevant agencies to deal with bank recovery and resolution issues. The absence of domestic and cross-border MOUs significantly impedes effective coordination and needs to be addressed as part of the wider effort to strengthen bank recovery and resolution arrangements.

Authorities in the region, potentially led by the SARB given the prevalence of cross-border banks headquartered in South Africa, should promote dialogue on cross-border cooperation and coordination on bank early intervention, recovery planning, ELA, and resolution. Initially, South Africa could host such an effort in the form of a policy dialogue or conference of all relevant authorities to agree on the areas needing cooperation and coordination. In addition, the region's authorities could host a work session to establish the frameworks that include developing MOUs, creating policies to coordinate each stage of generic crisis management, and identifying key elements needed for bank-specific cross-border coordination of recovery plans and resolution plans.

Except for South Africa and Namibia, which have entered into supervisory groups (SG) or colleges and crisis management groups (CMG) for some D-SIBs, the authorities lack formal coordination mechanisms. This lack impedes effective cross-border coordination, especially in relation to the major South African banks. Once suitable cross-border bank recovery and resolution MOUs have been established, the authorities (led by the SARB) should establish a regional SG and CMG covering the South African banks operating in the region. The SG and CMG would help to foster the development of coordinated recovery and resolution plans for these banks.

4.5. Deposit Insurance Arrangements

Of the eight countries covered in this study, only two (Mozambique and Zimbabwe) have established a deposit insurance scheme. South Africa will implement a deposit insurance scheme following passage of its resolution bill in 2019. Namibia is currently establishing a deposit insurance scheme. Zambia prepared a draft bill for a deposit insurance scheme, but this draft apparently has not been enacted. Botswana and Lesotho have received technical support that included recommendations (in 2016 and 2017 respectively) to establish deposit insurance schemes.[22] Lesotho has undertaken some work in developing proposals for deposit insurance, but the effort has not progressed to a public discussion paper or formal proposal.

The absence of deposit insurance in most of the countries in the region presents a significant gap in the financial safety net and increases the risk of retail deposit runs in periods of banking system stress. The absence of deposit insurance increases the probability of fiscal authorities coming under political pressure to bail out failing banks or to introduce ad hoc protection of deposits in cases of bank stress. The relatively high level of interconnectedness between banking systems in southern African countries results in a significant risk of contagion should the parent banks fail or become acutely distressed. The absence of deposit insurance in most countries in the region increases the risk of contagious runs triggered by distress in the parent banks.

Before deposit insurance is established, basic preconditions must be in place to reduce moral hazard. A summary of the standard preconditions for deposit insurance are listed in box 4. In addition, countries must have a comprehensive insolvency law and efficient, well-resourced judicial systems to enable banks to be liquidated in a timely manner and without undue sacrifice of value or disruption to financial

[22] IMF TA reports provided to Botswana in March 2016 and Lesotho in February 2017

markets and the economy. To varying degrees, those preconditions exist in the countries included in this study. However, significant deficiencies and further improvements are needed, including the following:

- Further develop accounting and auditing standards and practice.
- Strengthen governance and risk management frameworks in banks.
- Further strengthen risk-based supervision, capital requirements, and corrective action frameworks.
- Establish more comprehensive recovery and resolution arrangements.
- Strengthen insolvency laws and provide courts with specialist resources needed to facilitate efficient insolvency and liquidation proceedings.
- Strengthen cross-border cooperation and coordination to ensure effective regulation, supervision, and resolution.

Addressing those improvements requires a comprehensive effort at the national level in the medium to long term. Subject to this effort, deposit insurance schemes need to be established in the countries in question, in parallel with other reforms to strengthen the overall financial safety net.

Box 4: Preconditions for Effective Deposit Insurance

The International Association of Deposit Insurers' (IADI) "Core Principles for Effective Deposit Insurance Systems" (2014) describe how the establishment and design features of deposit insurance depend on many preconditions. Without these, deposit insurance would be less effective and could create moral hazard. The preconditions include the following:

- **Macroeconomic environment.** Macroeconomic conditions influence the effectiveness of markets, the ability of the financial system to intermediate resources, and economic growth. Persistent instability hampers the functioning of markets, and such conditions affect the ability of financial institutions to absorb and manage their risks. In periods of economic instability, market volatility can lead to destabilizing creditor runs (including depositor runs).
- **Financial system structure.** The soundness of a financial system influences the appropriate design features of a deposit insurance system. Any assessment of a deposit insurance system should consider the health and structure of the financial sector and the range of possible demands on the deposit insurer. The existence of and nature of depositor preference is also relevant to consider when designing a deposit insurance framework.
- **Prudential regulation, supervision, and resolution.** Strong prudential regulation and supervision help to ensure that an institution's weaknesses are promptly identified and corrected. Implementation of corrective measures is monitored and, where deficient, early intervention and an effective resolution regime help to lower the costs associated with bank failures. Supervision helps to reduce moral hazard risks that would otherwise arise. An effective resolution regime is essential, including timely entry into resolution and the availability of a range of resolution options.
- **Legal framework.** Deposit insurance systems cannot be effective if relevant and comprehensive laws do not exist or if the legal regime is characterized by significant inconsistencies. The legal framework has a significant impact on the activities of the deposit insurance system. A well-developed legal framework should incorporate a system of business laws, including corporate, insolvency, contract, creditor rights, consumer protection, anti-corruption and fraud and private property laws.
- **Accounting, disclosure, and auditing.** Sound accounting and disclosure regimes are necessary for the effective evaluation of risks by deposit insurance systems. Accurate, reliable, and timely information can be used by management, depositors, the market, and authorities to make decisions regarding the risk profile of an institution and thereby increase market, regulatory, and supervisory discipline. A sound accounting and disclosure regime includes comprehensive and well-defined accounting principles and rules that command wide international acceptance. Effective auditing is essential to the verification of the accuracy of disclosures and compliance with accounting standards.

The only fully operational deposit insurance regime in the region, in Zimbabwe, needs considerable strengthening to align with best practice.[23] A recent report identified the need to (a) establish an SCV, (b) develop the systems and processes for prompt payout (with an ultimate target of payout within seven days), (c) further enhance P&A capacity, (d) and ensure that there are robust domestic and cross-border coordination arrangements.[24] Contingency plans also need to be developed, and regular simulation testing needs to be adopted to ensure that the deposit insurance agency is capable of performing its functions to the standard required, both in the accuracy of payout and deposit account transfer and in the speed.

