



COLOMBIA

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE—CRISIS MANAGEMENT, RESOLUTION, AND SAFETY NETS

June 2022

This Technical Note on Crisis Management, Resolution, and Safety Nets was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in April 2022.

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International Monetary Fund
Washington, D.C.



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May 25, 2022

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CRISIS MANAGEMENT, RESOLUTION, AND SAFETY NETS

Prepared By
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Monetary Fund**

This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) virtual mission in Colombia during June 2021 led by Ms. Zsofia Arvai, IMF and Ms. Raquel Letelier, World Bank, and overseen by the Monetary and Capital Markets Department, International Monetary Fund, and the Finance and Markets Global Practice, World Bank. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

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Glossary

BIS	Bank for International Settlements
BP	Bridge Bank (Banco Puente)
BR	Colombian Central Bank (Banco de la República)
CA	Advisory Council (Consejo Asesor)
CAAP	Asset Purchase and Assumption of Liabilities (Compra de Activos y Asunción de Pasivos)
CCSSF	Financial Sector Coordination and Monitoring Committee (Comité de Coordinación y Seguimiento del Sistema Financiero)
CIR	Resolution Intersectoral Commission (Comisión Intersectorial de Resolución)
COP\$	Colombian Pesos
ELA	Emergency Liquidity Assistance (Asistencia de Liquidez de Emergencia)
EOSF	Colombian Financial System Organic Statute (Estatuto Orgánico del Sistema Financiero) – Decree 663 of 1993
FOGAFIN	Insurance Deposit or Guarantee Fund for Financial Institutions (Fondo de Garantías de Instituciones Financieras)
<i>FSB</i>	<i>Financial Stability Board</i>
FSI	The Financial Stability Institute (Instituto de Estabilidad Financiera)
GCF	Financial Crisis Group (Grupo de Crisis Financiera)
GR	Resolution Mechanisms and Plans Group (Grupo de Mecanismos y Planes de Resolución)
IADI	International Association of Deposit Insurers
MoF	Ministry of Finance
MoU	Memorandum/Memoranda of Understanding (Memorando/s de Entendimiento)
P&A	Purchase and Assumption
RP	Resolution Plan (Planes de resolución)
SFC	Financial Superintendency of Colombia (Superintendencia Financiera de Colombia)
SIFIs	Systemically Important Financial Institutions (Instituciones Financieras Sistémicamente Importantes)

EXECUTIVE SUMMARY

1. The first mission of the Colombia FSAP was conducted virtually during June 1–21, 2021. This technical note focuses on the developments in the crisis management framework for the banking sector. The assessment examines the Colombian financial safety net and crisis management arrangements in light of the international best practices and standards on resolution and deposit insurance standards.

2. The Banco de la Republica (BR) is in charge of regulating money in circulation and market liquidity. It provides liquidity through four main channels: (i) open market operations; (ii) asset purchases of private and public debt instruments; (iii) intraday repos; and (iv) overnight repos. Most financial institutions are eligible for emergency liquidity assistance (ELA). In recent years, there has been no use of the facility. Neither the Ministry of Finance (MoF) nor the BR provide official liquidity or solvency support. Rather, such support is given by the Guarantee Fund for Financial Institutions (Fogafin). Fogafin can provide liquidity to open institutions, it is the resolution agent as it implements resolution powers, and to banks that are considered of systemic importance.

3. Recovery and resolution planning (RRP) has been introduced recently. Recovery planning is conducted annually and is based on stress tests designed by the Financial Superintendency of Colombia (SFC). Resolution planning is being developed by the four largest systemically important institutions and results are expected in April 2022. The SFC is currently implementing a regulation project aimed at formalizing the synergies between the Internal Capital Adequacy Assessment Process (ICAAP), the Internal Liquidity Adequacy Assessment Process (ILAAP), with the recovery and resolution plans. These plans could be further broadened. Recovery plans could include scenario-based exercises, including a range of severe but plausible, firm-specific scenarios, and scenarios of systemic stress. They could include both idiosyncratic failures and market-wide stress. Resolution planning is the responsibility of the institutions. They produce “living wills” that identify how they may be resolved in a crisis. These resolution plans could be more the responsibility of the resolution authorities, as they are in a better position to evaluate resolution options in the context of market-wide developments.

4. The resolution process is triggered by the SFC and involves both the Resolution Group (GR) and Fogafin. If supervisory interventions fail to reverse the deterioration of the institution, the SFC asks the GR—an independent entity within the SFC—to identify options. The GR may propose recapitalization of the institution, restructuring, and subsequent sale of the institution. These options are presented to the SFC, and its Board makes the final determination of the resolution strategy. The GR may also propose to the SFC that the institution be liquidated by Fogafin. If the SFC determines that liquidation is the appropriate strategy, Fogafin typically considers two options: (i) payout of depositors and liquidation of the shell; or (ii) transfer part of the assets and liabilities either to another operating entity, including all depositors, or to a bridge bank. If the institution’s failure would have a systemic impact on the economy, Fogafin may appoint an administrator to manage the institution and implement necessary changes. Fogafin could provide necessary capital. Before a

decision is made, these resolution options are discussed widely, both within the SFC and with the Resolution Intersectoral Commission (CIR).

5. While the resolution regime provides a sound framework for resolving failing deposit-taking financial institutions, it should be strengthened in several aspects to comply with international best practice.

The coordination between the financial safety net authorities is considerable, with the SFC, the GR, and Fogafin in close contact as options for addressing a failing institution are developed. While effective, these processes could be further enhanced. First, the separation between the supervisory functions and the resolutions functions within the SFC could be enhanced. The resolution decisions by the GR are shared at an early stage with the supervisory staff and with Fogafin. International best practice calls for the supervisors and resolution agencies to operate independently. Second, the decision concerning the resolution of a failing institution occurs at several stages. The GR proposes resolution measures to the SFC, including the use of P&A transactions to viable institutions and, if considered appropriate, a proposal to the SFC that an institution's failure could have a systemic impact. In the liquidation process, Fogafin may opt to use purchase and assumption (P&A) powers to transfer assets and liabilities to other viable institutions, or to a bridge bank. This resolution process could be streamlined by making a clear distinction between dealing with a going concern but failing institution when the original shareholders remain in the bank and dealing with it when the public sector takes over responsibility. Third, the financial demands on Fogafin can be substantial, with the institution having the authority to provide financial assistance and capital to open banks, recapitalize and finance the restructuring of failed but systemically important banks, and capitalizing bridge banks. Strong safeguards for Fogafin's funds are needed, as well as alternative sources of resolution financing. Fourth, consideration should be given to establishing a bail-in authority. The expansion of Colombian banks offshore and their growing complexity may make it necessary to have such power in order to effectively resolve a cross-border failure. Finally, legal reforms (such as introduction of bail-in powers) are needed to improve the ability of the resolution authority to resolve complex financial institutions at least cost. The authorities should introduce depositor preference and the resolution regime should also allow for departure from the creditor hierarchy in a resolution, subject to a no creditor worse off safeguard.

6. Fogafin has a broad mandate to protect depositors and creditors and preserve economic stability. It is authorized to assist both open banks and to finance the resolution of banks. Because of the large potential demands, the safeguards protecting Fogafin's fund could be strengthened. In addition to limited outlays to the amount that it would pay out in a liquidation, Fogafin's outlays for any single transaction could be limited to 50 percent of the fund level. In addition, Fogafin should have access to a guaranteed back-up liquidity facility in the event that the fund is depleted.

