



TECHNICAL ASSISTANCE REPORT

CABO VERDE

Review and Operationalization of the Resolution
Framework

March 2025

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Glossary

| | |
|------|---|
| AMV | Asset Management Vehicle |
| BCV | Banco de Cabo Verde |
| BdP | Banco de Portugal |
| CVE | Cabo Verde Escudo (local currency) |
| DGF | Deposit Guarantee Fund |
| DGS | Deposit Guarantee Scheme |
| DIS | Deposit Insurance Scheme |
| DSIB | Domestically Systematically Important Bank |
| ELA | Emergency Liquidity Assistance |
| FIAL | Financial Institutions Activities Law |
| FSB | Financial Stability Board |
| FSSR | Financial Sector Stability Review |
| GDP | Gross Domestic Product |
| IMF | International Monetary Fund |
| KA | Key Attributes of Effective Resolution Regimes (promulgated by the FSB) |
| LAC | Loss-absorbing Capacity |
| LSA | Loss Sharing Agreement |
| MoF | Ministry of Finance |
| MoU | Memorandum of Understanding |
| NB | Novo Banco |
| P&A | Purchase and Assumption (a common form of resolution transaction) |
| RA | Resolution Authority |
| SoB | Sale of Business (a resolution tool) |
| SRR | Special Resolution Regime |
| TA | Technical Assistance from the IMF |

Preface

At the request of the Banco de Cabo Verde, a Monetary and Capital Markets (MCM) Department mission visited Praia, Cabo Verde from March 13 to 24 of 2024 to assist the authorities in the Review and Operationalization of the Resolution Framework. This report presents the mission's assessment and main conclusions.

The mission met with Ms. Antónia Lopes, Ms. Tereza Henriques, and Mr. António Semedo, all members of the Board of Directors of the Banco de Cabo Verde. The mission also met with Ms. Teresa Barbosa, Head of the Macroprudential and Resolution Office, Mr. Carlos Benoni, Senior Advisor of the Macroprudential and Resolution Office and Ms. Isabel Freire, Senior Counsel of the Banco de Cabo Verde. The mission wishes to thank Ms. Teresa Barbosa and all her staff, for their cooperation, productive discussions, and their hospitality.

Executive Summary

Cabo Verde has had a special resolution regime (SRR) in place since 2014 with the BCV as the Resolution Authority. The SRR was applied only once in 2017 to resolve a non-systemic publicly owned bank. The resolution framework has significant gaps when compared to best international practices. The resolution toolkit is limited and the BCV is lacking a series of powers that are critical for ensuring financial stability and an orderly resolution of banks in the system. The safeguards element of the framework is also limited and should be expanded to protect creditors' rights and avoid legal uncertainty.

The mission discussed with the BCV the main pillars of a modern and effective resolution regime, and made several recommendations to revise the SRR with the objective of aligning it with international standards and best practices. The recommendations include, among several others, (i) providing a clear statutory mechanism to determine if a bank is failing or likely to fail, (ii) expanding the statutory resolution tools to include 1) the write-down or conversion powers (bail-in) without ex ante judicial consent but subject to ex post appeal to courts, 2) to transfer assets from a bank under resolution to an AMV under strict conditions and at fair value; and 3) to require the continuity of essential services from other parts of a group or third parties: (iii) provide the power and obligation to the BCV as resolution authority to develop a resolution plan for all banks within the scope of the regime. It is expected that the BCV will coordinate with the Minister of Finance to prepare a draft law in the coming months.

The operationalization of the resolution framework has been impeded because the BCV is severely lacking in human resources allocated to the resolution function. The resolution function is carried out within an office (not a department) that is also responsible for the macroprudential function. Currently, there is only one staff member that is allocated full time to the resolution function. Furthermore, the head of the Office is responsible for macroprudential supervision and resolution, which limits the operational independence of the resolution function. Considering these limitations, the BCV has not made any significant progress in operationalizing the resolution framework 10 years after it was created.

The mission made several recommendations to mitigate existing conflict of interests, improving the organization and efficiency of the resolution functions as well as its staffing level. An important change that is recommended concerns the governance structure of the resolution function and separating it from all other functions of the BCV, including the Macroprudential function where the resolution function is currently housed. Furthermore, the BCV should give the same status and seniority to the organizational unit that will hold the resolution function that is awarded to the prudential supervision function and to the head of supervision (department). Finally, the staffing of the resolution function will need to be expanded in the very short-term enabling the BCV to deliver on its mandate as resolution authority.

The BCV should also strengthen and expand resolution planning. There is a legal limitation in the current SRR, which does not set a statutory power or obligation for the BCV to prepare resolution plans – instead, banks are expected to prepare such plans. This situation has severely limited the ability of the BCV to progress with the resolution planning process. Until today, only one bank (a subsidiary of a Portuguese bank) has presented a resolution plan, and the BCV had some limited discussions with this bank regarding the plan. On top of a very much needed change to the SRR in order to provide clear powers to the BCV to draft resolution plans, the framework should clearly mandate the BCV to undertake resolvability assessments and provide the necessary powers to remove impediments to resolvability. It was also recommended to introduce in a revised SRR the power to set loss-absorbing capacity

requirements. These requirements need to be flexible, simple, and proportionate to the reality of a small jurisdiction like Cabo Verde with limited access to international markets.

The BCV needs to urgently start its work on the operationalization of resolution powers to increase its capabilities as a resolution authority. It is not sufficient to prepare individual plans for banks and remove impediments to resolvability. A resolution authority should also have the operational capability to execute its mandate. To achieve this goal, the mission recommended the BCV to prepare a resolution manual compiling all the policies and procedures that need to be followed when there is a need to implement a resolution action. This is a comprehensive and living document, that will take significant efforts to build, but is critical to confer adequate capacity to the BCV to correctly and swiftly implement any resolution action. Additionally, once progress has been made in operationalizing the resolution regime and increased resources, the mission also recommends that the BCV carries out table-top or walk-through crisis simulation exercises for a large domestic bank failure. These exercises need not to be extremely complex but allow the authorities to be mindful of the gaps in their capacity and work toward closing those gaps. Besides resolution manuals and crisis simulations exercises, the BCV is recommended to establish clear coordination and information-sharing arrangements between the resolution function and the prudential supervision functions as an essential precondition for an effective BCV-wide crisis management framework.

Recommendations

Table 1. Cabo Verde: Table of Recommendations

| Recommendations and Authority Responsible for Implementation | Priority 2/ | Timeframe 1/ |
|--|-------------|--------------|
| Review of the Resolution Framework | | |
| Propose a statutory mechanism for determining whether a bank has met the conditions for entry into resolution based on a determination that 1) the bank is failing or likely to fail defined as breach of minimum conditions of authorization, 2) the bank is unable to take any private sector action to avoid failure, and 3) its entry into resolution is in the public interest. (BCV) (¶16, 17, 20, 68) | High | Near-Term |
| Propose the expansion of the statutory resolution tools to include 1) the write-down or conversion powers (bail-in) without ex ante consent but subject to ex post appeal, 2) to transfer assets from a bank under resolution to an AMV under strict conditions and at fair value; and 3) to require the continuity of essential services from other parts of a group or third parties. (BCV) (¶29) | High | Near-Term |
| Propose an update of the statutory resolution safeguards to integrate the “no creditor worse off” principle and the payment of compensation if such principle is breached (BCV) (¶32, 36) | High | Near-Term |
| Propose the definition of a statutory power and obligation on the BCV as resolution authority to develop a resolution plan for all banks within scope of the regime, communicate a summary of the plan to the bank and ensure the plan can be implemented in an orderly manner by conducting resolvability assessments and removing any barriers identified (BCV) (¶61) | High | Near-Term |
| Propose providing the BCV with a power to make regulations to remove barriers to resolvability consistent across a class of banks and a bank specific power of direction to remove any barriers to resolvability (BCV) (¶62) | High | Near-Term |
| Propose providing the BCV with a power to set loss-absorbing capacity requirements. (BCV) (¶62, 54) | High | Near-Term |
| Propose updating the Deposit Guarantee Fund (DGF) law to maximize the BCV flexibility to require funds to support any resolution costs, including by establishing general depositor preference instead of the current tiered | High | Near-Term |

| Recommendations and Authority Responsible for Implementation | Priority 2/ | Timeframe 1/ |
|--|-------------|--------------|
| depositor preference and the basis for DGF contributions is a counterfactual liquidation valuation. (BCV) (¶58) | | |
| The Board of Directors of the BCV should agree on a policy on loss distribution in resolution that is based on minimizing risk to public funds through the imposition of losses on bank shareholders and creditors and use of DGF funds to support resolution costs. (BCV) (¶54 - ¶58) | Medium-High | Medium-Term |
| Based on future policy on loss distribution, the BCV should develop a 10-year plan for a multi-pronged strategy to achieve its DGF target fund size reflecting its current role in payouts and proposed role in supporting resolution costs by increasing premiums on the banks and soliciting donor (e.g., KfW or the World Bank) sources of seed capital (BCV) (¶58) | | |
| Publish a BCV “Approach to Resolution” policy statement, approved by the Board, which should describe the BCV’s preferred approach to use of the expanded tool kit, BCV’s objectives, safeguards. It should also define its approach to bank resolution planning that explains expectations on banks resolvability. (BCV) (¶40) | Medium-High | Medium-Term |
| Resolution Authority: Organization and Staffing | | |
| Establish a new resolution organizational unit within the BCV that is operationally independent from other BCV statutory functions with equivalent status and comparable senior leadership to prudential supervision. (BCV) (¶46) | High | Near-Term |
| Increase the number of staff members allocated to the resolution function. The functions should have adequate number of staff to enable the BCV to ensure the new resolution regime is operational over the medium-term (i.e., 3-5 years) (BCV). (¶47 - ¶51) | High | Near-Term |
| BCV should prepare a protocol and framework that enables it both to acquire external professional advice and also to rapidly expand the resolution dept. resources that might be needed to prepare for and execute a resolution transaction (BCV). (¶52) | Medium | Medium-Term |

| Recommendations and Authority Responsible for Implementation | Priority 2/ | Timeframe 1/ |
|---|-------------|--------------|
| Resolution Planning | | |
| Update the BCV resolution planning information regulations to reflect international best practice and the advice provided by the IMF. (BCV) (¶60, ¶62-63) | High | Near-Term |
| Develop an internal BCV resolution planning manual designed to support the setting of bank specific preferred resolution strategies, resolvability assessment processes and the removal of impediments to resolvability. (BCV) (¶69) | Medium-High | Near-Term |
| Draft institution-specific resolution plans for D-SIBs in a first phase, followed by all banks in Cabo Verde representing more than 5 percent of banking sector assets thereafter. (BCV) (¶54, 60, 62) | High | Medium-Term |
| Resolution Manual and Execution | | |
| Draft a resolution manual for the execution of resolution tools, which includes coordination arrangements with the DGF's complimentary procedures. The resolution manual should be approved by the Board (BCV) (¶80 - ¶85) | Medium-High | Medium-Term |
| Following increase in resources and progress in operationalizing the resolution regime, carry-out a table-top or walk-through crisis simulation exercise of a large domestic bank failure (e.g., failure of a systemic cross-border subsidiary). (BCV). (¶86 - ¶88) | Medium | Medium-Term |
| Review and update crisis coordination arrangements to establish a BCV Watchlist Framework and Resolution Conditions Assessment Framework, and ensure appropriate coordination, consult and consent arrangements with the Ministry of Finance (MoF) on resolution issues (BCV) (¶71) | Medium-High | Medium-Term |
| As part of the collegial relationship with Portuguese authorities, codify collaboration regarding resolution in an updated Memorandum of Understanding (MoU) (BCV) (¶69) | Medium | Medium-Term |

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

2/ Priority: High (H); Medium High (MH); Medium (M).