In South Africa, the deposit insurance scheme is intended to be a paybox plus scheme and operated independently from, but affiliated to, the SARB. This scheme will be pre-funded by regular levies on banks, with back-up funding from the SARB.

Some of the countries in the region are likely to require technical support to establish or improve their deposit insurance arrangements. Key areas include (a) design of the policy framework and institutional arrangements, (b) mandate (for example, paybox, paybox plus, or a more complicated risk minimization), (c) types of deposits covered, (d) size of insurance limit, (e) gross versus net payment, and (f) funding arrangements (including the regular bank levy arrangements, contingent funding line with the government or another party, and ex post additional bank levy arrangements).

Additional support may be needed for the design of the funding arrangements, including the scoping of the required target size of the fund, the period to reach the target size and the levies needed to establish this, plus supplementary credit lines with the government. Operational support would include arrangements to (a) enable an SCV, (b) facilitate prompt payout (that is, seven days or less), (c) facilitate P&A transactions, and (d) have a methodology to calculate the least-cost contribution to alternative forms of resolution, in case of a paybox plus model.

Depositor preference is a related issue that warrants careful consideration in the countries covered by this study. Most of the countries do not have depositor preference (that is, a law under which depositors meeting specified eligibility criteria rank ahead of other senior unsecured creditors in the liquidation of a bank). The absence of depositor preference creates a heightened risk of depositor runs in periods of instability and can make it more difficult to apply certain forms of resolution, such as bail-in. Accordingly, questions that warrant further assessment across the region are as follows: Should some form of depositor preference be established? If so, what form should it take? Should preference be limited to categories of depositors or should it apply to all types of depositors? Authorities should undertake an assessment of these matters as part of their review of resolution laws and depositor protection arrangements.

4.6. Emergency Liquidity Assistance

Existing laws across the region generally provide adequate powers for central banks to provide ELA to banks. However, in most of the countries the laws lack clear objectives for ELA, such as an objective relating to financial system stability. The laws are also unclear about the preconditions for providing ELA and the central banks' obligations to develop clearly specified policies and procedures for ELA. This impedes the transparency of ELA policies and accountability for ELA.

Existing laws in the region do not provide for government indemnities when a central bank is required or encouraged by the government to provide ELA where there is inadequate collateral or where there is material doubt over a bank's capital adequacy. This gap is significant and could impede effective ELA, especially in situations where a bank that needs ELA is undercapitalized (but still solvent) and is either in recovery mode or being resolved.

[23] World Bank, "Zimbabwe: Deposit Protection Corporation: Action Plan to Improve Its Compliance with the IADI Core Principles" (technical note, World Bank, Washington DC, January 2017).

[24] SCV is the ability to identify eligible depositors for deposit insurance purposes and calculate, at any given time, the aggregate amount payable to each individual depositor including depositors with multiple bank deposits and joint accounts.

Although details on ELA policy in the region are not publicly available, central banks appear to have underdeveloped ELA policies, procedures, and indicative terms sheets. According to TA reports for Botswana and Lesotho (2016 and 2017) and FSAP reports on some of the other countries, central banks need to establish clearly documented preconditions and terms and conditions for ELA if they are to avoid ad hoc responses in periods of crisis. In Botswana in 2016 and Lesotho in 2017, no substantive ELA preconditions, terms, or conditions were in place.

Collateral arrangements require further attention and documentation. Laws must ensure that banks' loan portfolios can be used for collateral purposes and that banks are pre-positioned to enable sale and repurchase agreements to be in place and activated quickly when needed. The capacity to undertake valuations of collateral and to obtain legally robust arrangements for accessing bank collateral, including over bank loan portfolios, needs further development. In addition, there is inadequate specification of the allocation of authorities' respective responsibilities for viability assessment, systemic impact assessment, and collateral valuation as part of the ELA framework.

Countries belonging to the Common Monetary Area (CMA) for the South African rand are constrained in their ability to provide ELA, given the need for 100 percent reserves to support parity with the rand. The central banks in these countries (Eswatini, Lesotho, and Namibia) need to ensure that their ELA frameworks are designed within this constraint. Accordingly, several factors need to be considered, including ELA funding for CMA host jurisdictions in a form that does not impede the ability to maintain parity with the rand and any need to arrange currency swaps between countries in the CMA.

Coordination arrangements for ELA appear to be insufficient between central banks, supervisory agencies, ministries of finance, and resolution authorities. Also, adequate coordination for ELA is lacking between central banks across the region in areas such as home and host central bank responsibilities in group distress situations, cross-border access to collateral, cross-border asset pledges, and parent bank guarantees. Currency swap arrangements between the SARB and other central banks in the region also warrant attention.

Central banks appear not to be adequately testing their ELA capacity, including through regular cross-agency bank stress or failure simulation exercises. This testing should be given appropriate priority in the efforts to strengthen crisis management preparedness.

5. POLICY RECOMMENDATIONS

Countries in southern Africa need significant reforms to establish robust frameworks for the early detection of bank stress, recovery planning, preventive and corrective action, ELA, resolution planning, resolution measures, deposit insurance, and resolution funding (beyond deposit insurance). Considerable strengthening is also needed for the domestic and cross-border coordination frameworks across these areas. Capacity building is also a pressing area, particularly in the form of regular domestic crisis simulation exercises and occasional cross-border exercises.

Technical support requirements will vary considerably from country to country, taking into account each country's stage of development, policy frameworks, internal capacity, and initiatives proposed or under way. Technical support also needs to be considered for each country's financial sector development programs. Technical support needs to be coordinated with existing TA and FSAP programs and with the various TA providers. Each country will need a coordinated and prioritized strategy. As important, the authorities receiving TA must establish their internal capacity to follow through on the assistance provided. In that way, senior levels in each agency will claim ownership of the programs and TA providers will monitor the implementation of post-TA work programs.