7. While considerable progress has been made in information sharing, resolution planning for cross-border institutions should be strengthened. Cross-border firms pose particular challenges. They may be composed of both financial and nonfinancial institutions, resolution regimes may differ between home and host authorities, and there may be disagreements

about what constitutes critical functions between home and host authorities. Accordingly, the resolution authority will need to plan in advance, identifying resolution options and identifying the resolution alternatives. Financing options for such contingencies should also be developed and implemented.

Table 1. Colombia: Table of Recommendations

Recommendations	Time¹	Priority²
Institutional arrangements		
Strengthen the operational independence of the GR.	I	H
Resolution regime		
A bridge bank should be used only in the event that a failure would undermine financial stability. Subject bridge bank to all prudential regulations if the bank is to operate in the financial system for more than a brief transitory period (i.e., 2–3 months).	M	M
Develop a plan for the eventual introduction of bail-in powers.	M	M
Recovery and resolution planning		
Make the financial institutions responsible for recovery planning; make the GR responsible for resolution planning.	I	H
Require institutions to develop a wide range of risk scenarios and mitigating measures as part of their recovery planning.	I	H
The separation between the supervisory functions and the resolutions functions within the SFC could be strengthened. While the GR is a separate and independent unit within the SFC, its decision-making procedures allow for overlap between supervisory and resolution oversight. Steps should be considered to increase the separation between those responsible for supervision and those responsible for resolution of a failed institution.	I	H
Resolution funding		
Fogafin's financing should be limited to resolution funding (i.e., financing that is used to support the use of resolution powers and achieve the resolution objectives).	I	H
Identify financing options for resolving cross-border banks when Fogafin resources are insufficient.	M	H
Cross-border arrangement		
Strengthen home/host planning for a possible failure of a cross-border institution.	I	H
Develop and test resolution plan for the failure of a cross-border institution.	I	H
Deposit insurance		
Establish guaranteed back-up liquidity facility for Fogafin.	I	H
Strengthen safeguards on use of Fogafin resources to (i) the amount of insured deposits; and (ii) 50 percent of the fund.	I	M
¹ C = continuous; I (immediate) = within one year; M (medium term) = 2–5 years. ² H = high; M = medium; L = low.		

INTRODUCTION¹

8. The first mission of the Colombia FSAP was conducted virtually during June 1–21, 2021. The previous FSAP, conducted in 2013, found the financial health of credit institutions to be sound, with a healthy balance sheet of corporate and households, strong credit quality, and profitable banks, as well as well-performing nonbank financial intermediaries. Some weaknesses were noted in the independence of regulatory agencies, in the supervision of financial conglomerates, broker dealers, and collective investment schemes.

9. In response to the recommendations of the 2013 FSAP, the authorities undertook a series of wide-ranging reforms. Measures were taken to introduce new resolution mechanisms and tools, identify tools for systemic and non-systemic crises, improve information exchange and coordination within the safety net, reform the legal framework, and strengthen cross-border cooperation and coordination. These measures strengthened the resolution and crisis management framework and resulted in a high degree of information exchange and coordination of decision making.

10. This note focuses on the developments in the crisis management framework for the banking sector. Colombia has a broad financial system dominated by complex financial conglomerates. Credit institutions account for about 76 percent of financial system assets, followed by trust companies and private pension funds and, to a lesser extent, insurance companies. The five largest financial conglomerates own about 60 percent of the system's assets. Colombian financial conglomerates have significant exposure abroad. Such exposures increased from US\$11 billion in 2009 to US\$93 billion in 2020, with about 83 percent of these assets held in Central America. There were 288 entities abroad in 2020, compared to 46 entities in 2009.

11. The banking system appears to be coping well in the wake of the recent shocks. In 2020, it was hit by the largest economic contraction on record. Banks entered the crisis from a position of relative strength, with healthy capitalization and profitability. After initially declining, partly due to debtor support and regulatory relief programs, nonperforming loans (NPLs) peaked later in 2020 but started to decline in 2021.

12. This assessment examines the Colombian financial safety net and crisis management arrangements against international best practices and standards. While the note does not reflect a formal assessment of compliance with any standard, it is informed by the Financial Stability Board (FSB) Key Attributes (KAs) of Effective Resolution Regimes and the International Association of Deposit Insurer (IADI) Core Principles for Effective Deposit Insurance Systems. The note is further based on the assessment manuals of the FSB and the IADI as well as the IMF's technical assistance experience involving how to implement these standards. The note aims to help strengthen the Colombian financial safety net and crisis management framework, and to address specific challenges that Colombia is facing.

¹ This Technical Note was prepared by David Hoelscher.

FINANCIAL OVERSIGHT ARCHITECTURE

13. The Banco de la Republica (BR): The BR is responsible for regulating monetary circulation and liquidity in the Colombian economy, as well as ensuring the smooth functioning of payment systems. It provides liquidity through four main channels: (i) open market operations; (ii) asset purchases of private and public debt instruments; (iii) intraday repos; and (iv) overnight repos. Most financial institutions are eligible for ELA. In recent years, there has been no use of the facility.

14. The Financial Superintendency of Colombia (SFC). The SFC is responsible for the supervision of financial entities and for the resolution of failing or failed institutions. It is operationally and financially independent. It has broad oversight responsibilities to preserve financial stability, protect depositors, investors, and insurance policy holders, oversee consumer protection, and capital market oversight. The SFC has full discretion to take any supervisory action or decision on the banks and banking groups under its supervision.

15. Resolution Group (GR): Within the SFC, there is the Resolution Group (GR). The GR is a newly created unit, operating independently within the SFC. It is allocated resources but has no separate budget nor authority to hire staff. Its staff is recruited from the SFC. It is authorized to hire specialized staff, including lawyers, with expertise in resolution. It is responsible for analyzing the financial conditions of a weakening or failed institution and developing proposals for its resolution, which are approved and implemented by the SFC. GR proposals are shared with the supervisor in charge, discussed with the Superintendent, and presented to the CIR, where the analysis and strategy are discussed. The final decision on the appropriate resolution strategy for a bank under shareholder control is made by the SFC and is shared with Fogafin.

16. Fogafin: Fogafin is an autonomous legal entity, attached to the MoF but subject to the SFC's supervision. Fogafin provides deposit insurance and is responsible for the design and implementation of resolution strategies for banks after the SFC has decided they must be liquidated. Such strategies can include liquidation and payout of depositors, implementation of P&A transactions, establishment of a bridge bank, or capitalization of the institution under public ownership. Fogafin's Board of Directors includes the MoF, the Governor of the BR, the Superintendent, and two representatives from the financial sector, all of whom are appointed by the president of the republic and cannot be active bankers. The Director of Fogafin serves at the discretion of the president of the republic.

A. Inter-Institutional Coordination Fora

17. The Resolution Intersectoral Commission (CIR): The CIR is a technical body made up of senior officials from the SFC and Fogafin. It ensures inter-institutional coordination between the SFC and Fogafin in the design and implementation of resolution strategies. The CIR is not a decision-making body but a coordinating forum. It coordinates resolution strategies at an inter-institutional level. The members of the CIR present proposals concerning resolution and recovery strategies for a failing institution. The representatives of the SFC and Fogafin then present the discussed proposals

to their respective management for any final decision. The CIR is also responsible for setting guidelines for the resolution plans and coordinating comments and requests for adjustments to them. The CIR meets once every two months.