Introduction

1. **This TA mission follows the 2022 Financial Sector Stability Review (FSSR).** The FSSR is a demand-driven technical assistance (TA) instrument that provides a baseline diagnostic review and proposes prioritized capacity building, through a TA roadmap. The scope of the FSSR included, among other topics, financial crisis management and resolution. For this section of the FSSR 17 recommendations were made. Among those recommendations some were related to the need for the Banco de Cabo Verde (BCV) to progress on its resolution planning efforts and to increase its operational capacity to implement resolution measures, which until now were not implemented. In 2012, 2013, and 2014, the Fund also provided a series of TA on Crisis Management to Cape-Verdean authorities, with limited traction.¹ The TA mission provided some guidance and training to the BCV to achieve those goals and left the authorities with a renewed set of recommendations and a workplan for the next three years.
2. **Cabo Verde has a special resolution regime (SRR) in place since 2014, with the BCV being the Resolution Authority.** The resolution regime in Cabo Verde is included in the Financial Institutions Activities Law (FIAL). This framework was based in an earlier version of the Portuguese SRR. The BCV considers the current framework is outdated and is in need of a revision to align it with international best practices. Therefore, the scope of his TA mission will also include that objective.

Table 2. Cabo Verde: Financial Soundness Indicators of the Banking Sector, 2018–23Q2 (End-year; percent unless otherwise indicated)

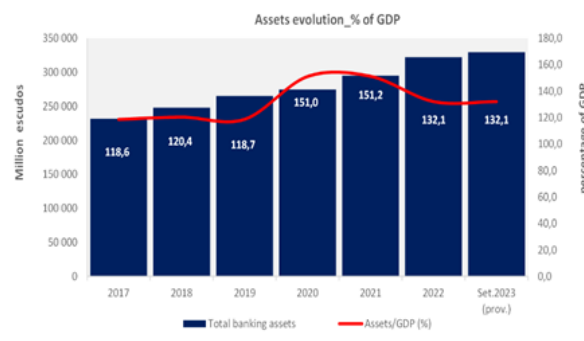
| | 2018 | 2019 | 2020Q1 | 2020Q2 | 2020Q3 | 2020Q4 | 2021Q1 | 2021Q2 | 2021Q3 | 2021Q4 | 2022Q1 | 2022Q2 | 2022Q3 | 2022Q4 | 2023Q1 | 2023Q2 |
|---|------|------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Capital adequacy | | | | | | | | | | | | | | | | |
| Regulatory capital to risk-weighted assets | 16.2 | 17.7 | 18.1 | 18.3 | 18.6 | 19.4 | 19.6 | 20.0 | 20.9 | 21.4 | 22.0 | 21.4 | 21.9 | 22.2 | 22.7 | 21.4 |
| Regulatory Tier 1 capital to risk-weighted assets | 16.1 | 18.2 | 18.6 | 18.8 | 19.0 | 19.8 | 20.1 | 20.5 | 20.9 | 21.1 | 21.6 | 21.1 | 21.5 | 22.6 | 23.2 | 22.1 |
| Asset quality 1/ | | | | | | | | | | | | | | | | |
| Nonperforming loans to total loans | 12.2 | 10.4 | 10.1 | 11.0 | 10.5 | 9.5 | 9.5 | 9.1 | 9.0 | 8.1 | 8.2 | 8.8 | 8.9 | 7.8 | 9.1 | 8.7 |
| Nonperforming loans net of provisions to capital | 26.0 | 15.0 | 20.4 | 23.9 | 16.6 | 7.1 | 10.9 | 8.5 | 7.6 | 1.6 | 7.4 | 9.4 | 11.6 | 3.9 | 8.6 | 10.8 |
| Provisions to nonperforming loans | 71.0 | 77.0 | 70.1 | 66.5 | 73.3 | 86.4 | 80.0 | 83.0 | 84.1 | 95.5 | 81.3 | 77.9 | 73.2 | 88.4 | 77.1 | 73.5 |
| Earnings and profitability | | | | | | | | | | | | | | | | |
| Return on assets | 0.3 | 1.3 | 0.4 | 0.6 | 1.0 | 1.3 | 0.4 | 0.8 | 1.2 | 1.4 | 0.4 | 0.8 | 1.3 | 1.5 | 0.4 | 0.9 |
| Return on equity | 4.8 | 17.8 | 5.3 | 7.9 | 12.7 | 15.4 | 4.9 | 9.1 | 12.7 | 14.9 | 4.4 | 8.7 | 13.6 | 16.0 | 4.4 | 9.2 |
| Interest margin to gross income | 79.6 | 81.1 | 78.2 | 85.8 | 86.7 | 85.7 | 84.8 | 83.1 | 83.5 | 80.8 | 83.9 | 82.0 | 78.6 | 80.0 | 83.6 | 82.7 |
| Noninterest expenses to gross income | 69.6 | 49.4 | 46.4 | 49.3 | 48.9 | 48.9 | 45.5 | 45.3 | 45.4 | 46.0 | 46.5 | 45.6 | 44.2 | 46.2 | 45.7 | 45.4 |
| Liquidity 2/ | | | | | | | | | | | | | | | | |
| Liquid assets to total assets | 21.4 | 24.3 | 23.8 | 25.4 | 25.9 | 25.1 | 23.0 | 21.7 | 22.6 | 24.3 | 24.1 | 22.8 | 23.2 | 24.6 | 24.8 | 25.2 |
| Liquid assets to short-term liabilities | 25.5 | 28.3 | 27.8 | 30.0 | 30.8 | 29.9 | 27.5 | 26.1 | 28.0 | 30.5 | 30.1 | 28.5 | 29.1 | 31.5 | 31.6 | 32.3 |
| Additional indicators | | | | | | | | | | | | | | | | |
| Government deposits over total deposits | 18.3 | 19.1 | 19.6 | 19.1 | 19.7 | 19.6 | 19.0 | 18.0 | 17.7 | 16.0 | 15.7 | 15.8 | 17.1 | 17.0 | 17.3 | 17.6 |
| Demand deposits over total deposits | 50.5 | 50.9 | 51.8 | 51.6 | 51.7 | 51.1 | 51.6 | 51.4 | 50.9 | 51.8 | 52.6 | 51.8 | 52.9 | 53.3 | 53.8 | 54.3 |
| Total credit over total deposits | 55.2 | 52.9 | 52.9 | 53.2 | 53.6 | 54.7 | 55.5 | 56.1 | 57.8 | 56.9 | 55.5 | 56.3 | 56.1 | 57.4 | 56.7 | 56.9 |
| Personnel cost over cost of operations | 66.6 | 56.6 | 59.2 | 57.8 | 57.7 | 58.0 | 60.4 | 59.7 | 58.4 | 58.0 | 58.0 | 57.4 | 56.5 | 55.6 | 58.1 | 57.5 |

Source: Bank of Cabo Verde.
1/ Based on IAS/IFRS definition.
2/ Liquid assets include cash in vault and marketable securities. Short-term liabilities include demand deposits.

¹ See Annex IX for the assessment made in the 2021 FSSR about the compliance of Cape-Verdean authorities with previous recommendations provided in TAs on Crisis Management in 2012, 2013 and 2014.

3. **Cabo Verde's financial sector is bank based, and mostly foreign owned.** The financial sector is dominated by eight banks with total assets amounting to 132 percent of GDP in 2023 (see Figure 1) and holding 97 percent of all the assets of the financial sector. The banking sector is also highly concentrated (See Figure 2), with two of the banks being considered D-SIBs, corresponding to 55.4 percent of total assets of the system. The biggest D-SIB (BCA) is owned by a government owned Portuguese bank. The other D-SIB (CECV) was until recently owned directly by the state and other public entities. However, in February 2024

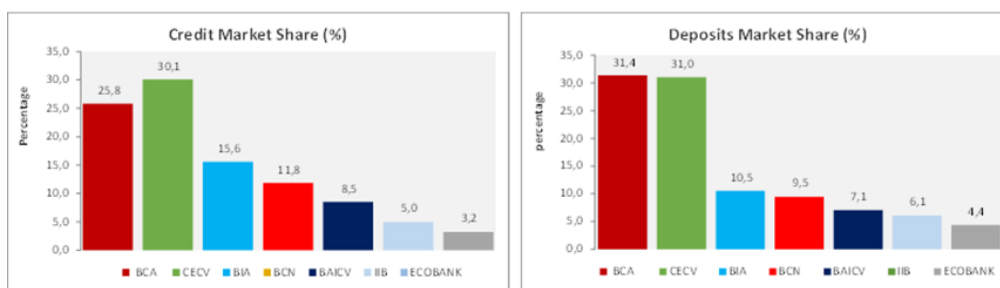
Figure 1. Cabo Verde: Banking Assets Evolution



Source: Banco de Cabo Verde

the State of Cabo Verde sold its stake (27,44%) in the market. The rest are domestically owned, one public and the other privately owned. Deposits correspond to 103 percent of GDP and are highly concentrated, with the total share of Social Security at around 20 percent of system deposits. In some cases, the share of Social Security deposits is almost 40 percent, and it is also a shareholder in several banks, including a 50 percent share in one of the D-SIBs.

Figure 2. Cabo Verde: Market Share - 2023



Source: Banco de Cabo Verde

4. **Cabo Verde has a Deposit Insurance Scheme (DIS) in place since 2018. The Deposit Guarantee Fund (DGF) is the DIS in Cabo Verde, with a Paybox Plus mandate.** It is currently building its reserves toward a 5.0 percent target fund level as a percentage of eligible deposits, with the fund level currently standing at 0.3 percent. The DGF's initial capital contributions were entirely made up of member institution contributions. If the contributions from banks keep the current pace, the DGF will only meet its target level in around 30 years.

5. **The responsibility for the supervision of non-bank financial institutions falls to the BCV.** The non-bank industries do not currently pose major risks to the broader financial system given their modest size compared to the banking sector, but the BCV does monitor the building risks in these other sectors. Nevertheless, these institutions are not under the remit of the SRR.