The sequencing of reforms will be important. The particular sequence of reforms will vary depending on each country's stage of development in economic policies, risk management arrangements for banks, banking supervision, insolvency law, and many other considerations. An example of the importance of sequencing is deposit insurance. Before deposit insurance can be established, a country must first establish a robust banking regulatory and supervisory framework, sound insolvency law, and high-quality bank governance and risk management practices, together with effective financial reporting and auditing standards. Another example of sequencing is in ELA. A country needs to establish comprehensive liquidity prudential requirements for banks, including minimum liquidity buffers and risk management requirements, before ELA policies are formalized and announced. Likewise, before resolution laws are introduced, detailed resolution policies and practices must be developed. And before the policies and practices are developed, bank-specific resolvability assessments and resolution plans must be developed. Accordingly, to identify the reforms needed, the authorities in each country may need guidance on developing appropriate sequencing of reforms that consider the country's current legal, institutional, and policy environment.

Subject to those points, the main areas of focus for reform and TA are likely to include the following:

- **Early detection of bank stress and preventive and corrective action.** In most countries, the early detection of bank stress and preventive and corrective action need to be strengthened. Most of the countries in the region are likely to benefit from TA in this area. The matters on which TA might be helpful could include (a) developing and using EWIs, (b) interconnecting EWIs and triggers in a preventive and corrective action framework, (c) developing a structured framework of triggers and response actions, (d) integrating bank recovery plan activation with supervisory preventive and corrective action frameworks, (e) promoting amendments to laws to ensure the supervision authority has comprehensive powers under a preventive and corrective action framework and that the penalties are appropriate, and (f) developing a framework to regularly test the preventive and corrective action arrangements.
- **Recovery planning.** In most countries in the region, TA might be helpful to assist supervisory authorities develop and implement recovery planning for

D-SIBs and eventually for all banks. Such TA would likely include assistance in the following areas: (a) ensuring that supervisory authorities have the necessary legal powers to require banks to prepare and regularly test recovery plans, (b) designing recovery planning regulatory requirements, (c) integrating recovery plan activation into supervisory preventive and corrective action arrangements, and (d) designing recovery plan testing arrangements. TA might also be useful to assist authorities to develop the frameworks required for supervisors to assess bank recovery plans and undertake comparative analysis.

- **Resolution arrangements.** In most countries in the region, TA might be helpful to develop resolution frameworks that potentially include the following: (a) amendments to laws to establish a dedicated resolution authority or expand the authority of the central bank or supervision authority to include resolution; (b) the specification of statutory objectives and powers for resolution; (c) resolution safeguards; (d) funding for resolution beyond deposit insurance and associated safeguards; (e) resolution methodologies, policies, and toolkit; (f) framework required for resolvability assessments and resolution planning; (g) data templates and reporting requirements needed for resolvability assessments and resolution plans; (h) domestic coordination frameworks; (i) cross-border coordination frameworks; (j) mutual recognition and enforcement frameworks for cross-border resolution; (k) guidance on crisis management groups; and (l) capacity-building and testing arrangements.
- **ELA.** Depending on the country, TA for ELA may be needed for the following: (a) specifying the statutory objectives of ELA and incorporating these into central bank laws, (b) strengthening the central banks' powers for ELA, (c) specifying the statutory preconditions for ELA, (d) developing the policy framework for ELA, (e) developing indicative terms and conditions for ELA, (f) specifying collateral requirements and pre-positioning, (g) developing the frameworks for viability assessment, (h) developing collateral valuation methodology, (i) establishing appropriate coordination between the central bank and other agencies (especially the supervision authority), and (j) developing regular testing arrangements.
- **Deposit insurance.** Countries that do not have deposit insurance may need targeted TA for designing and implementing deposit insurance, in combination with TA for establishing the preconditions for deposit insurance. In these cases, the TA would likely be informed by the IADI Core Principles and cover various matters, including the following: (a) design of an appropriate form of deposit insurance for the country (for example, paybox plus); (b) architecture of the deposit insurance scheme, including the agency to perform the functions and its governance and accountability arrangements; (c) functions of the deposit insurance scheme and the legal powers required; (d) SCV capacity; (e) payout and P&A capacity; (f) funding options; (g) levy arrangements; and (h) recovery powers. For countries with deposit insurance, TA might be needed for such matters as (a) ensuring the capacity for SCV, (b) ensuring prompt payout options and pre-positioning, (c) developing P&A options and pre-positioning, (d) providing a least-cost assessment framework, and (e) coordinating with supervisory authorities and with cross-border matters. TA might also be useful in helping to build capacity in the deposit insurance agency through regular testing arrangements.
- **Domestic coordination.** In some countries, TA might be helpful to strengthen domestic coordination for crisis management, including the following: (a) establish an FSC or similar domestic coordination body, (b) develop multilateral and bilateral MOUs, (c) develop a crisis management toolkit, and (d) develop arrangements for capacity building and testing.
- **Cross-border coordination.** All countries in the region need effective cross-border coordination for bank recovery and resolution. TA might be useful in various areas, including the development of (a) multilateral and bilateral MOUs, (b) SPE and MPE cross-border resolution frameworks, (c) crisis management groups, and (d) testing arrangements.

A brief assessment of TA needs for each country in the region is summarized in annex I.

ANNEX I: POTENTIAL AREAS FOR TECHNICAL ASSISTANCE, BY COUNTRY

BOTSWANA	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed for the following: • Strengthen the legal powers relating to corrective action. • Develop a more structured and transparent approach to corrective action triggers and associated actions. • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Further develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and non-compliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might be needed to help review the supervisory authority's existing legal capacity to require banks to prepare and test recovery plans. TA might also help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for integrating recovery plan activation into corrective action arrangements, and for testing recovery plans. Guidance might help supervisors assess recovery plans, through both off-site and on-site methodologies.
Resolution	TA might help review and advise on amendments to laws on bank resolution to ensure that the laws are sufficiently comprehensive and aligned to the Key Attributes and have appropriate modifications for the country's institutional framework and stage of development. TA might also be needed to help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. TA might also be needed to assist in cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might be helpful to develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might be helpful to develop home and host cross-border resolution frameworks, including offering guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure it is sufficiently comprehensive in statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with the bank's solvency or capital soundness. TA might help develop policies, procedures, and terms and conditions of ELA; collateral selection; collateral valuation; and solvency or capital adequacy assessments. TA might also be helpful for developing a framework of regular ELA testing.
Deposit insurance	TA might be needed for the following: • Establishing a deposit insurance regime, including statutory purposes, institutional arrangements, legal powers, deposit insurance limit, deposit insurance coverage, funding arrangements, and interagency coordination • Developing the capacity for SCV and pre-positioning in banks for payouts and for P&A transactions • Developing prompt payout capacity within the deposit insurance agency • Developing P&A arrangements • Developing a least-cost methodology • Developing, in conjunction with the supervision authority, defined triggers for handing responsibility to the deposit insurance agency • Developing the levy arrangements and supplemental funding structure with the government or other agency