18. The Coordination Committee for the Monitoring of the Financial System (CCSSF). The CCSSF coordinates information among the financial sector authorities. It conducts analyses of sectoral risk, particularly for financial institutions, and reviews stress tests results. The CCSSF is composed of the MoF, the BR, the SFC, and Fogafin. Its principal functions are to: (i) share relevant information among the safety net institutions; (ii) ensure that appropriate tools are available for financial system monitoring; and (iii) coordinate the responses to potential systemic financial crises.

19. Financial Crisis Group (GCF): In the face of an emerging systemic crisis, the CCSSF may activate the GCF. This group provides technical support to the CCSSF and coordinates quantitative and qualitative information. It also analyzes and monitors the emerging crisis and developing policy options for consideration by the CCSSF.

20. Advisory Council (CA). The Advisory Council (CA) of the SFC is a consultative body comprised of five experts in economics, finance, securities markets, or general legislation matters, appointed by the president of the republic. Decisions made by the SFC concerning the recovery and resolution of a failing bank have to be submitted to the CA; however, the CA only provides technical advice to the Superintendent. Typically, the CA's opinions do not bind the Superintendent, but the CA has a voice in decisions concerning the granting of a license to a supervised entity, its merger, conversion, transformation, or transfer of assets and liabilities, as well as for the adoption of resolution measures. However, in the case of revocation of operating authorization of a supervised entity that is part of a financial conglomerate whose controlling entity is located in another jurisdiction, the CA's opinion is binding.

ADDRESSING FINANCIAL WEAKNESSES

A. Official Liquidity Support

21. The BR is in charge of regulating money in circulation and market liquidity. It provides liquidity through four main channels:

- open market operations (repos) with public, private, and foreign debt instruments;
- asset purchases of private and public debt instruments;
- intraday repos (which may be converted automatically into overnight repos at a penalty rate); and
- overnight repo (for check clearing).

22. Monetary operations are carried out through securities' auctions. The BR's Board of Directors determines the details of monetary operations, including required collateral and maturities to be auctioned. Those decisions are based on the estimates of demand for liquidity in the economy. In normal times, repo operations use only public debt instruments as admissible collateral, and auctions are open only to credit institutions and a subset of broker dealers. The BR has the

authority to determine access criteria and, in times of market stress, may expand the types of permitted institutions to include trust companies, pension funds, insurance companies, and MBS underwriters.

23. Neither the MoF nor the BR provides official liquidity or solvency support. Under normal circumstances, they do not provide capital for the restructuring of a failing bank. Such support is normally given through Fogafin, which can provide liquidity to open institutions as well as finance resolution measures of failed institutions. The MoF may be called on to recapitalize an undercapitalized or insolvent public sector institution.

24. The BR also provides ELA funding. ELA facilities are given initially for 30 days, but the SFC has the authority to extend maturity. It charges a penalty interest rate of 4.75 percent over the monetary policy rate. Once the institution has borrowed from this facility, it cannot expand its loan portfolio or financial investments. A wide range of institutions are eligible for such support, including banks, finance companies, and financial cooperatives. Any financial institution is eligible for ELA, except those that are (i) insolvent; (ii) under administrative control or liquidation order by SFC; and (iii) when the balance of savings and current accounts is zero.

25. Prior to granting liquidity resources, Fogafin analyzes the entity's financial conditions. It reviews the institution's capacity to regain financial viability and meet its debt obligations. In addition, Fogafin enters into contracts with the entities, ensuring the adequate use of the resources and establishing agreed performance criteria aimed at restoring its financial viability. The borrowing entity is closely monitored through periodic financial reports and meetings with management.

B. Recovery and Resolution Plans

26. Recovery and resolution planning (RRP) has been introduced recently. The CIR has a central role in determining the content of the RRP, in evaluating submissions, and identifying changes that are required by the institutions. Four systemically important institutions, which are the first group subject to such plans, will finalize their resolution plans by April 2022. The exercise may be expanded to other banks.

Recovery Plans

27. The SFC is responsible for overseeing the recovery planning requirements. Recovery planning is conducted annually and is based on stress tests of the institution. The SFC identifies the stress conditions and the financial institutions run them using their internal models. The SFC reviews the results and identifies potential weaknesses of the institution. If the stress tests identify areas of particular weakness, the supervisors require the institution to identify mitigating actions and triggers for their implementation. Possible measures could include recapitalization, sales of a portion of the portfolio, or other physical assets. In these plans, the institution is allowed to consider the use of Fogafin's liquidity facility to address illiquidity but not for capitalization. The SFC is currently implementing a regulation project aimed at formalizing the synergies between the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process

(ILAAP) with the recovery and the resolution plans. This project will be presented toward the beginning of 2022, and seeks to formalize the requirement for supervised entities to have an approach to risk management in which the risk appetite framework is combined with the other variables considered in ICAAP and ILAAP.

Resolution Plans

28. The CIR coordinates the inter-institutional review of the resolution plans. It establishes the guidelines and criteria for preparing resolution plans by supervised entities and coordinates the comments, as well as the request to submitting institutions for any needed adjustments to them.

29. Resolution planning has been introduced and is in the early stages of implementation. The CIR identified systemically important institutions and the SFC asked the four systemically important institutions to prepare resolution plans. This approach is consistent with the “living wills” framework, where institutions themselves are responsible for identifying resolution options. The CIR provides guidelines, establishing the minimum contents. It also coordinates the review and comments on the plans. In identifying mitigating measures, no public resources for recapitalization can be included in the plan. The four institutions are required to provide the first draft by November 2021. The CIR will provide comments and suggestions and the institutions will submit the final plan by April 2022.

30. The resolution plans must include both organizational and operational details. Such details include the firm’s structure, size, main business lines, critical operations, degree of interconnection, financial situation, main counterparties, payment systems, resolution strategy, sources of funding for resolution, preparatory actions, and obstacles to resolution. These plans must be updated every two years, or when there are significant changes in its legal or organizational structure, its financial situation, or when the SFC so requires.

C. Recommendations

31. The responsibility for developing RRP should be reviewed. The current RRP framework is in line with the “living wills” approach followed by many countries, including the United States. However, in recent times, that approach has been revised. The KAs suggest that the preparation of a recovery plan is the responsibility of the institution, while preparation of the resolution plan is the responsibility of the resolution authority. Institutions have a deeper understanding of their business and the constraints they face, while the resolution authorities have a clearer view of the resolution options available and can see such plans in the context of the financial system, not of an individual institution. In addition to expanding the scope of recovery planning, the SFC should ensure that most financial institutions engage in such recovery planning.

32. The content of the recovery plans could be expanded. While use of stress testing as an initial indicator of potential stresses to the firms can be effective in identifying potential difficulties, the content of the recovery plans could be expanded. The financial institutions, rather than the SFC, could be asked to identify the range of risks they could face and the recovery options they would

use to recover from an unexpected shock. Such shocks should include a range of clearly articulated, severe but plausible, firm-specific scenarios and systemic stress scenarios. They could include both idiosyncratic failures and market-wide stress. The scenarios should cover both fast-moving and slow-moving events. The recovery plans would identify the likely impact of such developments on capital and liquidity and then identify the measures the institutions could consider for recovery. In developing possible responses to shocks, the institution should assume no public liquidity or solvency support.