6. **This report is organized as follows.** Section II will provide a limited gap analysis of the current SRR in Cabo Verde and will recommend a series of policy options that the authorities can consider in the legal revision process that is ongoing. Section III will focus on the organizational and staffing challenges faced by the BCV as a resolution authority. In this Section the mission will identify some problems and recommend solutions that can be quickly adopted by the BCV Board. Section IV will consider the policy option for the BCV in terms of setting a policy for loss absorption in resolution that is adequate for the banking sector in Cabo Verde. The balance between privatizing and socializing losses is very much jurisdiction dependent, but authorities need to set their priorities from the outset to create the conditions for an orderly resolution of banks without impinging excessively on public funds. Section V will focus on the resolution planning process, and how the BCV should progress in setting the preferred resolution strategies for its banks and undertake comprehensive resolvability assessment that allow the removal of impediments to resolution. On Section VI the aim will be to discuss the need for the resolution function of the BCV to coordinate as much as possible with all relevant stakeholders, from banks to the supervision department of the BCV and to other national and foreign agencies. Section VII will provide the BCV with a series of recommendations on how it should prepare for a real crisis case and operationalize its resolution powers. A strong emphasis will be put on the drafting of a resolution manual as the cornerstone of an effective preparation to implement resolution actions. The mission also delves in the need to perform crisis simulation exercises, even if limited in scope, as a way of identifying gaps in the preparation of the BCV.

I. Review of the Resolution Framework

7. **Cabo Verde has a SRR in place since 2014.** The resolution regime in Cabo Verde is included in the FIAL. This framework was based in an earlier version of the Portuguese. The provisions under the FIAL provide for a sale of business tool (SoB) with the transfer of the business to another institution and subsequent transfer of the residual assets and liabilities of the failed bank to liquidation (Article 165); and the partial or total transfer of a business to a bridge bank (Article 168). Where a transaction cannot be consummated and a bridge bank would not advance resolution, compulsory liquidation is the alternative (Article 108). The BCV has the power necessary to take the relevant decisions, including to assess the presence of the legal grounds required.

8. **The triggers for resolution are explicitly laid down in the FIAL.** The trigger for resolution measures is “when a bank fails to comply with its obligations or runs a serious risk of not meeting the requirements for maintaining authorization for the exercise of its business.” This trigger is forward looking and gives the BCV the power to initiate resolution before the failing bank is balance-sheet insolvent.

9. **Resolution measures are subject to a public interest test. Such measures should only be applied if there is a need to: preserve financial stability and the provision of essential financial services, protect against systemic risk, and safeguard public funds and the confidence of depositors.** Resolution measures are considered a last resort as stated under the FIAL, contemplated only when necessary, in the public interest. This was the balancing undertaken as part of the deliberations in the run-up to the resolution of NB.²

10. **Alternatively, the BCV has the clear power to establish a temporary bridge institution.** If a P&A cannot be negotiated timely, this power allows the BCV to transfer the institution’s systemically important assets and liabilities and ensure continuity of its critical functions. During this bridge period, the bank is marketed by the BCV in its role as resolution authority. The non-viable institution, including any remaining equity and the assets and liabilities not transferred to the bridge institution enter into ordinary liquidation procedures, as provided for under the regime.

11. **No formal assessment of compliance based on approved assessment methodology was undertaken.** However, the SRR has substantial gaps when assessed against the Financial stability Board’s (FSB) Key Attributes of Effective Resolution Regimes (KA), including:

- **KA 1 – Scope:** Banks licensed by the BCV can be subject to the toolkit provided by the SRR. However, holding companies and branches of foreign banks are not under the scope of the SRR, even if they create a substantial risk for financial stability in Cabo Verde. It is important for the BCV to have the flexibility to address failure scenarios that reflect the structure of their banking system.
- **KA 2 – Resolution Authority:** The BCV is the authority responsible for applying resolution tools. The BCV is the Central Bank in Cabo Verde and is operationally independent. However, there is no structural separation between the resolution function and all other functions undertaken by the BCV. See **Part III** for a more detailed discussion on resolution authority **organizational** and staffing issues.

² Articles 147, 160, 162, Financial Institution Activities Law.

- **KA 3 – Entry into resolution and Assessment of Conditions for entry into resolution:** The current framework includes a list of conditions for entry into resolution, however it is essential to improve the regime by establishing a clear mechanism for determining whether a bank has met the conditions for entry into resolution.
- **KA 3 – Resolution Powers:** While relevant, the toolkit provided to the BCV as resolution authority is limited. Currently, the BCV can only apply the SoB tool and the Bridge Bank tool. The BCV does not have any power to create an asset management company where to transfer non-performing assets or assets that a potential purchaser is not interested in. There is also no power to write-down or convert into equity liabilities of the failing bank. The updated statutory resolution tools should provide the administrative powers to 1) bail-in creditors without ex ante consent but subject to ex post appeal as a means of recapitalize failing banks and 2) require the continuity of essential services from other parts of a group or third parties.
- **KA 4 – Safeguards:** The FIAL is parsimonious in what concerns safeguards. There is only one safeguard explicitly provided in the law, which demands that loss allocation in resolution should comply with the creditor hierarchy in liquidation (Article 160/1). There is no broad set of safeguards as provided in the Kas, including the “no creditor worse off than in liquidation” (NCWO) safeguard.
- **KA 5 – Loss distribution in resolution:** According to Article 51 of the Basic Law for the Financial System (Law no. 61/VIII/2014, of 23 April), articles 2(2) and the future 8-A of the DGF Law³, and articles 166 and 171 of the Banking Law (Law no. 62/VIII/2014, of 23 April), the financing of any resolution measure is supported by the DGF. The BCV has the discretion to decide whether the DGF should finance a resolution action and the DGF is not legally authorized to refuse compliance with such decision. The future Article 8-A(1) of the DGF Law will limit this contribution to the difference between the amount of covered deposits and the assets that are transferred from the failing bank to an acquirer or to a bridge bank. Furthermore, Article 8-A(3) confers a preferential claim in insolvency for the contributions made by the DGF to any resolution action. However, this framework, especially the provisions under Article 8-A of the DGF Law, might create substantial limitation for an adequate financing of a resolution measure. See **Part IV** for a further discussion of loss distribution in resolution.
- **KA7 – Cross Border Cooperation:** The FIAL only provides for a notification obligation from BCV to foreign resolution authorities in case a subsidiary or branch in Cabo Verde is resolved. However, there is an explicit mandate empowering the BCV to promote cross-border cooperation with foreign resolution authorities both for resolution planning and for the execution of resolution action. There are also no provisions allowing the BCV to support a resolution action taken by a foreign resolution authority or an expedited process for the recognition of foreign resolution actions.
- **KA 10 and 11 – Resolvability Assessments and Resolution Plans:** While banks are under a duty to submit resolution information to the BCV under Article 58 of the FIAL, this requirement is not in keeping with the standard best practice of having the plans compiled by the resolution authority. See **Part V** below more a more detailed discussion.

³ There is a draft law currently being prepared that will add Article 8-A to the DGF Law, which is intended to regulate more precisely the mechanism through which the DGF will finance resolution costs.

- Additional issues:
 - **Valuation:** There are no valuation obligations provided in the law, which can have a detrimental effect in the effectiveness of the resolution action, but also in the protection of creditors rights.
 - **Power to levy for resolution costs** – There should be statutory power for the BCV to recover any costs incurred related to preparing for resolution actions and implementing resolution acts from the bank in resolution and industry more broadly. For example, any external advisory costs incurred by BCV as a resolution authority should be able to be recouped from the bank in resolution or directly from industry. Such powers would be in addition to the statutory flexibility of the DGF to contribute to any resolution costs. The power to recoup resolution authority costs must include external advisory costs related to contingency planning for banks that are at risk of failure but ultimately recover and avoid resolution⁴.

A. Scope

12. **An SRR should be applicable at a minimum to all the systemic, or potentially systemic, financial institutions in a jurisdiction.** Each jurisdiction has its own particularities, and it is not possible to say from the outset which institutions should be in the scope of an SRR. However, because banks are usually the larger component of most financial sectors, and because banks are deposit taking institutions and if subject to a disorderly failure, they could jeopardize the confidence of depositors in the banking system in general, it is common that at least banks are under the scope of any SRR. The resolution regime should be applicable to banks “that could be systemically important or critical if it fails”.⁵ This may include institutions that are much smaller than those captured by the Basel III D-SIB classification methodology for capital add-on purpose. It could include very small banks if they provide a critical economic function (e.g., instant access deposit taking). Ultimately, it should be for the resolution authorities to judge whether even a very small bank failure is a risk to the resolution objectives (e.g., depositor protection) and therefore merits use of resolution tools. In addition, in jurisdictions with very developed capital markets, some financial institutions operating in these markets can also be critical for financial stability, and authorities should consider including them in the scope of an SRR.

13. **Currently, only banks are under the scope of the FIAL in Cabo Verde.** Under Article 160 of the FIAL, only banks can be subject to resolution measures. Considering that the financial sector in Cabo Verde is extremely concentrated in the banking sector (with 97 percent of total assets of the financial sector), the current framework covers the systemically more important financial institutions. There are foreign branches operating in Cabo Verde but today there are currently no financial holding companies.

⁴ See PRA RULEBOOK: USE OF SKILLED PERSONS INSTRUMENT 2014 ([link](#)) as an example – these are regulatory powers to require a financial services bank to commission skilled person (i.e., professional advisors) reports on the regulator’s behalf into any aspect of the bank’s business at the bank’s expense.

⁵ In some jurisdictions, there is a presumption that the SRR would never be needed for banks other than those designated in advance as systemically important banks. The preferred approach would be for all resolution tools to be available for all banks and for the BCV to decide at the point in time of a resolution whether a bank should be resolved or liquidated based on the resolution objectives and which tool(s) is most appropriate given the specific circumstances of the bank.

14. **Holding companies can pose a problem for resolution authorities if not included under the scope of the FIAL.** While banking groups in Cabo Verde are not complex and follow an organizational structure where the operating entity is the parent company, there might be cases where that structure is not followed, and a holding company is the parent company. In such a case, the BCV might be put in a situation where it cannot resolve the entire banking group, as some relevant subsidiaries, both financially and operationally, might not be subsidiaries of the failing bank, but rather from a holding company.

15. **The FIAL should also include branch of foreign companies.** The banking sector in Cabo Verde is mainly foreign owned. This is to be expected in a small market with an open economy. While the most relevant market participants are locally incorporated banks, it's possible that in the future some foreign company prefers to establish a branch instead of a local bank. In this situation, the branch needs to be supervised like any bank, which also means that it should be subject to the same standards of other local banks in terms of resolution. If the objective of a resolution framework is to mitigate risks to financial stability and protect depositor confidence, then it should also include branches of foreign companies that undertaking banking activities in Cabo Verde.

B. Assessing the Conditions for Entry into Resolution

16. **On assessing the conditions for entry into resolution the statutory resolution regime should establish three conditions for determining whether a bank should enter resolution.** All three conditions must be met before a bank can be taken into resolution. The first two conditions should be: 1) the bank is failing or likely to fail, and 2) it is not reasonably likely that action will be taken that will result in the bank recovering. The first determination should be made by BCV as prudential supervisory authority, following consultation with BCV as resolution authority and MoF. The second determination should be made by BCV as resolution authority in consultation with the prudential supervisory authority, BCV, and MoF.

17. **Even if the first two conditions are met, the resolution powers should only be applied by BCV as resolution authority if it judges it is in the public interest (having consulted the supervision department and MoF).** It is in the public interest to resolve the bank if allowing it to enter liquidation would undermine confidence in the financial system or would harm depositors. The resolution authority determines whether the public interest test is met by assessing the objectives for resolution as set out in the legislation. This resolution conditions and public interest assessment framework should be set out in the future statutory resolution regime. The conditions for assessing condition 1 should be clarified in the legislation so that a breach of minimum regulatory requirements is sufficient basis for assessing Condition 1 as met. Currently, the framework, even if forward looking, relies on late-stage triggers for assessing such conditions, e.g., when the equity of the bank is consumed, there is a default on obligations, etc.