ESWATINI	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed to help with the following: • Strengthen the legal powers relating to corrective action. • Develop a more structured and transparent approach to corrective action triggers and associated actions • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and noncompliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might be needed to help review existing legal capacity for the supervisory authority to require banks to prepare and test their recovery plans.T A might also help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for integrating recovery plan activation into corrective action arrangements, and for testing recovery plans. Guidance might help supervisors assess recovery plans, through both off-site and on-site methodologies.
Resolution	TA might be needed to help review and advise on changes to the laws for bank resolution to ensure that the laws are sufficiently comprehensive and aligned to the Key Attributes, with appropriate modifications to suit the institutional framework and stage of the country's development. TA might also help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. TA might also assist in cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might help develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might help develop home or host cross-border resolution frameworks, including guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure that the law is sufficiently comprehensive in respective statutory purposes of ELA, the preconditions for ELA, the ability to impose terms and conditions on ELA, and the capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with bank solvency or capital soundness. TA might also help develop policies for preconditions and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also help develop a framework of regular ELA testing.
Deposit insurance	TA might be needed for the following: • Establishing a deposit insurance regime, including statutory purposes, institutional arrangements, legal powers, deposit insurance limit, deposit insurance coverage, funding arrangements, and interagency coordination • Developing the capacity for SCV and pre-positioning in banks for payouts and for P&A transactions • Developing prompt payout capacity within the deposit insurance agency • Developing P&A arrangements • Developing a least-cost methodology • Developing, in conjunction with the supervision authority, defined triggers for handing responsibility to the deposit insurance agency • Developing the levy arrangements and supplemental funding structure with the government or other agency

LESOTHO	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed for the following: • Strengthen the legal powers relating to corrective action. • Develop a more structured and transparent approach to corrective action triggers and associated actions • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Further develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and non-compliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might be needed to help review existing legal capacity for the supervisory authority to require banks prepare and test their recovery plans. TA might also help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for integrating recovery plan activation into arrangements for corrective action, and for testing recovery plans. Guidance might help supervisors to assess recovery plans, both through off-site and on-site methodologies.
Resolution	TA might help review and advise on changes to the laws on bank resolution to ensure that the laws are sufficiently comprehensive and aligned to the Key Attributes and have appropriate modifications for the country's institutional framework and stage of development. TA might also be needed to help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. TA might also be needed to assist in cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might be helpful to develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might be helpful to develop home and host cross-border resolution frameworks, including offering guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure it is sufficiently comprehensive in statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with the bank's solvency or capital soundness.T A might help develop policies for preconditions and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also be helpful for developing a framework of regular ELA testing.
Deposit insurance	TA might be needed for the following: • Establishing a deposit insurance regime, including statutory purposes, institutional arrangement, legal powers, deposit insurance limit, deposit insurance coverage, funding arrangements and interagency coordination • Developing the capacity for SCV and pre-positioning in banks for payouts and for P&A transactions • Developing prompt payout capacity within the deposit insurance agency • Developing P&A arrangements • Developing a least-cost methodology • Developing, in conjunction with the supervision authority, defined triggers for handing responsibility to the deposit insurance agency • Developing the levy arrangements and supplemental funding structure with the government or other agency

MOZAMBIQUE	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed for the following: • Strengthen the legal powers relating to corrective action. • Develop a more structured and transparent approach to corrective action triggers and associated actions • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and noncompliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might be needed to help review the supervisory authority's existing legal capacity to require banks to prepare and test recovery plans. TA might also help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for integrating recovery plan activation into corrective action arrangements, and for testing recovery plans. Guidance might help supervisors assess recovery plans, through both off-site and on-site methodologies.
Resolution	TA might be needed to help review and advise on changes to laws on bank resolution to ensure that the laws are sufficiently comprehensive and aligned to the Key Attributes and have appropriate modifications for country's institutional framework and stage of development. TA might also be needed to help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. TA might also be needed to assist in cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might be helpful to develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might be helpful to develop home and to host cross-border resolution frameworks, including offering guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure it is is sufficiently comprehensive in statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with bank solvency or capital soundness. TA might also assist develop policies for preconditions, and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also be helpful for developing a framework of regular ELA testing.
Deposit insurance	A deposit insurance scheme was created in 2010 by Government Decree No. 49. However, reports indicate that the scheme is not fully operational. This situation needs to be clarified. Subject to clarification, TA might be needed to do as follows: • Review existing law to ensure that it is sufficiently comprehensive, including for statutory purposes, institutional arrangements, legal powers, deposit insurance limit, deposit insurance coverage, funding arrangements, and interagency coordination. • Develop the capacity for SCV and pre-positioning in banks for payouts and for P&A transactions. • Develop prompt payout capacity in the deposit insurance agency. • Develop P&A arrangements. • Develop a least-cost methodology. • Develop in conjunction with the supervision authority defined triggers for handing responsibility to the deposit insurance agency. • Develop levy arrangements and supplemental funding structure with the government or other agency.

NAMIBIA	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed to do the following: • Develop a more structured and transparent approach to corrective action triggers and associated actions. • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and noncompliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for the integration of recovery plan activation into corrective action arrangements, and for the testing of recovery plans. Guidance might help supervisors assess recovery plans, through both off-site and on-site methodologies.
Resolution	TA might be needed to help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. In addition, recent draft amendments to the law to strengthen resolution powers and safeguards may benefit from review and further TA to ensure comprehensiveness and alignment with sound international principles and practice. TA might also help in cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might be helpful to develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might be helpful to develop home and host cross-border resolution frameworks, including offering guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure it is sufficiently comprehensive in statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with the bank's solvency or capital soundness. TA might help develop policies for preconditions and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also be helpful for developing a framework of regular ELA testing.
Deposit insurance	TA might be needed for the following: • Assisting in the development of the new deposit insurance scheme (based on the draft legislation already developed) • Developing the capacity for SCV and pre-positioning in banks for payouts and for P&A transactions • Developing prompt payout capacity within the deposit insurance agency. • Developing P&A arrangements • Developing a least-cost methodology • Developing, in conjunction with the supervision authority, defined triggers for handing responsibility to the deposit insurance agency • Developing the levy arrangements and supplemental funding structure with the government or other agency