33. Clear triggers for implementing recovery plans should be presented by the institutions. Such triggers should be clearly outlined and include steps to strengthen capital shortfalls, illiquidity, profitability, and problems with asset quality or investment performance. The SFC, in its discussion with the institution, should ensure that these recovery plans are fully integrated into the institution's risk management functions and have the support of the highest level of management.

34. The recovery plan provides more than potential responses to increasing risk. An important benefit of recovery planning is that they include important institutional details, including governance structure and beneficial owners of the institution, identification of the core business, the scope of the institution's business, and the markets where it is active. It should identify the critical functions of the institutions. Such functions are likely to include payment, clearing, settlement, and custody services, retail deposit taking and retail lending, and specialist lending. The plans would also be expected to identify the early warnings that the institution would monitor.

35. Resolution planning is the responsibility of the resolution authorities, who are in a better position to evaluate resolution options than the institution itself. The resolution authorities and the supervisors understand the conditions of the financial sector and the possibilities of finding private sector solutions in a failure. Moreover, they can judge the systemic impact of any potential failure, making the design of the resolutions more effective.

36. While resolution planning is underway for the four systemic institutions, consideration is being given to expanding such requirements to all banks. Such an extension of the requirement would have important benefits. Even for relatively simple liquidations, understanding the particulars of an institution, the extent to which it has a market niche, or other core functions is best analyzed in peace time.

37. The recovery and resolution plans form the basis for a resolvability assessment. Based on these exercises, the SFC may require changes in both business practices and the structure or organization of the company. For example, the SFC can require that the institution merge with another institution or sell assets and liabilities to a third party. These measures may reduce the complexity of the institution and facilitate the resolution process. Such resolvability assessments should be a regular aspect of the oversight of financial institutions.

38. Resolution planning is particularly important when dealing with complex, cross-border institutions. When dealing with a group consisting of both financial and nonfinancial institutions,

such planning is complex and involves a number of regulators. In a cross-border context, it would also include foreign regulators. The recently passed Financial Conglomerates Law provides the SFC with sufficient powers.

39. While resolution planning is a critical element of supervisory oversight, it is unlikely to be sufficient in the event of an actual failure. Developing the plans gives the resolution agent needed experience and provides important information for consideration. In the midst of a crisis, however, such plans, at best, only provide a baseline from which the resolution authorities can begin to work. Every crisis has idiosyncratic elements with unexpected developments and conditions. Preparing a resolution plan gives insight into the conditions of the institution and experience in considering options. In a crisis, however, the day-to-day shocks and uncertainties will require adjustments and compromises.

40. Fogafin's role in financing the recovery of institutions should be curtailed. Although Fogafin only provides resources to institutions undergoing recovery plans, this financing role is not recommended for the deposit insurer. This practice goes beyond the mandate of a deposit insurer and mixes the responsibilities of the deposit insurer, the central bank, and the resolution agent. Such practice is especially worrisome in light of the absence of a formalized liquidity backstop of Fogafin. Moreover, if Fogafin's resources are provided but the institution fails, costs to Fogafin will be higher. Development of alternative emergency liquidity mechanisms for institutions undergoing financial distress is warranted.

RESOLUTION

A. Preventive Measures

41. The SFC has a number of supervisory interventions for addressing the deteriorating conditions of a financial institution. As the institution's difficulties worsen, the SFC will analyze the financial weaknesses and develop alternative plans for its recovery. Such alternatives can include organizational changes, sales of assets, and write down of shareholder equity to absorb losses, and the recapitalization by the shareholders.

42. At this preventive stage, Fogafin can contribute resources to the strengthening of the institution. It can provide capital, provide guarantees, and grant loans to the institution. The amount that Fogafin can contribute is limited to what would have been paid in deposit payout had the institution failed. If the failure of the institution would have a systemic impact, these safeguards can be suspended.

B. Resolution Process

43. If supervisory interventions fail to reverse the deterioration of the institution, the SFC begins the resolution process. It takes over the institution. The first step is to appoint a specialized agent for managing the institution while the SFC prepares for resolution. The agent is responsible for such tasks as notifying the legal representative and informing the employees of the

intervention's scope. Other actions include coordination with the SFC's technology officers to block employee access to the entity's information systems and identification of the computer centers and communication links. After taking possession and appointment of the specialized agent, the SFC can ask the GR to evaluate resolution options or determine whether the institution should be liquidated by Fogafin.

44. The GR, an independent entity within the SFC, is responsible for the analysis of financial conditions and, when necessary, propose to the SFC resolution options for failing institutions. The GR focuses on six activities. First, it evaluates conditions of financial stress facing supervised entities and proposes to the SFC guidelines for the preparation and presentation of resolution plans. Second, it analyzes the financial, administrative, and operational conditions of supervised entities and proposes those institutions that should prepare resolution plans. Third, it evaluates and follows up on modifications to the resolution plans submitted by the supervised entities. Fourth, it prepares draft manuals on the management of crisis situations. Fifth, it proposes to the SFC practices for the diagnosis of resolution mechanisms. Finally, the GR can propose resolution measures for the entities on the request of the SFC. Such proposals may include mergers, the write down of shareholder capital, proposals for recapitalization, the sale of the institution, and the provision of financial support while restructuring activities are implemented. The SFC approves and then implements these measures. Fogafin may be asked to provide financing, contribute to the capitalization, or contribute resources to implement other resolution measures required by SFC. If these efforts lead to a return to financial viability, the original shareholders may regain control of the institution, or the institution may be sold to new investors.

45. If the shareholders are unable to recapitalize their institution, the GR reviews the conditions of the institution. After an analysis, and if the SFC determines that the institution's failure would pose a systemic threat to the economy, Fogafin recapitalizes the institution, diluting the original shareholders. When Fogafin's participation exceeds 51 percent of the entity's capital, the institution becomes publicly owned. Creditors (insured or not) are not affected, and their claims remain in force with the resulting official bank.

46. Alternatively, the SFC may determine that the institution should be liquidated by Fogafin. Fogafin is responsible for four major areas: (i) implementation of resolution mechanisms; (ii) deposit insurance; (iii) reserve management; and (iv) management of guarantees, liquidations, and acquired assets. In this context, Fogafin appoints a separate liquidator. With the appointment of the liquidator, shareholders lose all management powers but retain an economic interest in the institution. Fogafin can then decide on the resolution mechanism to be implemented. Fogafin typically considers: (i) payout of depositors and liquidation of the shell; or (ii) transfer part of the assets and all liabilities (including all depositors), either to another financial institution or by creating a bridge bank, requesting a license from the SFC, and transferring assets and all liabilities to it. Fogafin has the authority to provide capital, thus becoming its principal shareholder. The resolution decision between liquidation and using a P&A transaction is based on least-cost criteria, unless the institution's failure poses a systemic threat to the financial system or causes severe damage to the economy.

47. Before a decision is made, these resolution options are discussed widely, both within the SFC and with the CIR. The GR first reviews its proposed options with the supervisors of the institution and with the Superintendent. Then the GR presents them in the broader forum of the CIR, with the participation of both the SFC and Fogafin. No decisions are made in the CIR. Rather, the GR presents its analysis and proposals, and there is a discussion aimed at coordinating the actions among different agencies. Following the CIR, representatives return to their institutions where the Boards of the SFC and Fogafin make final decisions.