C. Resolution Toolkit and Powers

18. **Resolution regimes should be properly designed to facilitate prompt resolution of failing financial institutions while maintaining financial stability, ensuring continuity of critical financial services and functions, minimizing fiscal costs, and avoiding unnecessary destruction of value.** The speed and flexibility with which a failed financial institution can be resolved is critical to preserving financial stability. The design of the legal framework should promote swiftness of action, but also respect due process and other rights. Banks that could have systemic consequences if they cease operations

need a legal regime that preserves their essential operations (“critical functions”) while imposing losses on shareholders and other creditors. Cost minimization requires that the losses are predominantly borne by shareholders and creditors of the institution, in accordance with the applicable hierarchy of claims.

19. **The FIAL was amended during 2014 as one component of a series of legal reforms to develop the resolution regime and construct the financial safety net comprised of supervisory early intervention, emergency liquidity assistance, deposit insurance and a resolution regime.** The FIAL amendments codified a legal structure with BCV at the center as the administrative authority responsible for exercising resolution powers. Key improvements to the FIAL resolution regime empowered the BCV to execute a transaction, whereby all or part of the assets, liabilities and off-balance sheet assets are transferred to one or more authorized institutions; or to initiate the establishment of a bridge bank. These powers under the amended law have been applied once to resolve Novo Banco through a partial transfer of the business during 2017. Since 2014, the BCV has also continued to scrutinize its resolution regime in the context of the evolving international best practices.

20. **The current resolution triggers cover a broad range of circumstances and are forward-looking in nature.** The trigger for the application of resolution tools contained in Article 162 of the FIAL is whether “...a bank fails to comply with its obligations or runs the serious risk of not meeting the requirements for maintaining authorization for the exercise of its business.” This article further enumerates a number of circumstances that would meet the definition of a serious risk of not meeting the requirements for authorization.⁶ This definition reflects a non-viability test and is largely patterned after the major elements of the triggers for resolution under the European Union’s Single Resolution Board: the institution is failing or likely to fail; there are no measures available that can restore viability within a reasonable timeframe; and resolution is necessary in the public interest.⁷ The latter public interest test takes into consideration preservation of financial stability and provision of essential financial services, protection against systemic risk, and safeguarding of taxpayer interests, public funds and confidence of depositors.⁸ Resolution measures are considered as a last resort as stated under the FIAL, contemplated only when necessary, in the public interest.⁹

21. **The resolution regime in Cabo Verde includes the power for partial or total transfer of the business as the primary resolution tool, complemented by bridge bank authority, all of which are to be operationalized by the BCV.** Key features of the SRR that are in place include the full range of powers for the BCV, ranging in severity from corrective measures such as restoring liquidity and capital levels and bolstering corporate governance; to more severe measures, such as removing and replacing weak management; placing a bank under interim administration; facilitating a recapitalization; executing a partial or total transfer; creating a bridge bank to facilitate resolution; and revoking a license and placing an institution into liquidation.

⁶ Losses likely to consume equity capital, assets of the bank become lower, bank is unable to meet its obligations, a restructuring plan under Article 152 of the FIAL does not solve the bank’s problems, and shareholders and creditors of the bank show resistance to cooperate with the interim administrator.

⁷ Article 32, Conditions for Resolution, Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment banks. This was the contemporary directive at the time of the 2014 amendment.

⁸ Article 160, Purpose of Resolution Measures, FIAL.

⁹ Article 147, Principles and General Guidelines, FIAL.

22. **A partial or total sale or transfer of all or part of the activity is a more effective and seamless resolution tool compared to an outright liquidation.** Such transactions usually involve a transfer of a significant share of the assets and liabilities to an existing or newly approved institution rather than a piecemeal resolution over time through liquidation. The transaction is thus less disruptive than outright liquidation. This is why the amendment to the FIAL in 2014 to provide the BCV with the authority to undertake this resolution tool was a significant step forward.

23. **The FIAL provides the BCV with the power to execute a partial or full transfer and the residual assets and liabilities of the failed bank proceed to liquidation.** The BCV determines how the transfer is structured, and the transaction can be executed without the consent of the failed bank's shareholders, creditors, or borrowers. The BCV under the FIAL mandates must "safeguard the interests of taxpayers and public funds,"¹⁰ which implies a least cost comparison, which can be applied to assess potential acquirers in a transfer bidding process and also as compared to the cost of liquidation. In the case of the transfer for Novo Banco, there was only one approved bid submitted, so there was no comparison between multiple bidders. If a transaction cannot be consummated and a bridge bank would not advance resolution, compulsory liquidation is the alternative.¹¹

24. **For circumstances where resolution cannot be accomplished rapidly through the use of resolution tools, including transfer with one or more purchasers, the BCV has authority to establish a bridge institution.** If it is not possible to undertake a full or partial transfer, the power to establish a publicly owned bridge bank allows the BCV to transfer the institution's assets and liabilities and ensure continuity of its critical functions in cases where a healthy bank acquirer or newly established bank acquirer cannot be found in a timely manner. The purpose of a bridge institution is to cover the gap between resolution and the time a private buyer can be found. During this bridge period, the bank would be marketed by the BCV. Under the FIAL, the bridge bank is a limited life institution, two years with the possibility of subsequent one-year extensions.¹² As of yet, there have been no cases of the establishment of bridge banks under the FIAL. The mission team provided a case study and lessons learned for the run up to the failure of a bank and the ensuing establishment of a bridge bank in another jurisdiction.¹³

25. **A bridge bank is established with the aim of receiving good quality assets (including assets related to critical functions) and a commensurate amount of stable deposits (primarily insured deposits).** The bridge bank can then be marketed as a "clean" institution with deposits that should not run off upon the announcement of the creation of the bridge bank. The remaining non-viable elements, including the assets and liabilities not transferred to the bridge institution, should enter into ordinary liquidation procedures under the management of the BCV.

26. **Ownership of the bridge bank is held by the DGF.** Irrespective of the ownership structure, which varies from jurisdiction to jurisdiction, the most important principle is that a clear ownership and

¹⁰ Article 160, Purposes of Resolution Measures, FIAL.

¹¹ Article 108, Compulsory Dissolution, FIAL.

¹² These extensions should not be done in perpetuity.

¹³ Department of the Treasury, Inspector General, "Material Loss Review of IndyMac Bank, FSB, February 26, 2009. The noted institution was a savings association and the institution's supervisor was empowered to create a conservatorship, which was a bridge bank-like entity in all material respects.

governance structure is established from the outset¹⁴. The bridge bank, which is capitalized by the DGF¹⁵, should be subject to full supervisory oversight and requirements, carried out by the BCV but this authority should not be implemented by the department with involvement in resolution and measures should be in place to avoid any conflicts of interest. In order to level the competitive marketplace, the bridge bank should be a member of the deposit guarantee system and pay periodic deposit guarantee premiums.

27. **Under the FIAL the bridge bank must have capital of no less than the amount determined by the BCV and must comply with the standards for banks.**¹⁶ Any exemption to this requirement should only be temporary and specify a time bound achievement for meeting the standard for banks, taking into account that capitalization shortfalls may undermine confidence; risk unfair competition; and may hamper efforts to privatize the bridge bank. Equity can accumulate in the bridge bank depending on the amounts of assets and liabilities transferred from the defaulting bank to the bridge bank and the profit-making capacity of the bridge bank franchise. Select jurisdictions exempt bridge banks from capitalization.¹⁷

28. **Once a bridge bank is established, it should engage in limited operations to preserve assets, protect depositors, communicate regularly with its customers and avoid adversely impacting other banks in the system.** To prevent a significant outflow of customers, the bridge bank would maintain a safe risk profile, making limited loans as deemed appropriate. Management should also work to identify assets that may need to be transferred back to the DGF, subject to a time limitation (typically not to exceed 180 days) and a narrow set of circumstances (such as addressing valuation errors). Targeted selling of assets related to activities that are not in keeping with the business plan may also be appropriate.

29. **Beyond bridge bank authority, the Key Attributes cite other resolution tools, which may include so-called “bail-in” powers or the power to transfer assets and liabilities of a bank(s) to an asset management vehicle (AMV) as well as other supplementary resolution powers.** “Bail-in” powers allow the resolution authority to write down equity or convert other capital instruments and unsecured and uninsured creditor claims of a bank in resolution into capital to the extent necessary to absorb losses. While the legislation should not rank resolution tools or constrain BCV’s ability to choose one tool over another, in practice, in a small jurisdiction like Cabo Verde, these “write-down and conversion powers” might be of more effective use as ancillary powers to support the transfer powers to an acquirer or to a bridge bank. However, such policy views can be expressed during BCV resolution planning and the in setting bank specific preferred resolution strategies. Regarding AMVs, these vehicles might be useful, for example, when in a sale process the buyer is opposed to receive specific categories of assets. In such cases, there is a need to transfer those assets to a vehicle in order to be able to extract some value from them. Nevertheless, we suggest that the law only allows these AMVs for these very specific purposes and not as systemwide AMVs with the objective of transferring risk from the balance

¹⁴ See, Dobler, Marc; Moretti, Marina; Piris, Alvaro; “Managing Systemic Banking Crisis – New Lessons and Lesson Relearned”, Monetary and Capital Markets, International Monetary Fund, 2020, p. 54.

¹⁵ Article 169(1) of the FIAL.

¹⁶ Article 169(4) of the FIAL.

¹⁷ See 12 USC 1821(n)(5), Federal Deposit Insurance Act. It should be noted that beyond its deposit insurance fund, the FDIC has the full faith and credit backing of the government and has a sizeable standing line of credit with the Treasury Department.

sheet of banks to the public sector¹⁸. BCV should also ensure it has the necessary ancillary or supplementary resolution powers, such as the power to (i) appoint the corporate bodies of the resolved bank; (ii) stay the exercise of early termination rights; (iii) suspend contractual delivery obligations; (iv) override shareholders' rights, (v) to require continuity of essential services from other parts of a group or third parties.

D. Judicial Review and Safeguards

30. **Requirements for judicial review and legal safeguards underpin a robust legal framework for bank resolution.** These provisions allow for the prompt exercise of resolution powers within appropriate safeguards for creditors and shareholders, while providing confidence to the resolution authority and their staff and agents that available powers are being exercised in the interest of protecting depositors and the stability of the financial sector.