SOUTH AFRICA	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed for the following: • Strengthen the legal powers relating to corrective action. But strengthening would need to be assessed following the enactment of the resolution bill. • Develop a more structured and transparent approach to corrective action triggers and associated actions. • Integrate recovery planning activation into the supervisory authority's corrective action framework. Although this integration needs to be assessed considering the recovery planning implementation in South Africa. • Further develop EWIs and link them to corrective action and recovery plan activation triggers. • Further develop contingency plans for dealing with indicative examples of bank weakness and noncompliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	The SARB has established recovery planning requirements for at least the systemic banks in South Africa. It is unlikely that the SARB will require TA on recovery planning, other than to develop a framework for recovery plan testing and to develop a cross-border coordination arrangement for SA banks in other countries. That arrangement would to enable the SARB to assist host supervisory authorities develop recovery planning requirements for SA banks in the host countries.
Resolution	Once the resolution bill has been enacted, the SARB might benefit from targeted TA in some areas, such as the following: • Resolvability assessments • Resolution planning • Development of cross-border resolution arrangements with host countries in which SA banks have systemic operations, including SPE and MPE resolution options
Domestic coordination	TA is probably not needed at this stage, given the existing arrangements.
Cross-border coordination	TA might be helpful to assist the SARB to promote a coordination framework for regional cross-border resolution for SA banks in the region, including for SPE and MPE options, coordinating resolution planning, and developing a program for cross-border crisis simulation exercises.
ELA	TA might help review existing central bank laws to ensure it is sufficiently comprehensive in statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity where insufficient collateral exists or the central bank is not satisfied with bank solvency or capital soundness. TA might also help develop policies for preconditions and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also help develop a framework of regular ELA testing.
Deposit insurance	Once the resolution bill has been enacted to establish the deposit insurance scheme (likely to be in 2019), authorities might benefit from targeted assistance in the following areas: • Developing the capacity for SCV and pre-positioning in banks for payouts and P&A • Developing prompt payout capacity within the deposit insurance agency • Developing P&A arrangements • Developing a least-cost methodology • Transitioning eventually to a risk-based levy arrangement

ZAMBIA	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed to do the following: • Strengthen the legal powers relating to corrective action. • Develop a more structured and transparent approach to corrective action triggers and associated actions. • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and noncompliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might help review existing legal capacity for the supervisory authority to require banks to prepare and test their recovery plans. TA might also help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for integrating recovery plan activation into corrective action arrangements, and for testing recovery plans. Guidance might help supervisors assess recovery plans, through both off-site and on-site methodologies.
Resolution	TA might help review and advise on changes to the laws for bank resolution to ensure that the laws are sufficiently comprehensive and aligned to the Key Attributes, with appropriate modifications to suit the institutional framework and stage of development of the country. TA might also help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. TA might also help assist with cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might help develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might help develop home or host cross-border resolution frameworks, including guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure it is sufficiently comprehensive in statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with bank solvency or capital soundness. TA might also help develop policies for preconditions and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also help develop a framework of regular ELA testing.
Deposit insurance	TA might be needed for the following: • Establishing a deposit insurance regime, including statutory purposes, institutional arrangements, legal powers, deposit insurance limit, deposit insurance coverage, funding arrangements and interagency coordination • Developing the capacity for SCV and pre-positioning in banks for payouts and for P&A transactions • Developing prompt payout capacity within the deposit insurance agency • Developing P&A arrangements • Developing a least-cost methodology • Developing, in conjunction with the supervision authority, defined triggers for handing responsibility to the deposit insurance agency • Developing the levy arrangements and supplemental funding structure with the government or other agency

ZIMBABWE	
Topic	**Possible Technical Assistance Needs**
Corrective action	TA might be needed to do the following: • Strengthen the legal powers relating to corrective action. • Develop a more structured and transparent approach to corrective action triggers and associated actions. • Integrate recovery planning activation into the supervisory authority's corrective action framework. • Develop EWIs and link them to corrective action and recovery plan activation triggers. • Develop contingency plans for dealing with indicative examples of bank weakness and noncompliance. • Develop a program for regular testing of the corrective action framework.
Recovery planning	TA might be needed to review existing legal capacity for the supervisory authority to require banks to prepare and test their recovery plans. TA might also help develop policy for recovery planning regulations (covering recovery plan triggers, restoration points, recovery options, recovery implementation and preparatory measures, governance arrangements for recovery plans, scenario development, recovery communications, and integration of recovery plans with banks' risk management frameworks), for integrating recovery plan activation into corrective action arrangements, and testing recovery plans. Guidance might help assist supervisors assess recovery plans, through both off-site and on-site methodologies.
Resolution	TA might be needed to review and advise on changes to the laws for bank resolution to ensure that the laws are sufficiently comprehensive and aligned to the Key Attributes, with appropriate modifications to suit the institutional framework and the country's stage of development. TA might also help develop resolution policies, a resolution toolkit, a framework for resolvability assessment and resolution planning, and resolution testing. TA might also assist in cross-border resolution arrangements, especially SPE and MPE options, in conjunction with the home authorities.
Domestic coordination	TA might help develop or refine domestic coordination arrangements for crisis management, including bilateral and multilateral crisis management MOUs, an FSC framework, and a program for domestic crisis simulation exercises.
Cross-border coordination	TA might help develop home or host cross-border resolution frameworks, including guidance on SPE and MPE options, bilateral and multilateral MOUs, and the eventual development of cross-border crisis simulation exercises.
ELA	TA might help review existing central bank law to ensure it is sufficiently comprehensive in respective statutory purposes of ELA, preconditions for ELA, ability to impose terms and conditions on ELA, and capacity for the central bank to lend on the basis of a government indemnity when insufficient collateral exists or the central bank is not satisfied with bank solvency or capital soundness. TA might also help develop policies for preconditions and terms and conditions of ELA, collateral selection, collateral valuation, and solvency or capital adequacy assessment. TA might also help develop a framework of regular ELA testing.
Deposit insurance	• Reforms are intended to implement regulations under the Banking Amendment Act 2015 and to develop SCV capacity, least-cost test capacity, and P&A capacity. A World Bank technical note made extensive recommendations for improving the deposit insurance arrangements, including SCV capacity, payout functionality, P&A capacity, and domestic coordination arrangements—especially with Zimbabwe.