48. The administration's resolution decisions are subject to legal review. Any person may initiate a judicial process to determine whether the resolution decision was correctly determined. A successful appeal does not automatically invalidate the resolution. The judicial review may result in a monetary judgment against the authorities. However, the parties in the lawsuit may request a provisional suspension of the administrative act. If the case goes to trial, the judge has the authority to nullify a decision that is found to be illegal. For such action, it must be proven in court that the administration acted illegally and in violation of the law governing its actions. There has been no case where the judicial authorities have reversed a resolution decision. The authorities should assess whether limiting remedies under the statutory framework to ex post compensation in cases where an authority acted within its legal powers and in good faith is practicable in Colombia.²

C. Coordination Mechanisms

49. The decision-making process for the resolution of a failing institution is coordinated through the CIR. Both the SFC (the GR) and Fogafin participate in that entity. When additional specialist knowledge is needed, the CIR may invite other participants, including the BR and the MoF. In the preparatory stage, before the SFC decides on liquidation, the GR may present the resolution options under consideration to CIR participants. In this forum, the GR can discuss private-sector solutions, including recapitalization by the shareholders, recapitalization by Fogafin, mergers with other institutions, and asset/liability transfers. While the resolution strategy is discussed in CIR, the decision and execution of the strategy are taken by each authority. Even at the preliminary stage, Fogafin will use information presented at the meeting—such as the diagnosis and data on assets and liabilities—to prepare a range of resolution alternatives that could be applied in the event of liquidation.

50. In the event of a systemic crisis, the inter-institutional coordination and strategy development is managed by the CCSSF. That institution is composed of the MoF, the BR, the SFC, and Fogafin. The CCSSF determines if a crisis is systemic based on the SFC's recommendations, from analyzing the size, interconnectedness, substitutability, and complexity of the institutions involved. At the outbreak of a crisis, the CCSSF activates the Financial Crisis Group (GCF). Once activated, the GCF must meet within hours and manage the crisis response. The group provides technical support

² "The legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified" (KA 5.5).

to the CCSSF and coordinates quantitative and qualitative information. It also monitors ongoing development and prepares policy options for the CCSSF.

D. Resolution Tools

Takeover and Control

51. Following consultation with the Advisory Council, the SFC has the power to take over and manage an institution. Criteria for taking control are wide-ranging and include a serious deterioration in the financial conditions of the institution when the shareholders cannot recapitalize it, sustained losses, or other conditions that jeopardize the security of deposits. The SFC must take control of the institution when its capital falls below 40 percent of the required minimum capital.

52. After the takeover by the SFC, Fogafin may appoint a special agent who manages the institution while a resolution strategy is determined. The existing managers and shareholders cannot interfere with the agent's actions. In this role, the agent can control the property and the business. The initial objective is to analyze the situation and identify measures to rehabilitate the institution. Shareholders absorb losses but retain their economic interest in the institution. If the institution recovers, full authority is returned to the shareholders. Under these circumstances, Fogafin can contribute to the recapitalization of the institution if the shareholders are unable to comply with the recapitalization order. If the institution does not recover, the SFC can decide to liquidate the institution. Fogafin appoints a liquidator who manages the bank while Fogafin designs and implements a resolution strategy.

P&A Transaction

53. The Colombian resolution authorities use P&A of assets and liabilities in both a precautionary regime and in a resolution regime. This mechanism was established as a resolution tool in 2017 to prevent loss of value of assets in the resolution of a failed institution.

54. P&A transactions can be used as a recovery mechanism aimed at returning an institution to profitability. If the shareholders are unable to recapitalize it, the GR may propose appointment of an administrator and, as part of the restructuring, sell assets and liabilities. The SFC will appoint the administrator, who has full authority to restructure the institution. In this context, the administrator may sell assets and liabilities to other viable institutions. The shareholders remain in the institution but are unable to influence the operation.

55. If the SFC determines that the institution is not viable and must be liquidated, Fogafin may opt to sell packages of assets and liabilities to a third institution. It appoints a liquidator who has the authority to analyze the asset data, construct bidding packages, and allow interested institutions to perform their own due diligence. In this transaction, assets are valued at their market prices and all deposits—both insured and uninsured—are included. The authorities explained that the inclusion of all deposits is a policy decision of the SFC, reflecting a concern about maintaining financial stability, however this increases the cost and moral hazard associated with the resolution.

Identifying and valuing assets can be time consuming and, formally, Fogafin cannot begin the resolution until its Board approves that strategy. However, when the resolution options are discussed in CIR, Fogafin gains access to all relevant information and can begin preparations before the final resolution decision is made.

Bridge Bank

56. If there is no demand in the market for the asset/liability bundles, Fogafin may ask the SFC to establish a bridge bank. Fogafin capitalizes the bridge bank and appoints a manager. The decision to establish a bridge bank is not related to the systemic impact that the institution's failure could have. Rather, it is related to the absence of private institutions willing and able to participate in a P&A transaction.

57. A bridge bank is not subject to most regulatory requirements; it is not subject to minimum solvency requirements or reserve requirements. Rather, the entity must comply with minimum liquidity requirements and implement required risk management systems. The bridge bank will have sufficient capital to cover operating expenses and have adequate liquidity. The bridge bank may function for a two-year period, extendable for an additional year on three occasions, and for a maximum duration of five years.

Asset Management Company

58. Neither the SFC nor Fogafin can establish an asset management company. The liquidator of the institution may package and sell assets as part of the liquidation. In the event of a systemic crisis and the need to dispose of large amounts of assets, Fogafin may work with private agents to manage the recovery and sell remaining assets. The assets of the failed banks remain in the entity in liquidation, and the liquidator is in charge of disposing of them to the highest bidder in the market, but always under the supervision of Fogafin. Fogafin did establish a company to act as a public collector of NPLs. However, after 2007, responsibility for the institution was passed to the MoF. In a future financial crisis, the SFC would rely on private collectors with a mixed management between Fogafin and such collectors.

Bail-In

59. While the SFC has some powers that are in line with bail-in (the write-down of shareholder equity), bail-in is not a formal resolution power available to the authorities. The SFC can reduce the share capital through its supervisory powers, or if it takes over the institution. The SFC can also write down shareholder capital, place new shares in the institution, and conduct forced sale of assets. Shareholders' approval for such actions is not needed. However, there are no provisions allowing the authorities to write down and convert unsecured creditor claims to equity.

60. A major limitation to implementing bail-in is the lack of loss-absorbing securities held by financial institutions. In the current environment, financial institutions are funded mainly

through deposits rather than through capital markets. Moreover, the authorities are concerned that the introduction of loss-absorbing securities could dampen capital market development.

Nationalization

61. Fogafin has the power to take over an institution, disenfranchise the shareholders, and capitalize it. If a P&A option is not available but the institution plays a significant role in the market and cannot be liquidated, Fogafin may capitalize the institution. This process may be faster than the establishment of a bridge bank and may be used when systemic distress is rising. If Fogafin acquires more than 50 percent of the entity's capital, the bank comes under public ownership with Fogafin as majority shareholder. This institution must be privatized as soon as possible.

SIFI Resolution

62. The legislative and administrative tools contemplated in the legal framework for recovery and resolution purposes make no distinction based on size or systemic importance of the failed institution. All financial institutions can be required to produce recovery and resolution plans. In addition, all resolution tools are available for use in the resolution of any institution. In the case of Fogafin, there are no instruments for the exclusive use of systemic entities. However, if its liquidation has an impact on financial stability and economic activity, there can be an exception to the minimum cost criterion. Similarly, there is a systemic exception to the limits on the use of Fogafin resources.