31. **Resolution powers and measures should be implemented by the BCV without being subjected to prior judicial examination; only an ex-post judicial appeal should be possible, one that allows solely for monetary compensation.**¹⁹ All resolution decisions and measures adopted by the BCV should be implemented rapidly and without the possibility of a judicial appeal prior to implementation of those measures, or the capability to suspend, amend or annul the resolution measures adopted by the BCV. Deference to the technical expertise of supervisory and resolution authorities should limit the scope of judicial or administrative review while preserving the economic value of any valid claims against bad faith actions of the resolution authority and its staff or agents. A judicial appeal should be allowed only after the resolution measures have been implemented, and it should give rise only to monetary compensation, and not to any cancellation of the measures adopted or of those taken subsequently in application of the first measures adopted.²⁰

32. **The FIAL should incorporate measures for the protection of the shareholders and creditors of banks placed in resolution.**²¹ In combination with the power to undertake extraordinary measures granted to the resolution authority the law establishes safeguards for shareholders and creditors of the banks in resolution. Statutory safeguards are essential for an effective resolution regime, in that resolution powers can affect ownership rights or the rights of creditors. These safeguards need to include requirements on the resolution authority to 1) ensure no shareholder or creditor is left worse off (“NCWO”) than they would have been had the failed bank been placed into a liquidation or insolvency

¹⁸ These systemwide AMVs can reap economies of scale and scope when troubled assets have reached systemic levels and asset recoveries would benefit from consolidating creditor claims and scarce expertise. Establishing an AMV entails significant upfront costs to the government, fiscal risks, and moral hazard. It is also best suited for jurisdictions with liquid markets in the disposition of the assets that require management. This tool is therefore not recommended at this time.

¹⁹ FSB KA 5.5.

²⁰ International best practice is to exclude any positive effects on the bank of any public support such as ELA when assessing compensation. Relevant articles regarding judicial review include Article 128, Appeal Against Decisions of the Winding Up Committee, FIAL; Article 177 Litigation Means and Means of Public Interest, FIAL; and Article 178 Assessment and Clarification of Indemnities, FIAL.

²¹ FSB KA 5.2.

procedure, 2) conduct a valuation of the bank's assets and liabilities prior to the use of resolution powers to inform the no creditor worse off protections, and 3) respect netting, set-off or collateral arrangements. It should be clear in the resolution framework that shareholders and creditors should have a right of ex-post appeal for compensation against the actions of the resolution authority if their treatment in resolution leaves them worse off than if placed into liquidation. The FIAL does not contain such safeguards, and this exposes the BCV to a risk of judicial appeal if it puts its resolution powers into effect.

E. Valuation

33. **Resolution valuations are necessary to ensure BCV can determine 1) if a bank is failing or likely to fail, 2) the choice of resolution tools, 3) that all losses are absorbed in the moment of resolution, and 4) that creditors are no worse off than in a liquidation.** As a result, valuations are essential to informing BCV's decision making on choice of resolution tool and ensuring resolution actions are orderly. Establishing a resolution valuation framework in Cabo Verde requires BCV to decide the range of valuations required to support orderly resolution and the types of valuation capabilities banks need to have in order to support a valuer in relation to resolution valuations.

34. **The BCV established a methodology for valuation in the run-up to the resolution of Novo Banco (NB), but that information was not ultimately utilized in the decision-making process for the resolution.** The valuation methodology assessed assets, liabilities, and off-balance sheet items at NB. The portfolio was divided between performing assets, which were earmarked for transfer in the resolution and non-performing assets, which were earmarked as residual assets in liquidation. The larger value assets for transfer were valued individually, while smaller value assets were valued on a collective basis, with haircuts derived for each asset category. The analysis was based on the BCV's notice on risk classification and provisions, which assumes a going concern basis. There was ultimately only one bidder for NB and the resolution terms were negotiated rather than being determined through a bidding process involving multiple bidders relying on underlying valuation methodologies. However, a database is being constructed that retains 20 data elements for the assets transferred and retained in liquidation as a basis for future resolution valuation exercises.

35. **It is essential to have a clear division of roles and responsibilities between the BCV, the independent valuer and the institution under resolution to produce robust and timely valuations.** For example, the BCV should specify to the valuer the resolution measures it intends to take and oversee the valuation process consistent with an agreed methodology. The valuer should form his or her own judgment on the valuation assumptions and methodologies to be used. The resolution entity should provide the valuer with rapid access to its data, information, documents, and relevant personnel.

36. **It is recommended that the updated resolution legislation in Cabo Verde define the range of valuations required to support an orderly resolution that complies with the resolution objectives. This should include:**

- a. Valuation 1: Valuation of banks' financial position under relevant accounting and regulatory standards to inform an assessment of whether it is failing or likely to fail.
- b. Valuation 2: Valuation of banks' assets and liabilities on a hold value or disposal value basis, reflecting the intended resolution strategy to understand all expected losses.
- c. Valuation 3: No creditor worse off than in liquidation valuation to determine whether creditors are worse off in resolution than they would have been in liquidation.

F. Cross-Border Resolution

37. **One of the DSIBs in Cabo Verde is majority-owned as a subsidiary by a Portuguese financial group.** The subsidiary is subject to a supervisory regime comparable to domestic institutions in CV, with some additional mandates due to its designation as a DSIB. The subsidiary had to first apply for a license to operate in CV. The BCV imposes the same methodology for designation and capital requirements on the subsidiary as applied to the other designated SIBs and has the power to revoke the subsidiary's license. The subsidiary is also required to be a member of the DGF and pay the applicable guarantee levies.²²

38. **The MoU between the BCV and the Banco de Portugal (BdP) addresses the exchange of supervisory information and matters of required consultation and coordination, but it will have to be revised to support an effective resolution regime.**²³ In the case of cross-border banking relationships, the MoU requires sharing of supervisory information, but does not address resolution planning or other aspects of the coordination of a cross-border resolution. The BCV plans to work with the BdP to address this deficiency. Under the FIAL, notice is required to the home authority if BCV is considering an intervention, interim administration or resolution. The BCV does not participate in a supervisory college for the bank that is organized by the BdP, but staff plans to approach the BdP about future participation. The BCV is not aware of the extent to which the parent group's resolution plans reference the activities of the CV subsidiary.

39. **The resolution regime that would be applied to the Portuguese subsidiary in CV, were it to approach failure, is the FIAL given the status of the institution as a subsidiary.** Instability could arise if the source of weakness was at the group level in Portugal, which might result in the drawing of resources from the subsidiary. Alternatively, the subsidiary in CV could be the source of financial weakness, which might adversely impact the financial position of the group. To address this scenario, the addition of defensive measures under the FIAL should be considered as part of contemplated legal reforms. No simulation exercises have been undertaken either independently by the BCV or jointly with the BdP regarding the failure of a cross-border subsidiary.

G. Approach to Resolution Publication

40. **Once the BCV has updated its statutory resolution framework, it should publish a policy statement that provides guidance on the way the BCV plans to carry out its new statutory responsibilities as the statutory resolution authority.** The objective of this document is to improve the market's understanding of the new regime and how it might be used by BCV in the event of a bank failure. This publication should also provide a vehicle to publicly communicate the BCV approach to ensuring its resolution authority function is operationally independent and its approach to resolution governance (internal and inter-agency). This publication should also describe the BCV role in preparing to use the new statutory resolution tools by setting a preferred resolution strategy for banks within scope of

²² Article 6(5) (Licensing); Article 39(1) (Capital requirements); Article 15, 108 (License revocation and liquidation), FIAL. Article 4 (Participating institutions), DGF Law.

²³ See Moretti, Dobler, et al., 'Cross-Border Resolution: Recent Developments,' June 2014.

the regime and conducting banks specific resolution planning and resolvability assessments necessary to identify the changes banks must make to be judged resolvable.

41. **The policy statement should describe in narrative form the objectives of the resolution regime.** This should include describing its key objectives, powers, the main strategies the BCV will develop to deal with failing banking institutions and the arrangements for safeguarding the rights of depositors, clients, counterparties, and creditors. It should describe how the BCV would be likely to implement these resolution strategies. This will inform a description of the steps the BCV will take in 'business as usual' well before a crisis to prepare for bank failure as part of resolution planning with individual financial institutions.

II. Resolution Authority: Organization and Staffing

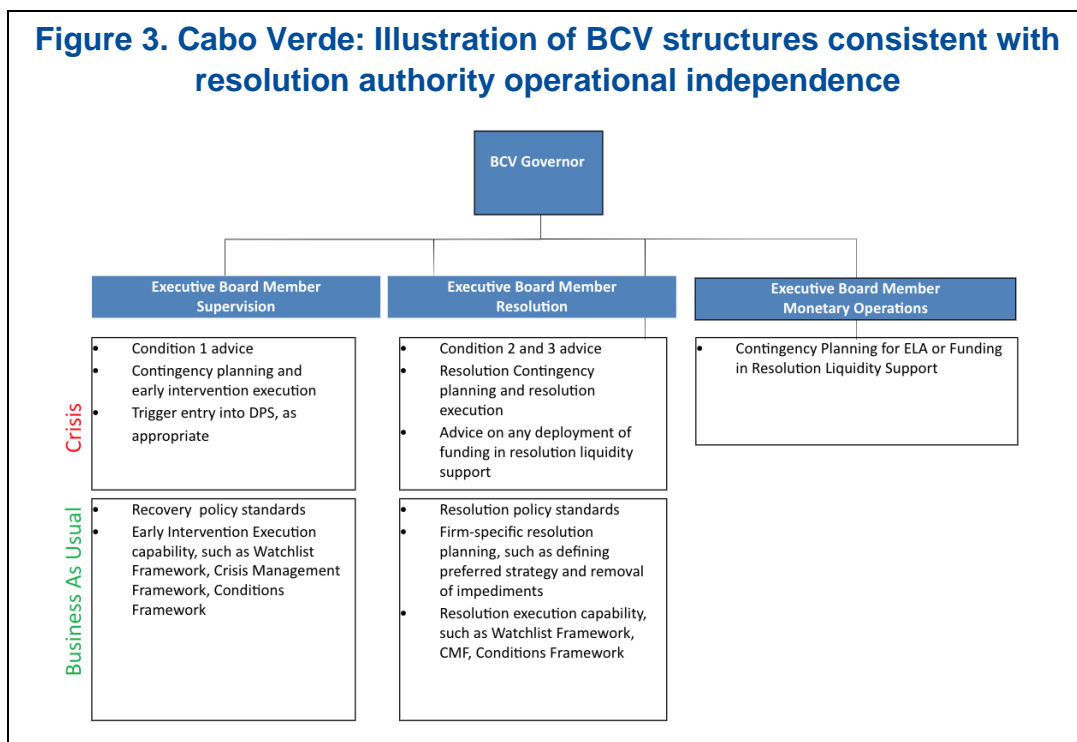
42. **The BCV does not have a unit or department solely dedicated to the resolution function and its organizational arrangements as a resolution authority are very limited.** The resolution function is housed within a unit also responsible for the macroprudential supervision function, which limits the operational independence of the resolution function. Law No.61 2014 describes the role of the BCV in a banking crisis in a way that blends the role of prudential supervisor and resolution authority functions. This does not recognize the tension between resilience and resolvability objectives of the BCV as both a prudential supervisor and resolution authority and will undermine the required operational independence of the resolution function within the BCV. This unit is headed by a coordinator that ranks lower than a director of the supervision department. There is also a severe lack of human resources required to discharge the functions of the resolution authority in both peacetime and a future crisis. Currently, there is only one staff member that is allocated full time to the resolution function which is not enough to fully comply with BCV's statutory mandate. The DGF has also no staff allocated, which further weighs on the workload of the resolution function. Furthermore, the resolution authority function lacks a dedicated BCV resolution governance forum to enable decisions related to its functions to be taken in a way that ensures its operational independence and minimizes conflicts of interests with other BCV statutory functions, e.g., micro and macro prudential supervision.