Note: ELAs = emergency liquidity assistance; EWIs = early warning indicators; FSC = financial stability committee; IADI = International Association of Deposit Insurers; MOUs = memoranda of understanding; MPE = multiple points of entry; P&A = purchase and assumption; SARB = South African Reserve Bank; SCV = single customer view; SPE = single point of entry; TA = technical assistance.

ANNEX II: IADI "CORE PRINCIPLES FOR EFFECTIVE DEPOSIT INSURANCE SYSTEMS"

The International Association of Deposit Insurers (IADI) and the Basel Committee on Banking Supervision (BCBS) issued the "Core Principles for Effective Deposit Insurance Systems" (Core Principles) in June 2009 and revised them in November 2014. The Core Principles are used by jurisdictions as a benchmark for assessing the quality of their deposit insurance systems and for identifying gaps in their deposit insurance practices and measures to address them. The Core Principles are also used by the International Monetary Fund (IMF) and the World Bank (WB) to assess the effectiveness of jurisdictions' deposit insurance systems and practices.

The Core Principles comprise 16 principles:

Principle 1: Public Policy Objectives

The principal public policy objectives for deposit insurance systems are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The design of the deposit insurance system should reflect the system's public policy objectives.

Principle 2: Mandate and Powers

The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.

Principle 3: Governance

The deposit insurer should be operationally independent, well-governed, transparent, accountable, and insulated from external interference.

Principle 4: Relationships with Other Financial Safety Net Providers

To protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants.

Principle 5: Cross-Border Issues

Where there is a material presence of foreign banks in a jurisdiction, formal information sharing and coordination arrangements should be in place among deposit insurers in relevant jurisdictions.

Principle 6: Deposit Insurer's Role in Contingency Planning and Crisis Management

The deposit insurer should have in place effective contingency planning and crisis management policies and procedures to ensure that it is able to effectively respond to the risk of, and actual, bank failures and other events. The development of system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety-net participants. The deposit insurer should be a member of any institutional framework for ongoing communication and coordination involving financial safety-net participants related to systemwide crisis preparedness and management.

Principle 7: Membership

Membership in a deposit insurance system should be compulsory for all banks.

Principle 8: Coverage

Policy makers should define clearly the level and scope of deposit coverage. Coverage should be limited, credible, and cover most depositors but leave a substantial amount of deposits exposed to market discipline. Deposit insurance coverage should be consistent with the deposit insurance system's public policy objectives and related design features.

Principle 9: Sources and Uses of Funds

The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by banks.

Principle 10: Public Awareness

To protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.

Principle 11: Legal Protection

The deposit insurer and individuals working both currently and formerly for the deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits, or other proceedings for their decisions, actions, or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.

Principle 12: Dealings with Parties at Fault in a Bank Failure

The deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.

Principle 13: Early Detection and Timely Intervention

The deposit insurer should be part of a framework within the financial safety-net that provides for the early detection of, and timely intervention in, troubled banks. The framework should provide for intervention before the bank becomes nonviable. Such actions should protect depositors and contribute to financial stability.

Principle 14: Failure Resolution

An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.

Principle 15: Reimbursing Depositors

The deposit insurance system should reimburse depositors' insured funds promptly, to contribute to financial stability. There should be a clear and unequivocal trigger for insured depositor reimbursement.

Principle 16: Recoveries

The deposit insurer should have, by law, the right to recover its claims in accordance with the statutory creditor hierarchy.

ANNEX III: EARLY WARNING INDICATORS

Early warning indicators (EWIs) are used by supervisory authorities and banks' management and boards to identify early signs of emerging stress.

For banks, EWIs are often linked to risk appetite statements and are monitored regularly by bank boards and management to identify early indications of deteriorating risk so that adjustments can be made to the tolerances for risks. EWIs are also used by banks with their contingency plans, such as recovery plans, capital contingency plans, liquidity contingency plans, and business continuity plans, to provide early alerts for remedial actions.

For supervisory authorities, EWIs are used to monitor individual banks and the banking system, particularly to detect emerging stress points and vulnerabilities. EWIs can be linked to the triggers in supervisory preventive and correction action frameworks to take preparatory initiatives in anticipation of potential breaches of triggers. They are typically selected for their predictive capacity to enable supervisors to proactively address emerging risks in individual banks and banking systems.

Table 3: Examples of Early Warning Indicators (EWIs) for Capital, Asset Quality, and Liquidity

Risk Area	EWIs
Capital	• Rapid lending growth • Deteriorating asset quality • Weakening profitability, narrowing of margins • Shift in assets to higher risk-weighted credit exposures • Rapid growth in off-balance sheet credit exposures and in market risks and operating risks • Increase in exposure concentration • Increase in lending to related parties • Deterioration in quality of governance • Deterioration in risk management
Asset quality	• Weakening asset prices • Deteriorating household incomes • Deteriorating business incomes • Increasing interest rates • Increasing household and business leverage • Decrease in credit risk management • Increase in lending relative to other banks
Liquidity	• Shortening of liability maturities • Lengthening of asset maturities • Increase in maturity mismatches • Weakening depositor confidence • Increasing rate of depositor withdrawal • Increase in risk premium on funding • Tightening in interbank funding • Decline in credit rating

ANNEX IV: STRESS TESTING

Stress tests are used to assess the vulnerability of a bank or the banking system to a range of economic and financial shocks. There are several forms of stress tests, but the main types are summarized here.

Single Factor Sensitivity Tests

Single factor sensitivity tests evaluate the effect on capital and liquidity of movements in specific variables, such as interest rates, exchange rates, and asset prices, in isolation from broader shocks. Commonly used stress tests of this nature include parallel and nonparallel shifts in the yield curve to assess the effect of interest rate shocks on net profits and capital. Similarly, sensitivity stress tests are often used to assess the effects on profits and capital arising from increases or decreases in bilateral or trade-weighted exchange rates. Other forms of single factor sensitivity tests can include shocks to asset prices, such as residential property, commercial property, or rural property to assess the effect on asset quality, profits, and capital.