E. Recommendations

63. The separation between the supervisory functions and the resolutions functions within the SFC could be strengthened. The supervision and resolution decisions are made within the SFC. The GR conducts an independent and thorough analysis of options and proposes resolution alternatives to the SFC, but the final decision and implementation is done by the SFC. The KAs call for an independent decision-making process (KA 2.3). While institutional independence is not prescribed, operational independence is generally reflected in the decision-making process. Resolution authorities in a variety of jurisdictions clearly separate decision making on resolution and supervision (for example, the European Union, the United Kingdom, Australia, and Hong Kong SAR.) While the GR is a separate and independent unit within the SFC, its decision-making procedures allow for overlap between supervisory and resolution oversight. Once the GR develops a proposal for a resolution strategy, that proposal is discussed with the institution's supervisor and then with the Superintendent. The proposal is then discussed within the CIR, where representatives of both the SFC and Fogafin review it. While this system leads to a high degree of coordination and cooperation among safety net players, steps should be considered to increase the separation between those responsible for supervision and those responsible for resolution of a failed institution.

64. The P&A powers should be made more flexible. Currently, Fogafin must package all deposits, both insured and uninsured, with performing assets and, possibly, Fogafin resources for transfer to another financial institution. The requirement to transfer all deposits reflects a policy view

that financial stability is enhanced by guaranteeing all deposits. However, this requirement also limits Fogafin's flexibility and may increase the cost of the resolution strategy. Fogafin should be given the option of only transferring insured deposits.

65. The authorities should introduce depositor preference. Such preference gives priority to depositors over other senior unsecured creditors. The hierarchy of creditor claims establishes the order in which general unsecured claims will be paid in insolvency. Depositor preference places all deposit liabilities in a more senior position than other senior unsecured creditor claims. As such, depositors increase the chances of recovering value from a failed bank's assets. Such preference reduces the risk to unsecured depositors in resolution. It also facilitates the use of resolution tools (such as P&A) where not all senior creditors or deposits (depending on the type of depositor preference introduced) are transferred to another institution.

66. Fogafin's power to recapitalize an institution could be refined. First, Fogafin's authority to be the main shareholder of an open bank should be circumscribed. Recapitalization of an open bank is beyond the typical responsibilities of a deposit insurer or resolution agent. Fogafin's restructuring options should be limited to banks that are taken over and whose shareholders have been disenfranchised. Fogafin has the power to both recapitalize a failed institution or request that a bridge bank be established and capitalize the institution. In principle, both types of Fogafin-owned banks will be sold to the private sector as quickly as possible, or, in the case of a bridge bank, within five years. However, if the institutions remain in public sector ownership for more than a few months, there is a potential conflict of interest. An alternative is to transfer ownership to another public institution or bank holding company. Second, the bridge bank should meet all prudential requirements (including capital). If the bridge bank exists for only a few months before it is sold, then meeting all prudential requirements is of minor importance. However, if the bank remains in the market for a longer period of time, it should compete on an even playing field, meeting all prudential rules and regulations, including the minimum capital requirements,

67. The use of the bridge bank as a resolution tool should be limited. Fogafin will establish such an institution when there are no private participants for a P&A transaction. However, such use is too broad and could result in the maintenance of a weak financial institution rather than an orderly elimination of a failed bank. If the bank's failure has no systemic impact, Fogafin should choose between a P&A resolution or, failing that, a straight liquidation. However, a bridge bank could be an important tool if the liquidation of the institution would have systemic impact, either because of its size and complexity or because of conditions in the market at the point of failure.

68. The resolution agency in Colombia does not have a full bail-in authority. The SFC can write down securities if they contain contractual arrangements for such conversion, but unsecured securities cannot be written down and converted to equity. The authorities are concerned that the liability of Colombian banks is dominated by deposits. Bail-in is not effective under such conditions and, moreover, could undermine capital market development. While there is merit to such concerns, the lack of a bail-in authority could pose limitations in the future. As conglomerates grow and as international firms extend into neighboring countries, bail-in powers may be the least-cost resolution alternative. Moreover, cross-border bank resolution is difficult when resolution tools differ

across jurisdictions. Consideration should be given to having the authority to bail in creditors, even if there is no intention to use such authority in the resolution of domestic institutions. Were the authorities to introduce bail-in power, such introduction would have to be accompanied with measures to ensure that banks that are subject to bail-in had adequate loss-absorbing securities that make the use of that power feasible. The methodology for determining the appropriate level of loss-absorbing securities must take into consideration the interconnectedness of the financial system, limiting the exposure of financial institutions to securities eligible for bail-in.

FINANCING OF RESOLUTION

69. The funding for both recovery measures in a weak bank and for resolution measures in a failed bank is provided by Fogafin. The government does not provide direct solvency or liquidity support to a bank in difficulty unless it is a public entity. Before liquidation, Fogafin can finance recovery mechanisms implemented by the GR, including recapitalization, if the SFC finds it to be capital deficient. If Fogafin contributes 51 percent of equity, it becomes the majority shareholder, and the entity comes under public ownership.

70. In the event of a liquidation, Fogafin decides between payout to depositors and the transfer of asset and liabilities either to other viable institutions or a bridge bank. If depositors are paid out, they receive up to COP\$50 million, and Fogafin is subrogated in the liquidation. If Fogafin determines that the banks or some part of the bank should remain in the financial system, it can finance a P&A transaction where performing assets and all deposits are transferred to another financial institution or to a bridge bank. If assets are lower than insured deposit levels, Fogafin can compensate the difference.

71. The use of Fogafin's resources is protected by safeguards aimed at limiting their use and preserving the deposit insurance fund. Specifically, safeguards include that: (i) shareholders must absorb losses; and (ii) the contribution from Fogafin must not exceed the amount it would have paid out in liquidation. This criterion has an exception for the case where the entity's failure could undermine the stability of the financial system, or cause serious damage to the economy. Fogafin analyzes the conditions, and the exception is made by the CCSSF. If Fogafin's reserve becomes insufficient, it may increase premiums, issue debt in the market that is guaranteed by the government, or it may request contributions from the national budget, with the obligation to repay the budget's contribution.

72. The legal framework does not provide for exceptions to the pari passu principle, and the hierarchies provided by law are strictly respected. Accordingly, the regulatory framework does not provide for any right of compensation to any creditor because of the measures. In a

complex resolution, the authorities may need to depart from the creditor hierarchy and should have the capacity to do so in accordance with the KAs³ and subject to a no-creditor-worse-off safeguard.

Recommendations

73. Plans should be developed for the financing of a failed cross-border, systemic institution. In the case of such a failure, Fogafin is not likely to have adequate resources. In a systemic crisis, it is important that needed resources be made available, in part because of the impact on private confidence in the authorities' ability to address the conditions. As part of the review of resolution alternatives for cross-border firms, the resolution agency will need to identify alternative funding sources. In this context, consideration could be given to the establishment of an ex post resolution fund. Such a facility could be temporarily funded with public money but reimbursed with contributions from the private sector.

74. Consideration should be given to establishing a more comprehensive bail-in provision for financing the resolution of a cross-border, systemic institution. Not only would the bail-in power be useful, but the authorities could introduce *pari passu* guarantees for creditors.

DEPOSITOR PROTECTION AND PAYOUT

75. Fogafin has a broad mandate to protect depositors and creditors and preserve economic stability. In meeting these objectives, it can provide financial assistance (i) to banks under recovery measures where shareholders have not been disenfranchised; (ii) for the pay out of depositors in a failure; and (iii) to finance the recapitalization and resolution measures of nonviable banks.