43. **The BCV has not made any significant progress in operationalizing the resolution framework even after 10 years after it has entered into force.** The mission discussed at length the need to correct this situation, by changing the governance structure of the resolution function and separating it from all other functions of the BCV, including the Macroprudential function.

44. **To establish an operationally independent resolution authority, legislation in Cabo Verde needs to provide a clear statutory resolution authority mandate and powers to the BCV.** The FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (Kas) state that jurisdictions should have a designated administrative authority or authorities responsible for exercising the resolution powers over failing banks within the scope of the resolution regime. An effective resolution framework depends on the existence of an authority that is legally and operationally able to exercise the mandate provided by the law. Regardless of the institutional model pursued, adequate structural arrangements are necessary to ensure the operational independence of the RA and avoid conflicts of interest (perceived or otherwise) between the functions of prudential supervision and the functions of the RA. The purpose of this requirement is to ensure that conflicts of interest between prudential supervisory objectives (i.e., bank resilience) and the RA's objectives (i.e., bank resolvability). The requirement for the structural separation of the RA should be seen as the means for avoiding conflicts of interest with supervisory or other authority objectives. Any such arrangements must be "adequate" for that purpose. To be adequate, at a minimum, there must be operational independence between the supervision and resolution functions. Ensuring operational independence of the resolution authority from the supervisory authority requires both separate: 1) staff and leadership of the same seniority: This must involve structural separation of staff involved in those functions, as well as separate reporting lines; and 2) decision-making/governance framework: The resolution authority must be able to take the decisions needed to discharge its responsibilities without the consent of any supervisory authority.

45. **In authorities with multiple statutory functions, the resolution function should be independent from other functions i.e., prudential supervisions, monetary operations etc.** Adequate firewalls, including different reporting lines, should exist to insulate the resolution function from conflict of interests. In the case of central banks with several mandates, which may include the supervision function as well as the monetary policy mandate, this is a pressing issue that should be addressed by the legal framework. While the supervision and resolution function strive both to mitigate risks to financial stability, the ways to achieve such objective might defer and there is a well-documented trend of supervisors avoiding admitting the need to timely resolve or put a bank under insolvency. By insulating both functions from each other, these conflicts of interests are mitigated, and the institution will be able to more effectively to comply with both mandates.

46. **It is recommended that the BCV resolution function needs to be operationally independent and have adequate structural separation from other statutory functions of BCV in terms of staff, reporting lines and governance.** Any revision to the resolution regime should crystallize in the framework the need for legal and operational independence within the BCV including its governance arrangements. This should cover decision making with respect to resolution policy, bank-specific resolution planning as well as the implementation of a resolution action when a bank fails. Such change would then have to trigger a change of the organization plan of the BCV to support structural separation through: 1) ensuring separate lines of reporting for each key functional department at the top of the central bank; 2) enabling a structure of standing committees with functional mandates as part of the governing structure of the BCV including for resolution functions; 3) providing to the resolution and deposit guarantee groups sufficient staff and means; and 4) formalizing a comprehensive protocol of coordination among functions. Figure 3. Provides an illustration of the distinct needed in organizational arrangements and different roles and responsibilities across the statutory functions of the BCV.



47. **The development of BCV resolution policy, verification of banks' resolvability capabilities and the execution of resolution actions will be resource intensive.** Resolution authorities should have adequate staffing to cope with such cases internally and through the capacity to engage external parties. This demand on authorities' resources in a crisis continues long after the resolution action has been taken and involves executing the bail-in mechanism, overseeing the restructuring plan, ensuring the bank returns to normal liquidity markets, and responding to any litigation claims.

48. **BCV staffing of the resolution function should be proportionate to its functions and risk of implementing resolutions actions.** The functions of the resolution department include: 1) the development resolvability policy framework; 2) bank-specific resolution planning and resolvability assessments; and 3) the development and implementation of the capabilities required to use the resolution tools in the event of a failure. BCV should ensure their resources are sufficient to conduct this work in a manner that reflects the complexity of the financial system in Cabo Verde. This includes resolvability assessment and testing whether banks' resolvability capabilities are operational or not. Regarding the required staff capabilities, the resolution function should leverage relevant internal (i.e., prudential supervision, prudential policymakers, financial stability analysts, and payment systems expertise) and external (e.g. commercial lawyers, credit rating experts, accountants etc.) expertise when developing its staffing model. In practice, it will not be possible to recruit staff with relevant resolution expertise in the market and the BCV should be prepared to invest in new staff to develop their knowledge of resolution as well as retain those staff once they have become more experienced (e.g., after 3-5 years).

49. **Different jurisdictions approach the staffing of their resolution authority function in different ways.** For context, in 2020, the Bank of England's Resolution Directorate has c. 90 staff after 10 years of operation. In 2019, the Hong Kong Monetary Authority Resolution Office has c. 26 staff after only 3 years of operation. FINMA's had c. 25 staff covering recovery and resolution planning after, and at end 2018 the Banca d'Italia's Resolution and Crisis Management Unit had 51 staff members, expected to increase to about 60. The Central Bank of Ireland resolution division has c. 30 staff at end 2021. The Central Bank of Moldova, a small jurisdiction with the lowest GDP per capita of Europe, had c. 11 staff allocated to the resolution function and was in the process of increasing that number quickly. The Jersey Resolution Authority (JRA) is made up of two full-time staff and an independent board with four members, and the Isle of Man Resolution Authority has over four staff working on resolution on a full-time basis. Both British Crown Dependencies have put together less than a quarter of the population of Cabo Verde. More regional examples can be found in the resolution authority functions within central banks of Southern African Jurisdictions. While the size and complexity of the financial systems in Southern African jurisdictions will vary significantly, the number of dedicated resolution staffing across a sample of 5 jurisdictions shows staffing of between four and 15 permeant staff. It should also be noted that in most cases there was no assessment of the adequacy of the human resources devoted to the resolution function in these central banks, which means that the benchmarking above should not be considered as a benchmarking against best practices, but solely to provide some context.

50. **The final decision of the level of BCV resolution authority resources is a matter of risk appetite and prioritization for the BCV board.** Any such risk appetite decision will have implications for the contingent exposure of industry as DGF levy payers and ultimately the fiscal authority in Cabo Verde. Looking at jurisdictions with a financial sector of a similar proportion of GDP as Cabo Verde, the resolution authority staffing level should not be lower than three to six permanent staff working on

resolution policy, resolution planning and resolution implementation. It should be acknowledged that in any authority there is always a minimum level of tasks that need to be undertaken and that work does not depend on the size of the jurisdiction or of the banking sector.

51. **It is important to note that the operational independence of the BCV resolution authority function does not prohibit close cooperation or information sharing between the supervisory and resolution functions of the authorities.** Instead, the operational independence of the resolution authority is necessary to ensure resolution issues are prioritized in wider authority engagement with banks. Ideally, supervisor and resolution authority officials should have seamless access to the same bank-specific information relevant to their respective functions. Indeed, there should be clear statutory information-sharing gateways in the resolution legislation to facilitate close cooperation between supervisors and the resolution authority when working to improve banks' resolvability in peacetime and coordinating their respective actions in a crisis.

52. BCV should prepare a protocol or framework that enables it both to acquire external professional advice and also to rapidly expand the resolution dept. resources that might be needed to execute a resolution transaction. On the former, BCV should ensure it has procurement arrangements in place to facilitate the rapid appointment of any external professional advisory (e.g. commercial lawyers or valuers) needed to support it in both preparing for and implementing resolution actions. On the latter, it is recommended that BCV develop internal plans to facilitate the rapid redeployment of staff to the resolution dept. in order to execute a resolution transaction.

III. Loss Distribution in Resolution

53. **A credible resolution policy and planning strategy for ensuring there are sufficient sources of loss-absorbing capacity available is essential to stabilize a failing bank in resolution mitigating risks to public funds.** A key question to achieving this objective is whether losses related to a failing bank should be socialized or privatized. Socializing losses refers to recapitalizing failing banks by drawing on resources beyond the banks' own balance sheet, including: 1) taxpayer-funded bailouts or 2) industry funding arrangements either via ex-ante resolution or deposit guarantee scheme (DGS) funds or ex-post levy arrangements to repay any temporary financing provided by the state. Privatizing losses means ensuring the losses associated with bank failure are imposing losses on the bank's own shareholders and creditors.

54. **Any judgement of whether to socialize or privatize the losses when banks fail represents a judgement about a trilemma of policy priorities: financial stability, competition and protecting public funds.** For example, if the authorities want to privatize losses related to bank failure there need to be sufficient liabilities on the banks' balance sheet available at the point of failure. This requires setting a requirement for all banks that could be systemically important or critical if they fail (i.e., D-SIBs and mid-tier banks) to hold sufficient loss-absorbing capacity (LAC) on their balance sheets represent a low appetite for risk to public funds and financial instability in the event of bank failure. Alternatively, if the authorities plan to socialize losses with respect to bank failure by relying on DGF contributions to resolution costs, there need to be sufficient resources in the DGF to play this role or alternatively, the DGF needs to be able to access temporary liquidity sufficient to provide these recapitalization resources which it can then repay by levying industry ex-poste.

55. **The Board of Directors of the BCV should approve a loss distribution policy in resolution.** In designing an approach to funding the recapitalization of banks in resolution, authorities need to determine what balance of these objectives is appropriate in the context of their financial system structure. This includes deciding how much of the cost of bank failure their creditors should be expected to bear (e.g., through LAC requirements) versus socializing these costs via DIS bank contributions. For example, if banks are entirely deposit-funded or have limited ability to issue additional capital or unsecured liabilities as a source of loss-absorbing capacity, this may constrain a jurisdiction's ability to privatize losses related to bank failure without requiring banks to issue new liabilities. It would be essential to understand the feasibility of such a new requirement regarding the market's ability to absorb such additional issuance and the impact on the viability of the bank's business model.

56. **Under the existing resolution framework in Cabo Verde, the DGF has a statutory mandate to contribute its resources to support resolution costs.** BCV has the discretion to decide whether the DGF should finance a resolution action (Article 166 of the FIAL). The DGF cannot refuse to comply with such BCV decisions. A draft law changing the DGF Law intends to introduce a provision (Article 8-A(19) limiting this contribution to the difference between the amount of covered deposits and the assets that are transferred from the failing bank to an acquirer or to a bridge bank. Furthermore, number three of the same future provision will confer a preferential claim in insolvency for the contributions made by the DGF to any resolution action. However, this framework, especially the provisions under the future new Article 8-A of the DGF Law, might create substantial limitation for an adequate financing of a resolution measure. While it is considered a best practice to limit the use of DGF funds to a "lesser cost" test, the current framework the DGF is designed for DIS only, and it does not fit for purpose as a mechanism or source of

funds to meet BCV resolution costs in Cabo Verde. This means that if the DGF is not able to finance a resolution action due to statutory limitations or lack of funds, then there is no alternative for the BCV to finance a resolution action. Such an outcome would be extremely detrimental to financial stability in Cabo Verde. Therefore, we recommend that authorities remove limitations on the DGF to support any resolution costs as assessed by BCV as resolution authority, which could be undertaken in a more comprehensive change of the resolution framework.