These stress tests isolate the effects of financial shocks on asset quality, profits, and capital (and sometimes on liquidity). In turn, the tests can help formulate prudential requirements for risk management, such as prudential regulations on net open currency positions, interest rate exposure, and exposures to asset categories. However, single factor sensitivity tests are of limited use for comprehensively evaluating the potential vulnerability of financial institutions to economic and financial shocks because they assume that all other variables, other than the ones being tested for, remain stable. They do not reflect the real-world impact of economic and financial shocks because they ignore the interconnectedness of shocks and second-round effects. For a more meaningful and comprehensive assessment to be undertaken, stress tests need to broader, generally anchored to a particular scenario, and based on an integrated approach where the interplay of different variables is captured, albeit relatively simplified, in the stress testing framework.

Scenario-based Stress Tests

Scenario-based stress tests involve selecting a given scenario and assessing the effects on a financial institution's profits, capital, and liquidity, among other matters. These tests tend to be the most commonly used forms of stress tests because they are more comprehensive than single factor sensitivity tests and they seek to capture the interconnectedness of the different factors at play in a broad-based scenario. They represent a closer approximation of real-world economic and financial shocks than is possible in limited-scope sensitivity tests.

Scenario-based stress tests involve a combination of economic and financial shocks based on a macrofinancial scenario and where the shocks to variables are integrated in a manner that broadly resembles historical patterns of actual economic and financial shocks. The factors included in a typical scenario-based stress test can include the following:

- Contraction in real GDP and other proxies for economic activity, such as economic output by sector, manufacturing output, consumption expenditure, and so forth
- Increase in unemployment and underemployment (and hence a strain on borrower debt servicing capacity)
- Increase in individual and business bankruptcies (and therefore borrower default)
- Contraction in real incomes of the household and business sectors (and hence adverse implications for borrower debt servicing capacity)
- Decline in asset prices, with impacts on bank collateral values and on the value of investment

assets of insurers and wealth management vehicles (and therefore implications for loss given default [LGD] and investment losses)

- Shifts in interest rates and the exchange rate, commensurate with the primary shock
- Liquidity shocks that are designed to be consistent with the primary shock (for example, reduced cash inflows caused by increases in nonperforming loans [NPLs], reduced cash inflows arising from reductions in new deposits, and increased cash outflows because of higher-than-normal deposit withdrawals)

Scenario-based stress tests can also feature individual counterparty failures, such as large exposure counterparties associated with industries that, in the scenario, are assumed to be experiencing adverse effects of the economic and financial shocks.

Reverse Stress Tests

Reverse stress tests specify the magnitude and nature of economic or financial shocks required to cause an entity or group to breach capital or liquidity requirements or to default on financial obligations. These stress tests are not yet commonly applied by supervisory authorities or banks. However, with the increasing importance of recovery and resolution planning, and therefore the focus on nonviability, reverse stress testing is likely to become more commonly used by supervisory authorities in the future. They will be particularly helpful in calibrating the magnitude and dynamic of economic and financial shocks needed in scenarios within banks' recovery plans to result in a breach of recovery plan triggers and hence the activation of the recovery plan.

Liquidity Stress Tests

Liquidity stress tests involve an assessment of the liquidity impact of shocks to financial institutions (especially banks). There are two main kinds of liquidity stress tests, as discussed here.

Isolated Liquidity Stress Tests

In isolated liquidity stress tests, a financial institution's cash inflows and outflows, and changes to the maturity profile and composition of assets and liabilities, are assessed by reference to specified shocks, isolated from an assessment of wider economic shocks that might affect asset quality, net income, and capital. For example, shocks can affect cash inflows because of increases in NPLs, reduced growth in new deposits, reduced reinvestment of existing deposits, and so forth. They can also include shocks to cash outflows because of increased withdrawals of deposits. Specified assumptions will also be made to changes in the maturity profile of assets and liabilities (such as a shortening in the average maturity of new deposits) and to the behavior of depositors and other providers of funding. These stress tests are often used by banks and supervisors to assess whether a bank's holdings of high-quality liquid assets (HQLA) are sufficient to withstand a range of liquidity shocks. They are also used to test a bank's liquidity coverage ratio (LCR) under assumed stress conditions.

Although these tests are typically applied to banks, especially in the context of testing LCR, a modified form of liquidity stress testing can be applied to other financial institutions, including insurers and wealth management vehicles.

For insurers, liquidity stress can arise from higher-than-normal claims, as well as cancellations of policies (for a short-term insurer, if policyholders decide to cancel existing policies because of concerns over the claims payment strength of that insurer). Liquidity pressures can also arise from stressed asset markets, where investment assets fall in value and may also become less liquid in nature (for example, harder to liquidate in the financial markets). This pressure has the potential to affect an insurer's capacity to meet its financial obligations.

In wealth management vehicles, liquidity pressures can arise from investors seeking to withdraw funds from investment vehicles because of concerns over adverse market conditions and possible further downside rise to their investment portfolios.

Liquidity Stress Testing as Part of a Broader Scenario Test

In a macrofinancial scenario stress test, liquidity pressures can be incorporated into the test alongside

the stresses to credit risk, market risks, and investment risks. Some of the liquidity stress will arise directly from the impact of credit risk and market risk because of reduced cash flows from the loan portfolio and changes in net interest income from the assumed movement in interest rates. These are part of an integrated stress test, in which the impact of financial and economic shocks will flow to different parts of a financial institution's balance sheet and income statement—and therefore cash flows and HQLA. In addition, a macrofinancial stress test will also typically include shocks to funding, such as assumed higher levels of deposit withdrawals, a reduction in new deposits, a shortening of deposit maturities, and reduced interbank lending.

Again, the liquidity implications of macrofinancial stress tests will be most acute for banks, given the nature of their balance sheets. The implications will be less pertinent for insurers and wealth management vehicles. However, liquidity stress tests can be incorporated into macrofinancial stress tests that will have implications for insurers and wealth management entities, such as through the effects of falls in investment portfolios and the behavioral changes to decision making by policyholders and investors.

Top-Down Versus Bottom-Up Stress Tests

Scenario-based stress tests can either be top down or bottom up, or a combination of both.

