THE BAHAMAS

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

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Prepared By
Gayon Hosin (Mission Chief, MCM); David Hoelscher and Geof Mortlock (External Experts)
High-Level Summary Technical Assistance Report
Monetary and Capital Markets Department

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The High-Level Summary Technical Assistance Report series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: The Bahamas has made considerable progress in developing the legal framework, infrastructure and resolution tools for an effective bank recovery and resolution regime, with legislation entered into force in September 2020. Implementation of recovery planning and development of other strategic and preparatory initiatives commenced after the first Technical Assistance mission in October/November 2021. The Central Bank of The Bahamas is committed to continuing apace with the operationalization of the reforms supported by the Fund’s TA guidance and recommendations, including with respect to: steps to further strengthen recovery planning; resolution framework, policies, and procedures including for credit unions; resolution planning and resolvability assessments; inter-agency coordination and communications; the contingency public funding framework; building capacity within the Deposit Insurance Corporation; and a program for testing authorities’ preparedness for a bank failure.

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Background

At the request of the Central Bank of The Bahamas (CBOB), the IMF’s Monetary and Capital Markets Department (MCM) conducted a virtual technical assistance (TA) mission during November 2022 to support the operationalization of the new bank recovery, resolution, and depositor protection regimes introduced in September 2020. Discussions built on the recommendations of the first (virtual) TA mission held in November 2021 and the 2019 FSAP and centered on: (i) resolution planning and crisis preparation; and (ii) resolution and crisis management. Based on these discussions, the mission provided advice to support the authorities’ implementation of the resolution and financial crisis management regime in line with international standards and adapted to the economy’s size and context.

Summary of Findings

The Bahamas has made considerable progress in developing the legal framework, infrastructure, and key tools for an effective bank recovery and resolution regime and is taking steps to operationalize the regime. Some aspects of the law would benefit from review to better align it with international principles and good practice, and the recovery planning and resolution framework for credit unions should be strengthened. Implementing recovery plans for the domestic systemically important banks (DSIBs) has commenced with the conduct of a pilot program following the first mission, and should be built out with structured feedback by the CBOB to participating DSIBs and pilot-informed updates to industry guidance on the required content for recovery plans and their periodic testing. The CBOB plans to consult with the industry on a paper on resolution planning and resolvability assessment framework and thereafter finalize resolution guidance and commence implementation via a pilot program. Strengthening of domestic coordination on financial stability and crisis management matters is advancing with work toward the establishment of an interagency Council, comprising financial safety net agencies, with the mandate to monitor and coordinate policy for emerging risks to financial stability and coordination of a response to a financial crisis.

Effective operationalization of the resolution regime will also require review and reform in other key framework areas, including contingency arrangements for public resolution funding if required, fully implementing the deposit insurance system, and establishing a program of regular testing. In particular, there is a need to clarify the purposes for which public funds may be used, the preconditions for the use of public funds, the source of public funding, and the means by which funding outlays net of recoveries from the assets of the resolved bank can be repaid. Strengthening and fully implementing the deposit insurance system with respect to governance arrangements, data and information requirements, access to supplementary funding, the reimbursement process, and public education will enhance financial stability and lower the risk of depositor runs. Notably also, the desired infrequency of actual bank failures creates a risk that staff of the relevant financial safety net agencies might lack the experience and necessary skills to implement a bank resolution, notwithstanding the preparation of resolution manual and plans. Regular testing, coupled with other capacity-building initiatives, will help strengthen the ability of the CBOB and other financial safety net participants to be prepared should a bank failure arise.

Summary of Recommendations

Strengthening and updating the supervisory early intervention and recovery planning frameworks and requirements are critical to maintaining financial system stability in the context of acknowledged limits of the structure and depth of the financial system that, in turn, constrain resolution options. The supervisory early intervention framework should be reviewed and updated to
incorporate the triggering of recovery plans and ensure that early warning indicators are used more effectively in the context of early intervention. Recovery plans must be closely integrated into banks’ and credit unions’ risk management frameworks, ICAAP, and existing contingency plans, and be subject to robust governance arrangements and periodic testing. Contingency plans for dealing with weak banks should be prepared and regularly tested by the CBOB. Supervisory engagement with home supervisory authorities of foreign-owned banks in these regards should also be strengthened.

**Enhancement of the underpinning legislation is recommended to support building out and implementing the operational infrastructure for bank resolution.** Legislation on bank resolution should be reviewed and strengthened to (i) better align the legal framework with the Financial Stability Board’s Key Attributes of Effective Resolution Regimes, including clarifying resolution tools, establishing appropriate safeguards for their use, and specifying the preconditions for the contingency of public support; (ii) clarify the respective responsibilities of the CBOB and the Ministry of Finance, including on the provision of public funding/guarantees and the ownership of a bridge bank; and (iii) align the resolution framework for credit unions to that applicable to banks with appropriate modifications. The operational framework requires the development of a resolution manual including step-by-step implementation guidance for the resolution tools established in law and addressing institutional arrangements, and a resolution planning and resolvability assessment framework for domestic systemically important banks, with its implementation to commence via a pilot exercise.

**Essential to effective operationalization of the resolution regime are focused collaboration, coordination and capacity building across the safety net participants.** Measures to ensure effective crisis management collaboration and coordination should include strengthening the structure and governance of the Bahamas Financial Stability Council that is being established, and the arrangements for cross-border cooperation for recovery and resolution with particular focus on foreign banks with a systemically significant presence. Strengthening the framework and operational capacity of the Deposit Insurance Corporation, including formalizing a backstop funding arrangement, building capacity for rapid payout, and establishing a public awareness program, are key to optimizing that agency’s critical safety net mandate. The CBOB should also develop and implement a strategy for building capacity for dealing with financial distress and failure situations, in liaison with the other financial safety net agencies, including a program of regular training, conducting crisis simulations, and testing safety net and resolution frameworks.