57. **The limited loss absorbing capacity on bank balance sheets combined with the constrained role of the DGF in supporting resolution costs mean that BCV lacks a credible strategy for recapitalizing banks in resolution or a credible policy on loss distribution in resolution.** Without overcoming this policy problem, BCV will not be able to meet the resolution objectives when banks fail and enter resolution without creating risk to public funds.

58. **It is recommended that the BCV's policy on loss distribution in resolution set as its priority the privatization of losses associated with bank failure supported by contributions from the DGF to resolution costs.** This requires imposing losses on shareholders and available creditors when banks enter resolution where consistent with the resolution objectives. However, the limitations in domestic bank liability structure and limited or no access to capital markets means that reliance on privatization of losses as the sole source of recapitalization capacity is unlikely to be sufficient to ensure orderly resolution in the medium to long term. As a result, it is important to consider this first best approach of privatization of losses in resolution as a medium to long-term strategy as it will take time for banks and the market to build up more internal loss-absorbing financial instruments. This will need to be complemented by BCV maximizing its flexibility to leverage DGF resources to support resolution costs.

59. **To improve the DGF capacity to support resolution costs, it is recommended that a number of statutory reforms are made to maximise the BCV's flexibility to require the DGF to contribute sufficient funds to ensure bank failure is orderly.** These reforms should include establishing a general depositor preference which means that all deposits (covered deposits, non-covered preferred deposits, non-covered non-preferred and excluded deposits) will rank *pari passu* above ordinary unsecured claims. The DGF's statutory mandate should be to protect depositors and contribute to financial stability. These DGF statutory objectives can be achieved either by funding the payout or transfer of protected deposits or supporting resolution costs. It should also be clear that there are no caps on the DGF contribution to resolution costs beyond the condition that the DGF should be no worse off than under a liquidation scenario, or if it is, it is due compensation. DGF should have no decision-making role in the choice of resolution tools when banks fail and the "Lesser Cost" principle should be the basis for calculating DGF contributions to resolution costs, not the "least cost". DGF can contribute any amount to resolution as determined by BCV long as it is less than the losses incurred under a hypothetical insolvency counterfactual valuation. There should be no separate fund for resolution purposes. Instead, the DGF should update its target fund methodology to reflect its role in funding payouts and supporting resolution costs and reflect this in its calculation of bank contributions, target fund size and compliance timeline. In particular, the BCV should develop a 10-year plan for a multi-pronged strategy to achieve its target fund size by increasing premiums on the banks and soliciting donor (e.g., KfW or the World Bank) sources of seed capital.

IV. Resolution Planning

60. **Resolution authorities need to establish a preferred resolution strategy for banks within the scope of the resolution regime to ensure the application of the resolution tools is feasible and credible.** This resolution strategy or plan is developed with reference to information gathered by the resolution authority from the bank. A preferred resolution strategy should describe an approach for resolving the bank through the effective use of resolution powers in a way that is, or can be made to be, both credible and feasible. The strategy should be credible in that it should enable the protection of the bank's critical economic functions, of public funds and of systemic stability and generally achieve the resolution objectives. The strategy should be feasible in that it should be operationally achievable, including under stressed conditions, e.g., during an economic downturn.

61. **BCV does not conduct bank-specific resolution planning and has not determined its preferred approach to managing the orderly resolution of any banks since becoming a resolution authority in 2014.** Instead, banks in Cabo Verde are required to submit resolution planning information to the BCV under Article 58 of the FIAL. This submission also requires banks to describe the possible resolution tools that the BCV could use in the event of the bank's failure. The intended purpose of the resolution plan is to collect necessary information for the BCV to be prepared for an orderly resolution. The resolution plan will be operationalized if a recovery plan is not successful in returning a bank to normal operation. However, unlike bank recovery plans, the resolution plan should be owned by the resolution authority as banks are not well placed to determine the resolution tools to use in the event of failure. Currently, BCV considers it lacks the necessary statutory powers to formally determine its preferred resolution strategy for banks in Cabo Verde as well as lacking the resources to develop resolution plans or conduct resolvability assessments. As a result, BCV has yet to develop a resolution plan for either of the designated DSIBs.

62. **It is recommended that the resolution legislation set a statutory requirement on the BCV as the statutory resolution authority to develop resolution plans, conduct resolvability assessments for banks and ensure they are resolvable.** BCV should be required to conduct resolution planning for banks with the objective of improving their resolvability well before any crisis. The statutory aim of resolution planning and resolvability assessments should be to ensure those plans can be implemented in an orderly manner consistent with the resolution objectives in the event of failure by requiring BCV to remove any impediments to resolvability it identifies during resolution planning. BCV should have a statutory obligation to communicate its preferred resolution strategy to a bank once it has been formally decided by the BCV as a resolution authority. This should include a simple description (i.e., 1-2 page summary document) of the main elements of the resolution plan and the impediments to resolution identified by the BCV that the bank needs to remove.

63. **The updated resolution legislation should provide BCV with the power to gather information necessary to support resolution planning and to remove impediments to resolvability both through the making of regulations and firm-specific powers of direction.** The legislation should provide BCV as a resolution authority with the power to make regulations setting general resolution planning information requirements and resolvability requirements as well as a power to direct individual banks to remove any impediments the BCV has identified. In addition, given the importance of minimum loss absorbing requirements for resolution purposes, the legislation should provide BCV with a specific rule making power to set loss-absorbing capacity requirements on banks. The legislation should prescribe that BCV can set a minimum loss-absorbing capacity requirements for within scope by specifying the

amounts, form and eligibility criteria of a minimum amount of loss-absorbing capacity to support orderly resolution.

64. **While the legislative reforms are progressing, BCV should begin bank resolution planning and determine its preferred resolution for each within scope bank.** This will enable it to identify the structural changes each bank needs to undertake to ensure the use of resolution powers by the BCV is orderly in the event of the bank's failure. BCV should define an internal resolution planning process consist of the following phases: 1) Gather resolution planning information, 2) Set the preferred resolution strategy, 3) Conduct resolvability assessments, and 4) Remove impediments to resolvability.

65. **The first step in the resolution planning process is to request banking institutions to submit core information.** The information will assist the BCV with the development and the setting of a preferred resolution strategy. The submission of core information may be followed by the submission of supplementary information to firstly, support further development of the preferred resolution strategy; secondly, to inform the BCV's resolvability assessments and thirdly, to identify actions for the banking institution to take to remove any identified impediments to resolvability.

66. **BCV should establish its preferred resolution strategy for each bank with reference to information provided by the bank** (e.g., structure, critical functions, interconnectedness, arrangements to ensure operational continuity, funding needs etc). The preferred resolution strategy will form the basis for subsequent resolution planning work for the bank and will also be the foundation of any measures that the bank may need to take to remove or mitigate the effect of any significant impediments to orderly resolution and to be considered resolvable by BCV.

67. **BCV should assess the bank's resolvability under the preferred resolution strategy with a view to identifying barriers and removing any impediments to the preferred strategy.** The scope of the resolvability assessments will vary depending on the size and nature of the bank and group, and the types of resolution options being considered. Resolvability assessments will be comprehensive and involve a clearly documented identification of the feasible resolution options and the initiatives required to ensure they are capable of timely implementation.

68. **Planning for a cross-border resolution:** BCV is the host to foreign subsidiaries and should therefore be able to recognize and support foreign resolution decisions. BCV is also considerate of the cross-border financial stability impact of its resolution decisions. As part of the collegial relationship with Portuguese authorities, BCV should codify resolution planning collaboration with respect to Portuguese banks in Cabo Verde and update its MoU.

69. **BCV should develop an internal BCV resolution planning manual that codifies its approach to resolution planning for domestic and cross-border banks.** This internal manual or guidance document should describe the overall BCV approach to resolution planning as well as specify the detailed information required to set a preferred resolution strategy, assess bank resolvability under that strategy and confirm whether actions have been sufficient to remove any impediments identified. It should also include template documents for setting resolution strategies or standardised assessment frameworks for identifying impediments to resolvability under each resolution resolution strategy: bail-in, transfer, bridge etc.

V. Crisis Coordination Arrangements

70. **While the BCV Resolution Authority functions should be operationally independent from banking supervision, this does not prevent very close coordination and sharing of quantitative and qualitative information between the different functions of the BCV.** Establishing clear coordination and information-sharing arrangements between the new statutory resolution functions of the BCV and prudential supervision is an essential precondition for an effective BCV-wide crisis management framework. Ideally, there should be seamless information sharing and shared databases for the banking supervision and resolution functions within BCV, including information sharing of bank-specific quantitative (e.g., bank regulatory reporting returns) and qualitative (e.g., supervisory risks scoring of banks) information. The BCV as resolution authority should also have explicit information-gathering powers which can be deployed, for example, to support effective resolution planning and resolvability assessment, as well as policy work in making the resolution regime operational.

71. **In the discharge of the functions under the statutory resolution regime, it is essential for the BCV Resolution function to have close coordination with banks and other within-scope banks.** For instance, during business as usual (“BAU”) resolution planning as well as crisis management, the BCV resolution function will work directly with banks. In particular, the Key Attributes recognize the need for a resolution authority to have unimpeded access to banks where that is material for this purpose. To achieve this, BCV resolution function will need to coordinate closely with other departments of the BCV and with banking supervision in particular.

72. **To support smooth internal coordination, the BCV should establish the following internal coordination and information sharing arrangements for resolution purposes:**

- a. **“Watchlist” arrangements** -- this is a formal notification mechanism of the BCV resolution function by banking supervision based on a supervisory assessment of bank’s proximity to failure based on the predetermined triggers derived from existing supervisory mechanisms.
- b. **Framework for determining when to take a bank into resolution** - an essential aspect to establish a clear mechanism for determining whether a bank has met the conditions for entry into resolution. In the first instance, two conditions must be judged and met before a bank can be taken into resolution: 1) the bank is failing or likely to fail, and 2) it is not reasonably likely that action will be taken that will result in the bank recovering. The BCV prudential supervision function should make the first determination, following consultation with the BCV as resolution authority. The second determination should be made by the BCV resolution function in consultation with the BCV prudential supervisory authority. Even if the above conditions are met, resolution powers should only be applied by the resolution authority if it judges it is in the public interest.

73. **BCV should also invest in inter-agency crisis management coordination and capacity building.**

For example, if the DGF is expected to play a role in support resolution costs in a manner consistent with the “lesser costs” principle, then the BCV as resolution authority should establish coordination arrangements to agree ex-ante the insolvency counterfactual valuation methodology for assessing DGF contributions and the procedures for BCV’s execution such valuations in a resolution scenario in consultation with DGF. In addition, once it has made progress in operationalizing the resolution regime, BCV should reinvigorate its dialogue with the MoF on the implications of resolution for fiscal contingent exposure to banking sector risk in a crisis.