Top-Down Stress Tests

A top-down stress test is one that is run by a central bank or supervisory authority on a common scenario, applied across a category of financial institutions. Its primary purpose is to assess the potential vulnerability of the financial system to specified economic and financial shocks. Probabilities of default (PD) and LGD are assessed institution by institution using either the data generated by each institution from its own models or by applying the supervisory authority's model to generalized data on historical PD and LGD; then the data are aggregated across the financial system, considering second-round effects and the behavioral reactions of financial institutions. Where a financial institution's PDs and LGDs appear to be an outlier to historical norms or to other financial institutions, the supervisory authority may adjust the institution's PDs and LGDs using a PD and a LGD that are closer to historical norms or industry averages.

Bottom-up Stress Tests

In contrast, a bottom-up stress test is undertaken by individual financial institutions using their own internal models for calculating PD and LGD, based on historical data. This test generally disregards the impact of second-round effects and behavioral impacts arising from other financial institutions. Bottom-up stress tests are based on each institution's chosen scenario unless a generalized scenario is imposed on the institutions by the supervisory authority (which is often the case). Bottom-up stress tests are helpful in identifying potential impacts on individual financial institutions but are less useful for system-wide impact assessment because of a lack of consistency in modelling for PD and LGD. Unless the PD and LGD for each institution are reviewed by the supervisory authority and adjusted where they appear to be out of line with historical norms or industry averages, bottom-up stress tests tend to be less useful as a means of comparing the impacts of stress events on a range of financial institutions than is the case with top-down stress tests.

A Balanced Approach Between Top Down and Bottom Up

Reflecting the pros and cons of the two approaches, central banks and supervisory authorities often adopt a blend of top-down and bottom-up approaches to stress testing, with a view to using the tests to assess the potential effects of defined economic and financial shocks on individual financial institutions and the financial system. They are typically based on a common scenario, with PDs and LGDs being drawn from individual financial institutions and then recalibrated as appropriate, drawing on the supervisory agency's model, to ensure a reasonable degree of consistency across financial institutions.

ANNEX V: SUMMARY OF BANK RESOLUTION (BR) AND DEPOSIT INSURANCE (DI) IN SOUTHERN AFRICA

Risk Area	Botswana	Eswatini	Lesotho	Mozambique	Namibia	South Africa	Zambia	Zimbabwe
Responsible for BR	BOB	CBS	CBL	BOM	BON	SARB, MoF	BOZ	Reserve Bank
BR alternatives								
Closure & liquidation	Yes	No	TBC	Yes	Yes[c]	Yes[c]	Yes	Yes[c]
Temp. administration	Yes	TBC	Yes	Yes	Yes	Yes	Yes	Yes
Purchase & assumption	No	No	No	No[b]	No	No[b]	No	Yes
Good bank/bad bank[e]	No	No	No	No[b]	No	No[b]	TBC	Yes
Merger & acquisition	No	Not clear	No	No[b]	No	No[b]	Not clear	Yes
Bridge bank	No	No	No	No[b]	No	No[b]	Not clear	Yes
Bail-in	No	No	No	No[b]	No	No[b]	Not clear	No
Nationalization	Not explicitly	Not explicitly	Not explicitly	Not explicitly	Not explicitly	Not explicitly	Not explicitly	Not explicitly
Degree of protection of the supervisor	Inadequate	Not clear	Limited	Inadequate	Limited	Limited[b]	Limited	Not clear
Specific legislation for systemic cases?	Yes, but limited	Not clear	Yes, but limited	No[b]	Not clear	Yes	Not clear	Not clear
Explicit deposit insurance	No[a]	No	No[a]	Yes	No[a]	No[a]	No	Yes
Institution responsible for DIS	N/A	N/A	N/A	Deposit Guarantee Fund	TBD	Agency affiliated with SARB	N/A	Deposit Protection Corporation
Type of mandate	N/A	N/A	N/A	Paybox[d]	N/A	N/A[d]	N/A	Paybox plus
Bank representatives on DI Board?	N/A	N/A	N/A	Yes	N/A	N/A	N/A	Yes
Insured amount in US$ (and as percentage of GDP per capita)	N/A	N/A	N/A	300 (84%)	N/A	N/A	N/A	500 (52%)
Insured/total deposits	N/A	N/A	N/A	10	N/A	N/A	N/A	-
Fixed premium rate (per thousand)	N/A	N/A	N/A	TBC	N/A	N/A	N/A	2
Maximum risk adjusted rate	N/A	N/A	N/A	TBC	N/A	N/A	N/A	-
Operational expenses (in US$ and as percentage of premium income)	N/A	N/A	N/A	TBC	N/A	N/A	N/A	3m (24%)
Funds/total deposits	N/A	N/A	N/A	<0.1%	N/A	N/A	N/A	0.3%
Does it contribute to BR processes?	N/A	N/A	N/A	No[b, d]	N/A	No[b, d]	N/A	No
Does it cover public institutions?	N/A	N/A	N/A	Yes	N/A	N/A	N/A	Yes
Target fund	N/A	N/A	N/A	No	N/A	N/A	N/A	No

Notes: 3m = 3 million US dollars; DIS = Deposit Insurance Scheme; N/A=Not applicable; SARB = South Africa Reserve Bank; TBC= To Be Confirmed.

[a] The national authorities are currently considering incorporating this into their legal framework.

[b] Deposit insurance is implicit as the government has, in the past, reimbursed small depositors following a bank failure. South Africa and Namibia are of establishing a formal deposit insurance scheme, which will provide capped and funded protection to eligible small depositors. In South Africa, deposit insurance will be partly funded by premiums from banks and a back-up facility from SARB.

[c] Closure and liquidation require court approval.

[d] The national authorities are considering moving to paybox plus.

[e] Good bank/bad bank (GB-BB) is a specific case of purchase & assumption (P&A). The "good bank" contains the privileged liabilities and assets with economic value whereas the "bad bank" receives the remaining assets and liabilities. The good bank is transferred to one or more solvent institutions willing to acquire it, enabling it to maintain banking services and the jobs. The bad bank is left to its owner and is liquidated. The difference between P&A and GB-BB is that P&A may only include the assumption of assets and liabilities but not necessarily in the same amounts nor in the form of a business unit. GB-BB requires creating a business unit with assets and liabilities for the same amount. The existence of P&A does not necessarily allow for GB-BB.

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This paper and the study on which it is based drew on a wide range of sources. The main reference material is set here.

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