76. The Board of Directors is composed of five representatives. They include the MoF, the BR General Manager, the Superintendent, and two representatives appointed by the president of the republic from the financial sector. The private sector representatives cannot be active bankers and are subject to a strict code of conduct aimed at preventing conflicts of interest.⁴

³ "Resolution powers should be exercised in a way that respects the hierarchy of claims while providing flexibility to depart from the general principle of equal (*pari passu*) treatment of creditors of the same class, with transparency about the reasons for such departures, if necessary, to contain the potential systemic impact of a firm's failure or to maximize [sic] the value for the benefit of all creditors as a whole. Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime ("no creditor worse off than in liquidation" safeguard)." (KAs 5.1–5.2).

⁴ Among the elements of the Code of Conduct are requirements to (i) decide in favor of the interests of the fund; (ii) disclose any situation generating the conflict to the interested party; (iii) refrain from performing operations involving conflicts of interest; and (iv) avoid conflicts of interest due to family relationships.

77. Fogafin can finance a wide range of activities:

- With open banks, it can finance operations through the provision of loans and capital, assist in mergers, asset purchases, guarantee capital, and bond underwriting, and contribute to a P&A.
- Once the SFC takes possession of the failing institution, Fogafin can appoint a special agent of the failed institution for analysis of options and determinization of a resolution strategy. If the bank can recover, or its failure would cause a systemic impact, Fogafin can recapitalize it, restructure its operations, and sell it to the private sector. Alternatively, Fogafin may finance a P&A operation (covering the gap between the value of assets and deposits in the failed bank) or pay out depositors and liquidate the remaining shell.
- If the SFC decides on liquidation, Fogafin can appoint a liquidator. That liquidator can pay out depositors and begin the liquidation process, or it can use P&A transactions to transfer assets and all deposit liabilities to other, viable institutions. If there are no private sector solutions, Fogafin may ask the SFC to establish a bridge bank and Fogafin capitalizes the bank and becomes its owner.

78. The selection of the resolution options is based on least-cost criteria. Except in the case that the institution's failure would have a systemic impact, Fogafin calculates the net cost of each resolution alternative and selects the least-cost option. Moreover, Fogafin's financial support is constrained to the minimum cost criteria, whereby the net cost of the financial operation cannot exceed the cost of paying out the insured depositors. The only exception to these criteria is if the liquidation would jeopardize financial system stability, in which case the net cost criteria is not binding.

79. Fogafin provides full coverage to most individual depositors, leaving a significant portion of the value of deposits subject to market discipline. The maximum insurance coverage is COP\$50 million per depositor, per financial institution. The number of fully insured depositors amounts to 81.7 million and represents 99.2 percent of the total number of depositors in the financial system. The value of fully insured deposits is COP\$95.7 billion and represents 20.3 percent of total insurable deposits.

80. Fogafin's resources are derived from member institutions. Quarterly premiums are paid by the member institutions and Fogafin receives a return on investments. The base premium is 0.3 percent of insured deposits. Risk-weighted premiums are charged from financial institutions. The base rate is a quarterly charge of 0.075 percent of covered deposits plus a "risk weight" based on the CAMEL methodology. In addition, Fogafin can place a temporary surcharge on members in order to ensure that the 2029 target reserve level is met. This coefficient is calculated annually. As the fund target was within projected range, no surcharge was collected for 2019, 2020, or 2021.

81. The reserve fund has a target range of 4.7 percent to 5.9 percent of total insurable deposits. The reserve fund, as of January 31, 2021, amounted to COP\$26.45 billion or 5.2 percent of insurable deposits. The methodology used to establish the reserve level is based on a Monte Carlo

simulation using (i) the probability of failure of each bank, estimated using the average CAMEL of each institution; (ii) Fogafin's exposure to that bank; and (iii) a correlation matrix of default among small and too-big-to-fail institutions. Calculations are made assuming "normal times" and assuming a systemic crisis.

82. If the resources in the fund are insufficient, Fogafin has a number of options. It may (i) increase premiums above the legal limit of 0.3 percent; (ii) request contributions from the budget; or (iii) borrow in the market with a government guarantee. There is no back-up liquidity support facility available in case the fund is exhausted, but Fogafin needs to pay out depositors.

83. Information about the deteriorating condition of an institution is discussed in the CIR, where Fogafin is a member. Fogafin's participation in the CIR gives it access to information about the assets and liabilities of a weakened institution, and the resolution options being considered by the SFC and GR. Fogafin uses these meetings to obtain detailed information about the institution's assets and liabilities, so it can prepare alternative resolution options. Additionally, Fogafin and the SFC have an information exchange agreement in place and can exchange both quantitative and qualitative information in times of crisis. This channel has only been used in simulation exercises.

84. Fogafin's goal is to pay most depositors within seven business days following the liquidation of their entity. While recent payouts have taken slightly longer, Fogafin has implemented a series of measures to accelerate that payout. Entities registered with Fogafin submit quarterly data to it, allowing Fogafin to have a database containing depositor information based on a single customer view. Measures to accelerate depositor payout include (i) establishment of a standardized database containing depositor data; (ii) establishment of a formal contract with paying banks, so that Fogafin has pre-established agreements for depositor payout; and (iii) tests of the reimbursement process through simulations to identify inefficiencies. Fogafin is able to identify a depositor's accounts in other banks and will transfer their deposit to that bank. The depositor has no requirement to request the transfer, except in those cases that require specific documentation such as heirs of deceased depositors.

85. Fogafin informs depositors of a bank's failure through a variety of channels. It issues public notices of the liquidation, puts information about the reimbursement process on a specialized website, sends text messages and emails to depositors, and publishes a special call center.

Recommendations

86. Fogafin's capacity to provide liquidity to both open and intervened banks could be curtailed. In addition to funding resolution measures up to the safeguard limit, Fogafin can support the recovery of a financial institution while the shareholders remain in place and before the institution is intervened by the SFC. This blurring of Fogafin's role of providing finance to an open bank, albeit under restructuring and financing resolution measures mixes the role of Fogafin. In the former case, Fogafin, together with the supervisors, must monitor the ongoing operations of the open banks, while in the latter case, Fogafin focuses on the restructuring and rehabilitation of a failed institution under new management. A more traditional arrangement would be to limit

Fogafin's financial support to financing of the resolution liquidation of a bank. Fogafin would limit its activities to providing funding and developing resolution strategies for banks whose shareholders have been disenfranchised, and either assets and liabilities are being purchased by other viable institutions or Fogafin has opted to request establishment of a bridge bank owned by the public sector. The provision of financial support to open banks, including banks temporarily managed by a special advisor by the GR, would be provided by the BR. Such a distinction would limit possibilities of conflict of interest. Under these circumstances, the BR could extend its emergency liquidity facility and the SFC would monitor the institution's use and recovery.

87. Alternatively, GR and Fogafin could be combined. In this case, open banks would be supervised by the SFC, and the treatment of failed banks would be addressed by Fogafin. This approach would focus the restructuring of failing banks and the liquidation of failed banks in one institution.