VI. Operationalizing Other Resolution Powers, Resolution Manuals & Simulations

74. **Loss sharing can expand the pool of assets under the transfer of business resolution tool, particularly where due diligence cannot be fully implemented, but risks accompany its implementation.**²⁴ A loss sharing agreement (LSA) can facilitate the transfer of a higher portion of assets than a resolution might otherwise allow and may reduce the upfront commitment of resolution funding. The LSA may take the form of an agreement by the DGF to absorb a significant share (80 percent) of future disposition losses for a specified pool of assets over a predetermined period of time (3 to 5 years). However, it can create an incentive for the beneficiary of the agreements to find ways to dispose of assets quickly, benefiting from the LSA compensation, and such guarantees may expose the DGF to losses that exceed the potential cost of a deposit payout. The LSA construct can also be a drain on resources and capacity of the RA or DGF in drafting and monitoring compliance.

75. **A complimentary power to the use of loss sharing is the reverse transfer power.** The KAs stipulate that the RA should have the power to reverse the transfer of assets and liabilities from the bridge bank to the failed entity under liquidation (KA 3.4.(iii)). This power of reverse transfer is to be used under strictly limited conditions and for a limited time, e.g., to correct valuation errors. However, under FIAL Article 170(4), the power to transfer is not circumscribed within any limitations. If creditors transferred to a bridge bank perceive a substantial risk of being transferred back to the entity in liquidation, they may be incentivized to flee from the bridge bank as soon as possible, which could undermine the effectiveness of the tool going forward. This risk shows the importance of making valuation estimates as realistic and reliable as possible and avoiding underestimating capital requirements before setting up a bridge bank.

76. **After the transfer of business tool is applied, capacity is needed to address the residual assets, liabilities and contingencies.** After a transfer, the BCV has the legal capacity to liquidate the failing institution once part of its assets and liabilities have been transferred to a third-party buyer.²⁵ The liquidating entity must also have access to a resolution funding mechanism to bridge any funding gap or timing differences between the value of transferred assets and the value of transferred liabilities.

77. **The application of a resolution tool requires an underlying resolution funding mechanism, but the BCV does not have available a comprehensive resolution financing mechanism.** When a bank fails or approaches failure, capital and liquidity will have already been seriously eroded. Even if the RA intervenes promptly to trigger resolution before the bank is insolvent, a resolution funding need larger than initially anticipated may be revealed by the (independent) Valuation 2, or by the disclosure of adverse transactions previously undisclosed to the RA. As detailed in the discussion regarding loss distribution in resolution, the financial system in CV is characterized by banks with low internal capacity for loss absorption and recapitalization. As a consequence, it is very likely that the resolution of a systemic bank may require financial resources originating from outside the bank in default. The DGF

²⁴ For more information on loss sharing see Banco de España, “Report on the Financial and Banking Crisis in Spain,” 2008-2014,” pp. 127–129; FDIC, “Resolutions Handbook,” 15 January 2019, p. 35.

²⁵ Article 118, Winding up committee, FIAL. A committee was constituted in the aftermath of the Novo Banco resolution and worked through the issues of the sale of collateral committed to the liquidity support by the BCV and the bank’s relationship with the National Social Security Institute (Instituto Nacional de Previdência Social).

constitutes the only formalized resolution financing mechanism and its current access to funding for a resolution is woefully inadequate as it falls far short of its mandated target level and without adjustment it will take decades to achieve that level.

78. **A bank in resolution is likely to continue to need ready access to a liquidity facility.** The BCV must be prepared to provide liquidity to a bank whose solvency may be questioned at the time of resolution, but which is considered systemic and viable under the resolution plan being implemented. The assessment of viability of a bank under resolution depends on the resolution measures to be implemented by the BCV, their feasibility, their financing, and their timely execution. Even if resolution measures restore the solvency of a failing institution or help ensure continuity of critical functions through a transfer of business tool by a purchasing institution or by the establishment of a bridge bank, liquidity pressures may still materialize, at least until depositors' confidence (and counterparties' confidence in the interbank market) is restored.

79. **The case studies discussed with BCV during the mission provided examples of the inherent risk of depositor runs and subsequent liquidity needs when implementing resolution tools.** The IndyMac case study revealed the inherent uncertainty surrounding the bridge bank tool and the impact of depositor runs on the bridge bank. Before failure, IndyMac was subjected to a run of \$1.6 billion over the course of two weeks. After a tumultuous closing weekend and notwithstanding the imposition of a bridge bank structure, the newly chartered successor institution was the subject of a nearly \$3.0 billion depositor run over the two ensuing weeks after closure.

A. Meaning and Functionality of a Resolution Manual

80. **The term “resolution manual” refers to a document that sets out policies and procedures for undertaking the key organizational responsibilities of an RA** (other terms in usage are “handbook” and “playbook”).²⁶ A resolution manual is a compilation of the processes that the RA is responsible for implementing and is held accountable for. It also addresses legally mandated responsibilities and activities and the application of that authority. The manual should be prepared jointly with other financial authorities, such as the MoF, which oversees public financial commitments.

81. **The resolution manual makes the operational link between the statutory resolution regime and individual bank resolution plans.** The statutory regime sets forth resolution policies, but it is also ambiguous on some aspects where the RA will have to develop and formalize its own policies. Some policies will be laid down in the resolution manual, for example, on the methodology to carry out resolution valuations or to select the bank directors for a bridge bank. By laying out these policies in the resolution manual, the RA will avoid having to recount the methodology for valuation in each individual resolution plan or the process for selecting bridge bank directors. Individual resolution plans can focus on those aspects that are bank-specific, such as the impact of resolution scenarios and resolution strategies and the assessment of the critical functions for a specific bank. In operational terms the resolution manual avoids duplication of work. The manual also acts as the core training material for new staff or as a refresher for existing staff.

²⁶ See, for instance, the US Federal Deposit Insurance Corporation (FDIC), “Resolutions Handbook,” January 15, 2019, <https://www.fdic.gov/resources/resolutions/bank-failures/reshandbook/index.html>. This is the current FDIC link; according to the webpage, the Resolutions Handbook “is being revised,” no doubt to update the handbook for issues flowing from the financial instability during 2023.

82. **While there is no standard format set forth in the Key Attributes or other documents on best resolution practices, a resolution manual details step-by-step procedures that guide the actions of the resolution management and staff.** Procedures form the bulk of a resolution manual. The procedures specify decision points that may lead to the use of related procedures. Having a comprehensive set of procedures in place and consistently adhering to them can also be important when the organization's actions are subject to challenge in the courts, as is often the case in the field of financial regulation, supervision, and bank failure resolution.

83. **A resolution manual also incorporates policies adopted by the BCV's decision-making bodies.** These policies provide guidance, for example, on how to interpret relevant legal texts on decisions that need to be taken and on how management and staff are to make judgements and use discretion. They may also provide guidance on what actions that management and staff are to avoid. Policies can be set out separately in a resolution manual or can be embedded within the step-by-step procedures.

84. **The resolution decision-making body will have to take ownership of the resolution manual.** The resolution manual should be presented for discussion and approval to the BCV Board of Directors. This discussion will make the Board aware of the operational issues associated with bank resolution. In addition, it is preferable that any disagreements related to the operationalization of the new resolution powers or resolution strategies be discussed and resolved in advance rather than during a crisis situation.

B. Organization of the Resolution Manual

85. **The following is a suggested structure (outline) for a resolution manual:**

a) Confidentiality level. There is a tension between the transparency and confidentiality aspects of the resolution manual. A transparency element is present given the need to provide notice or due process for a bank that is subjected to resolution process. The confidentiality element is present given some aspects of the resolution may involve internal procedures that the BCV may not want to or may not be required to disclose. Select portions of the manual may be made publicly available while others may be kept confidential. Alternatively, the contents of a resolution manual may already fall under an existing classification system within the BCV.

b) Background. Including for each subject covered: (i) citation of legal provisions that relate to the subject, addressing the authority's responsibilities, activities, authorities, discretions, and restrictions on the use of legal authorities; (ii) the authority's internal delegations of institutional responsibilities (e.g., are all decisions taken by the board or are there delegations in place from the board to specific individuals?); (iii) an overview of the division's responsibilities and duties relevant to the subject (e.g., tasks that must be fulfilled, required reporting, etc.); and (iv) the general responsibilities and authorities of the specific managers and staff (i.e., who is responsible for what with respect to the subject).

c) Policies. The resolution manual describes the policies the RA or the division has adopted relevant to the subject, including citation of specific policy documents. For instance, the RA may elaborate its policy to declare a bank "failing or likely to fail" according to the provisions of the statutory resolution regime, without describing these policies in a public document, such as an implementing regulation. The RA may

also document its interpretation of certain provisions of the statutory regime as the authority does not have the power to amend the laws but has the task to implement them.

d) Procedures. Detailed step-by-step procedures to be followed for the execution of resolution tools and powers internally within the division, in collaboration with others in the authority (e.g., other departments or divisions); in collaboration with other domestic authorities (e.g., MoF); and with outside stakeholders (e.g., supervised banks, financial market participants, media, and foreign authorities). The following list is not meant to be exhaustive:

- drafting a resolution plan, resolvability assessments;
- non-viability assessment;
- choice of resolution tools;
- selection of resolution options considering systemic importance, contagion risk, structure and operation of the bank;
- application of powers in coordination with other departments, external authorities (foreign or domestic), outside stakeholders and exchange of information;
- transfer of business implementation (marketing process including public disclosures, acquirers, due diligence, bid meeting and acceptance, asset valuation);
- governance details for a bridge bank;
- liquidity support to a resolved bank ('liquidity in resolution');
- communications strategies (depositors, other creditors, borrowers, management and staff, financial institutions, foreign supervisors, media and general public);
- access to external funding;
- use of government guarantees or indemnities and exit from government support;
- employee/agent ethics issues;
- coordination of operations with DGF, including documentation;
- Crisis Management Groups; and
- use of agents and third-party experts to support resolution actions.

e) Suggested Annexes: flowcharts, decision trees or process maps; templates for legal documents, such as decision-making for the resolution of an institution; legal agreements (confidentiality, deposit transfer, asset sales, asset servicing, bidder); documents approved by resolution (financial stability) decision-making body; list of approved banks acceptable as an acquirer; job descriptions for resolution staff; and allocation of duties between supervision, resolution and DGF, with designation of the lead discipline and role of others.

C. Simulations

86. **Financial sector Crisis Simulation Exercises (CSEs) are essential tools for authorities to gather practice decision making in the face of a financial crisis.** The CSE should not be a test or exam that can be passed or failed. Instead, CSE should be used to ensure that participants learn lessons from the exercise and practice using an organisation's crisis management plans and procedures. CSEs

are an important part of how the authorities develop and maintain crisis management capabilities both within their own organization as well as across authority capabilities.

87. **The BCV has not conducted a crisis simulation in recent years.** This includes simulations of conducted independently by the BCV or jointly with other domestic or international authorities regarding the failure of a domestic bank or cross-border subsidiary. This is in part due to the shortage of BCV resources for such preparatory work and the limitations in the development in the statutory and regulatory regime.

88. **Once progress has been made in operationalizing the resolution regime and increased resources, the mission also recommends that the BCV carries out table-top or walk-through crisis simulation exercises of a large domestic bank failure.** Initial attempts at CSEs should avoid complex scenarios but instead attempt to enable the resolution authority to identify gaps in their capacity and work toward closing those gaps.