88. Fogafin should have access to a guaranteed back-up liquidity facility in the event that the fund is depleted. While Fogafin has several options for reconstructing its fund (increases in premiums, borrowing in the market, and requesting explicit budgetary support), these alternatives will take time to implement. However, public confidence in the deposit insurance system could be undermined if the fund were to be depleted, and yet the financial system remained under stress. Having either guaranteed access to immediate liquidity or assurances that public policy will ensure that deposits are paid out within the time limit will reinforce private sector confidence.

89. The safeguards for Fogafin's fund can be strengthened. Currently, Fogafin outlays are limited to the amount that it would pay out in a liquidation. However, there is a systemic exception: allowing Fogafin to finance a larger amount if the institution's failure would have a systemic impact. Additional safeguards are warranted. For example, in all cases, Fogafin's outlays could be limited to 50 percent of the current fund level. If additional resources are required, reflecting the systemic nature of the failure, public resources could be used.

CONTINGENCY PLANNING AND CRISIS MANAGEMENT

90. The Colombian safety net has a strong framework for inter-institutional cooperation and coordination. In the event of a system-wide crisis, the CCSSF, on the SFC's advice, declares the crisis to be systemic, which initiates the Financial Crisis Group (GCF). This group is made up of representatives of the CIR, the CCSSF Technical Subcommittee, and other officials appointed by the SFC. Its function is to exchange quantitative and qualitative information, analyze current information, and prepare draft policy options for the CCSSF.

91. The GCF's purpose is (i) to exchange quantitative and qualitative information; and (ii) carry out joint analyses, so that the crisis management decisions can be presented to the CCSSF. It will undertake the necessary analysis and coordinate the development of policy options. Once activated, the GCF must meet within hours. If the crisis is triggered by the failure of a single

institution or number of institutions, the SFC supervisors responsible for the institutions will diagnose the situation and the CIR (the SFC and Fogafin) will review the recovery or resolution options. If multiple institutions are involved, supervisors will coordinate with the GCF.

92. In preparation for a systemic crisis, the CCSSF runs periodic crisis simulations. The Simulation Exercise Group (CES), led by Fogafin, prepares and coordinates such simulations. Simulations are run on a regular cycle, with full simulations being held at least once every four years. These inter-institutional simulations involve all safety net members. The simulations range from simple desktop exercises to full-fledged simulations involving multiple institutions. The objectives of the simulations are to test data collection and analysis tasks, to clarify the protocols governing the management of a crisis, and to evaluate the decision-making process. Participants in these simulations are the high-level management of the institution. The tests last for up to five days, depending on the topic.

93. In addition to simulations at the safety net level, institutions manage their own internal simulations:

- Fogafin periodically tests its internal processes, including the payout of deposits. Between 2017 and 2020, three simulations were conducted.
- The SFC and Fogafin conducted three exercises of resolution simulations in 2020.
- The BR conducts ELA simulation exercises with financial institutions, with the SFC's collaboration.

94. In 2017, an inter-agency drill was conducted with the support of the Toronto Centre. The purpose of that exercise was to evaluate the authorities' preparedness and response capacity. It was based on three crisis scenarios of varying difficulty. The main conclusions of the exercise included the following:

- A formal protocol of actions should be established for the management of financial crises;
- The mechanisms for sharing information among the members of the safety net should be reviewed to identify what data each institution needs in order to carry out its functions in a crisis;
- Resolution powers should be enhanced, in particular, in the areas of transfer of assets and liabilities, bail-in, and recovery and resolution planning; and
- Fogafin's powers to grant liquidity to financial entities should be restricted to intervened institutions, as that function currently overlaps with those of the BR as the lender of last resort. For its part, the BR should review the flexibility of its regulations for granting liquidity support during a crisis.

95. In 2021, the SFC, the BR, and Fogafin participated in the crisis management simulation exercise organized by the Financial Stability Institute. The exercise was undertaken at

the South American level and included authorities in Argentina, Brazil, Chile, Colombia, Paraguay, and Uruguay, and the results are being evaluated.

CROSS-BORDER ARRANGEMENTS

96. The SFC does not differentiate between locally owned and foreign-owned institutions.

Its toolkit of resolution powers can be applied to all institutions, regardless of size or location, and the SFC has the authority to take measures on its own initiative against a foreign-owned branch or subsidiary. Branches of foreign entities are incorporated with the required capital in the country and are subject to compliance with local regulations. Moreover, there is no specific provision that allows the SFC to "give legal effect" to the resolution actions taken in third countries. The Colombian legislation does not require that the resolution authorities take into consideration the impact that its decisions may have on other jurisdictions.

97. Notwithstanding the above, there are significant methods for sharing information in a cross-border context.

Colombia is host to subsidiaries of four globally systemically important financial institutions (G-SIFIs). Colombia has made important strides in the area of consolidated supervision and has an extensive network of agreements on information sharing. The SFC has 30 Memoranda of Understanding (MoUs) signed with 22 countries, detailing information-sharing arrangements. Likewise, for Colombian bank subsidiaries abroad, the SFC has MoUs with home regulators. In addition, there is an MoU with the Central American Council of Superintendents of Banks, Insurance and Other Financial Institutions, which includes Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama. These MoUs include an agreement on the timely and effective management of cross-border crises. Fogafin has MoUs with deposit insurers in various jurisdictions, covering information exchanges related specifically to deposit insurance.

98. The SFC also participates in supervisory colleges. Between 2012 and 2020, the SFC has hosted 22 supervisory colleges for systemically important cross-border institutions. For those colleges hosted by the SFC (BBVA, Itaú, Santander, and Scotia Bank), the SFC reviewed the parent companies' willingness to support their subsidiaries with both liquidity and capital, as well as exchanging views on information systems and risk management capabilities.

Recommendations

99. While considerable progress has been made in information sharing, resolution planning for cross-border institutions should be strengthened. Cross-border firms pose particular problems. They may be composed of both financial and nonfinancial institutions, resolution regimes may differ between home and host authorities, and there may be disagreements about what constitutes critical functions between home and host authorities. Accordingly, the resolution authority will need to plan in advance, identifying resolution options and resolution alternatives.

100. The FSB has identified different alternatives that might be considered. The authorities could apply resolution measures to all entities in the group simultaneously (multiple point of entry resolution) or resolve the institution by resolving the holding company, holding loss-absorbing capacity in the home entity and down-streaming funding to the operating entities (single point of entry).

101. While this decision on the appropriate resolution strategy of such firms may not be needed immediately, work in developing such strategies and forming an international consensus is warranted. Steps for strengthening cross-border resolution could include the following:

- Clarify the roles and responsibilities of both home- and host-country resolution.
- Ensure that there are no legal barriers to information sharing and cooperation with foreign resolution authorities.
- Review the resolution regimes of home and host countries, identifying what powers may not be held in common and identifying alternative solutions.
- Allow legal recognition of the home-country's resolution actions and implement mechanisms for these actions to have legal effect in the host country. While not requiring Colombia to adopt the resolution strategy, or measures adopted by the foreign resolution authorities, such recognition could improve coordination and give the SFC the legal underpinnings to adopt measures, even if the foreign subsidiaries meet all prudential norms.
- Establish specific crisis management groups for major cross-border financial groups that are potentially subject to resolution. Such crisis management groups go beyond the supervisory colleges and could include the supervisory authorities, central banks, resolution authorities, finance ministries, and the deposit insurers.
- Financing the resolution of a large cross-border firm is likely to exceed local resources. In planning for such a failure, therefore, consideration could be given to establishing bail-in authority and requiring that loss-absorbing capacity be located in subsidiaries, either through external debt or equity.